

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-K

☒ **ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE
SECURITIES EXCHANGE ACT OF 1934**
For the fiscal year ended December 31, 2023

☐ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE
SECURITIES EXCHANGE ACT OF 1934**
Commission File Number: 001-34142

OAK VALLEY BANCORP
(Exact name of registrant as specified in its charter)

California
(State or other jurisdiction of incorporation or organization)

26-2326676
(I.R.S. Employer Identification No.)

125 North Third Avenue
Oakdale, California
(Address of principal executive offices)

95361
(Zip Code)

(209) 848-2265
(Registrant's telephone number including area code)

Securities registered pursuant to Section 12(b) of the Act:

Title of each class	Trading Symbol	Name of each exchange on which registered
Common Stock	OVLY	The Nasdaq Stock Market, LLC

Securities registered pursuant to Section 12(g) of the Act:

None
(Title of class)

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes ☐ No ☒

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Exchange Act. Yes ☐ No ☒

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes ☒ No ☐

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit such files). Yes ☒ No ☐

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company, or an emerging growth company. See definitions of "large accelerated filer," "accelerated filer," "smaller reporting company," and "emerging growth company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer ☐ Accelerated filer ☐ Non-accelerated filer ☒ Smaller reporting company ☒ Emerging growth company ☐

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act. ☐

Indicate by check mark whether the registrant has filed a report on and attestation to its management's assessment of the effectiveness of its internal control over financial reporting under Section 404(b) of the Sarbanes-Oxley Act (15 U.S.C. 7262(b)) by the registered public accounting firm that prepared or issued its audit report. ☐

If securities are registered pursuant to Section 12(b) of the Exchange Act, indicate by check mark whether the financial statements of the registrant included in the filing reflect the correction of an error to previously issued financial statements. ☐

Indicate by check mark whether any of those error corrections are restatements that required a recovery analysis of incentive-based compensation received by any of the registrant's executive officers during the relevant recovery period pursuant to §240.10D-1(b). ☐

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes ☐ No ☒

As of June 30, 2023, the last business day of the Registrant's most recently completed second fiscal quarter, the aggregate market value of the registrant's common stock held by non-affiliates of the registrant, based upon the closing price of \$25.19 per share of the registrant's common stock as reported by the Nasdaq, was approximately \$167 million. As of December 31, 2023, there were 8,293,168 shares of common stock outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the registrant's Proxy Statement for the Annual Meeting of Shareholders will be filed with the Commission within 120 days after the end of the Registrant's 2023 fiscal year end and are incorporated by reference into Part III of this report.

TABLE OF CONTENTS

PART I		
ITEM 1 -	BUSINESS	4
ITEM 1A -	RISK FACTORS	20
ITEM 1B -	UNRESOLVED STAFF COMMENTS	33
ITEM 1C -	CYBERSECURITY	33
ITEM 2 -	PROPERTIES	34
ITEM 3 -	LEGAL PROCEEDINGS	34
ITEM 4 -	MINE SAFETY DISCLOSURES	34
PART II		
ITEM 5 -	MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES	35
ITEM 6 -	[RESERVED]	35
ITEM 7 -	MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS	36
ITEM 7A -	QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK	57
ITEM 8 -	FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA	59
ITEM 9 -	CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE	59
ITEM 9A -	CONTROLS AND PROCEDURES	59
ITEM 9B -	OTHER INFORMATION	60
ITEM 9C -	DISCLOSURE REGARDING FOREIGN JURISDICTIONS THAT PREVENT INSPECTIONS	60
PART III		
ITEM 10 -	DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE	61
ITEM 11 -	EXECUTIVE COMPENSATION	61
ITEM 12 -	SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS	62
ITEM 13 -	CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS, AND DIRECTOR INDEPENDENCE	62
ITEM 14 -	PRINCIPAL ACCOUNTANT FEES AND SERVICES	62
PART IV		
ITEM 15 -	EXHIBITS AND FINANCIAL STATEMENT SCHEDULES	62
ITEM 16 -	FORM 10-K SUMMARY	64
SIGNATURES		65

SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS

This Annual Report on Form 10-K ("Annual Report") includes forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, (the "1933 Act") and Section 21E of the Securities Exchange Act of 1934, as amended, (the "1934 Act").

All statements contained in this Annual Report other than statements of historical fact, including, for example, statements regarding descriptions of plans or objectives of management for future operations, products or services, forecasts of our revenues, earnings or other measures of economic performance, our assessment of significant factors and developments that may affect our results, regulatory controls and processes and their impact on our business, our business strategy and plans and our objectives for future operations, are forward-looking statements. The words "believe," "may," "will," "potentially," "estimate," "forecast," "continue," "anticipate," "target," "intend," "could," "would," "project," "plan," "goal," "outlook," "expect," and similar expressions that convey uncertainty of future events or outcomes are intended to identify forward-looking statements.

We have based these forward-looking statements on our current expectations and projections about future events and trends. These forward-looking statements are subject to a number of risks, uncertainties and assumptions, that are difficult to predict the impact on our business, results of operations and financial condition, including those listed in this "Special Note Regarding Forward-Looking Statements," and those described in Part II, Item 7 "Management's Discussion and Analysis of Financial Condition and Results of Operations." Factors that could cause actual results to differ from results discussed in forward-looking statements include, but are not limited to: the credit exposure of certain loan products and other components of our business that could be impacted by the changing economic and business conditions; changes in monetary, fiscal or tax policy to address changing economic conditions including interest rate policies of the Federal Reserve Board, any of which could cause us to incur additional loan losses and adversely affect our results of operations in the future; economic conditions (both generally and in the markets where the Company operates) including unemployment levels, energy prices, inflation, supply chain issues, a decline in housing prices or collateral values and the risk of a recession or slowed economic growth in the United States economy; the continuing impact of the changing economic conditions on our employees and customers, including consumer income, creditworthiness, confidence, spending and savings; increasing geopolitical instability, including the war between Russia and Ukraine and the impact of sanctions and the conflict between Israel and Hamas in the Middle East; the success of our efforts to mitigate the impact of the changing economic conditions; competition from other providers of financial services offered by the Company and our response to competitive pressures; changes in government regulation and legislation; the impact of any failure by the U.S. government to increase the debt ceiling or any federal government shutdown; changes in interest rates and interest rate fluctuations; volatility in the capital markets; the amount and rate of deposit growth and changes in deposit costs; material unforeseen changes in the financial stability and liquidity of the Company's credit customers; risks associated with concentrations in real estate related loans; our ability to maintain adequate capital or liquidity levels or to comply with revised capital or liquidity requirements; changes in accounting standards and interpretations; changes in the level and direction of loan delinquencies and write-offs and changes in estimates of the adequacy of the allowance for credit losses; the soundness of other financial institutions, including disruptions, instability and failures in the banking industry; physical or transition risks related to climate change; cybersecurity risks and heightened legislative and regulatory focus on cybersecurity and data privacy; and other risks as may be detailed from time to time in the Company's filings with the Securities and Exchange Commission, all of which are difficult to predict and which may be beyond the control of the Company. For additional information on factors that could materially influence forward-looking statements included in this Annual Report, see the risk factors set forth under "Part I—Item 1A. Risk Factors." You should carefully consider the factors discussed above, and in our Risk Factors or other disclosures, in evaluating these forward-looking statements.

Moreover, we operate in a very competitive and rapidly changing environment, and new risks emerge from time to time. It is not possible for our management to predict all risks, nor can we assess the impact of all factors on our business or the extent to which any factor, or combination of factors, may cause actual results to differ materially from those contained in any forward-looking statements we may make. In light of these risks, uncertainties, and assumptions, the forward-looking events and circumstances discussed in this Annual Report may not occur and actual results could differ materially and adversely from those anticipated or implied in the forward-looking statements.

You should not rely upon forward-looking statements as predictions of future events. Although we believe that the expectations reflected in the forward-looking statements are reasonable, we cannot guarantee that the future results, levels of activity, performance or events and circumstances reflected in the forward-looking statements will be achieved or occur. Forward-looking statements speak only as of the date they are made, and we do not undertake to update forward-looking statements to reflect circumstances or events that occur after the date the forward-looking statements are made, whether as a result of new information, future developments or otherwise, except as may be required by law. You should read this Annual Report with the understanding that our actual future results, levels of activity, performance and events and circumstances may be materially different from what we expect.

PART I

ITEM 1. BUSINESS OF OAK VALLEY BANCORP

Overview of the Business

Oak Valley Bancorp. Oak Valley Bancorp (the “Company”) serves as the parent bank holding company of Oak Valley Community Bank (the “Bank”), a California state-chartered bank. The Bank and the Company may be generally referred to as “we”, “us” or “our”). The Company was incorporated under the laws of the State of California on May 31, 1990, and began operations in Oakdale, California on May 28, 1991.

The Company’s only assets are the outstanding capital stock of the Bank, which the Company wholly owns, cash and income tax benefits receivable classified as other assets.

Oak Valley Community Bank. The Bank commenced operations in May 1991. The Bank is an insured bank under the Federal Deposit Insurance Act and is a member of the Federal Reserve. The Bank is subject to regulation, supervision and regular examination by the California Department of Financial Protection and Innovation (“DFPI”), the Federal Deposit Insurance Commission (“FDIC”) and the Federal Reserve Board (“FRB”). Since its formation, the Bank has provided basic banking services to individuals and business enterprises in Oakdale, California and the surrounding areas. The focus of the Bank is to offer a range of commercial banking services designed for both individuals and small to medium-sized businesses in the two main areas of service of the Bank: the Central Valley and the Eastern Sierras.

The Bank offers a complement of business checking and savings accounts for its business customers. The Bank also offers commercial and real estate loans, as well as lines of credit. Real estate loans are generally of a short-term nature for both residential and commercial lending purposes. Longer-term real estate loans are generally made with adjustable interest rates and contain customary provisions for acceleration. Traditional residential mortgages are available to Bank customers through a third party.

The Bank offers other services for both individuals and businesses including online banking, remote deposit capture, mobile banking, merchant services, night depository, extended hours, wire transfer of funds, note collection, and automated teller machines in a national network. The Bank does not currently offer international banking or trust services although the Bank may make such services available to the Bank’s customers through financial institutions with which the Bank has correspondent banking relationships. The Bank does not offer stock transfer services, nor does it directly issue credit cards.

Expansion

Branch Expansion. Since opening the doors of our main Oakdale branch in 1991, our network of branches have been expanded geographically. As of December 31, 2023, we maintained eighteen full-service branch offices (in addition to our corporate headquarters) located in the cities of Oakdale, Sonora, Modesto, Bridgeport, Mammoth Lakes, Bishop, Escalon, Patterson, Turlock, Ripon, Stockton, Manteca, Tracy, Sacramento, and Roseville in California. We intend to continue our growth strategy in future years through the opening of additional branches and loan production offices as demand dictates and resources permit.

Business Segments

Management has determined that because all of the banking products and services offered by the Company are available in each branch of the Bank, all branches are located within the same economic environment, and management does not allocate resources based on the performance of different lending or transaction activities, it is appropriate to aggregate the Bank branches and report them as a single operating segment. No customer accounts for more than 10 percent of revenues for the Company or the Bank.

Primary Market Area

We conduct business from our main office in Oakdale, a city of approximately 23,000 residents located in Stanislaus County, California. Oakdale is approximately 15 miles from Modesto and sits at the foothills of the Sierra Nevada Mountains, at the edge of the California Central Valley agricultural area. Through our branches, we serve customers in the Central Valley, from Fresno to Sacramento, and in foothill locations. We also reach into the Highway 395 corridor in the Eastern Sierras and in the towns of Bishop, Mammoth and Bridgeport. Approximately 98% of our loans and 90% of our deposits are generated from the Central Valley. The Central Valley area includes Stanislaus, San Joaquin, Tuolumne, Sacramento, and Placer counties and has a total population of over 5 million.

Lending Activities

General. Our loan policies set forth the basic guidelines and procedures by which we conduct our lending operations. These policies address the types of loans available, underwriting and collateral requirements, loan terms, interest rate and yield considerations, compliance with laws and regulations and our internal lending limits. Our Board of Directors reviews and approves our loan policies on an annual basis. We supplement our own supervision of the loan underwriting and approval process with periodic loan audits by experienced external loan specialists who review credit quality, loan documentation and compliance with laws and regulations. We engage in a full complement of lending activities, including:

- commercial real estate loans,
- commercial business lending and trade finance,
- Small Business Administration lending, and
- consumer loans, including automobile loans, home mortgages, credit lines and other personal loans.

As part of our efforts to achieve long-term stable profitability and respond to a changing economic environment in the California Central Valley, we constantly evaluate a variety of options to augment our traditional focus by broadening the services and products we provide. Possible avenues of growth include more branch locations, expanded suite of technology-based services and new types of lending.

Loan Procedures. Loans are recommended for approval by the Senior Loan Committee, made up of our Board of Directors and designated executive officers of the bank, by joint management authority or by loan officers, to the extent of their lending authority. Our Board of Directors authorizes our lending limits. Our President and Chief Credit Officer are responsible for evaluating the authority limits for individual credit officers and recommending lending limits for all other officers to the Board of Directors for approval.

We grant individual lending authority to our Chief Executive Officer, Chief Credit Officer, Credit Administrator and to certain department managers and loan officers. Our highest management lending authority, known as Joint Authority, includes all amounts above the individual officer loan authority limits and below the Senior Loan Committee limits of: \$5,000,000 for real estate secured loans, \$2,500,000 for loans secured by collateral other than real estate and cash, \$1,500,000 for unsecured loans, or when the borrower's aggregate total outstanding commitment exceeds \$5,000,000. These loans require joint approval from two of the following officers: Chief Executive Officer, President, Chief Credit Officer, Senior Lending Officer or Credit Administrator.

As of December 31, 2023, the Bank's authorized legal lending limits were \$29.0 million for unsecured loans plus an additional \$19.3 million for specific secured loans. Legal lending limits are calculated in conformance with California law, which prohibits a bank from lending to any one individual or entity or its related interests an aggregate amount which exceeds 15% of primary capital plus the allowance for credit losses on an unsecured basis, plus an additional 10% on a secured basis. The Bank's primary capital plus allowance for credit losses as of December 31, 2023 totaled \$193.0 million.

We seek to mitigate the risks inherent in our loan portfolio by adhering to certain underwriting practices. The review of each loan application includes analysis of the applicant's prior credit history, income level, cash flow and financial condition, tax returns, cash flow projections, and the value of any collateral to secure the loan, based upon reports of independent appraisers and audits of accounts receivable or inventory pledged as security. In the case of real estate loans over a specified amount, the review of collateral value includes an appraisal report prepared by an independent, Bank-approved, appraiser.

Real Estate Loans. We offer commercial real estate loans to finance the acquisition of new or the refinancing of existing commercial properties, such as office buildings, industrial buildings, warehouses, hotels, shopping centers, automotive industry facilities and multiple dwellings. As of December 31, 2023, consumer and commercial real estate loans constituted 90% of our loan portfolio, of which 97% were commercial real estate loans.

Commercial real estate loans typically have 10-year maturities with up to 25-year amortization of principal and interest and loan-to-value ratios of not more than 75% of the appraised value or purchase price, whichever is lower. We usually impose a prepayment penalty during the period within 3 to 5 years of the date of the loan.

[Table of Contents](#)

Construction loans are comprised of loans on commercial, residential and income-producing properties that generally have terms of 1 year, with options to extend for additional periods to complete construction and to accommodate the lease-up period. We usually require 15% equity capital investment by the developer and loan-to-value ratios of not more than 75% of anticipated completion value.

Mini-perm loans finance the purchase and/or ownership of commercial properties, including owner-occupied and income-producing properties. We also offer mini-perm loans as take-out financing with our construction loans. Mini-perm loans are generally made with an amortization schedule ranging from 20 to 25 years, with a lump sum balloon payment due in 3 to 5 years.

Equity lines of credit are revolving lines of credit with repayment term and are collateralized by junior deeds of trust on residential real properties. They generally bear a rate of interest that floats with our base rate or the prime rate, and have maturities of 25 years (10-year interest only with 15-year amortization).

We purchase participation interests in loans made by other financial institutions from time to time. These loans are subject to the same underwriting criteria and approval process as loans made directly by us.

Our real estate loans are typically collateralized by first or junior deeds of trust on specific commercial properties and equity lines of credit, and are subject to corporate or individual guarantees from financially capable parties, as available. The properties collateralizing real estate loans are principally located in our primary market areas of the California Central Valley and the Eastern Sierra. Real estate loans typically bear interest rates that float with an established index.

Our real estate portfolio is subject to certain risks, including (i) downturns in the California economy, (ii) significant interest rate fluctuations, (iii) reduction in real estate values in the California Central Valley, (iv) increased competition in pricing and loan structure, and (v) environmental risks, including natural disasters. As a result of the high concentration of the real estate loan in our loan portfolio, potential difficulties in the real estate markets could cause significant increases in nonperforming loans, which would reduce our profits. A decline in real estate values could cause some of our mortgage loans to become inadequately collateralized, which would expose us to a greater risk of loss. Additionally, a decline in real estate values could adversely affect our portfolio of commercial real estate loans and could result in a decline in the origination of such loans. However, we strive to reduce the exposure to such risks and seek to continue to maintain high quality in our real estate loans by (a) reviewing each loan request and each loan renewal individually, (b) using a joint approval system for the approval of each loan request for loans over a certain dollar amount, (c) adhering to written loan policies, including, among other factors, minimum collateral requirements, maximum loan-to-value ratio requirements, cash flow requirements and personal guarantees, (d) performing secondary appraisals from time to time, (e) conducting external independent credit review, and (f) conducting environmental reviews, where appropriate. We review each loan request on the basis of our ability to recover both principal and interest in view of the inherent risks. We monitor and stress test our entire portfolio, evaluating debt coverage ratios and loan-to-value ratios, on a quarterly basis. We monitor trends and evaluate exposure derived from simulated stressed market conditions. The portfolio is stratified by owner classification (either owner-occupied or non-owner occupied), product type, geography and size.

As of December 31, 2023, the aggregate loan-to-value of the entire commercial real estate portfolio was 46.0%, based on the most recent appraisals as of the time of origination or renewal. Historical data suggests that the Bank continues to maintain strong loan-to-value which has served as a cushion against precipitous reductions in real estate values during economic downturns. Non-owner occupied commercial real estate comprises 67.0% of the Bank's total commercial real estate commitments, as of December 31, 2023. The loan-to-value on the non-owner occupied CRE segment was 47.9%, as of December 31, 2023. The highest concentration by product type is CRE Retail, which comprised 22.7% of total CRE loan commitments, as of December 31, 2023.

Our portfolio diversity in terms of both product types and geographic distribution, combined with strong debt coverage ratios, a low aggregate loan-to-value and a reasonable percentage of owner-occupied properties, mitigate the risks associated with excessive commercial real estate concentration. These elements contribute strength to our overall real estate portfolio in the event of any weakness in the real estate market.

Commercial Business Lending. We offer commercial loans to sole proprietorships, partnerships and corporations, with an emphasis on the real estate related industry. These commercial loans include business lines of credit and commercial term loans to finance operations, to provide working capital or for specific purposes, such as to finance the purchase of assets, equipment or inventory. Since a borrower's cash flow from operations is generally the primary source of repayment, our policies provide specific guidelines regarding required debt coverage and other important financial ratios.

Lines of credit are extended to businesses or individuals based on the financial strength and integrity of the borrower and are secured primarily by real estate, accounts receivable and inventory, and have a maturity of one year or less. Such lines of credit bear an interest rate that floats with the prime rate, constant maturity treasury or another established index.

[Table of Contents](#)

Commercial term loans are typically made to finance the acquisition of fixed assets, refinance short-term debts or to finance the purchase of businesses. Commercial term loans generally have terms from one to five years. They may be collateralized by the asset being acquired or other available assets and bear interest rates, which either floats with the prime rate, or another established index or is fixed for the term of the loan.

Our portfolio of commercial loans is also subject to certain risks, including (i) downturns in the California economy, (ii) significant interest rate fluctuations; and (iii) the deterioration of a borrower's or guarantor's financial capabilities. We attempt to reduce the exposure to such risks through (a) reviewing each loan request and renewal individually, (b) requiring a joint signature approval system, (c) mandating strict adherence to written loan policies, and (d) performing external independent credit review. In addition, we monitor loans based on short-term asset values as required on a monthly or quarterly basis. In general, during the term of the relationship, we receive and review the financial statements of our borrowing customers on an ongoing basis, and we promptly respond to any deterioration that we note.

Small Business Administration Lending Services. Small Business Administration ("SBA") lending, forms an important part of our business. Our SBA lending service places an emphasis on minority-owned businesses. Our SBA market area includes the geographic areas encompassed by our full-service banking offices in the California Central Valley and in the Eastern Sierra. As an SBA lender, we enable borrowers to obtain SBA loans in order to acquire new businesses, expand existing businesses, and acquire locations in which to do business. We also participated in the SBA's Paycheck Protection Program ("PPP") established in 2020 to provide economic assistance to small businesses during the COVID-19 pandemic.

Consumer Loans. Consumer loans include personal loans, auto loans, home improvement loans, home mortgage loans, revolving lines of credit and other loans typically made by banks to individual borrowers. We provide consumer loan products in an effort to diversify our product line.

Our consumer loan portfolio is subject to certain risks, including:

- amount of credit offered to consumers in the market,
- interest rate increases, and
- consumer bankruptcy laws which allow consumers to discharge certain debts.

We attempt to reduce the exposure to such risks through the direct approval of all consumer loans by:

- reviewing each loan request and renewal individually,
- using a dual signature system of approval,
- strictly adhering to written credit policies, and
- performing external independent credit review.

Deposit Activities

Our primary sources of funds are deposits and loan repayments. Scheduled loan repayments are a relatively stable source of funds, whereas deposit inflows, outflows and unscheduled loan prepayments (which are influenced significantly by general interest rate levels, interest rates available on other investments, competition, economic conditions and other factors) are not as stable. Customer deposits also remain a primary source of funds, but these balances may be influenced by adverse market changes in the industry. We may resort to other borrowings, on an as needed basis, as follows:

- on a short-term basis to compensate for reductions in deposit inflows at less than projected levels, and
- on a longer-term basis to support expanded lending activities and to match the maturity of repricing intervals of assets.

We offer a variety of accounts for depositors, which are designed to attract both short-term and long-term deposits. These accounts include certificates of deposit ("CDs"), regular savings accounts, money market accounts, checking accounts, savings accounts, health savings accounts and individual retirement accounts. These accounts generally earn interest at rates established by management based on competitive market factors and management's desire to increase or decrease certain types or maturities of deposits. As needs arise, we augment these customer deposits with brokered deposits. The more significant deposit accounts offered by us are described below:

Certificates of Deposit. We offer several types of CDs with a maximum maturity of five years. The substantial majority of our CDs have a maturity of one to twelve months and pay compounded interest typically credited monthly or at maturity.

Regular Savings Accounts. We offer savings accounts that allow for unlimited ATM and in-branch deposits and withdrawals. Interest is compounded daily and paid monthly.

Money Market Account. Money market accounts pay a variable interest rate that is tiered depending on the balance maintained in the account. Minimum opening balances vary. Interest is compounded daily and paid monthly.

Checking Accounts. Checking accounts are generally non-interest and interest-bearing accounts, respectively, and may include service fees based on activity and balances.

Other Sources of Funds

Federal Home Loan Bank Borrowings. To supplement our deposits as a source of funds for lending or investment, we borrow funds in the form of advances from the Federal Home Loan Bank ("FHLB"). We regularly make use of Federal Home Loan Bank advances as part of our interest rate risk management, primarily to extend the duration of funding to match the longer-term fixed rate loans held in the loan portfolio as part of our growth strategy.

As a member of the Federal Home Loan Bank system, we are required to invest in Federal Home Loan Bank stock based on a predetermined formula. Federal Home Loan Bank stock is a restricted equity security that can only be sold to other Federal Home Loan Bank members or redeemed by the Federal Home Loan Bank. As of December 31, 2023, we owned \$5,202,000 in FHLB stock.

Advances from the Federal Home Loan Bank are typically secured by our entire real estate loan portfolio, which includes residential and commercial loans. As of December 31, 2023, our borrowing limit with the Federal Home Loan Bank was approximately \$333 million.

Internet and Mobile Banking

We offer Internet banking services, which allows our customers to access their deposit accounts through the Internet. Customers are able to obtain transaction history and account information, transfer funds between accounts, make person-to-person payments and make online bill payments. We intend to improve and develop our Internet banking products and delivery channels as the need arises and our resources permit. Mobile Banking offers many of the same services as internet banking but also includes mobile check deposit.

Other Services

We offer ATMs located at branch offices, and customer access to an ATM network. Additionally, we offer remote deposit capture service to allow commercial deposit customers the convenience of scanning check deposits for quicker access to deposited funds.

Marketing

Our marketing relies principally upon local advertising and promotional activity and upon personal contacts by our directors, officers and shareholders to attract business and to acquaint potential customers with our personalized services. We emphasize a high degree of personalized client service in order to be able to provide for each customer's banking needs. Our marketing approach emphasizes the advantages of dealing with an independent, locally managed and state-chartered bank to meet the particular needs of consumers, professionals and business customers in the community. Our management continually evaluates all of our banking services with regard to their profitability and efforts and makes determinations based on these evaluations whether to continue or modify our business plan, where appropriate.

We do not currently have any plans to develop any new lines of business, which would require a material amount of capital investment on our part.

Competition

Regional Branch Competition. We consider our primary service area to be composed of the counties of San Joaquin, Stanislaus, Tuolumne, Sacramento, Placer, Inyo and Mono Counties, of California. The banking business in California generally, and in our primary service area, specifically, is competitive with respect to both loans and deposits and is dominated by a relatively small number of major banks, which have many offices operating over wide geographic areas. These include Wells Fargo Bank, Bank of America, JP Morgan Chase Bank, U.S. Bank, BMO Harris Bank and Citibank. We compete for deposits and loans principally with these banks, as well as with savings and loan associations, thrift and loan associations, credit unions, mortgage companies, insurance companies, offerors of money market accounts and other lending institutions.

Among the advantages of these institutions are their ability to finance extensive advertising campaigns and to allocate their investment assets to regions of highest yield and demand, their ability to offer certain services, such as international banking and trust services, which are not offered directly by the Company and, the ability by virtue of their greater total capitalization, to have substantially higher lending limits than we do. In addition, as a result of increased consolidation and the passage of interstate banking legislation, there is and will continue to be increased competition among banks, savings and loan associations and credit unions for the deposit and loan business of individuals and businesses.

As of June 30, 2023, our primary service areas contained 279 banking offices, with approximately \$91.4 billion in total deposits. As of June 30, 2023, we had total deposits of approximately \$1.7 billion, which represented approximately 1.8% of the total deposits in the Bank's primary service area. There can be no assurance that the Bank will maintain its competitive position against current and potential competitors, especially those with greater resources than the Bank. The four largest competing banks had 136 total branches and deposits averaged approximately \$501 million per office as of June 30, 2023 within the Bank's primary service area.

In order to compete with major financial institutions in our primary service areas, we use to the fullest extent the flexibility that our independent status permits. This includes an emphasis on specialized services, local promotional activity, and personal contacts by our officers, directors and employees. In the event that there are customers whose needs exceed our lending limits, we may arrange for such loans on a participation basis with other financial institutions. We also assist customers who require other services that we do not offer by obtaining such services from correspondent banks. However, no assurance can be given that our continued efforts to compete with other financial institutions will be successful.

In addition to other banks, our competitors include savings institutions, credit unions, and numerous non-banking institutions, such as finance companies, leasing companies, insurance companies, brokerage firms, and investment banking firms. In recent years, increased competition has also developed from specialized finance and non-finance companies that offer money market and mutual funds, wholesale finance, credit card, and other consumer finance services, including online banking services and personal finance software. Strong competition for deposit and loan products affects the rates of those products as well as the terms on which they are offered to customers.

Other Competitive Factors. General competitive trends in the industry include increased consolidation and competition. Strong competitors, other than financial institutions, have entered banking markets with focused products targeted at highly profitable customer segments. Many of these competitors are able to compete across geographic boundaries and provide customers with increasing access to meaningful alternatives to banking services in nearly all significant products areas. Mergers between financial institutions have placed additional pressure on banks within the industry to streamline their operations, reduce expenses, and increase revenues to remain competitive. Competition has also intensified due to the federal and state interstate banking laws, which permit banking organizations to expand geographically, and the California market has been particularly attractive to out-of-state institutions. The Financial Modernization Act, which has made it possible for full affiliations to occur between banks and securities firms, insurance companies, and other financial companies, is also expected to intensify competitive conditions.

Technological innovations have also resulted in increased competition in the financial services industry. Such innovations have, for example, made it possible for non-depository institutions to offer customers automated transfer payment services that were previously considered traditional banking products. In addition, many customers now expect a choice of several delivery systems and channels, including telephone, mail, home computer, mobile devices, ATMs, self-service branches and/or in-store branches.

Business Concentration. No individual or single group of related accounts is considered material in relation to our total assets or deposits, or in relation to our overall business. However, approximately 90% of our loan portfolio held for investment as of December 31, 2023 consisted of real estate-related loans, including construction loans, mini-perm loans, real estate mortgage loans and commercial loans secured by real estate. Moreover, our business activities are currently focused primarily in Central California, with the majority of our business concentrated in San Joaquin, Stanislaus, Tuolumne, Sacramento, Placer, Inyo and Mono Counties. Consequently, our results of operations and financial condition are dependent upon the general trends in the Central California economies and, in particular, the residential and commercial real estate markets. In addition, the concentration of our operations in Central California exposes us to greater risk than other banking companies with a wider geographic base in the event of catastrophes, such as earthquakes, fires and floods in this region.

