



REPORT OF INDEPENDENT AUDITORS
AND FINANCIAL STATEMENTS

PEOPLE'S BANK OF COMMERCE
(AN OREGON BANKING CORPORATION)

December 31, 2020 and 2019



MOSSADAMS

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Note: These financial statements have not been reviewed or confirmed for accuracy or relevance by the Federal Deposit Insurance Corporation.

Report of Independent Auditors

To the Board of Directors and Stockholders
People's Bank of Commerce

Report on the Financial Statements

We have audited the accompanying financial statements of People's Bank of Commerce (an Oregon Banking Corporation), which comprise the balance sheets as of December 31, 2020 and 2019, and the related statements of income, comprehensive income, changes in stockholders' equity, and cash flows for the years then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of People's Bank of Commerce as of December 31, 2020 and 2019, and the results of its operations and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

A handwritten signature in black ink that reads "Moss Adams LLP". The signature is written in a cursive, flowing style.

Portland, Oregon

March 15, 2021

People's Bank of Commerce

Balance Sheets

	December 31,	
	2020	2019
ASSETS		
Cash and cash equivalents	\$ 92,182,758	\$ 14,650,556
Time deposits with other institutions	1,740,000	996,000
Investment securities		
available-for-sale, at fair value	25,893,747	27,734,426
Federal Home Loan Bank (FHLB) stock	564,300	889,500
Loans held-for-sale	3,407,443	2,474,240
Factored accounts receivable, net of allowance	17,762,644	10,206,287
Loans, net of allowance for loan losses, and unearned income	341,744,684	275,158,174
Premises, equipment, and leasehold improvements, net of accumulated depreciation and amortization	17,796,522	16,111,428
Right-of-use asset, net	3,826,981	4,194,128
Other real estate owned	1,028,151	3,507,249
Bank-owned life insurance (BOLI)	7,475,619	6,269,368
Goodwill	3,335,384	3,335,384
Investment in real estate joint venture	2,360,850	2,409,967
Accrued interest receivable and other assets	4,211,549	2,237,050
	<u>\$ 523,330,632</u>	<u>\$ 370,173,757</u>
Total assets		
LIABILITIES		
Noninterest-bearing demand deposits	\$ 231,095,318	\$ 136,051,368
Interest-bearing demand and money market accounts	165,556,742	130,824,158
Savings deposits	36,730,181	21,501,072
Time deposits	22,365,573	18,416,485
	<u>455,747,814</u>	<u>306,793,083</u>
Total deposits		
FHLB Advances	3,000,000	11,750,000
Borrowings	-	211,815
Accrued interest payable and other liabilities	7,822,875	5,518,643
Lease liability	3,924,444	4,241,634
	<u>470,495,133</u>	<u>328,515,175</u>
Total liabilities		
COMMITMENTS AND CONTINGENCIES (Notes 9, 11, and 12)		
STOCKHOLDERS' EQUITY		
Common stock, \$5 par value, 6,000,000 shares authorized; 3,558,581 and 3,241,075 shares issued and outstanding at December 31, 2020 and 2019, respectively	17,804,396	16,205,371
Surplus	22,574,481	19,813,698
Unearned ESOP shares, 0 and 20,250 shares, respectively	-	(211,815)
Retained earnings	11,774,851	5,643,866
Accumulated other comprehensive income	681,771	207,462
	<u>52,835,499</u>	<u>41,658,582</u>
Total stockholders' equity		
Total liabilities and stockholders' equity	<u>\$ 523,330,632</u>	<u>\$ 370,173,757</u>

People's Bank of Commerce

Statements of Income

	Years Ended December 31,	
	2020	2019
INTEREST INCOME		
Interest and fees on loans	\$ 15,942,485	\$ 14,420,545
Asset-based financing income	3,409,516	2,426,775
Interest on investment securities	604,393	603,759
Interest on federal funds sold	121,661	409,697
Total interest income	20,078,055	17,860,776
INTEREST EXPENSE		
Interest-bearing deposit and savings accounts	499,087	1,060,247
Time deposit accounts	312,459	305,686
Other borrowings	165,051	29,434
Total interest expense	976,597	1,395,367
NET INTEREST INCOME BEFORE PROVISION FOR LOAN LOSSES	19,101,458	16,465,409
PROVISION FOR LOAN LOSSES	1,332,476	295,463
NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES	17,768,982	16,169,946
NONINTEREST INCOME		
Gain on sale of loans	3,916,181	958,690
Service charges and other fees	2,174,177	2,741,094
Mortgage loan fees	389,372	123,195
Net gain on sale of investment securities	36,957	624
Other noninterest income	445,064	403,260
Total noninterest income	6,961,751	4,226,863
NONINTEREST EXPENSE		
Salaries and employee benefits	10,524,015	9,448,211
Occupancy and equipment	2,505,205	2,504,071
Professional fees	754,431	463,850
Advertising and promotional	516,443	266,639
Data processing	580,645	444,423
Other noninterest expense	1,782,239	1,766,003
Total noninterest expense	16,662,978	14,893,197
INCOME BEFORE PROVISION FOR INCOME TAXES	8,067,755	5,503,612
PROVISION FOR INCOME TAXES	1,936,770	1,435,159
NET INCOME	\$ 6,130,985	\$ 4,068,453
Basic earnings per share of common stock	\$ 1.76	\$ 1.37
Diluted earnings per share of common stock	\$ 1.75	\$ 1.36

People's Bank of Commerce

Statements of Comprehensive Income

	Years Ended December 31,	
	2020	2019
NET INCOME	\$ 6,130,985	\$ 4,068,453
Unrealized losses on securities available-for-sale		
Unrealized holding gains arising during the period, pre-tax	637,349	406,439
Tax effect of unrealized holding gains arising during the period	(134,309)	(85,457)
Reclassification for gains realized in earnings, pre-tax	(36,957)	(624)
Tax effect of reclassification adjustment for gains realized in earnings	8,226	237
	<u>474,309</u>	<u>320,595</u>
Other comprehensive income		
COMPREHENSIVE INCOME	<u>\$ 6,605,294</u>	<u>\$ 4,389,048</u>

People's Bank of Commerce

Statements of Changes in Stockholders' Equity

	Common Stock			Unearned	Retained	Accumulated	Total
	Shares	Amount	Surplus	ESOP Shares	Earnings	Other Comprehensive Income (Loss)	Stockholders' Equity
BALANCE, December 31, 2018	2,953,464	\$ 14,767,317	\$ 17,376,452	\$ (444,550)	\$ 3,866,856	\$ (113,133)	\$ 35,452,942
Net income	-	-	-	-	4,068,453	-	4,068,453
Net unrealized gain on investment securities available-for-sale, net of taxes	-	-	-	-	-	320,595	320,595
5% stock dividend	147,835	739,175	1,552,268	-	(2,291,443)	-	-
Cash in lieu of fractional shares	(262)	(1,311)	(2,752)	-	-	-	(4,063)
Options exercised	19,187	95,935	8,739	-	-	-	104,674
Restricted stock grants issued	41,833	196,665	(196,665)	-	-	-	-
Stock-based compensation expense	-	-	231,331	-	-	-	231,331
Common stock issued, net of expenses	79,018	407,590	750,272	-	-	-	1,157,862
Allocation of 22,250 shares to Employee Stock Ownership Plan	-	-	94,053	232,735	-	-	326,788
BALANCE, December 31, 2019	3,241,075	\$ 16,205,371	\$ 19,813,698	\$ (211,815)	\$ 5,643,866	\$ 207,462	\$ 41,658,582
Net income	-	-	-	-	6,130,985	-	6,130,985
Net unrealized gain on investment securities available-for-sale, net of taxes	-	-	-	-	-	474,309	474,309
Stock bonus	22,570	112,850	100,437	-	-	-	213,287
Options exercised	2,933	14,665	(1,437)	-	-	-	13,228
Restricted stock grants issued	37,750	188,750	(188,750)	-	-	-	-
Stock-based compensation expense	-	-	287,820	-	-	-	287,820
Common stock issued, net of expenses	256,552	1,282,760	2,539,865	-	-	-	3,822,625
Restricted stock forfeited	(2,299)	-	-	-	-	-	-
Allocation of 20,250 shares to Employee Stock Ownership Plan	-	-	22,848	211,815	-	-	234,663
BALANCE, December 31, 2020	3,558,581	\$ 17,804,396	\$ 22,574,481	\$ -	\$ 11,774,851	\$ 681,771	\$ 52,835,499

People's Bank of Commerce
Statements of Cash Flows

	Years Ended December 31,	
	2020	2019
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income	\$ 6,130,985	\$ 4,068,453
Adjustments to reconcile net income to net cash:		
Deferred income taxes	(770,000)	1
Provision for loan losses	1,332,476	295,463
Depreciation and amortization	952,154	983,588
Loss on disposition of donated land	30,000	-
Amortization of right-of-use asset	367,147	241,241
Stock-based compensation expense	735,770	558,119
Amortization of premiums on investment securities	144,734	144,263
Realized gain on sale of investment securities	(36,957)	1,503
Net appreciation of bank-owned life insurance	(157,593)	(200,361)
Gain on sale of loans	(3,916,181)	(958,690)
Proceeds from the sale of loans held-for-sale	135,236,252	22,920,416
Production of loans held-for-sale	(132,253,274)	(22,351,572)
(Gain) from sale on OREO	(13,876)	-
Changes in cash due to changes in certain assets and liabilities:		
Accrued interest receivable and other assets	(1,393,623)	329,090
Accrued interest payable and other liabilities	2,304,232	(468,290)
Decrease in lease liability	(317,190)	(193,735)
Net cash from operating activities	<u>8,375,056</u>	<u>5,369,489</u>
CASH FLOWS FROM INVESTING ACTIVITIES		
Purchase of investment securities available-for-sale	(9,684,295)	(11,872,674)
Proceeds from payments, calls, and sales of investment securities available-for-sale	12,017,589	10,275,968
Proceeds from sale of FHLB stock	325,200	-
Purchase of restricted equity securities	-	(526,800)
Purchase time deposits with other institutions	(744,000)	(996,000)
Net (increase) decrease in factored accounts receivable	(7,556,357)	2,810,329
Net increase in loans	(67,918,986)	(28,316,254)
Proceeds from sale of other real estate owned	2,492,974	872,949
Purchase of BOLI	(1,048,658)	-
Buyout of participating bank in other real estate owned	-	(848,300)
Distributions in excess of net income from real estate joint venture	49,117	49,117
Payments made for purchase of premises, equipment, and leasehold improvements	<u>(2,604,207)</u>	<u>(227,817)</u>
Net cash from investing activities	<u>(74,671,623)</u>	<u>(28,779,482)</u>

