

**2020**  
**Annual Report**



**United Security Bancshares**

*Your Community Bank of Choice*



## **MISSION**

To provide a truly superior customer service experience by:

- supporting and enhancing the communities we serve
- providing relevant products and services to the Company's customers
- attracting, developing and retaining superior team members

# UNITED SECURITY BANCSHARES

## *Corporate Profile*

Headquartered in Fresno, California, United Security Bancshares was formed in 2001 as a bank holding company to provide commercial banking services through its wholly owned subsidiary, United Security Bank. Founded in 1987, United Security Bank is a state-chartered community bank, which operates twelve full-service branches, construction, and commercial and consumer lending operations, in Fresno, Madera, Kern, and Santa Clara counties. United Security is a customer-oriented financial institution engaged in providing a wide range of competitively priced commercial banking services primarily to the business community and individuals located in the central and southern San Joaquin Valley, as well as the Campbell area in Santa Clara County.

At United Security Bancshares, we are committed to improving shareholder value and delivering the highest quality products and services while being responsive to the changing needs of our customers and business markets. Our primary business strategy is to increase market share in the local communities we serve, as well as to expand into new markets when sound business opportunities present themselves.

United Security Bancshares' common stock is traded on NASDAQ under the symbol "UBFO". For more information, please visit us at [www.unitedsecuritybank.com](http://www.unitedsecuritybank.com).



*Your Community Bank of Choice*

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## MESSAGE FROM THE PRESIDENT

To Our Shareholders, Customers and Friends,

2020 brought on many difficult and unique challenges for all of us. The COVID-19 pandemic caused stresses to our economy and industry unseen before. Like many of you, United Security Bank endeavored to weather the pandemic's storm while maintaining hope for future growth and accomplishment. We appreciate those who continued to seek our expertise in the market place, as we sought to provide excellent customer service and support. What we achieved throughout the year was a nod to the Company's tradition of success as we were able to reach historic highs in our loan balances and deposit base, and total assets.

Throughout 2020, we continued to expand our digital customer applications, such as our online and mobile banking platforms, and our interactive teller machine (ITM) fleet. Our ITMs provide customers with a virtual teller experience and additional hours of operation.

In August 2020 we celebrated the opening of our newest branch location in Mendota California. This has been an exciting step to further our relationship with the customers of this community.

It remains a priority to ensure our networks, data systems, and internal processes are secure. We have taken necessary steps to reduce our vulnerability to cyber-attacks and fraud.

For the year ended December 31, 2020, we generated net income of \$9.0 million or \$0.53 per share basic and diluted share.

Total assets of the Company grew to \$1.09 billion for the year ended December 31, 2020, reflecting an increase of \$135.7 million over the prior year. Gross loans at year-end totaled \$655.4 million, an increase of \$58.0 million, and total deposits increased to \$952.7 million, which was an increase of \$134.3 million over the prior year.

The allowance for credit losses totaled \$8.5 million at the end of 2020 representing 1.30% of the total loan portfolio. Nonperforming assets decreased during the year to

\$17.5 million for the year ended December 31, 2020, from \$21.2 million in the prior year. We executed \$69.8 million in COVID-19 related loan deferrals or modifications for customers directly affected by the pandemic. At December 31, 2020, we had one remaining modification for \$12.5 million.

### *Core Earnings*

Core earnings are defined as net interest income plus noninterest income less "normalized" noninterest expense and provision for credit losses. Core earnings decreased \$4.0 million in 2020 over core earnings in 2019 primarily due to the decreases in interest rates that occurred as a result of the global COVID-19 pandemic.

Net interest income before provision for credit losses totaled \$32.2 million, reflecting a decrease of \$5.2 million over the prior year. The Company's cost of funds decreased in the current year to 0.24% over a cost of funds of 0.45% in 2019.

Noninterest income is comprised primarily of customer service fees, but also includes other items such as income derived from the cash surrender value of bank-owned life insurance, rental income, as well as other gains or losses associated with the Company's assets. Customer service fees totaled \$2.7 million or 51.2% of the \$5.2 million recorded in total noninterest income for the year ended December 31, 2020. Noninterest expense totaled \$22.2 million for the year ended December 31, 2020, an increase of 1.4% from \$21.9 million for the year ended December 31, 2019.

### *On the Horizon:*

The Company will continue to look for opportunities to better the customer experience and enhance our shareholder value. Our talented team of dedicated employees remain committed to providing superior service to our customers.

We are excited to continue to overcome the challenges 2020 brought, and have confidence that the Company comes out stronger as a result.

We are grateful to our loyal customers who entrust us with their business, and our shareholders for their support and partnership. We are enthusiastic about the possibilities that lie ahead and look forward to serving you for many years to come.

Sincerely,



Dennis R. Woods  
Chairman of the Board & President



Benjamin Mackovak  
Lead Director

## SELECTED FINANCIAL HIGHLIGHTS

(in thousands except per share data and ratios)	For the Year Ended December 31,				
	2020	2019	2018	2017	2016
<u>Summary of Year-to-Date Earnings:</u>					
Interest income	\$ 34,457	\$ 41,282	\$ 36,615	\$ 32,930	\$ 29,473
Interest expense	2,290	3,888	2,703	1,730	1,409
Net interest income	32,167	37,394	33,912	31,200	28,064
Provision (recovery of provision) for credit losses	2,769	20	(1,764)	24	(21)
Net interest income after provision (recovery of provision) for credit losses	29,398	37,374	35,676	31,176	28,085
Noninterest income	5,174	5,754	4,605	4,306	4,514
Noninterest expense	22,160	21,859	20,932	19,803	20,345
Income before taxes on income	12,412	21,269	19,349	15,679	12,254
Taxes on income	3,451	6,097	5,332	7,039	4,869
Net income	\$ 8,961	\$ 15,172	\$ 14,017	\$ 8,640	\$ 7,385
<u>Per Share Data:</u>					
Net income – Basic	\$ 0.53	\$ 0.90	\$ 0.83	\$ 0.51	\$ 0.44
Net income – Diluted	\$ 0.53	\$ 0.89	\$ 0.83	\$ 0.51	\$ 0.44
Average shares outstanding – Basic	16,976,704	16,951,955	16,899,960	16,885,587	16,881,379
Average shares outstanding – Diluted	16,998,584	16,984,796	16,938,772	16,904,915	16,889,027
Book value per share	\$ 6.93	\$ 6.83	\$ 6.45	\$ 6.00	\$ 5.79
<u>Financial Position at Period-end:</u>					
Total assets	\$1,092,654	\$956,919	\$933,058	\$805,836	\$787,972
Total net loans and leases	645,825	588,646	579,419	593,123	561,931
Total deposits	952,651	818,362	805,643	687,693	676,629
Total shareholders' equity	117,807	115,988	109,240	101,353	96,654
<u>Selected Financial Ratios:</u>					
Return on average assets	0.86%	1.58%	1.61%	1.07%	0.98%
Return on average equity	7.55%	13.30%	13.23%	8.63%	7.86%
Average equity to average assets	11.45%	11.89%	12.14%	12.46%	12.43%
Net interest margin <sup>(1)</sup>	3.34%	4.22%	4.28%	4.27%	4.11%
Allowance for credit losses as a percentage of total nonperforming assets	48.56%	37.26%	38.81%	52.62%	47.15%
Net charge-offs (recoveries) to net loans	0.33%	0.08%	(0.20)%	(0.06)%	0.14%
Allowance of credit losses as a percentage of period-end loans	1.30%	1.33%	1.43%	1.54%	1.56%
Dividend payout ratio	83.34%	49.16%	42.17%	33.22%	—%

See accompanying notes to consolidated financial statements

## United Security Bancshares and Subsidiaries Consolidated Balance Sheets

December 31, 2020 and 2019

(In thousands except shares)

	December 31, 2020	December 31, 2019
<b>Assets</b>		
Cash and noninterest-bearing deposits in other banks	\$ 29,490	\$ 27,291
Due from Federal Reserve Bank ("FRB")	264,579	191,704
Cash and cash equivalents	294,069	218,995
Investment securities (at fair value)		
Available-for-sale ("AFS") securities	82,341	76,312
Marketable equity securities	3,851	3,776
Total investment securities	86,192	80,088
Loans	655,411	597,374
Unearned fees and unamortized loan origination costs – net	(1,064)	(820)
Allowance for credit losses	(8,522)	(7,908)
Net loans	645,825	588,646
Premises and equipment – net	9,110	9,380
Accrued interest receivable	8,164	8,208
Other real estate owned	5,004	6,753
Goodwill	4,488	4,488
Deferred tax assets – net	2,907	3,191
Cash surrender value of life insurance	20,715	20,955
Operating lease right-of-use assets	2,864	3,360
Other assets	13,316	12,855
<b>Total assets</b>	<b>\$1,092,654</b>	<b>\$956,919</b>
<b>Liabilities &amp; Shareholders' Equity</b>		
<b>Liabilities</b>		
Deposits		
Noninterest-bearing	\$ 391,897	\$311,950
Interest-bearing	560,754	506,412
Total deposits	952,651	818,362
Operating lease liabilities	2,967	3,463
Other liabilities	8,305	8,298
Junior subordinated debentures (at fair value)	10,924	10,808
<b>Total liabilities</b>	<b>974,847</b>	<b>840,931</b>
Commitments and contingencies (Note 14)		
<b>Shareholders' Equity</b>		
Common stock, no par value; 20,000,000 shares authorized; issued and outstanding: 17,009,883 at December 31, 2020 and 16,973,885 at December 31, 2019	59,397	58,973
Retained earnings	59,138	57,647
Accumulated other comprehensive loss	(728)	(632)
<b>Total shareholders' equity</b>	<b>117,807</b>	<b>115,988</b>
<b>Total liabilities and shareholders' equity</b>	<b>\$1,092,654</b>	<b>\$956,919</b>

See accompanying notes to consolidated financial statements

## United Security Bancshares and Subsidiaries

### Consolidated Statements of Income

Years Ended December 31, 2020 and 2019

(In thousands except shares and EPS)

	December 31, 2020	December 31, 2019
<b>Interest Income:</b>		
Interest and fees on loans	\$32,294	\$34,605
Interest on investment securities	1,433	1,797
Interest on deposits in FRB	730	4,880
Total interest income	34,457	41,282
<b>Interest Expense:</b>		
Interest on deposits	2,014	3,432
Interest on other borrowed funds	276	456
Total interest expense	2,290	3,888
<b>Net Interest Income</b>	<b>32,167</b>	<b>37,394</b>
<b>Provision for Credit Losses</b>	<b>2,769</b>	<b>20</b>
<b>Net Interest Income after Provision for Credit Losses</b>	<b>29,398</b>	<b>37,374</b>
<b>Noninterest Income:</b>		
Customer service fees	2,663	3,257
Increase in cash surrender value of bank-owned life insurance	504	528
Unrealized gain on fair value of marketable equity securities	74	117
Gain on proceeds from bank-owned life insurance	310	—
Gain on fair value of junior subordinated debentures	970	1,165
Loss on dissolution of real estate investment trust	—	(115)
Other	653	802
Total noninterest income	5,174	5,754
<b>Noninterest Expense:</b>		
Salaries and employee benefits	10,825	11,109
Occupancy expense	3,475	3,332
Data processing	493	583
Professional fees	3,217	3,760
Regulatory assessments	459	164
Director fees	376	373
Correspondent bank service charges	71	57
Net cost on operation and sale of OREO	972	244
Other	2,272	2,237
Total noninterest expense	22,160	21,859
<b>Income Before Provision for Taxes</b>	<b>12,412</b>	<b>21,269</b>
<b>Provision for Taxes on Income</b>	<b>3,451</b>	<b>6,097</b>
<b>Net Income</b>	<b>\$ 8,961</b>	<b>\$15,172</b>
<b>Net Income per common share</b>		
Basic	\$ 0.53	\$ 0.90
Diluted	\$ 0.53	\$ 0.89
<b>Shares on which net income per common share were based</b>		
Basic	16,976,704	16,951,955
Diluted	16,998,584	16,984,796

See accompanying notes to consolidated financial statements

## United Security Bancshares and Subsidiaries

### Consolidated Statements of Comprehensive Income

Years Ended December 31, 2020 and 2019

<i>(In thousands)</i>	Year Ended December 31,	
	2020	2019
Net Income	<b>\$8,961</b>	\$15,172
Unrealized holdings gains on debt securities	<b>1,143</b>	279
Unrealized loss on unrecognized post-retirement costs	<b>(135)</b>	(307)
Unrealized loss on junior subordinated debentures	<b>(1,144)</b>	(1,826)
Other comprehensive loss, before tax	<b>(136)</b>	(1,854)
Tax expense related to debt securities	<b>(338)</b>	(82)
Tax benefit related to unrecognized post-retirement costs	<b>40</b>	91
Tax benefit related to junior subordinated debentures	<b>338</b>	539
Total other comprehensive loss	<b>(96)</b>	(1,306)
Comprehensive Income	<b>\$8,865</b>	\$13,866

See accompanying notes to consolidated financial statements

## United Security Bancshares and Subsidiaries

### Consolidated Statements of Changes in Shareholders' Equity

Years Ended December 31, 2020 and 2019

	Common Stock		Accumulated Other		
	Number of Shares	Amount	Retained Earnings	Comprehensive Income (Loss)	Total
<i>(In thousands except shares)</i>					
<b>Balance December 31, 2018<sup>(1)</sup></b>	16,946,622	\$58,624	\$49,942	\$674	\$109,240
(1) Excludes 59,217 unvested restricted shares					
Other comprehensive income				(1,306)	(1,306)
Dividends on common stock (\$0.33 per share)			(5,599)		(2,870)
Dividends payable (\$0.11 per share)			(1,868)		(1,182)
Restricted stock units released	27,263				
Stock-based compensation expense		349			349
Net Income			15,172		15,172
<b>Balance December 31, 2019<sup>(2)</sup></b>	16,973,885	58,973	57,647	(632)	115,988
(2) Excludes 35,572 unvested restricted shares					
Other comprehensive loss				(96)	(96)
Dividends on common stock (\$0.33 per share)			(5,600)		(5,600)
Dividends payable (\$0.11 per share)			(1,870)		(1,870)
Restricted stock units released	35,998				
Tax benefit from restricted stock units released		(1)			(1)
Stock-based compensation expense		425			425
Net Income			8,961		8,961
<b>Balance December 31, 2020<sup>(3)</sup></b>	17,009,883	\$59,397	\$59,138	\$(728)	\$117,807
(3) Excludes 11,924 unvested restricted shares					

See accompanying notes to consolidated financial statements

## United Security Bancshares and Subsidiaries

### Consolidated Statements of Cash Flows

Years Ended December 31, 2020 and 2019

(In thousands)

	December 31, 2020	December 31, 2019
<b>Cash Flows From Operating Activities:</b>		
Net Income	\$ 8,961	\$15,172
Adjustments to reconcile net income to cash provided by operating activities:		
Provision for credit losses	2,769	20
Depreciation and amortization	1,411	1,402
Amortization of operating lease right-of-use assets	(600)	(741)
Amortization of premium/discount on investment securities, net	1,073	713
Decrease in accrued interest receivable	44	133
(Decrease) increase in accrued interest payable	(27)	2
Decrease in unearned fees and unamortized loan origination costs, net	244	701
Decrease (increase) in income taxes receivable	367	(337)
Stock-based compensation expense	425	349
Recovery of provision for deferred income taxes	324	533
(Decrease) increase in accounts payable and accrued liabilities	(160)	212
Loss on dissolution of real estate investment trust	—	115
Write down on other real estate owned	727	—
Loss on sale of other real estate owned	113	—
Unrealized gain on marketable equity securities	(74)	(117)
Gain on fair value option of junior subordinated debentures	(970)	(1,165)
Gain on bank owned life insurance	(310)	—
Increase in surrender value of bank-owned life insurance	(504)	(528)
Gain on sale of premises and equipment	—	(1)
Net increase in other assets	(13)	(303)
Net cash provided by operating activities	13,800	16,160
<b>Cash Flows From Investing Activities:</b>		
Purchase of correspondent bank stock	(45)	(52)
Principal payments on available-for-sale securities	23,055	17,510
Purchases of available-for-sale securities	(29,016)	(27,830)
Purchase of company-owned life insurance	(220)	(220)
Net increase in loans	(60,192)	(10,956)
Cash proceeds from sales of other real estate owned	909	—
Cash proceeds from sales of premises and equipment	—	12
Proceeds from bank owned life insurance	1,243	—
Capital expenditures of premises and equipment	(1,141)	(956)
Investment in limited partnership	(140)	(271)
Net cash used in investing activities	(65,547)	(22,763)
<b>Cash Flows From Financing Activities:</b>		
Net increase in demand deposit and savings accounts	138,171	29,751
Net decrease in time deposits	(3,882)	(17,032)
Dividends on common stock	(7,468)	(7,458)
Net cash provided by financing activities	126,821	5,261
<b>Net increase (decrease) in cash and cash equivalents</b>	<b>75,074</b>	<b>(1,342)</b>
<b>Cash and cash equivalents at beginning of year</b>	<b>218,995</b>	<b>220,337</b>
<b>Cash and cash equivalents at end of year</b>	<b>\$294,069</b>	<b>\$218,995</b>

See accompanying notes to consolidated financial statements

## Notes to Consolidated Financial Statements

### 1. *Organization and Summary of Significant Accounting and Reporting Policies*

**Basis of Presentation** – The consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States, with rules and regulations of the Securities and Exchange Commission (“SEC”), and with prevailing practices within the banking industry. The consolidated financial statements include the accounts of United Security Bancshares, and its wholly-owned subsidiaries, United Security Bank and subsidiary (the “Bank”) and USB Capital Trust II (the “Trust”). The Trust is deconsolidated pursuant to ASC 810. As a result, the Trust Preferred Securities are not presented on the Company’s consolidated financial statements as equity, but instead they are presented as Junior Subordinated Debentures and are presented as a separate liability category (see Note 10 to the Company’s consolidated financial statements). Intercompany accounts and transactions have been eliminated in consolidation. In the following notes, references to the Bank are references to United Security Bank. References to the Company are references to United Security Bancshares (including the Bank). United Security Bancshares operates as one business segment providing banking services to commercial establishments and individuals primarily in the San Joaquin Valley of California.

**Nature of Operations** – United Security Bancshares is a bank holding company, incorporated in the state of California for the purpose of acquiring all the capital stock of the Bank through a holding company reorganization (the “Reorganization”) of the Bank. The Reorganization, which was accounted for in a manner similar to a pooling of interests, was completed on June 12, 2001. Management believes the Reorganization has provided the Company greater operating and financial flexibility and has permitted expansion into a broader range of financial services and other business activities.

The Bank was founded in 1987 and currently operates twelve branches, one commercial lending office, one consumer lending office, and one construction lending office in an area from eastern Madera County to western Fresno County, as well as Taft and Bakersfield in Kern County, and Campbell in Santa Clara County. The Bank’s primary source of revenue is interest income through providing loans to customers, who are predominantly small and middle-market businesses and individuals. The Bank engages in a full complement of lending activities, including real estate mortgage, commercial and industrial, real estate construction, agricultural and consumer loans, with particular emphasis on short and medium term obligations.

The Bank offers a wide range of deposit instruments. These include personal and business checking accounts and savings accounts, interest-bearing negotiable order of withdrawal (NOW) accounts, money market accounts and time certificates of deposit. Most of the Bank’s deposits are attracted from individuals and from small and medium-sized business-related sources.

The Bank also offers a wide range of specialized services designed to attract and service the needs of commercial customers and account holders. These services include cashiers checks, travelers checks, money orders, and foreign drafts. In addition, the Bank offers Internet banking services to its commercial and retail customers. The Bank does not operate a trust department, however it makes arrangements with its correspondent bank to offer trust services to its customers upon request.

York Monterey Properties, Inc. (“YMP”) was incorporated in California on April 17, 2019, for the purpose of holding specific parcels of real estate acquired by the Bank through, or in lieu of, loan foreclosures in Monterey County. These properties exceeded the 10-year holding period for other real estate owned, or “OREO.” YMP was funded with a \$250,000 cash investment and the transfer of those parcels by the Bank to YMP. As of December 31, 2020, these properties are included within the consolidated balance sheets as part of “other real estate owned.”

**Use of Estimates in the Preparation of Financial Statements**

– The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates.

Material estimates that are particularly susceptible to significant change relate to the determination of the allowance for loan losses, goodwill, fair value of junior subordinated debt and certain collateralized mortgage obligations, and the valuation of real estate acquired in connection with foreclosures or in satisfaction of loans.

**Subsequent events** – The Company has evaluated events and transactions for potential recognition or disclosure through the day the financial statements were issued.

**Significant Accounting Policies** – The Company follows accounting standards set by the Financial Accounting Standards Board, commonly referred to as “FASB.” FASB sets generally accepted accounting principles (GAAP) that the Company follows to ensure the consistent reporting of its consolidated financial condition, consolidated results of operations, and consolidated cash flows. References to GAAP issued by FASB in these footnotes are to FASB Accounting Standards Codification, sometimes referred to as the Codification or ASC. The following is a summary of significant policies:

- a. *Cash and cash equivalents* – Cash and cash equivalents include cash on hand, amounts due from banks, federal funds sold and repurchase agreements. At times throughout the year, balances can exceed FDIC insurance limits. Generally, federal funds sold and repurchase agreements are sold for one-day periods. The Bank did not have any repurchase agreements during 2020 or 2019, or at December 31, 2020 and 2019. All cash and cash equivalents have maturities when purchased of three months or less.

- b. *Securities* – Debt securities classified as available for sale are reported at fair value, with unrealized gains and losses excluded from net income and reported, net of tax, as a separate component of comprehensive income and shareholders’ equity. Debt securities classified as held to maturity are carried at amortized cost. Gains and losses on disposition are reported using the specific identification method for the adjusted basis of the securities sold. Premiums and discounts are recognized in interest income using the interest method over the period to maturity.

The Company classifies its debt securities as available for sale or held to maturity, and periodically reviews its investment portfolio on an individual security basis. Securities that are to be held for indefinite periods of time (including, but not limited to, those that management intends to use as part of its asset/liability management strategy, and those which may be sold in response to changes in interest rates, changes in prepayments or any such other factors) are classified as securities available for sale. Securities which the Company has the ability and intent to hold to maturity are classified as held to maturity.

Debt securities with fair values that are less than amortized cost are considered impaired. Impairment may result from either a decline in the financial condition of the issuing entity or, in the case of fixed interest rate investments, from rising interest rates. At each financial statement date, management assesses each investment to determine if impaired investments are temporarily impaired or if the impairment is other-than-temporary based upon the positive and negative evidence available. Evidence evaluated includes, but is not limited to, industry analyst reports, credit market conditions, and interest rate trends. Management also assesses whether it intends to sell, or it is more likely than not that it will be required to sell, a security in an unrealized loss position before recovery of its amortized cost basis. If either of the criteria regarding intent or requirement to sell is met, the entire difference between the amortized cost and fair value is

recognized as impairment through earnings. For debt securities that do not meet the aforementioned criteria, the amount of impairment is split into two components as follows: (1) OTTI related to credit loss, which is recognized in the income statement; and (2) OTTI related to other factors, which is recognized in other comprehensive income. The credit loss is defined as the difference between the present value of the cash flows expected to be collected and the amortized cost basis.

Equity securities are reported at fair value with gains and losses included in net income on the Consolidated Statement of Operations.

- c. *Loans* – Interest income on loans is credited to income as earned and is calculated by using the simple interest method on the daily balance of the principal amounts outstanding. Outside of student loans, loans are typically placed on non-accrual status when principal or interest is past due for 90 days and/or when management believes the collection of amounts due is doubtful. Student loans are typically placed on non-accrual status when principal or interest is past due for 120 days. For loans placed on nonaccrual status, the accrued and unpaid interest receivable may be reversed based upon management’s assessment of collectability, and interest is thereafter credited to principal to the extent necessary to eliminate doubt as to the collectability of the net carrying amount of the loan.

Nonrefundable fees and related direct costs associated with the origination or purchase of loans are deferred and netted against outstanding loan balances. The net deferred fees and costs are generally amortized into interest income over the loan term using the interest method. Other credit-related fees, such as standby letter of credit fees and loan placement fees are recognized as noninterest income during the period the related service is performed.

- d. *Allowance for Credit Losses and Reserve for Unfunded Loan Commitments* – The allowance for credit losses is maintained to provide for losses that can reasonably be anticipated. The allowance is based on ongoing quarterly assessments of the probable

losses inherent in the loan portfolio, and to a lesser extent, unfunded loan commitments. The reserve for unfunded loan commitments is a liability on the Company’s consolidated financial statements and is included in other liabilities. The liability is computed using a methodology similar to that used to determine the allowance for credit losses, modified to take into account the probability of a drawdown on the commitment.

The allowance for credit losses is increased by provisions charged to operations during the current period and reduced by negative provisions and loan charge-offs, net of recoveries. Loans are charged against the allowance when management believes that the collection of the principal is unlikely. The allowance is an amount that management believes will be adequate to absorb losses inherent in existing loans, based on evaluations of the probability of collection. In evaluating the probability of collection, management is required to make estimates and assumptions that affect the reported amounts of loans, allowance for credit losses and the provision for credit losses charged to operations. Actual results could differ significantly from those estimates. These evaluations take into consideration such factors as the composition of the portfolio, overall portfolio quality, loan concentrations, specific problem loans, and current economic conditions that may affect the borrowers’ ability to pay.

The Company’s methodology for assessing the adequacy of the allowance for credit losses consists of several key elements, which include:

- The formula allowance
- Specific allowances for problem graded loans identified as impaired; and
- The unallocated allowance

The formula allowance is calculated by applying loss factors to outstanding loans and certain unfunded loan commitments. Loss factors are based on the Company’s historical loss experience and on the internal risk grade of those loans, and may be adjusted for significant factors that, in management’s judgment, affect the collectability

of the portfolio as of the evaluation date. Factors that may affect collectability of the loan portfolio include:

- Levels of, and trends in delinquencies and nonaccrual loans;
- Trends in volumes and term of loans;
- Effects of any changes in lending policies and procedures including those for underwriting, collection, charge-off, and recovery;
- Experience, ability, and depth of lending management and staff;
- National and local economic trends and conditions and;
- Concentrations of credit that might affect loss experience across one or more components of the portfolio, including high-balance loan concentrations and participations.

Management determines the loss factors for problem graded loans (substandard, doubtful, and loss), special mention loans, and pass graded loans, based on a loss migration model. The migration analysis incorporates loan losses over the previous quarters as determined by management (time horizons adjusted as business cycles or environment changes) and loss factors are adjusted to recognize and quantify the loss exposure from changes in market market conditions and trends in the Company's loan portfolio. For purposes of this analysis, loans are grouped by internal risk classifications and categorized as pass, special mention, substandard, doubtful, or loss. Certain loans are homogeneous in nature and are therefore pooled by risk grade. These homogeneous loans include consumer installment and home equity loans. Special mention loans are currently performing but are potentially weak, as the borrower has begun to exhibit deteriorating trends which, if not corrected, could jeopardize repayment of the loan and result in further downgrades. Substandard loans have well-defined weaknesses which, if not corrected, could jeopardize the full satisfaction of the debt. A loan classified as doubtful has critical weaknesses that make full collection of the obligation improbable.

The student loan portfolio is reviewed for allowance adequacy under the same guidelines as other loans in the Company's portfolio, with additional emphasis for specific risks associated with the portfolio. For student loans, principal amounts outstanding also include interest that has been capitalized. Charge-offs and recoveries of amounts that relate to capitalized interest on student loans are treated as principal charge-offs and recoveries, affecting the allowance for loan losses rather than interest income. Capitalized interest earned in the current year is reversed from interest income. Accrued but unpaid interest related to charged-off student loans is reversed against interest income. In general, the Company reserves for a percentage of loans in forbearance and loans rated substandard.

Loan participations are reviewed for allowance adequacy under the same guidelines as other loans in the Company's portfolio, with an additional participation factor added, if required, for specific risks associated with participations. In general, participations are subject to certain thresholds set by the Company, and are reviewed for geographic location as well as the well-being of the underlying agent bank.

Specific allowances are established based on management's periodic evaluation of the loss exposure inherent in impaired loans. For impaired loans, specific allowances are determined based on the collateralized value of the underlying properties, the net present value of the anticipated cash flows, or the market value of the underlying assets.

Specific allowances are established based on management's periodic evaluation of loss exposure inherent in impaired loans. For impaired loans, specific allowances are determined based on the net realizable value of the underlying collateral, the net present value of the anticipated cash flows, or the market value of the underlying assets. Formula allowances for classified loans, excluding impaired loans, are determined on the basis of additional risks involved with individual loans that may be in excess of risk factors associated with the loan portfolio as a whole. The specific allowance is different from the formula

allowance in that the specific allowance is determined on a loan-by-loan basis based on risk factors directly related to a particular loan, as opposed to the formula allowance which is determined for a pool of loans with similar risk characteristics, based on past historical trends and other risk factors which may be relevant on an ongoing basis.

The unallocated portion of the allowance is based upon management's evaluation of various conditions that are not directly measured in the determination of the formula and specific allowances. The conditions may include, but are not limited to, general economic and business conditions affecting the key lending areas of the Company, credit quality trends, collateral values, loan volumes and concentrations, and other business conditions.

- e. *Premises and Equipment* – Premises and equipment are carried at cost less accumulated depreciation. Depreciation expense is computed principally on the straight-line method over the estimated useful lives of the assets. Estimated useful lives are as follows:

Buildings	31 years
Furniture and equipment	3-7 years

- f. *Other Real Estate Owned* – Real estate properties acquired through, or in lieu of, loan foreclosure are to be sold and are initially recorded at fair value of the property, less estimated costs to sell. The excess, if any, of the loan amount over the fair value is charged to the allowance for credit losses. Subsequent declines in the fair value of other real estate owned, along with related revenue and expenses from operations, are charged to noninterest expense.
- g. *Intangible Assets and Goodwill* – Intangible assets are comprised of core deposit intangibles, other specific identifiable intangibles, and goodwill acquired in certain branch acquisitions where the consideration given exceeded the fair value of the net assets acquired.
- Goodwill amounts resulting from acquisitions are considered to have an indefinite life and are not amortized. At December 31, 2020, goodwill

totaled \$4.5 million, held at the Company as the reporting unit. During 2020 and 2019, the Company did not recognize impairment charges on goodwill.