Employees

As of December 31, 2023, we had 230 employees (198 full-time employees and 32 part-time employees). None of our employees are currently represented by a union or covered by a collective bargaining agreement. We consider our relations with our employees to be good.

Economic Conditions and Legislative and Regulatory Developments

As is the case with financial institutions with our size and scope, our profitability primarily depends on interest rate differentials. Interest rates are highly sensitive to many factors that are beyond our control and cannot be predicted, such as inflation, recession and unemployment, and the impact that future changes in domestic and foreign economic conditions might have on the Company. A more detailed discussion of the Company's interest rate risks and the mitigation of those risks is included in Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations, in this Annual Report on Form 10-K.

Our business is also influenced by the monetary and fiscal policies of the federal government and the policies of regulatory agencies. The Federal Reserve Board implements national monetary policies (with objectives such as maintaining price stability, stimulating growth and reducing unemployment) through its open-market operations in U.S. Government securities, by adjusting the required level of reserves for depository institutions subject to its reserve requirements, and by varying the target Federal funds and discount rates applicable to borrowings by depository institutions. The actions of the Federal Reserve Board in these areas influence the growth of bank loans, investments, and deposits and also affect interest earned on interest-earning assets and interest paid on interest-bearing liabilities. The nature and impact of any future changes in monetary and fiscal policies on us cannot be predicted.

From time to time, federal and state legislation is enacted that may have the effect of materially increasing the cost of doing business, limiting or expanding permissible activities, or affecting the competitive balance between banks and other financial services providers. In light of recent conditions in the United States economy and the financial services industry, the Biden administration, Congress, the regulators and various states continue to focus attention on the financial services industry. Additional proposals that affect the industry have been and will likely continue to be introduced. The Company cannot predict whether any of these proposals will be enacted or adopted or, if they are, the effect they would have on our business, the Company's operations or financial condition.

Supervision and Regulation in General

The banking and financial services business in which we engage is highly regulated. Such regulation is intended, among other things, to protect depositors insured by the FDIC and the entire banking system. These regulations affect our lending practices, consumer protections, capital structure, investment practices and dividend policy.

The Company is a legal entity separate and distinct from the Bank. The Company and the Bank are each subject to supervision and regulation by a number of federal and state agencies and regulatory bodies, as outlined below.

The Company is subject to regulation under the Bank Holding Company Act of 1956, as amended ("BHCA"). As a bank holding company, the Company is regulated and is subject to inspection, examination and supervision by the Federal Reserve Board. It is also subject to the California Financial Code (the "Financial Code"), as well as limited oversight by the DFPI and the FDIC. Under the Federal Reserve Board's regulations, a bank holding company is required to serve as a source of financial and managerial strength to its subsidiary banks. The BHCA regulates the activities of holding companies including acquisitions, mergers, and consolidations and, together with the Gramm-Leach Bliley Act of 1999, the scope of allowable banking activities.

As a California-state chartered bank, the Bank is subject to primary supervision, examination and regulation by the DFPI and the Federal Reserve Board. The Federal Reserve Board is the primary federal regulator of state member banks. The Bank is also subject to regulation by the FDIC, which insures the Bank's deposits as permitted by law. If, as a result of an examination of a bank, the Federal Reserve Board determines that the financial condition, capital resources, asset quality, earnings prospects, management, liquidity or other aspects of its operations are unsatisfactory, or that it or its management is violating or has violated any law or regulation, various remedies are available to the Federal Reserve Board. Such remedies include the power to: enjoin "unsafe or unsound" practices; require affirmative action to correct any conditions resulting from any violation or practice; issue an administrative order that can be judicially enforced; direct an increase in capital; restrict growth; assess civil monetary penalties; remove officers and directors; institute a receivership; and, ultimately terminate the bank's deposit insurance, which would result in a revocation of its charter. The DFPI separately holds many of the same remedial powers.

The commercial banking business is also influenced by the monetary and fiscal policies of the federal government and the policies of the Board of Governors of the Federal Reserve System, also known as the FRB or the Federal Reserve Board. As a member of the Federal Reserve System, we are subject to certain regulations of the Board of Governors of the Federal Reserve System. The regulations of these agencies govern most aspects of our business, including the filing of periodic reports, and activities relating to dividends, investments, loans, borrowings, capital requirements, certain check-clearing activities, branching, mergers and acquisitions, reserves against deposits, and numerous other areas. Supervision, legal action and examination of us by the FRB is generally intended to protect depositors and is not intended for the protection of our shareholders. The Federal Reserve Board implements national monetary policies (with objectives such as curbing inflation and combating recession) by its open-market operations in U.S. government securities, by adjusting the required level of reserves for financial intermediaries subject to its reserve requirements, and by varying the discount rates applicable to borrowings by depository institutions. The actions of the Federal Reserve Board in these areas influence the growth of bank loans, investments and deposits and affects interest rates charged on loans and paid on deposits. Indirectly such actions may also impact the ability of non-bank financial institutions to compete with us. The nature and impact of any future changes in monetary policies cannot be predicted.

The laws, regulations and policies affecting financial services businesses are continuously under review by Congress and state legislatures and by federal and state regulatory agencies. From time to time, legislation is enacted which has the effect of increasing the cost of doing business, limiting or expanding permissible activities, or affecting the competitive balance between banks and other financial intermediaries. Proposals to change the laws and regulations governing the operations and taxation of banks, bank holding companies and other financial intermediaries are frequently made in Congress, in the California legislature and by various bank regulatory agencies and other professional agencies. Changes in the laws, regulations or policies that impact us cannot necessarily be predicted, but they may have a material effect on our business and earnings.

The federal and state bank regulatory agencies may respond to concerns and trends identified in examinations by taking enforcement actions against, and entering into cease and desist orders, consent orders and memoranda of understanding with, financial institutions, that would require action by management and boards of directors to address credit quality, liquidity, risk management and capital adequacy concerns, as well as other safety and soundness or compliance issues. Banks and bank holding companies are also subject to examination and potential enforcement actions by their state regulatory agencies.

Bank Holding Company and Bank Regulation

Bank holding companies and their subsidiaries are subject to significant regulation and restrictions by federal and state laws and regulatory agencies. Federal and state laws, regulations and restrictions, which may affect the cost of doing business, limit permissible activities and expansion or impact the competitive balance between banks and other financial services providers, are intended primarily for the protection of depositors and the FDIC deposit insurance fund, and secondarily for the stability of the U.S. banking system. They are not intended for the benefit of shareholders of financial institutions. The following discussion of key statutes and regulations to which the Company and the Bank are subject is a summary and does not purport to be complete nor does it address all applicable statutes and regulations. This discussion is qualified in its entirety by reference to the statutes and regulations referred to in this discussion.

The wide range of requirements and restrictions contained in both federal and state banking laws include:

- *Requirements that bank holding companies serve as a source of strength for their banking subsidiaries.* In addition, the regulatory agencies have "prompt corrective action" authority to limit activities and order an assessment of a bank holding company if the capital of a bank subsidiary falls below required capital levels.
- *Limitations on dividends payable to shareholders.* A substantial portion of the Company's funds to pay dividends or to pay principal and interest on our debt obligations is derived from dividends paid by the Bank. The Company's and the Bank's ability to pay dividends is subject to legal and regulatory restrictions. The Federal Reserve Board has authority to prohibit bank holding companies from paying dividends if such payment is deemed to be an unsafe or unsound practice.
- *Limitations on dividends payable by bank subsidiaries.* These dividends are subject to various legal and regulatory restrictions. The federal banking agencies have indicated that paying dividends that deplete a depository institution's capital base to an inadequate level would be an unsafe and unsound banking practice. Moreover, federal agencies have issued policy statements that provide that bank holding companies and insured banks should generally only pay dividends out of current operating earnings.
- *Safety and soundness requirements.* Banks must be operated in a safe and sound manner and meet standards applicable to internal controls, information systems, internal audit, loan documentation, credit underwriting, interest rate exposure, asset growth and compensation, as well as other operational and management standards. These safety and soundness requirements give bank regulatory agencies significant latitude in exercising their supervisory authority and their authority to initiate informal or formal enforcement action.
- *Requirements for approval of acquisitions and activities.* Prior approval or non-objection of the applicable federal regulatory agencies is required for most acquisitions and mergers and in order to engage in certain non-banking activities and activities that have been determined by the Federal Reserve Board to be financial in nature, incidental to financial activities, or complementary to a financial activity. Laws and regulations governing state-chartered banks contain similar provisions concerning acquisitions and activities.
- *The Community Reinvestment Act (the "CRA").* The CRA requires that banks help meet the credit needs in their communities, including the availability of credit to low and moderate income individuals. If the Company or the Bank fails to adequately serve their communities, penalties may be imposed, including denials of applications for branches, to add subsidiaries and affiliates, or to merge with or purchase other financial institutions.
- *The Bank Secrecy Act, the USA Patriot Act, and other anti-money laundering laws.* These laws and regulations require financial institutions to assist U.S. government agencies in detecting and preventing money laundering and other illegal acts by maintaining policies, procedures and controls designed to detect and report money laundering, terrorist financing, and other suspicious activity.
- Limitations on the amount of loans to one borrower and its affiliates and to executive officers and directors.
- Limitations on transactions with affiliates.
- Restrictions on the nature and amount of any investments in, and ability to underwrite certain securities.
- Requirements for opening of branches intra- and interstate.
- Fair lending and truth in lending laws to ensure equal access to credit and to protect consumers in credit transactions.
- Provisions of the Gramm-Leach Bliley Act of 1999 ("GLBA") and other federal and state laws dealing with privacy for nonpublic personal information of customers.

The following discussion summarizes certain significant laws, rules and regulations affecting both the Company and the Bank. The Bank addresses the many state and federal regulations it is subject to through a comprehensive compliance program that addresses the various risks associated with these issues. The following discussion is not meant to cover all applicable rules and regulations and it is qualified in its entirety by reference to such laws, rules and regulations which may change from time to time.

The Dodd-Frank Wall Street Reform and Consumer Protection Act

The Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act"), enacted in 2010 has broadly affected the financial services industry by creating resolution authorities, requiring ongoing stress testing of capital, mandating higher capital and liquidity requirements, increasing regulation of executive and incentive-based compensation and requiring numerous other provisions aimed at strengthening the sound operation of the financial services sector depending, in part, on the size of the financial institution. Among other things, the Dodd-Frank Act provides for:

- capital standards applicable to bank holding companies may be no less stringent than those applied to insured depository institutions;
- annual stress tests and early remediation or so-called living wills are required for larger banks with more than \$50 billion of assets as well as risk committees of their boards of directors that include a risk expert, and such requirements may have the effect of establishing new best practices standards for smaller banks;
- trust preferred securities must generally be deducted from Tier 1 capital although depository institution holding companies with assets of less than \$15 billion as of year-end 2009 were grandfathered with respect to such securities issued prior to March 19, 2020 for purposes of calculating regulatory capital;
- the assessment base for federal deposit insurance was changed to consolidated assets less tangible capital instead of the amount of insured deposits, which generally increased the insurance fees of larger banks, but had relatively less impact on smaller banks;
- repeal of the federal prohibition on the payment of interest on demand deposits, including business checking accounts, and made permanent the \$250,000 limit for federal deposit insurance;
- the establishment of the Consumer Finance Protection Bureau (the "CFPB") with responsibility for promulgating regulations designed to protect consumers' financial interests and prohibit unfair, deceptive and abusive acts and practices by financial institutions, and with authority to directly examine those financial institutions with \$10 billion or more in assets for compliance with the regulations promulgated by the CFPB;
- limits, or places significant burdens and compliance and other costs, on activities traditionally conducted by banking organizations, such as originating and securitizing mortgage loans and other financial assets, arranging and participating in swap and derivative transactions, proprietary trading and investing in private equity and other funds; and
- the establishment of new compensation restrictions and standards regarding the time, manner and form of compensation given to key executives and other personnel receiving incentive compensation, including documentation and governance, proxy access by stockholders, deferral and claw-back requirements.

As required by the Dodd-Frank Act, federal regulators have adopted regulations to (i) increase capital requirements on banks and bank holding companies pursuant to Basel III, and (ii) implement the so-called "Volcker Rule" of the Dodd-Frank Act, which significantly restricts certain activities by covered bank holding companies, including restrictions on proprietary trading and private equity investing.

In addition to the Dodd-Frank Act, other legislative and regulatory proposals affecting banks have been made both domestically and internationally. Among other things, these proposals include significant additional capital and liquidity requirements and limitations on size or types of activity in which banks may engage.

Legislation is introduced from time to time in the United States Congress that may affect our operations. In addition, the regulations governing us may be amended from time to time. Any legislative or regulatory changes in the future could adversely affect our operations and financial condition.

Volcker Rule

The "Volcker Rule" prohibits insured depository institutions and companies affiliated with insured depository institutions ("banking entities") from engaging in short-term proprietary trading of certain securities, derivatives, commodity futures and options on these instruments, for their own account. The Volcker Rule also imposes limits on banking entities' investments in, and other relationships with, hedge funds or private equity funds. Certain collateralized debt obligations, securities backed by trust preferred securities are exempted.

The Volcker Rule provides exemptions for certain activities, including market making, underwriting, hedging, trading in government obligations, insurance company activities, and organizing and offering hedge funds or private equity funds. The Volcker Rule also clarifies that certain activities are not prohibited, including acting as agent, broker, or custodian.

The compliance requirements under the Volcker Rule vary based on the size of the banking entity and the scope of activities conducted. Banking entities with significant trading operations will be required to establish a detailed compliance program and their CEOs will be required to attest that the program is reasonably designed to achieve compliance with the final rule. Independent testing and analysis of an institution's compliance program will also be required. The Volcker Rule reduces the burden on smaller, less-complex institutions by limiting their compliance and reporting requirements. Additionally, a banking entity that does not engage in covered trading activities will not need to establish a compliance program. The Company and the Bank held no investment positions at December 31, 2023 or 2022 that were subject to the final rule. Therefore, while these new rules may require us to conduct certain internal analysis and reporting, we believe that they will not require any material changes in our operations or business.

Capital Adequacy Requirements

Banks and bank holding companies are subject to various capital requirements administered by state and federal banking agencies. Capital adequacy guidelines involve quantitative measures of assets, liabilities and certain off-balance-sheet items calculated under regulatory accounting practices. Capital amounts and classifications are also subject to qualitative judgments by regulators about components, risk weighting and other factors.

The federal banking agencies have adopted risk-based minimum capital guidelines intended to provide a measure of capital that reflects the degree of risk associated with a banking organization's operations for both transactions reported on the balance sheet as assets and transactions which are recorded as off balance sheet items. Under these guidelines, nominal dollar amounts of assets and credit equivalent amounts of off balance sheet items are multiplied by one of several risk adjustment percentages, which range from 0% for assets with low credit risk, such as federal banking agencies, to 100% for assets with relatively high credit risk. The higher the category, the more risk a bank is subject to and thus the more capital that is required.

The regulatory agencies' risk-based capital guidelines are based upon capital accords of the internal Basel Committee on Bank Supervision ("Basel Committee"), a committee of central banks and bank supervisors/regulators from the major industrialized countries that develops broad policy guidelines, which each country's supervisors can use to determine the supervisory policies they apply to their home jurisdiction. The U.S. regulatory capital rules implementing the Basel III regulatory capital framework provide for a minimum common equity Tier 1 ratio (4.5% of risk-weighted assets), a minimum Tier 1 risk-based capital requirement (6.0% of risk-weighted assets) and a minimum non-risk-based leverage ratio (4.00% eliminating a 3.00% exception for higher rated banks) as well as an additional capital conservation buffer of 2.5% of risk weighted assets over each of the required capital ratios, which must be met to avoid limitations on the ability of the Bank to pay dividends, repurchase shares or pay discretionary bonuses. The additional "countercyclical capital buffer" is also required for larger and more complex institutions. The rules assign higher risk weighting to exposures that are more than 90 days past due or are on nonaccrual status and certain commercial real estate facilities that finance the acquisition, development or construction of real property.

In addition to the risk-based guidelines, federal banking regulators require banking organizations to maintain a minimum amount of Tier 1 capital to total average assets, referred to as the leverage ratio. Banks that have received the highest rating of the five categories used by regulators to rate banks and are not anticipating or experiencing any significant growth must maintain a ratio of Tier 1 capital (net of all intangibles) to adjusted total assets, or "Leverage Capital Ratio", of at least 3%. All other institutions are required to maintain a leverage ratio of at least 100 to 200 basis points above the 3% minimum, for a minimum of 4% to 5%. Pursuant to federal regulations, banks must maintain capital levels commensurate with the level of risk to which they are exposed, including the volume and severity of problem loans.

Federal banking regulators may set capital requirements higher than the minimums described above for financial institutions whose circumstances warrant it. For example, a financial institution experiencing or anticipating significant growth may be expected to maintain capital positions substantially above the minimum supervisory levels without significant reliance on intangible assets.

A bank may be treated as though it were in the next lower capital category if, after notice and the opportunity for a hearing, the appropriate federal agency finds an unsafe or unsound condition or practice so warrants, but no bank may be treated as "critically undercapitalized" unless its actual capital ratio warrants such treatment.

At each successively lower capital category, an insured bank is subject to increased restrictions on its operations. For example, a bank is generally prohibited from paying management fees to any controlling persons or from making capital distributions, if to do so would make the Bank "undercapitalized." Asset growth and branching restrictions apply to undercapitalized banks, which are required to submit written capital restoration plans meeting specified requirements (including a guarantee by the parent holding company, if any). "Significantly undercapitalized" banks are subject to broad regulatory authority, including among other things, capital directives, forced mergers, restrictions on the rates of interest they may pay on deposits, restrictions on asset growth and activities, and prohibitions on paying certain bonuses without FRB approval. Even more severe restrictions apply to critically undercapitalized banks. Most importantly, except under limited circumstances, the appropriate federal banking agency is required to appoint a conservator or receiver for an insured bank not later than 90 days after the Bank becomes critically undercapitalized.

In addition to measures taken under the prompt corrective action provisions, insured banks may be subject to potential actions by federal regulators for unsafe or unsound practices in conducting their businesses or for violations of any law, rule, regulation or any condition imposed in writing by the agency or any written agreement with the agency. Enforcement actions may include the issuance of cease and desist orders, termination of insurance of deposits (in the case of a bank), the imposition of civil money penalties, the issuance of directives to increase capital, formal and informal agreements, or removal and prohibition orders against "institution-affiliated" parties.

Proposed new rules for U.S. implementation of capital requirements under Basel IV rules, more recently referred to as the Basel III "Endgame", were issued by the U.S. federal banking agencies on July 27, 2023. These proposed rules include broad-based changes to the risk-weighting framework for various credit exposures and operational risk capital requirements. However, the proposed rules generally apply only to large banking organizations with total assets of \$100 billion or more, and hence, would not be applicable to the Company.

Dividends

The payment of cash dividends by the Bank to the Company is subject to restrictions set forth in the Financial Code. Prior to any distribution from the Bank to the Company, a calculation is made to ensure compliance with the provisions of the Financial Code and to ensure that the Bank remains within capital guidelines set forth by the DFPI and the FRB. In the event that the intended distribution from the Bank to the Company exceeds the restriction in the Financial Code, advance approval from the FRB is required. Management anticipates that there will be sufficient earnings at the Bank level to provide dividends to the Company to meet its cash requirements for 2024.

Safety and Soundness Standards

Federal banking agencies have also adopted guidelines establishing safety and soundness standards for all insured depository institutions. Those guidelines relate to internal controls, information systems, internal audit systems, loan underwriting and documentation, compensation and interest rate exposure. In general, the standards are designed to assist the federal banking agencies in identifying and addressing problems at insured depository institutions before capital becomes impaired. If an institution fails to meet these standards, the appropriate federal banking agency may require the institution to submit a compliance plan and institute enforcement proceedings, if an acceptable compliance plan is not submitted.

Compensation

Federal banking agencies have issued joint guidance on incentive compensation designed to ensure that the incentive compensation policies of banking organizations such as the Company are consistent with the safety and soundness of the organization and its subsidiary banks. In 2016, as required by the Dodd-Frank Act, the federal bank regulatory agencies and the SEC proposed revised rules on incentive-based payment arrangements at specified regulated entities having at least \$1 billion of total assets. These guidelines prohibit excessive compensation as an unsafe and unsound practice and describe compensation as excessive when the amounts paid are unreasonable or disproportionate to the services performed by an executive officer, employee, director, or principal stockholder.

In October 2022, the SEC adopted final rules implementing the incentive-based compensation recovery ("clawback") provisions of the Dodd-Frank Act. The final rules direct stock exchanges to adopt listing standards that require listed companies to implement clawback policies to recover incentive-based compensation from current or former executive officers in the event of certain financial restatements and to disclose their clawback policies and their actions under those policies. In June 2023, the SEC approved the Nasdaq Stock Market and the New York Stock Exchange's proposed clawback listing standards. Listed companies were required to adopt their clawback policy no later than December 1, 2023. The Company has adopted a Nasdaq compliant clawback policy which is included as an exhibit to this Annual Report on Form 10-K.

Deposit Insurance and FDIC Insurance Assessments

Our deposits are insured by the FDIC to the maximum amount permitted by law, which is currently \$250,000 per depositor.

As insurer, the FDIC imposes deposit insurance premiums and is authorized to conduct examinations of and to require reporting by FDIC-insured institutions.

The FDIC assesses deposit insurance premiums quarterly on each FDIC-insured institution based on annualized rates. Each institution with \$10 billion or more in assets is assessed under a scorecard method using supervisory ratings, financial ratios and other factors. Such institutions are also subject to a temporary surcharge required by the Dodd-Frank Act. As required by the Dodd-Frank Act, deposit insurance premiums are assessed on the amount of an institution's total assets minus its Tier 1 capital. Smaller institutions are assessed by a method using supervisory ratings and financial ratios.

Community Reinvestment Act

We are subject to certain requirements and reporting obligations involving the CRA. The CRA generally requires federal banking agencies to evaluate the record of financial institutions in meeting the credit needs of local communities, including low and moderate-income neighborhoods. The CRA further requires that a record be kept of whether a financial institution meets its community credit needs, which record will be taken into account when evaluating applications for, among other things, domestic branches, consummating mergers or acquisitions, or holding company formations. In measuring a bank's compliance with its CRA obligations, the regulators now utilize a performance-based evaluation system, which bases CRA ratings on the Company's actual lending service and investment performance, rather than on the extent to which the institution conducts needs assessments, documents community outreach activities or complies with other procedural requirements. In connection with its assessment of CRA performance, the FRB assigns a rating of "outstanding," "satisfactory," "needs to improve" or "substantial noncompliance." Our CRA performance is evaluated by the FRB under the intermediate small bank requirements. The FRB's last CRA performance examination was performed on us and completed in January of 2023 and we received an overall "Outstanding" CRA Assessment Rating.

On May 5, 2022, the FDIC, OCC and the Federal Reserve issued a joint notice of proposed rulemaking to strengthen and modernize the CRA regulatory framework. On October 24, 2023, the federal bank regulatory agencies jointly issued a final rule to modernize CRA regulations consistent with the following key goals: (1) to encourage banks to expand access to credit, investment, and banking services in low to moderate income communities; (2) to adapt to changes in the banking industry, including internet and mobile banking and the growth of non-branch delivery systems; (3) to provide greater clarity and consistency in the application of the CRA regulations, including adoption of a new metrics-based approach to evaluating bank retail lending and community development financing; and (4) to tailor CRA evaluations and data collection to bank size and type, recognizing differences in bank size and business models may impact CRA evaluations and qualifying activities. Most of the final CRA rule's requirements will be applicable beginning January 1, 2026, with certain requirements, including the data reporting requirements, applicable as of January 1, 2027. We are currently evaluating the impact of the modified CRA regulations, but do not anticipate any resulting material impact to its operations or compliance objectives.

Anti-Money Laundering Regulations

A series of banking laws and regulations beginning with the Bank Secrecy Act in 1970 require banks to prevent, detect, and report illicit or illegal financial activities to the federal government to prevent money laundering, international drug trafficking, and terrorism. Under the USA Patriot Act, financial institutions are subject to prohibitions against specified financial transactions and account relationships as well as enhanced due diligence and "know your customer" standards in their dealings with high risk customers, foreign financial institutions, and foreign individuals and entities. We have extensive controls to comply with these requirements.

Privacy, Data Security and Cybersecurity

The GLBA of 1999 imposed requirements on financial institutions with respect to consumer privacy. The GLBA generally prohibits disclosure of consumer information to non-affiliated third parties unless the consumer has been given the opportunity to object and has not objected to such disclosure. Financial institutions are further required to disclose their privacy policies to consumers annually. The GLBA also directs federal regulators to prescribe standards for the security of consumer information. We are subject to such standards, as well as standards for notifying consumers in the event of a security breach. We must disclose our privacy policy to consumers and permit consumers to "opt out" of having certain personal financial information disclosed to unaffiliated third parties. We are required to have an information security program to safeguard the confidentiality and security of customer information and to ensure proper disposal. Customers must be notified when unauthorized disclosure involves sensitive customer information that may be misused.

Data privacy and data security are areas of increasing state legislative focus. For example, the California Consumer Protection Act of 2018 (the "CCPA"), which became effective on January 1, 2020, applies to for-profit businesses that conduct business in California and meet certain revenue or data collection thresholds. The CCPA gives California residents the right to, among other things, request disclosure of information collected about them and whether that information has been sold to others, request deletion of personal information (subject to certain exceptions), opt out of the sale of their personal information, and not be discriminated against for exercising these rights. In addition, the California Privacy Rights Act ("CPRA"), which became effective in most material respects on January 1, 2023, significantly modifies the CCPA, including by expanding California residents' rights with respect to certain sensitive personal information. The CPRA also creates a new state agency which will be vested with authority to implement and enforce the CCPA and the CPRA. We will continue to monitor developments related to the CPRA. The full impact of the CPRA on our business is yet to be determined.

Like other lenders, we use credit bureau data in their underwriting activities. Use of such data is regulated under the Fair Credit Reporting Act ("FCRA"), and the FCRA also regulates reporting information to credit bureaus, prescreening individuals for credit offers, sharing of information between affiliates and using affiliate data for marketing purposes. Similar state laws may impose additional requirements on us.

Cybersecurity also remains an area of significant regulatory focus, and state regulators have also been increasingly active in implementing cybersecurity standards and regulations. In November 2021, the Federal Reserve, OCC, and FDIC issued a final rule that, among other things, requires all banking organizations in the United States to notify their primary federal regulators of certain material computer-security incidents as soon as possible and no later than 36 hours after determining that the incident has occurred. The SEC recently issued a Cybersecurity Risk Management, Strategy, Governance, and Incident Disclosure rule, which became effective in December of 2023, and which requires that a registered company file a Form 8-K to disclose the occurrence of a material cybersecurity incident within four business days of determining that such an incident has occurred. The rule also requires that a registered company include certain information regarding its information security program as part of its annual Form 10-K filing, including a discussion of its processes for assessing, identifying, and managing material risks from cybersecurity threats and a description of oversight and management of cybersecurity threats at the board and management levels. Recently, several states have adopted regulations requiring certain financial institutions to implement cybersecurity programs and providing detailed requirements with respect to these programs, including data encryption requirements. Many states have also recently implemented or modified their data breach notification and data privacy requirements.

Other Consumer Protection Laws and Regulations

Bank regulatory agencies are increasingly focusing on compliance with consumer protection laws and regulations.

Interest and other charges collected or contracted for by the Bank are subject to state usury laws and federal laws concerning interest rates. The Bank's operations are also subject to federal laws applicable to credit transactions, and consumer protection statutes and regulations, such as the:

- Truth-In-Lending Act, governing disclosures of credit terms to consumer borrowers;
- Home Mortgage Disclosure Act, requiring financial institutions to provide information to enable the public and public officials to determine whether a financial institution is fulfilling its obligation to help meet the housing needs of the community it serves;
- Equal Credit Opportunity Act, prohibiting discrimination on the basis of race, creed or other prohibited factors in extending credit;
- Fair Credit Reporting Act, governing the use and provision of information to credit reporting agencies;
- Fair Debt Collection Act, governing the manner in which consumer debts may be collected by collection agencies;
- Truth in Savings Act; and
- rules and regulations of the various federal agencies charged with the responsibility of implementing such federal laws.

The operations of the Bank are also subject to the:

- Right to Financial Privacy Act, which imposes a duty to maintain confidentiality of consumer financial records and prescribes procedures for complying with administrative subpoenas of financial records;
- Electronic Funds Transfer Act and Regulation E promulgated thereunder, which govern automatic deposits to and withdrawals from deposit accounts and customers' rights and liabilities arising from the use of automated teller machines and other electronic banking services;
- Check Clearing for the 21st Century Act, which gives "substitute checks," such as digital check images and copies made from that image, the same legal standing as the original paper check; and
- The Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act of 2001, as amended (the "USA Patriot Act"), which requires financial institutions to, among other things, establish broadened anti-money laundering compliance programs, and due diligence policies and controls to ensure the detection and reporting of money laundering. Such required compliance programs are intended to supplement existing compliance requirements that also apply to financial institutions under the Bank Secrecy Act and the Office of Foreign Assets Control regulations.

Due to heightened regulatory concern related to compliance with consumer protection laws and regulations generally, we may incur additional compliance costs or be required to expend additional funds for investments in the local communities we serve.

Restriction on Transactions between Member Banks and their Affiliates

Transactions between the Company and the Bank are quantitatively and qualitatively restricted under Sections 23A and 23B of the Federal Reserve Act and Federal Reserve Regulation W. Section 23A places restrictions on the Bank's "covered transactions" with the Company, including loans and other extensions of credit, investments in the securities of, and purchases of assets from the Company. Section 23B requires that certain transactions, including all covered transactions, be on market terms and conditions. Federal Reserve Regulation W combines statutory restrictions on transactions between the Bank and the Company with FRB interpretations in an effort to simplify compliance with Sections 23A and 23B.