People's Bank of Commerce

Statements of Cash Flows

	Years Ended December 31,	
	2020	2019
CASH FLOWS FROM FINANCING ACTIVITIES		
Net increase (decrease) in deposit accounts	\$ 148,954,731	\$ (1,223,998)
Proceeds from borrowings	-	11,750,000
Repayment of borrowings	(8,961,815)	(232,735)
Cash paid in lieu of fractional shares from stock dividend	-	(4,063)
Proceeds from stock options exercised	13,228	104,674
Proceeds from sale of common stock, net of expenses	3,822,625	1,157,862
Net cash from financing activities	143,828,769	11,551,740
NET CHANGE IN CASH AND CASH EQUIVALENTS	77,532,202	(11,858,253)
CASH AND CASH EQUIVALENTS, beginning of year	14,650,556	26,508,809
CASH AND CASH EQUIVALENTS, end of year	<u>\$ 92,182,758</u>	<u>\$ 14,650,556</u>
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION		
Cash paid for interest	\$ 1,015,358	\$ 1,431,852
Cash paid for taxes	<u>\$ 2,979,000</u>	<u>\$ 600,000</u>
SUPPLEMENTAL DISCLOSURE OF NONCASH INVESTING ACTIVITIES		
Change in fair value of investment securities available-for-sale, net of taxes	\$ 474,309	\$ 320,595
Establishment of right-of-use asset	\$ -	\$ 4,435,369
Establishment of lease liability	\$ -	\$ 4,435,369

Note 1 – Organization and Summary of Significant Accounting Policies

Organization

In July 1997, People's Bank of Commerce (the Bank) was incorporated and received regulatory approval to become a state-chartered institution authorized to provide banking services in the state of Oregon. The Bank is subject to the regulations of certain federal and state agencies and will undergo periodic examinations by those regulatory authorities.

The Bank, which is headquartered in Medford, Oregon, operates six full-service branches in Ashland, Central Point, Grants Pass, Klamath Falls and Medford, Oregon, and provides banking services to businesses and individuals located primarily in Southern Oregon.

The Company declared 5% stock dividend during 2019. All per share amounts and calculations in the accompanying financial statements have been restated to reflect the effects of these stock dividends.

On September 1, 2017, the Bank acquired all of the outstanding shares of Capital Associates, Inc. dba Steelhead Finance (Steelhead) for cash and exchange of the Bank's stock. Steelhead is an asset-based lender serving the commercial freight delivery industry as a factor of freight bills.

On November 5, 2020, the Bank announced plans to merge and acquire Willamette Community Bank, headquartered in Albany, Oregon. The merger closed on March 1, 2021. See Note 21.

Management's estimates and assumptions

In preparing the financial statements, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities as of the date of the balance sheets, and revenues and expenses for the reporting periods. Actual results could differ significantly from management's estimates. Material estimates that are particularly susceptible to significant change in the near term relate to the determination of the allowance for loan losses, the valuation of investment securities available-for-sale, other real estate owned, deferred tax assets, and the fair value of financial instruments.

Cash and cash equivalents

Cash equivalents are generally short-term investments with a maturity of three months or less. Cash and cash equivalents include cash on hand, amounts due from banks, and federal funds sold. Generally, federal funds are purchased and sold within a one-day period.

The Bank maintains balances in correspondent bank accounts which, at times, may exceed federally insured limits. Management believes that its risk of loss associated with such balances is minimal due to the financial strength of correspondent banks. The Bank has not experienced any losses in such accounts.

People's Bank of Commerce

Notes to Financial Statements

Note 1 – Organization and Summary of Significant Accounting Policies (continued)

Investment securities

The Bank is required to specifically identify its investment securities as “available-for-sale,” “held-to-maturity,” or “trading accounts.” The Bank holds no trading securities. However, debt securities that the Bank has the positive intent and ability to hold to maturity are classified as held-to-maturity and recorded at amortized cost. Securities not classified as held-to-maturity are classified as available-for-sale and recorded at fair value. Premiums and discounts are recognized in interest income using the effective interest method over the period to maturity.

Available-for-sale securities consist of bonds, notes, and debentures. Securities are generally classified as available-for-sale if the instrument may be sold in response to such factors as: (1) changes in market interest rates and related changes in prepayment risk, (2) needs for liquidity, (3) changes in the availability of and the yield on alternative instruments, and (4) changes in funding sources and terms. Unrealized holding gains and losses, net of taxes, on available-for-sale securities are reported as a net amount in a separate component of equity until realized.

Fair values for these investment securities are based on quoted market prices. Gains and losses on the sale of available-for-sale securities are determined using the specific-identification method.

Management reviews investment securities on an ongoing basis for the presence of other-than-temporary impairment (OTTI) or permanent impairment, taking into consideration current market conditions; fair value in relationship to cost; extent and nature of the change in fair value; issuer rating changes and trends; whether management intends to sell a security or if it is likely that the Bank will be required to sell the security before recovery of the amortized cost basis of the investment, which may be maturity; and other factors. For debt securities, if management intends to sell the security, or it is likely that the Bank will be required to sell the security before recovering its cost basis, the entire impairment loss would be recognized in earnings as an OTTI. If management does not intend to sell the security and it is not likely that the Bank will be required to sell the security, but management does not expect to recover the entire amortized cost basis of the security, only the portion of the impairment loss representing credit losses would be recognized in earnings. The credit loss on a security is measured as the difference between the amortized cost basis and the present value of the cash flows expected to be collected. Projected cash flows are discounted by the original or current effective interest rate depending on the nature of the security being measured for potential OTTI. The remaining impairment related to all other factors, which is the difference between the present value of the cash flows expected to be collected and fair value, is recognized as a charge to other comprehensive income. Impairment losses related to all other factors are presented as separate categories within other comprehensive income.

Transfers of securities from held-to-maturity to available-for-sale are accounted for at amortized costs as of the date of the transfer. Fair value adjustments are recognized in other comprehensive income at the time of the transfer and, thereafter, among unrealized gains or losses recognized for all securities classified as available-for-sale.

Note 1 – Organization and Summary of Significant Accounting Policies (continued)

Factored accounts receivable, net of allowance

To help ensure collection of accounts receivable, Steelhead has required factoring clients to maintain factoring reserves of 5% to 20% of their monthly factoring activity. The factored accounts receivable are secured, and are presented net of an allowance for doubtful accounts. As of December 31, 2020 and 2019, the allowance was \$210,072 and \$105,215, respectively. Management estimates the allowance for doubtful accounts based on historical bad debt and losses and aging of current receivable balances. Management considers accounts to be past due after 60 days without a payment. Management's only measure of credit quality for factored accounts receivable is days past due. The amount of factored accounts receivable past due as of December 31, 2020 and 2019 was insignificant.

Loans held-for-sale

Mortgage loans held-for-sale are carried at the lower of cost or estimated market value. Market value is determined on an aggregate loan basis. Market value adjustments that reduce the carrying value of loans held-for-sale are recorded within a valuation allowance account and charged to noninterest income.

Loans, net of allowance for loan losses, and unearned income

In the normal course of business, the Bank originates and services loans receivable from borrowers. Loans are stated at the amount of unpaid principal, net of an allowance for loan losses, and net of deferred loan fees or costs. Interest on loans is calculated using the simple-interest method on daily balances of the principal amount outstanding. Loan origination fees and certain direct origination costs are capitalized and recognized as an adjustment to the yield of the related loan.

Loans are classified as impaired when, based on current information and events, it is probable that the Bank will be unable to collect the scheduled payments of principal and interest when due, in accordance with the terms of the original loan agreement. The carrying value of impaired loans is based on the present value of expected future cash flows (discounted at each loan's effective interest rate) or, for collateral dependent loans, at fair value of the collateral. If the measurement of each impaired loan's value is less than the recorded investment in the loan, an impairment allowance is created by either charging the provision for loan losses or allocating an existing component of the allowance for loan losses.

Loans, including impaired loans, are classified as non-accrual if the collection of principal and interest is doubtful. Generally, this occurs when a loan is past due as to maturity or payment of principal or interest by 90 days or more, unless such loans are well-secured and in the process of collection. If a loan or portion thereof is partially charged-off, the loan is considered a troubled debt restructuring and impaired. Loans that are less than 90 days past due may also be classified as non-accrual if repayment in full of principal and/or interest is in doubt.

When a loan is classified as non-accrual, all uncollected accrued interest is reversed against interest income and the accrual of interest income is terminated. Generally, any cash payments are applied as a reduction of principal outstanding. In cases where the future collectability of the principal balance in full is expected, interest income may be recognized on a cash basis. A loan may be restored to accrual status when the borrower's financial condition improves so that full collection of principal is considered likely.

People's Bank of Commerce

Notes to Financial Statements

Note 1 – Organization and Summary of Significant Accounting Policies (continued)

A troubled debt restructuring is a formal restructure of a loan in which the Bank, for economic or legal reasons related to the borrower's financial difficulties, grants a concession to the borrower. The concessions may be granted in various forms, including reduction in the stated interest rate, reduction in the loan balance or accrued interest, and extension of the maturity date. Troubled debt restructurings are measured at the time of restructure for impairment, and are subjected to the Bank's impaired loan accounting policy.

In conjunction with the passage of the Coronavirus Aid, Relief, and Economic Security Act ("CARES Act") in March 2020, financial institutions have been provided the option, for loans meeting specific criteria, to temporarily suspend certain requirements under GAAP related to Troubled Debt Restructurings ("TDRs") for a limited time to assist borrowers experiencing financial hardship due to the COVID-19 Pandemic (the Pandemic). As a result, the Bank has not recognized eligible CARES Act loan modifications as TDRs. Additionally, loans qualifying for these modifications are not required to be reported as delinquent, nonaccrual, impaired or criticized solely as a result of loan modification resulting from the economic effects of the Pandemic. Modifications include deferral of payments and interest only periods. The Bank accrues and recognizes interest income on loans under payment relief based on the original contractual interest rates. When payments resume at the end of the relief period, the payments will generally be applied to accrued interest due until accrued interest is fully paid. Accrued interest balances are assessed for collectability on a periodic basis.