- h. *Income Taxes* – Deferred income taxes are provided for the temporary differences between the financial reporting basis and the tax basis of the Company's assets and liabilities using the liability method, and are reflected at currently enacted income tax rates applicable to the period in which the deferred tax assets or liabilities are expected to be realized or settled. Estimates are based on the enacted tax rate of the applicable period.
- i. *Net Income per Share* – Basic income per common share is computed based on the weighted average number of common shares outstanding. Diluted income per share includes the effect of stock options and other potentially dilutive securities using the treasury stock method to the extent they have a dilutive impact. If applicable, net income per share is retroactively adjusted for all stock dividends declared.
- j. *Cash Flow Reporting* – For purposes of reporting cash flows, cash and cash equivalents include cash on hand, noninterest-bearing amounts due from banks, federal funds sold and securities purchased under agreements to resell. Federal funds and securities purchased under agreements to resell are generally sold for one-day periods. Net cash flows are reported for interest-bearing deposits with other banks, loans to customers, and deposits held for customers.
- k. *Transfers of Financial Assets* – Transfers of financial assets are accounted for as sales when control over the assets has been surrendered. Control over transferred assets is deemed to be surrendered when (1) the assets have been isolated from the Company, (2) the transferee obtains the right (free of conditions that constrain it from taking advantage of that right, beyond a trivial benefit) to pledge or exchange the transferred assets, and (3) the Company does not maintain effective control over the transferred assets through an agreement to repurchase them before their maturity.

l. *Stock Based Compensation* – The Company has a stock-based employee compensation plan, which is described more fully in Note 12. The Company accounts for all share-based payments to employees, including grants of employee stock options and restricted stock units and awards, to be recognized in the consolidated financial statements based on the grant date fair value of the award. The fair value is amortized over the requisite service period (generally the vesting period). Included in salaries and employee benefits for the years ended December 31, 2020 and 2019 are \$425,000 and \$349,000, respectively, of share-based compensation.

m. *Federal Home Loan Bank Stock and Federal Reserve Stock* – As a member of the Federal Home Loan Bank of San Francisco (“FHLB”), the Company is required to maintain an investment in capital stock of the FHLB. In addition, as a member of the Federal Reserve Bank of San Francisco (“FRB”), the Company is required to maintain an investment in capital stock of the FRB. The investments in both the FHLB and the FRB are carried at cost in the accompanying consolidated balance sheets under other assets and are subject to certain redemption requirements by the FHLB and FRB. Stock redemptions are at the discretion of the FHLB and FRB.

While technically these are considered equity securities, there is no market for the FHLB or FRB stock. Therefore, the shares are considered as restricted investment securities. Management periodically evaluates the stock for other-than-temporary impairment. Management’s determination of whether these investments are impaired is based on its assessment of the ultimate recoverability of cost rather than by recognizing temporary declines in value. The determination of whether a decline affects the ultimate recoverability of cost is influenced by criteria such as (1) the significance of any decline in net assets of the FHLB or FRB as compared to the capital stock amount of the FHLB or FRB and the length of time this situation has persisted, (2) commitments by the FHLB or FRB to make payments required by law or regulation and the level of such payments in relation to the operating performance of the FHLB or FRB, (3) the impact of

legislative and regulatory changes on institutions and, accordingly, the customer base of the FHLB or FRB, and (4) the liquidity position of the FHLB or FRB.

n. *Comprehensive Income* – Comprehensive income is comprised of net income and other comprehensive income. Other comprehensive income includes items recorded directly to equity, such as unrealized gains and losses on securities available-for-sale, unrecognized costs of salary continuation defined benefit plans, and unrealized gains and losses on trust preferred securities. Comprehensive income is presented in the Consolidated Statements of Other Comprehensive Income.

o. *Segment Reporting* – The Company’s operations are solely in the financial services industry and include providing to its customers traditional banking and other financial services. The Company operates primarily in California’s San Joaquin Valley. Management makes operating decisions and assesses performance based on an ongoing review of the Company’s consolidated financial results. Therefore, the Company has a single operating segment for financial reporting purposes.

p. *Revenue from Contracts with Customers* – The Company records revenue from contracts with customers in accordance with Accounting Standards Codification Topic 606, “Revenue from Contracts with Customers” (“Topic 606”). Under Topic 606, the Company must identify the contract with a customer, identify the performance obligations in the contract, determine the transaction price, allocate the transaction price to the performance obligations in the contract, and recognize revenue when (or as) the Company satisfies a performance obligation.

The Company’s primary sources of revenue are derived from interest and dividends earned on loans, investment securities, and other financial instruments that are not within the scope of Topic 606. The Company has evaluated the nature of its contracts with customers and determined that further disaggregation of revenue from contracts with customers into more granular categories beyond what is presented in the Consolidated Statements of Income is not necessary. The

Company generally fully satisfies its performance obligations on its contracts with customers as services are rendered and the transaction prices are typically fixed; charged either on a periodic basis or based on activity. The contracts evaluated that are in scope of Topic 606 are primarily related to service charges and fees on deposit accounts, debit card fees, ATM processing fees, and other service charges, commissions and fees. Because performance obligations are satisfied as services are rendered and the transaction prices are fixed, there is little judgment involved in applying Topic 606 that significantly affects the determination of the amount and timing of revenue from contracts with customers.

- q. *Leases* – The Company recognizes lease assets and lease liabilities on the consolidated balance sheet and disclosing key information about leasing arrangements. The Company combines lease and associated non-lease components by class of underlying asset in contract that meet certain criteria. The lease and related non-lease components have the same timing and pattern of transfer, and the lease component, when accounted for on a stand-alone basis, is classified as an operating lease.
- r. *Recent Accounting Standards Not Yet Adopted:* In June 2016, FASB issued *ASU 2016-13, Financial Instruments- Credit Losses* (Topic 326). The FASB is issuing this Update to improve financial reporting by requiring timelier recording of credit losses on loans and other financial instruments held by financial institutions and other organizations. The Update requires enhanced disclosures and judgments in estimating credit losses and also amends the accounting for credit losses on available-for-sale debt securities and purchased financial assets with credit deterioration. This original amendment was effective for fiscal years beginning after December 15, 2019, including interim periods within those fiscal years. In October 2019 FASB unanimously approved a vote to delay the effective date of this Standard to be effective for fiscal years beginning after December 15, 2022. The Company has formed a project team that is responsible for oversight of the Company's implementation strategy for

compliance with provisions of the new standard. An external provider specializing in community bank loss driver and the Current Expected Credit Loss ("CECL") reserving model design as well as other related consulting services has been retained, and the Company continues to evaluate potential CECL modeling alternatives. As part of this process, the Company has determined potential loan pool segmentation and sub-segmentation under CECL, as well as evaluated the key economic loss drivers for each segment. The Company has begun to generate and evaluate model scenarios under CECL in tandem with its current reserving processes for interim and annual reporting beginning in March 2020. While the Company is currently unable to reasonably estimate the impact of adopting this new guidance, management expects the impact of adoption will be significantly influenced by the composition and quality of the Company's loan portfolio as well as the economic conditions as of the date of adoption. The Company also anticipates significant changes to the processes and procedures for calculating the reserve for credit losses and continues to evaluate the potential impact on the Company's consolidated financial statements. Additionally, in regard to the recently approved delay in implementation, the Company continues to evaluate its expected implementation date.

In March 2020, FASB issued *ASU 2020-04, Reference Rate Reform* (Topic 848). This ASU provides optional expedients and exceptions for contracts, hedging relationships, and other transactions that reference LIBOR or other reference rates expected to be discontinued because of reference rate reform. The ASU is effective for all entities as of March 12, 2020 through December 31, 2022. The Company is in the process of evaluating the provisions of this ASU and its effects on our consolidated financial statements.

- s. *Reclassifications* – Certain reclassifications have been made to prior year financial statements to conform to the classifications used in 2020. None of the reclassifications had an impact on equity or net income.

## 2. Investment Securities

Following is a comparison of the amortized cost and approximate fair value of investment securities at December 31, 2020 and December 31, 2019:

<i>(In thousands)</i>				
<b>December 31, 2020</b>	<b>Amortized Cost</b>	<b>Gross Unrealized Gains</b>	<b>Gross Unrealized Losses</b>	<b>Fair Value (Carrying Amount)</b>
<u>Securities available for sale:</u>				
U.S. Government agencies	\$33,800	\$142	\$(232)	\$33,710
U.S. Government sponsored entities & agencies collateralized by mortgage obligations	37,732	722	(9)	38,445
Asset-backed securities	3,871	38	—	3,909
Municipal bonds	1,045	13	—	1,058
Corporate bonds	5,000	219	—	5,219
Total securities available for sale	\$81,448	\$1,134	\$(241)	\$82,341
<b>December 31, 2019</b>				
<u>Securities available for sale:</u>				
U.S. Government agencies	\$28,737	\$152	\$(190)	\$28,699
U.S. Government sponsored entities & agencies collateralized by mortgage obligations	47,824	120	(331)	47,613
Total securities available for sale	\$76,561	\$272	\$(521)	\$76,312

There were no sales of securities and no gross realized losses or gains on available-for-sale securities during the years ended December 31, 2020 and 2019. There were no other-than-temporary impairment losses during the years ended December 31, 2020 and 2019.

The amortized cost and fair value of securities available for sale at December 31, 2020, by contractual

maturity, are shown below. Actual maturities may differ from contractual maturities because issuers have the right to call or prepay obligations with or without call or prepayment penalties. Contractual maturities on collateralized mortgage obligations cannot be anticipated due to allowed paydowns.

	<b>December 31, 2020</b>	
<i>(In thousands)</i>	<b>Amortized Cost</b>	<b>Fair Value (Carrying Amount)</b>
Due in one year or less	\$ —	\$ —
Due after one year through five years	491	489
Due after five years through ten years	17,301	17,451
Due after ten years	25,924	25,956
U.S. Government sponsored entities & agencies collateralized by mortgage obligations	37,732	38,445
	\$81,448	\$82,341

At December 31, 2020 and 2019, available-for-sale securities with an amortized cost of approximately \$80,527,000 and \$65,874,000 (fair value of \$81,420,000

and \$65,683,000, respectively) were pledged as collateral for FHLB borrowings, securitized deposits, and public funds balances, respectively.

The following summarizes temporarily impaired investment securities at December 31, 2020 and 2019:

(In thousands)	Less than 12 Months		12 Months or More		Total	
	Fair Value (Carrying Amount)	Unrealized Losses	Fair Value (Carrying Amount)	Unrealized Losses	Fair Value (Carrying Amount)	Unrealized Losses
<b>December 31, 2020</b>						
<u>Securities available for sale:</u>						
U.S. Government agencies	\$ 9,013	\$(73)	\$16,963	\$(159)	\$25,976	\$(232)
U.S. Government sponsored entities & agencies collateralized by mortgage obligations	30	(1)	1,684	(8)	1,714	(9)
Asset-backed securities	—	—	—	—	—	—
Municipal bonds	—	—	—	—	—	—
Corporate bonds	—	—	—	—	—	—
Total impaired securities	\$ 9,043	\$(74)	\$18,647	\$(167)	\$27,690	\$(241)
<b>December 31, 2019</b>						
<u>Securities available for sale:</u>						
U.S. Government agencies	\$3,961	\$(12)	\$15,989	\$(178)	\$19,950	\$(190)
U.S. Government sponsored entities & agencies collateralized by mortgage obligations	25,400	(187)	11,244	(144)	36,644	(331)
Total impaired securities	\$29,361	\$(199)	\$27,233	\$(322)	\$56,594	\$(521)

Temporarily impaired securities at December 31, 2020, were comprised of twelve U.S. Government agency securities, and three U.S. Government sponsored entities & agencies collateralized by mortgage obligations. Temporarily impaired securities at December 31, 2019, were comprised of ten U.S. Government agency securities, and nineteen U.S. Government sponsored entities & agencies collateralized by mortgage obligations.

The Company evaluates investment securities for other-than-temporary impairment (OTTI) at least quarterly, and more frequently when economic or market conditions warrant such an evaluation. The investment securities portfolio is evaluated for OTTI by segregating the portfolio into two general segments and applying the appropriate OTTI model. Investment securities of high credit quality are generally evaluated for OTTI under ASC Topic 320-10, "Investments – Debt and Equity Instruments" and ASC Topic 321, "Investment – Equity Securities".

In the first segment, the Company considers many factors in determining OTTI, including: (1) the length of time and the extent to which the fair value has been less than cost, (2) the financial condition and near-term prospects of the issuer, (3) whether the

market decline was affected by macroeconomic conditions, and (4) whether the Company has the intent to sell the debt security or more likely than not will be required to sell the debt security before its anticipated recovery. The assessment of whether an other-than-temporary decline exists involves a high degree of subjectivity and judgment and is based on the information available to the Company at the time of the evaluation.

The second segment of the portfolio uses the OTTI guidance that is specific to purchased beneficial interests including private label mortgage-backed securities. Under this model, the Company compares the present value of the remaining cash flows as estimated at the preceding evaluation date to the current expected remaining cash flows. An OTTI is deemed to have occurred if there has been an adverse change in the remaining expected future cash flows.

Other-than-temporary-impairment occurs when the Company intends to sell the security or more likely than not will be required to sell the security before recovery of its amortized cost basis. If an entity intends to sell or more likely than not will be required to sell the security before recovery of its amortized cost basis, the other-than-temporary-impairment shall be

recognized in earnings equal to the entire difference between the investment's amortized cost basis and its fair value at the balance sheet date. If an entity does not intend to sell the security and it is not more likely than not that the entity will be required to sell the security before recovery of its amortized cost basis, the other-than-temporary-impairment shall be separated into the amount representing the credit loss and the amount related to all other factors. The amount of the total other-than-temporary-impairment related to the credit loss is recognized in earnings, and is determined based on the difference between the present value of cash flows expected to be collected and the current amortized cost of the security. The amount of the total other-than-temporary-impairment related to other factors shall be recognized in other comprehensive (loss) income, net of applicable taxes. The previous amortized cost basis less the other-than-temporary-impairment recognized in earnings shall become the new amortized cost basis of the investment.

At December 31, 2020, the decline in fair value of the twelve U.S. Government agency securities, and the

three U.S. Government sponsored entities and agencies collateralized by mortgage obligations securities is attributable to changes in interest rates, and not credit quality. Because the Company does not have the intent to sell these impaired securities, and it is not more likely than not that it will be required to sell these securities before its anticipated recovery, the Company does not consider these securities to be other-than-temporarily impaired at December 31, 2020.

During the year ended December 31, 2020, the Company recognized \$74,000 of unrealized gains related to marketable equity securities, related to one mutual fund, held at December 31, 2020 in the consolidated statements of income. During the year ended December 31, 2019, the Company recognized \$117,000 of unrealized gains related to marketable equity securities held at December 31, 2019 in the consolidated statements of income.

The Company had no held-to-maturity or trading securities at December 31, 2020 or December 31, 2019.

### 3. Loans

*Loans are comprised of the following:*

<i>(In thousands)</i>	<b>December 31,</b>	
	<b>2020</b>	<b>2019</b>
Commercial and business loans	\$ 37,349	\$ 44,534
Government program loans	10,165	744
Total commercial and industrial	47,514	45,278
Real estate – mortgage:		
Commercial real estate	282,951	245,183
Residential mortgages	37,236	45,881
Home improvement and home equity loans	107	173
Total real estate mortgage	320,294	291,237
Real estate construction and development	175,016	138,784
Agricultural	51,079	52,197
Installment and student loans	61,508	69,878
Total loans	\$655,411	\$597,374

The Company's loans are predominantly in the San Joaquin Valley, and the greater Oakhurst/East Madera County area, as well as the Campbell area of Santa Clara County. Although the Company does participate in loans with other financial institutions, they are primarily in the state of California.

Commercial and industrial loans represent 7.2% of total loans at December 31, 2020, and are generally made to support the ongoing operations of small-to-medium sized commercial businesses. Commercial and industrial loans have a high degree of industry diversification and provide working capital, financing

for the purchase of manufacturing plants and equipment, or funding for growth and general expansion of businesses. A substantial portion of commercial and industrial loans are secured by accounts receivable, inventory, leases, or other collateral including real estate. The remainder are unsecured; however, extensions of credit are predicated upon the financial capacity of the borrower. Repayment of commercial and industrial loans generally comes from the cash flow of the borrower. Included within the balance of Commercial and industrial loans is \$9,547,000 in Paycheck Protection Program ("PPP") loans administered by the SBA. PPP loans have a two-year term and earn interest at 1%. The Company believes that the majority of these loans will ultimately be forgiven by the SBA in accordance with the terms of the program.

Real estate mortgage loans, representing 48.9% of total loans at December 31, 2020, are secured by trust deeds on primarily commercial property, but are also secured by trust deeds on single family residences. Repayment of real estate mortgage loans is generally from the cash flow of the borrower.

- Commercial real estate mortgage loans comprise the largest segment of this loan category and are available on all types of income producing and commercial properties, including: office buildings and shopping centers; apartments and motels; owner occupied buildings; manufacturing facilities and more. Commercial real estate mortgage loans can also be used to refinance existing debt. Commercial real estate loans are made under the premise that the loan will be repaid from the borrower's business operations, rental income associated with the real property, or personal assets.
- Residential mortgage loans are provided to individuals to finance or refinance single-family residences. Residential mortgages are not a primary business line offered by the Company. The majority of residential mortgages are conventional mortgages that were purchased as a pool.
- Home improvement and home equity loans comprise a relatively small portion of total real estate mortgage loans. Home equity loans are generally secured by junior trust deeds, but may be secured by 1st trust deeds.

Real estate construction and development loans, representing 26.7% of total loans at December 31, 2020, consist of loans for residential and commercial construction projects, as well as land acquisition and development, or land held for future development. Loans in this category are secured by real estate including improved and unimproved land, as well as single-family residential, multi-family residential, and commercial properties in various stages of completion. All real estate loans have established equity requirements. Repayment on construction loans generally comes from long-term mortgages with other lending institutions obtained at completion of the project or from the sale of the constructed homes to individuals.

Agricultural loans represent 7.8% of total loans at December 31, 2020, and are generally secured by land, equipment, inventory and receivables. Repayment is from the cash flow of the borrower.

Installment loans represent 9.4% of total loans at December 31, 2020 and generally consist of student loans as well as loans to individuals for household, family, and other personal expenditures such as credit cards, automobiles or other consumer items. See Note 4 – Student Loans for specific information on the student loan portfolio.

In the normal course of business, the Company is party to financial instruments with off-balance sheet risk to meet the financing needs of its customers. At December 31, 2020 and 2019, these financial instruments include commitments to extend credit of \$216,799,000 and \$197,559,000, respectively, and standby letters of credit of \$3,668,000 and \$1,662,000, respectively. These instruments involve elements of credit risk in excess of the amount recognized on the consolidated balance sheet. The contract amounts of these instruments reflect the extent of the involvement the Company has in off-balance sheet financial instruments.

The Company's exposure to credit loss in the event of nonperformance by the counterparty to the financial instrument for commitments to extend credit and standby letters of credit is represented by the contractual amounts of those instruments. The Company uses the same credit policies as it does for on-balance sheet instruments.

Commitments to extend credit are agreements to lend to a customer, as long as there is no violation of any condition established in the contract. Substantially all of these commitments are at floating interest rates based on the Prime rate. Commitments generally have fixed expiration dates. The Company evaluates each customer's creditworthiness on a case-by-case basis. The amount of collateral obtained, if deemed necessary, is based on management's credit

evaluation. Collateral held varies but includes accounts receivable, inventory, leases, property, plant and equipment, residential real estate, and income-producing properties.

Standby letters of credit are generally unsecured and are issued by the Company to guarantee the performance of a customer to a third party. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loans to customers.

*Loans to directors, officers, principal shareholders and their affiliates are summarized below:*

<i>(In thousands)</i>	<b>December 31,</b>	
	<b>2020</b>	<b>2019</b>
Aggregate amount outstanding, beginning of year	\$ 1,093	\$ 7,408
New loans or advances during year	4,950	2,675
Repayments during year	(4,143)	(8,990)
Aggregate amount outstanding, end of year	\$ 1,900	\$ 1,093
Undisbursed commitments, end of year	\$21,000	\$12,000

Key terms and conditions for loans to directors, officers, principal shareholders and their affiliates do not differ from that of other borrowers.

#### Past Due Loans

The Company monitors delinquency and potential problem loans on an ongoing basis through weekly reports to the Loan Committee and monthly reports to the Board of Directors.

*The following is a summary of delinquent loans at December 31, 2020 (in thousands):*

<b>December 31, 2020</b>	<b>Loans 30-60 Days Past Due</b>	<b>Loans 61-89 Days Past Due</b>	<b>Loans 90 or More Days Past Due</b>	<b>Total Past Due Loans</b>	<b>Current Loans</b>	<b>Total Loans</b>	<b>Accruing Loans 90 or More Days Past Due</b>
Commercial and business loans	\$184	\$ —	\$ —	\$ 184	\$ 37,165	\$ 37,349	\$ —
Government program loans	—	—	—	—	10,165	10,165	—
Total commercial and industrial	184	—	—	184	47,330	47,514	—
Commercial real estate loans	—	—	—	—	282,951	282,951	—
Residential mortgages	—	—	—	—	37,236	37,236	—
Home improvement and home equity loans	—	—	—	—	107	107	—
Total real estate mortgage	—	—	—	—	320,294	320,294	—
Real estate construction and development loans	—	—	8,605	8,605	166,411	175,016	—
Agricultural loans	—	—	439	439	50,640	51,079	—
Installment and student loans	510	875	513	1,898	59,077	60,975	513
Overdraft protection lines	—	—	—	—	29	29	—
Overdrafts	—	—	—	—	504	504	—
Total installment and student loans	510	875	513	1,898	59,610	61,508	513
Total loans	\$694	\$875	\$9,557	\$11,126	\$644,285	\$655,411	\$513

The following is a summary of delinquent loans at December 31, 2019 (in thousands):

December 31, 2019	Loans 30-60 Days Past Due	Loans 61-89 Days Past Due	Loans 90 or More Days Past Due	Total Past Due Loans	Current Loans	Total Loans	Accruing Loans 90 or More Days Past Due
Commercial and business loans	\$ 568	\$—	\$ 75	\$ 643	\$ 43,891	\$ 44,534	\$—
Government program loans	—	—	—	—	744	744	—
Total commercial and industrial	568	—	75	643	44,635	45,278	—
Commercial real estate loans	—	—	—	—	245,183	245,183	—
Residential mortgages	28	—	—	28	45,853	45,881	—
Home improvement and home equity loans	—	—	—	—	173	173	—
Total real estate mortgage	28	—	—	28	291,209	291,237	—
Real estate construction and development loans	—	—	8,825	8,825	129,959	138,784	—
Agricultural loans	957	423	144	1,524	50,673	52,197	—
Installment and student loans	292	657	386	1,335	68,280	69,615	386
Overdraft protection lines	—	—	—	—	33	33	—
Overdrafts	—	—	—	—	230	230	—
Total installment and student loans	292	657	386	1,335	68,543	69,878	386
Total loans	\$1,845	\$1,080	\$9,430	\$12,355	\$585,019	\$597,374	\$386

#### Nonaccrual Loans

Commercial, construction and commercial real estate loans are placed on non-accrual status under the following circumstances:

- When there is doubt regarding the full repayment of interest and principal.
- When principal and/or interest on the loan has been in default for a period of 90-days or more, unless the asset is both well secured and in the process of collection that will result in repayment in the near future.
- When the loan is identified as having loss elements and/or is risk rated "8" Doubtful.

Other circumstances which jeopardize the ultimate collectability of the loan include certain troubled debt restructurings, identified loan impairment, and certain loans to facilitate the sale of OREO.

Loans meeting any of the preceding criteria are placed on non-accrual status and the accrual of interest for financial statement purposes is discontinued. Previously accrued but unpaid interest is reversed and charged against interest income.

All loans, outside of student loans, where principal or interest is due and unpaid for 90 days or more are placed on nonaccrual and the accrual of interest for financial statement purposes is discontinued.

Previously accrued but unpaid interest is reversed and charged against interest income. Student loans are generally charged off at the end of the month during which an account becomes 120 days contractually past due. Charge-offs and recoveries of amounts that relate to capitalized interest on student loans are treated as principal charge-offs and recoveries, affecting the allowance for loan losses rather than interest income. Capitalized interest earned in the current year is reversed from interest income. Accrued but unpaid interest related to charged-off student loans is reversed against interest income. In general, the Company reserves for a percentage of loans in forbearance and loans rated substandard.

When a loan is placed on non-accrual status and subsequent payments of interest (and principal) are received, the interest received may be accounted for in two separate ways.

Cost recovery method: If the loan is in doubt as to full collection, the interest received in subsequent payments is diverted from interest income and treated as a reduction of principal for financial reporting purposes.

Cash basis: This method is only used if the recorded investment or total contractual amount is expected to be fully collectible, under which circumstances the subsequent payments of interest is credited to interest income as received.

Loans on non-accrual status are usually not returned to accruing status unless and until all delinquent principal and/or interest has been brought current, there is no identified element of loss, and current and

continued satisfactory performance is expected (loss of the contractual amount not the carrying amount of the loan). Repayment ability is generally demonstrated through the timely receipt of at least six monthly payments on a loan with monthly amortization.

There were no remaining undisbursed commitments to extend credit on nonaccrual loans at December 31, 2020 and 2019.

The following is a summary of nonaccrual loan balances at December 31, 2020 and 2019 (in thousands):

(In thousands)	December 31,	
	2020	2019
Commercial and business loans	\$ —	\$ 75
Government program loans	—	—
Total commercial and industrial	—	75
Commercial real estate loans	—	—
Residential mortgages	—	—
Home improvement and home equity loans	—	—
Total real estate mortgage	—	—
Real estate construction and development loans	11,057	11,478
Agricultural loans	439	144
Installment and student loans	—	—
Total installment and student loans	—	—
Total loans	\$11,496	\$11,697

### Impaired Loans

A loan is considered impaired when based on current information and events, it is probable that the Company will be unable to collect all amounts due, including principal and interest, according to the contractual terms of the loan agreement.

The Company applies its normal loan review procedures in making judgments regarding probable losses and loan impairment. The Company evaluates for impairment those loans on nonaccrual status, graded doubtful, graded substandard or those that are troubled debt restructures. The primary basis for inclusion in impaired status under generally accepted accounting pronouncements is that it is probable that the Bank will be unable to collect all amounts due according to the contractual terms of the loan agreement.

A loan is not considered impaired if there is merely an insignificant delay or shortfall in the amounts of

payments and the Company expects to collect all amounts due, including interest accrued, at the contractual interest rate for the period of the delay.

Review for impairment does not include large groups of smaller balance homogeneous loans that are collectively evaluated to estimate the allowance for loan losses. The Company's present allowance for loan losses methodology, including migration analysis, captures required reserves for these loans in the formula allowance.

For loans determined to be impaired, the Company evaluates impairment based upon either the fair value of underlying collateral, discounted cash flows of expected payments, or observable market price.

- For loans secured by collateral including real estate and equipment, the fair value of the collateral less selling costs will determine the carrying value of the loan. The difference between the recorded investment in the loan and the fair

value, less selling costs, determines the amount of impairment. The Company uses the measurement method based on fair value of collateral when the loan is collateral dependent and foreclosure is probable. For loans that are not considered collateral dependent, a discounted cash flow methodology is used.

- The discounted cash flow method of measuring the impairment of a loan is used for impaired loans that are not considered to be collateral dependent. Under this method, the Company assesses both the amount and timing of cash flows expected from impaired loans. The estimated cash flows are discounted using the loan's effective interest rate. The difference between the amount of the loan on the Bank's books and the discounted cash flow amounts determines the amount of impairment to be provided. This method is used for most of the Company's troubled debt restructurings or other impaired loans where some payment stream is being collected.

- The observable market price method of measuring the impairment of a loan is only used by the Company when the sale of loans or a loan is in process.

The method for recognizing interest income on impaired loans is dependent on whether the loan is on nonaccrual status or is a troubled debt restructure. For income recognition, the existing nonaccrual and troubled debt restructuring policies are applied to impaired loans. Generally, except for certain troubled debt restructurings which are performing under the restructure agreement, the Company does not recognize interest income received on impaired loans, but reduces the carrying amount of the loan for financial reporting purposes.

Loans other than certain homogeneous loan portfolios are reviewed on a quarterly basis for impairment. Impaired loans are written down to estimated realizable values by the establishment of specific reserves for loans utilizing the discounted cash flow method, or charge-offs for collateral-based impaired loans, or those using observable market pricing.

The following is a summary of impaired loans at December 31, 2020 (in thousands):

December 31, 2020	Unpaid Contractual Principal Balance	Recorded Investment With No Allowance (1)	Recorded Investment With Allowance (1)	Total Recorded Investment	Related Allowance	Average Recorded Investment (2)	Interest Recognized (2)
Commercial and business loans	\$ 250	\$ 251	\$ —	\$ 251	\$ —	\$ 551	\$ 23
Government program loans	214	215	—	215	—	236	14
Total commercial and industrial	464	466	—	466	—	787	37
Commercial real estate loans	874	878	—	878	—	1,822	54
Residential mortgages	365	—	366	366	13	867	17
Home improvement and home equity loans	—	—	—	—	—	—	—
Total real estate mortgage	1,239	878	366	1,244	13	2,689	71
Real estate construction and development loans	11,057	11,057	—	11,057	—	11,223	252
Agricultural loans	610	293	316	609	196	675	39
Installment and student loans	—	—	—	—	—	—	—
Total installment and student loans	—	—	—	—	—	—	—
Total impaired loans	\$13,370	\$12,694	\$682	\$13,376	\$209	\$15,374	\$399

(1) The recorded investment in loans includes accrued interest receivable of \$6.

(2) Information is based on the year ended December 31, 2020.

The following is a summary of impaired loans at December 31, 2019 (in thousands).

<b>December 31, 2019</b>	<b>Unpaid Contractual Principal Balance</b>	<b>Recorded Investment With No Allowance (1)</b>	<b>Recorded Investment With Allowance (1)</b>	<b>Total Recorded Investment</b>	<b>Related Allowance</b>	<b>Average Recorded Investment (2)</b>	<b>Interest Recognized (2)</b>
Commercial and business loans	\$1,484	\$368	\$1,128	\$1,496	\$606	\$1,930	\$116
Government program loans	257	258	—	258	—	275	18
Total commercial and industrial	1,741	626	1,128	1,754	606	2,205	134
Commercial real estate loans	2,073	1,181	902	2,083	263	2,031	123
Residential mortgages	1,060	517	546	1,063	20	1,577	56
Home improvement and home equity loans	—	—	—	—	—	—	—
Total real estate mortgage	3,133	1,698	1,448	3,146	283	3,608	179
Real estate construction and development loans	11,478	11,478	—	11,478	—	11,572	231
Agricultural loans	684	262	432	694	256	726	57
Installment and student loans	—	—	—	—	—	14	—
Total installment and student loans	—	—	—	—	—	14	—
Total impaired loans	\$17,036	\$14,064	\$3,008	\$17,072	\$1,145	\$18,125	\$601

(1) The recorded investment in loans includes accrued interest receivable of \$36.

(2) Information is based on the twelve month period ended December 31, 2019.

In most cases, the Company uses the cash basis method of income recognition for impaired loans. In the case of certain troubled debt restructuring for which the loan is performing under the current contractual terms for a reasonable period of time, income is recognized under the accrual method.

#### Troubled Debt Restructurings

Under the circumstances, when the Company grants a concession to a borrower as part of a loan restructuring, the restructuring is accounted for as a troubled debt restructuring (TDR). TDRs are reported as a component of impaired loans.

A TDR is a type of restructuring in which the Company, for economic or legal reasons related to the borrower's financial difficulties, grants a concession (either imposed by court order, law, or agreement between the borrower and the Bank) to the borrower that it would not otherwise consider. Although the restructuring may take different forms, the Company's objective is to maximize recovery of its investment by granting relief to the borrower.