Securities Laws and Corporate Governance

The Company is subject to the disclosure and regulatory requirements of the 1933 Act and the 1934 Act, both as administered by the SEC. As a company listed on the Nasdaq Global Select Market, the Company is subject to Nasdaq listing standards for listed companies.

As discussed above, we are also subject to the Sarbanes-Oxley Act of 2002, provisions of the Dodd-Frank Act, and other federal and state laws and regulations which address, among other issues, required executive certification of financial presentations, corporate governance requirements for board audit committees and their members, and disclosure of controls and procedures and internal control over financial reporting, auditing and accounting, executive compensation, and enhanced and timely disclosure of corporate information. Nasdaq has also adopted corporate governance rules, which are intended to allow shareholders and investors to more easily and efficiently monitor the performance of companies and their directors.

Finally, the Company is subject to the provisions of the California General Corporation Law, while the Bank is also subject to the Financial Code provisions.

Environmental Regulations

In the course of our business, we may foreclose and take title to real estate, and could be subject to environmental liabilities with respect to these properties. We may be held liable to a governmental entity or to third parties for property damage, personal injury, investigation and clean-up costs incurred by these parties in connection with environmental contamination, or may be required to investigate or clean up hazardous or toxic substances, or chemical releases at a property. The costs associated with investigation or remediation activities could be substantial. In addition, as the owner or former owner of a contaminated site, we may be subject to common law claims by third parties based on damages and costs resulting from environmental contamination emanating from the property. If we ever become subject to significant environmental liabilities, our business, financial condition, liquidity and results of operations could be materially and adversely affected.

Climate-related Developments

Climate change and the risks it may pose to financial institutions is an area of increased focus by the federal and state legislative bodies and regulators, including the federal banking agencies. In the future, new regulations or guidance may be issued, or other regulatory or supervisory actions may be taken, in this area by the federal banking agencies or other regulatory agencies, or new statutory requirements may be adopted. For example, the federal banking agencies have issued principles for climate-related financial risk management, which are designed to support the identification and management of climate-related financial risks at regulated institutions with more than \$100 billion in total consolidated assets. Recently, on March 6, 2024, the SEC adopted new rules that require public companies to disclose substantial information about the material impacts of climate-related risks on their business, financial condition, and governance. These new rules require disclosure of a range of climate-related matters, including: (i) any material climate-related risks and their impacts on the registrant's business strategy, results of operations, and financial condition, as well as on the registrant's outlook and business model, (b) any activities, plans, or processes to mitigate, adapt to, or manage material climate-related risks, including the use of transition plans, scenario analyses, or internal carbon prices, (c) Any board oversight and management role in assessing and managing material climate-related risks, (d) any targets or goals that have materially affected or are reasonably likely to materially affect the registrant's business, results of operations, or financial condition, and (e) the financial statement effects of severe weather events and other natural conditions, including costs and losses. Compliance dates will be phased-in among different classes of registrants, with most disclosure and financial statement rules taking effect for smaller reporting companies beginning on fiscal year 2027.

Other Pending and Proposed Legislation

Other legislative and regulatory initiatives which could affect us and the banking industry, in general, are pending and additional initiatives may be proposed or introduced before the United States Congress, the California legislature and other governmental bodies in the future. Such proposals, if enacted, may further alter the structure, regulation and competitive relationship among financial institutions, and may subject us to increased regulation, disclosure and reporting requirements. In addition, the various banking regulatory agencies often adopt new rules and regulations to implement and enforce existing legislation. We cannot predict whether, or in what form, any such legislation or regulations may be enacted or the extent to which our business would be affected thereby.

Available Information

The Company maintains an Internet website at www.ovcb.com. The Company makes available its annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and amendments to such reports filed or furnished pursuant to Section 13(a) or 15(d) of the 1934 Act and other information related to the Company free of charge, through this site as soon as reasonably practicable after it electronically files those documents with, or otherwise furnishes them to, the SEC. The SEC maintains a website, <http://www.sec.gov>, that contains the reports, proxy and information statements and other information we file with them. The Company's website also contains its Committee Charters, Code of Ethics, Code of Conduct and Corporate Governance Guidelines. We also use our website as a tool to disclose important information about the company and comply with our disclosure obligations under Regulation Fair Disclosure. The Company's internet website and the information contained therein or connected thereto are not intended to be incorporated into this annual report on Form 10-K.

In addition, copies of our filings are available by requesting them in writing or by phone from:

Corporate Secretary
Oak Valley Bancorp
125 North Third Avenue
Oakdale, California
209-844-7578

ITEM 1A. RISK FACTORS

An investment in our securities is subject to certain risks. These risk factors and the risks discussed in Management's Discussion and Analysis of Financial Condition and Results of Operations and Quantitative and Qualitative Disclosures About Market Risk should be considered by prospective and current investors in our securities when evaluating the disclosures in this Annual Report on Form 10-K. The risks and uncertainties not presently known to us or that we currently deem immaterial also may impair our business operations. If any of the following risks actually occur, our business, results of operations and financial condition could suffer. In that event, the value of our securities could decline, and you may lose all or part of your investment.

Risks Associated with Our Business

Our business strategy includes sustainable growth plans, and our financial condition and results of operations could be negatively affected if we fail to grow or fail to manage our growth effectively.

We intend to pursue an organic growth strategy for our business. If appropriate opportunities present themselves, we may also engage in selected acquisitions of financial institutions, branch acquisitions and other business growth initiatives or undertakings. There can be no assurance that we will successfully execute our organic growth strategy, that we will be able to negotiate or finance such activities or that such activities, if undertaken, will be successful.

There are risks associated with our growth strategy. To the extent that we grow through acquisitions, we cannot ensure that we will be able to adequately or profitably manage this growth. Acquiring other banks, branches or other assets, as well as other expansion activities, involves various risks including the risks of incorrectly assessing the credit quality of acquired assets, encountering greater than expected costs of integrating acquired banks or branches, the risk of loss of customers and/or employees of the acquired institution or branch, executing cost savings measures, not achieving revenue enhancements and otherwise not realizing the transaction's anticipated benefits. Our ability to address these matters successfully cannot be assured. There is also the risk that the requisite regulatory approvals might not be received and other conditions to consummation of a transaction might not be satisfied during the anticipated timeframes, or at all. In addition, our strategic efforts may divert resources or management's attention from ongoing business operations, may require investment in integration and in development and enhancement of additional operational and reporting processes and controls, and may subject us to additional regulatory scrutiny. To finance an acquisition, we may borrow funds, thereby increasing our leverage and diminishing our liquidity, or raise additional capital, which could dilute the interests of our existing stockholders.

Our growth initiatives may also require us to recruit experienced personnel to assist in such initiatives. Accordingly, the failure to identify and retain such personnel would place significant limitations on our ability to successfully execute our growth strategy. In addition, to the extent we expand our lending beyond our current market areas, we could incur additional risks related to those new market areas. We may not be able to expand our market presence in our existing market areas or successfully enter new markets.

If we do not successfully execute our growth plan, it could adversely affect our business, financial condition, results of operations, reputation and growth prospects. In addition, if we were to conclude that the value of an acquired business had decreased and that the related goodwill had been impaired, that conclusion would result in an impairment of goodwill charge to us, which would adversely affect our results of operations. While we believe we will have the executive management resources and internal systems in place to successfully manage our future growth, there can be no assurance growth opportunities will be available or that we will successfully manage our growth.

Our financial condition and results of operations are dependent on the economy, particularly in the Bank's market areas.

Our primary market area is concentrated in the Central Valley and the Eastern Sierras. Adverse economic conditions in any of these areas can reduce our rate of growth, affect our customers' ability to repay loans and adversely impact our financial condition and earnings. General economic conditions, including inflation, unemployment and money supply fluctuations, also may affect our profitability adversely.

A deterioration in economic conditions in the market areas we serve could result in the following consequences, any of which could have a material adverse effect on our business, financial condition and results of operations:

- Demand for our products and services may decline;
- Loan delinquencies, problem assets and foreclosures may increase;
- Collateral for our loans may further decline in value; and
- The amount of our low cost or noninterest-bearing deposits may decrease.

We cannot accurately predict the possibility of weakness in the national or local economy effecting our future operating results.

We cannot accurately predict the possibility of the national or local economy's return to recessionary conditions or to a period of economic weakness, which would adversely impact the markets we serve. Any deterioration in national or local economic conditions would have an adverse effect, which could be material, on our business, financial condition, results of operations and prospects, and any economic weakness could present substantial risks for the banking industry and for us.

Adverse developments affecting the financial services industry, such as actual events or concerns involving liquidity, defaults, or non-performance by financial institutions or transactional counterparties, could adversely affect our current and projected business operations and our financial condition and results of operations.

Actual events involving limited liquidity, defaults, non-performance or other adverse developments that affect financial institutions, transactional counterparties or other companies in the financial services industry or the financial services industry generally, or concerns or rumors about any events of these kinds or other similar risks, have in the past and may in the future lead to market-wide liquidity problems. For example, on March 10, 2023, Silicon Valley Bank ("SVB") was closed by the California Department of Financial Protection and Innovation, which appointed the FDIC as receiver. Similarly, on March 12, 2023, Signature Bank and Silvergate Capital Corp. were each swept into receivership. Although a statement by the Department of the Treasury, the Federal Reserve and the FDIC indicated that all depositors of SVB would have access to all of their money after only one business day of closure, including funds held in uninsured deposit accounts, it is not certain that the Federal Reserve or FDIC will treat future bank failures similarly. Hence, borrowers under credit agreements, letters of credit and certain other financial instruments with any financial institution that is placed into receivership by the FDIC may be unable to access undrawn amounts thereunder. In addition, if any of our customers, suppliers or other parties with whom we conduct business are unable to access funds pursuant to such instruments or lending arrangements with such a financial institution, such parties' ability to pay their obligations to us or to enter into new commercial arrangements requiring additional payments to us could be adversely affected.

Inflation and rapid increases in interest rates have led to a decline in the trading value of previously issued government securities with interest rates below current market interest rates. Additionally, there is no guarantee that the U.S. Department of Treasury, FDIC and Federal Reserve Board will provide access to uninsured funds in the future in the event of the closure of other banks or financial institutions, or that they would do so in a timely fashion. There can be no assurance that there will not be additional bank failures or issues such as liquidity concerns in the broader financial services industry or in the U.S. financial system as a whole. Adverse financial market and economic conditions can exert downward pressure on stock prices, security prices, and credit availability for certain issuers without regard to their underlying financial strength.

Any of these impacts, or any other impacts resulting from the factors described above or other related or similar factors, could have material adverse effect on our liquidity and our current and/or projected business operations and financial condition and results of operations.

Recent bank failures have created significant market volatility, regulatory uncertainty, and decreased confidence in the U.S. banking system.

The failures of Silicon Valley Bank and Signature Bank in March 2023, followed by the failure of First Republic Bank in May 2023, have caused significant market volatility, regulatory uncertainty, and decreased confidence in the U.S. banking system. These bank failures occurred during a period of rapidly rising interest rates which, among other things, has resulted in unrealized losses in longer duration securities and more competition for bank deposits, and may increase the risk of a potential economic recession in the United States. The failure of other financial institutions may cause deposit outflows as customers spread deposits among several different banks so as to maximize their amount of FDIC insurance, move deposits to banks deemed "too big to fail" or remove deposits from the U.S. financial system entirely. Given such an environment, we may experience more deposit volatility as customers react to adverse events or market speculation involving financial institutions. Inability to access short-term funding or the loss of client deposits could increase our cost of funding, limit access to capital markets or negatively impact our overall liquidity or capitalization.

Ratings agencies have also reacted to recent events by issuing updated ratings and assessments. On April 21, 2023, Moody's lowered the macro profile of the U.S. banking system reflecting general concern around the banking industry as a whole. Our ratings are subject to further adjustments based on a number of factors, including our financial strength and ability to generate earnings as well as factors not entirely within our control, such as conditions affecting the financial services industry generally.

In response to the bank failures, the United States government may adopt a variety of measures and new regulations designed to strengthen capital levels, liquidity standards, and risk management practices and otherwise restore confidence in financial institutions. Any reforms, if adopted, could have a significant impact on banks and bank holding companies. The premiums of the FDIC's deposit insurance program are expected to increase, and banking regulators have signaled further review of regulatory requirements and the potential for changes to laws or regulations governing banks and bank holding companies. Changes resulting from these events could include increased regulatory oversight, higher capital requirements or changes in the way regulatory capital is calculated, and the impositions of additional restrictions through regulatory changes or supervisory or enforcement activities, each of which could have a material impact on our business.

The failure to address the federal debt ceiling in a timely manner, downgrades of the U.S. credit rating and uncertain credit and financial market conditions may affect the stability of securities issued or guaranteed by the federal government, which may affect the valuation or liquidity of our investment securities portfolio and increase future borrowing costs.

Recent federal budget deficit concerns and political conflict over legislation to raise the U.S. government's debt limit have increased the possibility of a default by the U.S. government on its debt obligations, related credit-rating downgrades, or an economic recession in the United States. As a result of uncertain political, credit and financial market conditions, including the potential consequences of the federal government defaulting on its obligations for a period of time due to federal debt ceiling limitations or other unresolved political issues, investments in financial instruments issued or guaranteed by the federal government pose credit default and liquidity risks. Given that future deterioration in the U.S. credit and financial markets is a possibility, losses or significant deterioration in the fair value of our U.S. government issued or guaranteed investments may occur. Downgrades to the U.S. credit rating could affect the stability of securities issued or guaranteed by the federal government and the valuation or liquidity of our portfolio of such investment securities, and could result in our counterparties requiring additional collateral for our borrowings. Further, unless and until U.S. political, credit and financial market conditions have been sufficiently resolved or stabilized, it may increase our future borrowing costs.

There are risks associated with our lending activities and our allowance for credit losses may prove to be insufficient to absorb actual incurred losses in our loan portfolio.

Lending money is a substantial part of our business. Every loan carries a certain risk that it will not be repaid in accordance with its terms or that any underlying collateral will not be sufficient to assure repayment. This risk is affected by, among other things:

- cash flow of the borrower and/or the project being financed;
- in the case of a collateralized loan, the changes and uncertainties as to the future value of the collateral;
- the credit history of a particular borrower;
- changes in economic and industry conditions; and
- the duration of the loan.

We maintain an allowance for credit losses which we believe is appropriate to provide for current expected credit losses inherent in our loan portfolio. The amount of this allowance is determined by our management through a periodic review and consideration of several factors, including, but not limited to:

- an ongoing review of the quality, size and diversity of the loan portfolio;
- evaluation of non-performing loans;
- historical default and loss experience;
- historical recovery experience;
- existing economic conditions;
- reasonable and supportable forecasts that affect the collectability of reported amounts;
- risk characteristics of the various classifications of loans; and
- the amount and quality of collateral, including guarantees, securing the loans.

If actual losses on our loans exceed our estimates used to establish our allowance for credit losses, our business, financial condition and profitability may suffer.

The determination of the appropriate level of the allowance for credit losses inherently involves a high degree of subjectivity and requires us to make various assumptions and judgments about the collectability of our loan portfolio, including the creditworthiness of our borrowers and the value of the real estate and other assets serving as collateral for the repayment of many of our loans. In determining the amount of the allowance for credit losses, we review our loans and the loss and delinquency experience, and evaluate economic conditions and make significant estimates of current credit risks and future trends, all of which may undergo material changes. If our estimates are incorrect, the allowance for credit losses may not be sufficient to cover losses inherent in our loan portfolio, resulting in the need for additions to our allowance through an increase in the provision for credit losses. Deterioration in economic conditions affecting borrowers, new information regarding existing loans, identification of additional problem loans and other factors, both within and outside of our control, may require an increase in the allowance for credit losses. In addition, bank regulatory agencies periodically review our allowance for credit losses and may require an increase in the provision for credit losses or the recognition of further charge-offs (which will in turn also require an increase in the provision for credit losses if the charge-offs exceed the allowance for credit losses), based on judgments different than that of management. Any increases in the provision for credit losses will result in a decrease in net income and may have a material adverse effect on our financial condition and results of operations.

Our underwriting practices may not protect us against losses in our loan portfolio.

We seek to mitigate the risks inherent in our loan portfolio by adhering to specific underwriting practices, including: analyzing a borrower's credit history, financial statements, tax returns and cash flow projections; valuing collateral based on reports of independent appraisers; and verifying liquid assets. Although we believe that our underwriting criteria are, and historically have been, appropriate for the various kinds of loans we make, we have incurred losses on loans that have met these criteria, and may continue to experience higher than expected losses depending on economic factors and consumer behavior. In addition, our ability to assess the creditworthiness of our customers may be impaired if the models and approaches we use to select, manage, and underwrite our customers become less predictive of future behaviors. Finally, we may have higher credit risk, or experience higher credit losses, to the extent our loans are concentrated by loan type, industry segment, borrower type, or location of the borrower or collateral. Deterioration in real estate values and underlying economic conditions in the Central Valley and the Eastern Sierras could result in significantly higher credit losses to our portfolio.

Because our loan portfolio has a large concentration of real estate loans, and commercial real estate loans in particular, negative changes in the economy affecting real estate values and liquidity, or regional and national market conditions, could impair the value of collateral securing our real estate loans and result in loan and other losses.

As of December 31, 2023, consumer and commercial real estate loans constituted 90% of our loan portfolio, of which 97% were commercial real estate loans. Our real estate portfolio is subject to certain risks, including (i) downturns in the California economy, (ii) significant interest rate fluctuations, (iii) reduction in real estate values in the California Central Valley, (iv) increased competition in pricing and loan structure, and (v) environmental risks, including natural disasters. As a result of the high concentration of real estate loans in our loan portfolio, potential difficulties in the real estate markets could cause significant increases in nonperforming loans, which would reduce our profits. The market value of real estate can fluctuate significantly in a short period of time as a result of market conditions in the geographic area in which the real estate is located. A decline in real estate values could cause some of our mortgage loans to become inadequately collateralized, which would expose us to a greater risk of loss. Real estate values and real estate markets are generally affected by changes in national, regional or local economic conditions, the rate of unemployment, fluctuations in interest rates and the availability of loans to potential purchasers, changes in tax laws and other governmental statutes, regulations and policies and acts of nature, such as earthquakes and other natural disasters. Additionally, a decline in real estate values could adversely affect our portfolio of commercial real estate loans and could result in a decline in the origination of such loans.

Our commercial real estate loans involve higher principal amounts than other loans and repayment of these loans may be dependent on factors outside our control or the control of our borrowers.

We originate commercial real estate loans for individuals and businesses for various purposes, which are secured by commercial properties. These loans typically involve higher principal amounts than other types of loans, and repayment is dependent upon income generated, or expected to be generated, by the property securing the loan in amounts sufficient to cover operating expenses and debt service, which may be adversely affected by changes in the economy or local market conditions. For example, if the cash flow from the borrower's project is reduced as a result of leases not being obtained or renewed in a timely manner or at all, the borrower's ability to repay the loan may be impaired.

Commercial real estate loans also expose us to greater credit risk than loans secured by residential real estate because the collateral securing these loans typically cannot be sold as easily as residential real estate. In addition, many of our commercial real estate loans are not fully amortizing and contain large balloon payments upon maturity. Such balloon payments may require the borrower to either sell or refinance the underlying property in order to make the payment, which may increase the risk of default or non-payment.

If we foreclose on a commercial real estate loan, our holding period for the collateral typically is longer than for residential mortgage loans because there are fewer potential purchasers of the collateral. Additionally, commercial real estate loans generally have relatively large balances to single borrowers or groups of related borrowers. Accordingly, if we make any errors in judgment in the collectability of our commercial real estate loans, any resulting charge-offs may be larger on a per loan basis than those incurred with our residential or consumer loan portfolios.

Repayment of our commercial and industrial loans is often dependent on the cash flows of the borrower, which may be unpredictable, and the collateral securing these loans may not be sufficient to repay the loan in the event of default.

We make our commercial and industrial loans primarily based on the identified cash flow of the borrower and secondarily on the underlying collateral provided by the borrower. Collateral securing commercial and industrial loans may depreciate over time, be difficult to appraise and fluctuate in value. In the case of loans secured by accounts receivable, the availability of funds for the repayment of these loans may be substantially dependent on the ability of the borrower to collect the amounts due from its customers.

We are exposed to risk of environmental liabilities with respect to real properties which we may acquire.

In prior years, due to weakness of the U.S. economy and, more specifically, the California economy, including higher levels of unemployment than the nationwide average and declines in real estate values, certain borrowers have been unable to meet their loan repayment obligations and, as a result, we have had to initiate foreclosure proceedings with respect to and take title to a number of real properties that had collateralized their loans. As an owner of such properties, we could become subject to environmental liabilities and incur substantial costs for any property damage, personal injury, investigation and clean-up that may be required due to any environmental contamination that may be found to exist at any of those properties, even though we did not engage in the activities that led to such contamination. In addition, if we are the owner or former owner of a contaminated site, we may be subject to common law claims by third parties seeking damages for environmental contamination emanating from the site. If we were to become subject to significant environmental liabilities or costs, our business, financial condition, results of operations and prospects could be adversely affected.

Our business is subject to interest rate risk and variations in interest rates may hurt our profits.

To be profitable, we have to earn more money in interest that we receive on loans and investments than we pay to our depositors and lenders in interest. If interest rates rise, our net interest income and the value of our assets could be reduced if interest paid on interest-bearing liabilities, such as deposits, increases more quickly than interest received on interest-earning assets, such as loans, other mortgage-related investments and investment securities. This is most likely to occur if short-term interest rates increase at a faster rate than long-term interest rates, which would cause our net interest income to go down. In addition, rising interest rates may hurt our income, because that may reduce the demand for loans and the value of our securities. In a rapidly changing interest rate environment, we may not be able to manage our interest rate risk effectively, which would adversely impact our financial condition and results of operations.

If interest rates decline, our net interest income could be reduced if interest rates on interest-earning assets such as loans, investment securities and cash balances, decrease more quickly than interest paid on interest-bearing liabilities, such as deposits.

New lines of business, new products and services, or strategic project initiatives may subject us to additional risks.

From time to time, we may seek to implement new lines of business or offer new products and services within existing lines of business. There are substantial risks and uncertainties associated with these efforts, particularly in instances where the markets are not fully developed. In developing and marketing new lines of business and/or new products and services, we may invest significant time and resources. Initial timetables for the introduction and development of new lines of business and/or new products or services may not be achieved, and price and profitability targets may not prove feasible, which could in turn have a material negative effect on our operating results. New lines of business and/or new products or services also could subject us to additional regulatory requirements, increased scrutiny by our regulators and other legal risks.

Additionally, from time to time we undertake strategic project initiatives. Significant effort and resources are necessary to manage and oversee the successful completion of these initiatives. These initiatives often place significant demands on a limited number of employees with subject matter expertise and management and may involve significant costs to implement as well as increase operational risk as employees learn to process transactions under new systems. The failure to properly execute on these strategic initiatives could adversely impact our business and results of operations.

Strong competition within our market areas may limit our growth and profitability.

Competition in the banking and financial services industry is intense. In our market areas, we compete with commercial banks, savings institutions, mortgage brokerage firms, credit unions, finance companies, mutual funds, insurance companies, and brokerage and investment banking firms operating locally and elsewhere. Many of these competitors have substantially greater name recognition, resources and lending limits than we do and may offer certain services or prices for services that we do not or cannot provide. Our profitability depends upon our continued ability to successfully compete in our markets.

In addition, our future success will depend, in part, upon our ability to address the needs of our clients by using technology to provide products and services that will satisfy client demands for convenience, as well as to create additional efficiencies in our operations. Many of our competitors have substantially greater resources to invest in technological improvements. We may not be able to effectively implement new technology-driven products and services or be successful in marketing these products and services to our clients.

Risks Related to Our Operations

We face significant operational risks.

We operate many different financial service functions and rely on the ability of our employees, third party vendors and systems to process a significant number of transactions. Operational risk is the risk of loss from operations, including fraud by employees or outside persons, employees' execution of incorrect or unauthorized transactions, data processing and technology errors or hacking and breaches of internal control systems.

Our enterprise risk management framework may not be effective in mitigating risk and reducing the potential for losses.

Our enterprise risk management framework seeks to mitigate risk and loss to us. We have established comprehensive policies and procedures and an internal control framework designed to provide a sound operational environment for the types of risk to which we are subject, including credit risk, market risk (interest rate and price risks), liquidity risk, operational risk, compliance risk, strategic risk, and reputational risk. However, as with any risk management framework, there are inherent limitations to our current and future risk management strategies, including risks that we have not appropriately anticipated or identified. In certain instances, we rely on models to measure, monitor and predict risks. However, these models are inherently limited because they involve techniques, including the use of historical data in some circumstances, and judgments that cannot anticipate every economic and financial outcome in the markets in which we operate, nor can they anticipate the specifics and timing of such outcomes. There is no assurance that these models will appropriately capture all relevant risks or accurately predict future events or exposures. Accurate and timely enterprise-wide risk information is necessary to enhance management's decision-making in times of crisis. If our enterprise risk management framework proves ineffective or if our enterprise-wide management information is incomplete or inaccurate, we could suffer unexpected losses, which could materially adversely affect our results of operations or financial condition. In addition, our businesses and the markets in which we operate are continuously evolving. We may fail to fully understand the implications of changes in our businesses or the financial markets or fail to adequately or timely enhance our enterprise risk framework to address those changes. If our enterprise risk framework is ineffective, either because it fails to keep pace with changes in the financial markets, regulatory requirements, our businesses, our counterparties, clients or service providers or for other reasons, we could incur losses, suffer reputational damage or find ourselves out of compliance with applicable regulatory or contractual mandates.

An important aspect of our enterprise risk management framework is creating a risk culture in which all employees fully understand that there is risk in every aspect of our business and the importance of managing risk as it relates to their job functions. We continue to enhance our enterprise risk management program to support our risk culture, ensuring that it is sustainable and appropriate to our role as a major financial institution. Nonetheless, if we fail to create the appropriate environment that sensitizes all of our employees to managing risk, our business could be adversely impacted.

Managing reputational risk is important to attracting and maintaining customers, investors and employees.

Threats to our reputation can come from many sources, including adverse sentiment about financial institutions generally, unethical practices, employee misconduct, failure to deliver minimum standards of service or quality, compliance deficiencies, regulatory investigations, cybersecurity breaches, marketplace rumors and questionable or fraudulent activities of our customers. We have policies and procedures in place to promote ethical conduct and protect our reputation. However, these policies and procedures may not be fully effective and cannot adequately protect against all threats to our reputation. Negative publicity regarding our business, employees, or customers, with or without merit, may result in the loss of customers, investors and employees, costly litigation, a decline in revenues and increased governmental oversight.

Liquidity risk could impair our ability to fund operations and jeopardize our financial condition.

Liquidity is essential to our business. An inability to raise funds through deposits, borrowings, the sale of loans and other sources could have a substantial negative effect on our liquidity. Our access to funding sources in amounts adequate to finance our activities or on terms that are acceptable to us could be impaired by factors that affect us specifically or the financial services industry or economy in general.

Factors that could detrimentally impact our access to liquidity sources include a decrease in the level of our business activity as a result of a downturn in the markets in which our loans are concentrated or adverse regulatory action against us. Our ability to borrow could also be impaired by factors that are not specific to us, such as a disruption in the financial markets or negative views and expectations about the prospects for the financial services industry.

We currently hold a significant amount of bank owned life insurance.

At December 31, 2023, we held bank owned life insurance ("BOLI") on certain key and former employees and executives and our directors, with a cash surrender value of \$31,506,000. The eventual repayment of the cash surrender value is subject to the ability of the various insurance companies to pay death benefits or to return the cash surrender value to us if needed for liquidity purposes. We continually monitor the financial strength of the various companies with whom we carry these policies.

However, any one of these companies could experience a decline in financial strength, which could impair its ability to pay benefits or return our cash surrender value. If we need to liquidate these policies for liquidity purposes, we would be subject to taxation on the increase in cash surrender value and penalties for early termination, both of which would adversely impact earnings.

We rely on numerous external vendors.

We rely on numerous external vendors to provide us with products and services necessary to maintain our day-to-day operations. Accordingly, our operations are exposed to risk that these vendors will not perform in accordance with the contracted arrangements under service level agreements. The failure of an external vendor to perform in accordance with the contracted arrangements under service level agreements because of changes in the vendor's organizational structure, financial condition, support for existing products and services or strategic focus or for any other reason, could be disruptive to our operations, which in turn could have a material negative impact on our financial condition and results of operations. We also could be adversely affected to the extent such an agreement is not renewed by the third-party vendor or is renewed on terms less favorable to us.

Our holding company relies on dividends from the Bank for substantially all of its income and the net proceeds of capital raising transactions are currently the primary source of funds for cash dividends to our preferred and common stockholders.

Our primary source of revenue at the holding company level is dividends from the Bank and we also have previously relied on the net proceeds of capital raising transactions as the primary source of funds for cash dividends to our preferred and common stockholders. To the extent we are limited in our ability to raise capital in the future, our ability to pay cash dividends to our stockholders could likewise be limited, especially if we are unable to increase the amount of dividends the Bank pays to us. If the Bank is unable to pay dividends to us, then we may not be able to service our debt, including our senior notes, pay our other obligations or pay cash dividends on our preferred and common stock. Our inability to service our debt, pay our other obligations or pay dividends to our stockholders could have a material adverse impact on our financial condition and the value of your investment in our securities.

We may elect or be compelled to seek additional capital in the future, but that capital may not be available when it is needed.

We are required by federal regulatory authorities to maintain adequate levels of capital to support our operations. At some point, we may need to raise additional capital to support continued growth.