The allowance for loan losses is established through a provision for loan losses charged to expenses. Loans are charged against the allowance for loan losses when management believes that the collectability of principal is unlikely. The allowance is an amount that management believes will be adequate to absorb possible losses on existing loans that may become uncollectible, based on evaluations of the collectability of loans and prior loan loss experience. These evaluations take into consideration such factors as changes in the nature and volume of the loan portfolio, overall portfolio quality, review of specific problem loans, and current economic conditions that may affect the borrower's ability to pay. Management carefully monitors changing economic conditions, the concentrations of loan categories and collateral, the financial condition of borrowers, the history of the loan portfolio, and historical peer group loan loss data to determine the adequacy of the allowance for loan losses. The allowance is based on estimates, and actual losses may vary from the estimates. No assurance can be given that adverse future economic conditions will not lead to delinquent loans, increases in the provision for loan losses, and/or charge-offs. In addition, regulatory agencies, as an integral part of their examination process, periodically review the estimated losses on loans. Such agencies may require the Bank to recognize additional losses based on their judgment about information available to them at the time of their examination.

Premises, equipment, and leasehold improvements

Premises, equipment, and leasehold improvements are stated at cost, less accumulated depreciation and amortization. Depreciation and amortization are computed principally by the straight-line method over the estimated useful lives of the assets, or lease term in the case of leasehold improvements, which range from two to forty years.

Note 1 – Organization and Summary of Significant Accounting Policies (continued)

Other real estate owned

Property and assets acquired through foreclosure or deed in lieu of foreclosure are initially recorded at fair value and are subsequently stated at the lower of the carrying value of the loan or the fair value of the assets received, less estimated costs to sell, at the date the asset is acquired. Adjustments that reduce loan balances to the lower carrying value at the time of foreclosure are recognized as charge-offs in the allowance for loan losses. Subsequent impairment write-downs to net realizable value, if any, or any disposal gains or losses are included in noninterest income or expense. Costs relating to the development and improvement of property are capitalized and holding costs are charged to expense as incurred.

Revenue from contracts with customers

The Bank accounts for revenue arising through contracts with customers under the guidance of the Financial Accounting Standards Board's Accounting Standards Codification Topic 606 ("ASC 606"), which (i) creates a single framework for recognizing revenue from contracts with customers that fall within its scope and (ii) revises when it is appropriate to recognize a gain (loss) from the transfer of nonfinancial assets, such as OREO. To determine revenue recognition for arrangements that an entity determines are within the scope of Topic 606, the Bank performs the following five steps: (i) identify the contract(s) with a customer; (ii) identify the performance obligations in the contract; (iii) determine the transaction price; (iv) allocate the transaction price to the performance obligations in the contract; and (v) recognize revenue when (or as) the Bank satisfies a performance obligation.

The majority of the Bank's revenues come from interest income and other sources, including loans, leases, securities and derivatives, that are outside the scope of ASC 606. The Bank's services that fall within the scope of ASC 606 are presented within Non-Interest Income and are recognized as revenue as the Bank satisfies its obligation to the customer. Services within the scope of ASC 606 include deposit service charges, debit and ATM interchange income, brokerage revenue, merchant fee income, credit card and interchange income, and gain (loss) on other real estate owned, net. Refer to Note 13 – Revenue from Contracts with Customers for further discussion on the Bank's accounting policies for revenue sources within the scope of ASC 606.

Federal Home Loan Bank (FHLB) stock

At December 31, 2020 and 2019, the Bank held FHLB stock with a par value of \$564,300 and \$889,500, respectively. As a member of the FHLB system, the Bank is required to maintain a minimum investment level in FHLB stock based on specific percentages of the Bank's outstanding mortgages, total assets, or FHLB advances. These securities are reported at par value, which represents the Bank's cost.

Stock in the FHLB of Des Moines is classified as restricted stock and is evaluated for impairment based on ultimate recoverability. The determination of whether the investment is impaired is based on the Bank's assessment of the ultimate recoverability of par value rather than by recognizing temporary declines in value. The determination of whether a decline affects the ultimate recoverability is influenced by criteria such as (1) the significance of the decline in the net assets of the FHLB as compared to the capital stock amount for the FHLB and the length of time this situation has persisted, (2) commitments by the FHLB to make payments required by law or regulation and the level of such payments in relation to the operating performance of the FHLB, (3) the impact of the legislative and regulatory changes on institutions and, accordingly, on the customer base of the FHLB, and (4) the liquidity position of the FHLB. Management concluded that the Bank's FHLB stock investment was not impaired as of December 31, 2020.

People's Bank of Commerce

Notes to Financial Statements

Note 1 – Organization and Summary of Significant Accounting Policies (continued)

Investment in real estate joint venture

During 2011, the Bank entered a joint with another investor in a limited liability company formed to manage the construction and ownership of a commercial building that the Bank has utilized for operations. The Bank has accounted for its initial investment at 50% of total costs incurred to construct the new building. Following completion of construction and occupancy of the building, the Bank accounts for its investment in the limited liability company by following the equity method of accounting. Under this accounting treatment, the Bank recognizes its proportionate share of earnings and losses as a component of noninterest expense. During 2020 and 2019, the Bank recognized net income from its investment in the limited liability company of \$148,883 in each year.

Goodwill

Goodwill arises from business combinations and represents the fair value of assets acquired net of liabilities assumed that exceeds the consideration provided at the acquisition date. Goodwill is not amortized, but instead is measured for impairment annually and when impairment is determined to exist, goodwill is written down through a charge to earnings. The Bank performs impairment testing at least annually to determine whether it is more likely than not that the fair value of a reporting unit is less than its carrying amount.

Income taxes

Income taxes are accounted for using an asset and liability approach that requires the recognition of deferred tax assets and liabilities for the expected future tax consequences of temporary differences between the financial statement and tax basis of assets and liabilities at the applicable enacted tax rates. Changes in enacted tax rates result in a revaluation of deferred tax assets and liabilities through the income tax provision in the period that the tax rate changes are enacted. A valuation allowance is provided when it is more likely than not that some portion or all of the deferred tax assets will not be realized. The Bank evaluates the realizability of its deferred tax assets by assessing its valuation allowance and by adjusting the amount of such allowance, if necessary.

The Bank recognizes the tax benefit from uncertain tax positions only if it is more likely than not that the tax positions will be sustained on examination by taxing authorities, based on the technical merits of the position. The tax benefit is measured based on the largest benefit that has a greater than 50% likelihood of being realized upon ultimate settlement. The Bank does not anticipate that any amount of unrecognized tax benefits will significantly increase or decrease in the next 12 months. Additionally, the Bank recognizes interest and penalties related to income tax matters in income tax expense, although there were no interest and penalties recognized for the years ended December 31, 2020 and 2019.

Off-balance sheet financial instruments

The Bank holds no derivative financial instruments. However, in the ordinary course of business, the Bank enters into off-balance sheet financial instruments consisting of commitments to extend credit and standby letters of credit. These financial instruments are recorded in the financial statements when they are funded or related fees are incurred or received.

Note 1 – Organization and Summary of Significant Accounting Policies (continued)

The Bank evaluates its exposure to off-balance sheet credit losses periodically for unfunded loan commitments and loans sold in the secondary market. The allowance for off-balance sheet credit losses is increased through charges to noninterest expense and is decreased by charge-offs or transfers to the allowance for loan losses at the time that the related loan is funded or the off-balance sheet credit exposure becomes probable and estimable. Management periodically evaluates the adequacy of this allowance based on the Bank's off-balance sheet credit loss experience, known and inherent risks in the portfolio, adverse situations which may increase the likelihood of loss, and current economic conditions. This reserve for unfunded loan commitments is included in the balance sheets under the caption "accrued interest payable and other liabilities."

Asset-based financing income

Asset-based financing income on factored accounts receivable includes service fees and finance income. Service fee income from freight bills and other factored receivables purchased is calculated as a percentage of receivables purchased from clients plus a variable or fixed charge per bill. Finance income from factored receivables is recognized as income over the period the related factored receivables are outstanding. Fees charged vary among clients and are based upon a credit evaluation and expected profit contribution to Steelhead from each client.

Service charges on other deposit accounts

The performance obligation is satisfied and the fees are recognized on a monthly basis as the service period is completed. Transaction-based fees on deposit accounts are charged to deposit customers for specific services provided to the customer, such as non-sufficient funds fees, overdraft fees, and wire fees. The performance obligation is completed as the transaction occurs and the fees are recognized at the time each specific service is provided to the customer.

Advertising and promotional expenses

Advertising and promotional costs are charged to expense during the period in which they are incurred.

Earnings per share

Basic earnings per share is computed by dividing net income available to stockholders by the weighted average number of common shares outstanding during the period, after giving retroactive effect to stock dividends and splits. Outstanding shares includes shares issued to the Employee Stock Ownership Plan and granted restricted stock units. Diluted earnings per share is computed similar to basic earnings per share except that the denominator is increased to include dilutive common equivalent shares for stock options assumed to be outstanding during the period utilizing the treasury-stock method.

Stock compensation plans

The Bank has adopted stock-based compensation plans, and recognizes compensation expense based on the fair value of options or restricted stock awards on the date of grant. Share-based awards that do not require future service (i.e., fully vested awards at grant date) are expensed immediately. Share-based employee awards that require future service are amortized over the relevant service period. The phantom stock plans are settled in cash, based on the stock price on the vesting date, as they vest annually. The Bank recognizes share-based compensation expense on a straight-line basis.

People's Bank of Commerce

Notes to Financial Statements

Note 1 – Organization and Summary of Significant Accounting Policies (continued)

Employee Stock Ownership Plan (ESOP)

Unallocated shares issued to the ESOP for eventual allocation to the Plan's participants serve as collateral for outstanding debt associated with the ESOP's purchase of such shares from the Bank. Unallocated shares are accounted for as a reduction in the value of outstanding common stock until such shares are legally released by the lender as collateral on the loan. Generally, this occurs as the loan is repaid. The Bank guarantees an outside loan carried by the ESOP and has recorded the loan within Borrowings on its balance sheet. As shares are released to be allocated to participants, the Bank recognizes compensation expense equal to the fair value of the shares when released.