A TDR may include, but is not limited to, one or more of the following:

- A transfer from the borrower to the Company of receivables from third parties, real estate, other assets, or an equity interest in the borrower is granted to fully or partially satisfy the loan.
- A modification of terms of a debt such as one or a combination of:
  - The reduction (absolute or contingent) of the stated interest rate.
  - The extension of the maturity date or dates at a stated interest rate lower than the current market rate for new debt with similar risk.
  - The reduction (absolute or contingent) of the face amount or maturity amount of debt as stated in the instrument or agreement.
  - The reduction (absolute or contingent) of accrued interest.

For a restructured loan to return to accrual status there needs to be, among other factors, at least six months successful payment history. In addition, the Company performs a financial analysis of the credit to determine whether the borrower has the ability to continue to meet payments over the remaining life of the loan. This includes, but is not limited to, a review of financial statements and cash flow analysis of the borrower. Only after determination that the borrower has the ability to perform under the terms of the loans will the restructured credit be considered for accrual status.

Although the Company does not have a policy which specifically addresses when a loan may be removed from TDR classification, as a matter of practice, loans classified as TDRs generally remain classified as such until the loan either reaches maturity or its outstanding balance is paid off.

There was one new TDR and no defaults during the year ended December 31, 2020. Additionally there were no modifications or defaults during the year ended December 31, 2019.

The following tables illustrate TDR modification activity for the year ended December 31, 2020 (in thousands):

	Year ended December 31, 2020				
	Number of Contracts	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment	Number of Contracts in Default	Recorded Investment on Defaulted TDRs
<b>Troubled Debt Restructurings</b>					
Commercial and business loans	—	\$ —	\$ —	—	\$ —
Government program loans	—	—	—	—	—
Commercial real estate term loans	—	—	—	—	—
Single family residential loans	—	—	—	—	—
Home improvement and home equity loans	—	—	—	—	—
Real estate construction and development loans	—	—	—	—	—
Agricultural loans	1	179	179	—	—
Installment and student loans	—	—	—	—	—
Overdraft protection lines	—	—	—	—	—
Total loans	1	\$179	\$179	—	\$ —

The following tables summarize all TDR activity by loan category for the years ended December 31, 2020 and 2019 (in thousands).

<b>Twelve Months Ended December 31, 2020</b>	<b>Commercial and Industrial</b>	<b>Commercial Real Estate</b>	<b>Residential Mortgages</b>	<b>Home Improvement and Home Equity</b>	<b>Real Estate Construction Development</b>	<b>Agricultural</b>	<b>Installment and Student Loans</b>	<b>Total</b>
Beginning balance	\$ 9	\$ 898	\$1,060	\$—	\$2,654	\$566	\$—	\$5,187
Defaults	—	—	—	—	—	—	—	—
Additions	—	—	—	—	—	179	—	179
Principal reductions	(9)	(898)	(695)	—	(202)	(136)	—	(1,940)
Charge-offs	—	—	—	—	—	—	—	—
Ending balance	\$—	\$ —	\$ 365	\$—	\$2,452	\$609	\$—	\$3,426
Allowance for loan loss	\$—	\$ —	\$ 13	\$—	\$ —	\$196	\$—	\$209

  

<b>Twelve Months Ended December 31, 2019</b>	<b>Commercial and Industrial</b>	<b>Commercial Real Estate</b>	<b>Residential Mortgages</b>	<b>Home Improvement and Home Equity</b>	<b>Real Estate Construction Development</b>	<b>Agricultural</b>	<b>Installment and Student Loans</b>	<b>Total</b>
Beginning balance	\$75	\$1,305	\$2,029	\$—	\$2,838	\$812	\$—	\$7,059
Defaults	—	—	—	—	—	—	—	—
Principal reductions	(66)	(407)	(969)	—	(184)	(210)	—	(1,836)
Charge-offs	—	—	\$—	\$—	\$(36)	\$—	(36)	—
Ending balance	\$ 9	\$ 898	\$1,060	\$—	\$2,654	\$566	\$—	\$5,187
Allowance for loan loss	\$—	\$ 262	\$ 20	\$—	\$ —	\$256	\$—	\$538

The Company makes various types of concessions when structuring TDRs including rate reductions, payment extensions, and forbearance. At December 31, 2020, the Company had 7 restructured loans totaling \$3,426,000, as compared to 13 restructured loans totaling \$5,187,000 at December 31, 2019. The Company had no unfunded commitments outstanding for TDRs at December 31, 2020 and December 31, 2019.

The Company is working with customers directly affected by COVID-19. The Company has offered and continues to be prepared to offer short-term assistance. Throughout 2020 the company made \$69,800,000 in COVID-19 related modifications, which were generally no more than six months in duration and were not considered troubled debt restructurings. As of December 31, 2020, the Company had one payment modification outstanding with a loan balance of \$12,500,000 in connection with the COVID-19 relief provided by the CARES Act.

#### Credit Quality Indicators

As part of its credit monitoring program, the Company utilizes a risk rating system which quantifies the risk the Company estimates it has assumed during the life of a loan. The system rates the strength of the borrower and the facility or transaction, and is designed to provide a program for risk management and early detection of problems.

For each new credit approval, credit extension, renewal, or modification of existing credit facilities, the Company assigns risk ratings utilizing the rating scale identified in this policy. In addition, on an on-going basis, loans and credit facilities are reviewed for internal and external influences impacting the credit facility that would warrant a change in the risk rating. Each loan credit facility is given a risk rating that takes into account factors that materially affect credit quality.

When assigning risk ratings, the Company evaluates two risk rating approaches, a facility rating and a borrower rating as follows.

#### *Facility Rating:*

The facility rating is determined by the analysis of positive and negative factors that may indicate that the quality of a particular loan or credit arrangement requires that it be rated differently from the risk rating assigned to the borrower. The Company assesses the risk impact of these factors:

Collateral – The rating may be affected by the type and quality of the collateral, the degree of coverage, the economic life of the collateral, liquidation value, and the Company's ability to dispose of the collateral.

Guarantees – The value of third party support arrangements varies widely. Unconditional guaranties from persons with demonstrable ability to perform are more substantial than that of closely related persons to the borrower who offer only modest support.

Unusual Terms – Credit may be extended on terms that subject the Company to a higher level of risk than indicated in the rating of the borrower.

#### *Borrower Rating:*

The borrower rating is a measure of loss possibility based on the historical, current and anticipated financial characteristics of the borrower in the current risk environment. To determine the rating, the Company considers at least the following factors:

- Quality of management
- Liquidity
- Leverage/capitalization
- Profit margins/earnings trend
- Adequacy of financial records
- Alternative funding sources
- Geographic risk
- Industry risk
- Cash flow risk
- Accounting practices
- Asset protection
- Extraordinary risks

The Company assigns risk ratings to loans other than consumer loans and other homogeneous loan pools based on the following scale. The risk ratings are used when determining borrower ratings as well as facility ratings. When the borrower rating and the facility ratings differ, the lowest rating applied is:

- *Grades 1 and 2* – These grades include loans which are given to high quality borrowers

with high credit quality and sound financial strength. Key financial ratios are generally above industry averages and the borrower's strong earnings history or net worth. These may be secured by deposit accounts or high-grade investment securities.

- *Grade 3* – This grade includes loans to borrowers with solid credit quality with minimal risk. The borrower's balance sheet and financial ratios are generally in line with industry averages, and the borrower has historically demonstrated the ability to manage economic adversity. Real estate and asset-based loans assigned this risk rating must have characteristics which place them well above the minimum underwriting requirements for those departments. Asset-based borrowers assigned this rating must exhibit extremely favorable leverage and cash flow characteristics, and consistently demonstrate a high level of unused borrowing capacity.
- *Grades 4 and 5* – These include "pass" grade loans to borrowers of acceptable credit quality and risk. The borrower's balance sheet and financial ratios may be below industry averages, but above the lowest industry quartile. Leverage is above and liquidity is below industry averages. Inadequacies evident in financial performance and/or management sufficiency are offset by readily available features of support, such as adequate collateral, or good guarantors having the liquid assets and/or cash flow capacity to repay the debt. While the borrower may have recognized a loss over three or four years, recent earnings trends, while perhaps somewhat cyclical, are improving and cash flows are adequate to cover debt service and fixed obligations. Real estate and asset-borrowers fully complying with all underwriting standards and performing according to projections would be assigned this rating. These also include grade 5 loans which are "leveraged" or on management's "watch list." While still considered pass loans (loans given a grade 5), the borrower's financial condition, cash flow, or operations evidence more than average risk and short term weaknesses. These loans warrant a higher than average level of monitoring, supervision, and attention from the Company, but do not reflect credit weakness trends that weaken or

inadequately protect the Company's credit position. Loans with a grade rating of 5 are not normally acceptable as new credits unless they are adequately secured or carry substantial endorsers/guarantors.

- *Grade 6* – This grade includes “special mention” loans which are loans that are currently protected but are potentially weak. This generally is an interim grade classification and these loans will usually be upgraded to an “acceptable” rating or downgraded to a “substandard” rating within a reasonable time period. Weaknesses in special mention loans may, if not checked or corrected, weaken the asset or inadequately protect the Company's credit position at some future date. Special mention loans are often loans with weaknesses inherent in the loan origination and loan servicing, and may have some technical deficiencies. The main theme in special mention credits is the distinct probability that the classification will deteriorate to a more adverse class if the noted deficiencies are not addressed by the loan officer or loan management.
- *Grade 7* – This grade includes “substandard” loans which are inadequately supported by the current sound net worth and paying capacity of the borrower or of the collateral pledged, if any. Substandard loans have a well-defined weakness or weaknesses that may impair the regular

liquidation of the debt. When a loan has been downgraded to “substandard,” there exists a distinct possibility that the Company will sustain a loss if the deficiencies are not corrected. Substandard loans also include impaired loans.

- *Grade 8* – This grade includes “doubtful” loans which exhibit the same characteristics as the “substandard” loans. Additionally, loan weaknesses make collection or liquidation in full, on the basis of currently existing facts, conditions and values, highly questionable and improbable. The possibility of loss is extremely high, but because of certain important and reasonably specific pending factors, which may work to the advantage and strengthening of the loan, its classification as an estimated loss is deferred until its more exact status may be determined. Pending factors include a proposed merger, acquisition, or liquidation procedures, capital injection, perfecting liens on additional collateral, and refinancing plans.
- *Grade 9* – This grade includes loans classified “loss” which are considered uncollectible and of such little value that their continuance as bankable assets is not warranted. This classification does not mean that the asset has absolutely no recovery or salvage value, but rather it is not practical or desirable to defer writing off the asset even though partial recovery may be achieved in the future.

*The following tables summarize the credit risk ratings for commercial, construction, and other non-consumer related loans for December 31, 2020 and 2019. The Company did not carry any loans graded as loss at December 31, 2020 or December 31, 2019:*

<b>December 31, 2020</b> <i>(In thousands)</i>	<b>Commercial and Industrial</b>	<b>Commercial Real Estate</b>	<b>Real Estate Construction and Development</b>	<b>Agricultural</b>	<b>Total</b>
Grades 1 and 2	\$ 9,811	\$ —	\$ —	\$ 30	\$ 9,841
Grade 3	—	519	—	—	519
Grades 4 and 5 – pass	35,919	267,215	163,959	49,006	516,099
Grade 6 – special mention	1,307	14,343	—	1,434	17,084
Grade 7 – substandard	477	874	11,057	609	13,017
Grade 8 – doubtful	—	—	—	—	—
<b>Total</b>	<b>\$47,514</b>	<b>\$282,951</b>	<b>\$175,016</b>	<b>\$51,079</b>	<b>\$556,560</b>

<b>December 31, 2019</b> <i>(In thousands)</i>	<b>Commercial and Industrial</b>	<b>Commercial Real Estate</b>	<b>Real Estate Construction and Development</b>	<b>Agricultural</b>	<b>Total</b>
Grades 1 and 2	\$ 278	\$ 2,806	\$ —	\$ —	\$ 3,084
Grade 3	—	981	—	—	981
Grades 4 and 5 – pass	41,757	238,612	126,308	50,234	456,911
Grade 6 – special mention	919	1,608	998	1,279	4,804
Grade 7 – substandard	2,324	1,176	11,478	684	15,662
Grade 8 – doubtful	—	—	—	—	—
<b>Total</b>	<b>\$45,278</b>	<b>\$245,183</b>	<b>\$138,784</b>	<b>\$52,197</b>	<b>\$481,442</b>

The Company follows consistent underwriting standards outlined in its loan policy for consumer and other homogeneous loans but does not specifically assign a risk rating when these loans are originated. Consumer loans are monitored for credit risk and are considered “pass” loans until some issue or event requires that the credit be downgraded to special mention or worse. Within the student loan portfolio, the Company does not grade these loans individually, but monitors credit quality indicators such as delinquency and program defined status codes such as forbearance.

*The following table summarizes the credit risk ratings for consumer related loans and other homogeneous loans for December 31, 2020 and 2019 (in thousands):*

	<b>December 31, 2020</b>				<b>December 31, 2019</b>			
	<b>Residential Mortgages</b>	<b>Home Improvement and Home Equity</b>	<b>Installment and Student Loans</b>	<b>Total</b>	<b>Residential Mortgages</b>	<b>Home Improvement and Home Equity</b>	<b>Installment and Student Loans</b>	<b>Total</b>
Not graded	\$27,484	\$ 92	\$60,414	\$87,990	\$33,059	\$155	\$68,752	\$101,966
Pass	9,752	15	570	10,337	12,542	18	740	13,300
Special Mention	—	—	11	11	88	—	386	474
Substandard	—	—	513	513	192	—	—	192
Doubtful	—	—	—	—	—	—	—	—
<b>Total</b>	<b>\$37,236</b>	<b>\$107</b>	<b>\$61,508</b>	<b>\$ 98,851</b>	<b>\$45,881</b>	<b>\$173</b>	<b>\$69,878</b>	<b>\$115,932</b>

#### Allowance for Loan Losses

The Company analyzes risk characteristics inherent in each loan portfolio segment as part of the quarterly review of the adequacy of the allowance for loan losses. The following summarizes some of the key risk characteristics for the ten segments of the loan portfolio (Consumer loans include three segments):

Commercial and industrial loans – Commercial loans are subject to the effects of economic cycles and tend to exhibit increased risk as economic conditions deteriorate, or if the economic downturn is prolonged. The Company considers this segment to be one of higher risk given the size of individual loans and the balances in the overall portfolio.

Government program loans – This is a relatively a small part of the Company’s loan portfolio, but has historically had a high percentage of loans that have

migrated from pass to substandard given their vulnerability to economic cycles.

Commercial real estate loans – This segment is considered to have more risk in part because of the vulnerability of commercial businesses to economic cycles as well as the exposure to fluctuations in real estate prices because most of these loans are secured by real estate. Losses in this segment have however been historically low because most of the loans are real estate secured, and the bank maintains appropriate loan-to-value ratios.

Residential mortgages – This segment is considered to have low risk factors both from the Company and peer statistics. These loans are secured by first deeds of trust. The losses experienced over the past sixteen quarters are isolated to approximately three loans and are generally the result of short sales.

Home improvement and home equity loans – Because of their junior lien position, these loans have an inherently higher risk level. Because residential real estate has been severely distressed in the recent past, the anticipated risk for this loan segment has increased.

Real estate construction and development loans – This segment of loans is considered to have a higher risk profile due to construction and market value issues in conjunction with normal credit risks.

Agricultural loans – This segment is considered to have risks associated with weather, insects, and marketing issues. In addition, concentrations in certain crops or certain agricultural areas can increase risk. Additionally, from time to time, California experiences severe droughts, which can significantly harm the business of customers and the credit quality of the loans to those customers. Water resources and related issues affecting customers are closely monitored. Signs of deterioration within the loan portfolio are also monitored in an effort to manage credit quality and work with borrowers where possible to mitigate any losses.

Installment and student loans (Includes consumer loans, student loans, overdrafts, and overdraft protection lines) – This segment is higher risk because many of the loans are unsecured. Additionally, in the case of student loans, there are increased risks associated with liquidity as there is a significant time lag between funding of a student loan and eventual repayment.

COVID-19 – As a result of the current economic environment caused by the COVID-19 virus, the Company has engaged in more frequent communication with borrowers to better understand their situation and the challenges faced, allowing it to respond proactively as needs and issues arise. While the Company has not yet experienced any charge-offs related to COVID-19, the allowance for credit loss and resulting provision for credit losses are significantly impacted by changes in economic conditions resulting from significant increase in unemployment and weakened economy in our markets.

The following summarizes the activity in the allowance for credit losses by loan category for the years ended December 31, 2020 and 2019 (in thousands).

<b>December 31, 2020</b>	<b>Commercial and Industrial</b>	<b>Real Estate Mortgage</b>	<b>Real Estate Construction Development</b>	<b>Agricultural</b>	<b>Installment &amp; Student Loans</b>	<b>Unallocated</b>	<b>Total</b>
Beginning balance	\$1,322	\$712	\$2,808	\$761	\$2,132	\$173	\$7,908
(Recovery of provision)							
provision for credit losses	(726)	(227)	1,235	(50)	2,435	102	2,769
Charge-offs	—	(1)	(358)	—	(1,961)	—	(2,320)
Recoveries	29	91	37	—	8	—	165
Net recoveries (charge-offs)	29	90	(321)	—	(1,953)	—	(2,155)
Ending balance	\$ 625	\$575	\$3,722	\$711	\$2,614	\$275	\$8,522
Period-end amount allocated to:							
Loans individually evaluated for impairment	—	13	—	196	—	—	209
Loans collectively evaluated for impairment	625	562	3,722	515	2,614	275	8,313
Ending balance	\$ 625	\$575	\$3,722	\$711	\$2,614	\$275	\$8,522

<b>December 31, 2019</b>	<b>Commercial and Industrial</b>	<b>Real Estate Mortgage</b>	<b>Real Estate Construction and Development</b>	<b>Agricultural</b>	<b>Installment</b>	<b>Unallocated</b>	<b>Total</b>
Beginning balance	\$1,673	\$1,015	\$2,424	\$1,131	\$1,559	\$593	\$8,395
Provision (recovery of provision) for credit losses	(421)	(352)	384	(334)	1,163	(420)	20
Charge-offs	—	(16)	—	(36)	(761)	—	(813)
Recoveries	70	65	—	0	171	—	306
Net recoveries (charge-offs)	70	49	—	(36)	(590)	—	(507)
Ending balance	\$1,322	\$ 712	\$2,808	\$ 761	\$2,132	\$173	\$7,908
Period-end amount allocated to:							
Loans individually evaluated for impairment	606	283	—	256	—	—	1,145
Loans collectively evaluated for impairment	716	429	2,808	505	2,132	173	6,763
Ending balance	\$1,322	\$ 712	\$2,808	\$ 761	\$2,132	\$173	\$7,908

The following summarizes information with respect to the loan balances at December 31, 2020 and 2019.

<i>(In thousands)</i>	<b>December 31, 2020</b>		
	<b>Loans Individually Evaluated for Impairment</b>	<b>Loans Collectively Evaluated for Impairment</b>	<b>Total Loans</b>
Commercial and business loans	\$ 251	\$ 37,098	\$ 37,349
Government program loans	215	9,950	10,165
Total commercial and industrial	466	47,048	47,514
Commercial real estate loans	878	282,073	282,951
Residential mortgage loans	366	36,870	37,236
Home improvement and home equity loans	—	107	107
Total real estate mortgage	1,244	319,050	320,294
Real estate construction and development loans	11,057	163,959	175,016
Agricultural loans	609	50,470	51,079
Installment and student loans	—	61,508	61,508
Total loans	\$13,376	\$642,035	\$655,411

	December 31, 2019		
	Loans Individually Evaluated for Impairment	Loans Collectively Evaluated for Impairment	Total Loans
<i>(In thousands)</i>			
Commercial and business loans	\$ 1,496	\$ 43,038	\$ 44,534
Government program loans	258	486	744
Total commercial and industrial	1,754	43,524	45,278
Commercial real estate loans	2,083	243,100	245,183
Residential mortgage loans	1,063	44,818	45,881
Home improvement and home equity loans	—	173	173
Total real estate mortgage	3,146	288,091	291,237
Real estate construction and development loans	11,478	127,306	138,784
Agricultural loans	694	51,503	52,197
Installment and student loans	—	69,878	69,878
Total loans	\$17,072	\$580,302	\$597,374

#### 4. Student Loans

Included in installment loans are \$57,385,000 and \$65,800,000 in student loans at December 31, 2020 and 2019 made to medical and pharmacy school students. Upon graduation the loan is automatically placed on deferment for six months. This may be extended up to 48 months for graduates enrolling in internship, medical residency, or fellowship. As approved, the student may receive additional deferment for hardship or administrative reasons in the form of forbearance for a maximum of 24 months throughout the life of the loan. Accrued interest on loans that had not entered repayment status totaled \$3,201,000 at December 31, 2020 and \$4,689,000 at December 31, 2019. At December 31, 2020 there were 944 loans within repayment, deferment, and forbearance which represented \$28,906,000, \$7,407,000, and \$7,179,000, respectively. At December 31, 2019, there were 855 loans within repayment, deferment, and forbearance which represented \$24,986,000, \$4,392,000 and \$10,626,000,

respectively. As of December 31, 2020 and December 31, 2019, the reserve against the student loan portfolio was \$2,546,000 and \$2,091,000, respectively. There were no TDRs within the portfolio as of December 31, 2020 or December 31, 2019. At December 31, 2020 and December 31, 2019, student loans totaling \$513,000 were included in the substandard category and \$386,000 in the special mention category, respectively.

ZuntaFi (previously known as Reunion Student Loan Finance Corporation (RSLFC)) is the third-party servicer for the student loan portfolio. ZuntaFi's services include application administration, processing, approval, documenting, funding, and collection. They also provide borrower file custodial responsibilities. Except in cases where applicants/loans do not meet program requirements, or extreme delinquency, ZuntaFi is responsible for complete program management. ZuntaFi is paid a monthly servicing fee based on the outstanding principal balance.

The following tables summarize the credit quality indicators for outstanding student loans as of December 31, 2020 and December 31, 2019 (in 000's, except for number of borrowers):

	December 31, 2020			December 31, 2019		
	Number of Loans	Amount	Accrued Interest	Number of Loans	Amount	Accrued Interest
School	319	\$12,905	\$3,201	601	\$24,198	\$4,689
Grace	34	988	719	49	1,598	394
Repayment	623	28,906	292	507	24,986	203
Deferment	187	7,407	209	124	4,392	204
Forbearance	134	7,179	553	224	10,626	188
Total	1,297	\$57,385	\$4,974	1,505	\$65,800	\$5,678

**School** – The time in which the borrower is still actively in school at least half time. No payments are expected during this stage, though the borrower may begin immediate payments.

**Grace** – A six month period of time granted to the borrower immediately upon graduation, or if deemed no longer an active student. Interest continues to accrue. Upon completion of the six month grace period the loan is transferred to repayment status. Additionally, if applicable, this status may represent a borrower activated to military duty while in their in-school period, they will be allowed to return to that status once their active duty has expired. The borrower must return to an at least half time status within six months of the active duty end date in order to return to an in-school status.

**Repayment** – The time in which the borrower is no longer actively in school at least half time, and has not received an approved grace, deferment, or forbearance. Regular payment is expected from these borrowers under an allotted payment plan.

**Deferment** – May be granted up to 48 months for borrowers who have begun the repayment period on their loans but are (1) actively enrolled in an eligible school at least half time, or (2) are actively enrolled in an approved and verifiable medical residency, internship, or fellowship program.

**Forbearance** – The period of time during which the borrower may postpone making principal and interest payments, which may be granted for either hardship

or administrative reasons. Interest will continue to accrue on loans during periods of authorized forbearance. If the borrower is delinquent at the time the forbearance is granted, the delinquency will be covered by the forbearance and all accrued and unpaid interest from the date of delinquency or if none, from the date of beginning of the forbearance period, will be capitalized at the end of each forbearance period. The term of the loan will not change and payments may be increased to allow the loan to pay off in the required time frame. A forbearance that results in only a delay in payment considered insignificant, is not a concessionary change in terms provided the borrower affirms the obligation. Forbearance is not an uncommon status designation, this designation is standard industry practice, and is consistent with the succession of students migrating to employed medical professionals.

#### *Student Loan Aging*

Student loans are generally charged off at the end of the month during which an account becomes 120 days contractually past due. Accrued but unpaid interest related to charged off student loans is reversed and charged against interest income. For the year ended December 31, 2020, \$125,000 in accrued interest receivable was reversed due to charge-offs of \$1,947,000 within the student loan portfolio. For the year ended December 31, 2019, \$43,000 in accrued interest receivable was reversed due to charge-offs of \$740,000 within the student loan portfolio.

*The following tables summarize the student loan aging for loans in repayment and forbearance as of December 31, 2020 and December 31, 2019 (in 000's, except for number of borrowers):*

	December 31, 2020		December 31, 2019	
	Number of Borrowers	Amount	Number of Borrowers	Amount
Current or less than 31 days	304	\$34,188	295	\$34,277
31 – 60 days	4	510	4	292
61 – 90 days	10	875	7	657
Greater than 90 days	5	513	6	386
Total	323	\$36,086	312	\$35,612

## 5. Premises and Equipment

The components of premises and equipment are as follows:

(In thousands)	December 31,	
	2020	2019
Land	\$ 968	\$ 968
Buildings and improvements	16,111	15,868
Furniture and equipment	9,921	9,372
	27,000	26,208
Less accumulated depreciation and amortization	(17,890)	(16,828)
Total premises and equipment	\$ 9,110	\$ 9,380

The depreciation expense on Company premises and equipment totaled \$1,411,000 and \$1,402,000, for the years ended December 31, 2020 and 2019, respectively, and is included in occupancy expense in the accompanying consolidated statements of operations.

## 6. Investment in Limited Partnership

The Bank owns a 3.01% interest in a limited partnership which provides private capital for small to mid-sized businesses used to finance later stage growth, strategic acquisitions, ownership transitions, and recapitalizations, or mezzanine capital. At December 31, 2020 and December 31, 2019, the total investment in this limited partnership was \$2,322,000, and \$2,183,000, respectively. The investment is accounted for under the cost method. No income was recognized for the years ended December 31, 2020 and 2019. Remaining unfunded commitments as of December 31, 2020 and 2019 totaled \$2,239,000 and \$2,817,000, respectively.

## 7. Deposits

Deposits include the following:

(In thousands)	December 31, 2020	December 31, 2019
Noninterest-bearing deposits	\$391,897	\$311,950
Interest-bearing deposits:		
NOW and money market accounts	402,565	360,934
Savings accounts	96,669	80,078
Time deposits:		
Under \$250,000	40,303	44,926
\$250,000 and over	21,217	20,474
Total interest-bearing deposits	560,754	506,412
Total deposits	\$952,651	\$818,362

At December 31, 2020, the scheduled maturities of all certificates of deposit and other time deposits are as follows:

(In thousands)	December 31, 2020	December 31, 2019
One year or less	\$49,253	\$46,103
More than one year, but less than or equal to two years	10,577	16,563
More than two years, but less than or equal to three years	1,021	1,617
More than three years, but less than or equal to four years	184	882
More than four years, but less than or equal to five years	385	135
Greater than five years	100	100
	\$61,520	\$65,400

Deposit balances representing overdrafts reclassified as loan balances totaled \$506,000 and \$230,000 as of December 31, 2020 and 2019, respectively.

Deposits of directors, officers and other related parties to the Bank totaled \$11,192,000 and \$6,809,000 at December 31, 2020 and 2019, respectively. The rates paid on these deposits were similar to those customarily paid to the Bank's customers in the normal course of business.

## 8. Short-term Borrowings/Other Borrowings

At December 31, 2020, the Company had collateralized lines of credit with the Federal Reserve Bank of San Francisco totaling \$336,788,000, as well as Federal Home Loan Bank (FHLB) lines of credit totaling \$4,881,000. At December 31, 2020, the Company had uncollateralized lines of credit with Pacific Coast Bankers Bank (PCBB) and Union Bank totaling \$10,000,000 each and a Fed Funds line of \$20,000,000 with Zions First National Bank. All lines of credit are on an "as available" basis and can be revoked by the grantor at any time. These lines of credit have interest rates that are generally tied to the Federal Funds rate or are indexed to short-term U.S. Treasury rates or LIBOR. FHLB advances are collateralized by the Company's stock in the FHLB, investment securities, and certain qualifying mortgage loans.

As of December 31, 2020, \$5,294,000 in investment securities at FHLB were pledged as collateral for FHLB advances. Additionally, \$517,516,000 in real-estate secured loans were pledged at December 31, 2020, as collateral for used and unused borrowing lines with the Federal Reserve Bank. At December 31, 2020, and for the year then ended, the Company had no outstanding borrowing balances.

The Company had collateralized lines of credit with the Federal Reserve Bank of San Francisco totaling \$313,445,000, as well as Federal Home Loan Bank (FHLB) lines of credit totaling \$5,815,000 at December 31, 2019. At December 31, 2019, the Company had uncollateralized lines of credit with Pacific Coast Bankers Bank (PCBB) and Union Bank totaling \$10,000,000 each and a Fed Funds line of \$20,000,000 with Zions First National Bank. All lines of credit are on an "as available" basis and can be revoked by the grantor at any time. These lines of credit have interest rates that are generally tied to the Federal Funds rate or are indexed to short-term U.S. Treasury

rates or LIBOR. FHLB advances are collateralized by the Company's stock in the FHLB, investment securities, and certain qualifying mortgage loans.

As of December 31, 2019, \$6,201,000 in investment securities at FHLB were pledged as collateral for FHLB advances. Additionally, \$462,937,000 in real-estate secured loans were pledged at December 31, 2019, as collateral for used and unused borrowing lines with the Federal Reserve Bank. At December 31, 2019, and for the year then ended, the Company had no outstanding borrowing balances.

## 9. Leases

The Company leases land and premises for its branch banking offices, administration facilities, and ATMs. The initial terms of these leases expire at various dates through 2030. Under the provisions of most of these leases, the Company has the option to extend the leases beyond their original terms at rental rates adjusted for changes reported in certain economic indices or as reflected by market conditions. Lease terms may include options to extend or terminate the lease when it is reasonably certain the Company will exercise that option. As of December 31, 2020, the Company had 13 operating leases and no financing leases.

*The components of lease expense were as follows:*

(in 000's)	Year Ended December 31,	
	2020	2019
Operating lease expense	\$ 764	\$765
Short-term lease expense	—	—
Variable lease expense	249	205
Sublease income	—	—
Total	\$1,013	\$970

*Supplemental balance sheet information related to leases was as follows:*

(in 000's)	December 31,	
	2020	2019
Operating cash flows used in operating leases (years ended)	\$764	\$741
ROU assets obtained in exchange for new operating lease liabilities	104	3,944
Weighted-average remaining lease terms in years for operating leases	5.85	6.36
Weighted-average discount rate for operating leases	5.16%	5.15%

*Maturities of lease liabilities were as follows:*

<i>(in 000's)</i>	<b>Year Ended December 31, 2020</b>
2021	\$ 665
2022	675
2023	674
2024	513
2025	333
Thereafter	580
Total undiscounted cash flows	3,440
Less: present value discount	(473)
Present value of net future minimum lease payments	\$2,967

<i>(in 000's)</i>	<b>Year Ended December 31, 2019</b>
2020	\$ 763
2021	653
2022	663
2023	661
2024	501
Thereafter	826
Total undiscounted cash flows	4,067
Less: present value discount	(604)
Present value of net future minimum lease payments	\$3,463

## **10. Junior Subordinated Debt/Trust Preferred Securities**

Effective September 30, 2009 and beginning with the interest payment due October 1, 2009, the Company elected to defer interest payments on the Company's \$15.0 million of junior subordinated debentures relating to its trust preferred securities for the allowable five-year period. Interest payments were subsequently resumed at the end of the allowable deferment. In September 2015, the Company redeemed \$3.0 million at par value. The contractual principal balance of the Company's debentures relating to its trust preferred securities is \$12.0 million as of December 31, 2020. The Company may redeem the junior subordinated debentures at any time at par.