Our ability to raise additional capital, if needed, will depend on conditions in the capital markets, economic conditions, our financial performance and a number of other factors, many of which are outside our control. Accordingly, we cannot assure you of our ability to raise additional capital if needed or on terms acceptable to us. If we cannot raise additional capital when needed, our ability to further expand our operations could be materially impaired and our financial condition and liquidity could be materially and adversely affected.

Climate change manifesting as physical or transition risks could adversely affect our operations, businesses and customers.

There is an increasing concern over the risks of climate change and related environmental sustainability matters. The physical risks of climate change include discrete events, such as flooding and wildfires, and longer term shifts in climate patterns, such as extreme heat, sea level rise, and more frequent and prolonged drought. Such events could disrupt the Company's operations or those of its clients or third parties on which it relies, including through direct damage to assets and indirect impacts from supply chain disruption and market volatility. Additionally, transitioning to a low carbon economy may entail extensive policy, legal, technology, and market initiatives. Transition risks, including changes in consumer preferences and additional regulatory requirements or taxes, could increase expenses and undermine business strategies. In addition, Company's reputation and client relationships may be damaged as a result of practices related to climate change, including its involvement, or its clients' involvement, in certain industries or projects associated with causing or exacerbating climate change, as well as any decisions the Company makes to continue to conduct or change its activities in response to considerations relating to climate change, including the setting of climate-related goals, commitments and targets. As climate risk is interconnected with all key risk types, the Company is advancing its processes to embed climate risk considerations into risk management strategies such as market, credit and operational risks; however, because the timing and severity of climate change may not be predictable, risk management strategies may not be effective in mitigating climate risk exposure.

Technology Risks

Our security measures may not be sufficient to mitigate the risk of a cyber-attack or cyber theft.

Communications and information systems are essential to the conduct of our business, as we use such systems to manage our customer relationships, our general ledger and virtually all other aspects of our business. Our operations rely on the secure collection, processing, storage, and transmission of confidential, personal, and other information using our computer systems and networks and as part of our internet banking activities, as well as the computer systems and networks of third party service providers that support our operations, but which we do not control. Although we take protective measures and endeavor to enhance them as circumstances warrant, the security of our computer systems, software, and networks, as well as those of our computer systems and networks of third party service providers that support our operations, may be vulnerable to security breaches, unauthorized access, misuse, computer viruses, or other malicious code and cyber-attacks whose objectives include obtaining unauthorized access to confidential and personal information, manipulation or destruction of data, disruption of our services, or theft of money. The rapid evolution and increased adoption of artificial intelligence technologies have also given rise to additional vulnerabilities and potential entry points for cyber threats. If one or more of these events occur, this could jeopardize our or our customers' confidential, personal, and other information collected and processed by, stored in, and transmitted through our computer systems and networks and our third party service providers, or otherwise cause interruptions or malfunctions in our operations or adversely impact our customers or counterparties. These adverse consequences could include causing certain customers to cease doing business with us, impair our ability to attract new customers or expand relationships with existing customers and third parties, making it difficult to service customers and comply with regulatory obligations (including privacy and banking laws), or impair our brand and reputation. We may be required to expend significant additional resources to enhance our protective measures, to investigate any such event, notify individuals, third parties, or regulators, and remediate vulnerabilities or other exposures, and we may be subject to litigation and financial losses that are either not insured against or not fully covered through any insurance maintained by us. We could also suffer significant reputational damage.

Our security measures may not protect us from systems failures or interruptions.

While we have established policies and procedures to prevent or limit the impact of systems failures and interruptions, there can be no assurance that such events will not occur or that they will be adequately addressed if they do. In addition, we outsource certain aspects of our data processing and other operational functions to certain third-party providers. If our third-party providers encounter difficulties, or if we have difficulty in communicating with them, our ability to adequately process and account for transactions could be affected, and our business operations could be adversely impacted. Threats to information security also exist in the processing of customer information through various other vendors and their personnel.

We may be required to expend significant additional resources to continue to modify or enhance our information security infrastructure or to investigate and remediate any information security vulnerabilities in response to continuing information systems security threats.

The occurrence of any systems failure or interruption could damage our reputation and result in a loss of customers and business, could subject us to additional regulatory scrutiny, or could expose us to legal liability. Any of these occurrences could have a material adverse effect on our financial condition and results of operations.

We rely on communications, information, operating and financial control systems technology from third party service providers, and we may suffer an interruption in those systems.

We rely heavily on third party service providers for much of our communications, information, operating and financial control systems technology, including our online banking services and data processing systems. We also rely on third party vendors, who may experience unauthorized access to and disclosure of client or customer information or the destruction or theft of such information. Any failure or interruption, or breaches in security, of these systems could result in failures or interruptions in our customer relationship management, general ledger, deposit, servicing and/or loan origination systems and, therefore, could harm our business, operating results and financial condition. Additionally, interruptions in service and security breaches could lead existing customers to terminate their banking relationships with us and could make it more difficult for us to attract new banking customers.

We are subject to a variety of federal and state privacy and data security laws, which govern the collection, safeguarding, sharing and use of customer information

We are subject to a variety of federal and state privacy and data security laws, which govern the collection, safeguarding, sharing and use of customer information, and require that financial institutions have in place policies regarding information privacy and security. For example, the Gramm-Leach-Bliley Act of 1999 ("GLBA") requires all financial institutions offering financial products or services to retail customers to provide such customers with the financial institution's privacy policy and practices for sharing nonpublic information with third parties, provide advance notice of any changes to the policies and provide such customers the opportunity to "opt out" of the sharing of certain personal financial information with unaffiliated third parties. It also requires banks to safeguard personal information of consumer customers. Some state laws also protect the privacy of information of state residents and require adequate security for such data, and certain state laws may, in some circumstances, require us to notify affected individuals of security breaches of computer databases that contain their personal information. These laws may also require us to notify law enforcement, regulators or consumer reporting agencies in the event of a data breach, as well as businesses and governmental agencies that own data.

Data privacy and data security are areas of increasing state legislative focus. The California Consumer Privacy Act ("CCPA"), which became effective and enforceable in 2020 requires, among other things, covered companies to provide new disclosures to California consumers regarding the use of personal information, gives California residents expanded rights to access their personal information and allows such consumers new abilities to opt-out of certain sales of personal information. Further, the new California Privacy Rights Act ("CPRA") which was passed in November 2020, significantly modifies the CCPA. These modifications may result in additional uncertainty and require us to incur additional costs and expenses in our effort to comply. Because we meet the thresholds set forth in the CCPA and the CPRA, we will be required to comply with these laws. We will continue to monitor developments related to the CCPA and the CPRA. The full impact of the CCPA and the CPRA on our business is yet to be determined.

Like other lenders, we use credit bureau data in their underwriting activities. Use of such data is regulated under the Fair Credit Reporting Act ("FCRA"), and the FCRA also regulates reporting information to credit bureaus, prescreening individuals for credit offers, sharing of information between affiliates and using affiliate data for marketing purposes. Similar state laws may impose additional requirements on us.

Regulatory Risks

We operate in a highly regulated environment and our operations and income may be affected adversely by changes in laws, rules and regulations governing our operations.

We are subject to extensive regulation and supervision by the DFPI, FRB and the FDIC. The FRB regulates the supply of money and credit in the United States. Its fiscal and monetary policies determine in a large part our cost of funds for lending and investing and the return that can be earned on those loans and investments, both of which affect our net interest margin. FRB policies can also materially affect the value of financial instruments that we hold, such as debt securities. Its policies also can affect our borrowers, potentially increasing the risk that they may fail to repay their loans or satisfy their obligations to us. Changes in policies of the FRB are beyond our control and the impact of changes in those policies on our activities and results of operations can be difficult to predict.

The Company and the Bank are heavily regulated. This regulation is to protect depositors, federal deposit insurance funds and the banking system as a whole, and not stockholders. These regulatory authorities have extensive discretion in connection with their supervisory and enforcement activities, including the ability to impose increased capital requirements and restrictions on a bank's operations, to reclassify assets, to determine the adequacy of a bank's allowance for credit losses and to set the level of deposit insurance premiums assessed.

Congress, state legislatures and federal and state agencies continually review banking, lending and other laws, regulations and policies for possible changes. Any change in such regulation and oversight, whether in the form of regulatory policy, new regulations or legislation, that applies to us or additional deposit insurance premiums could have a material adverse impact on our operations. Because our business is highly regulated, the laws and applicable regulations are subject to frequent change. Any new laws, rules and regulations could make compliance more difficult or expensive or otherwise adversely affect our business, financial condition or growth prospects. Such changes could subject us to additional costs, limit the types of financial services and products we may offer and/or increase the ability of non-banks to offer competing financial services and products, among other things.

The Dodd-Frank Act and supporting regulations could have a material adverse effect on us.

The Dodd-Frank Act provides for various capital requirements and new restrictions on financial institutions and their holding companies. These changes may result in additional restrictions on investments and other activities.

Regulations under the Dodd-Frank Act significantly impact our operations, and we expect to continue to face increased regulation. These regulations may affect the manner in which we do business and the products and services that we provide, affect or restrict our ability to compete in our current businesses or our ability to enter into or acquire new businesses, reduce or limit our revenue or impose additional fees, assessments or taxes on us, intensify the regulatory supervision of us and the financial services industry, and adversely affect our business operations.

The Dodd-Frank Act, among other things, established the CFPB with broad authority to administer and enforce a new federal regulatory framework of consumer financial regulation. Many of the provisions of the Dodd-Frank Act have extended implementation periods and require extensive rulemaking, guidance and interpretation by various regulatory agencies. While some rules have been finalized or issued in proposed form, some have yet to be proposed. It is impossible to predict when all such additional rules will be issued or finalized, and what the content of such rules will be.

We must apply resources to ensure that we are in compliance with all applicable provisions of the Dodd-Frank Act and any implementing rules, which may increase our costs of operations and adversely impact our earnings. We expect that the Dodd-Frank Act, including current and future rules implementing its provisions and the interpretations of those rules, will reduce our revenues, increase our expenses, require us to change certain of our business practices, increase the regulatory supervision of us, increase our capital requirements and impose additional assessments and costs on us, and otherwise adversely affect our business.

The short-term and long-term impact of the changing regulatory capital requirements and new capital rules is uncertain.

Under the U.S. regulatory capital rules to implementing the Basel III regulatory capital framework, banking organizations, including the Company are subject to a common equity Tier 1 minimum capital requirement of 4.5 percent of risk-weighted assets and a minimum Tier 1 risk-based capital requirement of 6.0 percent of risk-weighted assets and assigns higher risk-weightings than in the past (150 percent) to exposures that are more than 90 days past due or are on non-accrual status and certain commercial real estate facilities that finance the acquisition, development or construction of real property. The final rule also limits a banking organization's capital distributions and certain discretionary bonus payments if the banking organization does not hold a "capital conservation buffer" in excess of 2.5 percent of common equity tier 1 capital in addition to the minimum risk-based capital ratios. An institution will be subject to limitations on paying dividends, engaging in share repurchases, and paying discretionary bonuses if its capital level falls below the buffer amount.

While our current capital levels exceed the capital requirements, our capital levels could decrease in the future as a result of factors such as acquisitions, faster than anticipated growth, reduced earnings levels, operating losses and other factors. The application of more stringent capital requirements for us could, among other things, result in lower returns on equity, require the raising of additional capital, and result in our inability to pay dividends or repurchase shares if we were to be unable to comply with such requirements.

We are subject to federal and state fair lending laws, and failure to comply with these laws could lead to material penalties.

Federal and state fair lending laws and regulations, such as the Equal Credit Opportunity Act, impose nondiscriminatory lending requirements on financial institutions. The Department of Justice, CFPB and other federal and state agencies are responsible for enforcing these laws and regulations. Private parties may also have the ability to challenge an institution's performance under fair lending laws in private class action litigation. A successful challenge to our performance under the fair lending laws and regulations could adversely impact our rating under the CRA and result in a wide variety of sanctions, including the required payment of damages and civil money penalties, injunctive relief, imposition of restrictions on merger and acquisition activity and restrictions on expansion activity, which could negatively impact our reputation, business, financial condition and results of operations.

Non-compliance with the USA Patriot Act, Bank Secrecy Act, or other laws and regulations could result in fines or sanctions or operating restrictions.

The USA Patriot Act and Bank Secrecy Act require financial institutions to develop programs to prevent financial institutions from being used for money laundering and terrorist activities. If such activities are detected, financial institutions are obligated to file suspicious activity reports with the U.S. Treasury's Office of Financial Crimes Enforcement Network. These rules require financial institutions to establish procedures for identifying and verifying the identity of customers seeking to open new financial accounts. In addition, legal requirements relating to the collection, storage, handling, use, disclosure, transfer, and security of personal data continue to increase, along with enforcement actions and investigations by regulatory authorities related to data security incidents and privacy violations. Failure to comply with these regulations could result in fines, sanctions or restrictions that could have a material adverse effect on our strategic initiatives. Several banking institutions have received large fines, or suffered limitations on their operations, for non-compliance with these laws and regulations. Although we have developed policies and procedures designed to assist in compliance with these laws and regulations, no assurance can be given that these policies and procedures will be effective in preventing violations of these laws and regulations.

Increases in deposit insurance premiums and special FDIC assessments will negatively impact our earnings.

FDIC-insured banks are required to pay deposit insurance assessments to the FDIC. The amount of the deposit insurance assessment for institutions with less than \$10.0 billion in assets, such as the Bank, is based on its risk category, with certain adjustments for any unsecured debt or brokered deposits held by the insured bank. We may pay higher FDIC premiums in the future and increases in deposit insurance premiums and special FDIC assessments will negatively impact our earnings.

Tax and Financial Risks

The Company has a deferred tax asset that may or may not be fully realized.

The Company has a deferred tax asset and cannot assure that it will be fully realized. Deferred tax assets and liabilities are the expected future tax amounts for the temporary differences between the carrying amounts and the tax basis of assets and liabilities computed using enacted tax rates. If we determine that we will not achieve sufficient future taxable income to realize our net deferred tax asset, we are required under generally accepted accounting principles (GAAP) to establish a full or partial valuation allowance. If we determine that a valuation allowance is necessary, we are required to incur a charge to operations. We regularly assess available positive and negative evidence to determine whether it is more likely than not that our net deferred tax asset will be realized. Realization of a deferred tax asset requires us to apply significant judgment and is inherently speculative because it requires estimates that cannot be made with certainty. At December 31, 2023, the Company had a net deferred tax asset of \$13.2 million. For additional information, see Note 10 to Consolidated Financial Statements included in Item 8 of this Annual Report on Form 10-K.

We may experience future goodwill impairment.

If our estimates of the fair value of our reporting units change as a result of changes in our business or other factors, we may determine that a goodwill impairment charge is necessary. Estimates of fair value are based on a complex model using, among other things, estimated cash flows and industry pricing multiples. The Company tests its goodwill for impairment annually as of December 31 (the Measurement Date), and quarterly if a triggering event causes concern of a possible goodwill impairment charge. At each Measurement Date, the Company, in accordance with ASC 350-20-35-3, evaluates, based on the weight of evidence, the significance of all qualitative factors to determine whether it is more likely than not that the fair value of each of the reporting units is less than its carrying amount.

The assessment of qualitative factors at the most recent Measurement Date (December 31, 2023), indicated that it was not more likely than not that impairment existed; as a result, no further testing was performed. No assurance can be given that the Company will not record an impairment loss on goodwill in the future and any such impairment loss could have a material adverse effect on our results of operations and financial condition.

In preparing our financial statements we make certain assumptions, judgments and estimates that affect amounts reported in our consolidated financial statements, which, if not accurate, may significantly impact our financial results.

We make assumptions, judgments and estimates for a number of items, including the fair value of financial instruments, goodwill and other intangible assets, the realizability of deferred tax assets, the fair value of stock awards, the allowances for loan losses, income tax provisions and determination, recognition and measurement of impaired loans. These assumptions, judgments and estimates are drawn from historical experience and various other factors that we believe are reasonable under the circumstances as of the date of the consolidated financial statements. Actual results could differ materially from our estimates, and such differences could significantly impact our financial results.

General Risks

We depend on our key employees.

Our future prospects are and will remain highly dependent on our directors and executive officers. Our success will, to some extent, depend on the continued service of our directors and continued employment of the executive officers. The unexpected loss of the services of any of these individuals could have a detrimental effect on our business. Although we have entered into employment agreements with members of our senior management team, no assurance can be given that these individuals will continue to be employed by us. The loss of any of these individuals could negatively affect our ability to achieve our business plan and could have a material adverse effect on our results of operations and financial condition.

Severe weather, natural disasters, acts of war or terrorism and other external events could significantly impact our business.

Severe weather, natural disasters such as earthquakes and wildfires, acts of war or terrorism, global pandemics and other adverse external events could have a significant impact on our ability to conduct business. Such events could affect the stability of our deposit base, impair the ability of our borrowers to repay their outstanding loans, cause significant property damage or otherwise impair the value of collateral securing our loans, and result in loss of revenue and/or cause us to incur additional expenses. Although we have established disaster recovery plans and procedures, and we monitor the effects of any such events on our loans, properties and investments, the occurrence of any such event could have a material adverse effect on us or our earnings or our financial condition.

Anti-takeover provisions could negatively impact our stockholders.

Provisions in our charter and bylaws, the corporate law of the State of California and federal regulations could delay, defer or prevent a third party from acquiring us, despite the possible benefit to our stockholders, or otherwise adversely affect the market price of any class of our equity securities. These provisions include: the election of directors to staggered terms of three years; advance notice requirements for nominations for election to our Board of Directors and for proposing matters that stockholders may act on at stockholder meetings, a requirement that only directors may fill a vacancy in our Board of Directors, and the other provisions of our charter and bylaws. Our charter also authorizes our Board of Directors to issue preferred stock, and preferred stock could be issued as a defensive measure in response to a takeover proposal. In addition, pursuant to federal banking regulations, as a general matter, no person or company, acting individually or in concert with others, may acquire more than 10 percent of our common stock without prior approval from our federal banking regulator. These provisions may discourage potential takeover attempts, discourage bids for our common stock at a premium over market price or adversely affect the market price of, and the voting and other rights of the holders of, our common stock. These provisions could also discourage proxy contests and make it more difficult for holders of our common stock to elect directors other than the candidates nominated by our Board of Directors.

Our business could be negatively affected as a result of actions by activist stockholders.

Campaigns by stockholders to effect changes at publicly traded companies are sometimes led by investors seeking to increase short-term stockholder value through various corporate actions. In the future we may have disagreements with activist stockholders which could prove disruptive to our operations. Activist stockholders could seek to elect their own candidates to our board of directors or could take other actions intended to challenge our business strategy and corporate governance. Responding to actions by activist stockholders may adversely affect our profitability or business prospects, by diverting the attention of management and our employees from executing our strategic plan. Any perceived uncertainties as to our future direction or strategy arising from activist stockholder initiatives could also cause increased reputational, operational, financial, regulatory and other risks, harm our ability to raise new capital, or adversely affect the market price or increase the volatility of our securities.

If we fail to maintain proper and effective internal controls, our ability to produce accurate and timely financial statements could be impaired and investors' views of us could be harmed.

As a public company, we are required to maintain internal control over financial reporting and to report any material weaknesses in such internal controls. We have evaluated and tested our internal controls in order to allow management to report on our internal controls, as required by Section 404 of the Sarbanes-Oxley Act of 2002. If we are not able to meet the requirements of Section 404 in a timely manner or with adequate compliance, we would be required to disclose material weaknesses if they develop or are uncovered and we may be subject to sanctions or investigation by regulatory authorities, such as the Securities and Exchange Commission. Any such action could negatively impact the perception of us in the financial market and our business. In addition, our internal controls may not prevent or detect all errors and fraud. A control system, no matter how well designed and operated, is based upon certain assumptions and can provide only reasonable assurance that the objectives of the control system will be met.

If securities or industry analysts do not publish research or reports about our business, or if they publish negative reports about our business, our stock price and trading volume could decline.

The trading market for our common stock may be influenced by the research and reports that securities or industry analysts publish about us or our business. We do not have control over these analysts. If one or more of the analysts who cover us downgrade our stock or change their opinion of our shares or publish inaccurate or unfavorable research about our business, our stock price would likely decline. If one or more of these analysts cease coverage of our company or fail to publish reports on us regularly, we could lose visibility in the financial markets, which could cause our stock price or trading volume to decline.

The price of our common stock may fluctuate significantly, and this may make it difficult for you to sell shares of common stock owned by you at times or at prices you find attractive.

The trading price of our common stock may fluctuate widely as a result of a number of factors, many of which are outside our control. In addition, the stock market is subject to fluctuations in the share prices and trading volumes that affect the market prices of the shares of many companies. These broad market fluctuations could adversely affect the market price of our common stock. Among the factors that could affect our stock price are:

- actual or anticipated quarterly fluctuations in our operating results and financial condition and prospects;
- changes in revenue or earnings estimates or publication of research reports and recommendations by financial analysts;
- failure to meet analysts' revenue or earnings estimates;
- speculation in the press or investment community;
- strategic actions by us or our competitors, such as acquisitions or restructurings;
- acquisitions of other banks or financial institutions;
- actions by institutional stockholders;
- fluctuations in the stock price and operating results of our competitors;
- general market conditions and, in particular, developments related to market conditions for the financial services industry;
- proposed or adopted regulatory changes or developments;
- anticipated or pending investigations, proceedings, or litigation that involve or affect us;
- successful management of reputational risk;
- health epidemics, such as the recent outbreak of coronavirus; and
- domestic and international economic factors, such as interest or foreign exchange rates, stock, commodity, credit, or asset valuations or volatility, unrelated to our performance.

The stock market and, in particular, the market for financial institution stocks, has experienced significant volatility. As a result, the market price of our common stock may be volatile. In addition, the trading volume in our common stock may fluctuate more than usual and cause significant price variations to occur. The trading price of the shares of our common stock and the value of our other securities will depend on many factors, which may change from time to time, including, without limitation, our financial condition, performance, creditworthiness and prospects, future sales of our equity or equity related securities, and other factors identified above in "Forward-Looking Statements," and in this Item 1A — "Risk Factors." The capital and credit markets can experience volatility and disruption. Such volatility and disruption can reach unprecedented levels, resulting in downward pressure on stock prices and credit availability for certain issuers without regard to their underlying financial strength. A significant decline in our stock price could result in substantial losses for individual stockholders and could lead to costly and disruptive securities litigation.

ITEM 1B. UNRESOLVED STAFF COMMENTS

None.

ITEM 1C. CYBERSECURITY

Cybersecurity risk management and strategy

Cybersecurity and risks associated with information security are operational risks included in the Company's Enterprise Risk Management ("ERM") Framework. Under the ERM Framework, the Company's Information Technology department and all employees are the first line of defense ("First Line"). Those in the First Line are each responsible for identifying and managing the information security risk associated with their activities. The Company's IT Steering Committee is part of the independent risk oversight of information security risk along with the Company's Compliance and ERM Committees, both of which are management risk oversight committees.

The BOD and IT Steering committee are primarily responsible for monitoring management's implementation of operations and technology risk controls, including those relating to cyber security and information security. The Company maintains a data protection and information security program designed to ensure adequate governance and oversight is in place while evolving to meet changes in applicable laws and regulations, and best practices. The Company's information security controls and programs are designed to align with the National Institute of Standards and Technology ("NIST") standards for cybersecurity and the Federal Financial Institutions Examination Council ("FFIEC") examination guidelines, along with applicable privacy laws.

Information Security is the responsibility of the officers, employees, and agents of the Company with oversight by the Board of Directors ("BOD"). Our investment in people is critical to maintaining an effective cyber defense, which begins by developing and maintaining a robust Information Security function within the First Line. The Company's Chief Information Officer ("CIO") has over 25 years of network architecture, information technology and cybersecurity experience. Collectively, the Company's senior leadership in this area have nearly 80 years of experience. Each Company employee is responsible for an effective cybersecurity defense which is enforced with mandatory interactive cyber awareness training, periodic newsletters, executive security briefs and updates. Additionally, the BOD is informed about cybersecurity and the relevant risks posed to the Company via regular updates from the Company's CIO. The BOD is regularly informed and actively oversees the data security and privacy program and its policies. The BOD also receives regular education on innovative technology, cybersecurity, information systems/data management, fintech and privacy.

Cybersecurity assessments

The Company engages external third parties to perform assessments on our adherence to the FFIEC's recommendations on cyber preparedness and NIST Cybersecurity Framework, as well as to review for best practices for the use of cloud services and FedLine requirements. To validate the effectiveness of the Company's overall information security controls, external third parties also perform full-scope external and internal penetration testing designed to mimic the tactics used by individual hackers or criminal hacking organizations. The Company also engages external third parties to perform ongoing adversarial simulation.

The Company conducts regular internal cybersecurity assessments intended to measure inherent risk and drive the adjustment of our security posture according to the latest threats. These assessments include alignment with the FFIEC's recommendations on cyber preparedness and GLBA Safeguards Rule to protect user data. The Company performs continuous internal and external vulnerability scanning to measure and react to new vulnerabilities and seeks conformance to industry best practices for both cloud-based and on-premises technology. The Company reviews vendor and partner security practices to ensure they maintain proper information security safeguards.

Cybersecurity operational measures

Led by our CIO, the Company's data protection, information, cyber and technology services team collaborates with subject-matter experts throughout the business to identify, monitor and mitigate material risks, as well as to monitor compliance with the Company's security policies, applicable laws and regulations. The Company's security monitoring team manages the security of our systems through the ingestion of multiple external threat feeds and systems logs. Through the collection and integration of security-related IT infrastructure information, external threat intelligence and the expertise of trained security analysts, the Company works to identify and address potential indicators of compromise. Potential security events are identified and addressed through defined IT incident response activities and with support of the Company's Incident Response Plan. The Incident Response Plan is in place and updated regularly with the intent to reduce impacts to clients and the Company caused by a declared cyber incident, such as an event involving malicious code, unauthorized disclosure, loss of information or unauthorized use of information or systems. The Incident Response Plan organizes resources to manage and resolve events that harm or threaten the security of information assets. The Incident Response Plan includes involvement of the Company's Executive Leadership Team and BOD based on the severity of a cyber event, including the analysis of reporting requirements. The Incident Response Plan is tested annually and includes technical and executive management in simulated crisis management cybersecurity tabletop exercises.

[Table of Contents](#)

As of the date of this report, other than the risks discussed in "Risk Factors," the Company knows of no risks from cybersecurity threats that have materially affected or are reasonably likely to materially affect the Company, including its business strategy, results of operations, or financial condition.

ITEM 2. PROPERTIES

Not applicable.

ITEM 3. LEGAL PROCEEDINGS

From time to time, the Company is a party to claims and legal proceedings arising in the ordinary course of business. Our management evaluates its exposure to these claims and proceedings individually and in the aggregate and provides for potential losses on such litigation if the amount of the loss is estimable and the loss is probable.

There are no pending, or to management's knowledge, any threatened, material legal proceedings to which the Company is a party, or to which any of the Company's properties are subject. Although the results of any such litigation matters and claims cannot be predicted with certainty, we believe that the final outcome of any such claims and proceedings will not have a material adverse impact on the Company's financial position, liquidity, or results of operations.

ITEM 4. MINE SAFETY DISCLOSURES

Not applicable.

PART II

ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES.

Trading Symbol and Holders of Common Stock

Our common stock is traded on the Nasdaq Capital Market under the symbol "OVLY." On February 29, 2024, there were approximately 360 shareholders of record of the common stock and 8,359,556 outstanding shares of common stock. The actual number of shareholders is greater than this number of record holders and includes shareholders who are beneficial owners but whose shares are held in street name by brokers and other nominees.

Dividends

Our ability to pay any cash dividends will depend not only upon our earnings during a specified period, but also on our meeting certain capital requirements.

Dividends the Company declares are subject to the restrictions set forth in the California General Corporation Law (the "Corporation Law"). The Corporation Law provides that a corporation may make a distribution to its shareholders if the corporation's retained earnings equal at least the amount of the proposed distribution. The Corporation Law also provides that, in the event that sufficient retained earnings are not available for the proposed distribution, a corporation may nevertheless make a distribution to its shareholders if it meets two conditions, which generally stated are as follows: (i) the corporation's assets equal at least 1 and 1/4 times its liabilities, and (ii) the corporation's current assets equal at least its current liabilities or, if the average of the corporation's earnings before taxes on income and before interest expenses for the two preceding fiscal years was less than the average of the corporation's interest expenses for such fiscal years, then the corporation's current assets must equal at least 1 and 1/4 times its current liabilities.

Additionally, the Federal Reserve Board has authority to limit the payment of dividends by bank holding companies, such as the Company, in certain circumstances, requiring, among other things, a holding company to consult with the Federal Reserve Board prior to payment of a dividend if the company does not have sufficient recent earnings in excess of the proposed dividend.

The principal source of funds from which the Company may pay dividends is the receipt of dividends from the Bank. The availability of dividends from the Bank is limited by various statutes and regulations. The Bank is subject first to corporate restrictions on its ability to pay dividends. Further, the Bank may not pay a dividend if it would be undercapitalized after the dividend payment is made. The payment of cash dividends by the Bank is subject to restrictions set forth in the Financial Code. The Financial Code provides that a bank may not make a cash distribution to its shareholders in excess of the lesser of (a) bank's retained earnings; or (b) bank's net income for its last three fiscal years, less the amount of any distributions made by the bank or by any majority-owned subsidiary of the bank to the shareholders of the bank during such period. However, a bank may, with the approval of the DFPI, make a distribution to its shareholders in an amount not exceeding the greatest of (a) its retained earnings; (b) its net income for its last fiscal year; or (c) its net income for its current fiscal year. In the event that the DFPI determines that the shareholders' equity of a bank is inadequate or that the making of a distribution by the bank would be unsafe or unsound, the DFPI may order the bank to refrain from making a proposed distribution. The FDIC may also restrict the payment of dividends if such payment would be deemed unsafe or unsound or if after the payment of such dividends, the bank would be included in one of the "undercapitalized" categories for capital adequacy purposes pursuant to federal law.