Leases

Right-of-use (ROU) assets represent the right to use an underlying asset for the lease term and lease liabilities represent the obligation to make lease payments arising from the lease. ROU assets and lease liabilities are recognized at the lease commencement date based on the estimated present value of lease payments over the lease term. The Bank uses an incremental borrowing rate at lease commencement to calculate the present value of lease payments when the rate implicit in a lease is not known. The Bank's borrowing rate is based on the FHLB amortizing advance rate, adjusted for the lease term and other factors.

The lease agreements relate to real estate and generally provide that the Bank pay taxes, insurance, maintenance and certain other operating expenses applicable to the leased premises. Variable lease components and nonlease components are not included in the Bank's computation of the ROU asset or lease liability. The Bank also does not include short-term leases in the computation of the ROU asset or lease liability. Short-term leases are leases with a term at commencement of 12 months or less. Short-term lease expense is recorded on a straight-line basis over the term of the lease. Lease agreements do not contain any residual value guarantees or restrictive covenants.

Certain leases have renewal options at the expiration of the lease terms. Option periods are included in the computation of the lease term for ROU assets or lease liabilities if the Bank's current intent is to utilize the locations through those periods.

Note 1 – Organization and Summary of Significant Accounting Policies (continued)

Fair value measurements

Fair value is defined as the price that would be received to sell an asset, or paid to transfer a liability, in an orderly transaction between market participants at the measurement date. The Bank determines fair value based upon quoted prices when available or through the use of alternative approaches, such as matrix or model pricing, when market quotes are not readily accessible or available. The valuation techniques used are based on observable and unobservable inputs. Observable inputs reflect market data obtained from independent sources, while unobservable inputs reflect the Bank's market assumptions. These two types of inputs create the following fair value hierarchy:

Level 1 – Quoted prices in active markets for identical assets or liabilities.

Level 2 – Quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active, and model-derived valuations whose inputs are observable or whose significant value drivers are observable.

Level 3 – Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the asset or liability. Unobservable inputs are used to measure fair value to the extent that observable inputs are not available. The Bank's own data used to develop unobservable inputs shall be adjusted for market consideration when reasonably available.

The Bank used the following methods and significant assumptions to estimate fair value for its assets measured and carried at fair value on a recurring or nonrecurring basis in the accompanying financial statements:

Investment securities available-for-sale – Investment securities available-for-sale are measured and carried at fair value on a recurring basis. For these securities, the Bank obtains fair value measurements from an independent pricing service. The fair value measurements consider observable data that may include dealer quotes, market spreads, cash flows, the U.S. Treasury yield curve, live trading levels, trade execution data, market consensus prepayment speeds, credit information, and the bond's terms and conditions, among other things (Level 1). When market quotes are not readily accessible or available, alternative approaches are utilized, such as matrix or model pricing (Level 2).

People's Bank of Commerce

Notes to Financial Statements

Note 1 – Organization and Summary of Significant Accounting Policies (continued)

Impaired loans – Impaired loans are measured and adjusted to fair value on a nonrecurring basis. Impaired loans are measured for impairment at the present value of expected future cash flows discounted at the loan's effective interest rate (Level 3), the loan's market price (Level 2), or the fair value of the collateral based on independent appraisals, less costs to sell, if the loan is collateral dependent (Level 3).

Other real estate owned – Other real estate owned is measured and adjusted to fair value on a nonrecurring basis. On the date that other real estate owned is received in satisfaction of a loan receivable, it is measured at fair value, less cost to sell, based on recent independent appraisals (Level 3). Subsequent to the acquisition date, it is measured for impairment and written down to its fair value, less costs to sell, based on updated independent appraisals (Level 3).

The Bank assumes interest rate risk (the risk that general interest rate levels will change) as a result of its normal operations. Consequently, the fair value of the Bank's financial instruments will change when interest rate levels change, and that change may be either favorable or unfavorable to the Bank. Management attempts to match maturities of assets and liabilities to the extent believed necessary to minimize interest rate risk. However, borrowers with fixed-rate obligations are less likely to prepay in a rising rate environment and more likely to prepay in a falling rate environment. Conversely, depositors who are receiving fixed rates are more likely to withdraw funds before maturity in a rising rate environment and less likely to do so in a falling rate environment. Management monitors rates and maturities of assets and liabilities, and attempts to minimize interest rate risk by adjusting terms of new loans and deposits and by investing in securities with terms that mitigate the Bank's overall interest rate risk.

Reclassifications

Certain reclassifications have been made to the prior year financial statements to conform to the current year presentation. These reclassifications have no effect on previously reported net income, earnings per share, or retained earnings.

Note 1 – Organization and Summary of Significant Accounting Policies (continued)

Subsequent events

Subsequent events are events or transactions that occur after the balance sheet date but before financial statements are issued. The Bank recognizes in the financial statements the effects of all subsequent events that provide additional evidence about conditions that existed at the date of the balance sheet, including the estimates inherent in the process of preparing the financial statements. The Bank's financial statements do not recognize subsequent events that provide evidence about conditions that did not exist at the date of the balance sheet but arose after the balance sheet date and before financial statements are available to be issued. The Bank has evaluated subsequent events through March 15, 2021, which is the date the financial statements became available to be issued.

People's Bank of Commerce

Notes to Financial Statements

Note 2 – Investment Securities

Investment securities consist of the following as of December 31, 2020 and 2019:

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
December 31, 2020				
Investment securities available-for-sale				
U.S. government agency obligations	\$ 1,000,000	\$ 788	\$ -	\$ 1,000,788
SBA backed securities	174,875	1,349	(317)	175,907
Residential mortgage backed securities	14,372,345	332,181	(8,340)	14,696,186
Municipal securities	9,483,525	537,341	-	10,020,866
Total investment securities:	<u>\$ 25,030,745</u>	<u>\$ 871,659</u>	<u>\$ (8,657)</u>	<u>\$ 25,893,747</u>
December 31, 2019				
Investment securities available-for-sale				
U.S. government agency obligations	\$ 999,908	\$ 922	\$ -	\$ 1,000,830
SBA backed securities	464,913	4,178	(746)	468,345
Residential mortgage backed securities	14,863,341	70,966	(47,501)	14,886,806
Municipal securities	11,143,654	257,820	(23,029)	11,378,445
Total investment securities:	<u>\$ 27,471,816</u>	<u>\$ 333,886</u>	<u>\$ (71,276)</u>	<u>\$ 27,734,426</u>

People's Bank of Commerce

Notes to Financial Statements

Note 2 – Investment Securities (continued)

At December 31, 2020, the Bank had three available-for-sale investment securities in a loss position for less than 12 months, and three available-for-sale investment securities in a loss position for greater than 12 months as shown in the following table.

	December 31, 2020					
	Less Than 12 Months		12 Months or Greater		Totals	
	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses
Investment securities available-for-sale						
U.S. government agency obligations	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
SBA backed securities	-	-	60,700	(317)	60,700	(317)
Residential mortgage backed securities	3,141,342	(8,340)	-	-	3,141,342	(8,340)
Municipal securities	-	-	-	-	-	-
	<u>\$ 3,141,342</u>	<u>\$ (8,340)</u>	<u>\$ 60,700</u>	<u>\$ (317)</u>	<u>\$ 3,202,042</u>	<u>\$ (8,657)</u>

At December 31, 2019, the Bank had 18 available-for-sale investment securities in a loss position for less than 12 months, and three available-for-sale investment securities in a loss position for greater than 12 months as shown in the following table.

	December 31, 2019					
	Less Than 12 Months		12 Months or Greater		Totals	
	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses
Investment securities available-for-sale						
U.S. government agency obligations	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
SBA backed securities	172,939	(743)	469	(3)	173,408	(746)
Residential mortgage backed securities	9,934,858	(41,669)	979,028	(5,832)	10,913,886	(47,501)
Municipal securities	879,890	(23,029)	-	-	879,890	(23,029)
	<u>\$ 10,987,687</u>	<u>\$ (65,441)</u>	<u>\$ 979,497</u>	<u>\$ (5,835)</u>	<u>\$ 11,967,184</u>	<u>\$ (71,276)</u>

Management believes that unrealized losses are solely the result of changes in interest rates since the securities have been purchased and that no other-than-temporary impairment exists.

In 2020, the Bank received proceeds of \$3,963,218 on the sale of available-for-sale securities, resulting in gross realized gains of \$36,957. In 2019, the bank received proceeds of \$5,693,438 on the sale of available-for-sale securities, resulting in gross realized gains of \$624. At December 31, 2020 and 2019, securities in the amount of \$4,291,986 and \$4,982,443, respectively, were pledged to secure public deposit.

People's Bank of Commerce

Notes to Financial Statements

Note 3 – Investment Securities (continued)

The amortized cost and estimated fair value of investment securities by contractual maturity at December 31, 2020 are as follows:

	Available-for-Sale	
	Amortized Cost	Estimated Fair Value
Due within one year	\$ -	\$ -
Due from one year through five years	1,593,345	1,615,002
Due from five years through ten years	1,633,892	1,720,422
Due after ten years	7,431,163	7,862,137
Residential mortgage backed securities	14,372,345	14,696,186
	<u>\$ 25,030,745</u>	<u>\$ 25,893,747</u>

Residential mortgage backed securities are able to be prepaid and the Bank is unable to estimate the maturities per year. As a result, they have been shown separately within the maturity table above.

Note 4 – Loans, Net of Allowance for Loan Losses, and Unearned Income

The composition of loan balances is summarized as follows as of December 31:

	2020	2019
Real estate loans	\$ 217,281,259	\$ 221,166,096
Commercial loans	108,980,176	37,520,502
Construction loans	18,044,495	15,742,667
Consumer loans	4,453,662	4,312,569
Total loans	348,759,592	278,741,834
Allowance for loan losses	(4,453,266)	(3,118,541)
Unearned income, net of deferred costs	(2,561,642)	(465,119)
Loans, net of allowance for loan losses, and unearned income	<u>\$ 341,744,684</u>	<u>\$ 275,158,174</u>

Note 4 – Loans, Net of Allowance for Loan Losses, and Unearned Income (continued)

Cares Act Program

Pursuant to the CARES Act passed in March 2020, the Company funded over 1,050 loans to eligible small businesses and non-profit organizations who participated in the Paycheck Protection Program ("PPP") administered by the U.S. Small Business Administration ("SBA"). PPP loans have terms of two to five years and earn interest at 1%. In addition, the Bank received a fee of 1%-5% from the SBA depending on the loan amount, which was netted with loan origination costs and amortized into interest income under the effective yield method over the contractual life of the loan. The recognition of fees and costs is accelerated when the loan is forgiven by the SBA and/or paid off prior to maturity. PPP loans are fully guaranteed by the SBA and are expected to be forgiven by the SBA if they meet the requirements of the program. The balance of PPP loans at December 31, 2020 was \$79.3 million. The Company has classified the PPP loans within the commercial grouping. The Company ended its origination of new PPP loans on August 14, 2020. On June 5, 2020, the PPP Flexibility Act was signed into law that modified, among other things, rules governing the PPP payment deferral period. In October 2020, due to updated guidance from the SBA that PPP loan payments were to be deferred until SBA had remitted forgiveness funds to the lender if the Borrower applied for forgiveness within ten months after the end of their covered period, the Bank modified the first payment due dates for PPP loans that originated prior to June 5, 2020 and extended the payment deferral period from six to sixteen months. The extended payment deferral period will affect the timing over which the accretion of PPP net loan origination fees are recognized.