The Company accounts for its junior subordinated debt issued under USB Capital Trust II at fair value. The Company believes the election of fair value accounting for the junior subordinated debentures

better reflects the true economic value of the debt instrument on the consolidated balance sheet. As of December 31, 2020, the rate paid on the junior subordinated debt issued under USB Capital Trust II is 3-month LIBOR plus 129 basis points, and is adjusted quarterly.

At December 31, 2020, the Company performed a fair value measurement analysis on its junior subordinated debt using a cash flow model approach to determine the present value of those cash flows. The cash flow model utilizes the forward 3-month LIBOR curve to estimate future quarterly interest payments due over the thirty-year life of the debt instrument. These cash flows are discounted at a rate which incorporates a current market rate for similar-term debt instruments, adjusted for additional credit and liquidity risks associated with junior subordinated debt. The 3.57% discount rate used represents what a market participant would consider under the circumstances based on current market assumptions. At December 31, 2020, the total cumulative gain recorded on the debt was \$1,586,000.

The net fair value calculation performed as of December 31, 2020 resulted in a pretax loss adjustment of \$174,000 for the year ended December 31, 2020, compared to a pretax loss adjustment of \$661,000 for the year ended December 31, 2019.

For the year ended December 31, 2020, the \$174,000 fair value loss adjustment was separately presented as a \$970,000 gain recognized on the consolidated statements of income, and a \$1,144,000 loss associated with the instrument-specific credit risk recognized in other comprehensive income. For the year ended December 31, 2019, the \$661,000 fair value loss adjustment was separately presented as a \$1,165,000 gain recognized on the consolidated statements of income, and a \$1,826,000 loss associated with the instrument-specific credit risk recognized in other comprehensive income. The Company calculated the change in the discounted cash flows based on updated market credit spreads for the periods ended.

## 11. Taxes on Income

The tax effects of significant items comprising the Company's net deferred tax assets (liabilities) are as follows:

(In thousands)	December 31,	
	2020	2019
Deferred tax assets:		
Credit losses not currently deductible	\$2,906	\$1,837
Deferred compensation	1,506	1,438
Depreciation	256	180
Accrued reserves	109	120
Write-down on other real estate owned	291	89
Unrealized gain on retirement obligation	325	285
Unrealized gain (loss) on TRUPs	246	(91)
Interest on nonaccrual loans	443	336
Lease liability	875	1,021
Other	467	1,499
Total deferred tax assets	7,424	6,714
Deferred tax liabilities:		
State Tax	(211)	(196)
FHLB dividend	(46)	(46)
Loss on limited partnership investment	(1,353)	(1,014)
Deferred gain ASC 825 – fair value option	(771)	(462)
Fair value adjustments for purchase accounting	(98)	(98)
Deferred loan costs	(689)	(548)
Prepaid expenses	(239)	(241)
Unrealized (gain) loss on available for sale securities	(265)	73
Right-of-use asset	(845)	(991)
Total deferred tax liabilities	(4,517)	(3,523)
Net deferred tax assets	\$2,907	\$3,191

The Company periodically evaluates its deferred tax assets to determine whether a valuation allowance is required based upon a determination that some or all of the deferred assets may not be ultimately realized. The Company did not record a valuation allowance at December 31, 2020 or December 31, 2019.

Income tax expense for the years ended December 31, consist of the following:

(In thousands)			
	Federal	State	Total
<b>2020</b>			
Current	\$1,871	\$1,256	\$3,127
Deferred	399	(75)	324
	\$2,270	\$1,181	\$3,451
<b>2019</b>			
Current	\$3,627	\$1,937	\$5,564
Deferred	269	264	533
	\$3,896	\$2,201	\$6,097

A reconciliation of the statutory federal income tax rate to the effective income tax rate is as follows:

	<b>Year Ended December 31,</b>	
	<b>2020</b>	<b>2019</b>
Statutory federal income tax rate	21.0%	21.0%
State franchise tax, net of federal income tax benefit	8.2	8.3
Other	(1.4)	(0.6)
	<b>27.8%</b>	<b>28.7%</b>

The Company periodically reviews its tax positions under the accounting standards related to uncertainty in income taxes, which defines the criteria that an individual tax position would have to meet for some or all of the income tax benefit to be recognized in a taxable entity's financial statements. Under the guidelines, an entity should recognize the financial statement benefit of a tax position if it determines that it is more likely than not that the position will be sustained on examination. The term, "more likely than not," means a likelihood of more than 50 percent. In assessing whether the more-likely-than-not criterion is met, the entity should assume that the tax position will be reviewed by the applicable taxing authority and all available information is known to the taxing authority. As of December 31, 2020 and 2019, the Company has no uncertain tax positions.

The Company and its subsidiary file income tax returns in the U.S federal jurisdiction and California. There are no filings in foreign jurisdictions. The Company is no longer subject to income tax examinations by taxing authorities for years before 2017 and 2016 for Federal and California jurisdictions, respectively.

The Company's policy is to recognize any interest or penalties related to uncertain tax positions in income tax expense. Interest and penalties recognized during the periods ended December 31, 2020 and December 31, 2019 were insignificant.

On March 27, 2020, the Coronavirus Aid, Relief, and Economic Security Act (CARES Act) was enacted in response to the COVID-19 pandemic. The CARES Act, among other things, permits NOL carryovers and carrybacks to offset 100% of taxable income for taxable years beginning before 2021. In addition, the CARES Act allows NOLs incurred in 2018, 2019, and 2020 to be carried back to each of the five preceding taxable years to generate a refund of previously paid income taxes. The Company has evaluated the impact of the CARES Act and determined that none of the

changes would result in a material income tax benefit to the Company.

## 12. Stock Based Compensation

On December 27, 2020, the Consolidated Appropriations Act, 2021 was signed into law and extends several provisions of the CARES Act. As of December 31, 2020 the Company has determined that neither this Act nor changes to income tax laws or regulations in other jurisdictions have a significant impact on our effective tax rate.

Options and restricted stock units and awards have been granted to officers and key employees at an exercise price equal to estimated fair value at the date of grant as determined by the Board of Directors. All options, units, and awards granted are service awards, and are based solely upon fulfilling a requisite service period (the vesting period). At December 31, 2020, the Company had two stock based compensation plans.

In May 2005, the Company adopted the United Security Bancshares 2005 Stock Option Plan (2005 Plan) for which 34,601 shares remain reserved for issuance for options already granted to employees and directors under incentive and nonstatutory agreements. The 2005 plan expired in May 2015. While outstanding arrangements to issue shares under this plan, including options, continue in force until their expiration, no new options will be granted under this plan.

In May 2015, the Company adopted the United Security Bancshares 2015 Equity Incentive Award Plan (2015 Plan). The 2015 Plan provides for the granting of up to 758,000 shares of authorized and unissued shares of common stock in the form of stock options, restricted stock units, and restricted stock awards. The 2015 Plan requires that the exercise price may not be less than the fair value of the stock at the date the option is granted, and that the option price must be paid in full at the time it is exercised.

The options granted (incentive stock options for employees and non-qualified stock options for Directors) have an exercise price at the prevailing market price on the date of grant. All options granted are exercisable 20% each year commencing one year after the date of grant and expire ten years after the date of grant. Restricted stock awards are granted at the prevailing market price of the Company's stock and typically vest over a five-year period. Restricted stock awards are subject to forfeiture if employment terminates prior to vesting. The cost of these awards is recognized over the vesting period of the awards based on the fair value of the common stock on the date of the grant.

Under the 2005 Plan, 34,601 granted options are outstanding and vested (34,601 incentive stock options and 0 nonqualified stock options) as of December 31, 2020. No options were granted under this plan during the year ended December 31, 2020.

Under the 2015 Plan, 71,924 granted stock instruments are outstanding as of December 31, 2020, of which 36,000 are exercisable. Of the 71,924 granted stock instruments, 11,924 are restricted stock units and 60,000 are nonqualified stock options.

*A summary of the status of the Company's stock option plan and changes during the year are presented below:*

	<b>Shares (a)</b>	<b>Weighted Average Exercise Price</b>
Options outstanding December 31, 2019	94,601	\$7.87
Granted during the year	—	—
Exercised during the year	—	—
Forfeited during the year	—	—
Options outstanding December 31, 2020	94,601	\$7.87

*A summary of the status of the Company's restricted stock and changes during the year are presented below:*

	<b>Shares (a)</b>	<b>Weighted Average Grant-Date Fair Value</b>
Non-vested units at December 31, 2019	35,572	\$ 9.96
Granted during the year	12,500	9.73
Vested during the year	36,148	9.58
Forfeited during the year	—	—
Non-vested units at December 31, 2020	11,924	\$10.85

Included in total outstanding options at December 31, 2020, are 70,601 exercisable shares at a weighted average price of \$7.10, a weighted average remaining contract term of 4.75 years and intrinsic value of \$108,000.

Included in salaries and employee benefits for the years ended December 31, 2020 and 2019 is \$425,000 and \$349,000 of share-based compensation,

respectively. The related tax benefit on share-based compensation recorded in the provision for income taxes was not material to any year.

As of December 31, 2020 and 2019 there was \$147,000 and \$226,000, respectively, of total unrecognized compensation expense related to non-vested stock options. This cost is expected to be recognized over a weighted average period of approximately 6.68 years.

A summary of the status of the Company's stock option values and activity is presented below:

	December 31, 2020	December 31, 2019
Weighted average grant-date fair value per share of stock options granted	\$ —	\$ —
Weighted average fair value of stock options vested	\$86,000	\$90,000
Total intrinsic value of stock options exercised	\$ —	\$ —

As of December 31, 2020 and 2019 there was \$106,000 and \$300,000, respectively, of total unrecognized compensation expense related to restricted stock. This cost is expected to be recognized over a weighted-average period of approximately 2.72 years.

The Bank determines fair value of stock options at grant date using the Black-Scholes-Merton pricing model that takes into account the stock price at the grant date, the exercise price, the expected life of the option, the volatility of the underlying stock and the expected dividend yield and the risk-free interest rate over the expected life of the option. The Bank determines fair value of restricted stock based on the quoted stock price as of the grant date.

The expected term of options granted is derived from management's experience, which is based upon historical data on employee exercise and post-vesting behavior. The risk free rate for periods within the contractual life of the option is based on the U.S. Treasury yield curve in effect at the time of the grant. Expected volatility is based on the historical volatility of the Bank's stock over a period commensurate with the expected term of the options. The Company believes that historical volatility is indicative of expectations about its future volatility over the expected term of the options.

The Bank expenses the fair value of the option on a straight-line basis over the vesting period for each separately vesting portion of the award. The Bank estimates forfeitures and only recognizes expense for those shares expected to vest. Based upon historical evidence, the Company has determined that because options are granted to a limited number of key employees rather than a broad segment of the employee base, expected forfeitures, if any, are not material.

The Black-Scholes-Merton option valuation model requires the input of highly subjective assumptions, including the expected life of the stock based award and stock price volatility. The assumptions listed above represent management's best estimates, but these

estimates involve inherent uncertainties and the application of management judgment. As a result, if other assumptions had been used, the Bank's recorded stock-based compensation expense could have been materially different from that previously reported in proforma disclosures. In addition, the Bank is required to estimate the expected forfeiture rate and only recognize expense for those shares expected to vest. If the Bank's actual forfeiture rate is materially different from the estimate, the share-based compensation expense could be materially different.

### 13. Employee Benefit Plans

#### 401K Plan

The Company has a Cash or Deferred 401(k) Stock Ownership Plan (the "401(k) Plan") organized under Section 401(k) of the Code. All employees of the Company are initially eligible to participate in the 401(k) Plan upon the first day of the month after date of hire. Under the terms of the plan, the participants may elect to make contributions to the 401(k) Plan as determined by the Board of Directors. Participants are automatically vested 100% in all employee contributions. Participants may direct the investment of their contributions to the 401(k) Plan in any of several authorized investment vehicles. The Company contributes funds to the Plan up to 4% of the employees' eligible annual compensation. Company contributions are immediately 100% vested at the time of contribution. The Company made matching contributions of \$250,000 and \$256,000 to the 401(k) Plan for the years ended December 31, 2020 and 2019, respectively.

#### Salary Continuation Plan

The Company has an unfunded, non-qualified Salary Continuation Plan for senior executive officers and certain other key officers of the Company, which provides additional compensation benefits upon retirement for a period of at least 15 years. Future compensation under the Plan is earned by the employees for services rendered through retirement

and vests over a period of 12 to 32 years. As of December 31, 2020, the Company maintains a total of eleven Salary Continuation agreements.

The Company's current benefit liability is determined based upon vesting and the present value of the benefits at a corresponding discount rate. The discount rate used is an equivalent rate for high-quality investment-grade bonds with lives matching those of the service periods remaining for the salary continuation contracts, which averages approximately 20 years. At December 31, 2020 and 2019, \$4,731,000 and \$4,516,000, respectively, had been accrued to date, based on a discounted cash flow using an average discount rate of 1.36% and 2.43%, respectively, and is included in other liabilities on the consolidated balance sheets. Salary continuation expense is included in salaries and benefits expense, and totaled \$284,000 and \$272,000 for the years ended December 31, 2020 and 2019, respectively.

Included within the eleven total Salary Continuation agreements, the Company entered into three separate agreements with officers of the Bank in 2015. The Company accrues for this salary continuation liability based on anticipated years of service and vesting schedules provided under the individual agreements. The three policies are considered individual contracts, and the Company applies guidance contained in ASC Topic 710. Additionally, the Company purchased company owned life insurance (COLI) policies on the life of the officers in connection with the Salary Continuation agreements. The COLI policy premiums are paid over a seven year period. Life insurance premium expense totaled \$30,000 and \$37,000 for the years ended December 31, 2020 and 2019.

For the eight Salary Continuation agreements in place prior to 2015, the Company recognizes in accumulated other comprehensive (loss) income, the amounts that have not yet been recognized as components of net periodic benefit costs, per the guidance contained in ASC Topic 715 "Compensation". These unrecognized costs arise from changes in estimated interest rates used in the calculation of net liabilities under the Plan. As of December 31, 2020 and 2019, the Company had approximately \$770,000 and \$675,000, respectively in unrecognized net periodic benefit costs arising from changes in interest rates

used in calculating the current post-retirement liability required under the Plan. This amount represents the difference between the plan liabilities calculated under net present value calculations, and the net plan liabilities actually recorded on the Company's books at December 31, 2020 and 2019.

#### Officer Supplemental Life Insurance Plan

The Company owns Bank-owned life insurance policies (BOLI) and Company-owned life insurance policies (COLI) on certain officers, including those covered under the Salary Continuation Plan, with a portion of the death benefits available to the officers' beneficiaries. The BOLI and COLI initial net cash surrender value is equivalent to the premium paid, and it adds income through non-taxable increases in its cash surrender value, net of the cost of insurance, plus any death benefits ultimately received by the Company. The cash surrender value of these insurance policies totaled \$20,715,000 and \$20,955,000 at December 31, 2020 and 2019, and is included on the consolidated balance sheet in cash surrender value of life insurance. These policies resulted in income, net of expense, of approximately \$474,000 and \$491,000 for the years ended December 31, 2020 and 2019, respectively. Although the Plan remains unfunded, the Company intends to utilize the proceeds of such policies to settle the Plan obligations. Under Internal Revenue Service regulations, the life insurance policies are the property of the Company and are available to satisfy the Company's general creditors.

## **14. Commitments and Contingent Liabilities**

*Financial Instruments with Off-Balance Sheet Risk:* The Company is party to financial instruments with off-balance sheet risk which arise in the normal course of business. These instruments may contain elements of credit risk, interest rate risk and liquidity risk, and include commitments to extend credit and standby letters of credit. The credit risk associated with these instruments is essentially the same as that involved in extending credit to customers and is represented by the contractual amount indicated in the table below:

<i>(In thousands)</i>	<b>Contractual amount – December 31,</b>	
	<b>2020</b>	<b>2019</b>
Commitments to extend credit	\$216,799	\$197,559
Standby letters of credit	3,668	1,662

Commitments to extend credit are agreements to lend to a customer, as long as there is no violation of any condition established in the contract. Substantially all of these commitments are at floating interest rates based on the Prime rate, and most have fixed expiration dates. The Company evaluates each customer's creditworthiness on a case-by-case basis, and the amount of collateral obtained, if deemed necessary, is based on management's credit evaluation. Collateral held varies but includes accounts receivable, inventory, leases, property, plant and equipment, residential real estate, and income-producing properties. Many of the commitments are expected to expire without being drawn upon and, as a result, the total commitment amounts do not necessarily represent future cash requirements of the Company.

Standby letters of credit are generally unsecured and are issued by the Company to guarantee the performance of a customer to a third party. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loans to customers. The Company's letters of credit are short-term guarantees and generally have terms from less than one month to approximately 3 years. At December 31, 2020, the maximum potential amount of future undiscounted payments the Company could be required to make under outstanding standby letters of credit totaled \$3,668,000.

In the ordinary course of business, the Company becomes involved in litigation arising out of its normal business activities. Management, after consultation with legal counsel, believes that the ultimate liability,

if any, resulting from the disposition of such claims would not be material to the financial position of the Company.

## **15. Fair Value Measurements and Disclosure**

The following summary disclosures are made in accordance with the guidance provided by ASC Topic 825 "Fair Value Measurements and Disclosures" which requires the disclosure of fair value information for both on- and off-balance sheet financial instruments where it is practicable to estimate that value.

GAAP guidance clarifies the definition of fair value, describes methods used to appropriately measure fair value in accordance with generally accepted accounting principles and expands fair value disclosure requirements. This guidance applies whenever other accounting pronouncements require or permit fair value measurements.

The fair value hierarchy prioritizes the inputs to valuation techniques used to measure fair value into three broad levels (Level 1, Level 2, and Level 3). Level 1 inputs are unadjusted quoted prices in active markets (as defined) for identical assets or liabilities that the reporting entity has the ability to access at the measurement date. Level 2 inputs are inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly. Level 3 inputs are unobservable inputs for the asset or liability, and reflect the reporting entity's assumptions regarding the pricing of an asset or liability by a market participant (including assumptions about risk).

The table below is a summary of fair value estimates for financial instruments and the level of the fair value hierarchy within which the fair value measurements are categorized at the periods indicated:

<b>December 31, 2020</b>					
<i>(In thousands)</i>	<b>Carrying Amount</b>	<b>Estimated Fair Value</b>	<b>Quoted Prices In Active Markets for Identical Assets Level 1</b>	<b>Significant Other Observable Inputs Level 2</b>	<b>Significant Unobservable Inputs Level 3</b>
Financial Assets:					
Investment securities	\$ 86,192	\$ 91,768	\$ 3,851	\$87,917	\$ —
Loans	645,825	636,470	—	—	636,470
Accrued interest receivable	8,164	8,164	—	8,164	—
Financial Liabilities:					
Deposits:					
Noninterest-bearing	391,897	430,210	430,210	—	—
NOW and money market	402,565	406,707	406,707	—	—
Savings	96,669	94,467	94,467	—	—
Time deposits	61,520	61,519	—	—	61,519
Total deposits	952,651	992,903	931,384	—	61,519
Junior subordinated debt	10,924	10,924	—	—	10,924
Accrued interest payable	—	—	—	—	—

<b>December 31, 2019</b>					
<i>(In thousands)</i>	<b>Carrying Amount</b>	<b>Estimated Fair Value</b>	<b>Quoted Prices In Active Markets for Identical Assets Level 1</b>	<b>Significant Other Observable Inputs Level 2</b>	<b>Significant Unobservable Inputs Level 3</b>
Financial Assets:					
Investment securities	\$ 80,088	\$ 80,088	\$ 3,776	\$76,312	\$ —
Loans	588,646	581,695	—	—	581,695
Accrued interest receivable	8,208	8,208	—	8,208	—
Financial Liabilities:					
Deposits:					
Noninterest-bearing	311,950	311,950	311,950	—	—
NOW and money market	360,934	360,934	360,934	—	—
Savings	80,078	80,078	80,078	—	—
Time deposits	65,400	65,236	—	—	65,236
Total deposits	818,362	818,198	752,962	—	65,236
Junior subordinated debt	10,808	10,808	—	—	10,808
Accrued interest payable	—	—	—	—	—

The Company performs fair value measurements on certain assets and liabilities as the result of the application of current accounting guidelines. Some fair value measurements, such as available-for-sale securities (AFS) and junior subordinated debt are performed on a recurring basis, while others, such as collateral dependent impaired loans, other real estate owned, goodwill and other intangibles, are performed on a nonrecurring basis.

The Company's Level 1 financial assets consist of money market funds and highly liquid mutual funds for which fair values are based on quoted market prices. The Company's Level 2 financial assets include highly liquid debt instruments of U.S. Government agencies, collateralized mortgage obligations, and debt obligations of states and political subdivisions, whose fair values are obtained from readily-available pricing sources for the identical or similar underlying security that may, or may not, be actively traded. The Company's Level 3 financial assets include certain impaired loans, other real estate owned, goodwill, and intangible assets where the assumptions may be made by us or third parties about assumptions that market participants would use in pricing the asset or liability. From time to time, the Company recognizes transfers between Level 1, 2, and 3 when a change in circumstances warrants a transfer. There were no transfers in or out of Level 1 and Level 2 fair value measurements during the year ended December 31, 2020.

The following methods and assumptions were used in estimating the fair values of financial instruments measured at fair value on a recurring and non-recurring basis:

**Investments** – Available for sale and marketable securities are valued based upon open-market price quotes obtained from reputable third-party brokers that actively make a market in those securities. Market pricing is based upon specific CUSIP identification for each individual security. To the extent there are observable prices in the market, the mid-point of the bid/ask price is used to determine fair value of individual securities. If that data is not available for the last 30 days, a Level 2-type matrix pricing approach based on comparable securities in the market is

utilized. Level-2 pricing may include using a forward spread from the last observable trade or may use a proxy bond such as a TBA mortgage to determine a price for the security being valued. Changes in fair market value are recorded through other comprehensive income as the securities are available for sale.

**Impaired Loans** – Fair value measurements for collateral dependent impaired loans are performed pursuant to authoritative accounting guidance and are based upon either collateral values supported by appraisals and observed market prices. Collateral dependent loans are measured for impairment using the fair value of the collateral. Changes are recorded directly as an adjustment to current earnings.

**Other Real Estate Owned** – Nonrecurring adjustments to certain commercial and residential real estate properties classified as other real estate owned (OREO) are measured at the lower of carrying amount or fair value, less costs to sell. Fair values are generally based on third party appraisals of the property, resulting in a Level 3 classification. In cases where the carrying amount exceeds the fair value, less costs to sell, an impairment loss is recognized.

**Junior Subordinated Debt** – The fair value of the junior subordinated debt was determined based upon a discounted cash flows model utilizing observable market rates and credit characteristics for similar debt instruments. In its analysis, the Company used characteristics that market participants generally use, and considered factors specific to (a) the liability, (b) the principal (or most advantageous) market for the liability, and (c) market participants with whom the reporting entity would transact in that market. Cash flows are discounted at a rate which incorporates a current market rate for similar-term debt instruments, adjusted for credit and liquidity risks associated with similar junior subordinated debt and circumstances unique to the Company. The Company believes that the subjective nature of these inputs, and credit concerns in the capital markets and inactivity in the trust preferred markets that have limited the observability of the market spreads, require the junior subordinated debt to be classified as a Level 3 fair value.

The following table provides a description of the valuation technique, unobservable input, and qualitative information about the unobservable inputs for the Company's liabilities classified as Level 3 and measured at fair value on a recurring basis at December 31, 2020 and 2019:

December 31, 2020				December 31, 2019			
Financial Instrument	Valuation Technique	Unobservable Input	Weighted Average	Financial Instrument	Valuation Technique	Unobservable Input	Weighted Average
Subordinated Debt	Discounted cash flow	Discount Rate	3.57%	Subordinated Debt	Discounted cash flow	Discount Rate	4.46%

Management believes that the credit risk adjusted spread utilized in the fair value measurement of the junior subordinated debentures carried at fair value is indicative of the nonperformance risk premium a willing market participant would require under current market conditions, that is, the inactive market. Management attributes the change in fair value of the junior subordinated debentures during the period to market changes in the nonperformance expectations and pricing of this type of debt, and not as a result of changes to the entity-specific credit risk. The

narrowing of the credit risk adjusted spread above the Company's contractual spreads has primarily contributed to the negative fair value adjustments. Generally, an increase in the credit risk adjusted spread and/or a decrease in the three month LIBOR swap curve will result in positive fair value adjustments (and decrease the fair value measurement). Conversely, a decrease in the credit risk adjusted spread and/or an increase in the three month LIBOR swap curve will result in negative fair value adjustments (and increase the fair value measurement).

The following tables summarize the Company's assets and liabilities that were measured at fair value on a recurring and non-recurring basis as of December 31, 2020 (in 000's):

Description of Assets	December 31, 2020	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
AFS Securities <sup>(2)</sup> :				
U.S. Government agencies	\$33,710	\$ —	\$33,710	\$ —
U.S. Govt collateralized mortgage obligations	38,445	—	38,445	—
Asset-backed securities	3,909	—	3,909	—
Municipal bonds	1,058	—	1,058	—
Corporate bonds	5,219	—	5,219	—
Total AFS securities	82,341	—	82,341	—
Marketable equity securities <sup>(2)</sup>	3,851	3,851	—	—
Impaired Loans <sup>(1)</sup> :				
RE construction & development	3,364	—	—	3,364
Total impaired loans	3,364	—	—	3,364
Other real estate owned <sup>(1)</sup>	5,004	—	—	5,004
Total	\$94,560	\$3,851	\$82,341	\$8,368
Description of Liabilities	December 31, 2020	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Junior subordinated debt <sup>(2)</sup>	\$10,924	\$ —	\$ —	\$10,924
Total	\$10,924	\$ —	\$ —	\$10,924

(1) Nonrecurring

(2) Recurring

The following table presents quantitative information about Level 3 fair value measurements for the Company's assets measured at fair value on a non-recurring basis at December 31, 2020 (in 000's).

December 31, 2020				
Financial Instrument	Fair Value	Valuation Technique	Unobservable Input	Adjustment Percentage
Impaired Loans:				
RE construction & development	\$3,364	Fair Value of Collateral Method for Collateral Dependent Loans	Adjustment for difference between appraised value and net realizable value	7.02%
Other Real Estate Owned:	\$5,004	Fair Value of Collateral Method for Collateral Dependent Loans	Adjustment for difference between appraised value and net realizable value	13.69%

The following tables summarize the Company's assets and liabilities that were measured at fair value on a recurring and non-recurring basis as of December 31, 2019 (in 000's):

Description of Assets	December 31, 2019	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
AFS Securities <sup>(2)</sup> :				
U.S. Government agencies	\$28,699	\$ —	\$28,699	\$ —
U.S Govt collateralized mortgage obligations	47,613	—	47,613	—
Total AFS securities	76,312	—	76,312	—
Marketable equity securities <sup>(2)</sup>	3,776	3,776	—	—
Impaired Loans <sup>(1)</sup> :				
Real estate mortgage	144	—	—	144
Total impaired loans	144	—	—	144
Total	\$80,232	\$3,776	\$76,312	\$144
Description of Liabilities	December 31, 2019	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Junior subordinated debt <sup>(2)</sup>	\$10,808	\$—	\$—	\$10,808
Total	\$10,808	\$—	\$—	\$10,808

(1) Nonrecurring

(2) Recurring

The following table presents quantitative information about Level 3 fair value measurements for the Company's assets measured at fair value on a non-recurring basis at December 31, 2019 (in 000's).

December 31, 2019				
Financial Instrument	Fair Value	Valuation Technique	Unobservable Input	Adjustment Percentage
Impaired Loans:				
Real estate mortgage	\$144	Fair Value of Collateral Method for Collateral Dependent Loans	Adjustment for difference between appraised value and net realizable value	6.00%

The Company did not record a write-down on other real estate owned during the year ended December 31, 2019.

The following tables provide a reconciliation of liabilities at fair value using significant unobservable inputs (Level 3) on a recurring basis during the period (in 000's):

	December 31, 2020 Junior Subordinated Debt	December 31, 2019 Junior Subordinated Debt
<b>Reconciliation of Liabilities:</b>		
Beginning balance	\$10,808	\$10,155
Total gains included in earnings	(970)	(1,165)
Total losses included in OCI	1,144	1,826
Capitalized interest	(58)	(8)
Ending balance	\$10,924	\$10,808
The amount of total gains for the period included in earnings attributable to the change in unrealized gains or losses relating to liabilities still held at the reporting date	\$ (970)	\$(1,165)

## 16. Supplemental Cash Flow Disclosures

(In thousands)	Year Ended December 31,	
	2020	2019
Cash paid during the period for:		
Interest	\$2,316	\$3,887
Income Taxes	3,443	5,910
Noncash activities:		
Transfer to other real estate owned	—	1,008
Unrealized losses on junior subordinated debentures	(1,144)	(1,826)
Unrealized gains on available for sale securities	1,143	279
Unrealized losses on unrecognized post retirement costs	(135)	(307)
Cash dividend declared	1,870	1,868
Right-of-use assets and liabilities recognized	104	3,944
Adoption of ASU 2016-02: recognition of lease right-of-use (ROU) asset	—	3,502
Adoption of ASU 2016-02: recognition of lease liability	—	3,593

## 17. Dividends on Common Stock

On March 24, 2020, the Company's Board of Directors declared a cash dividend of \$0.11 per share on the Company's common stock. The dividend was payable on April 15, 2020, to shareholders of record as of April 6, 2020. Approximately \$1,867,000 was transferred from retained earnings to dividends payable to allow for distribution of the dividend to shareholders.

On June 23, 2020, the Company's Board of Directors declared a cash dividend of \$0.11 per share on the Company's common stock. The dividend was payable on July 15, 2020, to shareholders of record as of July 6, 2020. Approximately \$1,866,000 was transferred from retained earnings to dividends payable to allow for distribution of the dividend to shareholders.

On September 22, 2020, the Company's Board of Directors declared a cash dividend of \$0.11 per share

on the Company's common stock. The dividend was payable on October 16, 2020, to shareholders of record as of October 6, 2020. Approximately \$1,867,000 was transferred from retained earnings to dividends payable to allow for distribution of the dividend to shareholders.

On December 15, 2020, the Company's Board of Directors declared a cash dividend of \$0.11 per share on the Company's common stock. The dividend was payable on January 19, 2021, to shareholders of record as of January 4, 2021. Approximately \$1,870,000 was transferred from retained earnings to other liabilities to allow for distribution of the dividend to shareholders.