While the Federal Reserve Board has no general restriction with respect to the payment of cash dividends by an adequately capitalized bank to its parent holding company, the Federal Reserve Board might, under certain circumstances, place restrictions on the ability of a particular bank to pay dividends based upon peer group averages and the performance and maturity of the particular bank, or object to management fees to be paid by a subsidiary bank to its holding company on the basis that such fees cannot be supported by the value of the services rendered or are not the result of an arm's length transaction.

Shareholders are entitled to receive dividends only when and if dividends are declared by our Board of Directors. Although we have paid dividends in the past, it is no guarantee that we will pay cash dividends in the future.

Share Repurchases

The Company has no repurchase plans or programs with respect to its common stock or equity securities in place and therefore there were no repurchased shares during the quarter ended December 31, 2023.

ITEM 6. [RESERVED]

ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following discussion of financial condition as of December 31, 2023 and 2022 and results of operations for each of the years in the two-year period ended December 31, 2022 should be read in conjunction with our consolidated financial statements and related notes thereto, included in this report. Average balances, including balances used in calculating certain financial ratios, are generally comprised of average daily balances. This discussion contains forward-looking statements that reflect our plans, estimates and beliefs and involve numerous risks and uncertainties. Actual results may differ materially from those contained in any forward-looking statements. You should carefully read "Special Note Regarding Forward-Looking Statements" included in this report.

Introduction

Our continued focus on responsible community banking fundamentals and our strong customer relationships have enabled us to increase our market presence through growth in our loan portfolio, which is primarily funded by steady core deposit growth.

As of December 31, 2023, we had approximately \$1.84 billion in total assets, \$1.02 billion in total gross loans, and \$1.65 billion in total deposits.

We believe the following were key indicators of our performance during 2023:

- Total assets decreased to \$1.84 billion at the end of 2023, a decrease of 6.4%, from \$1.97 billion at the end of 2022.
- Total deposits decreased to \$1.65 billion at the end of 2023, a decrease of 9.0%, from \$1.81 billion at the end of 2022.
- Total net loans increased to \$1.00 billion at the end of 2023, an increase of 11.0%, from \$905 million at the end of 2022.
- Net interest income increased to \$75.8 million in 2023, an increase of \$15.7 million or 26.2%, compared to \$60.1 million in 2022, mainly as a result of rising interest rates and growth of our loan portfolio.
- Provisions for credit losses of \$970,000 and a reversal of credit loss provisions totaling \$1,350,000 were recorded in 2023 and 2022, respectively. The provision in 2023 was mainly due to macro-economic conditions and loan growth.
- The ratio of total non-performing loans to total loans remained at 0.00% as of December 31, 2023 and 2022.
- Total noninterest income increased to \$6.6 million in 2023, an increase of 19.0%, from \$5.6 million in 2022, which is mainly due to positive changes in the fair value of equity securities and increases in service charges on deposit accounts.
- Total noninterest expense increased from \$37.3 million in 2022 to \$41.2 million in 2023, primarily due to staffing increases and general operating costs necessary to support the growing loan and deposit portfolios.
- Provision from income taxes increased by \$2.7 million to \$9.5 million in 2023, due to higher pre-tax income.

These items, as well as other factors, contributed to the increase in net income for 2023 to \$30.8 million from \$22.9 million in 2022, which translates into \$3.75 per diluted share in 2023 as compared to \$2.79 per diluted share in 2022.

Over the past several years, our network of branches and loan production offices have expanded geographically. We currently maintain eighteen full-service offices. We intend to continue our growth strategy in future years through the opening of additional branches and loan production offices as our needs and resources permit.

2024 Outlook

As we begin our strategic business plan for 2024, we remained focused on relationship-based expansion throughout our market area. We plan to continue to focus on growth of our loan and deposit portfolios to ease pressure on our net interest margin, while attempting to control expenses and credit losses.

Unfavorable trends in inflation prompted the Federal Reserve Open Market Committee, or FOMC, to increase the target federal funds rate in 2022 and 2023, which resulted yield increases on our earning assets. We expect this positive impact will continue to some degree in 2024 due to continued repricing of existing loans. However, the negative impact of the FOMC rate hikes was increased rates on deposit accounts, which we expect will continue into 2024. Deposit interest rates are determined based on customer demand, market surveys of offerings from competitive institutions, and overall liquidity position.

[Table of Contents](#)

The Fed Funds rate is forecasted to decrease towards the end of 2024, which could potentially compress net interest income and net interest margin further, given that our balance sheet is slightly asset sensitive to interest rate changes primarily due to the variable rate loans and interest-earning cash balances.

For 2024, management remains focused on the above challenges and opportunities and other factors affecting the business similar to the factors driving the 2023 results as discussed in this section.

Critical Accounting Estimates

Critical accounting estimates are those estimates made in accordance with generally accepted accounting principles that involve a significant level of estimation and uncertainty and have had or are reasonably likely to have a material impact on our financial condition and results of operations. We consider accounting estimates to be critical to our financial results if (i) the accounting estimate requires management to make assumptions about matters that are highly uncertain, (ii) management could have applied different assumptions during the reported period, and (iii) changes in the accounting estimate are reasonably likely to occur in the future and could have a material impact on our financial statements. Management has determined the following accounting estimates and related policies to be critical:

Goodwill Impairment

The Company applies a qualitative analysis of conditions in order to determine if it is more likely than not that the carrying value is impaired. In the event that the qualitative analysis suggests that the carrying value of goodwill may be impaired, the Company uses several quantitative valuation methodologies in evaluating goodwill for impairment that includes assumptions and estimates made concerning the future earnings potential of the organization, and a market-based approach that looks at values for organizations of comparable size, structure and business model.

Estimates of fair value are based on a complex model using, among other things, estimated cash flows and industry pricing multiples. The Company tests its goodwill for impairment annually as of December 31 (the Measurement Date), and quarterly if a triggering event causes concern of a possible goodwill impairment charge. At each Measurement Date, the Company, in accordance with ASC 350-20-35-3, evaluates, based on the weight of evidence, the significance of all qualitative factors to determine whether it is more likely than not that the fair value of each of the reporting units is less than its carrying amount.

The assessment of qualitative factors at the most recent Measurement Date (December 31, 2023), indicated that it was not more likely than not that impairment existed; as a result, no further testing was performed.

Allowance for credit losses

Credit risk is inherent in the business of lending and making commercial loans. Accounting for our allowance for credit losses involves significant judgment and assumptions by management and is based on historical data as well as reasonable and supportable forecasts of future events. At least on a quarterly basis, our management reviews the methodology and adequacy of allowance for credit losses and reports its assessment to the Board of Directors for its review and approval.

The allowance for credit losses is an estimate dependent upon many factors, including loan growth, net charge-offs, changes in the composition of the loans, qualitative factors, the valuation of problem loans and the general economic conditions in our market area. See Note 1 and Note 4 to the consolidated financial statements, and the "Provision for Credit Losses" and "Allowance for Credit Losses" sections of this discussion and analysis for more information on the establishment of the Allowance for Credit Losses and the implementation of the Current Expected Credit Loss ("CECL") model.

Income Taxes

Deferred income taxes are provided for the temporary differences between the financial reporting basis and the tax basis of our assets and liabilities. Deferred tax assets and liabilities are reflected at currently enacted income tax rates applicable to the period in which the deferred tax assets or liabilities are expected to be realized or settled using the liability method. As changes in tax laws or rates are enacted, deferred tax assets and liabilities are adjusted through the provision for income taxes.

We file income tax returns in the U.S. federal jurisdiction, and the State of California. We are no longer subject to examination by taxing authorities for years before 2020 for U.S. federal or for years before 2019 for California.

Fair Value Measurements

We use fair value measurements to record fair value adjustments to certain assets and liabilities and to determine fair value disclosures. We base our fair values on 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. Securities available for sale, derivatives, and loans held for sale, if any, are recorded at fair value on a recurring basis. Additionally, from time to time, we may be required to record certain assets at fair value on a non-recurring basis, such as certain impaired loans held for investment and securities held to maturity that are other-than-temporarily impaired. These non-recurring fair value adjustments typically involve write-downs of individual assets due to application of lower-of-cost or market accounting.

We have established and documented a process for determining fair value. We maximize the use of observable inputs and minimize the use of unobservable inputs when developing fair value measurements. Whenever there is no readily available market data, management uses its best estimate and assumptions in determining fair value, but these estimates involve inherent uncertainties and the application of management's judgment. As a result, if other assumptions had been used, our recorded earnings or disclosures could have been materially different from those reflected in these financial statements. For detailed information on our use of fair value measurements and our related valuation methodologies, see Note 14 to the Consolidated Financial Statements in Item 8 of this report.

Recently Issued Accounting Standards

See Note 1 to the Consolidated Financial Statements in Item 8 of this report.

Results of Operations

The Company earns income from two primary sources. The first is net interest income, which is interest income generated by earning assets less interest expense on interest-bearing liabilities. The second is noninterest income, which primarily consists of deposit service charges and fees, the increase in cash surrender value of life insurance, investment advisory service fee income and mortgage commissions. The majority of the Company's noninterest expenses are operating costs that relate to providing a full range of banking services to our customers.

Overview

We recorded net income for the year ended December 31, 2023 of \$30,848,000 or \$3.75 per diluted share compared to \$22,902,000 or \$2.79 per diluted share for the year ended December 31, 2022. The increase in net income for the year ended December 31, 2023 was primarily due to an increase of \$15,726,000 in net interest income, mainly from the positive impact of FOMC interest rate hikes and the growth of our loan portfolio. Non-interest income increased by \$1,060,000 in 2023, mainly as a result of fair value changes on equity securities and increased service charges on deposit accounts. The provision for credit losses increased compared to last year, mainly due to loan growth. Non-interest expense increased by \$3,849,000 associated with staffing and general operating overhead increases to support the growth of our loan and deposit portfolios.

[Table of Contents](#)

Highlights of the financial results are presented in the following table:

	As of and for the years ended December 31,	
	2023	2022
(Dollars in thousands, except per share data)		
For the period:		
Net income available to common shareholders	\$ 30,848	\$ 22,902
Net income per common share:		
Basic	\$ 3.76	\$ 2.80
Diluted	\$ 3.75	\$ 2.79
Return on average common equity	21.87%	18.21%
Return on average assets	1.64%	1.17%
Common stock dividend payout ratio of earnings during the period	8.53%	10.75%
Efficiency ratio	48.81%	54.29%
At period end:		
Book value per common share	\$ 20.03	\$ 15.33
Total assets	\$ 1,842,422	\$ 1,968,346
Total gross loans	\$ 1,016,579	\$ 915,758
Total deposits	\$ 1,650,534	\$ 1,814,297
Net loan-to-deposit ratio	60.85%	49.88%

Net Interest Income and Net Interest Margin

Our primary source of revenue is net interest income, which is the difference between interest and fees derived from earning assets and interest paid on liabilities obtained to fund those assets. Our net interest income is affected by changes in the level and mix of interest-earning assets and interest-bearing liabilities, referred to as volume changes. Our net interest income is also affected by changes in the yields earned on assets and rates paid on liabilities, referred to as rate changes. Interest rates charged on our loans are affected principally by the demand for such loans, the supply of money available for lending purposes and competitive factors. Those factors are, in turn, affected by general economic conditions and other factors beyond our control, such as federal economic policies, the general supply of money in the economy, legislative tax policies, governmental budgetary matters, and the actions of the Federal Reserve Board.

For a detailed analysis of interest income and interest expense, see the "Average Balance Sheets" and the "Rate/Volume Analysis" below.

Distribution, Yield and Rate Analysis of Net Income
For the Years Ended December 31,

(Dollars in Thousands)

	2023			2022		
	Average Balance	Interest Income/ Expense	Avg Rate/ Yield	Average Balance	Interest Income/ Expense	Avg Rate/ Yield
Assets:						
Earning assets:						
Gross loans (1) (2)	\$ 949,429	\$ 44,854	4.72%	\$ 888,135	\$ 38,972	4.39%
Securities - tax-exempt (2)	313,559	12,487	3.98%	278,859	10,367	3.72%
Securities - taxable	243,300	10,550	4.34%	194,034	5,935	3.06%
Federal funds sold	27,197	1,414	5.20%	22,164	415	1.87%
Interest-earning deposits	275,160	13,901	5.05%	495,854	7,738	1.56%
Total interest-earning assets	1,808,645	83,206	4.60%	1,879,046	63,427	3.38%
Total noninterest earning assets	70,820			83,576		
Total Assets	\$ 1,879,465			\$ 1,962,622		
Liabilities and Shareholders' Equity:						
Interest-bearing liabilities:						
Demand	493,164	1,358	0.28%	481,515	452	0.09%
Money market	374,828	2,711	0.72%	417,896	481	0.12%
Savings	147,180	197	0.13%	167,582	82	0.05%
Time deposits \$250,000 and under	24,172	375	1.55%	23,365	58	0.25%
Time deposits over \$250,000	16,443	222	1.35%	17,339	46	0.27%
Borrowed funds	20	1	5.00%	0	0	0.00%
Total interest-bearing liabilities	1,055,807	4,864	0.46%	1,107,697	1,119	0.10%
Noninterest-bearing liabilities:						
Noninterest-bearing demand deposits	653,034			709,150		
Other liabilities	29,585			20,004		
Total noninterest-bearing liabilities	682,619			729,154		
Shareholders' equity	141,039			125,771		
Total liabilities and shareholders' equity	\$ 1,879,465			\$ 1,962,622		
Net interest income		\$ 78,342			\$ 62,308	
Net interest spread (3)			4.14%			3.27%
Net interest margin (4)			4.33%			3.32%

(1) Loan fees have been included in the calculation of interest income.

(2) Yields on municipal securities and loans have been adjusted to their fully-taxable equivalents (FTE), based on a federal marginal tax rate of 21.0%.

(3) Represents the average rate earned on interest-earning assets less the average rate paid on interest-bearing liabilities.

(4) Represents net interest income as a percentage of average interest-earning assets.

Net interest income, on a fully tax equivalent basis ("FTE"), increased \$16,034,000 or 25.7% to \$78,342,000 for the year ended December 31, 2023, compared to \$62,308,000 in 2022. Net interest spread and net interest margin were 4.14% and 4.33%, respectively, for the year ended December 31, 2023, compared to 3.27% and 3.32%, respectively, for the year ended December 31, 2022. This upward trend is mainly due to the FOMC rate hikes that began in March 2022, resulting in an increase in earning asset yields, as described below.

Our earning asset yield increased 122 basis points in 2023 compared to 2022. The FOMC increased the federal funds target rate from a range of 0% to 0.25% at the beginning of 2022, to 4.25% to 4.50% by the end of the year. The FOMC approved additional rate hikes in 2023 to a range of 5.25% to 5.50%. All earning asset yields benefited from these increases, especially our interest-bearing cash accounts that receive the full impact of those increases. These cash balances averaged \$302 million in 2023, representing over 16% of total average assets. The yield on loans recognized an increase of 33 basis points for 2023 as compared to 2022, due to the upward repricing of variable rate loans and higher rate indexes on new loans. Growth in average gross loans of \$61 million, also contributed to net interest margin expansion.

The cost of funds on interest-bearing liabilities increased to 0.46% in 2023 compared to 0.10% in 2022 as a result of the FOMC rate hikes, competitive pressure and customer demand for higher rates. The decrease in deposit balances in 2023 also contributed to the rise in deposit rates, as management utilized promotional rates in order to match competition as a means to retain deposit relationships.

The net interest margin expansion the Company recognized in 2023, is due to the factors discussed above but could reverse and result in interest margin compression if rate indexes on assets were to fall, and/or: 1) deposit interest rates continue to increase due to customer demand, or competitive pressure from peer banks, 2) competition in the lending market restrict significant increases in new loan rates, and 3) deposit growth outpaces loan growth as recognized in recent years, resulting in higher interest-bearing cash balances, which would offer lower yields than loans and investments depending if the FOMC were to cut the Federal Funds rate.

Changes in volume resulted in an increase in net interest income (on a FTE basis) of \$2,186,000 for the year of 2023 compared to the year 2022, and changes in interest rates and the mix resulted in an increase in net interest income (on a FTE basis) of \$13,848,000 for the year 2023 versus the year 2022. Management closely monitors both total net interest income and the net interest margin.

Market rates are in part based on the FOMC target Federal funds interest rate (the interest rate banks charge each other for short-term borrowings). The change in the Federal funds sold rates is the result of target rate changes implemented by the FOMC. In 2020, the FOMC decreased the Federal funds rate by 0.50% and 1.00% on two occasions in March resulting in a range of 0.00% to 0.25% as of December 31, 2020 and 2021. In 2022, the FOMC raised the federal funds rate seven times by an aggregate of 4.00%. In 2023, the FOMC raised the Federal funds rate four times by 0.25% resulting in a range of 5.25% to 5.50%. If FOMC were to cut rates in 2024 or thereafter, we expect this would have a negative impact on our net interest income, due to repricing of interest-bearing cash balances, existing loans and investment securities.

Rate/Volume Analysis

The following table below sets forth certain information regarding changes in interest income and interest expense of the Company for the periods indicated. For each category of earning assets and interest-bearing liabilities, information is provided on changes attributable to (i) changes in volume (change in average volume multiplied by old rate); and (ii) changes in rates (change in rate multiplied by old average volume). Changes in rate/volume (change in rate multiplied by the change in volume) have been allocated to the changes due to volume and rate in proportion to the absolute value of the changes due to volume and rate prior to the allocation.

(Dollars in Thousands)	Rate/Volume Analysis of Net Interest Income					
	For the Year Ended December 31, 2023 vs. 2022			For the Year Ended December 31, 2022 vs. 2021		
	Increases (Decreases) Due to Change In			Increases (Decreases) Due to Change In		
	Volume	Rate	Total	Volume	Rate	Total
Interest income:						
Net loans (1)	\$ 2,690	\$ 3,192	\$ 5,882	\$ (2,616)	\$ (2,264)	\$ (4,880)
Securities - tax exempt	1,290	830	2,120	5,135	630	5,765
Securities - taxable	1,507	3,108	4,615	1,839	2,343	4,182
Federal funds sold	94	905	999	(12)	391	379
Interest-earning deposits	(3,444)	9,607	6,163	80	7,057	7,137
Total interest income	2,137	17,642	19,779	4,426	8,157	12,583
Interest expense:						
Interest-Earning DDA	\$ 11	\$ 895	\$ 906	\$ 110	\$ (69)	\$ 41
Money market deposits	(50)	2,280	2,230	63	41	104
Savings deposits	(10)	125	115	13	0	13
Time deposits \$250,000 and under	2	315	317	4	(7)	(3)
Time deposits over \$250,000	(2)	178	176	1	(8)	(7)
Borrowed funds	0	1	1	0	0	0
Total interest expense	(49)	3,794	3,745	191	(43)	148
Change in net interest income	\$ 2,186	\$ 13,848	\$ 16,034	\$ 4,235	\$ 8,200	\$ 12,435

(1) Loan fees have been included in the calculation of interest income.

Provision for credit losses

Credit risk is inherent in the business of making loans. The Company establishes an allowance for credit losses through charges to earnings, which are shown in the consolidated statements of income as the provision for credit losses. Specifically identifiable and quantifiable losses are promptly charged off against the allowance. The Company maintains the allowance for credit losses at a level that it considers to be adequate to provide for credit losses inherent in its loan portfolio. Management determines the level of the allowance by performing a quarterly analysis that considers concentrations of credit, past loss experience, current economic conditions, the amount and composition of the loan portfolio (including nonperforming and potential problem loans), estimated fair value of underlying collateral, and other information relevant to assessing the risk of loss inherent in the loan portfolio such as loan growth, net charge-offs, changes in the composition of the loan portfolio, and delinquencies. As a result of management's analysis, a range of the potential amount of the allowance for credit losses is determined.

[Table of Contents](#)

The Company recorded provision for credit loss of \$970,000 and a reversal totaling \$1,350,000 during the years ended December 31, 2023 and 2022, respectively. The 2023 provision was mainly due to loan growth and was based on macro-economic conditions among other factors as determined by our internal credit risk model. Included in 2022, was the reversal of approximately \$1,100,000 for the qualitative adjustment corresponding to the COVID-19 pandemic, which was initially recorded during the second quarter of 2020 and totaled \$1,620,000 at that time. The Company did not have any nonperforming loans as of December 31, 2023 and 2022. The allowance for credit losses was \$10,896,000 and \$9,468,000 as of December 31, 2023 and 2022, or 1.07% and 1.03%, respectively, of total loans. The increase as a percentage of total loans is due to the previously mentioned loan growth and macro-economic conditions. The strong credit quality has resulted in net loan recoveries of \$112,000 and \$80,000 in 2023 and 2022, respectively.

The Company will continue to monitor the adequacy of the allowance for credit losses and make additions to the allowance in accordance with the analysis referred to above. Because of uncertainties inherent in estimating the appropriate level of the allowance for credit losses, actual results may differ from management's estimate of credit losses and the related allowance.

Noninterest Income

The following table sets forth a summary of noninterest income for the periods indicated:

(in thousands)

	For the Year Ended December 31,					
	2023		2022		Year-Over-Year	
	Amount	%	Amount	%	\$ Change	% Change
Service charges on deposits	\$ 1,813	27.3%	\$ 1,596	28.6%	\$ 217	13.6%
Debit card transaction fee income	1,773	26.7%	1,734	31.1%	39	2.2%
Earnings on cash surrender value of life insurance	788	11.9%	749	13.4%	39	5.2%
Mortgage commissions	20	0.3%	73	1.3%	(53)	-72.6%
Gain on sales and calls of available-for-sale securities	156	2.4%	0	0.0%	156	0.0%
Other income	2,081	31.4%	1,419	25.6%	662	46.7%
Total non-interest income	\$ 6,631	100.0%	\$ 5,571	100.0%	\$ 1,060	19.0%
Average assets	\$ 1,879,465		1,962,622			
Noninterest expenses as a % of average assets		0.4%		0.3%		

Noninterest income was \$6,631,000 for the year ended December 31, 2023, compared to \$5,571,000 for the year 2022. Service charge income increased to \$1,813,000 in 2023 compared to \$1,596,000 for 2022, due to an increase in overdraft fees and the number of checking accounts. Debit card transaction fee income increased to \$1,773,000 in 2023 as compared to \$1,734,000 in 2022, as a result of the increase in the aggregate number of transaction deposit accounts and corresponding service fee income. Earnings on the cash surrender value of life insurance recognized an increase of \$39,000 in 2023 compared to 2022, due to higher yields earned on certain life insurance policies. Mortgage commissions have decreased by \$53,000 for the year 2023, as compared to 2022, as a result of the decreased demand for home purchases and refinancing. In 2023, other income increased by \$662,000, which includes a \$511,000 positive change in the fair value of equity securities, and an increase of \$156,000 from gains on called and sold securities, as compared to 2022. The Company continues to evaluate its deposit product offerings with the intention of continuing to expand its offerings to the consumer and business depositors.

Noninterest Expense

The following table sets forth a summary of noninterest expenses for the periods indicated:

(in thousands)

	For the Year Ended December 31,					
	2023		2022		Year-Over-Year	
	Amount	%	Amount	%	\$ Change	% Change
Salaries and employee benefits	\$ 26,109	63.4%	\$ 23,045	61.8%	\$ 3,064	13.3%
Occupancy expenses	4,541	11.0%	4,151	11.1%	390	9.4%
Data processing fees	2,729	6.6%	2,343	6.3%	386	16.5%
Regulatory assessments (FDIC & DFPI)	1,020	2.5%	927	2.5%	93	10.0%
Other operating expenses	6,758	16.5%	6,842	18.3%	(84)	-1.2%
Total non-interest expense	\$ 41,157	100.0%	\$ 37,308	100.0%	\$ 3,849	10.3%
Average assets	\$ 1,879,465		\$ 1,962,622			
Noninterest expenses as a % of average assets		2.2%		1.9%		

Noninterest expense was \$41,157,000 for the year ended December 31, 2023, an increase of \$3,849,000 or 10.3% compared to \$37,308,000 for the year ended 2022. Salaries and employee benefits increased by \$3,064,000 in 2023, due to expansion of our staff to support loan and deposit growth, including the staff at our new Roseville branch that opened in December 2022.

Occupancy expense realized an increase of \$390,000 in 2023 compared to the prior year, primarily from rent, utilities and facility maintenance increases on certain branch locations, including the overhead expenses related to our new Roseville branch that opened in December 2022.

Data processing costs increased in 2023 over 2022 by \$386,000, primarily due to servicing costs on the growing number of loan and deposit accounts, as well as upgrades to our online banking platform.

Federal Deposit Insurance Corporation ("FDIC") and California Department of Financial Protection and Innovation ("DFPI") regulatory assessments increased by \$93,000 in 2023 over 2022, mainly due to the FDIC increasing the base rate to 0.05%, on an annual basis, for all member banks in order to build up the Deposit Insurance Fund. The FDIC adopted a final rule in June 2022, applicable to all insured depository institutions, to increase initial base deposit insurance assessment rate schedules uniformly by 2 basis points, beginning in the first quarterly assessment period of 2023. The final rule became effective as of January 1, 2023, with an invoice payment date of June 30, 2023. The FDIC said that the increase in assessment rate schedules is intended to increase the likelihood that the reserve ratio of the Deposit Insurance fund reaches the statutory minimum of 1.35 percent by the statutory deadline of September 30, 2028. The final assessment rate for financial institutions is determined by making adjustments to the base rate for various credit quality factors and other risk metrics of the institution as defined by the FDIC. The Company's risk profile and the related assessment rate remains at a relatively low level due to our strong credit quality, earnings and risk-based capital ratios. Management recognizes that assessments could increase further depending on deposit growth throughout the remainder of 2024, as the FDIC assessment rates are applied to average quarterly total liabilities as the primary basis, and based on FDIC's discretion to increase the base assessment rate as needed to replenish the Deposit Insurance Fund. Moreover, the FDIC retains the authority and discretion to increase base assessment rates for banking entities in the future, as circumstances warrant.

Other operating expenses decreased by \$84,000 in 2023 as compared to 2022, due to the reversal of \$484,000 in undisbursed loan commitment loss provisions as dictated by the calculation within our CECL internal loan-risk model, which was partially offset by various general operating expense increases required to support our growing business portfolios and compliance mandates. Some of these included audit expenses, software license fees and ATM processing expenses.

Management anticipates that noninterest expense should continue to increase as we continue to grow, and management believes the Company's administration as currently set up is scalable to handle future deposit growth. However, management remains committed to cost-control and efficiency, and we expect to keep these increases to a minimum relative to growth.

Provision for Income Taxes

We reported a provision for income taxes of \$9,458,000 and \$6,787,000 for the years 2023 and 2022, respectively. The effective income tax rate on income from continuing operations was 23.5% for the year ended December 31, 2023, compared to 22.9% for the year 2022. These provisions reflect accruals for taxes at the applicable rates for federal income tax and California franchise tax based upon reported pre-tax income and adjusted for the effects of all permanent differences between income for tax and financial reporting purposes (such as earnings on qualified municipal securities, BOLI and certain tax-exempt loans). The disparity between the effective tax rates for 2023 as compared to 2022 is primarily due to tax credits from low-income housing projects as well as tax-free income on municipal securities and loans that comprised a larger proportion of pre-tax income in 2022 as compared to 2023.

Financial Condition

The Company's total assets were \$1,842,422,000 at December 31, 2023 compared to \$1,968,346,000 at December 31, 2022, a decrease of \$125,924,000 or 6.4%. Net loans increased by \$99,242,000, investments decreased \$9,218,000, bank premises and equipment increased \$565,000, interest receivable and other assets decreased \$4,651,000 while cash and cash equivalents decreased \$213,065,000 for the year ended December 31, 2023 as compared to December 31, 2022.

Loans gross of the allowance for credit losses and deferred fees were \$1,016,579,000 as of December 31, 2023, compared to \$915,758,000 as of December 31, 2022, an increase of \$100,821,000 or 11.0%. The increase was due to an increase of \$101,126,000 or 12.8% in commercial real estate loans, a decrease of \$1,904,000 or 5.7% in consumer loans, an increase of \$4,745,000 or 22.4% in agriculture loans, and a decrease of \$3,146,000 or 4.6% in commercial and industrial loans. The composition remained relatively unchanged as a percentage of total loans, with commercial real estate comprising 88% and 85% of the loan portfolio at December 31, 2023 and 2022, respectively.

Deposits decreased \$163,763,000 or 9.0% to \$1,650,534,000 as of December 31, 2023 compared to \$1,814,297,000 at December 31, 2022. Demand, Money Market, and Savings decreased by \$102,491,000, \$42,411,000 and \$34,198,000, respectively, while Time Deposits increased by \$15,337,000, as of December 31, 2023 as compared to December 31, 2022.

There were no short-term borrowing or long-term debt outstanding balances at December 31, 2023 and 2022. The Company uses short-term borrowings, primarily short-term FHLB advances, to fund short-term liquidity needs, if needed, and manage net interest margin.

Equity increased \$39,466,000 or 31.2% to \$166,092,000 as of December 31, 2023, compared to \$126,626,000 at December 31, 2022. Equity increased due to earnings and the positive impact interest rates had on our unrealized loss on available-for-sale investment securities.

Investment Activities

Investments are a key source of interest income. Management of our investment portfolio is set in accordance with strategies developed and overseen by our Investment Committee. Investment balances, including cash equivalents and interest-bearing deposits in other financial institutions, are subject to change over time based on our asset/liability funding needs and interest rate risk management objectives. Our liquidity levels take into consideration anticipated future cash flows and all available sources of credits and are maintained at levels management believes are appropriate to assure future flexibility in meeting anticipated funding needs.