People's Bank of Commerce

Notes to Financial Statements

Note 4 – Loans, Net of Allowance for Loan Losses, and Unearned Income (continued)

The following table displays the activity and allocation of the allowance for loan losses to significant segments of the loan portfolio at December 31:

	2020					Total
	Real Estate	Commercial	Construction	Consumer	Unallocated	
Allowance for loan losses						
Beginning balance	\$ 1,847,782	\$ 714,601	\$ 53,670	\$ 53,792	\$ 448,696	\$ 3,118,541
Charge-offs	-	-	-	(395)	-	(395)
Recoveries	2,250	-	-	394	-	2,644
Provision for loan losses	1,360,435	(119,760)	53,388	987	37,426	1,332,476
Ending balance	<u>\$ 3,210,467</u>	<u>\$ 594,841</u>	<u>\$ 107,058</u>	<u>\$ 54,778</u>	<u>\$ 486,122</u>	<u>\$ 4,453,266</u>
Ending balance						
Loans individually evaluated for impairment	<u>\$ -</u>	<u>\$ 23,655</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 23,655</u>
Ending balance						
Loans collectively evaluated for impairment	<u>\$ 3,210,467</u>	<u>\$ 571,186</u>	<u>\$ 107,058</u>	<u>\$ 54,778</u>	<u>\$ 486,122</u>	<u>\$ 4,429,611</u>
2019						
	Real Estate	Commercial	Construction	Consumer	Unallocated	Total
Allowance for loan losses						
Beginning balance	\$ 1,799,099	\$ 358,166	\$ 49,052	\$ 45,928	\$ 559,685	\$ 2,811,930
Charge-offs	-	-	-	-	-	-
Recoveries	11,148	-	-	-	-	11,148
Provision for loan losses	37,535	356,435	4,618	7,864	(110,989)	295,463
Ending balance	<u>\$ 1,847,782</u>	<u>\$ 714,601</u>	<u>\$ 53,670</u>	<u>\$ 53,792</u>	<u>\$ 448,696</u>	<u>\$ 3,118,541</u>
Ending balance						
Loans individually evaluated for impairment	<u>\$ 126,203</u>	<u>\$ 333,182</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 459,385</u>
Ending balance						
Loans collectively evaluated for impairment	<u>\$ 1,721,579</u>	<u>\$ 381,419</u>	<u>\$ 53,670</u>	<u>\$ 53,792</u>	<u>\$ 448,696</u>	<u>\$ 2,659,156</u>

People's Bank of Commerce

Notes to Financial Statements

Note 4 – Loans, Net of Allowance for Loan Losses, and Unearned Income (continued)

The following table displays the activity and allocation of loans evaluated individually and collectively for impairment to significant segments of the loan portfolio at December 31:

		2020				
		Real Estate	Commercial	Construction	Consumer	Total
Loans						
Ending balance		<u>\$ 217,281,259</u>	<u>\$ 108,980,176</u>	<u>\$ 18,044,495</u>	<u>\$ 4,453,662</u>	<u>\$ 348,759,592</u>
Ending balance						
Loans individually						
evaluated for						
impairment		<u>\$ 42,856</u>	<u>\$ 59,077</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 101,933</u>
Ending balance						
Loans collectively						
evaluated for						
impairment		<u>\$ 217,238,403</u>	<u>\$ 108,921,099</u>	<u>\$ 18,044,495</u>	<u>\$ 4,453,662</u>	<u>\$ 348,657,659</u>
		2019				
		Real Estate	Commercial	Construction	Consumer	Total
Loans						
Ending balance		<u>\$ 221,166,096</u>	<u>\$ 37,520,502</u>	<u>\$ 15,742,667</u>	<u>\$ 4,312,569</u>	<u>\$ 278,741,834</u>
Ending balance						
Loans individually						
evaluated for						
impairment		<u>\$ 1,041,126</u>	<u>\$ 886,073</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 1,927,199</u>
Ending balance						
Loans collectively						
evaluated for						
impairment		<u>\$ 220,124,970</u>	<u>\$ 36,634,429</u>	<u>\$ 15,742,667</u>	<u>\$ 4,312,569</u>	<u>\$ 276,814,635</u>

The Bank's risk rating methodology assigns risk ratings ranging from 1 to 10, where a higher rating represents higher risk. Assignment of a risk rating is done on the individual loan rather than at the borrower level. Loans are graded from inception and on a continuing basis until the debt is repaid. The risk rating categories can be generally described by the following groupings:

Pass (1-6) – An acceptable asset carrying a normal degree of credit risk exhibiting the capacity to perform according to the repayment terms.

Special Mention (7) – A special mention asset has potential weaknesses that deserve management's close attention. If left uncorrected, these potential weaknesses may result in a deterioration of the repayment prospects for the asset or in the Bank's credit position at some future date. Special mention assets are not adversely classified and do not expose an institution to sufficient risk to warrant adverse classification.

People's Bank of Commerce

Notes to Financial Statements

Note 4 – Loans, Net of Allowance for Loan Losses, and Unearned Income (continued)

Substandard (8) – A substandard asset is inadequately protected by the current sound worth and paying capacity of the obligor or of the collateral pledged. Assets so classified must have a well-defined weakness or weaknesses that jeopardize the liquidation of the debt.

Doubtful (9) – Any asset classified doubtful has all the weaknesses inherent in one classified substandard with the added characteristic that the weaknesses make collection or liquidation in full, on the basis of currently existing facts, conditions, and value, highly questionable and improbable.

Loss (10) – Assets classified loss are considered uncollectible and of such minimal value that the continuance as bankable assets are not warranted. This classification does not mean that the asset has absolutely no recovery or salvage value but that it is not practical or desirable to defer writing off this basically worthless asset even though a partial recovery may occur in the future.

The following table represents loan portfolio information by loan type and credit grade as of December 31:

		2020				
		Real Estate	Commercial	Construction	Consumer	Total
Grade						
Pass		\$ 215,107,362	\$ 108,700,146	\$ 18,044,495	\$ 4,453,662	\$ 346,305,665
Special Mention		932,389	-	-	-	932,389
Substandard		1,241,508	280,030	-	-	1,521,538
Doubtful		-	-	-	-	-
Loss		-	-	-	-	-
Total		<u>\$ 217,281,259</u>	<u>\$ 108,980,176</u>	<u>\$ 18,044,495</u>	<u>\$ 4,453,662</u>	<u>\$ 348,759,592</u>
		2019				
		Real Estate	Commercial	Construction	Consumer	Total
Grade						
Pass		\$ 217,631,710	\$ 36,226,250	\$ 15,742,667	\$ 4,312,569	\$ 273,913,196
Special Mention		1,669,785	154,110	-	-	1,823,895
Substandard		1,864,601	1,140,142	-	-	3,004,743
Doubtful		-	-	-	-	-
Loss		-	-	-	-	-
Total		<u>\$ 221,166,096</u>	<u>\$ 37,520,502</u>	<u>\$ 15,742,667</u>	<u>\$ 4,312,569</u>	<u>\$ 278,741,834</u>

People's Bank of Commerce
Notes to Financial Statements

Note 4 – Loans, Net of Allowance for Loan Losses, and Unearned Income (continued)

Past due loans are loans for which principal and interest were not paid timely according to the contractual payment terms. The following table represents loans past due by loan category as of December 31:

2020					
	30 – 59 Days Past Due	60 – 89 Days Past Due	Greater than 90 Days Past Due	Total Past Due	Total Loans
Real estate	\$ -	\$ -	\$ -	\$ -	\$ 217,281,259
Commercial	187,661	-	-	187,661	108,792,515
Construction	-	-	-	-	18,044,495
Consumer	-	3,724	-	3,724	4,449,938
	<u>\$ 187,661</u>	<u>\$ 3,724</u>	<u>\$ -</u>	<u>\$ 191,385</u>	<u>\$ 348,568,207</u>
2019					
	30 – 59 Days Past Due	60 – 89 Days Past Due	Greater than 90 Days Past Due	Total Past Due	Total Loans
Real estate	\$ -	\$ 150,243	\$ -	\$ 150,243	\$ 221,015,853
Commercial	-	-	655,598	655,598	36,864,904
Construction	-	-	-	-	15,742,667
Consumer	-	369	-	369	4,312,200
	<u>\$ -</u>	<u>\$ 150,612</u>	<u>\$ 655,598</u>	<u>\$ 806,210</u>	<u>\$ 277,935,624</u>

As of December 31, 2020, there were no non-accrual loans. As of December 31, 2019, two loans were non-accrual status totaling \$655,559.