During 2019, the Company's Board of Directors declared cash dividends of \$0.11 on March 26, 2019, June 25, 2019, September 24, 2019, and December 17, 2019.

## 18. Net Income Per Share

The following table provides a reconciliation of the numerator and the denominator of the basic net income per share computation with the numerator and the denominator of the diluted net income per share computation.

*(In thousands, except earnings per share data)*

	Year Ended December 31,	
	2020	2019
Net income available to common shareholders	\$8,961	\$15,172
Weighted average shares outstanding	16,976,704	16,951,955
Add: dilutive effect of stock options	21,880	32,841
Weighted average shares outstanding adjusted for potential dilution	16,998,584	16,984,796
Basic earnings per share	\$0.53	\$0.90
Diluted earnings per share	\$0.53	\$0.89
Anti-dilutive shares excluded from earnings per share calculation	72,000	60,000

Dilutive income per share includes the effect of stock options, unvested restricted stock awards, and other potentially dilutive securities using the treasury stock method. There is only one form of outstanding common stock. Holders of unvested restricted stock awards do not receive dividends.

## 19. Common Stock Repurchase Plan

During 2017, the Board of Directors authorized the repurchase of up to \$3 million of the outstanding common stock of the Company. The timing of the purchases will depend on certain factors, including but not limited to, market conditions and prices, available funds, and alternative uses of capital. The stock repurchase program may be carried out through open-market purchases, block trades, or negotiated private transactions. At this time, no shares have been repurchased.

The Company did not repurchase any common shares during the years ended December 31, 2020 and 2019.

## 20. Goodwill and Intangible Assets

At December 31, 2020, the Company had goodwill in the amount of \$4,488,000 in connection with various business combinations and purchases. This amount was unchanged from the balance of \$4,488,000 at December 31, 2019. While goodwill is not amortized, the Company does conduct periodic impairment analysis on goodwill at least annually or more often as conditions require. The Company performed interim analyses of goodwill impairment throughout 2020 due to a triggering event of the current stock price falling below the Company's calculated book value. Additionally, the Company determined that the COVID-19 pandemic was a triggering event based on adverse impact on our business and results of operations.

Historically the goodwill analysis had been performed for the specific goodwill assessed to each of the Company's two reporting units, Legacy and Taft, with no impairment recommended to date. As the COVID-19 pandemic took over 2020, the Company had to dramatically evolve its understanding of the economies affecting the business as a whole, and the

branches individually. The pandemic also forced the Company to prioritize strategic goals related to technology and branch banking. With this in mind, the Board approved increasing the Company's ITM fleet and modifying the structure of certain branch locations to ITM exclusive locations. The Board's focus on ITMs represents a change in the Company's business structure. As a result these factors we consolidated the Taft and Legacy reporting units into a single consolidated Company-level reporting unit. Goodwill as assessed at December 31, 2019 remained unchanged.

At December 31, 2020, the Company performed a quantitative assessment of goodwill, utilizing a third party valuation specialist, and concluded that it is more likely than not that the fair value of the reporting units exceeds the carrying value and no impairment was recommended. However, it is reasonably possible if adverse economic conditions worsen, or recent stock price fluctuation and market capitalization as a result of the COVID-19 pandemic were to be deemed sustained rather than temporary, it may impact the fair value of the Company's goodwill and result in impairment.

## 21. Accumulated Other Comprehensive Income

The components of accumulated other comprehensive income, included in shareholders' equity, are as follows:

	December 31, 2020			December 31, 2019		
	Net unrealized loss on available for sale securities	Unfunded status of the supplemental retirement plans	Net unrealized gain on junior subordinated debentures	Net unrealized loss on available for sale securities	Unfunded status of the supplemental retirement plans	Net unrealized gain on junior subordinated debentures
(in 000's)						
Beginning balance	\$(175)	\$(675)	\$ 218	\$(372)	\$(459)	\$1,505
Current period comprehensive income (loss)	805	(95)	(806)	197	(216)	(1,287)
Ending balance	\$630	\$(770)	\$(588)	\$(175)	\$(675)	\$ 218
Accumulated other comprehensive loss			\$(728)			\$(632)

## 22. Investment in York Monterey Properties

The Bank wholly-owns the subsidiary York Monterey Properties Inc., organized as a California corporation. The Bank capitalized the subsidiary through a transfer of eight unimproved lots at a historical cost of \$5.3 million comprised of approximately 186.97 acres in the York Highlands subdivision of the Monterra Ranch residential development in Monterey County, California ("Properties") together with \$250,000 in cash. The Bank transferred the Properties to York Monterey Properties Inc, in order to maintain ownership beyond the ten year regulatory holding period applicable to a national bank. The Bank acquired five of the lots through a non-judicial

foreclosure on or about May 29, 2009. In addition, the Bank purchased three of the lots from another bank. The Bank had continuously held the Properties since the date of foreclosure and acquisition. At the time of transfer, the Properties had reached the end of the ten year regulatory holding period limit.

As of December 31, 2020, the Bank's investment in York Monterey Properties Inc. totaled \$4,736,000. York Monterey Properties Inc. is included within the consolidated financial statements of the Company, with \$4,582,000 of the total investment recognized within the balance of other real estate owned on the consolidated balance sheets.

## 23. Parent Company Only Financial Statements

*The following are the condensed financial statements of United Security Bancshares and should be read in conjunction with the consolidated financial statements:*

### United Security Bancshares – (parent only) Balance Sheets – December 31, 2020 and 2019

(In thousands)

	2020	2019
Assets		
Cash and equivalents	\$2,810	\$2,659
Investment in bank subsidiary	126,459	124,663
Other assets	1,332	2,025
Total assets	130,601	129,347
Liabilities & Shareholders' Equity		
Liabilities:		
Junior subordinated debt securities (at fair value)	10,924	10,808
Dividends declared	1,870	1,868
Other liabilities	—	683
Total liabilities	12,794	13,359
Shareholders' Equity:		
Common stock, no par value; 20,000,000 shares authorized; issued and outstanding: 17,009,883 at December 31, 2020 and 16,973,885 at December 31, 2019	59,397	58,973
Retained earnings	59,138	57,647
Accumulated other comprehensive (loss) income	(728)	(632)
Total shareholders' equity	117,807	115,988
Total liabilities and shareholders' equity	\$130,601	\$129,347

**United Security Bancshares – (parent only)**
**Income Statements**
*(In thousands)*

	<b>Year ended December 31,</b>	
	<b>2020</b>	<b>2019</b>
Income		
Gain (loss) on fair value of junior subordinated debentures	\$ 970	\$ 1,165
Dividends from subsidiary	8,025	8,346
Total income	8,995	9,511
Expense		
Interest expense	276	455
Other expense	305	253
Total expense	581	708
Income before taxes and equity in undistributed income of subsidiary	8,414	8,803
Income tax expense	115	135
Equity in undistributed income of subsidiary	662	6,504
Net Income	\$8,961	\$15,172

**United Security Bancshares – (parent only)**
**Statement of Cash Flows**
*(In thousands)*

	<b>Year ended December 31,</b>	
	<b>2020</b>	<b>2019</b>
Cash Flows From Operating Activities		
Net income	\$8,961	\$15,172
Adjustments to reconcile net income to cash provided by operating activities:		
Equity in undistributed income of subsidiary	(662)	(6,504)
Provision for deferred income taxes	54	343
(Gain) loss on fair value of junior subordinated debentures	(970)	(1,165)
Decrease in income tax receivable	51	30
Net change in other assets	185	(56)
Net cash provided by operating activities	7,619	7,820
Cash Flows From Financing Activities		
Dividends paid	(7,468)	(7,458)
Net cash used in by financing activities	(7,468)	(7,458)
Net increase in cash and cash equivalents	151	362
Cash and cash equivalents at beginning of year	2,659	2,297
Cash and cash equivalents at end of year	\$2,810	\$2,659

## 24. Summary of Quarterly Results of Operations (unaudited)

The following table sets forth the results of operations for the four quarters of 2020 and 2019, and is unaudited; however, in the opinion of Management, it reflects all adjustments (which include only normal recurring adjustments) necessary to present fairly the summarized results for such periods.

<i>(dollars in thousands, except per share data)</i>	<b>2020 Quarters Ended</b>			
	<b>December 31,</b>	<b>September 30,</b>	<b>June 30,</b>	<b>March 31,</b>
Interest income:				
Loans, including fees	\$8,672	\$7,563	\$7,713	\$8,346
Investment securities, interest bearing cash at Banks	369	405	394	995
Total interest income	9,041	7,968	8,107	9,341
Interest expense	499	500	530	761
Net interest income	8,542	7,468	7,577	8,580
Provision for credit losses	631	4	427	1,707
Net interest income after provision for credit losses	7,911	7,464	7,150	6,873
Noninterest income	467	911	1,216	2,580
Noninterest expense	5,805	5,210	5,554	5,591
Income before provision for taxes	2,573	3,165	2,812	3,862
Provision for taxes on income	651	894	798	1,108
Net income	\$1,922	\$2,271	\$2,014	\$2,754
Net income per common share				
Basic	\$ 0.11	\$ 0.13	\$ 0.12	\$ 0.16
Diluted	\$ 0.11	\$ 0.13	\$ 0.12	\$ 0.16

<i>(dollars in thousands, except per share data)</i>	<b>2019 Quarters Ended</b>			
	<b>December 31,</b>	<b>September 30,</b>	<b>June 30,</b>	<b>March 31,</b>
Interest income:				
Loans, including fees	\$ 8,872	\$ 8,648	\$ 8,443	\$ 8,642
Investment securities, interest bearing cash at Banks	1,266	1,769	1,867	1,775
Total interest income	10,138	10,417	10,310	10,417
Interest expense	862	1,061	1,008	957
Net interest income	9,276	9,356	9,302	9,460
Provision for credit losses	5	5	4	6
Net interest income after provision for credit losses	9,271	9,351	9,298	9,454
Noninterest income	647	1,853	1,731	1,523
Noninterest expense	5,915	5,335	5,262	5,347
Income before provision for taxes	4,003	5,869	5,767	5,630
Provision for taxes on income	1,108	1,696	1,670	1,623
Net income	\$2,895	\$4,173	\$4,097	\$ 4,007
Net income per common share				
Basic	\$ 0.17	\$ 0.25	\$ 0.24	\$ 0.24
Diluted	\$ 0.17	\$ 0.25	\$ 0.24	\$ 0.24

## **25. Regulatory Matters**

### *Capital Adequacy*

The Company and Bank are subject to various regulatory capital requirements adopted by the Board of Governors of the Federal Reserve System and the FDIC. Failure to meet minimum capital requirements can initiate certain mandates and possible additional discretionary actions by regulators that, if undertaken, could have a direct material effect on the Company's consolidated financial statements. Under capital adequacy guidelines and the regulatory framework, the consolidated Company and the Bank must meet specific capital guidelines that involve quantitative measures of their assets, liabilities, and certain off-balance sheet items as calculated under regulatory accounting practices. The capital amounts and classification are also subject to qualitative judgments by the regulators about components, risk weightings, and other factors. Prompt corrective action provisions are not applicable to bank holding companies.

The Basel III Capital Rules, a comprehensive capital framework for U.S. banking organizations, includes quantitative measures designed to ensure capital adequacy. The Basel III Rules require the Company and the Bank to maintain (i) a minimum common equity Tier 1 ratio minimum of 4.50 percent plus a 2.50 percent "capital conservation buffer", (ii) Tier 1 risk-based capital minimum of 6.00 percent plus the capital conservation buffer, (iii) total risk-based capital ratio minimum of 8.00 percent plus the capital conservation buffer and (iv) Tier 1 leverage capital ratio minimum of 4.00 percent. The capital conservation buffer is designed to absorb losses during periods of economic stress and effectively increases the minimum required risk-weighted capital ratios. Failure to meet minimum capital requirements may result in certain actions by regulators that could have a direct material effect on the consolidated financial statements.

The federal banking agencies published a final rule on November 13, 2019, that provided a simplified measure of capital adequacy for qualifying community banking organizations. A qualifying community banking organization that opts into the community bank leverage ratio framework and maintains a leverage ratio greater than 9 percent will be considered to have met the minimum capital requirements, the capital ratio requirements for the well capitalized category under the Prompt Corrective Action framework, and any other capital or leverage requirements to which the qualifying banking organization is subject. A qualifying community banking organization with a leverage ratio of greater than 9 percent may opt into the community bank leverage ratio framework if it has average consolidated total assets of less than \$10 billion, has off-balance-sheet exposures of 25% or less of total consolidated assets, and has total trading assets and trading liabilities of 5 percent or less of total consolidated assets. Further, the bank must not be an advance approaches banking organization.

The final rule became effective January 1, 2020 and banks that meet the qualifying criteria can elect to use the community bank leverage framework starting with the quarter ended March 31, 2020. The CARES Act reduced the required community bank leverage ratio to 8% until the earlier of December 31, 2020, or the national emergency is declared over. The federal bank regulatory agencies adopted an interim final rule to implement this change from the CARES Act. The Company and the Bank meet the criteria outlined in the final rule and the interim final rule and adopted the community bank leverage ratio framework in the third quarter 2020. As of December 31, 2020, the Company and Bank met all capital adequacy requirements to which they were subject.

The following table shows the Company's and the Bank's regulatory capital and regulatory capital ratios at December 31, 2020 and 2019 as compared to the applicable capital adequacy guidelines:

	Actual		Minimum requirement for Community Bank Leverage Ratio (2) (4)		For Capital Adequacy Purposes (1) (3)		To be Well Capitalized Under Prompt Corrective Action Provisions (1) (3)	
	Amount	Ratio	Amount	Ratio	Amount	Ratio	Amount	Ratio
<b>As of December 31, 2020 (Company):</b>								
Tier 1 Leverage (to Average Assets)	\$124,507	11.37%	\$87,577	8.00%	N/A	N/A	N/A	N/A
<b>As of December 31, 2020 (Bank):</b>								
Tier 1 Leverage (to Average Assets)	\$122,112	11.17%	\$87,491	8.00%	N/A	N/A	N/A	N/A
<b>As of December 31, 2019 (Company):</b>								
Total Capital (to Risk Weighted Assets)	\$130,936	17.98%	N/A	N/A	\$58,275	8.00%	N/A	N/A
Tier 1 Capital (to Risk Weighted Assets)	122,476	16.81%	N/A	N/A	43,706	6.00%	N/A	N/A
Common Equity Tier 1 (to Risk Weighted Assets)	112,132	15.39%	N/A	N/A	32,779	4.50%	N/A	N/A
Tier 1 Leverage (to Average Assets)	122,476	12.82%	N/A	N/A	38,190	4.00%	N/A	N/A
<b>As of December 31, 2019 (Bank):</b>								
Total Capital (to Risk Weighted Assets)	\$129,485	17.78%	N/A	N/A	\$58,275	8.00%	\$72,843	10.00%
Tier 1 Capital (to Risk Weighted Assets)	121,025	16.61%	N/A	N/A	56,599	6.00%	58,275	8.00%
Common Equity Tier 1 (to Risk Weighted Assets)	121,025	16.61%	N/A	N/A	32,779	4.50%	47,348	6.50%
Tier 1 Leverage (to Average Assets)	121,025	12.83%	N/A	N/A	37,733	4.00%	47,737	5.00%

(1) Current data is not applicable as the Bank adopted the Community Bank Leverage Ratio Framework as of the third quarter of 2020.

(2) The minimum required Community Bank Leverage Ratio is 9.00%, but the CARES Act temporarily lowers this to 8% as described below.

(3) The Company was subject to these minimum requirements under the regulatory framework for Prompt Corrective Action at December 31, 2019.

(4) If the subsidiary bank's Leverage Ratio exceeds the minimum ratio under the Community Bank Leverage Ratio Framework, it is deemed to be "well capitalized" under all other regulatory capital requirements. The Company may revert back to the regulatory framework for Prompt Corrective Action if the subsidiary bank's Leverage Ratio falls below the minimum under the Community Bank Leverage Ratio Framework.

### *Dividends*

Dividends paid to shareholders are subject to restrictions set forth in the California General Corporation Law. The California General Corporation Law provides that distributions may be made to shareholders if retained earnings immediately prior to the dividend payment are at least equal to the amount of the proposed distribution or if, immediately after the distribution, the value of assets equals the sum of total liabilities. The primary source of funds with which dividends will be paid to shareholders come from cash dividends received by the Holding Company from the Bank. During the year ended December 31, 2020, the Holding Company paid \$7,468,000 in cash dividends to shareholders.

The Bank is subject to dividend restrictions set forth in California state banking law and administered by the DFPI. Under such restrictions, the Bank may not pay cash dividends in an amount which exceeds the lesser of the retained earnings of the Bank or the Bank's net income for the last three fiscal years (less the amount of distributions to shareholders during that period of time). If the above test is not met, cash dividends may only be paid with the prior approval of the DFPI, in an amount not exceeding the Bank's net income for its last fiscal year or the amount of its net income for the current fiscal year. Such restrictions do not apply to stock dividends, which generally require neither the

satisfaction of any tests nor the approval of the DFPI. Notwithstanding the foregoing, if the DFPI finds that the shareholders' equity is not adequate or that the declarations of a dividend would be unsafe or unsound, the DFPI may prevent the bank from paying a dividend. The FRB may also limit dividends paid by the Bank. During the year ended December 31, 2020, the Bank paid cash dividends of \$8,025,000 to the Holding Company in order to fund the Holding Company's operating costs, payments of interest on junior subordinated debentures, estimated tax payments, and cash dividends paid to shareholders.

### **26. Subsequent Events**

Subsequent events are events or transactions that occur after the balance sheet date but before financial statements are issued. Recognized subsequent events are events or transactions that provide additional evidence about conditions that existed at the date of the balance sheet, including the estimates inherent in the process of preparing financial statements. Nonrecognized subsequent events are events that provide evidence about conditions that did not exist at the date of the balance sheet but arose after that date. Management has reviewed events occurring through the date the financial statements were issued and no subsequent events occurred requiring accrual or disclosure.

## MANAGEMENT'S REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING

Management of United Security Bancshares, including its consolidated subsidiaries (the "Company") is responsible for establishing and maintaining adequate internal control over financial reporting as defined in Rules 13a-15(f) and 15d-15(f) under the Securities Exchange Act of 1934, and for performing an assessment of the effectiveness of internal control over financial reporting as of December 31, 2020. The Company's internal control over financial reporting is a process designed under the supervision of the Company's management, including the Chief Executive Officer and Chief Financial Officer, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with accounting principles generally accepted in the United States.

The Company's system of internal control over financial reporting includes policies and procedures that (i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect transactions and dispositions of assets of the Company; (ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with accounting principles generally accepted in the United States, and that receipts and expenditures of the

Company are being made only in accordance with authorizations of management and directors of the Company; and (iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of the Company's assets that could have a material effect on the financial statements.

Management recognizes that there are inherent limitations in the effectiveness of any system of internal control, and accordingly, even effective internal control can provide only reasonable assurance with respect to financial statement preparation and fair presentation. Further, because of changes in conditions, the effectiveness of internal control may vary over time.

Under the supervision and with the participation of the Company's management, including the Company's Chief Executive Officer and Chief Financial Officer, the Company performed an assessment of the effectiveness of the Company's internal control over financial reporting as of December 31, 2020 based upon criteria in *Internal Control — Integrated Framework (2013)* issued by the Committee of Sponsoring Organizations of the Treadway Commission ("COSO"). As a result of this assessment, management has concluded that the Company's internal control over financial reporting is effective as of December 31, 2020.

## Report of Independent Registered Public Accounting Firm

### To the Shareholders and the Board of Directors of United Security Bancshares and Subsidiaries

#### **Opinion on the Financial Statements**

We have audited the accompanying consolidated balance sheets of United Security Bancshares and Subsidiaries (the "Company") as of December 31, 2020 and 2019, the related consolidated statements of income, comprehensive income, changes in shareholders' equity and cash flows for each of the two years in the period ended December 31, 2020, and the related notes (collectively referred to as the "consolidated financial statements"). In our opinion, the consolidated financial statements present fairly, in all material respects, the consolidated financial position of the Company as of December 31, 2020 and 2019, and the consolidated results of its operations and its cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

#### **Basis for Opinion**

These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on the Company's consolidated financial statements based on our audits. We are a public accounting firm registered with the Public Company Accounting Oversight Board (United States) ("PCAOB") and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audits in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement, whether due to error or fraud. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. As part of our audits we are required to obtain an understanding of internal control over financial reporting but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion.

Our audits included performing procedures to assess the risks of material misstatement of the consolidated financial statements, whether due to error or fraud, and performing procedures to respond to those risks. Such procedures included examining, on a test basis, evidence regarding the amounts and disclosures in the consolidated financial statements. Our audits also included evaluating the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements. We believe that our audits provide a reasonable basis for our opinion.

#### **Critical Audit Matters**

The critical audit matters communicated below are matters arising from the current period audit of the consolidated financial statements that were communicated or required to be communicated to the audit committee and that (1) relate to accounts or disclosures that are material to the consolidated financial statements and (2) involved our especially challenging, subjective, or complex judgments. The communication of critical audit matters does not alter in any way our opinion on the consolidated financial statements, taken as a whole, and we are not, by communicating the critical audit matters below, providing a separate opinion on the critical audit matters or on the accounts or disclosures to which they relate.

#### **Allowance for Credit Losses**

As described in Notes 1 and 3 to the consolidated financial statements, the Company's allowance for Credit losses balance was \$8.5 million at December 31, 2020. The allowance for credit losses is maintained to provide for estimated inherent losses based on evaluating risks in the loan portfolio and is based upon the Company's analysis of the factors underlying the quality of the loan portfolio. These factors are based on the Company's historical loss experience and on the internal risk grade of those loans, and may be adjusted for significant factors that, in management's judgment, affect the collectability of the portfolio as of the evaluation date. Significant factors include amount and timing of expected future cash flows on impaired loans, estimated losses on pools of homogeneous loans based on historical loss experience, and consideration of current economic trends and conditions may be susceptible to significant variations.

We identified management's risk classification of loans and significant factors that affect the collectability of the portfolio, or qualitative and environmental factors, both of which are used in the allowance for credit losses calculation, as a critical audit matter. The Company groups loans by internal risk classifications and categorized as pass, special mention, substandard, doubtful, or loss. Certain loans are homogeneous in nature and are therefore pooled by risk grade. Determination of the risk classifications involves significant management judgement. The qualitative factors affect the collectability of the portfolio as of the evaluation date and include: levels of, and trends in delinquencies and nonaccrual loans, trends in volumes and term of loans, effects of any changes in lending policies and procedures including those for underwriting, collection, charge-off, and recovery, experience, ability, and depth of lending management and staff, national and local economic trends and conditions; and concentrations of credit that might affect loss experience across one or more components of the portfolio, including high-balance loan concentrations and participations. Auditing management's judgments regarding the determination of risk ratings and qualitative factors applied to the allowance for credit losses involved a high degree of subjectivity.

The primary procedures we performed to address this critical audit matter included:

- Obtaining an understanding of controls relating to management's calculation of the Allowance for Credit Losses.
- Testing a risk-based targeted selection of loans to gain substantive evidence that the Company is appropriately rating these loans in accordance with its policies, and that the risk ratings for the loans are reasonable.
- Obtaining management's analysis and supporting documentation related to the qualitative and environmental factors, and testing whether the qualitative and environmental factors used in the calculation of the allowance for credit losses are supported by the analysis provided by management.
- Testing the appropriateness of the methodology and assumptions used in the calculation of the allowance for credit losses, and testing the calculation itself, including completeness and accuracy of the data used in the calculation, application of the loan risk ratings determined by management and used in the calculation,

application of the qualitative and environmental determined by management and used in the calculation, and recalculation of the Allowance for Credit Losses balance.

### **Goodwill Impairment**

As described in Notes 1 and 20 to the consolidated financial statements, the Company's goodwill balance was \$4.5 million at December 31, 2020, resulting from various business combinations. The Company conducts periodic impairment analysis on goodwill at least annually or more often as conditions require. In conjunction with the Company's annual evaluation of goodwill impairment, management performed a quantitative evaluation of goodwill impairment. The Company used a third-party valuation specialist to assist management in performing the impairment test, which includes a quantitative analysis evaluating the estimated fair value of the reporting unit.

We identified management's goodwill impairment testing as a critical audit matter because the methods and underlying assumptions in performing a quantitative test involves high levels of management judgment and in turn led to a high degree of auditor judgment and subjectivity in performing procedures and evaluating audit evidence related to management's valuation methods and significant assumptions.

The primary procedures we performed to address this critical audit matter included:

- We validated completeness and accuracy of the inputs and historical data used in the analyses.
- We validated the accuracy of the inputs to peer data used in the analysis.
- We evaluated the reasonableness of the cash flow projections utilized in the discounted cash flow calculations by comparing the forecasts to historical results and industry trends.
- We used a valuation specialist to evaluate the methodologies and assumptions used by the Company in the fair value analysis.

*Moss Adams LLP*

Sacramento, California  
March 5, 2021

We have served as the Company's auditor since 1999.

## Management's Discussion and Analysis of Financial Condition and Results of Operations

### **Overview**

#### ***The Company***

United Security Bancshares, a California corporation, is a bank holding company registered under the BHCA with corporate headquarters located in Fresno, California. The principal business of United Security Bancshares is to serve as the holding company for its wholly-owned subsidiary, United Security Bank. References to the "Bank" refer to United Security Bank together with its wholly-owned subsidiary, York Monterey Properties, Inc. References to the "Company" refer to United Security Bancshares together with its subsidiaries on a consolidated basis. References to the "Holding Company" refer to United Security Bancshares, the parent company, on a stand-alone basis. The Bank currently has twelve banking branches, which provide financial services in Fresno, Madera, Kern, and Santa Clara counties in the state of California.

#### ***Current Trends Affecting Results of Operations and Financial Position***

The Company's overall operations are impacted by a number of factors, including not only interest rates and margin spreads, which impact the results of operations, but also the composition of the Company's balance sheet. One of the primary strategic goals of the Company is to maintain a mix of assets that will generate a reasonable rate of return without undue risk, and to finance those assets with a low-cost and stable source of funds. Liquidity and capital resources must also be considered in the planning process to mitigate risk and allow for growth.

Since the Bank primarily conducts banking operations in California's Central Valley, its operations and cash flows are subject to changes in the economic condition of the Central Valley. Our business results are dependent in large part upon the business activity, population, income levels, deposits and real estate activity in the Central Valley, and declines in economic conditions can have adverse material effects upon the Bank. In addition, the Central Valley remains largely dependent on agriculture. A downturn in agriculture and agricultural related business could indirectly and adversely affect the Company as many borrowers and customers are involved in, or are impacted to some extent, by the agricultural industry.

While a great number of our borrowers are not directly involved in agriculture, they would likely be impacted by difficulties in the agricultural industry since many jobs in our market areas are ancillary to the regular production, processing, marketing and sale of agricultural commodities. Beginning in 2011, the state of California recently experienced one of the worst droughts in recorded history. While the drought has subsequently been declared over, it is not possible to quantify the drought's impact on businesses and consumers located in the Company's market areas or to predict adverse economic impacts related to future droughts. In response to the prolonged drought, the California state legislature passed the Sustainable Groundwater Management Act with the purpose to ensure better local and regional management of groundwater use and sustainable groundwater management in California by 2042. The local districts began to develop, prepare, and begin implementation of the Groundwater Sustainability Plans in 2020. The effect of such plans to Central Valley agriculture, if any, is still unknown.

The Company continually evaluates its strategic business plan as economic and market factors change in its market area. Balance sheet management, enhancing revenue sources, and maintaining market share will continue to be of primary importance.

#### **COVID-19**

The COVID-19 pandemic has impacted the local economy in the Central Valley. Federal, State and local shelter-in-place recommendations were enacted in our markets in March 2020 causing many businesses to close and workers to be furloughed or lose jobs. Essential purpose entities such as medical professionals, food and agricultural businesses, and transportation and logistical businesses were exempted from the closures; however, unemployment rates are increasing in our local market area. As of December 2020, the unemployment rate in Fresno County was 10.4%. Congress, the President, and the Federal Reserve have taken several actions designed to cushion the economic fallout. Most notably, the Coronavirus Aid, Relief and Economic Security ("CARES") Act was signed into law at the end of March 2020 as a \$2 trillion legislative package, and the Consolidated

Appropriations Act, 2021 was signed into law at the end of December 2020 as a \$900 billion legislative package. The goal of the CARES Act and Consolidated Appropriations Act, were to prevent a severe economic downturn through various measures, including direct financial aid to American families and economic stimulus to significantly impacted industry sectors. The package also includes extensive emergency funding for hospitals and providers. In addition to the general impact of COVID-19, certain provisions of the CARES Act as well as other recent legislative and regulatory relief efforts may have a material impact on our operations. While it is not possible to know the full universe or extent of these impacts as of the date this filing, we are disclosing potentially material items of which we are aware.

#### *Financial position and results of operations*

Pertaining to the Company's December 31, 2020 financial condition and results of operations, COVID-19 has had an impact on the allowance for credit losses. While the Company has not yet experienced any charge-offs related to COVID-19, its allowance for credit loss calculation and resulting provision for credit losses are significantly impacted by changes in economic conditions resulting from a significant increase in unemployment. Given that economic scenarios have darkened significantly since the pandemic was declared in early March 2020, the credit risk in the loan portfolio has increased resulting in the need for an additional reserve for credit loss. Should economic conditions worsen, the Company could experience further increases in its required allowance for credit loss and record additional provision expense.

The Company's interest income could be reduced due to COVID-19. In keeping with guidance from regulators, the Company is actively working with COVID-19 affected borrowers to defer their payments, interest, and fees. Interest and fees will still accrue to income pursuant to normal GAAP accounting policies. Should eventual credit losses on these deferred payments emerge, interest income and fees accrued would need to be reversed. In such a scenario, interest income in future periods could be negatively impacted. At this time, the Company is unable to project the materiality of such an impact, but recognizes the breadth of the economic impact may affect its borrowers' ability to repay in future periods.

#### *Capital and liquidity*

As of December 31, 2020, the Company and Bank's capital ratios were in excess of all regulatory requirements. The Company's management team believes that while the Company and Bank have sufficient capital to withstand an extended economic recession brought about by COVID-19, its reported and regulatory capital ratios could be adversely impacted by further credit losses. The Company relies on cash on hand as well as dividends from the Bank to service its debt. If the Bank is unable to pay dividends for an extended period of time, the Company may not be able to service its debt.

The Company maintains access to multiple sources of liquidity. If an extended recession caused large numbers of its deposit customers to withdraw their funds, it might become more reliant on volatile or more expensive sources of funding. Wholesale funding markets are available to the Company, but rates for short-term funding have recently been volatile. If funding costs are elevated for an extended period of time, it could have an adverse effect on net interest margin.

#### *Asset valuation*

Currently, the Company does not expect COVID-19 to affect its ability to account timely for the assets on the balance sheet; however, this could change in future periods. While certain valuation assumptions and judgments will change to account for pandemic-related circumstances such as widening credit spreads, the Company does not anticipate significant changes in methodology used to determine the fair value of assets measured in accordance with GAAP.