Cash Equivalents and Interest-bearing Deposits in other Financial Institutions

The Company holds federal funds sold, unpledged available-for-sale securities and salable government guaranteed loans to help meet liquidity requirements and provide temporary holdings until the funds can be otherwise deployed or invested. As of December 31, 2023, and 2022, we had \$36,500,000 and \$13,830,000, respectively, in federal funds sold.

Investment Securities

Management of our investment securities portfolio focuses on providing an adequate level of liquidity and establishing an interest rate-sensitive position, while earning an adequate level of investment income without taking undue risk. Investment securities that we intend to hold until maturity are classified as held-to-maturity securities, and all other investment securities are classified as either available-for-sale or equity securities. Currently, all of our investment securities are classified as available-for-sale, except for one mutual fund classified as an equity security.

[Table of Contents](#)

The fair value of the equity security was \$3,132,000 and \$2,990,000 at December 31, 2023 and December 31, 2022, respectively. Consistent with ASU 2016-01, equity securities are carried at fair value with the changes in fair value recognized in the consolidated statement of income. Accordingly, the Company recognized an unrealized gain of \$41,000 during the year ended December 31, 2023, and an unrealized loss of \$475,000 during the year ended December 31, 2022.

Our available-for-sale investment securities holdings decreased by \$9,360,000 or 1.8% to \$518,078,000 at December 31, 2023, compared to holdings of \$527,438,000 at December 31, 2022. The carrying values of available-for-sale investment securities are adjusted for unrealized gains or losses as a valuation allowance and any gain or loss is reported on an after-tax basis as a component of other comprehensive income.

Total investment securities as a percentage of total assets increased to 28.3% as of December 31, 2023 compared to 26.9% at December 31, 2022. As of December 31, 2023, \$288,199,000 of the investment securities were pledged to secure public deposits.

As of December 31, 2023, the total unrealized loss on debt securities that were in a loss position for less than 12 continuous months was \$465,000 with an aggregate fair value of \$52,079,000. The total unrealized loss on debt securities that were in a loss position for greater than 12 continuous months was \$29,679,000 with an aggregate fair value of \$336,756,000.

The following table summarizes the maturity and repricing schedule of our debt investment securities, which does not include equity securities, at their amortized cost and their weighted average yields at December 31, 2023:

Debt Investment Maturities and Repricing Schedule

(Dollars in Thousands)	Within One Year		After One But Within Five Years		After Five But Within Ten Years		After Ten Years		Total	
	Amount	Yield	Amount	Yield	Amount	Yield	Amount	Yield	Amount	Yield
Available-for-sale:										
U.S. agencies	\$ 50,000	1.01%	\$ 1,110	1.00%	\$ 2,657	5.52%	\$ 30,911	3.48%	\$ 84,678	2.05%
Collateralized mortgage obligations	0	0.00%	0	0.00%	0	0.00%	9,108	4.60%	9,108	4.60%
Municipalities	10,428	3.88%	137,298	4.30%	196,559	3.03%	1,696	3.89%	345,981	3.56%
SBA pools	0	0.00%	170	0.05%	912	7.45%	312	7.95%	1,394	6.66%
Corporate debt	41,000	2.64%	6,500	5.52%	0	0.00%	0	0.00%	47,500	3.03%
Asset backed securities	0	0.00%	836	5.90%	19,676	7.45%	36,101	6.35%	56,613	6.73%
Total debt securities	<u>\$ 101,428</u>	<u>1.96%</u>	<u>\$ 145,914</u>	<u>4.33%</u>	<u>\$ 219,804</u>	<u>3.47%</u>	<u>\$ 78,128</u>	<u>4.96%</u>	<u>\$ 545,274</u>	<u>3.64%</u>

Yields in the above table have been adjusted to a fully tax equivalent basis. The yields are calculated using a weighted average method based on the investment security balances as of December 31, 2023. Securities are reported at the earliest possible call, repricing or maturity date.

Loans

Our residential loan portfolio includes no sub-prime loans, nor is it our normal practice to underwrite loans commonly referred to as "Alt-A mortgages", the characteristics of which are loans lacking full documentation, borrowers having low FICO scores or collateral compositions reflecting high loan-to-value ratios. Substantially all of our residential loans are indexed to U.S. Treasury Constant Maturity Rates and have provisions to reset five years after their origination dates.

[Table of Contents](#)

The following table summarizes our commercial real estate loan portfolio by the geographic location in which the property is located as of December 31, 2023 and 2022:

(Dollars in Thousands)

	December 31, 2023		December 31, 2022	
	Amount	% of Commercial Real Estate Loans	Amount	% of Commercial Real Estate Loans
Commercial real estate loans by geographic location (County)				
Stanislaus	\$ 209,505	23.4%	\$ 202,239	25.5%
San Joaquin	180,408	20.2%	177,455	22.4%
Sacramento	107,270	12.0%	83,116	10.5%
Fresno	64,578	7.2%	54,747	6.9%
Tuolumne	32,950	3.7%	33,563	4.2%
Shasta	27,979	3.1%	19,547	2.5%
Merced	26,620	3.0%	29,211	3.7%
Marin	20,703	2.3%	11,175	1.4%
Yolo	19,091	2.1%	11,911	1.5%
Solano	17,942	2.0%	12,217	1.5%
Sonoma	14,102	1.6%	12,792	1.6%
Contra Costa	13,941	1.6%	12,044	1.5%
Alameda	13,675	1.5%	13,307	1.7%
Sutter	12,758	1.4%	8,537	1.1%
Placer	11,804	1.3%	9,979	1.3%
Tulare	10,037	1.1%	3,394	0.4%
San Diego	9,180	1.0%	9,905	1.3%
Santa Clara	8,833	1.0%	5,642	0.7%
Other	92,376	10.5%	81,845	10.3%
Total	\$ 893,752	100.0%	\$ 792,626	100.0%

[Table of Contents](#)

Construction and land loans are classified as commercial real estate loans and increased \$18.6 million in 2023 as compared to 2022. The table below shows an analysis of construction and land loans by type and location. Non-owner-occupied land loans of \$12.5 million as of December 31, 2023 included loans for lands specified for commercial development of \$10.7 million and for residential development of \$1.8 million, the majority of which are located in Stanislaus County.

Construction and Land Loans Outstanding by Type and Geographic Location

(Dollars in Thousands)

	December 31, 2023		December 31, 2022	
	Amount	% of Construction and Land Loans	Amount	% of Construction and Land Loans
Construction and land loans by type				
Single family non-owner-occupied	\$ 2,707	3.8%	\$ 1,679	3.8%
Single family owner-occupied	533	0.8%	275	0.6%
Commercial non-owner-occupied	40,092	56.4%	21,984	49.5%
Commercial owner-occupied	7,181	8.8%	7,946	17.9%
Land non-owner-occupied	12,547	30.2%	12,539	28.2%
Total	\$ 63,060	100.0%	\$ 44,423	100.0%
Construction and land loans by geographic location (County)				
Stanislaus	\$ 10,665	16.9%	\$ 4,818	10.8%
San Joaquin	9,621	15.3%	11,771	26.5%
Fresno	7,804	12.4%	7,215	16.2%
Shasta	7,606	12.1%	4,854	10.9%
Yolo	6,860	10.9%	1,306	2.9%
Tulare	6,125	9.7%	962	2.2%
Solano	4,109	6.5%	49	0.1%
Placer	2,360	3.7%	1,860	4.2%
Sacramento	2,028	3.2%	3,929	8.8%
Merced	1,626	2.6%	4,474	10.1%
Mono	1,469	2.3%	762	1.7%
Other	2,787	4.4%	2,423	5.6%
Total	\$ 63,060	100.0%	\$ 44,423	100.0%

Loan Maturities

The following table shows the contractual maturity distribution and repricing intervals of the outstanding loans in our portfolio, as of December 31, 2023. In addition, the table shows the distribution of such loans between those with variable or floating interest rates and those with fixed or predetermined interest rates. The large majority of the variable rate loans are tied to independent indices (such as the Wall Street Journal prime rate or a Treasury Constant Maturity Rate). Substantially all loans with an original term of more than five years have provisions for the fixed rates to reset, or convert to a variable rate, after one, three or five years and are therefore classified as a variable rate loan in the table below.

Loan Maturities and Repricing Schedule at December 31, 2023					
(in thousands)	Within 1 Year	After 1 But Within 5 Years	After 5 But Within 15 Years	After 15 Years	Total
Commercial real estate					
Construction & land	\$ 36,579	\$ 15,631	\$ 10,850	\$ 0	63,060
Multi-family	6,798	28,237	19,010	0	54,045
Owner occupied	13,475	71,578	124,644	710	210,407
Non-owner occupied	54,270	202,019	213,763	0	470,052
Farmland	7,713	24,473	63,583	419	96,188
Commercial & industrial	29,347	25,065	10,802	4	65,218
Consumer	10,557	14,516	6,035	579	31,687
Agriculture	19,939	4,434	1,549	0	25,922
Deferred loan fees and costs, net	(266)	(544)	(585)	(11)	(1,406)
Total loans, net of unearned income	<u>\$ 178,412</u>	<u>\$ 385,409</u>	<u>\$ 449,651</u>	<u>\$ 1,701</u>	<u>\$ 1,015,173</u>
Loans with variable (floating) interest rates	\$ 122,851	\$ 258,887	94,939	\$ 527	\$ 477,204
Loans with predetermined (fixed) interest rates	\$ 55,561	\$ 126,522	354,712	\$ 1,174	\$ 537,969

The majority of the properties taken as collateral are located in Northern California. We employ strict guidelines regarding the use of collateral located in less familiar market areas. Positive trends in Northern California real estate values, the low loan-to-value ratios in our commercial real estate portfolio, and the high percentage of owner-occupied properties further solidify our credit quality position.

Nonperforming Assets

Financial institutions generally have a certain level of exposure to credit quality risk and could potentially receive less than a full return of principal and interest if a debtor becomes unable or unwilling to repay. Since loans are the most significant assets of the Company and generate the largest portion of its revenues, the Company's management of credit quality risk is focused primarily on loan quality. Banks have generally suffered their most severe earnings declines due to customers' inability to generate sufficient cash flow to service their debts and/or downturns in national and regional economies which have brought about declines in overall property values. In addition, certain debt securities that the Company may purchase have the potential of declining in value if the obligor's financial capacity to repay deteriorates.

Nonperforming assets consist of loans on non-accrual status, loans 90 days or more past due and still accruing interest, loans restructured, where the terms of repayment have been renegotiated resulting in a reduction or deferral of interest or principal and OREO.

Loans are generally placed on non-accrual status when they become 90 days past due, unless management believes the loan is adequately collateralized and in the process of collection. The past due loans may or may not be adequately collateralized, but collection efforts are continuously pursued. Loans may be restructured by management when a borrower has experienced some changes in financial status, causing an inability to meet the original repayment terms, and where we believe the borrower will eventually overcome those circumstances and repay the loan in full. OREO consists of properties acquired by foreclosure or similar means and which management intends to offer for sale. The Company did not have any nonperforming loans as of December 31, 2023 and 2022.

The Company held no OREO properties as of December 31, 2023 and 2022. Accordingly, the Company had zero non-performing assets recorded on the balance sheet as of December 31, 2023 and 2022.

Allowance for credit losses

In anticipation of credit risk inherent in our lending business, we set aside allowances through charges to earnings. Such charges are not only made for the outstanding loan portfolio, but also for off-balance sheet items, such as commitments to extend credits or letters of credit. The charges made for the outstanding loan portfolio are credited to the allowance for credit losses, whereas charges for off-balance sheet items are credited to the reserve for off-balance sheet items, which is presented as a component of other liabilities. The provision for credit losses is discussed in the section entitled "Provision for credit losses" above.

The balance of our allowance for credit losses is management's best estimate of the current expected credit losses inherent in the portfolio. The ultimate adequacy of the allowance is dependent upon a variety of factors beyond our control, including the real estate market, changes in interest rate and economic and political environments.

In 2020, the economy briefly slipped into a recession following the COVID-19 pandemic which inevitably impacted the financial condition of certain borrowers. We responded by making qualitative risk-based discretionary adjustments in connection with the COVID-19 pandemic and corresponding economic stress. In 2022, the financial stress subsided and credit quality improved allowing the Company to reverse \$1,350,000 in loan loss provisions, which included the remaining COVID-19 discretionary adjustment of \$1,100,000. The allowance for credit losses increased to \$10,896,000 as of December 31, 2023, as compared with \$9,468,000 at December 31, 2022. The allowance for credit losses as a percentage of total loans increased to 1.07% as of December 31, 2023, as compared to 1.03% as of December 31, 2022, mainly due to loan growth. Based on the current conditions of the loan portfolio, management believes that the \$10,896,000 allowance for credit losses at December 31, 2023 is adequate to absorb losses inherent in our loan portfolio. No assurance can be given, however, that adverse economic conditions or other circumstances will not result in increased losses in the portfolio.

Diversification, low loan-to-values, strong credit quality and enhanced credit monitoring contribute to a reduction in the portfolio's overall risk in recent years and help to offset the various inherent credit risks. We continue to monitor the impact of the economic environment, and adjustments to the provision for credit loss will be made accordingly. During 2023, the Company recognized net loan recoveries of \$112,000 as compared to \$80,000 in 2022.

Management reviews these conditions with our senior credit officers. To the extent that any of these conditions is evidenced by a specifically identifiable problem credit or portfolio segment as of the evaluation date, management's estimate of the effect of such condition may be reflected as a specific allowance applicable to such credit or portfolio segment. Although management has allocated a portion of the allowance to specific loan categories, the adequacy of the allowance is considered in its entirety.

As required by ASU 2016-13, on January 1, 2023 the Company implemented CECL and increased our ACL, previously the allowance for loan losses, with a \$346,000 cumulative adjustment. Under ASU 2016-13, the allowance for credit losses is deducted from the amortized cost basis to present the net amount expected to be collected on the loans. The measurement of expected credit losses is based on relevant information, which includes experience, current conditions, and reasonable and supportable forecasts that affect the collectability of the reported amount over the remaining contractual life. The Company's ACL is calculated monthly, with any difference in the calculated ACL and the recorded ACL trued-up through an entry to the provision for credit losses. Management calculates the quantitative portion of collectively evaluated reserves for all loan categories, using a discounted cash flow ("DCF") methodology. For purposes of estimating the Company's ACL, management generally evaluates collectively evaluated loans by federal call code in order to group loans with similar risk characteristics together, however management has grouped loans in selected call codes together in determining portfolio segments, due to similar risk characteristics and reserve methodologies used for certain call code classifications.

The DCF quantitative reserve methodology incorporates the consideration of probability of default ("PD") and loss given default ("LGD") estimates to calculate expected lifetime losses. The PD estimates are derived using reasonable and supportable economic forecasts and historical loss rate data from both the bank and a selected peer group. The historical loss rate data is compared to identified benchmark economic indicators to create a regression model that is updated annually. Reasonable and supportable forecasts for the identified economic indicators are then incorporated to arrive at expected default rates for the various loan categories. The reasonable and supportable forecasts are based on the National Unemployment Rate and Real Gross Domestic Product. The expected default rates are then applied to expected monthly loan balances estimated through the consideration of contractual terms and expected prepayments. The Company utilizes a four-quarter forecast period, after which the expected default rates revert to the historical average, over a four-quarter reversion period, on a straight-line basis. The prepayment assumptions are estimated based on historical experience of the bank. The prepayment assumptions are updated quarterly and may be subject to additional updates by Management in the event that changing conditions impact Management's estimate. LGD utilized in the DCF is derived from the application of models that correlate LGD and PD based on historical peer data.

Management recognizes that there are additional factors impacting risk of loss in the loan portfolio beyond what is captured in the quantitative portion of collectively evaluated reserves. As current and expected conditions, may vary compared with conditions over historical periods, which are utilized in the calculation of quantitative reserves, management considers whether additional or reduced reserve levels on collectively evaluated loans may be warranted given the consideration of a variety of qualitative factors. Several of the following qualitative factors ("Q-factors") considered by management reflect regulatory guidance on Q-factors, whereas several others represent factors unique to the Company or unique to the current time period.

- Changes in lending policies and procedures, including changes in underwriting standards and collection, charge-off, and recovery practices
- Changes in international, regional and local economic and business conditions, and developments that affect the collectability of the portfolio, as reflected in forecasts of the California unemployment rate
- Changes in the nature and volume of the loan portfolio
- Changes in the experience, ability, and depth of lending management and other relevant staff
- Changes in the volume and severity of past due, watch loans and classified loans
- Changes in the quality of the Bank's loan review processes
- Changes in the value of underlying collateral for loans not identified as collateral dependent
- Changes in loan categorization concentrations
- Other external factors, which include, the regulatory risk ratings.

The qualitative portion of the Company's reserves on collectively evaluated loans are calculated using a combination of numeric frameworks, matrices defining reserve rate based on specified metrics, and management judgement, to determine risk categorizations in each of the Q-factors presented above. The amount of qualitative reserves is also contingent upon the relative weighting of Q-factors according to management's judgement.

Loans identified as losses by management and internal loan review are charged-off. Furthermore, consumer loan accounts are charged-off automatically based on regulatory requirements.

[Table of Contents](#)

The table below summarizes, for the periods indicated, loan balances at the end of each period, the daily averages during the period, changes in the allowance for credit losses arising from loans charged off, recoveries on loans previously charged off, additions to the allowance and certain ratios related to the allowance for credit losses:

Allowance for Credit Losses

(Dollars in thousands)	December 31, 2023	December 31, 2022
Balances:		
Average total loans outstanding during period	\$ 949,429	\$ 888,135
Total loans outstanding at end of period	\$ 1,016,579	\$ 915,758
Net loan recoveries	\$ 112	\$ 80
Provision for (Reversal of) credit losses	\$ 970	\$ (1,350)
Allowance for credit losses at end of period	\$ 10,896	\$ 9,468
Ratios:		
Net loan recoveries to average total loans	0.01%	0.01%
Allowance for credit losses to total loans at end of period	1.07%	1.03%
Nonperforming loans as a percentage of total loans	0.00%	0.00%
Allowance for credit losses as a percentage of nonperforming loans	NA	NA

The table below summarizes the allowance for credit loss balance by type of loan balance at the end of each period (See "Loan Portfolio" above for a description of each type of loan balance):

Allocation of the Allowance for Credit Losses

(Dollars in thousands)	December 31, 2023		December 31, 2022	
	Amount	% of Allowance for Loan Losses	Amount	% of Allowance for Loan Losses
Applicable to:				
Commercial real estate				
Construction & land	\$ 1,227	11.3%	\$ 1,055	11.1%
Multi-family	667	6.1%	479	5.1%
Owner occupied	1,805	16.6%	1,798	19.0%
Non-owner occupied	4,805	44.0%	4,211	44.4%
Farmland	1,468	13.5%	830	8.8%
Commercial and Industrial	650	6.0%	612	6.5%
Consumer	227	2.1%	311	3.3%
Agriculture	47	0.4%	172	1.8%
Total Allowance	\$ 10,896	100.0%	\$ 9,468	100.0%

Other Earning Assets

For various business purposes, we make investments in earning assets other than the interest-earning securities and loans discussed above. The primary other earning assets held by the Company as of December 31, 2023 and 2022, includes the cash surrender value of the BOLI policies, Federal Home Loan Bank stock and Federal Reserve Bank stock. During 2023, we purchased one new life insurance policy on a director for a total investment of \$500,000.

During 2018 and 2022, we committed to invest \$5 million and \$10.5 million, respectively, in low-income housing tax credit funds ("LIHTC") to promote our participation in CRA activities, which had unfunded commitments of \$9,782,000 and \$10,154,000 as of December 31, 2023 and 2022, respectively. For LIHTC investments, we receive the return in the form of tax credits and tax deductions over a period of approximately 15 years.

In 2017, we made a \$1 million commitment as a limited partner, to a small business private equity partnership to promote our participation in CRA activities. The value is recorded at fair market value with market gains or losses recorded to other income in the consolidate financial statements. As of December 31, 2023, we have remaining commitments to fund an additional \$200,000 on this investment.

The balances of other earning assets as of December 31, 2023 and December 31, 2022 were as follows:

(Dollars in Thousands)	December 31, 2023	December 31, 2022
BOLI	\$ 31,506	\$ 30,218
LIHTCs	\$ 12,655	\$ 13,627
Small business private equity partnership	\$ 1,029	\$ 955
Federal Reserve Bank Stock	\$ 755	\$ 755
Federal Home Loan Bank Stock	\$ 5,202	\$ 4,482

Deposits and Other Sources of Funds

Deposits

Total deposits at December 31, 2023 and 2022 were \$1,650,534 and \$1,814,297,000, respectively, representing a decrease of \$163,763,000 or 9.0% in 2023. The average deposits for the year ended December 31, 2023 decreased \$108,026,000 or 5.9% to \$1,708,821,000 compared to \$1,816,847,000 at December 31, 2022. Deposit data analysis has resulted in an estimate of \$768,103,000 in uninsured deposits, representing the balance that is not covered by FDIC insurance limits as of December 31, 2023.

Deposits are the Company's primary source of funds. Due to strategic emphasis by management, core deposits (based on a definition provided by FDIC's Uniform Bank Performance Report) decreased by \$168,025,000 or 9.4% in 2023 to \$1,622,136,000 at December 31, 2023. The percentage of core deposits to total deposits decreased slightly to 98.3% at December 31, 2023 as compared to 98.7% at December 31, 2022. The average rate paid on time deposits in denominations of over \$250,000 was 1.35% and 0.27% for the years ended December 31, 2023 and 2022, respectively. The composition and cost of the Company's deposit base are important components in analyzing the Company's net interest margin and balance sheet liquidity characteristics, both of which are discussed in greater detail in other sections herein. See "Net Interest Income and Net Interest Margin" for further discussion.

The Company's liquidity is impacted by the volatility of deposits or other funding instruments or, in other words, by the propensity of that money to leave the institution for rate-related or other reasons. Deposits can be adversely affected if economic conditions in California and the Company's market area in particular, were to weaken. Potentially, the most volatile deposits in a financial institution are jumbo certificates of deposit, meaning time deposits with balances that equal or exceed \$250,000, as customers with balances of that magnitude are typically more rate-sensitive than customers with smaller balances.

The following tables summarize the distribution of average daily deposits and the average daily rates paid for the periods indicated:

Distribution of Average Daily Deposits

(Dollars in Thousands)	Average Deposits			
	2023		2022	
	Average Balance	Average Rate	Average Balance	Average Rate
Demand	\$ 1,146,198	0.12%	\$ 1,190,665	0.04%
Money market	374,828	0.72%	417,896	0.12%
Savings	147,181	0.13%	167,582	0.05%
Time deposits \$250,000 and under	24,172	1.55%	23,365	0.25%
Time deposits over \$250,000	16,443	1.35%	17,339	0.27%
Total deposits	<u>\$ 1,708,822</u>	<u>0.28%</u>	<u>\$ 1,816,847</u>	<u>0.06%</u>

The scheduled maturities of our time deposits in denominations of more than \$250,000 at December 31, 2023 are as follows:

**Maturities of Time Deposits over \$250,000
(Dollars in Thousands)**

Three months or less	\$ 5,443
Over three months through six months	3,835
Over six months through twelve months	10,450
Over twelve months	2,395
Total	<u>\$ 22,123</u>

Because our client base is comprised primarily of commercial and industrial accounts, individual account balances are generally higher than those of consumer-oriented banks. Five of our clients carry deposit balances of more than 1% of our total deposits, one of which had a deposit balance of more than 3% of total deposits at December 31, 2023. The Company had no brokered deposits as of December 31, 2023 and 2022.

FHLB Borrowings

Although deposits are the primary source of funds for our lending and investment activities and for general business purposes, we may obtain advances from the FHLB as an alternative to retail deposit funds. We had no outstanding balances as of December 31, 2023 and 2022. The average balance of FHLB advances outstanding in 2023 and 2022 was \$0. See "Liquidity Management" below for the details on the FHLB borrowings program.

Deferred Compensation Obligations

We maintain a nonqualified, unfunded deferred compensation plan for certain key management personnel. Under this plan, participating employees may defer compensation, which will entitle them to receive certain payments upon retirement, death, or disability. The plan provides for payments commencing upon retirement and reduced benefits upon early retirement, disability, or termination of employment. As of December 31, 2023 and 2022, our aggregate payment obligations under this plan totaled \$11.4 million and \$11.3 million, respectively

Liquidity and Asset/Liability Management

Management seeks to ascertain optimum and stable utilization of available assets and liabilities as a vehicle to attain our overall business plans and objectives. In this regard, management focuses on measurement and control of liquidity risk, interest rate risk and market risk, capital adequacy, operation risk and credit risk.

Liquidity

Liquidity to meet borrowers' credit and depositors' withdrawal demands is provided by maturing assets, short-term liquid assets that can be converted to cash and the ability to attract funds from depositors. Additional sources of liquidity may include institutional deposits, advances from the FHLB and other short-term borrowings, such as federal funds purchased.

Since our deposit growth strategy emphasizes core deposit growth, we have avoided relying on brokered deposits as a consistent source of funds. The Company had no brokered deposits as of December 31, 2023 and 2022.

As a secondary source of liquidity, we rely on advances from the FHLB to supplement our supply of lendable funds and to meet deposit withdrawal requirements. Advances from the FHLB are typically secured by a portion of our loan portfolio and stock issued by the FHLB. The FHLB determines limitations on the amounts of advances by assigning a percentage to each eligible loan category that will count towards the borrowing capacity. As of December 31, 2023 and 2022, the Company had no FHLB advances outstanding and had sufficient collateral to borrow an additional \$333.1 million and \$322.4 million, respectively. In addition, the Company had lines of credit with its correspondent banks to purchase overnight federal funds totaling \$70 million at December 31, 2023 and 2022. No advances were made on these lines of credit as of December 31, 2023 and 2022.

The Company's liquidity depends primarily on dividends paid to it as the sole shareholder of the Bank. The Bank's ability to pay dividends to the Company may depend on whether the Bank will be in a position to pay dividends based on regulatory requirements and the performance of the Bank.

Maintenance of adequate liquidity requires that sufficient resources be available at all time to meet our cash flow requirements. Liquidity in a banking institution is required primarily to provide for deposit withdrawals and the credit needs of its customers and to take advantage of investment opportunities as they arise. Liquidity management involves our ability to convert assets into cash or cash equivalents without incurring significant loss, and to raise cash or maintain funds without incurring excessive additional cost. For this purpose, we maintain a portion of our funds in cash and cash equivalents, loans and securities available for sale. Our liquid assets at December 31, 2023 and 2022 totaled approximately \$489.0 million and \$754.9 million, respectively. Our liquidity level measured as the percentage of liquid assets to total assets was 26.5% and 38.4% as of December 31, 2023, and 2022, respectively.

We believe that our current unrestricted cash and cash equivalents, cash flows from operations and borrowing capacity under our credit facility will be sufficient to meet our working capital, capital expenditures, and any other capital needs for at least the next 12 months. We are currently not aware of any trends or demands, commitments, events or uncertainties that will result in or that are reasonably likely to result in our liquidity increasing or decreasing in any material way that will impact our capital needs during or beyond the next 12 months.

[Table of Contents](#)

The following tables summarizes short- and long-term material cash requirements as of December 31, 2023, which we believe that we will be able to fund these obligations through cash generated from our operations and available alternative sources of funds (dollars in thousands):

	Less than 1 year	1-3 years	3-5 years	More than 5 years	Total
Operating lease obligations	\$ 1,400	\$ 2,279	\$ 1,692	\$ 2,892	\$ 8,263
Supplemental retirement plans	62	220	502	10,665	11,449
Time deposit maturities	49,275	5,967	279	0	55,521
Total	<u>\$ 50,737</u>	<u>\$ 8,466</u>	<u>\$ 2,473</u>	<u>\$ 13,557</u>	<u>\$ 75,233</u>

Capital Resources and Capital Adequacy Requirements

In the past two years, our primary source of capital has been internally generated operating income through retained earnings. At December 31, 2023, total shareholders' equity increased to \$166.1 million, representing an increase of \$39.5 million from December 31, 2022. The increase was due to net income of \$30.8 million recorded to retained earnings and other comprehensive gains of \$11.6 million, net of income taxes, due to the positive effect that treasury yields had on the unrealized market value adjustment of our available-for-sale investment portfolio during 2023. Also, retained earnings was reduced by the common stock dividend payments totaling \$2.6 million during 2023. As of December 31, 2023, we had no material commitments for capital expenditures.

We are subject to various regulatory capital requirements administered by federal banking agencies. Failure to meet minimum capital requirements can trigger regulatory actions that could have a material adverse effect on our financial statements and operations. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, we must meet specific capital guidelines that rely on the quantitative measures of our assets, liabilities and certain off-balance-sheet items as calculated under regulatory accounting practices. Our capital amounts and classification are also subject to qualitative judgments by the regulators about components, risk weightings, and other factors. (See "Description of Business-Regulation and Supervision-Capital Adequacy Requirements" in this report for exact definitions and regulatory capital requirements.)

As of December 31, 2023, we were qualified as a "well capitalized institution" under the regulatory framework for prompt corrective action. For more information on our capital resources and capital adequacy requirements, see Note 19 to the Consolidated Financial Statements in Item 8 of this report.

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK.

Market Risk

Market risk is the risk of loss of future earnings, fair values, or future cash flows that may result from changes in the price of a financial instrument. The value of a financial instrument may change as a result of changes in interest rates, foreign currency exchange rates, commodity prices, equity prices and other market changes that affect market risk sensitive instruments. Market risk is attributed to all market risk sensitive financial instruments, including securities, loans, deposits and borrowings, as well as the Company's role as a financial intermediary in customer-related transactions. The objective of market risk management is to avoid excessive exposure of the Company's earnings and equity to loss, and to reduce the volatility inherent in certain financial instruments.