People's Bank of Commerce

Notes to Financial Statements

Note 4 – Loans, Net of Allowance for Loan Losses, and Unearned Income (continued)

The following table represents a comparison of impaired loans with and without specific allowance recorded for the period ended December 31:

		2020				
		Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized
With no related allowance recorded						
Real estate	\$ 42,856	\$ 42,856	\$ -	\$ 58,324	\$ 8,969	
Commercial	-	-	-	-	-	
		<u>\$ 42,856</u>	<u>\$ 42,856</u>	<u>\$ -</u>	<u>\$ 58,324</u>	<u>\$ 8,969</u>
With allowance recorded						
Real estate	\$ -	\$ -	\$ -	\$ -	\$ -	
Commercial	59,077	59,077	23,655	77,294	4,287	
		<u>\$ 59,077</u>	<u>\$ 59,077</u>	<u>\$ 23,655</u>	<u>\$ 77,294</u>	<u>\$ 4,287</u>
Total						
Real estate	\$ 42,856	\$ 42,856	\$ -	\$ 58,324	\$ 8,969	
Commercial	59,077	59,077	23,655	77,294	4,287	
		<u>\$ 101,933</u>	<u>\$ 101,933</u>	<u>\$ 23,655</u>	<u>\$ 135,618</u>	<u>\$ 13,256</u>
		2019				
		Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized
With no related allowance recorded						
Real estate	\$ 73,792	\$ 73,792	\$ -	\$ 87,332	\$ 9,713	
Commercial	9,528	9,528	-	16,327	792	
		<u>\$ 83,320</u>	<u>\$ 83,320</u>	<u>\$ -</u>	<u>\$ 103,659</u>	<u>\$ 10,505</u>
With allowance recorded						
Real estate	\$ 967,334	\$ 967,334	\$ 126,203	\$ 980,481	\$ 63,923	
Commercial	876,545	876,545	333,182	896,976	45,331	
		<u>\$ 1,843,879</u>	<u>\$ 1,843,879</u>	<u>\$ 459,385</u>	<u>\$ 1,877,457</u>	<u>\$ 109,254</u>
Total						
Real estate	\$ 1,041,126	\$ 1,041,126	\$ 126,203	\$ 1,067,813	\$ 73,636	
Commercial	886,073	886,073	333,182	913,303	46,123	
		<u>\$ 1,927,199</u>	<u>\$ 1,927,199</u>	<u>\$ 459,385</u>	<u>\$ 1,981,116</u>	<u>\$ 119,759</u>

Note 4 – Loans, Net of Allowance for Loan Losses, and Unearned Income (continued)

Troubled debt restructurings

At December 31, 2020 and 2019, impaired loans of \$42,856 and \$1,818,354, respectively, were classified as troubled debt restructured loans. The restructurings were granted in response to borrower financial difficulty, and generally provide for a temporary modification of loan repayment terms.

The types of modifications offered can generally be described in the following categories:

Rate modification – A modification in which the interest rate is modified.

Term modification – A modification in which the maturity date, timing of payments, or frequency of payments is changed.

Payment modification – A modification in which the payment amount is changed.

Combination modification – Any other type of modification, including the use of multiple types of modifications.

There were no newly restructured loans that occurred during the years ended December 31, 2020 and 2019. During 2020 and 2019, there were no troubled debt restructures that subsequently defaulted within twelve months of restructuring.

Section 4013 of the CARES Act and Section 541 of the Coronavirus Response and Relief Supplemental Appropriations Act of 2021 (the "Coronavirus Relief Act") passed in January 2021 provided optional, temporary relief from evaluating loans that may have been considered TDRs under GAAP. This relief applies to loan modifications executed between March 1, 2020 and the earlier of 60 days after the national emergency related to the Pandemic is terminated, or January 1, 2022. The Company elected to apply these temporary accounting provisions to payment relief loans beginning in March 2020. As of December 31, 2020, three loans totaling \$1.1 million were modified as CARES Act deferrals and not subject to TDR accounting and reporting. During 2020, 111 loans totaling \$48.1 million had been in a CARES Act deferment at some point during 2020 but were not in such deferment as of December 31, 2020.

People's Bank of Commerce

Notes to Financial Statements

Note 5 – Premises, Equipment, and Leasehold Improvements

The composition of premises, equipment, and leasehold improvements is summarized as follows as of December 31:

	2020	2019
Land	\$ 3,122,124	\$ 3,152,124
Bank premises	13,660,762	13,660,762
Furniture and equipment	3,990,194	3,526,117
Leasehold improvements	103,087	103,087
Automobiles and agreements	131,572	60,744
	<u>21,007,739</u>	<u>20,502,834</u>
Less accumulated depreciation and amortization	(5,280,519)	(4,391,406)
Construction in progress (CIP)	<u>2,069,302</u>	<u>-</u>
Premises, equipment, and leasehold improvements, net of accumulated depreciation and amortization	<u><u>\$ 17,796,522</u></u>	<u><u>\$ 16,111,428</u></u>

Depreciation and amortization expense for the years ended December 31, 2020 and 2019 was \$952,154 and \$983,588, respectively.

People's Bank of Commerce

Notes to Financial Statements

Note 6 – Time Deposits

Time certificates of deposit of \$250,000 and over totaled \$3,418,260 and \$3,131,614 at December 31, 2020 and 2019, respectively.

As of December 31, 2020, the scheduled maturities for all time deposits are as follows:

Years ending December 31,	2021	\$ 11,362,191
	2022	9,451,294
	2023	979,190
	2024	340,021
	2025	182,935
	Thereafter	<u>49,942</u>
		<u>\$ 22,365,573</u>

Note 7 – Borrowings

Federal Home Loan Bank advances

As a member of the Federal Home Loan Bank of Des Moines (FHLB), the Bank has entered into an "Advances, Security, and Deposit Agreement" with the FHLB.

Borrowings under the credit arrangement are collateralized by the Bank's FHLB stock as well as deposits or other instruments, which may be pledged. As of December 31, 2020 the Bank had \$3,000,000 outstanding borrowing with the FHLB. As of December 31, 2019 the Bank had \$11,750,000 outstanding borrowing with the FHLB. As of December 31, 2020 and 2019, the Bank had \$11,283,677 and \$13,920,529 in available borrowing capacity with FHLB.

Federal funds line of credit

The Bank has obtained lines of credit totaling \$20,000,000 with two correspondent banks. One Federal Funds line for \$10,000,000 will expire or renew at the discretion of the correspondent bank. A second line for \$10,000,000 was established with a term extending from June 30, 2020 through June 30, 2021. There were no balances outstanding on these lines of credit as of December 31, 2020.

Leveraged ESOP loan

During 2017, the Bank established a leveraged employee stock ownership plan (the Plan) and the Plan purchased 75,000 shares of the Bank's common stock with proceeds received from a related party loan in the amount of \$784,500. The loan requires monthly interest and principal payments, carries an annual interest rate of 5.5%, matures September 1, 2022, is secured by unallocated ESOP shares, and may be prepaid at any time. The outstanding balance of this loan was \$211,815 at December 31, 2019. During January 2020, this loan was paid off.

People's Bank of Commerce

Notes to Financial Statements

Note 8 – Income Taxes

The provision for income taxes consists of the following as of December 31:

	2020	2019
Current income taxes		
Federal	\$ 1,950,483	\$ 988,352
State	756,287	446,806
Total current income taxes	<u>2,706,770</u>	<u>1,435,158</u>
Deferred income taxes		
Federal	(585,714)	(13,726)
State	<u>(184,286)</u>	<u>13,727</u>
Total deferred income taxes	<u>(770,000)</u>	<u>1</u>
Provision for income taxes	<u><u>\$ 1,936,770</u></u>	<u><u>\$ 1,435,159</u></u>

The following summarizes the differences between the provision for income taxes for financial statement purposes and the federal statutory rate of 21.0% for the years ended December 31, 2020 and 2019:

	2020		2019	
Federal, at statutory rate	\$ 1,694,229	21.0%	\$ 1,155,759	21.0%
State, net of federal benefit	484,388	6.0%	330,437	6.0%
Tax-exempt interest, net of expenses	(52,331)	-0.7%	(55,784)	-1.0%
Bank-owned life insurance	(42,556)	-0.5%	(52,037)	-0.9%
Other	<u>(146,960)</u>	<u>-1.8%</u>	<u>56,784</u>	<u>1.0%</u>
Tax expense, at effective rate	<u><u>\$ 1,936,770</u></u>	<u><u>24.0%</u></u>	<u><u>\$ 1,435,159</u></u>	<u><u>26.1%</u></u>

People's Bank of Commerce
Notes to Financial Statements

Note 8 – Income Taxes (continued)

Net deferred tax assets, in the accompanying balance sheets, include the following components as of December 31:

	<u>2020</u>	<u>2019</u>
Deferred tax assets (liabilities)		
Lease liability	\$ 1,059,759	\$ 1,145,411
Allowance for loan losses	1,097,271	737,450
Supplemental executive retirement plan	663,710	591,350
Accrued bonuses	172,544	46,184
Split-dollar liability	47,961	44,108
Reserve for off-balance sheet instruments	44,829	18,970
Other	-	468
	<u>3,086,074</u>	<u>2,583,941</u>
Right-of-use asset	(1,033,438)	(1,132,582)
Depreciation and organization costs	(465,730)	(444,720)
Prepays	(160,014)	(112,078)
Unrealized gain on investment securities available-for-sale	(165,299)	(39,216)
Loan origination costs	(31,315)	(33,333)
Intangible assets – permits and licenses	(40,506)	(38,706)
Other	(94,880)	(316,399)
	<u>(1,991,182)</u>	<u>(2,117,034)</u>
Net deferred tax assets	<u>\$ 1,094,892</u>	<u>\$ 466,907</u>

A valuation allowance has not been recognized as an offset to the net deferred tax assets since management believes it is more likely than not that all deferred tax assets will be utilized in future periods.

People's Bank of Commerce

Notes to Financial Statements

Note 9 – Financial Instruments with Off-Balance Sheet Risk

In the normal course of business to meet the financing needs of its customers, the Bank is a party to financial instruments with off-balance sheet risk. These financial instruments include commitments to extend credit and the issuance of letters of credit. These instruments involve, to varying degrees, elements of credit and interest-rate risk in excess of the amount recognized in the balance sheets. The contractual amounts of those instruments reflect the extent of involvement the Bank has in particular classes of financial instruments.

The Bank's exposure to credit loss in the event of nonperformance by the other party to the financial instruments for commitments to extend credit and letters of credit written is represented by the contractual amount of those instruments. The Bank uses the same credit policies in making commitments and conditional obligations as it does for on-balance sheet instruments.

Commitments to extend credit are agreements to lend to customers as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Since many of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. The amount of collateral obtained, if deemed necessary by the Bank upon extension of credit, is based on management's credit evaluation of the counter party. Collateral held varies but may include accounts receivable, inventory, property and equipment, and income-producing properties.

Letters of credit written are conditional commitments issued by the Bank to guarantee the performance of a customer to a third party. Those guarantees are primarily issued to support bonding requirements for real estate developers and contractors. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loan facilities to customers. The Bank holds cash, marketable securities, or real estate as collateral supporting those commitments for which collateral is deemed necessary.