The Company's stock closed below book value at the end of the first three quarters of 2020. Management deemed the decline in stock price and the COVID-19 related economic downturn to be a triggering event to perform a qualitative assessment for goodwill impairment for the first three quarters of 2020. As of December 31, 2020, the Company's stock price has recovered. Management engaged a third party valuation specialist to assist with the performance of the quantitative goodwill impairment test as of the fourth quarter 2020. Based on this quantitative test, it was determined that the fair value of the reporting unit exceeded the carrying value as of December 31, 2020,

therefore, there was no impairment of goodwill recorded. COVID-19 could cause a further and sustained decline in the Company's stock price which could cause the Company to re-perform a goodwill impairment test and that could result in an impairment charge being recorded for that period. In the event that all or a portion of goodwill is impaired, a non-cash charge for the amount of such impairment would be recorded to earnings. Such a charge would have no impact on tangible capital or regulatory capital. At December 31, 2020, the Company had goodwill of \$4,488,000, representing approximately 3.8% of equity.

#### *Business Continuity Plan and controls*

The Company maintains a Business Continuity Plan to prepare, and respond to unforeseen circumstances, such as, natural disasters and pandemics. Upon the COVID-19 pandemic declaration, the Company invoked its Business Continuity Plan. Shortly after invoking the plan, the Company implemented protocols for team member safety, provided timely communication to team members and customers, established remote work capabilities to isolate certain personnel essential to critical business continuity operations, and initiated strategies for monitoring and responding to local COVID-19 impacts. Due to the nature of their functions, many team members continue to operate from physical Company locations, while effectively employing social distancing standards. The Company's Management Team continues to meet regularly to anticipate and respond to any future COVID-19 interruptions or developments. As of December 31, 2020, the Company does not anticipate significant challenges to its ability to maintain its systems and controls in light of the measures it has taken to prevent the spread of COVID-19. The Company does not currently face any material resource constraint through the implementation of its business continuity plans.

#### *Lending operations and accommodations to borrowers*

In keeping with regulatory guidance to work with borrowers during this unprecedented situation, the Company is executing a payment deferral program for our commercial lending clients that are adversely affected by the pandemic. Depending on the demonstrated need of

the client, the Company is deferring either the full loan payment or the principal component of the loan payment for up to six months. As of December 31, 2020, the Company had 1 remaining payment modification of \$12,500,000 in connection with the COVID-19 relief provided by the CARES Act and interagency guidance issued in March 2020.

With the passage of the Paycheck Protection Program ("PPP"), administered by the Small Business Administration ("SBA"), the Company participated in assisting our customers with applications for resources through the program. The PPP program ended on August 8, 2020. PPP loans have a two-year term and earn interest at 1%. The Company believes that the majority of these loans will ultimately be forgiven by the SBA in accordance with the terms of the program. As of December 31, 2020, there were 84 SBA PPP loans representing \$9,547,000 in funding and \$515,000 in unearned fees. The Company is participating in the second round of the PPP program which commenced in January 2021.

The Company is working with customers directly affected by COVID-19. The Company is prepared to offer short-term assistance in accordance with regulatory guidelines. As a result of the current economic environment caused by the COVID-19 virus, the Company is engaging in more frequent communication with borrowers to better understand their situation and the challenges faced, allowing it to respond proactively as needs and issues arise. The Company is engaging in more frequent communication with the servicer and individual schools participating in the student loan portfolio to better understand the effects of COVID-19 on students in school or in clinical programs. It is possible that the Company's asset quality measures could worsen at future measurement periods if the effects of COVID-19 are prolonged.

The Company continually evaluates its strategic business plan as economic and market factors change in its market area. The Company may see a short-term slowdown in new loan originations due to COVID-19. Balance sheet management, enhancing revenue sources, and maintaining market share will continue to be of primary importance for the Company.

### **Application of Critical Accounting Policies and Estimates**

The consolidated financial statements are prepared in accordance with generally accepted accounting principles and follow general practices within the banking industry. Application of these principles requires management to make estimates, assumptions, and judgments that affect the amounts reported in the financial statements and accompanying notes. These estimates, assumptions, and judgments are based on information available as of the date of the financial statements. As this information changes, the financial statements will reflect different estimates, assumptions, and judgments. Certain policies have a greater reliance on the use of estimates, assumptions, and judgments and may result in the possible production of results that could be materially different from those originally reported. Estimates, assumptions, and judgments are necessary when assets and liabilities are required to be recorded at fair value, when a decline in the value of an asset not carried on the financial statements at fair value warrants an impairment write-down or valuation reserve to be established, or when an asset or liability needs to be recorded contingent upon a future event. Carrying assets and liabilities at fair value results inherently in more financial statement volatility. The fair values and the information used to record valuation adjustments for certain assets and liabilities are based either on quoted market prices or are provided by other third-party sources, when available. When third-party information is not available, valuation adjustments are estimated based upon assumptions that market participants would use in pricing the asset or liability.

The most significant accounting policies are presented in Note 1 to the consolidated financial statements. These policies, along with the disclosures presented in the other financial statement notes and the financial review, provide information on how significant assets and liabilities are valued in the financial statements and how those values are determined. Based on the valuation techniques used and the financial statement sensitivity to underlying methods, assumptions, and estimates, the allowance for credit losses, other real estate owned through foreclosure, impairment of investment securities, revenue recognition, nonaccrual income recognition, fair value estimates on junior subordinated debt, valuation for deferred income taxes and goodwill require the most subjective judgments and may be subject to revision as new information becomes available.

#### *Allowance for Credit Losses*

The allowance for credit losses represents management's estimate of probable incurred credit losses inherent in the loan portfolio. Determining the amount of the allowance for credit losses is considered a critical accounting estimate because it requires significant judgment. The use of estimates related to the amount and timing of expected future cash flows on impaired loans, estimated losses on pools of homogeneous loans based on historical loss experience, and consideration of current economic trends and conditions may be susceptible to significant variations. The loan portfolio represents the largest asset type on the consolidated balance sheet. Note 1 to the consolidated financial statements describes the methodology used to determine the allowance for credit losses. A discussion of the factors driving changes in the amount of the allowance for credit losses is included in the Asset Quality and Allowance for Credit Losses section of this financial review.

#### *Other Real Estate Owned*

Real estate properties acquired through, or in lieu of, loan foreclosure are to be sold and are initially recorded at fair value of the property, less estimated costs to sell. The excess, if any, of the loan amount over the fair value of the collateral is charged to the allowance for credit losses. The determination of fair value is generally based upon pre-approved, external appraisals. Subsequent declines in the fair value of other real estate owned, along with related revenue and expenses from operations, are charged to noninterest expense. The fair market valuation of such properties is based upon estimates and is subject to change as circumstances in the market area, or general economic trends, fluctuate.

#### *Impairment of Investment Securities*

Investment securities are impaired when the amortized cost exceeds fair value. Investment securities are evaluated for other-than-temporary impairment ("OTTI") at least quarterly, and more frequently when economic or market conditions warrant such an evaluation. Management considers the extent and duration of the unrealized loss and assesses whether it intends to sell, or it is likely that it will be required to sell the security before the anticipated recovery. If the criteria regarding intent or requirement to sell is met, the difference between amortized cost and fair value is recognized as impairment through earnings.

For investment securities that do not meet the criteria regarding intent or requirement to sell, the present value of the remaining cash flows as estimated at the preceding evaluation date are compared to the current expected remaining cash flows to determine OTTI related to credit loss. The amount of OTTI related to credit loss is recognized in earnings, with the balance recognized in other comprehensive income.

#### *Revenue Recognition*

The Bank's primary sources of revenue is interest income from both the loan portfolio and investment securities. Interest income is generally recorded on an accrual basis, unless the collection of such income is not reasonably assured or cannot be reasonably estimated. Pursuant to accounting standards related to revenue recognition, nonrefundable fees and costs associated with originating or acquiring loans are recognized as a yield adjustment to the related loans by amortizing them into income over the term of the loan using a method which approximates the interest method. Other credit-related fees, such as standby letter of credit fees and loan placement fees are recognized as noninterest income during the period the related service is performed.

For loans placed on nonaccrual status, the accrued and unpaid interest receivable may be reversed at management's discretion based upon management's assessment of collectability. Interest is thereafter credited to principal to the extent necessary to eliminate doubt as to the collectability of the net carrying amount of the loan.

#### *Goodwill and Intangible Assets*

Goodwill and intangible assets are evaluated at least annually for impairment or more frequently if events or circumstances, such as changes in economic or market conditions, indicate that impairment may exist. When required, the goodwill impairment test involves a two-step process. The first test for goodwill impairment is done by comparing the reporting unit's aggregate fair value to its carrying value. Absent other indicators of impairment, if the aggregate fair value exceeds the carrying value, goodwill is not considered impaired and no additional analysis is necessary. If the carrying value of the reporting unit were to exceed the aggregate fair value, a second test would be performed to measure the amount of

impairment loss, if any. To measure any impairment loss, the implied fair value would be determined in the same manner as if the reporting unit were being acquired in a business combination. If the implied fair value of goodwill is less than the recorded goodwill, an impairment charge would be recorded for the difference. (See Note 20 of the Notes to Consolidated Financial Statements for further discussion.)

#### *Fair Value*

Effective January 1, 2007, a fair value option accounting standard was applied to the Company's junior subordinated debt. Concurrently, the accounting standards related to fair value measurements were adopted. The accounting standards related to fair value measurements define how applicable assets and liabilities are to be valued, and requires expanded disclosures in regard to financial instruments carried at fair value. The fair value measurement accounting standard establishes a hierarchical disclosure framework associated with the level of pricing observability utilized in measuring financial instruments at fair value. The degree of judgment utilized in measuring the fair value of financial instruments generally correlates to the level of pricing observability. Financial instruments with readily available active quoted prices, or whose fair value can be measured from actively quoted prices of related financial instruments, generally will have a higher degree of pricing observability and a lesser degree of judgment utilized in measuring fair value. Conversely, financial instruments infrequently traded or not quoted in an active market will generally have little or no pricing observability and a higher degree of subjectivity. Pricing observability is impacted by a number of factors, including the type of financial instrument, whether the financial instrument is new to the market, and the characteristics specific to the transaction. Determining fair values under the accounting standards may include judgments related to measurement factors that may vary from actual transactions executed in the marketplace. For the years ended December 31, 2020 and 2019, fair value adjustments related to the junior subordinated debt resulted in losses of \$174,000 and \$661,000, respectively. (See Notes 10 and 15 of the Notes to Consolidated Financial Statements for additional information about financial instruments carried at fair value.)

### Income Taxes

Deferred income taxes are provided for the temporary differences between the financial reporting basis and the tax basis of assets and liabilities. Deferred taxes are measured using current tax rates applied to taxable income in the years in which those temporary differences are expected to be recovered. If future income is not sufficient to apply the deferred tax assets within the tax years to which they may be applied, the deferred tax asset may not be realized and income will be reduced. No valuation allowances were recorded against the deferred tax asset at December 31, 2020 and 2019.

On January 1, 2007, accounting standards related to uncertainty in income taxes were adopted. The standard prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. Under the accounting standards, an entity should recognize the financial statement benefit of a tax position if it determines that it is more likely than not that the position will be sustained on examination. The term "more likely than not" means a likelihood of more than 50 percent. In assessing whether the more-likely-than-not criterion is met, the entity should assume that the tax position will be reviewed by the applicable taxing authority.

Pursuant to the accounting standards related to uncertainty in income taxes, tax positions will be

continually reevaluated. If it is determined that the tax positions are not "more likely than not" to be sustained (as defined by taxing authorities), additional tax liabilities may be recognized.

### Results of Operations

Net income for the year ended December 31, 2020 was \$8,961,000 or \$0.53 per basic share (\$0.53 diluted) compared to \$15,172,000 or \$0.90 per basic share (\$0.89 diluted) for year ended December 31, 2019. The decrease of \$6,211,000 between December 31, 2019 and December 31, 2020 is primarily the result of decreases in net interest income, resulting from lower interest rates, and the \$2,769,000 provision for credit losses recognized during the year ended December 31, 2020. Interest income decreased by \$6,825,000, or 16.53%, between December 31, 2019 and December 31, 2020. Taxes on income decreased by \$2,646,000, or 43.40%.

Return on average assets was 0.86% for the year ended December 31, 2020 compared to 1.58% for the year ended December 31, 2019. Return on average equity was 7.55% for the year ended December 31, 2020 compared to 13.30% for the year ended December 31, 2019.

As with variances in net income, changes in the return on average assets and average equity experienced by the Company during 2020 and 2019 were effected by decreases in net interest income, resulting from a decline in interest rates, and higher provision for credit losses.

*The following table sets forth certain selected financial data for each of the years in the five-year periods ended December 31, 2020, and should be read in conjunction with the more detailed information and financial statements contained elsewhere herein:*

*(In thousands except per share data and ratios)*

#### **Selected Financial Ratios:**

	<b>2020</b>	<b>2019</b>	<b>2018</b>	<b>2017</b>	<b>2016</b>
Return on average assets	0.86%	1.58%	1.61%	1.07%	0.98%
Return on average shareholders' equity	7.55%	13.30%	13.23%	8.63%	7.86%
Average shareholders' equity to average assets	11.45%	11.89%	12.14%	12.46%	12.43%
Dividend payout ratio	83.34%	49.16%	42.17%	33.22%	—%

### Net Interest Income

Net interest income, the most significant component of earnings, is the difference between the interest and fees received on earning assets and the interest paid on interest-bearing liabilities. Earning assets consist primarily of loans and, to a lesser extent, investments in securities issued by federal, state and local authorities, and corporations, as well as interest-bearing deposits and overnight investments in federal funds loaned to other financial institutions. These earning assets are funded by a

combination of interest-bearing and noninterest-bearing liabilities, primarily customer deposits, and may include short-term and long-term borrowings.

Net interest income before provision for credit losses was \$32,167,000 for the year ended December 31, 2020, representing a decrease of \$5,227,000, or 13.98%, compared to net interest income before provision for credit losses of \$37,394,000 for the year ended December 31, 2019. As market rates decreased in the current year, even a disciplined deposit pricing effort saw the net interest

margin, as shown in Table 1 below, decrease to 3.34% for the year ended December 31, 2020. The net interest margin was 4.22% for the year ended December 31, 2019.

Table 1. Distribution of Average Assets, Liabilities and Shareholders' Equity:

The following table summarizes the distribution of average assets, liabilities and shareholders' equity, as well as interest income and yields earned on average interest-earning assets and interest expense and rates paid on average interest-bearing liabilities, presented on a tax equivalent basis for the years indicated:

(Dollars in thousands)	2020			2019		
	Average Balance	Interest	Yield/Rate	Average Balance	Interest	Yield/Rate
<b>Assets:</b>						
Interest-earning assets:						
Loans and leases <sup>(1)</sup>	\$ 639,815	\$31,749	4.96%	\$576,015	\$34,025	5.91%
Investment Securities – taxable	90,685	1,433	1.58%	71,456	1,797	2.51%
Interest-bearing deposits in other banks	—	—	—%	1	—	—%
Interest-bearing deposits in FRB	217,273	730	0.34%	223,488	4,880	2.18%
Total interest-earning assets	947,773	\$33,912	3.58%	870,960	\$40,702	4.67%
Allowance for credit losses	(8,661)	(8,386)				
Noninterest-earning assets:						
Cash and due from banks	30,300			29,169		
Premises and equipment, net	9,385			9,596		
Accrued interest receivable	8,389			9,115		
Other real estate owned	5,815			5,922		
Other assets	43,968			42,861		
Total average assets	<u>\$1,036,969</u>			<u>\$959,237</u>		
<b>Liabilities and Shareholders' Equity:</b>						
Interest-bearing liabilities:						
NOW accounts	\$ 126,115	\$ 173	0.14%	\$108,048	\$ 155	0.14%
Money market accounts	258,196	1,145	0.44%	251,277	2,233	0.89%
Savings accounts	88,562	108	0.12%	85,954	235	0.27%
Time deposits	62,945	588	0.93%	71,419	809	1.13%
Junior subordinated debentures	9,746	276	2.83%	10,289	456	4.43%
Total interest-bearing liabilities	545,564	\$ 2,290	0.42%	526,987	\$ 3,888	0.74%
Noninterest-bearing liabilities:						
Noninterest-bearing checking	363,004			308,518		
Accrued interest payable	110			191		
Other liabilities	9,564			9,492		
Total average liabilities	<u>918,242</u>			<u>845,188</u>		
Total average shareholders' equity	<u>118,727</u>			<u>114,049</u>		
Total average liabilities and shareholders' equity	<u>\$1,036,969</u>			<u>\$959,237</u>		
Interest income as a percentage of average earning assets			3.58%			4.67%
Interest expense as a percentage of average earning assets			<u>0.24%</u>			<u>0.45%</u>
Net interest margin			<u>3.34%</u>			<u>4.22%</u>

(1) Loan amounts include nonaccrual loans, but the related interest income has been included only if collected for the period prior to the loan being placed on a nonaccrual basis. Loan interest income includes loan fees of approximately \$1,226 for the year ended December 31, 2020 and loan costs of approximately \$676 for the year ended December 31, 2019.

At the end of 2019 the prime rate was 4.75%. The prime rate decreased to 3.25% during the first quarter of 2020 and remained unchanged through the end of 2020. Future increases and decreases will affect rates for both interest income and expense and the resultant net interest margin.

Both net interest income and net interest margin are affected by changes in the amount and mix of interest-earning assets and interest-bearing liabilities, referred to as

“volume change.” Both are also affected by changes in yields on interest-earning assets and rates paid on interest-bearing liabilities, referred to as “rate change.” The following table sets forth the changes in interest income and interest expense for each major category of interest-earning asset and interest-bearing liability, and the amount of change attributable to volume and rate changes for the periods indicated.

Table 2. Rate and Volume Analysis

(In thousands)

	2020 compared to 2019		
	Total	Rate	Volume
Increase (decrease) in interest income:			
Loans	\$(2,311)	\$(5,893)	3,582
Investment securities	(364)	(772)	408
Interest-bearing deposits in other banks	—	—	—
Interest-bearing deposits in FRB	(4,150)	(4,133)	(17)
Total interest income	(6,825)	(10,798)	3,973
Increase (decrease) in interest expense:			
Interest-bearing demand accounts	(1,070)	(1,226)	156
Savings accounts	(127)	(134)	7
Time deposits	(221)	(132)	(89)
Subordinated debentures	(180)	(157)	(23)
Total interest expense	(1,598)	(1,649)	51
Increase in net interest income	\$(5,227)	\$(9,149)	3,922

The net interest margin decreased in 2020 due to decreases in loan portfolio yields, yields of overnight investments with the Federal Reserve Bank (“FRB”), and investment securities yields, offset by decreases in interest expense. The decreases in yields are a result of repricing of variable rate loans, floating rate investment securities, and interest-bearing deposits in FRB to lower rates. Interest-bearing deposits in FRB are the Company’s lowest-yielding interest-earning asset. Loans yielded 4.96% during the year ended December 31, 2020, as compared to 5.91% for the year ended December 31, 2019. For the year ended December 31, 2020, total interest income decreased approximately \$6,825,000, or 16.53%, as compared to the year ended December 31, 2019, reflective of decreases of \$2,311,000 and \$4,150,000 in loan interest income and income on interest bearing deposits with the FRB, respectively. Average interest-earning assets increased

approximately \$76,813,000 between 2020 and 2019 and the rate on interest-earning assets decreased 109 basis points during the two periods. The increase in average earning assets between 2020 and 2019 consisted of an increase of \$19,229,000 in investment securities and an increase of \$63,800,000 in loans, offset by a decreases of \$6,215,000 in interest-bearing deposits held with the FRB.

For the year ended December 31, 2020, total interest expense decreased approximately \$1,598,000, or 41.10%, as compared to the year ended December 31, 2019. Between the two periods, average interest-bearing liabilities increased by \$18,577,000, and the average rates paid on these liabilities decreased by 32 basis points. While the Company may utilize brokered deposits as an additional source of funding, the Company held no brokered deposits at December 31, 2020.

The following table summarizes the year-to-date averages of the components of interest-earning assets as a percentage of total interest-earning assets, and the components of interest-bearing liabilities as a percentage of total interest-bearing liabilities:

	YTD Average 12/31/20	YTD Average 12/31/19
Loans	67.51%	66.14%
Investment securities available for sale	9.57%	8.20%
Interest-bearing deposits in FRB	22.92%	25.66%
Total earning assets	100.00%	100.00%
NOW accounts	23.12%	20.50%
Money market accounts	47.32%	47.69%
Savings accounts	16.23%	16.31%
Time deposits	11.54%	13.55%
Subordinated debentures	1.79%	1.95%
Total interest-bearing liabilities	100.00%	100.00%

### Provision for Credit Losses

Provisions for credit losses are determined on the basis of management's periodic credit review of the loan portfolio, consideration of past loan loss experience, current and future economic conditions, and other pertinent factors. After reviewing these factors, management, at times, makes adjustments in order to maintain an allowance for credit losses adequate for the coverage of estimated losses inherent in the loan portfolio. Based on the condition of the loan portfolio, management believes the allowance is appropriate to cover risk elements in the loan portfolio.

For the year ended December 31, 2020, a \$2,769,000 provision was made to the allowance for credit losses. A

provision was made for the year ended December 31, 2019 and totaled \$20,000.

The allowance for credit losses decreased to 1.30% of total loans during the year ended December 31, 2020, as compared to 1.33% at December 31, 2019. The provision of \$20,000 recorded in 2019, and the provision of \$2,769,000 recorded during 2020, are a result of charge-offs recognized within the student loan portfolio and adjustment in qualitative factors related to the economic uncertainties caused by COVID-19. For further discussion, refer to Item 7 – Management's Discussion and Analysis of Financial Condition and Results of Operations – Asset Quality and Allowance for Credit Losses.

### Noninterest Income

The following table summarizes significant components of noninterest income for the years indicated and the net changes between those years:

(In thousands)	2020	% of Total	2019	% of Total
Customer service fees	\$2,663	51.47%	\$3,257	56.60%
Increase in cash surrender value of bank-owned life insurance	504	9.74%	528	9.18%
Loss on fair value of marketable equity securities	74	1.43%	117	2.03%
Gain on proceeds from bank-owned life insurance	310	5.99%	—	—
Gain on fair value of junior subordinated debentures	970	18.75%	1,165	20.25%
Loss on dissolution of real estate investment trust	—	—%	(115)	(2.00)%
Other	653	12.62%	802	13.94%
Total	\$5,174	100.00%	\$5,754	100.00%

Noninterest income consists primarily of fees and commissions earned on services provided to banking customers, fair value adjustments to the value of the junior subordinated debentures, and, to a lesser extent, gains on sales of Company assets and other miscellaneous income.

Noninterest income for the year ended December 31, 2020 decreased \$580,000, or 10.08%, when compared to the same period of 2019. Customer service fees, the primary component of noninterest income, decreased \$594,000, or 18.24%, between the two periods presented. The decrease in customer service fees is primarily the result of the

Company's election to lower fees and waive certain surcharges related to insufficient funds and electronic transfers in light of the COVID-19 pandemic.

The decrease in noninterest income of \$580,000 between the two periods is partially the result of a recorded gain on the fair value of junior subordinated debentures of \$970,000 during 2020 as compared to a gain of \$1,165,000 during 2019. The change in the fair value of junior subordinated debentures was primarily caused by fluctuations in the LIBOR yield curve.

### **Noninterest Expense**

The following table sets forth the components of total noninterest expense in dollars and as a percentage of average earning assets for the years ended December 31, 2020 and 2019:

	2020		2019	
	Amount	% of Average Earning Assets	Amount	% of Average Earning Assets
<i>(Dollars in thousands)</i>				
Salaries and employee benefits	\$10,825	1.14%	\$11,109	1.28%
Occupancy expense	3,475	0.37%	3,332	0.38%
Data processing	493	0.05%	583	0.07%
Professional fees	3,217	0.34%	3,760	0.43%
Regulatory assessments	459	0.05%	164	0.02%
Director fees	376	0.04%	373	0.04%
Correspondent bank service charges	71	0.01%	57	0.01%
Net cost on operation and sale of OREO	972	0.10%	244	0.03%
Other	2,272	0.24%	2,237	0.26%
Total	\$22,160	2.34%	\$21,859	2.51%

Noninterest expense increased \$301,000, or 1.38%, between the years ended December 31, 2020 and 2019. The net increase in noninterest expense between the comparative periods is primarily the result of increases in the cost on operation of OREO and regulatory assessments, offset by decreases in professional fees, data processing fees, and salaries and employee benefits. The increase in OREO costs are attributed to a \$727,000 write-down on one property and a \$113,000 loss on sale of another property. The increase in regulatory assessments was due to an increase in the assessment rate. Included in net costs on operations of OREO for the years ended December 31, 2020 and 2019 are OREO operating expenses totaling \$133,000 and \$244,000, respectively. The decrease in professional fees for the year ended December 31, 2020 is attributed to decreases in legal fees and consulting expense.

During the years ended December 31, 2020 and 2019, the Company recognized stock-based compensation expense of \$426,000 (\$0.02 per share basic and diluted) and \$349,000 (\$0.02 per share basic and diluted), respectively. This expense is included in noninterest expense under salaries and employee benefits. If new stock options or units are issued, or existing options fail to vest due, for example, to forfeiture, actual stock-based compensation expense in future periods will change.

### **Income Taxes**

Income tax expense is impacted to some degree by permanent taxable differences between income reported for book purposes and income reported for tax purposes, as well as certain tax credits which are not reflected in the statements of operations and comprehensive income. As pretax income or loss amounts become smaller, the

impact of these differences become more significant and are reflected as variances in the effective tax rate for the periods presented. In general, the permanent differences and tax credits affecting tax expense have a positive impact and tend to reduce the effective tax rates shown in the statements of operations and comprehensive income. The effective tax rate for the year ended December 31, 2020 was 27.80% compared to 28.67% for the year ended December 31, 2019.

The Company's tax position is reviewed at least quarterly based upon accounting standards related to uncertainty in income taxes. An individual tax position must meet certain criteria for some or all of the income tax benefit to be recognized in a taxable entity's financial statements. Under the income tax guidelines, an entity should recognize the financial statement benefit of a tax position if it determines that it is more likely than not that the position will be sustained on examination. The term "more likely than not" means a likelihood of "more than 50 percent." In assessing whether the more-likely-than-not criterion is met, the entity should assume that the tax position will be reviewed by the applicable taxing authority.

The Company's tax position was reviewed as of December 31, 2020, and it has been determined that there are no material amounts that should be recorded under the current income tax accounting guidelines.

### **Financial Condition**

Total assets increased by \$135,735,000, or 14.18%, from \$956,919,000 at December 31, 2019 to \$1,092,654,000 at

December 31, 2020. During the year ended December 31, 2020, net loans increased by \$57,179,000. Investment securities increased by \$6,104,000 during the year ended December 31, 2020, and overnight interest-bearing deposits in the Federal Reserve Bank and federal funds sold increased a net \$72,875,000. Total deposits of \$952,651,000 at December 31, 2020, increased \$134,289,000, or 16.41%, from \$818,362,000 at December 31, 2019.

Interest-earning assets averaged approximately \$947,773,000 during the year ended December 31, 2020, as compared to \$870,960,000 for the year ended December 31, 2019. Average interest-bearing liabilities increased to \$545,564,000 for the year ended December 31, 2020, as compared to \$526,987,000 for the year ended December 31, 2019.

### **Loans**

The Company's primary business is that of acquiring deposits and making loans, with the loan portfolio representing the largest component of earning assets. Loans totaled \$655,411,000 at December 31, 2020, an increase of \$58,037,000, or 9.72%, from total loans of \$597,374,000 at December 31, 2019. During 2020, average loans increased 11.08% when compared to the year ended December 31, 2019. Average loans totaled \$639,815,000 and \$576,015,000 for the years ended December 31, 2020 and 2019, respectively.

*The following table sets forth the amounts of loans outstanding by category and the category percentages as of the year-end dates indicated:*

	2020		2019		2018		2017		2016	
	Dollar Amount	% of Loans	Dollar Amount	% of Loans	Dollar Amount	% of Loans	Dollar Amount	% of Loans	Dollar Amount	% of Loans
<i>(In thousands)</i>										
Commercial and industrial	\$ 47,514	7.2%	\$ 45,278	7.6%	\$ 56,978	9.7%	\$ 47,026	7.8%	\$ 49,005	8.6%
Real estate mortgage	320,294	48.9%	291,237	48.8%	289,200	49.2%	306,293	50.9%	288,200	50.6%
RE construction & development	175,016	26.7%	138,784	23.2%	108,795	18.5%	122,970	20.4%	130,687	22.9%
Agricultural	51,079	7.8%	52,197	8.7%	61,149	10.4%	59,481	9.9%	56,918	10.0%
Installment and student loans	61,508	9.4%	69,878	11.7%	71,811	12.2%	65,581	11.0%	44,949	7.9%
Total loans	\$655,411	100.0%	\$597,374	100.0%	\$587,933	100.0%	\$601,351	100.0%	\$569,759	100.0%

Loan volume continues to be highest in what has historically been the primary lending emphasis: real estate mortgage, and construction lending. Total loans increased \$58,037,000 during 2020. There were increases of \$29,057,000, or 9.98%, in real estate mortgage loans, \$2,236,000, or 4.94%, in commercial and industrial loans, and \$36,232,000, or 26.11%, in real estate construction and development loans. There were decreases of \$8,370,000, or 12.0%, in installment loans and \$1,118,000, or 2.1%, in agriculture loans. The Bank is subject to internal and regulatory limits of 115% of capital on the real estate construction and development portfolio and 300% of capital for the non-owner occupied commercial real estate portfolio, which also includes construction and development loans. At December 31, 2020, the real estate construction and development portfolio totaled 112% of capital and non-owner occupied commercial real estate totaled 291% of capital. The current limits may affect the ability of the Bank to significantly grow these segments of the loan portfolio. The Bank is not approaching internal or regulatory concentration limits in other loan segments.

The real estate mortgage loan portfolio totaling \$320,294,000 at December 31, 2020, consists of commercial real estate, residential mortgages, and home equity loans. Commercial real estate loans have remained a significant percentage of total loans over the past year, amounting to 43.17% and 41.04%, of the total loan portfolio at December 31, 2020 and December 31, 2019, respectively. Commercial real estate balances increased to \$282,951,000 at December 31, 2020 from \$245,183,000 at December 31, 2019. Commercial real estate loans are generally a mix of short to medium-term, fixed and floating rate instruments and are mainly secured by commercial income and multi-family residential properties. Residential mortgage loans are generally 30-year amortizing loans with maturities of between three and five years. These loans totaled \$37,236,000 or 5.68% of the portfolio at December 31, 2020, and \$45,881,000, or 7.68% of the portfolio at December 31, 2019. Real estate mortgage loans in total increased \$29,057,000 during 2020 and increased \$15,278,000, or 5.54%, during 2019. Residential mortgage loans are not generally a large part of the loan portfolio, but some residential mortgage loans have been made over the past several years to facilitate take-out loans for construction borrowers who were unable to obtain permanent financing elsewhere. The Company does purchase residential mortgage portfolios.