Interest Rate Management

Market risk is the risk of a loss in earnings or economic value that arises from adverse changes or movements in market rates and prices, such as interest rates or credit spreads. The Company's market risk exposure is primarily that of interest rate risk inherent in its lending, investing, and deposit taking activities. The core banking activities of lending and deposit-taking expose the Company to interest rate risk, which occurs when assets and liabilities re-price at different times and by different amounts as interest rates change. The Company has established policies and procedures to monitor and limit earnings and balance sheet exposure to changes in interest rates. The Company does not engage in the trading of financial instruments, nor does the Company have exposure to currency exchange rates.

The principal objective of interest rate risk management (often referred to as "asset/liability management") is to manage the financial components of the Company in a manner that should optimize the risk/reward equation for earnings and capital in relation to changing interest rates. The Company's exposure to market risk is reviewed on a regular basis by the Investment Committee. Interest rate risk is the potential of economic losses due to future interest rate changes. These economic losses can be reflected as a loss of future net interest income and/or a loss of current fair market values. The objective is to measure the effect on net interest income and to adjust the balance sheet to minimize the inherent risk while at the same time maximizing income. Management realizes certain risks are inherent, and that the goal is to identify and manage the risks. Management uses two methodologies to manage interest rate risk: (i) a standard GAP analysis; and (ii) an interest rate shock simulation model.

The planning of asset and liability maturities is an integral part of the management of an institution's net interest margin. To the extent maturities of assets and liabilities do not match in a changing interest rate environment, the net interest margin may change over time. Even with perfectly matched repricing of assets and liabilities, risks remain in the form of prepayment of loans or securities or in the form of delays in the adjustment of rates of interest applying to either earning assets with floating rates or to interest bearing liabilities. The Company has generally been able to control its exposure to changing interest rates by maintaining a relatively high percentage of variable rate earning assets and a vast majority of its deposits are non-maturing that reprice only at management's discretion based on competition in the banking industry and liquidity needs of the Company.

Interest rate changes do not affect all categories of assets and liabilities equally or at the same time. Varying interest rate environments can create unexpected changes in prepayment levels of assets and liabilities, which may have a significant effect on the net interest margin and are not reflected in the interest sensitivity analysis table. Because of these factors, an interest sensitivity gap report may not provide a complete assessment of the exposure to changes in interest rates.

The Company uses modeling software for asset/liability management in order to simulate the effects of potential interest rate changes on the Company's net interest margin, and to calculate the estimated fair values of the Company's financial instruments under different interest rate scenarios. The program imports current balances, interest rates, maturity dates and repricing information for individual financial instruments, and incorporates assumptions on the characteristics of embedded options along with pricing and duration for new volumes to project the effects of a given interest rate change on the Company's interest income and interest expense. Rate scenarios consisting of key rate and yield curve projections are run against the Company's investment, loan, deposit and borrowed funds' portfolios. These rate projections can be shocked (an immediate and parallel change in all base rates, up or down) and ramped (an incremental increase or decrease in rates over a specified time period), based on current trends and econometric models or stable economic conditions (unchanged from current actual levels).

[Table of Contents](#)

Asset sensitivity indicates that in a rising interest rate environment the Company's net interest income would increase and in a decreasing interest rate environment the Company's net interest income would decrease. Liability sensitivity indicates that in a rising interest rate environment a Company's net interest income would decrease and in a decreasing interest rate environment the Company's net interest income would increase. For all of 2023, we were "asset-sensitive" meaning we expect our net interest income to increase as market rates increase and to decrease as market rates decrease. The relative level of asset sensitivity as of December 31, 2023 has decreased from 2022 primarily due to a decrease in interest-bearing cash balances that have floating rates. In the decreasing interest rate environments, we show a decline in net interest income as interest-bearing assets re-price lower while deposits reach their floors and cannot be reduced further.

Management believes that our interest rate risk modeling overcomes three shortcomings of the typical maturity gap methodology. First, it does not use arbitrary repricing intervals and accounts for all expected future cash flows. Second, because our model projects cash flows of each financial instrument under different interest rate environments, it can incorporate the effect of embedded options on an institution's interest rate risk exposure. Third, it allows interest rates on different instruments to change by varying amounts in response to a change in market interest rates, resulting in more accurate estimates of cash flows.

However, as with any method of gauging interest rate risk, there are certain shortcomings inherent to the methodology. The model assumes interest rate changes are instantaneous parallel shifts in the yield curve. In reality, rate changes are rarely instantaneous. The use of the simplifying assumption that short-term and long-term rates change by the same degree may also misstate historic rate patterns, which rarely show parallel yield curve shifts. Further, the model assumes that certain assets and liabilities of similar maturity or period to repricing will react in the same way to changes in rates. In reality, certain types of financial instruments may react in advance of changes in market rates, while the reaction of other types of financial instruments may lag behind the change in general market rates. When interest rates change, actual loan prepayments and actual early withdrawals from certificates may deviate significantly from the assumptions used in the model. Finally, this methodology does not measure or reflect the impact that higher rates may have on adjustable-rate loan clients' ability to service their debt. All of these factors are considered in monitoring the Company's exposure to interest rate risk.

Impact of Inflation; Seasonality

Inflation primarily impacts us by its effect on interest rates. Our primary source of income is net interest income, which is affected by changes in interest rates. We attempt to limit the impact of inflation on our net interest margin through management of rate-sensitive assets and liabilities and the analysis of interest rate sensitivity. The effect of inflation on premises and equipment as well as noninterest expenses has not been significant for the periods covered in this report. Our business is generally not seasonal.

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

Our consolidated financial statements and the Independent Auditors' Report appear on pages F-1 through F-42 of this Report and are incorporated into this Item 8 by reference.

INDEX TO FINANCIAL STATEMENTS

	<u>PAGE</u>
<u>MANAGEMENT'S ASSESSMENT OF INTERNAL CONTROL OVER FINANCIAL REPORTING</u>	<u>F-1</u>
<u>REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM</u>	<u>F-2</u>
CONSOLIDATED FINANCIAL STATEMENTS	
Balance sheets	F-5
Statements of income	F-6
Statements of comprehensive income	F-7
Statements of shareholders' equity	F-8
Statements of cash flows	F-9
Notes to financial statements	F-10

ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

None.

ITEM 9A. CONTROLS AND PROCEDURES

Disclosure Controls and Procedures

We maintain disclosure controls and procedures that are designed to ensure that information required to be disclosed in our reports under the Securities Exchange Act of 1934, as amended (the "Exchange Act") is recorded, processed, summarized and reported within the time periods specified in the rules and forms of the SEC, and that such information is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, to allow timely decisions regarding required disclosure. In designing and evaluating our disclosure controls and procedures, our management recognized that any system of controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives, as ours are designed to do, and management necessarily was required to apply its judgment in evaluating the cost-benefit relationship of possible controls and procedures.

As required by SEC rules, an evaluation was performed under the supervision and with the participation of our Chief Executive Officer and Chief Financial Officer of the effectiveness, as of December 31, 2023, of the Company's disclosure controls and procedures (as defined in Rule 13a-15(e) under the Exchange Act). Based on that evaluation, our Chief Executive Officer and Chief Financial Officer concluded that, as of December 31, 2023, the Company's disclosure controls and procedures were effective to provide reasonable assurance that information required to be disclosed in the reports that we file under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms and that such information is accumulated and communicated to management, including our Chief Executive Officer and Chief Financial Officer, to allow timely decisions regarding required disclosure.

Management's Annual Report on Internal Control Over Financial Reporting

Management of Oak Valley Bancorp is responsible for establishing and maintaining adequate internal control over financial reporting as defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act. Our internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with accounting principles generally accepted in the United States of America. Internal control over financial reporting includes those written policies and procedures that:

- pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of our assets;
- provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with accounting principles generally accepted in the United States of America;
- provide reasonable assurance that our receipts and expenditures are being made only in accordance with authorization of our management and board of directors; and
- provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of assets that could have a material effect on our consolidated financial statements.

Internal control over financial reporting includes the controls themselves, monitoring and internal auditing practices and actions taken to correct deficiencies as identified. Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risks that controls may become inadequate because of changes in conditions or because the degree of compliance with the policies or procedures may deteriorate.

Our management assessed the effectiveness of the Company's internal control over financial reporting as of December 31, 2023, based on criteria for effective internal control over financial reporting described in "Internal Control – Integrated Framework" (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission. Management's assessment included an evaluation of the design and the testing of the operational effectiveness of the Company's internal control over financial reporting. Management reviewed the results of its assessment with the Audit Committee of our Board of Directors.

Based on that assessment, management concluded that the Company's internal control over financial reporting was effective as of December 31, 2023.

Changes in Internal Control Over Financial Reporting

There have been no changes in our internal control over financial reporting during the quarter ended December 31, 2023 that materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

There were no significant changes in the Company's internal control over financial reporting during the year ended December 31, 2023 that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting subsequent to the evaluation date.

ITEM 9B. OTHER INFORMATION

Insider Adoption or Termination of Trading Arrangements

During the quarter ended December 31, 2023, no director or officer (as defined in Rule 16a-1(f) under the Exchange Act) of the Company informed us of the adoption or termination of any Rule 10b5-1 trading arrangements or non-Rule 10b5-1 trading arrangements (in each case, as defined in Item 408 of Regulation S-K).

ITEM 9C. DISCLOSURE REGARDING FOREIGN JURISDICTIONS THAT PREVENT INSPECTIONS

Not applicable.

PART III**ITEM 10. DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE**

The information required by this Item is incorporated by reference to the section entitled "Corporate Governance and Board Matters," and "Information About Directors and Executive Officers" in our Proxy Statement to be filed prior to the 2023 Annual Meeting of Shareholders.

The Company has adopted a Code of Ethics that applies to all staff including the Chief Executive Officer, and the Chief Financial Officer. A copy of the Code of Ethics will be provided to any person, without charge, upon written request to Corporate Secretary, Oak Valley Bancorp, 125 North Third Avenue, Oakdale, CA 95361. A copy of the Code of Ethics is also available at the Company's website at www.ovcb.com.

Delinquent Section 16(a) Reports

Section 16(a) of the 1934 Act requires the Company's officers and directors, and persons who own more than 10% of a registered class of the Company's equity securities, to file reports of ownership and changes in ownership with the SEC. Officers, directors and greater than 10% shareholders are required by SEC regulations to furnish the Company with copies of all Section 16(a) forms they file.

Based solely on its review of the copies of such forms received by it, or written representations from certain reporting persons, the Company believes that for the 2023 fiscal year the officers and directors of the Company complied with all applicable filing requirements, except for the late filings for the directors in the table below:

<u>Name</u>	<u>Form</u>	<u>Transaction Type</u>	<u>Transaction Date</u>	<u># of Shares</u>	<u>Filing Date</u>
Lynn Dickerson	4	Purchase	05/10/23	2,030	05/15/23
Lynn Dickerson	4	Purchase	08/12/22	100	05/15/23
Lynn Dickerson	4	Purchase	02/10/23	94	05/15/23
James L Gilbert	4	Purchase	08/15/22	44	04/04/23
James L Gilbert	4	Purchase	02/13/23	32	04/04/23
Gary Strong	4	Purchase	08/23/23	1,000	09/06/23
Gary Strong	4	Purchase	08/29/23	878	09/06/23

ITEM 11. EXECUTIVE COMPENSATION

The information required by this Item is incorporated by reference to the Section entitled "Executive Compensation Discussion and Analysis" in our Proxy Statement to be filed prior to the 2024 Annual Meeting of Shareholders.

ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS
Equity Compensation Plan Information

The following table provides information as of December 31, 2023 with respect to shares of our common stock that are authorized to be issued under the Company's 2018 Equity Plan. Shares subject to restricted stock awards are not included in the table below.

Plan Category	A	B	C
	Number of Securities to be Issued Upon Exercise of Outstanding Options, Warrants and Rights	Weighted Average Exercise Price of Outstanding Options, Warrants and Rights	Number of Securities Remaining Available for Future Issuance Under Equity Compensation Plans (Excluding Securities Reflected in Column A)
Equity Compensation Plans			
Approved by Shareholders	0	\$ 0	463,199
Equity Compensation Plans Not			
Approved by Shareholders	0	0	0
Total	0	\$ 0	463,199

Certain information required by this Item is incorporated by reference to the section entitled "Security Ownership of Certain Beneficial Owners and Management" in our Proxy Statement to be filed prior to the 2024 Annual Meeting of Shareholders.

ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS, AND DIRECTOR INDEPENDENCE

The information required by this Item is incorporated by reference to the section entitled "Certain Relationship and Related Transactions" in our Proxy Statement to be filed prior to the 2024 Annual Meeting of Shareholders.

ITEM 14. PRINCIPAL ACCOUNTANT FEES AND SERVICES

The Company's independent registered public accounting firm is RSM US LLP, Issuing Office: San Francisco, CA, PCAOB ID: 49.

The information required by this Item is incorporated by reference to "Proposal No. 2: Ratification of Appointment of Independent Registered Public Accounting Firm" in our Proxy Statement to be filed prior to the 2024 Annual Meeting of Shareholders.

PART IV
ITEM 15. EXHIBITS AND FINANCIAL STATEMENT SCHEDULES

Documents Filed as Part of this Report:

(a)(1) Financial Statements

The Financial Statements of the Company and the Report of Independent Registered Public Accounting Firm are set forth on pages F-1 through F-42.

(a)(2) Financial Statement Schedules

All schedules to the Financial Statements are omitted because of the absence of the conditions under which they are required or because the required information is included in the Financial Statements or accompanying notes.

(a)(3) Exhibits

INDEX TO EXHIBITS

Exhibit Number	Description
3.1	Articles of Incorporation of Oak Valley Bancorp, Inc. (incorporated by reference to Exhibit 3.1 to the Form 10 filed on July 31, 2008).
3.2	First Amendment to Articles of Incorporation of Oak Valley Bancorp, Inc. (incorporated by reference to Exhibit 3.2 to the Form 10 filed on July 31, 2008).
3.3	Bylaws, as amended and restated on June 21, 2022 (incorporated by reference to Exhibit 3.1 to the Quarterly Report on Form 10-Q filed on August 12, 2022)
4.1	Description of Securities of the Registrant (incorporated by reference to Exhibit 4.1 to the Form 10-K filed on March 13, 2020)
10.1	Oak Valley Community Bank Form of Director Retirement Agreement. (incorporated by reference to Exhibit 10.2 to the Form 10 filed on July 31, 2008)
10.3	Oak Valley Bancorp 2018 Equity Incentive Plan (incorporated by reference to Appendix A of the Registrant's Proxy Statement for its 2018 Annual Meeting of Stockholders filed as of May 7, 2018). †
10.4	Oak Valley Community Bank Form of Executive Salary Continuation Agreement (incorporated by reference to Exhibit 10.4 to the Form 10-K filed on March 31, 2021).
10.5	Executive Employment Agreement between Richard A. McCarty and Oak Valley Bancorp dated March 19, 2021 (incorporated by reference to Exhibit 10.5 to the Form 10-K filed on March 31, 2021).
21	Subsidiaries of the Issuer (incorporated by reference to Exhibit 21 to the Form 10 filed on July 31, 2008).
23.1	Consent of Independent Registered Accounting Firm.
24	Power of Attorney (included on the signature page of this report).
31.01	Certification of Chief Executive Officer pursuant to Exchange Act Rules 13a-14(a) and 15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.02	Certification of Chief Financial Officer pursuant to Exchange Act Rules 13a-14(a) and 15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.01	Certifications of Chief Executive Officer and Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.*
97.1	Oak Valley Bancorp Clawback Policy
101	The following financial statements from the Company's Annual Report on Form 10-K for the year ended December 31, 2023, formatted in Inline XBRL: (i) Consolidated Balance Sheets as of December 31, 2023 and 2022, (ii) Consolidated Statements of Income for the Years Ended December 31, 2023 and 2022, (iii) Consolidated Statements of Comprehensive Income for the Years Ended December 31, 2023 and 2022, (iv) Consolidated Statements of Shareholders' Equity for the Years Ended December 31, 2023 and 2022, (v) Consolidated Statements of Cash Flows for the Years Ended December 31, 2023 and 2022, and (vi) Notes to Consolidated Financial Statements.
104	Cover Page Interactive Data File (formatted as Inline XBRL and contained in Exhibit 101)

* Furnished, not filed.

† Indicates management contract or compensatory plan.

ITEM 16. FORM 10-K SUMMARY

None.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, as amended, (the “1934 Act”) the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized, in Oakdale, California on April 1, 2024.

OAK VALLEY BANCORP
a California corporation

By: /s/ CHRISTOPHER M. COURTNEY
Christopher M. Courtney, *Chief Executive Officer*

Pursuant to the requirements of the 1934 Act, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the date indicated.

Signature	Title	Date
<u>/s/ DONALD L. BARTON</u> Donald Barton	Director	April 1, 2024
<u>/s/ CHRISTOPHER M. COURTNEY</u> Christopher M. Courtney	Chief Executive Officer and Director (Principal Executive Officer)	April 1, 2024
<u>/s/ LYNN R. DICKERSON</u> Lynn R. Dickerson	Director	April 1, 2024
<u>/s/ JEFFREY A. GALL</u> Jeffrey A. Gall	Chief Financial Officer (Principal Financial and Principal Accounting Officer)	April 1, 2024
<u>/s/ JAMES L. GILBERT</u> James L. Gilbert	Director	April 1, 2024
<u>/s/ THOMAS A. HAIDLEN</u> Thomas A. Haidlen	Director	April 1, 2024
<u>/s/ H. RANDOLPH HOLDER</u> H. Randolph Holder	Director	April 1, 2024
<u>/s/ DANIEL J. LEONARD</u> Daniel J. Leonard	Director	April 1, 2024
<u>/s/ RONALD C. MARTIN</u> Ronald C. Martin	Director	April 1, 2024
<u>/s/ JANET S. PELTON</u> Janet S. Pelton	Director	April 1, 2024
<u>/s/ GARY STRONG</u> Gary Strong	Director	April 1, 2024
<u>/s/ DANNY L. TITUS</u> Danny L. Titus	Director	April 1, 2024
<u>/s/ TERRANCE P. WITHROW</u> Terrance P. Withrow	Director	April 1, 2024
<u>/s/ ALLISON C. LAFFERTY</u> Allison C. Lafferty	Director	April 1, 2024

MANAGEMENT'S ASSESSMENT OF INTERNAL CONTROL OVER FINANCIAL REPORTING

The management of Oak Valley Bancorp is responsible for establishing and maintaining adequate internal control over financial reporting as defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act. Our internal control system was designed to ensure that material information regarding our operations is made available to management and the board of directors to provide them reasonable assurance that the published financial statements are fairly presented. There are limitations inherent in any internal control, such as the possibility of human error and the circumvention or overriding of controls. As a result, even effective internal controls can provide only reasonable assurance with respect to financial statement preparation. As conditions change over time so too may the effectiveness of internal controls.

Our management has evaluated our internal control over financial reporting as of December 31, 2023 based on the framework in Internal Control — Integrated Framework issued by the Committee of Sponsoring Organizations (COSO 2013) of the Treadway Commission. Based on this assessment, our management concluded that our internal control over financial reporting was effective as of December 31, 2023.

/s/ CHRISTOPHER M. COURTNEY

Christopher M. Courtney, *Chief Executive Officer*

/s/ JEFFREY A. GALL

Jeffrey A. Gall, *Chief Financial Officer*

Report of Independent Registered Public Accounting Firm

Opinion on the Financial Statements

We have audited the accompanying consolidated balance sheets of Oak Valley Bancorp and its subsidiary (the Company) as of December 31, 2023 and 2022, the related consolidated statements of income, comprehensive income, shareholders' equity and cash flows for the years then ended, and the related notes to the consolidated financial statements (collectively, the financial statements). In our opinion, the financial statements present fairly, in all material respects, the financial position of the Company as of December 31, 2023 and 2022, and the results of its operations and its cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

Adoption of New Accounting Standard

As discussed in Note 1 to the consolidated financial statements, the Company changed its method of accounting for credit losses on financial instruments in 2023 due to the adoption of Accounting Standards Update 2016-13, *Financial Instruments—Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments (Credit Losses)*.

Basis for Opinion

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

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

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

Critical Audit Matters

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

Allowance for Credit Losses

As described in Notes 1 and 4 to the financial statements, the Company's allowance for credit losses (allowance) is deducted from the amortized cost basis of loans to present the net amount expected to be collected on the loans. The measurement of expected credit losses is based on relevant information, which includes historical experience, current conditions, and reasonable and supportable forecasts that affect the collectability of the reported amount over the contractual life. The total allowance represented \$10,896,000 at December 31, 2023.

[Table of Contents](#)

Management calculates the quantitative portion of collectively evaluated reserves for all loan categories using a discounted cash flow ("DCF") methodology. The DCF quantitative reserve methodology incorporates the consideration of probability of default ("PD") and loss given default ("LGD") estimates to calculate expected lifetime losses. The PD estimates are derived using reasonable and supportable economic forecasts and historical loss-rate data from both the bank and a selected peer group. The historical loss-rate data is compared to identified benchmark economic indicators to create a regression model that is updated annually. Reasonable and supportable forecasts for the identified economic indicators are then incorporated to arrive at expected default rates for the various loan categories. The reasonable and supportable forecasts are based on the National Unemployment Rate and Real Gross Domestic Product. The expected default rates are then applied to expected monthly loan balances estimated through the consideration of contractual terms and expected prepayments. The Company utilizes a four-quarter forecast period, after which the expected default rates revert to the historical average over a four-quarter reversion period on a straight-line basis. The prepayment assumptions are estimated based on historical experience of the bank. The prepayment assumptions may be updated by Management in the event that changing conditions impact Management's estimate. LGD utilized in the DCF is derived from the application of models that correlate LGD and PD based on historical peer data.

Management recognizes that there are additional factors impacting risk of loss in the loan portfolio beyond what is captured in the quantitative portion of collectively evaluated reserves. As current and expected conditions may vary compared with conditions over historical periods, which are utilized in the calculation of quantitative reserves, management considers whether additional or reduced reserve levels on collectively evaluated loans may be warranted given the consideration of a variety of qualitative factors.

Several of the following qualitative factors considered by management reflect regulatory guidance on qualitative factors, whereas several others represent factors unique to the Company or unique to the current time period.

- Changes in lending policies and procedures, including changes in underwriting standards and collection, charge-off, and recovery practices
- Changes in international, regional and local economic and business conditions, and developments that affect the collectability of the portfolio, as reflected in forecasts of the California unemployment rate
- Changes in the nature and volume of the loan portfolio
- Changes in the experience, ability, and depth of lending management and other relevant staff
- Changes in the volume and severity of past due, watch loans and classified loans
- Changes in the quality of the Bank's loan review processes
- Changes in the value of underlying collateral for loans not identified as collateral dependent
- Changes in loan categorization concentrations
- Other external factors, which include, the regulatory risk ratings

The qualitative portion of the Company's reserves on collectively evaluated loans are calculated using a combination of numeric frameworks (established matrices defining reserve rates based on specified metrics) and management judgement to determine risk categorizations in each of the qualitative factors. The amount of qualitative reserves is also contingent upon the relative weighting of qualitative factors according to management's judgement.

We identified the determination and evaluation of the PD, LGD, prepayment rate, reasonable and supportable forecast, and qualitative factors components of the allowance as a critical audit matter. The determination and evaluation of the PD, LGD, prepayment rate, reasonable and supportable forecast, and qualitative factors components of the allowance are a significant accounting estimates involving management's judgments and subjectivity. In turn, auditing management's judgments involved a high degree of subjectivity.

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

- Obtaining an understanding of the management review control over the determination and evaluation of the PD, LGD, prepayment rate, reasonable and supportable forecast, and qualitative factors components of the allowance, and testing such control for design and operating effectiveness.
- Obtaining an understanding of and testing the controls over the data used in the determination of these components.
- Testing the data inputs used in the determination of these components to ensure completeness and accuracy by comparing to source documents and independently validating certain external data inputs.
- Evaluating the reasonableness of management's judgments related to the assumptions used to determine the PD, LGD, prepayment rate, reasonable and supportable forecast, and qualitative factors components of the allowance, including considering the sensitivity analyses performed by management over these assumptions.

/s/ RSM US LLP

We have served as the Company's auditor since 2018.

San Francisco, California
April 1, 2024

**OAK VALLEY BANCORP
CONSOLIDATED BALANCE SHEETS**

(dollars in thousands)

	December 31, 2023	December 31, 2022
ASSETS		
Cash and due from banks	\$ 180,068	\$ 415,803
Federal funds sold	36,500	13,830
Cash and cash equivalents	216,568	429,633
Securities - available for sale	518,078	527,438
Securities - equity investments	3,132	2,990
Loans, net of allowance for credit losses of \$ 10,896 and \$9,468 at December 31, 2023 and 2022, respectively	1,004,277	905,035
Cash surrender value of life insurance	31,506	30,218
Bank premises and equipment, net	15,865	15,300
Goodwill and other intangible assets, net	3,473	3,558
Deferred tax asset	13,247	17,134
Interest receivable and other assets	36,276	37,040
	<u>\$ 1,842,422</u>	<u>\$ 1,968,346</u>
LIABILITIES AND SHAREHOLDERS' EQUITY		
Deposits	\$ 1,650,534	\$ 1,814,297
Interest payable and other liabilities	25,796	27,423
Total liabilities	1,676,330	1,841,720
Commitments and contingent liabilities (Note 13)		
Shareholders' equity		
Common stock, no par value; 50,000,000 shares authorized, 8,293,168 and 8,257,894 shares issued and outstanding at December 31, 2023 and 2022, respectively	25,435	25,435
Additional paid-in capital	5,512	5,190
Retained earnings	154,301	126,728
Accumulated other comprehensive loss, net of tax	(19,156)	(30,727)
Total shareholders' equity	166,092	126,626
	<u>\$ 1,842,422</u>	<u>\$ 1,968,346</u>

See accompanying notes

OAK VALLEY BANCORP
CONSOLIDATED STATEMENTS OF INCOME

(dollars in thousands, except per share amounts)

	YEAR ENDED DECEMBER 31,	
	2023	2022
INTEREST INCOME		
Interest and fees on loans	\$ 44,773	\$ 38,887
Interest on securities	20,578	14,155
Interest on federal funds sold	1,414	415
Interest on deposits with banks	13,901	7,738
Total interest income	80,666	61,195
INTEREST EXPENSE		
Deposits	4,863	1,119
Federal funds purchased	1	0
Total interest expense	4,864	1,119
Net interest income	75,802	60,076
Provision for (reversal of) credit losses	970	(1,350)
Net interest income after provision for (reversal of) credit losses	74,832	61,426
NON-INTEREST INCOME		
Service charges on deposits	1,813	1,596
Debit card transaction fee income	1,773	1,734
Earnings on cash surrender value of life insurance	788	749
Mortgage commissions	20	73
Gains on sales and calls of available-for-sale securities	156	0
Other	2,081	1,419
Total non-interest income	6,631	5,571
NON-INTEREST EXPENSE		
Salaries and employee benefits	26,109	23,045
Occupancy expenses	4,541	4,151
Data processing fees	2,729	2,343
Regulatory assessments (FDIC & DFPI)	1,020	927
Other operating expenses	6,758	6,842
Total non-interest expense	41,157	37,308
Net income before provision for income taxes	40,306	29,689
Total provision for income taxes	9,458	6,787
Net Income	\$ 30,848	\$ 22,902
Net income per share	\$ 3.76	\$ 2.80
Net income per diluted share	\$ 3.75	\$ 2.79

See accompanying notes

OAK VALLEY BANCORP
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(dollars in thousands)	YEAR ENDED DECEMBER 31,	
	2023	2022
Net income	\$ 30,848	\$ 22,902
Other comprehensive income (loss):		
Unrealized holding gains (losses) arising during the period	16,584	(52,410)
Less: reclassification for net gains included in net income	(156)	0
Other comprehensive income (loss), before tax	16,428	(52,410)
Tax (expense) benefit related to items of other comprehensive income	(4,857)	15,495
Total other comprehensive income (loss)	11,571	(36,915)
Comprehensive income (loss)	<u>\$ 42,419</u>	<u>\$ (14,013)</u>

See accompanying notes

OAK VALLEY BANCORP
CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY

YEAR ENDED DECEMBER 31, 2023 AND 2022

(dollars in thousands)	Common Stock		Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total Shareholders' Equity
	Shares	Amount				
Balances, January 1, 2023	8,257,894	\$ 25,435	\$ 5,190	\$ 126,728	\$ (30,727)	\$ 126,626
Restricted stock issued	43,446	0	0	0	0	0
Restricted stock forfeited	(300)	0	0	0	0	0
Restricted stock surrendered for tax withholding	(7,872)	0	(211)	0	0	(211)
Cash dividends declared \$0.32 per share of common stock	0	0	0	(2,646)	0	(2,646)
Stock based compensation	0	0	533	0	0	533
Other comprehensive gain	0	0	0	0	11,571	11,571
CECL adoption adjustments	0	0	0	(629)	0	(629)
Net income	0	0	0	30,848	0	30,848
Balances, December 31, 2023	<u>8,293,168</u>	<u>\$ 25,435</u>	<u>\$ 5,512</u>	<u>\$ 154,301</u>	<u>\$ (19,156)</u>	<u>\$ 166,092</u>
Balances, January 1, 2022	8,239,099	\$ 25,435	\$ 4,689	\$ 106,300	\$ 6,188	\$ 142,612
Restricted stock issued	27,047	0	0	0	0	0
Restricted stock forfeited	(1,800)	0	0	0	0	0
Restricted stock surrendered for tax withholding	(6,452)	0	(121)	0	0	(121)
Cash dividends declared \$0.30 per share of common stock	0	0	0	(2,474)	0	(2,474)
Stock based compensation	0	0	622	0	0	622
Other comprehensive loss	0	0	0	0	(36,915)	(36,915)
Net income	0	0	0	22,902	0	22,902
Balances, December 31, 2022	<u>8,257,894</u>	<u>\$ 25,435</u>	<u>\$ 5,190</u>	<u>\$ 126,728</u>	<u>\$ (30,727)</u>	<u>\$ 126,626</u>

See accompanying notes

OAK VALLEY BANCORP
CONSOLIDATED STATEMENTS OF CASH FLOWS

(dollars in thousands)	YEAR ENDED DECEMBER 31,	
	2023	2022
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	\$ 30,848	\$ 22,902
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for (reversal of) credit losses	970	(1,350)
Increase (decrease) in deferred fees/costs, net	151	(197)
Depreciation	1,329	1,312
Amortization of investment securities, net	1,151	1,328
Unrealized (gain) loss on equity securities	(41)	475
Amortization of operating lease right-of-use asset	(231)	(161)
Stock based compensation	533	622
Gain on sales and calls of available for sale securities	(156)	0
Earnings on cash surrender value of life insurance	(788)	(749)
Increase (decrease) in deferred tax asset	706	(489)
(Decrease) increase in interest payable and other liabilities	(1,411)	875
Increase in interest receivable	(456)	(3,872)
Decrease in other assets	454	2,110
Net cash provided by operating activities	33,059	22,806
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchases of available for sale securities	(40,660)	(358,845)
Purchases of equity securities	(101)	(74)
Proceeds from the sale of available-for-sale securities	42,791	0
Proceeds from maturities, calls, and principal paydowns of securities available for sale	22,662	40,558
Investment in LIHTC	(373)	(1,241)
Net increase in loans	(100,709)	(55,641)
Purchase of FHLB Stock	(720)	0
Redemption of FHLB stock	0	257
Purchase of BOLI policies	(500)	0
Purchases of premises and equipment	(1,894)	(1,190)
Net cash used in investing activities	(79,504)	(376,176)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Federal funds advances	1,855	0
Federal funds payments	(1,855)	0
Shareholder cash dividends paid	(2,646)	(2,474)
Net (decrease) increase in demand deposits and savings accounts	(179,098)	7,655
Net increase (decrease) in time deposits	15,335	(324)
Tax withholding payments on vested restricted shares surrendered	(211)	(121)
Net cash (used in) provided by financing activities	(166,620)	4,736
NET DECREASE IN CASH AND CASH EQUIVALENTS	(213,065)	(348,634)
CASH AND CASH EQUIVALENTS, beginning of period	429,633	778,267
CASH AND CASH EQUIVALENTS, end of period	\$ 216,568	\$ 429,633
SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION:		
Cash paid during the period for:		
Interest	\$ 4,715	\$ 1,119
Operating leases	\$ 1,469	\$ 1,331
Income taxes	\$ 10,449	\$ 3,910
NON-CASH INVESTING ACTIVITIES:		
Change in unrealized gain (loss) on securities	\$ 16,428	\$ (52,410)
Change in contributions payable to LIHTC limited partner investment	\$ 0	\$ 10,500
Right-of-use asset obtained in exchange for new operating lease liability	\$ (390)	\$ (2,389)

See accompanying notes

OAK VALLEY BANCORP
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1 — SUMMARY OF ACCOUNTING POLICIES

Nature of Operations

Oak Valley Bancorp (“the Company”, “us”, “our”) is the parent holding company for Oak Valley Community Bank (the “Bank”), a California state-chartered bank. The consolidated financial statements include the accounts of the parent company and its wholly-owned bank subsidiary. Unless otherwise stated, the “Company” refers to the consolidated entity, Oak Valley Bancorp, while the “Bank” refers to Oak Valley Community Bank. All material intercompany transactions have been eliminated. Certain prior period amounts have been reclassified to conform to the current period presentation. There was no effect on net income or shareholders’ equity as previously reported as a result of reclassifications. In the opinion of Management, the consolidated financial statements contain all adjustments necessary to present fairly the financial position, results of operations, changes in shareholders’ equity and cash flows. All adjustments are of a normal, recurring nature.