A summary of the notional amounts of the Bank's financial instruments with off-balance sheet risk as of December 31, 2020, is as follows:

Commitments to extend credit	
Commercial	\$ 19,120,539
Construction	10,863,877
Residential	7,732,856
Consumer	<u>30,805,673</u>
Total	<u>\$ 68,522,945</u>
Commercial and standby letters of credit	<u>\$ 1,924,246</u>

Note 10 – Concentrations of Credit Risk

All of the Bank's loans, commitments, and commercial and standby letters of credit have been granted to customers in the Bank's market area. The majority of such customers are also depositors of the Bank. Concentrations of credit by type of loan are set forth in Note 4.

During 2020, the Bank's loan policy did not allow the extension of credit to any single borrower or group of related borrowers in excess of \$1,000,000 on an unsecured basis and \$2,000,000 on a secured basis, without approval from the Loan Committee.

Note 11 – Commitments and Contingencies

The Bank may become a defendant in certain claims and legal actions arising in the ordinary course of business. As of December 31, 2020, the Bank was not involved in any current matters expected to have a material adverse effect on its financial condition or results of operations.

Note 12 – Leases

The outstanding leases have expirations continuing through 2036. Future minimum payments, including assumed extensions, under these lease agreements are as follows:

Years ending December 31,	2021	\$ 302,707
	2022	323,633
	2023	207,697
	2024	211,851
	2025	216,088
	Thereafter	<u>4,223,020</u>
	Total	5,484,996
	Less present value discount	<u>(1,560,551)</u>
	Present value of leases	<u>\$ 3,924,445</u>

The weighted average remaining lease term and discount rate as of December 31, 2020 were 14.61 years, and 3.08%, respectively. There were no new right-of-use assets obtained in exchange for new operating lease liabilities during the year ended December 31, 2020.

Rent expense, including common area maintenance, was \$449,486 and \$486,110 for the years ended December 31, 2020 and 2019, respectively. As discussed in Note 1, the Bank pays rent to a related party as part of a real estate joint venture. Rent paid to the related party was \$279,579 and \$274,096 for the year ends December 31, 2020 and 2019.

People's Bank of Commerce

Notes to Financial Statements

Note 13 – Revenue from Contracts with Customers

All of the Company's revenue from contracts with customers in the scope of ASC 606 is recognized in Noninterest Income. Gains/losses on the sale of other real estate owned are included in noninterest expense and are generally recognized when the performance obligation is complete. This is typically at delivery of control over the property to the buyer at time of each real estate closing.

The following table presents the Company's sources of noninterest income for the twelve months ended December 31:

	2020	2019
Noninterest income:		
Service charges and other fees		
Service charges on deposit accounts	\$ 365,850	\$ 642,019
Interchange fee income	501,675	409,614
Other processing fees	562,452	842,533
Merchant fee income	80,764	4,395
Gain on sale of loans (1)	3,916,181	958,690
Mortgage loan fees (1)	389,372	123,195
Net gain on sale of investment securities (1)	36,957	624
Other noninterest income		
Investment income from real estate joint venture (1)	148,883	148,883
Increase in cash surrender value of life insurance (1)	157,593	192,701
Remaining other income	138,588	61,676
Total noninterest income	<u>\$ 6,298,315</u>	<u>\$ 3,384,330</u>

(1) Not within the scope of ASC 606

Service charges on deposit accounts – The Company earns fees from its deposit customers for account maintenance, transaction-based activity and overdraft services. Account maintenance fees consist primarily of account fees and analyzed account fees charged on deposit accounts on a monthly basis.

Interchange fee income – Debit and ATM interchange income represent fees earned when a debit card issued by the Company is used. The Company earns interchange fees from debit cardholder transactions through the Mastercard payment network. Interchange fees from cardholder transactions represent a percentage of the underlying transaction value and are recognized daily, concurrently with the transaction processing services provided to the cardholder. The performance obligation is satisfied and the fees are earned when the cost of the transaction is charged to the cardholders' debit card. Certain expenses directly associated with the credit and debit card are recorded on a net basis with the interchange income.

Note 13 – Revenue from Contracts with Customers (continued)

Merchant fee income – Merchant fee income represents fees earned by the Company for card payment services provided to its merchant customers. The Company has a contract with a third party to provide card payment services to merchants that contract for those services. The third party provider passes the payments made by the merchants through to the Company. The Company, in turn, pays the third party provider for the services it provides to the merchants. These payments to the third party provider are recorded as expenses as a net reduction against fee income. In addition, a portion of the payment received represents interchange fees which are passed through to the card issuing bank. Income is primarily earned based on the dollar volume and number of transactions processed. The performance obligation is satisfied and the related fee is earned when each payment is accepted by the processing network.

Net gain on sale of other real estate owned – The Company records a gain or loss from the sale of other real estate owned when control of the property transfers to the buyer, which generally occurs at the time of an executed deed of trust. When the Company finances the sale of other real estate owned to the buyer, the Company assesses whether the buyer is committed to perform their obligations under the contract and whether collectability of the transaction price is probable. Once these criteria are met, the other real estate owned asset is derecognized and the gain or loss on sale is recorded upon the transfer of control of the property to the buyer. In determining the gain or loss on sale, The Company adjusts the transaction price and related gain or loss on sale if a significant financing component is present.

Note 14 – Transactions with Related Parties

Certain directors, executive officers, and principal stockholders are customers of and have had banking transactions with the Bank in the ordinary course of business, and the Bank expects to have such transactions in the future.

All loans and commitments to lend included in such transactions are made in compliance with applicable laws on substantially the same terms (including interest rates and collateral) as those prevailing at the time for comparable transactions with other persons and, in the opinion of the management of the Bank, do not involve more than the normal risk of collection or present any other unfavorable features.

People's Bank of Commerce

Notes to Financial Statements

Note 14 – Transactions with Related Parties (continued)

The amount of loans and loan commitments outstanding to directors, executive officers, and principal stockholders with the Bank was as follows as of December 31:

	2020	2019
Balance, beginning of year	\$ 262,183	\$ 3,104,997
Loans made and advances	640,926	384,332
Repayments and pay offs	(85,266)	(209,028)
New related parties with existing loans	1,438,000	-
Related party loans removed from disclosure	(1,476,106)	(3,018,118)
Balance, end of year	<u>\$ 779,737</u>	<u>\$ 262,183</u>
Outstanding loan commitments	<u>\$ 425,973</u>	<u>\$ 279,069</u>

(1) Represents loans existing at the beginning of the year that were outstanding to parties no longer meeting the definition of related parties.

In addition, the Bank has a loan to its other 50% member in the limited liability company that owns a branch location. The loan carries an interest rate of 6.25%, matures in December of 2037, and is collateralized by the member's interest in the land on which the building is located. The loan was originated for the purpose of funding the partner's portion of construction costs of the Bank's administrative office and had a balance of \$1,739,014 and \$1,793,948 as of December 31, 2020 and 2019, respectively.

As discussed in Note 7, the Bank established a leveraged ESOP during 2017 and financed the sale of 75,000 shares of the Bank's common stock to the ESOP through a loan made by a related party in the amount of \$784,500. The loan was fully repaid in 2020.

Related party deposits held by the Bank at December 31, 2020 and 2019, were \$15,089,629 and \$22,154,596, respectively.

Note 15 – Stock-Based Compensation Plans

Under its stock-based compensation plans, the Bank may grant nonqualified stock options and restricted stock awards to its directors, officers, and employees for up to 314,212 shares of common stock.

The exercise price of each option must be at least equal to 100% of the market price of the Bank's stock on the date of grant. An option's maximum term is 10 years.

Note 15 – Stock-Based Compensation Plans (continued)

The following summarizes stock option activity under the plans, adjusted for stock dividends:

	Number of Shares	Weighted Average Exercise Price	Aggregate Intrinsic Value	Weighted Average Contractual Term
Options under grant as of December 31, 2019	<u>15,048</u>	\$ 5.78		2.36
Options expired	-	\$ -		
Options exercised	(2,933)	\$ 4.51	\$ 27,257	
Options under grant as of December 31, 2020	<u>12,115</u>	\$ 5.74		1.45
Options exercisable as of December 31, 2020	<u>12,115</u>	\$ 5.47		1.45

Proceeds received from stock options exercised in 2020 were \$13,228.

The Bank determines fair value of stock options at grant date using the Black-Scholes 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, the expected dividend yield, and the risk-free interest rate over the expected life of the option. The expected term of options granted is derived from historical data on employee exercise and post-vesting employment termination 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 an index of comparable bank stocks.

The Black-Scholes option valuation model requires the input of highly subjective assumptions, including the expected life of the stock-based award and stock price volatility.

These assumptions represent management's best estimates, but 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. Additionally, the effects of applying this accounting model are not indicative of future amounts that may be realized by the option holders upon exercise.

People's Bank of Commerce

Notes to Financial Statements

Note 15 – Stock-Based Compensation Plans (continued)

The Bank expenses stock options on a straight-line basis over the options' related vesting term. As of December 31, 2020, there was no unrecognized compensation expense related to the granting of stock options.

The following table summarizes restricted stock award activity under the plan for the year ended December 31, 2020:

	Number of Shares	Weighted Average Fair Value
Restricted stock awards unvested at December 31, 2019	<u>95,234</u>	\$ 13.49
Awards vested	(22,430)	13.45
Award granted	37,750	10.82
Awards forfeited	(2,299)	
Adjustment for stock dividends	<u>-</u>	
Restricted stock awards unvested at December 31, 2020	<u>108,255</u>	\$ 12.80

As of December 31, 2020, there was \$1,438,940 of unrecognized stock-based compensation expense related to nonvested restricted stock awards. The cost is expected to be recognized over a weighted average period of 3.89 years as of December 31, 2020.

Compensation expense recognized for stock-based compensation plans was \$287,820 and \$231,331 for the years ended December 31, 2020 and 2019, respectively.

Under its phantom stock plan, the Bank may award cash or stock compensation to its directors, officers, and employees for up to 150,000 shares. Cash awards are recognized as liabilities until settled, measured at the net settlement value, and have no impact on the number of shares available to be issued under the plan. Awards granted under the phantom stock plan participate in stock dividends.