The home equity loan portfolio totaled \$107,000 at December 31, 2020, and \$173,000 at December 31, 2019. Real estate construction and development loans, representing 26.7% and 23.2% of total loans at December 31, 2020 and December 31, 2019, respectively, consist of loans for residential and commercial construction projects, as well as land acquisition and development, or land held for future development. Loans in this category are secured by real estate including improved and unimproved land, as well as single-family residential, multi-family residential, and commercial properties in various stages of completion. All real estate loans have established equity requirements. Repayment on construction loans generally comes from long-term mortgages with other lending institutions obtained at completion of the project or from the sale of the constructed homes to individuals.

Purchased loan participations totaled \$9,707,000 at December 31, 2020. There were \$5,955,000 purchased loan participations held at December 31, 2019. Loan participations sold increased from \$4,866,000, or 0.81%, of the portfolio at December 31, 2019, to \$12,948,000, or 1.98%, at December 31, 2020.

At December 31, 2020, approximately 59.8% of commercial and industrial loans have floating rates and, although some may be secured by real estate, many are secured by accounts receivable, inventory, and other business assets. Construction loans are generally short-term, floating-rate obligations, which consist of both residential and commercial projects. Agricultural loans, are primarily short-term, floating rate loans for crop financing.

Included within the installment loan portfolio are \$57,385,000 in student loans as of December 31, 2020, as compared to \$65,800,000 at December 31, 2019, a decrease of \$8,415,000. The student loan portfolio consists of unsecured loans to medical and pharmacy students currently enrolled in medical and pharmacy schools in the US and the Caribbean. The medical student loans are made to US citizens attending medical schools in the US and Antigua, while the pharmacy student loans are made to pharmacy students attending pharmacy school in the US. Upon graduation the loan is automatically placed on deferment for six months. This may be extended up to 48 months for graduates enrolling in internship, medical residency or fellowship. As approved the student may receive additional deferment for hardship

or administrative reasons in the form of forbearance for a maximum of 24 months throughout the life of the loan. The outstanding balance of student loans that have not entered repayment status totaled \$13,893,000 at December 31, 2020. Accrued interest on loans that have not entered repayment status totaled \$4,682,000 at December 31, 2020. At December 31, 2020, there were 944 loans within repayment, deferment, and forbearance which represented \$28,906,000, \$7,407,000, and \$7,179,000 in outstanding balances respectively.

Repayment of the unsecured student loans is premised on the medical and pharmacy students graduating and becoming high wage earners. Under program guidelines repayment terms can vary per borrower, however repayment occurs on average within 10 to 20 years. Underwriting is premised on qualifying credit scores. The weighted average credit score for the portfolio is in the mid-700s. In addition, there are non-student co-borrowers

for roughly one-third of the portfolio that provide additional repayment capacity. Graduation and employment placement rates are high for both medical and pharmacy students. The average student loan balance per borrower as of December 31, 2020 was approximately \$44,000. Loan interest rates range from 2.88% to 7.88%.

At December 31, 2020, \$28,906,000 in loans were in repayment compared to \$24,986,000 as of December 31, 2019. Accrued interest on student loans was \$4,974,000 and \$5,678,000 as of December 31, 2020 and 2019, respectively. At December 31, 2020, the reserve against the student loan portfolio totaled \$2,546,000. Additionally, during the year ended December 31, 2020, \$125,000 in accrued interest receivable was reversed, due to charge-offs of \$1,947,000. At December 31, 2019, the reserve totaled \$2,091,000,000 and \$43,000 in accrued interest was reversed due to charge-offs of \$740,000. There were no TDRs within the portfolio as of December 31, 2020 or 2019.

*The following table sets forth the Bank's student loan portfolio with activity from December 31, 2019 and December 31, 2020:*

(In thousands)

Student Loan Portfolio Balance as of December 31, 2018	\$68,221
Disbursements	1,005
Capitalized Interest	5,055
Payments Received	(7,741)
Loans Charged-off	(740)
Student Loan Portfolio Balance as of December 31, 2019	65,800
Disbursements	38
Capitalized Interest	3,936
Payments Received	(10,442)
Loans Charged-off	(1,947)
Student Loan Portfolio Balance as of December 31, 2020	\$57,385

Student Loan Finance Corporation (ZuntaFi) is the third-party servicer for the student loan portfolio. ZuntaFi provides servicing for the student loan portfolio, including application administration, processing, approval, documenting, funding, and collection. They also provide file custodial responsibilities. Except in cases where applicants/loans do not meet program requirements, or extreme delinquency, ZuntaFi provides complete program management. ZuntaFi is paid a monthly servicing fee based on the principal balance outstanding. This servicing fee is presented as part of professional fees within noninterest expense.

The following table sets forth the maturities of the Bank's loan portfolio at December 31, 2020. Amounts presented are shown by maturity dates rather than repricing periods:

<i>(In thousands)</i>	<b>Due in one year or less</b>	<b>Due after one year through five years</b>	<b>Due after five years</b>	<b>Total</b>
Commercial and agricultural	\$ 29,519	\$ 39,897	\$ 29,176	\$ 98,592
Real estate construction & development	96,485	71,630	6,901	175,016
Real estate – mortgage	41,424	125,306	153,565	320,295
All other loans	1,176	2,930	57,402	61,508
Total loans	\$168,604	\$239,763	\$247,044	\$655,411

For the years ended December 31, 2020 and 2019, the average yield on loans was 4.96% and 5.91%, respectively. Rate floors are occasionally used to mitigate interest rate risk if interest rates fall, as well as to compensate for additional credit risk under current market conditions. The loan portfolio is generally comprised of short-term or floating-rate loans that adjust in alignment to changes in market rates of interest.

At December 31, 2020 and 2019, approximately 60.8% and 54.2%, respectively, of the loan portfolio consisted of floating rate instruments, with the majority of those tied to the prime rate.

The following table sets forth the contractual maturities of the Bank's fixed and floating-rate loans at December 31, 2020. Amounts presented are shown by maturity dates rather than repricing periods, and do not consider renewals or prepayments of loans:

<i>(In thousands)</i>	<b>Due in one year or less</b>	<b>Due after one year through five years</b>	<b>Due after five years</b>	<b>Total</b>
Accruing loans:				
Fixed rate loans	\$ 1,259	\$ 496	\$ —	\$1,755
Floating rate loans	155,850	239,267	247,043	642,160
Total accruing loans	157,109	239,763	247,043	643,915
Nonaccrual loans:				
Fixed rate loans	11,180	—	—	11,180
Floating rate loans	316	—	—	316
Total nonaccrual loans	11,496	—	—	11,496
Total Loans	\$168,605	\$239,763	\$247,043	\$655,411

## Securities

The following is a comparison of the amortized cost and approximate fair value of available-for-sale securities for the years indicated:

<i>(In thousands)</i>	<b>December 31, 2020</b>		<b>December 31, 2019</b>	
	<b>Amortized Cost</b>	<b>Fair Value (Carrying Amount)</b>	<b>Amortized Cost</b>	<b>Fair Value (Carrying Amount)</b>
Available-for-sale:				
U.S. Government agencies	\$33,800	\$33,710	\$28,737	\$28,699
U.S. Government sponsored entities & agencies collateralized by mortgage obligations	37,732	38,445	47,824	47,613
Corporate bonds	5,000	5,219	—	—
Asset-backed securities	3,871	3,909	—	—
Municipal bonds	1,045	1,058	—	—
Total available-for-sale	\$81,448	\$82,341	\$76,561	\$76,312

The contractual maturities of investment securities as well as yields based on amortized cost of those securities at December 31, 2020 are shown below. Actual maturities may differ from contractual maturities because issuers have the right to call or prepay obligations with or without call or prepayment penalties.

(Dollars in thousands)	One year or less		After one year to five years		After five years to ten years		After ten years		Total	
	Amount	Yield <sup>(1)</sup>	Amount	Yield <sup>(1)</sup>	Amount	Yield <sup>(1)</sup>	Amount	Yield <sup>(1)</sup>	Amount	Yield <sup>(1)</sup>
Available-for-sale:										
U.S. Government agencies	\$—	—%	\$ 191	3.51%	\$11,891	3.02%	\$21,718	3.01%	\$33,800	3.02%
U.S. Government sponsored entities & agencies collateralized by mortgage obligations	7	(3.80)%	3,637	2.71%	3,744	2.71%	30,344	3.26%	37,732	3.15%
Corporate bonds	—	—%	—	—%	5,000	4.15%	—	—%	5,000	4.15%
Asset-backed securities	—	—%	—	—%	—	—%	3,871	0.90%	3,871	0.90%
Municipal bonds	—	—%	300	0.94%	410	1.69%	335	2.18%	1,045	1.33%
Total amortized cost	\$ 7	(3.80)%	\$4,128	2.62%	\$21,045	3.21%	\$56,268	2.99%	\$81,448	3.03%

(1) Weighted average yields are not computed on a tax equivalent basis

At December 31, 2020 and 2019, available-for-sale securities with an amortized cost of approximately \$80,527,000 and \$65,874,000, respectively (fair value of \$81,420,000 and \$65,683,000, respectively) were pledged as collateral for public funds and FHLB borrowings.

During the year ended December 31, 2020, the Company recognized unrealized gains of \$74,000 related to marketable equity securities held at December 31, 2020 in the consolidated statements of income. During the year ended December 31, 2019, unrealized gains of \$117,000 were recorded.

### Deposits

The Bank attracts commercial deposits primarily from local businesses and professionals, as well as retail checking accounts, savings accounts and time deposits. Core deposits, consisting of all deposits other than time deposits of \$250,000 or more and brokered deposits, continue to provide the foundation for the Bank's principal sources of funding and liquidity. Core deposits amounted to 97.8% and 97.5% of the total deposit portfolio at December 31, 2020 and 2019, respectively. The Bank currently holds no brokered deposits as part of its continuing effort to maintain sufficient liquidity without a reliance on brokered deposits.

The following table sets forth the year-end amounts of deposits by category for the years indicated, and the dollar change in each category during the year:

(In thousands)	December 31,				
	2020	2019	2018	2017	2016
Noninterest-bearing deposits	\$391,897	\$311,950	\$292,720	\$307,299	\$262,697
Interest-bearing deposits:					
NOW and money market accounts	402,565	360,934	340,445	234,154	235,873
Savings accounts	96,669	80,078	90,046	81,408	75,068
Time deposits:					
Under \$250,000	40,303	44,926	60,875	51,687	87,419
\$250,000 and over	21,217	20,474	21,557	13,145	15,572
Total interest-bearing deposits	560,754	506,412	512,923	380,394	413,932
Total deposits	\$952,651	\$818,362	\$805,643	\$687,693	\$676,629

The following table sets forth the year-end percentages of total deposits by category for the years indicated:

	December 31,				
	2020	2019	2018	2017	2016
Noninterest-bearing deposits	41.14%	38.12%	36.33%	44.69%	38.82%
Interest-bearing deposits:					
NOW and money market accounts	42.26%	44.10%	42.26%	34.05%	34.86%
Savings accounts	10.15%	9.79%	11.18%	11.84%	11.09%
Time deposits:					
Under \$250,000	4.23%	5.49%	7.56%	7.52%	12.92%
\$250,000 and over	2.23%	2.50%	2.68%	1.91%	2.30%
Total interest-bearing deposits	58.86%	61.88%	63.67%	55.31%	61.18%
Total deposits	100.00%	100.00%	100.00%	100.00%	100.00%

The Bank's deposit base consists of two major components represented by noninterest-bearing (demand) deposits and interest-bearing deposits. Interest-bearing deposits consist of time certificates, NOW and money market accounts, and savings deposits. During the year ended December 31, 2020, NOW and money market deposits increased \$41,631,000, or 11.53%, noninterest-bearing deposits increased \$79,947,000, or 25.63%, total time deposits decreased \$3,880,000, or 5.93%, and savings accounts increased \$16,591,000, or 20.72%.

During the year ended December 31, 2019, noninterest-bearing deposits increased \$19,230,000, or 6.57%, total time deposits decreased \$17,032,000, or 25.37%, NOW and money market increased \$20,489,000, or 6.02%, and savings accounts decreased \$9,968,000, or 11.07%.

On a year-to-date average basis, total deposits increased \$73,606,000, or 8.92%, between the years ended December 31, 2019 and December 31, 2020. Interest-bearing deposits increased by \$19,120,000, or 3.70%, and noninterest-bearing deposits increased \$54,486,000, or 17.66%, during 2020. On average, balances increased in all categories between the years ended December 31, 2019 and December 31, 2020, except for time deposits.

The following table sets forth the average deposits and average rates paid on those deposits for the years ended December 31, 2020 and 2019:

(Dollars in thousands)	2020		2019	
	Average Balance	Rate %	Average Balance	Rate %
Interest-bearing deposits:				
Checking accounts	\$384,311	0.34%	\$359,325	0.66%
Savings	88,562	0.12%	85,954	0.27%
Time deposits <sup>(1)</sup>	62,945	0.93%	71,419	1.13%
Noninterest-bearing deposits	\$363,004		\$308,518	

(1) Included at December 31, 2020, are \$21,217,000 in time certificates of deposit of \$250,000 or more, of which \$2,152,000 mature in three months or less, \$13,880,000 mature between three to twelve months, and \$5,185,000 mature in one to three years.

### Short-term Borrowings

The Bank has access to short-term borrowings which may consist of federal funds purchased, discount window borrowings, securities sold under agreements to repurchase ("repurchase agreements"), and Federal Home Loan Bank (FHLB) advances as alternatives to retail deposit funds. Collateralized and uncollateralized lines of credit have been established with several correspondent banks. The FRB discount window, as well as a securities dealer, may also be accessed as needed. Funds may be borrowed in the future as part of the Company's asset/liability strategy, and may be used to acquire assets as deemed appropriate by management for investment purposes or for capital utilization purposes. Federal funds purchased represent temporary overnight borrowings from correspondent banks and are generally unsecured. Repurchase agreements are collateralized by mortgage backed securities and securities of U.S. Government agencies, and generally have maturities of

one to six months, but may have longer maturities if deemed appropriate. FHLB advances are collateralized by investments in FHLB stock, securities, and certain qualifying mortgage loans. Additionally, borrowings collateralized by pledged loans may be secured from the Federal Reserve Bank of San Francisco (FRB). Credit lines are subject to periodic review by the credit lines grantors relative to the Company's financial statements. Lines of credit may be modified or revoked at any time.

Lines of credit with the FRB of \$336,788,000 and \$313,445,000, as well as FHLB lines of credit totaling \$4,881,000 and \$5,815,000 were held at December 31, 2020 and 2019, respectively. In addition, the Company obtained a \$10,000,000 uncollateralized line of credit during 2013 from Pacific Coast Bankers Bank, a \$20,000,000 uncollateralized line of credit during 2014 from Zion's Bank, and a \$10,000,000 uncollateralized line of credit during 2017 from Union Bank. At December 31, 2020, there were no outstanding balances drawn against any lines of credit. These lines of credit generally have interest rates tied to the Federal Funds rate or are indexed to short-term U.S. Treasury rates or LIBOR.

### ***Asset Quality and Allowance for Credit Losses***

Lending money is the principal business activity, and ensuring appropriate evaluation, diversification, and control of credit risks is a primary management responsibility. Losses are implicit in lending activities and the amount of such losses will vary, depending on the risk characteristics of the loan portfolio as affected by local economic conditions and the financial experience of borrowers.

The allowance for credit losses is maintained at a level deemed appropriate by management to provide for known and inherent risks in existing loans and commitments to extend credit. The adequacy of the allowance for credit losses is based upon management's continuing assessment of various factors affecting the collectability of loans and commitments to extend credit, including current economic conditions, past credit

experience, collateral, and concentrations of credit. There is no precise method of predicting specific losses which may ultimately be charged off on particular segments of the loan portfolio. The conclusion that a loan may become uncollectible, either in part or in whole is judgmental and subject to economic, environmental, and other conditions which cannot be predicted with certainty. The allowance for credit losses is determined in accordance with GAAP and the guidelines set forth in the Revised Interagency Policy Statement on the Allowance for Loan and Lease Losses ("Statement") issued by banking regulators in December 2006. The Statement is a revision of the previous guidance released in July 2001, and outlines characteristics that should be used in the segmentation of the loan portfolio for analytical purposes such as including risk classification, past due status, type of loan, industry and collateral. It also outlines factors to consider when adjusting the loss factors for various segments of the loan portfolio and updates previous guidance that describes the responsibilities of the board of directors, management, and bank examiners regarding the allowance for credit losses. Securities and Exchange Commission Staff Accounting Bulletin No. 102, released during July 2001, provides additional guidance regarding methodologies and supporting documentation for the Allowance for Loan and Lease Losses that are consistent with federal securities laws and the Commission's interpretations. Their guidance is generally consistent with the guidance published by banking regulators.

The allowance for loan losses includes an asset-specific component, as well as a general or formula-based component. The loan portfolio is divided into eight (8) segments and categorized primarily by loan class homogeneity and commonality of purpose for analysis under the formula-based component of the allowance. Loans which are determined to be impaired under current accounting guidelines are not subject to the formula-based reserve analysis, and are instead evaluated individually for specific impairment under the asset-specific component of the allowance.

The eight segments of the loan portfolio are as follows (subtotals are provided as needed to allow the reader to reconcile the amounts to loan classifications reported elsewhere in this Report):

#### Loan Segments for Loan Loss Reserve Analysis

(Dollars in thousands)

	Loan Balances at December 31,				
	2020	2019	2018	2017	2016
Commercial and business loans	\$ 37,349	\$ 44,534	\$ 55,929	\$ 46,065	\$ 47,464
Government program loans	10,165	744	1,049	961	1,541
Total commercial and industrial	47,514	45,278	56,978	47,026	49,005
Real estate – mortgage:					
Commercial real estate	282,951	245,183	229,448	221,032	200,213
Residential mortgages	37,236	45,881	59,431	84,804	87,388
Home improvement and home equity loans	107	173	321	457	599
Total real estate mortgage	320,294	291,237	289,200	306,293	288,200
Real estate construction and development	175,016	138,784	108,795	122,970	130,687
Agricultural	51,079	52,197	61,149	59,481	56,918
Installment and student loans	61,508	69,878	71,811	65,581	44,949
Total loans	\$655,411	\$597,374	\$587,933	\$601,351	\$569,759

The methodology for assessing the adequacy of the allowance for credit losses consists of several key elements, which include:

- the formula allowance;
- specific allowances for problem graded loans identified as impaired; and
- the unallocated allowance.

The formula allowance is calculated by applying loss factors to outstanding loans and certain unfunded loan commitments. Loss factors are based on the historical loss experience and on the internal risk grade of those loans and may be adjusted for significant factors that, in management's judgment, affect the collectability of the portfolio as of the evaluation date. Factors that may affect collectability of the loan portfolio include:

- Levels of, and trends in delinquencies and nonaccrual loans;
- Trends in volumes and term of loans;
- Effects of any changes in lending policies and procedures including those for underwriting, collection, charge-off, and recovery;
- Experience, ability, and depth of lending management and staff;

- National and local economic trends and conditions; and
- Concentrations of credit that might affect loss experience across one or more components of the portfolio, including high-balance loan concentrations and participations.

Management determines the loss factors for loans based on a loss migration model. The migration analysis incorporates loan losses over the previous quarters as determined by management (time horizons adjusted as business cycles or environment changes). Loss factors are adjusted to recognize and quantify the loss exposure due to changes in market conditions as well as trends in the loan portfolio. For purposes of analysis, loans are grouped by internal risk classifications and categorized as pass, special mention, substandard, doubtful, or loss. Certain loans are homogeneous in nature and are therefore pooled by risk grade. These homogeneous loans include consumer installment and home equity loans. Special mention loans are currently performing but are potentially weak, as the borrower has begun to exhibit deteriorating trends which, if not corrected, could jeopardize repayment of the loan and result in further downgrades. Substandard loans have well-defined weaknesses which, if not corrected, could jeopardize the full satisfaction of the debt. A loan classified as doubtful has critical weaknesses

that make full collection of the obligation improbable. Classified loans include impaired loans and loans categorized as substandard, doubtful, and loss, which are not considered impaired. At December 31, 2020, impaired and classified loans totaled \$13,390,000, or 2.04%, of gross loans as compared to \$17,664,000, or 2.96%, of gross loans at December 31, 2019.

Loan participations are reviewed for allowance adequacy under the same guidelines as other loans in the portfolio, with an additional participation factor added, if required, for specific risks associated with participations. In general, participations are subject to certain thresholds and are reviewed for geographic location as well as the financial status of the underlying agent bank.

The formula allowance includes reserves for certain off-balance sheet risks including letters of credit, unfunded loan commitments, and lines of credit. Reserves for undisbursed commitments are generally formula allocations based on historical loss experience and other loss factors, rather than specific loss contingencies. At December 31, 2020 and 2019, the formula reserve allocated to undisbursed commitments totaled \$606,000 and \$552,000, respectively. The reserve for unfunded commitments is considered a reserve for contingent liabilities and is therefore carried as a liability on the balance sheet for all periods presented.

Specific allowances are established based on management's periodic evaluation of loss exposure inherent in impaired loans. For impaired loans, specific allowances are determined based on the net realizable value of the underlying collateral, the net present value of the anticipated cash flows, or the market value of the underlying assets. Formula allowances for classified loans, excluding impaired loans, are determined on the basis of additional risks involved with individual loans that may be in excess of risk factors associated with the loan portfolio as a whole. The specific allowance is different from the formula allowance in that the specific allowance is determined on a loan-by-loan basis based on risk factors directly related to a particular loan, as opposed to the formula allowance which is determined for a pool of loans with similar risk characteristics, based on past historical trends and other risk factors which may be relevant on an ongoing basis.

The unallocated portion of the allowance is based upon management's evaluation of various conditions that are not directly measured in the determination of the formula and specific allowances. The conditions may include, but are not limited to, general economic and business conditions affecting key lending areas, credit quality trends, collateral values, loan volumes and concentrations, and other business conditions.

*The following table summarizes the specific allowance, formula allowance, and unallocated allowance at December 31, 2020 and 2019.*

*(In thousands)*

	<b>December 31, 2020</b>	<b>December 31, 2019</b>
Specific allowance – impaired loans	\$ 209	\$ 1,145
Formula allowance – classified loans not impaired	100	59
Formula allowance – special mention loans	256	355
Total allowance for special mention and classified loans	565	1,559
Formula allowance for pass loans	7,682	6,176
Unallocated allowance	275	173
Total allowance	8,522	7,908
Impaired loans	13,376	17,072
Classified loans not considered impaired	14	592
Total classified and impaired loans	13,390	17,664
Special mention loans not considered impaired	17,095	5,846

The following table summarizes allowance for loan losses, nonperforming loans, and classified loans for the periods shown:

(In thousands)

	December 31, 2020	December 31, 2019
Allowance for loan losses ("ALLL") – beginning of period	\$ 7,908	\$ 8,395
Net loans charged-off during period	2,155	507
Provision for credit loss	2,769	20
Allowance for loan losses – end of period	8,522	7,908
Loans outstanding at period-end	655,411	597,374
ALLL as % of loans at period-end	1.30%	1.33%
Nonaccrual loans	11,496	11,697
Accruing restructured loans	535	2,389
Loans, past due 90 days or more, still accruing	513	386
Total non-performing loans	12,544	14,472
ALLL as % of nonperforming loans	67.94%	54.64%
Impaired loans	13,376	17,072
Classified loans not considered impaired	14	592
Total classified and impaired loans	\$13,390	\$17,664
ALLL as % of classified loans	63.64%	44.77%

Impaired loans decreased \$3,696,000 between December 31, 2019 and December 31, 2020 and the specific allowance related to those impaired loans decreased \$936,000 between December 31, 2019 and December 31, 2020. The level of "pass" loans increased approximately \$48,544,000 between December 31, 2019 and December 31, 2020, and the related formula allowance increased \$1,506,000 during the same period. The formula allowance for "pass loans" is derived from loss factors using migration analysis and management's consideration of qualitative factors. The increase in formula allowance for "pass loans" was partially attributed to an adjustment in qualitative factor for COVID-19 related economic uncertainty. The unallocated reserve totaled \$275,000, or 3.2% of the total allowance for credit losses at December 31, 2020, and \$173,000, or 2.2%, of the total allowance for credit losses at December 31, 2019. In evaluating the level of the unallocated reserve, management considered loan relationships, construction and land development concentrations, and loss history relative to peers.

The specific allowance portion of the analysis is designed to be self-correcting by taking into account the current loan loss experience based on that segment of the portfolio. By analyzing the estimated losses inherent in the loan portfolio on a quarterly basis, management is able to adjust specific and inherent loss estimates using the most

recent information available. In performing the periodic migration analysis, management believes that historical loss factors used in the computation of the formula allowance need to be adjusted to reflect current changes in market conditions and trends in the loan portfolio. There are a number of other factors which are reviewed when determining adjustments in the historical loss factors. Those factors include (1) trends in delinquent and nonaccrual loans, (2) trends in loan volume and terms, (3) effects of changes in lending policies, (4) concentrations of credit, (5) competition, (6) national and local economic trends and conditions, (7) experience of lending staff, (8) loan review and Board of Directors oversight, (9) high balance loan concentrations, and (10) other business conditions.

The general reserve requirements (ASC 450-70) were adjusted as a result of the overall condition of the local, state, and national economies and resultant impact on the local lending base. This has resulted in a lower qualitative component being used for the general reserve calculation. The stake-in-the-ground methodology requires the Company to use December 31, 2005 as the starting point of the look back period to capture loss history and better capture an entire economic cycle. Time horizons are subject to Management's assessment of the current period, taking into consideration changes in business cycles and environment changes.

Management and the Company's lending officers evaluate the loss exposure of classified and impaired loans on a weekly basis and through discussions and officer meetings as conditions change. The Company's Loan Committee meets weekly, serving as a forum to discuss specific problem assets that pose significant concerns to the Company and to keep the Board of Directors informed through committee minutes. All special mention and classified loans are reported quarterly on Problem Asset Reports and Impaired Loan Reports and are reviewed by senior management. Migration analysis and impaired loan analysis are performed on a quarterly basis and adjustments are made to the allowance as deemed necessary. The Board of Directors is kept abreast of any changes or trends in problem assets on a monthly basis, or more often if required.

The specific allowance for impaired loans is measured based on the present value of the expected future cash flows discounted at the loan's effective interest rate or the fair value of the collateral if the loan is collateral dependent. The amount of impaired loans is not directly comparable to the amount of nonperforming loans. The primary differences between impaired loans and nonperforming loans are: (i) all loan categories are considered in determining nonperforming loans while impaired loan recognition is limited to commercial and industrial loans, commercial and residential real estate loans, construction loans, and agricultural loans, and (ii) impaired loan recognition considers not only loans 90 days or more past due, restructured loans and nonaccrual loans but may also include problem loans other than delinquent loans.

A loan is considered to be impaired when, based upon current information and events, it is probable the Company will be unable to collect all amounts due according to the contractual terms of the loan agreement. Impaired loans include nonaccrual loans, troubled debt restructures, and performing loans in which full payment of principal or interest is not expected. Management bases the measurement of these impaired loans either on the fair value of the loan's collateral or the expected cash flows on the loans discounted at the loan's stated interest rates. Cash receipts on impaired loans not performing to contractual terms and that are on nonaccrual status are

used to reduce principal balances. Impairment losses are included in the allowance for credit losses through a charge to the provision, if applicable.

At December 31, 2020 and 2019, the recorded investment in loans for which impairment has been recognized totaled \$13,376,000 and \$17,072,000, respectively. Included in total impaired loans at December 31, 2020, are \$682,000 of impaired loans for which the related specific allowance is \$209,000, as well as \$12,694,000 of impaired loans that, as a result of excess collateral or excess in the calculation of net present value of future cash flows, did not need a specific allowance. Total impaired loans at December 31, 2019 included \$3,008,000 of impaired loans for which the related specific allowance was \$1,145,000, as well as \$14,064,000 of impaired loans that as a result of excess collateral or excess in the calculation of net present value of future cash flows, did not have a specific allowance. The average recorded investment in impaired loans was \$15,374,000 and \$18,125,000 during the years ended December 31, 2020 and 2019, respectively. In most cases, the Company uses the cash basis method of income recognition for impaired loans. In the case of certain troubled debt restructuring for which the loan is performing under the current contractual terms, income is recognized under the accrual method.

The largest category of impaired loans at December 31, 2020 was real estate construction and development loans, comprising 82.66% of total impaired loans. Impaired commercial and industrial loans decreased \$1,288,000, impaired real estate mortgage loans decreased \$1,902,000, impaired construction loans decreased \$421,000, and impaired agricultural loans decreased \$85,000 during the year ended December 31, 2020. Specific collateral related to impaired loans is reviewed for current appraisal information, economic trends within geographic markets, loan-to-value ratios, and other factors that may impact the value of the loan collateral. Adjustments are made to collateral values as needed for these factors. Of total impaired loans, approximately \$12,767,000, or 95.4%, were secured by real estate at December 31, 2020, as compared to \$16,324,000, or 95.62%, of total impaired loans at December 31, 2019.

The following table summarizes the components of impaired loans and their related specific allowance at December 31, 2020 and 2019.

<i>(In thousands)</i>	<b>Balance December 31, 2020</b>	<b>Allowance December 31, 2020</b>	<b>Balance December 31, 2019</b>	<b>Allowance December 31, 2019</b>
Commercial and industrial	\$466	\$—	\$1,754	\$606
Real estate – mortgage	1,244	13	3,146	283
Real estate construction and development	11,057	—	11,478	—
Agricultural	609	196	694	256
Installment and student loans	—	—	—	—
<b>Total impaired loans</b>	<b>\$13,376</b>	<b>\$209</b>	<b>\$17,072</b>	<b>\$1,145</b>

Included in impaired loans are loans modified in troubled debt restructurings (TDRs), where concessions have been granted to borrowers experiencing financial difficulties in an attempt to enhance collection. The Company makes various types of concessions when structuring TDRs including rate reductions, payment extensions, and forbearance.

At December 31, 2020, total TDRs of \$3,426,000 included \$2,452,000 in real estate construction balances and, \$365,000 in residential mortgage balances. At December 31, 2019, total TDRs of \$5,187,000 included

\$2,654,000 in real estate construction balances and \$1,060,000 in residential mortgage balances, with \$898,000 in commercial real estate balances.

Total TDRs decreased by 33.95% at December 31, 2020, as compared to December 31, 2019. Nonaccrual TDRs increased by 3.32% and accruing TDRs decreased by 77.61% over the same period. All TDR categories decreased when compared on a year-over-year basis. Concessions granted include lengthened maturities and/or rate reductions that enabled the borrower to complete projects. In large part, current decreases are related to a recovering real estate market.

The following tables summarize TDRs by type, classified separately as nonaccrual or accrual, which are included in impaired loans at December 31, 2020 and December 31, 2019.

<i>(In thousands)</i>	<b>Total TDRs December 31, 2020</b>	<b>Nonaccrual TDRs December 31, 2020</b>	<b>Accruing TDRs December 31, 2020</b>
Commercial and industrial	\$ —	\$ —	\$ —
Real estate – mortgage:			
Commercial real estate	—	—	—
Residential mortgages	365	—	365
Total real estate mortgage	365	—	365
Real estate construction and development	2,452	2,452	—
Agricultural	609	439	170
Installment and student loans	—	—	—
<b>Total Troubled Debt Restructurings</b>	<b>\$3,426</b>	<b>\$2,891</b>	<b>\$535</b>

<i>(In thousands)</i>	<b>Total TDRs December 31, 2019</b>	<b>Nonaccrual TDRs December 31, 2019</b>	<b>Accruing TDRs December 31, 2019</b>
Commercial and industrial	\$ 9	\$ —	\$ 9
Real estate – mortgage:			
Commercial real estate	898	—	898
Residential mortgages	1,060	—	1,060
Total real estate mortgage	1,958	—	1,958
Real estate construction and development	2,654	2,654	—
Agricultural	566	144	422
Installment and student loans	—	—	—
<b>Total Troubled Debt Restructurings</b>	<b>\$5,187</b>	<b>\$2,798</b>	<b>\$2,389</b>

Of the \$3,426,000 in total TDRs at December 31, 2020, \$2,891,000 were on nonaccrual status at period-end. Of the \$5,187,000 in total TDRs at December 31, 2019, \$2,798,000 were on nonaccrual status at period-end. As of December 31, 2020, the Company has no commercial real estate (CRE) workouts whereby an existing loan was restructured into multiple new loans.

For a restructured loan to return to accrual status there needs to be at least six months successful payment

history. In addition, the Company's Credit Administration performs a financial analysis of the credit to determine whether the borrower has the ability to continue to perform successfully over the remaining life of the loan. This includes, but is not limited to, a review of financial statements and a cash flow analysis of the borrower. Only after determining that the borrower has the ability to perform under the terms of the loans will the restructured credit be considered for accrual status.

*The following table summarizes special mention loans by type for the years ended December 31, 2020 and December 31, 2019.*

<i>(In thousands)</i>	<b>December 31, 2020</b>	<b>December 31, 2019</b>
Commercial and industrial	\$1,307	\$ 919
Real estate – mortgage:		
Commercial real estate	14,343	1,608
Residential mortgages	—	88
Home equity loans	—	—
Total real estate mortgage	14,343	1,696
RE construction & development	—	998
Agricultural	1,434	1,279
Installment and student loans	11	386
Total Special Mention Loans	\$17,095	\$5,278

The Company focuses on competition and other economic conditions within its market area and other geographical areas in which it does business, which may ultimately affect the risk assessment of the portfolio. The Company continues to experience increased competition from major banks, local independents and non-bank institutions which creates pressure on loan pricing. The Company continues to place increased emphasis on reducing both the level of nonperforming assets and the level of losses on the disposition of these assets. It is in the best interest of both the Company and the borrowers to seek alternative options to foreclosure in an effort to reduce the impacts on the real estate market. As part of this strategy, the Company enters into troubled debt restructurings, when it improves collection prospects. While business and consumer spending have shown improvement over the last several years, it is difficult to forecast the impact COVID-19 will have on the economy. Local unemployment rates in the San Joaquin Valley have improved, but are expected to substantially increase due to closure of non-essential business and shelter-in-place orders. Management recognizes the increased risk of loss due to the Company's exposure to local and worldwide economic conditions, as well as potentially volatile real estate markets, and takes these factors into consideration when analyzing the adequacy of the allowance for credit losses.

The following table provides a summary of the Company's allowance for credit losses, provisions made to that allowance, and charge-off and recovery activity affecting the allowance for the years indicated.

<i>(Dollars in thousands)</i>	<b>December 31,</b>				
	<b>2020</b>	<b>2019</b>	<b>2018</b>	<b>2017</b>	<b>2016</b>
Total loans outstanding at end of period before deducting allowances for credit losses	\$654,347	\$596,554	\$587,814	\$602,390	\$570,834
Average net loans outstanding during period	639,815	576,015	581,221	569,079	540,777
Balance of allowance at beginning of period	7,908	8,395	9,267	8,902	9,713
Loans charged off:					
Real estate	(359)	(16)	(47)	(23)	(29)
Commercial, industrial & agricultural	—	(36)	(98)	(122)	(870)
Installment and student loans	(1,961)	(761)	(409)	(18)	(24)
Total loans charged off	(2,320)	(813)	(554)	(163)	(923)
Recoveries of loans previously charged off:					
Real estate	128	65	29	95	55
Commercial, industrial & agricultural	29	70	1,102	201	60
Installment and student loans	8	171	315	208	18
Total loan recoveries	165	306	1,446	504	133
Net loans (charged off) recovered	(2,155)	(507)	892	341	(790)
Provision (recovery of provision) charged to operating expense	2,769	20	(1,764)	24	(21)
Balance of allowance for credit losses at end of period	\$8,522	\$7,908	\$8,395	\$9,267	\$8,902
Net loan (charge-offs) recoveries to total average loans	(0.34)%	(0.09)%	0.15%	0.06%	(0.15)%
Net loan (charge-offs) recoveries to loans at end of period	(0.33)%	(0.09)%	0.15%	0.06%	(0.14)%
Allowance for credit losses to total loans at end of period	1.30%	1.33%	1.43%	1.54%	1.56%
Net loan (charge-offs) recoveries to allowance for credit losses	(25.29)%	(6.41)%	10.63%	3.68%	(8.87)%
Net loan (charge-offs) recoveries to provision (recovery of provision) for credit losses	(77.83)%	(2,535.00)%	(50.57)%	1,420.83%	3,761.90%

Loan charge-offs increased \$1,507,000 during the year ended December 31, 2020, when compared to the year ended December 31, 2019. Loan recoveries decreased \$141,000 during the same period. Student loan charge-offs totaled \$1,947,000 and \$740,000 during the years ended 2020 and 2019, respectively. The charge-offs in the student loan portfolio were primarily related to the Antigua medical school loans. Additions to the overdraft reserve of \$14,000 and \$20,000 were made during the same periods.

The following is a summary of the quarterly activity in the allowance for loan losses for the year ended December 31, 2020 (in thousands).

<b>Description</b>	<b>Loss</b>	<b>Recoveries</b>	<b>Provision</b>	<b>Balance</b>
Balance Forward				\$7,908
1st quarter – 2020	\$ 508	\$ 14	\$1,706	9,120
2nd quarter- 2020	700	14	428	8,862
3rd quarter – 2020	284	126	4	8,708
4th quarter – 2020	828	11	631	8,522
Total YTD – 2020	\$2,320	\$165	\$2,769	\$8,522

At December 31, 2020 and 2019, \$606,000 and \$552,000, respectively, of the formula allowance was allocated to unfunded loan commitments and was, therefore, carried separately in Other Liabilities on the consolidated balance sheets.

Management believes that the 1.30% credit loss allowance to total loans at December 31, 2020 is adequate to absorb known and inherent risks in the loan portfolio. There is no guarantee, however, against economic conditions or other circumstances materializing which could adversely affect the Company's service areas resulting in increased losses in the loan portfolio not captured by the current allowance for loan losses. Management is not currently

aware of any conditions that may adversely affect the levels of losses incurred in the Company's loan portfolio.

The allocations to specific loan categories are estimates based upon the same factors considered by management in determining the amount of additional provisions to the credit loss allowance and the overall adequacy of the allowance for credit losses. The unallocated portion provides for coverage of credit losses inherent in the loan portfolio but not captured in the loss factors used in the risk rating-based component or in the specific impairment reserve component of the allowance for credit losses. The unallocated portion acknowledges the inherent imprecision of all loss prediction models.

	2020		2019		2018		2017		2016	
	Allowance for Credit Losses	% of Loans	Allowance for Credit Losses	% of Loans	Allowance for Credit Losses	% of Loans	Allowance for Credit Losses	% of Loans	Allowance for Credit Losses	% of Loans
<i>(Dollars in thousands)</i>										
Commercial and industrial	\$ 625	0.10%	\$1,322	0.22%	\$1,673	0.28%	\$1,408	0.23%	\$1,843	0.32%
Real estate – mortgage	575	0.09%	712	0.12%	1,015	0.17%	1,182	0.20%	1,430	0.25%
RE construction and development	3,722	0.57%	2,808	0.47%	2,424	0.41%	2,903	0.48%	3,378	0.59%
Agricultural	711	0.11%	761	0.13%	1,131	0.19%	1,631	0.27%	666	0.12%
Installment and student loans	2,614	0.40%	2,132	0.36%	1,559	0.27%	887	0.15%	888	0.16%
Not allocated	275	0.05%	173	0.03%	593	0.10%	1,256	0.21%	697	0.12%
	<b>\$8,522</b>	<b>1.30%</b>	<b>\$7,908</b>	<b>1.33%</b>	<b>\$8,395</b>	<b>1.43%</b>	<b>\$9,267</b>	<b>1.54%</b>	<b>\$8,902</b>	<b>1.56%</b>

During 2020, reserve allocations as a percentage of loans decreased for commercial and industrial, real estate mortgage, and agricultural loans. These decreases are a result of a combination of factors including decreases in charge-offs, classified and past due loans, and credit quality improvements. Increases in reserve allocations for real estate construction and development loans were primarily due to the growth of the loan segment, adjusted by the change in the qualitative factors related to portfolio concentrations and uncertainty related to COVID-19. Increases in reserve allocation for installment loans were a result of an increase in loss factors attributed to the student loan portfolio and qualitative adjustments related to student loan forbearance balances. The qualitative adjustments related to the student loan forbearance balances result in a 5% reserve for pharmacy school

forbearance balances and a 15% reserve for medical school forbearance balances.

During 2019, reserve allocations as a percentage of loans decreased for commercial and industrial, real estate mortgage, and agricultural loans. These decreases are a result of a combination of factors including decreases in charge-offs, classified and past due loans, and credit quality improvements. Increases in reserve allocations for real estate construction and development loans were primarily due to the growth of the loan segment, adjusted by the change in the qualitative factors related to the nature and volume of the portfolio. Increases in reserve allocation for installment loans were a result of increases in the overall portfolio balances, and the addition of reserves related to student loans.

The following summarizes the allowance for credit losses related to the specific, formula, and unallocated reserves for the year-ends shown:

(In thousands)	December 31,				
	2020	2019	2018	2017	2016
Formula allowance	\$8,038	\$6,590	\$6,026	\$6,123	\$6,845
Specific allowance	209	1,145	1,776	1,888	1,360
Unallocated allowance	275	173	593	1,256	697
Total allowance	\$8,522	\$7,908	\$8,395	\$9,267	\$8,902

The total formula allowance has increased in the current period as a result of increased loan balances, qualitative adjustments for COVID-19, and the allowance attributed to student loans.

No loans were classified as doubtful at December 31, 2020 or December 31, 2019.

The accrual of interest income on loans is discontinued when reasonable doubt exists with respect to the timely collectability of interest or principal due to the inability of

the borrower to comply with the terms of the loan agreement. Outside of student loans, loans are typically placed on nonaccrual status when the payment of principal or interest is 90 days past due or earlier when the conditions warrant. Interest collected thereafter is credited to principal to the extent necessary to eliminate doubt as to the collectability of the net carrying amount of the loan. Exceptions may be granted to this policy if the loans are well secured and in the process of collection.

The following table sets forth nonperforming assets as of the dates indicated:

(Dollars in thousands)	December 31,				
	2020	2019	2018	2017	2016
Nonaccrual loans <sup>(1)</sup>	\$11,496	\$11,697	\$12,052	\$5,296	\$7,264
Accruing restructured loans	535	2,389	3,832	6,084	5,146
Loans, past due 90 days or more, still accruing	513	386	—	485	1,250
Total non-performing loans	12,544	14,472	15,884	11,865	13,660
Other real estate owned	5,004	6,753	5,745	5,745	6,471
Total non-performing assets	\$17,548	\$21,225	\$21,629	\$17,610	\$20,131
Non-performing loans to total gross loans	1.91%	2.42%	2.70%	1.97%	2.40%
Non-performing assets to total gross loans	2.68%	3.55%	3.68%	2.92%	3.53%
Allowance for loan losses to nonperforming loans	67.94%	54.64%	52.85%	78.10%	65.17%

(1) Included in nonaccrual loans at December 31, 2020 and 2019 are restructured loans totaling \$2,891 and \$2,797, respectively.

Non-performing assets at December 31, 2020 decreased \$3,677,000 between December 31, 2019 and December 31, 2020, due to decreases of \$1,854,000 in accruing restructured loans, decreases of \$201,000 in nonaccrual loans, and decreases in other real estate owned, offset by a slight increase in loans past due more than 90 days and still accruing.

Non-performing assets decreased \$404,000 between December 31, 2018 and December 31, 2019, due to decreases of \$1,443,000 in accruing restructured loans and decreases of \$355,000 in nonaccrual loans, offset by increases in other real estate owned and loans past due more than 90 days and still accruing.

The following table summarizes various nonperforming components of the loan portfolio as compared to total loans for the periods shown.

(In thousands)

	December 31, 2020	December 31, 2019
Provision for credit losses during period	\$2,769	\$20
Allowance as % of nonperforming loans	67.94%	54.64%
Nonperforming loans as % total loans	1.91%	2.42%
Restructured loans as % total loans	0.52%	0.87%

In determining the adequacy of the underlying collateral related to these loans, management monitors trends within specific geographical areas, loan-to-value ratios, appraisals, and other credit issues related to specific loans.

Management continues to monitor and reduce the level of problem assets by working with borrowers to identify options, such as loan restructures, which may help borrowers facing difficulties. Restructured loan numbers have been greatly reduced over the last four years. Net loan charge-offs during the year ended December 31, 2020 totaled \$2,155,000, as compared to net loan charge-offs of \$507,000 for the year ended December 31, 2019. Approximately 49 loans were charged-off during the year ended December 31, 2020, compared to 28 loans during the year ended December 31, 2019. Net loan charge-offs totaling \$2,155,000 during the year ended December 31, 2020, included \$494,000 in net charge-offs during the

quarter ended March 31, 2020, \$686,000 in net charge-offs during the quarter ended June 30, 2020, \$158,000 in net charge-offs during the quarter ended September 30, 2020, and \$817,000 in net charge-offs during the fourth quarter of 2020. Charge-offs of \$1,947,000 during the year were related to the student loan portfolio. The percentage of net charge-offs to average loans was 0.34%, for the year ended December 31, 2020.

The loan portfolio increased from \$597,374,000 at December 31, 2019 to \$655,411,000 at December 31, 2020. Nonperforming loans decreased to \$12,544,000 at December 31, 2020, from \$14,472,000 at December 31, 2019. Nonaccrual loans and accruing restructured loans are included in nonperforming loans. During the same period, total impaired and classified loans decreased from \$17,664,000 at December 31, 2019, to \$13,390,000 at December 31, 2020.

The following table summarizes the nonaccrual totals by loan category for the periods shown:

(In thousands)	Balance		Change
	December 31, 2020	December 31, 2019	2019-2020
Commercial and industrial	\$ —	\$ 75	\$ (75)
Real estate – mortgage	—	—	—
Real estate – construction	11,057	11,478	(421)
Agricultural	439	144	295
Total Nonaccrual Loans	\$11,496	\$11,697	\$(201)

Loans past due more than 30 days receive management attention and are monitored for increased risk. As of December 31, 2020 and 2019 loans past due more than 30 days totaled \$11,126,000 and \$12,355,000, respectively. Impaired loans, nonaccrual and restructured loans are reviewed for specific reserve allocations and the allowance for credit losses is adjusted accordingly.

Except for the loans included in the above tables, there were no loans at December 31, 2020, where the known credit problems of a borrower made doubtful the ability of such borrower to comply with the present loan repayment terms resulting in such loan being included as nonaccrual, past due, or restructured at some future date.

### **Liquidity and Asset/Liability Management**

The primary function of asset/liability management is to provide adequate liquidity and maintain an appropriate balance between interest-sensitive assets and interest-sensitive liabilities.

#### **Liquidity**

Liquidity management may be described as the ability to maintain sufficient cash flows to fulfill both on- and off-balance sheet financial obligations, including loan funding commitments and customer deposit withdrawals, without straining the Company's equity structure. To maintain an

adequate liquidity position, the Company relies on, in addition to cash and cash equivalents, cash inflows from deposits and short-term borrowings, repayments of principal on loans and investments, and interest income received. The Company's principal cash outflows are for loan origination, purchases of investment securities, depositor withdrawals and payment of operating expenses. Other sources of liquidity not on the balance sheet at December 31, 2020, include unused collateralized and uncollateralized lines of credit from other banks, the Federal Home Loan Bank, Pacific Coast Banker's Bank, Zion's Bank, Union Bank, and from the Federal Reserve Bank totaling \$381,669,000.

*Cash and cash equivalents have fluctuated during the three years ended December 31, 2020 and 2019, with period-end balances as follows (from Consolidated Statements of Cash Flows – in 000's):*

	<b>Balance</b>
December 31, 2020	\$294,069
December 31, 2019	\$218,995

Cash and cash equivalents increased \$75,074,000 during the year ended December 31, 2020, and increased \$1,342,000 during the year ended December 31, 2019.

The Company had a net cash inflow from operations of \$13,800,000 for the year ended December 31, 2020, and a net cash inflow from operations totaling \$16,160,000 for the period ended December 31, 2019. The Company experienced net cash outflows from investing activities totaling \$65,547,000 and net cash outflows of \$22,763,000 during the years ended December 31, 2020 and December 31, 2019, respectively.

During the year ended December 31, 2020 and 2019, the Company experienced net cash inflows from financing activities totaling \$126,821,000 and \$5,261,000, respectively, as increases in deposits outweighed purchases of available for sale securities and loan growth.

Liquidity risk arises from the possibility the Company may not be able to satisfy current or future financial commitments, or the Company may become unduly reliant on alternative funding sources. The Company maintains a liquidity risk management policy to address and manage this risk. The policy identifies the primary sources of liquidity, sets wholesale funding limits, establishes procedures for monitoring and measuring liquidity, and establishes minimum liquidity requirements in compliance with regulatory guidance. The liquidity

position is continually monitored and reported on a monthly basis to the Board of Directors.

The policy also includes a contingency funding plan to address liquidity needs in the event of an institution-specific or systemic financial market crisis. In addition to unused lines of credit from other banks totaling \$381,669,000, the contingency plan includes identified funding sources and steps to be taken if liquidity ratios fall or are projected to fall below policy limits for an extended period of time. One of the primary directives of the contingency funding plan is to limit the Company's overall level of wholesale funding to no more than 25% of deposits. The current funding program uses both asset-based and liability-based principles, and identifies core deposits as the favored funding source when attainable at a reasonable cost. The policy identifies a number of funding sources or methods the Bank's ALCO committee may utilize to fulfill the Company's liquidity funding requirements:

- 1) Local core deposits are the Company's primary funding source. The Company works to attract these deposits through service-related and competitive pricing tactics. Other liquidity funding sources are considered if local core deposits are not attractive due to maturity or pricing.
- 2) Unsecured Federal Funds lines with correspondent banks may be used to fund short-term peaks in loan demand or deposit run-off. Currently, unsecured borrowing lines with correspondents are limited and may not be reliable for long periods of time or in times of economic stress.
- 3) Other funding sources such as secured credit lines with the Federal Home Loan Bank or the Federal Reserve may be used for longer periods. These credit lines are collateralized by investment securities and pledged loans. The Company utilizes specific loan pledging with the Federal Reserve to better ensure the continued availability of those lines of credit.
- 4) The Company presently has a Discount Window facility available from the Federal Reserve Bank of San Francisco collateralized with loans as discussed above. At December 31, 2020, the Company had available credit of \$336,788,000 from the Federal Reserve based upon the loans

pledged at that date. The Federal Reserve will monitor use of the Discount Window closely given the current status of the Company and the economy as a whole. This credit facility may not be competitively priced under certain economic conditions. As such, the Company does not expect to use this facility except for short periods, but does consider this to be a key contingency funding source.

- 5) As long as the Bank remains "Well Capitalized," the Company may rely on brokered deposits when core deposit rates are higher in the marketplace or maturity structures are not desirable. The Company's current policy limit for brokered deposits is 25% of total deposits. The Company may also utilize other wholesale deposit sources such as memberships that advertise the Bank's time deposit rates to other subscribers such as banks and credit unions. The Company's current policy limit on other wholesale deposits is 25% of total deposits.
- 6) The Bank may sell whole loans or participations in loans to provide additional liquidity. During economic downturns or other crisis events, these funding sources may be difficult to achieve in a short period of time or at a reasonable price. As such, this strategy is better used as a long-term asset/liability management tool to effectively balance assets and liabilities in order to reduce liquidity risk.
- 7) The Company currently holds Bank-Owned Life Insurance (BOLI) and Corporate-Owned Life Insurance (COLI) policies issued by highly rated insurance companies. These policies may be sold to increase liquidity.
- 8) The Company owns certain real estate including its administration building and several of its branches. These may be sold and vacated or leased back from the purchaser after sale to provide additional liquidity if needed. The sales process may require substantial time to complete, and may have an adverse impact on earnings depending on market rates and other factors at the time of sale.
- 9) Investments nearing maturity may be sold to meet temporary funding needs but may need to be replaced to maintain liquidity ratios

within acceptable limits. At the current time approximately half of the investment portfolio is pledged to secure public deposits and borrowing lines. The Company seeks to maintain an investment-graded securities portfolio to ensure quality collateral for pledging against borrowing lines of credit as well as to provide liquidity in times of need.

The Company's liquid asset base, which generally consists of cash and due from banks, federal funds sold, securities purchased under agreements to resell ("reverse repos") and investment securities, is maintained at levels deemed sufficient to provide the cash necessary to fund loan growth and deposit runoff. Included in this framework is the objective of maximizing the yield on earning assets. This is generally achieved by maintaining a high percentage of earning assets in loans, which historically have represented the Company's highest yielding asset. At December 31, 2020, loans represented 59.89% of total assets and accounted for a loan to deposit ratio of 68.69%, as compared to 62.34% of total assets and a loan to deposit ratio of 72.90% at December 31, 2019. Liquid assets at December 31, 2020 include cash and cash equivalents totaling \$294,069,000, as compared to \$218,995,000 at December 31, 2019.

Liabilities used to fund liquidity sources include core and non-core deposits as well as short-term borrowings capability. Core deposits, which comprised approximately 97.77% of total deposits at December 31, 2020, provide a significant and stable funding source for the Company. At December 31, 2020, unused lines of credit with the Federal Home Loan Bank, Pacific Coast Banker's Bank, Zion's Bank, Union Bank and the Federal Reserve Bank totaling \$381,669,000 were collateralized in part by certain qualifying loans in the Company's loan portfolio. The carrying value of loans pledged on these used and unused borrowing lines totaled \$517,516,000 at December 31, 2020. For a further discussion of the Company's borrowing lines, see "Short Term Borrowings" in the Financial Condition section of Management's Discussion and Analysis.

The liquidity of the parent company, United Security Bancshares, is separate from the Bank and is primarily dependent on the payment of cash dividends by its subsidiary, United Security Bank, subject to limitations imposed by the Financial Code of the State of California and federal and state banking regulations. During the years ended December 31, 2020 and December 31, 2019,

the Bank paid \$8,025,000 and \$8,346,000 in cash dividends to the parent company, respectively.

## **Regulatory Matters**

### **Capital Adequacy**

The Company (on a consolidated basis) and the Bank are subject to various regulatory capital requirements adopted by the Board of Governors of the Federal Reserve System (the "Board of Governors"). Failure to meet minimum capital requirements can initiate certain mandates and possible additional discretionary actions by regulators that, if undertaken, could have a direct material effect on the Company's consolidated financial statements. Under capital adequacy guidelines and the regulatory framework, the consolidated Company and the Bank must meet specific capital guidelines that involve quantitative measures of their assets, liabilities, and certain off-balance sheet items as calculated under regulatory accounting practices. The capital amounts and classification are also subject to qualitative judgments by the regulators about components, risk weightings, and other factors.

The Company has adopted a capital plan that includes guidelines and trigger points to ensure sufficient capital is maintained at the Bank and the Company, and that capital ratios are maintained at a level deemed appropriate under regulatory guidelines given the level of classified assets, concentrations of credit, allowance for credit losses, current and projected growth, and projected retained earnings. The capital plan also contains contingency strategies to obtain additional capital as required to fulfill future capital requirements for both the Bank, as a separate legal entity, and the Company on a consolidated basis. The capital plan requires the Bank to maintain a ratio of tangible shareholders' equity to total tangible assets equal to or greater than 9%. The Bank's ratio of tangible shareholders' equity to total tangible assets was 11.2% and 12.7% at December 31, 2020 and 2019, respectively.

For a more detailed discussion of the capital adequacy requirements, see "Item 1 – Business – Supervision and Regulation – The Holding Company – Capital Adequacy" and "Item 1 – Business – Supervision and Regulation – The Bank – Capital Standards."

*The following table sets forth the Company's and the Bank's actual capital positions at December 31, 2020 and 2019, as well as the minimum capital requirements under the regulatory guidelines:*

	<b>Ratio at December 31, 2020</b>	<b>Ratio at December 31, 2019</b>	<b>Minimum Requirement to be well Capitalized (3)</b>	<b>Minimum Requirement for Community Bank Leverage Ratio – (2) (4)</b>
Total capital to risk weighted assets <sup>(1)</sup>				
Company	N/A	17.98%	10.00%	N/A
Bank	N/A	17.78%	10.00%	N/A
Tier 1 capital to risk-weighted assets <sup>(1)</sup>				
Company	N/A	16.81%	8.00%	N/A
Bank	N/A	16.61%	8.00%	N/A
Common equity tier 1 capital to risk-weighted assets <sup>(1)</sup>				
Company	N/A	15.39%	6.50%	N/A
Bank	N/A	16.61%	6.50%	N/A
Tier 1 capital to adjusted average assets ("Leverage Ratio")				
Company	11.37%	12.82%	5.00%	8.00%
Bank	11.17%	12.83%	5.00%	8.00%

(1) Current data is not applicable as the Bank and Company have adopted the Community Bank Leverage Ratio Framework as of the third quarter of 2020.

(2) The minimum required Community Bank Leverage Ratio is 9.00%, but the CARES Act temporarily lowers this to 8% as described below.

(3) The Company was subject to these minimum requirements under the regulatory framework for Prompt Corrective Action at December 31, 2019.

(4) If the subsidiary bank's Leverage Ratio exceeds the minimum ratio under the Community Bank Leverage Ratio Framework, it is deemed to be "well capitalized" under all other regulatory capital requirements. The Company may revert back to the regulatory framework for Prompt Corrective Action if the subsidiary bank's Leverage Ratio falls below the minimum under the Community Bank Leverage Ratio Framework.

The federal banking agencies published a final rule on November 13, 2019, that provided a simplified measure of capital adequacy for qualifying community banking organizations. A qualifying community banking organization that opts into the community bank leverage ratio framework and maintains a leverage ratio greater than 9 percent will be considered to have met the minimum capital requirements, the capital ratio requirements for the well capitalized category under the Prompt Corrective Action framework, and any other capital or leverage requirements to which the qualifying banking organization is subject. A qualifying community banking organization with a leverage ratio of greater than 9 percent may opt into the community bank leverage ratio framework if it has average consolidated total assets of less than \$10 billion, has off-balance-sheet exposures of 25% or less of total consolidated assets, and has total trading assets and trading liabilities of 5 percent or less of total consolidated assets. Further, the bank must not be an advance approaches banking organization.

The final rule became effective January 1, 2020 and banks that meet the qualifying criteria can elect to use the community bank leverage framework starting with the quarter ended March 31, 2020. The CARES Act reduced the required community bank leverage ratio to 8% until the earlier of December 31, 2020, or the national emergency is declared over. The federal bank regulatory agencies adopted an interim final rule to implement this change from the CARES Act. The Company and the Bank meet the criteria outlined in the final rule and the interim final rule and have adopted the community bank leverage ratio framework in the third quarter 2020.

As of December 31, 2020, the Company and the Bank meet all capital adequacy requirements to which they are subject. Management believes that, under the current regulations, both will continue to meet their minimum capital requirements in the foreseeable future.

### **Dividends**

Dividends paid to shareholders are subject to restrictions set forth in the California General Corporation Law. The California General Corporation Law provides that

distributions may be made to shareholders if retained earnings immediately prior to the dividend payment are at least equal to the amount of the proposed distribution or if, immediately after the distribution, the value of assets equals the sum of total liabilities. The primary source of funds with which dividends will be paid to shareholders come from cash dividends received by the Holding Company from the Bank.

During the year ended December 31, 2020, the Holding Company paid \$7,468,000 in cash dividends to shareholders. The Bank paid cash dividends of \$8,025,000 to the Holding Company in order to fund the Holding Company's operating costs, payments of interest on junior subordinated debentures, estimated tax payments, and cash dividends paid to shareholders. The balance of junior subordinated debentures remained at \$12.0 million for the years ended December 31, 2020 and December 31, 2019.

The Bank, as a state-chartered bank, is subject to dividend restrictions set forth in California state banking law and administered by the California Department of Financial Protection and Innovation ("DFPI"). Under such restrictions, the Bank may not pay cash dividends in an amount which exceeds the lesser of the retained earnings of the Bank or the Bank's net income for the last three fiscal years (less the amount of distributions to shareholders during that period of time). If the above test is not met, cash dividends may only be paid with the prior approval of the DFPI, in an amount not exceeding the Bank's net income for its last fiscal year or the amount of its net income for the current fiscal year. Such restrictions do not apply to stock dividends, which generally require neither the satisfaction of any tests nor the approval of the DFPI. Notwithstanding the foregoing, if the DFPI finds that the shareholders' equity is not adequate or that the declarations of a dividend would be unsafe or unsound, the DFPI may prevent the bank from paying a dividend. The FRB may also limit dividends paid by the Bank.

### **Reserve Balances**

The Bank is required to maintain average reserve balances with the Federal Reserve Bank. At December 31, 2020, the Bank was not subject to a reserve requirement.

## BANKING SERVICES

### Checking Accounts

- Business
- Personal
- Interest Bearing

### Certificates of Deposit

- Regular/Jumbo CD (various terms)
- Rate Increase CD™
- Variable Rate CD
- Individual Retirement Accounts (IRA) CD
- Certificates of Deposit Registry Service (CDARS)

### Loan Services

- Agricultural Development & Production
- Commercial Business
- Commercial Construction & Development
- Consumer

### Savings Accounts

- Business
- Personal
- Individual Retirement Accounts (IRA)

### Cash Management Services

- ACH
- Merchant Card Service
- Positive Pay
- Remote Deposit Capture
- Stop Payments
- Wire Transfers

### Online Services

- Bill Payment
- eStatements
- Mobile Banking
- Online Banking

### Safe Deposit Boxes

- Various sizes available at each branch location

## CORPORATE DATA

### BOARD OF DIRECTORS

**Dennis R. Woods**  
*Chairman of the Board*

**Benjamin Mackovak**  
*Lead Director*

**Susan Quigley, CPA**  
*Secretary of the Board*

**Stanley J. Cavalla**  
*Director*

**Tom Ellithorpe**  
*Director*

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**Robert Oberg**  
*Senior Vice President and Chief Risk Officer*

**William M. Yarbenet**  
*Senior Vice President and Chief Credit Officer*

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**Paul N. Thaxter**  
*First Vice President and Commercial Banking Center*

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*Vice President and Operations Assistant and Training Officer*

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