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Notes to Financial Statements

Note 15 – Stock-Based Compensation Plans (continued)

The Bank has granted phantom stock awards which are settled in cash when they vest. The following table summarizes activity for outstanding phantom stock awards for the years ended December 31, 2020 and 2019:

	2020	2019
Balance, beginning of year	\$ 20,761	\$ 31,090
Granted	-	-
Vested	(12,024)	(12,234)
Adjustment for stock dividend	-	1,905
Forfeited or expired	-	-
	<u>8,737</u>	<u>20,761</u>
Balance, end of year	<u>\$ 8,737</u>	<u>\$ 20,761</u>

As of December 31, 2020, based on the value of the Bank's stock, the value of the phantom stock awards outstanding was \$91,287. The weighted average vesting period for the awards is 1.77 years.

Total compensation expense recognized for phantom stock-based compensation plans was \$156,314 and \$188,578 for the year ended December 31, 2020 and 2019, respectively.

Note 16 – Employee Benefit Plans and Agreements

The Bank adopted a 401(k) plan in which substantially all employees participate. Employees may contribute the maximum amount permissible under federal tax laws.

During 2017, the Bank established a leveraged Employee Stock Ownership Plan (ESOP) with 75,000 unallocated shares of the Bank's common stock with a fair value of \$784,500. As the loan is repaid, shares are released and available to be allocated to participants no less frequently than annually. During 2020, the Bank made principal payments on the loan totaling \$211,815 and released 20,250 shares for allocation. During 2019, the Bank made principal payments on the loan totaling \$232,735 and released 22,250 shares for allocation.

The Bank is required to contribute 3% of each eligible employee's compensation under safe harbor provisions. For the years ended December 31, 2020 and 2019, the Bank's expense attributable to contributions to these plans was \$343,893 and \$315,177, respectively.

Beginning in 2005, the Bank entered into supplemental retirement plans with key executive officers. In 2006, to support its obligations under these plans and to provide death benefits to selected employees, the Bank acquired bank-owned life insurance. The Bank's liability pursuant to these supplemental retirement plans was \$2,635,429 and \$2,353,198 as of December 31, 2020 and 2019, respectively. These amounts are included on the balance sheet among "accrued interest payable and other liabilities." For 2020 and 2019, compensation expense related to these plans was \$334,655 and \$341,724, respectively.

People's Bank of Commerce

Notes to Financial Statements

Note 17 – Earnings Per Share

The following table illustrates the computations of basic and diluted earnings per share for the years ended December 31, 2020 and (adjusted for the 2019 stock dividends):

	Net Income	Weighted Average Shares	Per Share Amount
For the year ended December 31, 2020			
Basic income per share	\$ 6,130,985	3,487,219	\$ 1.76
Stock options		14,512	
Diluted income per share	\$ 6,130,985	3,501,731	\$ 1.75
For the year ended December 31, 2019			
Basic income per share	\$ 4,068,453	2,979,404	\$ 1.37
Stock options		18,329	
Diluted income per share	\$ 4,068,453	2,997,733	\$ 1.36

No stock options were excluded from the computation of diluted earnings per share, as all were dilutive during 2020 and 2019.

Note 18 – Fair Value of Financial Instruments

Assets are displayed at fair value in the table below based upon recurring or nonrecurring measurement status. Recurring assets are initially measured at fair value and are required to be re-measured at fair value in the financial statements at each reporting date. Assets measured on a nonrecurring basis are assets that, due to an event or circumstance, were required to be re-measured at fair value after initial recognition in the financial statements at some time during the reporting period.

People's Bank of Commerce

Notes to Financial Statements

Note 18 – Fair Value of Financial Instruments (continued)

The following tables disclose fair value information about all financial instruments, whether carried or not carried at fair value on the balance sheet, where it is practicable to estimate that value.

		Fair Value at December 31, 2020			
			Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
	Carrying Amount	Total			
Financial assets					
Cash and cash equivalents	\$ 92,182,758	\$ 92,182,758	\$ 92,182,758	\$ -	\$ -
Investment securities available-for-sale	25,893,747	25,893,747	-	25,893,747	-
Factored accounts receivable	17,762,644	17,762,644	-	17,762,644	-
Restricted equity securities	564,300	564,300	564,300	-	-
Loans held-for-sale	3,407,443	3,407,443	-	3,407,443	-
Loans receivable, net	341,744,684	350,108,970	-	-	350,108,970
Financial liabilities					
Noninterest-bearing demand deposits	\$ 231,095,318	\$ 231,095,318	\$ -	\$ 231,095,318	\$ -
Interest-bearing demand, money market accounts, and savings deposits	202,286,923	202,286,923	-	202,286,923	-
Time certificates of deposit	22,365,573	18,526,444	-	-	18,526,444
FHLB advances	3,000,000	3,000,000	3,000,000	-	-
Fair Value at December 31, 2019					
	Carrying Amount	Total	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Financial assets					
Cash and cash equivalents	\$ 14,650,556	\$ 14,650,556	\$ 14,650,556	\$ -	\$ -
Investment securities available-for-sale	27,734,426	27,734,426	-	27,734,426	-
Factored accounts receivable	10,206,287	10,206,287	-	10,206,287	-
Restricted equity securities	889,500	889,500	889,500	-	-
Loans held-for-sale	2,474,240	2,474,240	-	2,474,240	-
Loans receivable, net	275,158,174	273,703,676	-	-	273,703,676
Financial liabilities					
Noninterest-bearing demand deposits	\$ 136,051,368	\$ 136,051,368	\$ -	\$ 136,051,368	\$ -
Interest-bearing demand, money market accounts, and savings deposits	152,325,230	152,325,230	-	152,325,230	-
Time certificates of deposit	18,416,485	18,526,444	-	-	18,526,444
FHLB advances	11,750,000	11,750,000	11,750,000	-	-
Borrowings	211,815	211,815	-	211,815	-

The Bank normally intends to hold the majority of its financial instruments until maturity; it does not expect to realize many of the estimated amounts disclosed. The disclosures also do not include estimated fair value amounts for items which are not defined as financial instruments but which have significant value. These include such off-balance sheet items as core deposit intangibles on non-acquired deposits. The Bank does not believe that it would be practicable to estimate a representational fair value for these types of items as of December 31, 2020 and 2019.

People's Bank of Commerce

Notes to Financial Statements

Note 19 – Common Stock Issuance

During 2019, the Bank executed a Rights Offering (the Offering), selling 79,018 shares of common stock to directors, executives, and other investors at price of \$14.90 per share during the year ended December 31, 2019. Total proceeds to the Bank, net of direct offering costs, were \$1,157,862 for the year ended December 31, 2019, and are being used to fund continuing operations and anticipated growth. The Offering was extended through February 28, 2020, and the Bank received subscriptions for the remaining 256,522 shares. The shares were sold during 2020 at \$14.90 per share and the total proceeds were \$3,822,625.

Note 20 – Regulatory Matters

The Bank is subject to various regulatory capital requirements administered by federal banking agencies. Failure to meet minimum capital requirements can initiate certain mandatory and possibly additional discretionary actions by regulators that, if undertaken, could have a direct material effect on the Bank's financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Bank must meet specific capital guidelines that involve quantitative measures of the Bank's assets, liabilities, and certain off-balance sheet items as calculated under regulatory accounting practices. The Bank's capital amounts and classification are also subject to qualitative judgments by the regulators about components, risk weightings, and other factors.

Quantitative measures established by regulation to ensure capital adequacy require the Bank to maintain minimum amounts and ratios (set forth in the following table) of total capital, Tier 1 capital, and common equity Tier 1 to risk-weighted assets, and of Tier 1 capital to average assets (as defined in the regulations).

On January 1, 2020, the community bank leverage ratio (CBLR) final rule became effective, providing an optional capital reporting framework for qualifying community banks. This new framework was designed to reduce regulatory burden by removing the requirements for calculating and reporting risk-based capital ratios for qualifying community banking organizations that opt into the framework. Upon filing of the March 31, 2020 call report the Bank opted into this new capital framework. Upon the opt in, the Bank no longer calculated risk-based capital ratios.

People's Bank of Commerce

Notes to Financial Statements

Note 20 – Regulatory Matters (continued)

Under the CBLR the bank must maintain a leverage ratio greater than 9.0%. On April 6, 2020, the Federal Deposit Insurance Corporation (FDIC), Board of Governors of the Federal Reserve System and Office of the Comptroller of the Currency issued two interim final rules that change the CBLR and implement Section 4012 of the Coronavirus Aid, Relief, and Economic Security Act (Cares Act). The interim final rules change the CBLR to 8% for 2020, 8.5% for 2021 and back to 9% in 2020. As December 31, 2020, the Bank had Tier 1 capital of \$48,668,349 and a CBLR of 9.5%, which was in excess of the 8.0% requirement.

The Bank's capital amounts as of December 31, 2019 were as follows:

(dollars in thousands)	Actual		For Capital Adequacy Purposes		To Be Well-Capitalized under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
December 31, 2019						
Total capital to risk-weighted assets	\$ 41,156	12.7%	\$ 26,022	≥8.0%	\$ 32,528	≥10.0%
Tier 1 capital to risk-weighted assets	37,967	11.7%	19,517	≥6.0%	26,022	≥8.0%
Common Equity Tier 1 Capital to risk-weighted assets	37,967	11.7%	13,504	≥4.5%	16,880	≥6.5%
Tier 1 capital to average assets	37,967	10.4%	14,637	≥4.0%	21,143	≥5.0%

As of the most recent notifications from its regulatory agencies, the Bank was categorized as well-capitalized under the regulatory framework for prompt corrective action. To be categorized as well-capitalized, the Bank must maintain minimum total risk-based capital, Tier 1 risk-based capital, and Tier 1 leverage capital ratios as set forth in the following table. There are no conditions or events since that notification that management believes may have changed the Bank's category.

The Bank was required to establish and phase-in a "conservation buffer," consisting of a common equity Tier 1 capital amount equal to 2.5% of risk-weighted assets by 2019. An institution that does not meet the conservation buffer requirement will be subject to restrictions on certain activities including payment of dividends, stock repurchases, and discretionary bonuses to executive officers. The phase-in began in 2016 and increased 0.625% annually until fully phased-in during 2019.

Note 21– Subsequent Event

On March 1, 2021, the Bank closed the acquisition of Willamette Community Bank. As of March 1, 2021, Willamette Community Bank had total \$218.4 million in assets, \$145.5 million in loans, and \$196.6 million in deposits. The Bank paid \$20.3 million for the acquisition.