The Company was incorporated under the laws of the State of California on May 31, 1990 and began operations in Oakdale on May 28, 1991. The Company operates branches in Oakdale, Sonora, Bridgeport, Bishop, Mammoth Lakes, Modesto, Manteca, Patterson, Turlock, Ripon, Stockton, Escalon, Sacramento, and Roseville, California. The Bridgeport, Mammoth Lakes, and Bishop branches operate as a separate division, Eastern Sierra Community Bank. The Company’s primary source of revenue is providing loans to customers who are predominantly middle-market businesses.

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America (“U.S. GAAP”) requires management to make estimates and assumptions. These estimates and assumptions affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Significant accounting estimates reflected in the Company’s consolidated financial statements include the allowance for credit losses, accounting for income taxes, fair value measurements and goodwill impairment. Actual results could differ from these estimates.

A summary of the significant accounting policies applied in the preparation of the accompanying consolidated financial statements follows.

Subsequent events — The Company has evaluated events and transactions subsequent to December 31, 2023 through the date of the filing for potential recognition or disclosure.

Cash and cash equivalents — The Company has defined cash and cash equivalents to include cash, due from banks, certificates of deposit with original maturities of three months or less, and federal funds sold. Generally, federal funds are sold for one-day periods. At times throughout the year, balances can exceed FDIC insurance limits.

Securities available for sale — Available-for-sale securities consist of bonds, notes, and debentures not classified as trading securities or held-to-maturity securities. Available-for-sale securities with unrealized holding gains and losses are reported as an amount in accumulated other comprehensive income, net of tax. Gains and losses on the sale or call of available-for-sale securities are determined using the specific identification method. The amortization of premiums and accretion of discounts are recognized as adjustments to interest income over the period to maturity, except for premiums on securities with call dates which are amortized to the earliest call date.

Consistent with ASU 2016-01, equity securities consist of those securities with readily determinable fair value and are carried at fair value with the changes in fair value recognized in the consolidated statements of income.

For available-for-sale debt securities in an unrealized loss position, management evaluates whether the decline in fair value is a reflection of credit deterioration or other factors. In performing this evaluation, management considers the extent which fair value has fallen below amortized cost, changes in ratings by rating agencies, and other information indicating a deterioration in repayment capacity of either the underlying issuer or the borrowers providing repayment capacity in a securitization. If management’s evaluation indicates that a credit loss exists then a present value of the expected cash flows is calculated and compared to the amortized cost basis of the security in question and to the degree that the amortized cost basis exceeds the present value an allowance for credit loss (“ACL”) is established, with the caveat that the maximum amount of the reserve on any individual security is the difference between the fair value and amortized cost balance of the security in question. Any unrealized loss that has not been recorded through an ACL is recognized in other comprehensive income.

The unrealized losses are due primarily to rising market yields and not due to credit deterioration. As such, no ACL on available-for-sale securities has been established as of December 31, 2023. The Company does not intend to sell the securities and it is not likely that the Company will be required to sell the securities before the earlier of the forecasted recovery or the maturity of the underlying investment security.

Other real estate owned — Real estate properties acquired through, or in lieu of, loan foreclosure are to be sold and are initially recorded at fair value of the property at the date of foreclosure less estimated selling costs. Subsequent to foreclosure, valuations are periodically performed and any subject revisions in the estimate of fair value are reported as adjustment to the carrying value of the real estate, provided the adjusted carrying amount does not exceed the original amount at foreclosure. Revenues and expenses from operations and changes in the valuation allowance are included in other operating expenses.

Loans originated — Loans are reported at the principal amount outstanding, net of unearned income, deferred loan fees, and the allowance for credit losses. Unearned discounts on installment loans are recognized as income over the terms of the loans. Interest on other loans is calculated by using the simple interest method on the daily balance of the principal amount outstanding.

Loan fees net of certain direct costs of origination are deferred and amortized, as an adjustment to interest yield, over the estimated life of the loan.

Loans on which the accrual of interest has been discontinued are designated as non-accrual loans. Accrual of interest on loans is discontinued either when reasonable doubt exists as to the full and timely collection of interest or principal or when a loan becomes contractually past due by ninety days or more with respect to interest or principal. When a loan is placed on non-accrual status, all interest previously accrued, but not collected, is reversed against current period interest income. Income on such loans is then recognized only to the extent that cash is received and where the future collection of principal is probable. Interest accruals are resumed on such loans only when they are brought fully current with respect to interest and principal and when, in the judgment of management, the loans are estimated to be fully collectible as to both principal and interest.

Allowance for credit losses ("ACL") — As required by ASU 2016-13, on January 1, 2023 the Company implemented CECL and increased our ACL, previously the allowance for loan losses, with a \$346,000 cumulative adjustment. Under ASU 2016-13, the allowance for credit losses is deducted from the amortized cost basis to present the net amount expected to be collected on the loans. The measurement of expected credit losses is based on relevant information, which includes experience, current conditions, and reasonable and supportable forecasts that affect the collectability of the reported amount over the remaining contractual life. The Company's ACL is calculated monthly, with any difference in the calculated ACL and the recorded ACL trued-up through an entry to the provision for credit losses. Management calculates the quantitative portion of collectively evaluated reserves for all loan categories, using a discounted cash flow ("DCF") methodology. For purposes of estimating the Company's ACL, management generally evaluates collectively evaluated loans by federal call code in order to group loans with similar risk characteristics together, however management has grouped loans in selected call codes together in determining portfolio segments, due to similar risk characteristics and reserve methodologies used for certain call code classifications.

The DCF quantitative reserve methodology incorporates the consideration of probability of default ("PD") and loss given default ("LGD") estimates to calculate expected lifetime losses. The PD estimates are derived using reasonable and supportable economic forecasts and historical loss rate data from both the bank and a selected peer group. The historical loss rate data is compared to identified benchmark economic indicators to create a regression model that is updated annually. Reasonable and supportable forecasts for the identified economic indicators are then incorporated to arrive at expected default rates for the various loan categories. The reasonable and supportable forecasts are based on the National Unemployment Rate and Real Gross Domestic Product. The expected default rates are then applied to expected monthly loan balances estimated through the consideration of contractual terms and expected prepayments. The Company utilizes a four-quarter forecast period, after which the expected default rates revert to the historical average, over a four-quarter reversion period, on a straight-line basis. The prepayment assumptions are estimated based on historical experience of the bank. The prepayment assumptions are updated quarterly and may be subject to additional updates by Management in the event that changing conditions impact Management's estimate. LGD utilized in the DCF is derived from the application of models that correlate LGD and PD based on historical peer data.

[Table of Contents](#)

Management recognizes that there are additional factors impacting risk of loss in the loan portfolio beyond what is captured in the quantitative portion of collectively evaluated reserves. As current and expected conditions, may vary compared with conditions over historical periods, which are utilized in the calculation of quantitative reserves, management considers whether additional or reduced reserve levels on collectively evaluated loans may be warranted given the consideration of a variety of qualitative factors. Several of the following qualitative factors ("Q-factors") considered by management reflect regulatory guidance on Q-factors, whereas several others represent factors unique to the Company or unique to the current time period.

- Changes in lending policies and procedures, including changes in underwriting standards and collection, charge-off, and recovery practices
- Changes in international, regional and local economic and business conditions, and developments that affect the collectability of the portfolio, as reflected in forecasts of the California unemployment rate
- Changes in the nature and volume of the loan portfolio
- Changes in the experience, ability, and depth of lending management and other relevant staff
- Changes in the volume and severity of past due, watch loans and classified loans
- Changes in the quality of the Bank's loan review processes
- Changes in the value of underlying collateral for loans not identified as collateral dependent
- Changes in loan categorization concentrations
- Other external factors, which include, the regulatory risk ratings.

The qualitative portion of the Company's reserves on collectively evaluated loans are calculated using a combination of numeric frameworks, matrices defining reserve rate based on specified metrics, and management judgement, to determine risk categorizations in each of the Q-factors presented above. The amount of qualitative reserves is also contingent upon the relative weighting of Q-factors according to management's judgement.

Loans identified as losses by management and internal loan review are charged-off. Furthermore, consumer loan accounts are charged-off automatically based on regulatory requirements.

Accrued interest receivable for loans is included in the "Interest receivable and other assets" line item on the Company's Consolidated Balance Sheet. The Company elected not to measure an allowance for accrued interest receivable and instead elected to reverse accrued interest income on loans that are placed on nonaccrual status. The Company believes this policy results in the timely reversal of uncollectible interest.

The method for calculating the allowance for unfunded loan commitments is based on applying an estimated funding rate to the unfunded loan commitment balance to determine a projected cashflow schedule. Then the quantitative loan loss rate from each loan pool as calculated in the DCF model described above is used to calculate the allowance for unfunded loan commitments which is recorded included in interest payable and other liabilities on the consolidated balance sheet.

Premises and equipment — Premises and equipment are stated at cost less accumulated depreciation and amortization. Depreciation and amortization are provided for in amounts sufficient to relate the cost of depreciable assets to operations over their estimated service lives using the straight-line basis. The estimated lives used in determining depreciation and amortization are:

Building (in years)	31.5
Equipment (in years)	3 – 12
Furniture and fixtures (in years)	3 – 7
Leasehold improvements (in years)	5 – 15

The Company adopted ASU No. 2016-02, *Leases (Topic 842)* on the effective date of January 1, 2019. All of the Company's leases were determined to be operating leases. The Company determined the operating lease liability as of January 1, 2019, by calculating the present value of remaining base rent cash payments on each of its leases, excluding any renewal options regardless of the likelihood that the option would be exercised. The resulting operating lease liability recorded as of January 1, 2019 was \$5,246,000, which is included in interest payable and other liabilities in the consolidated balance sheet. The ROU asset was then determined by adjusting the operating lease liability by deferred rent and unamortized tenant improvement allowance. The ROU asset recorded on January 1, 2019 was \$4,817,000, which is included in interest receivable and other assets on the consolidated balance sheet.

Leasehold improvements are amortized over the lesser of the useful life of the asset or the remaining term of the lease. The straight-line method of depreciation is followed for all assets for financial reporting purposes, but accelerated methods are used for tax purposes. Deferred income taxes have been provided for the resulting temporary differences.

Income taxes — Deferred income taxes are provided for the temporary differences between the financial reporting basis and the tax basis of the Company's assets and liabilities. Deferred tax assets and liabilities are reflected at currently enacted income tax rates applicable to the period in which the deferred tax assets or liabilities are expected to be realized or settled using the liability method. As changes in tax laws or rates are enacted, deferred tax assets and liabilities are adjusted through the provision for income taxes.

The Company files income tax returns in the U.S. federal jurisdiction, and the State of California. With few exceptions, the Company is no longer subject to U.S. federal tax examinations by tax authorities for years before 2020 or to state/local income tax examinations by tax authorities for years before 2019.

Transfers of financial assets — Transfers of an entire financial asset, a group of financial assets, or a participating interest in an entire financial asset are accounted for as sales when control over the assets has been surrendered. Control over transferred assets is deemed to be surrendered when: (1) the assets have been isolated from the Company, (2) the transferee obtains the right (free of conditions that contain it from taking advantage of that right) to pledge or exchange the transferred assets, and (3) the Company does not maintain effective control over the transferred assets through an agreement to repurchase them before their maturity.

Advertising costs — The Company expenses advertising costs as they are incurred. Advertising expense was \$ 371,000 and \$355,000 for the years ended December 31, 2023 and 2022, respectively.

Comprehensive income — Comprehensive income is comprised of net income and other comprehensive income (loss). Other comprehensive income (loss) includes items previously recorded directly to shareholders' equity, such as unrealized gains and losses on securities available for sale. Comprehensive income is presented in the statements of comprehensive income and as a component of shareholders' equity. For the years ended December 31, 2023 and 2022, \$110,000 and \$0, net of tax, respectively, was reclassified from comprehensive income into net income related to gains on called and sold available for sale securities.

Federal Reserve Bank Stock — Federal Reserve Bank stock represents the Company's investment in the stock of the Federal Reserve Bank ("FRB") and is carried at par value, which reasonably approximates its fair value. While technically these are considered equity securities, there is no market for the FRB stock. Therefore, the shares are considered as restricted equity securities. Management periodically evaluates FRB stock for other-than-temporary impairment. Management's determination of whether these investments are impaired is based on its assessment of the ultimate recoverability of cost rather than by recognizing temporary declines in value. The determination of whether a decline affects the ultimate recoverability of cost is influenced by criteria such as (1) the significance of any decline in net assets of the FRB as compared to the capital stock amount for the FRB and the length of time this situation has persisted, (2) commitments by the FRB to make payments required by law or regulation and the level of such payments in relation to the operating performance of the FRB, (3) the impact of legislative and regulatory changes on institutions and, accordingly, the customer base of the FRB, and (4) the liquidity position of the FRB. This investment is reflected as a component of interest receivable and other assets on the consolidated balance sheets.

Federal Home Loan Bank Stock — Federal Home Loan Bank stock represents the Company's investment in the stock of the Federal Home Loan Bank of San Francisco ("FHLB") and is carried at par value, which reasonably approximates its fair value. While technically these are considered equity securities, there is no market for the FHLB stock. Therefore, the shares are considered as restricted equity securities. Management periodically evaluates FHLB stock for other-than-temporary impairment. Management's determination of whether these investments are impaired is based on its assessment of the ultimate recoverability of cost rather than by recognizing temporary declines in value. The determination of whether a decline affects the ultimate recoverability of cost is influenced by criteria such as (1) the significance of any decline in net assets of the FHLB 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 legislative and regulatory changes on institutions and, accordingly, the customer base of the FHLB, and (4) the liquidity position of the FHLB. This investment is reflected as a component of interest receivable and other assets on the consolidated balance sheets.

Earnings per common share ("EPS") — EPS is based upon the weighted average number of common shares outstanding during each year. The table in footnote 12 shows: (1) weighted average basic shares, (2) effect of dilutive securities related to stock options and non-vested restricted stock, and (3) weighted average diluted shares. Basic EPS are calculated by dividing net income by the weighted average number of common shares outstanding during each period, excluding dilutive stock options and unvested restricted stock awards. Diluted EPS are calculated using the weighted average diluted shares. The total dilutive shares included in annual diluted EPS is a year-to-date weighted average of the total dilutive shares included in each quarterly diluted EPS computation under the treasury stock method. We have two forms of outstanding common stock: common stock and unvested restricted stock awards. Holders of restricted stock awards receive non-forfeitable dividends at the same rate as common stockholders and they both share equally in undistributed earnings. Therefore, under the two-class method, the difference in EPS is not significant for these participating securities.

Stock based compensation — The Company recognizes in the consolidated statements of income the grant-date fair value of restricted stock, stock options and other equity-based forms of compensation issued to employees over the employees' requisite service period (generally the vesting period). The Company uses the straight-line recognition of expenses for awards with graded vesting. The fair value of each restricted stock grant is based on the closing market price of the Company's stock on the date of grant. The Company issued restricted stock grants totaling 43,446 and 27,047 shares in 2023 and 2022, respectively.

Fair values of financial instruments — The consolidated financial statements include various estimated fair value information as of December 31, 2023 and 2022. Such information, which pertains to the Company's financial instruments, does not purport to represent the aggregate net fair value of the Company. Further, the fair value estimates are based on various assumptions, methodologies, and subjective considerations, which vary widely among different financial institutions and which are subject to change.

Fair value measurements — The Company uses fair value measurements to record fair value adjustments to certain assets and liabilities and to determine fair value disclosures. The Company bases the fair values on 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. Securities available for sale are recorded at fair value on a recurring basis. Additionally, from time to time, the Company may be required to record certain assets at fair value on a non-recurring basis, such as certain impaired loans held for investment and securities held to maturity that are other-than-temporarily impaired. These non-recurring fair value adjustments typically involve write-downs of individual assets due to application of lower-of-cost or market accounting.

The Company has established and documented a process for determining fair value. The Company maximizes the use of observable inputs and minimizes the use of unobservable inputs when developing fair value measurements. Whenever there is no readily available market data, Management uses its best estimate and assumptions in determining fair value, but these estimates involve inherent uncertainties and the application of Management's judgment. As a result, if other assumptions had been used, our recorded earnings or disclosures could have been materially different from those reflected in these financial consolidated statements.

Revenue recognition — Revenue from deposit account-related fees, including general service fees charged for deposit account maintenance and activity and transaction-based fees charged for certain services, such as debit card, wire transfer or overdraft activities, is recognized when the performance obligation is completed, which is generally after a transaction is completed or monthly for account maintenance services. Investment advisory service fees are received from a third-party broker-dealer as part of a revenue sharing agreement for fees earned from customers that the Company refers to the third party for services that include custody of assets, investment management, trust services, and other fiduciary activities. Revenue is recognized when the performance obligation is completed, which is generally monthly.

Reclassifications — Certain prior year amounts have been reclassified to conform to the current year presentation. There was no effect on net income or shareholders' equity as a result of reclassifications.

Goodwill and other intangible assets — As of December 31, 2023 intangible assets are comprised of goodwill of \$ 3,313,000 and core deposit intangibles of \$159,000, which were acquired through a business combination, as compared to goodwill of \$ 3,313,000 and core deposit intangible of \$245,000 as of December 31, 2022. Intangible assets with definite useful lives are amortized over their respective estimated useful lives. If an event occurs that indicates the carrying amount of an intangible asset may not be recoverable, management reviews the asset for impairment. Any goodwill and any intangible asset acquired in a purchase business combination determined to have an indefinite useful life is not amortized, but is evaluated for impairment, at a minimum, on an annual basis.

The core deposit intangible represents the estimated future benefits of acquired deposits and is booked separately from the related deposits. The value of the core deposit intangible asset was determined using a discounted cash flow approach to arrive at the cost differential between the core deposits (non-maturity deposits such as transaction, savings and money market accounts) and alternative funding sources. The core deposit intangible is amortized on an accelerated basis over an estimated ten-year life, and it is evaluated periodically for impairment. No impairment loss was recognized as of December 31, 2023. At December 31, 2023, the core deposit intangibles future estimated amortization expense is as follows:

<i>(in thousands)</i>	2024	2025	Total
Core deposit intangible amortization	\$ 82	\$ 77	\$ 159

The Company applies a qualitative analysis of conditions in order to determine if it is more likely than not that the carrying value is impaired. In the event that the qualitative analysis suggests that the carrying value of goodwill may be impaired, the Company uses several quantitative valuation methodologies in evaluating goodwill for impairment that includes assumptions made concerning the future earnings potential of the organization, and a market-based approach that looks at values for organizations of comparable size, structure and business model. The current year's review of qualitative factors did not indicate that impairment has occurred, as such no quantitative analysis was performed at December 31, 2023.

Recently Issued Accounting Standards —

In June 2016, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2016-13, *Financial Instruments – Credit Losses (Topic 326)*. This update revises the methodology used by financial institutions under GAAP to recognize credit losses in the financial statements. Previously, GAAP required the use of an “incurred loss” model, whereby financial institutions recognize in current period earnings, incurred credit losses and those inherent in the financial statements, as of the date of the balance sheet. The “incurred loss” methodology for recognizing credit losses delayed recognition until it is probable that a loss has been incurred. ASU 2016-13 replaces such incurred loss impairment model with a new methodology that requires organizations to measure all expected credit losses for financial instruments held at the reporting date based on historical experience, current conditions and reasonable and supportable forecasts that affect the collectability of the reported amount. This ASU guidance results in a new model for estimating the allowance for credit losses, commonly referred to as the Current Expected Credit Loss (“CECL”) model. Under the CECL model, financial institutions are required to estimate future credit losses and recognize those losses in current period earnings. The amendments within the update were initially effective for fiscal years and all interim periods beginning after December 15, 2019. In October 2019, FASB approved an amendment that delayed the adoption of this ASU for three years for certain entities including the Company since we are classified as a Smaller Reporting Company. The Company adopted these standards as required on January 1, 2023 using the modified retrospective method for all financial assets measured at amortized cost and off-balance sheet credit exposures. There was no cumulative effect adjustment related to our available-for-sale investment portfolio upon adoption and the Company had no securities designated as held-to-maturity as of January 1, 2023.

Results for reporting periods beginning after January 1, 2023 are presented under CECL while prior period amounts continue to be reported in accordance with the probable incurred loss method accounting standards. The transition adjustment of the CECL adoption included an increase in the allowance for credit losses of \$346,000, an increase of \$547,000 to the reserve for unfunded commitments, a \$629,000 decrease to retained earnings, and a \$264,000 tax benefit recorded as part of the deferred tax asset in the Company's Consolidated Balance Sheet.

In March 2020, FASB issued ASU 2020-04 - *Reference Rate Reform (Subtopic 848): Facilitation of the Effects of Reference Rate Reform on Financial Reporting*. This ASU provides optional expedients and exceptions for contracts, hedging relationships, and other transactions that reference LIBOR or other reference rates expected to be discontinued because of reference rate reform. The ASU was effective for all entities as of March 12, 2020 through December 31, 2022. In December 2022, FASB Issued ASU 2022-06 to defer the sunset date from December 31, 2022 to December 31, 2024. The ASU did not have a material impact on our consolidated financial statements. As a result of the phase out of LIBOR immediately after June 30, 2023, our loans that were indexed to LIBOR have transitioned to CME Term SOFR.

In March 2022, the FASB issued ASU No. 2022-02, *Financial Instruments - Credit Losses (Topic 326): Troubled Debt Restructurings and Vintage Disclosures* (“ASU 2022-02”). ASU 2022-02 eliminates the accounting guidance for troubled debt restructurings in Accounting Standards Codification (“ASC”) Subtopic 310-40, *Receivables - Troubled Debt Restructurings by Creditors*, while enhancing disclosure requirements for certain loan refinancing and restructurings by creditors when a borrower is experiencing financial difficulty. Additionally, ASU 2022-02 requires entities to disclose current-period gross write-offs by year of origination for financing receivables and net investments in leases within the scope of ASC Subtopic 326-20, *Financial Instruments - Credit Losses - Measured at Amortized Cost*. ASU 2022-02 became effective on January 1, 2023. The adoption of ASU 2022-02 did not have a significant impact on our consolidated financial statements.

In March 2023, the FASB issued ASU No. 2023-02, *Investments-Equity Method and Joint Ventures (Topic 323): Accounting for Investments in Tax Credit Structures Using the Proportional Amortization Method (a consensus of the Emerging Issues Task Force)*. The amendments in this update permit reporting entities to elect to account for their tax equity investments, regardless of the program from which the income tax credits are received, using the proportional amortization method if certain conditions are met. A reporting entity may make an accounting policy election to apply the proportional amortization method on a tax-credit-program-by-tax-credit-program basis rather than electing to apply the proportional amortization method at the reporting entity level or to individual investments. Previously, only Low-Income Housing Tax Credit investments were eligible to apply the proportional amortization method. This ASU becomes effective on January 1, 2024, with early adoption permitted and can be adopted using either a retrospective or modified retrospective transition method. The Company intends to adopt this standard but does not expect it will have a material impact on the consolidated financial statements.

NOTE 2 — CASH AND DUE FROM BANKS

Cash and due from banks includes balances with the Federal Reserve Bank and other correspondent banks. Prior to March 2020, the Federal Reserve Bank required the Company to maintain a minimum reserve balance based on a percentage of the Company's deposit liabilities. Effective March 26, 2020, the Federal Reserve Bank reduced the reserve requirement ratios to zero percent, which eliminated the reserve requirements for all depository institutions. As of December 31, 2023 and 2022, the Company had Federal Reserve Bank balances of \$ 147,379,000 and \$225,366,000, respectively. In addition, the Company maintains other cash equivalent balances, of which insured balances totaled \$45,968,000 and uninsured balances totaled \$23,221,000 as of December 31, 2023.

NOTE 3 — SECURITIES

Equity Securities

The Company held equity securities with fair values of \$ 3,132,000 and \$2,990,000 at December 31, 2023 and December 31, 2022, respectively. There were no sales of equity securities during the year ended December 31, 2023 or 2022. Consistent with ASU 2016-01, these securities are carried at fair value with the changes in fair value recognized in the consolidated statements of income. Accordingly, the Company recognized an unrealized gain of \$41,000 and an unrealized loss of \$ 475,000 during the years ended December 31, 2023 and 2022, respectively.

Debt Securities

Debt securities have been classified in the financial statements as available for sale. The amortized cost and estimated fair values of debt securities as of December 31, 2023 are as follows:

(dollars in thousands)

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Available-for-sale securities:				
U.S. agencies	\$ 84,678	\$ 11	\$ (4,430)	\$ 80,259
Collateralized mortgage obligations	9,108	0	(444)	8,664
Municipalities	345,981	2,792	(19,865)	328,908
SBA pools	1,394	3	(2)	1,395
Corporate debt	47,500	9	(3,992)	43,517
Asset backed securities	56,613	133	(1,411)	55,335
	<u>\$ 545,274</u>	<u>\$ 2,948</u>	<u>\$ (30,144)</u>	<u>\$ 518,078</u>

The following tables detail the gross unrealized losses and fair values aggregated of debt securities by investment category and length of time that individual securities have been in a continuous unrealized loss position at December 31, 2023.

(dollars in thousands)

Description of Securities	Number of Securities	Less than 12 months		12 months or more		Total	
		Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
U.S. agencies	51	\$ 190	\$ (3)	\$ 79,556	\$ (4,427)	\$ 79,746	\$ (4,430)
Collateralized mortgage obligations	6	4,791	(1)	3,873	(443)	8,664	(444)
Municipalities	106	44,859	(453)	178,812	(19,412)	223,671	(19,865)
SBA pools	4	116	0	472	(2)	588	(2)
Corporate debt	13	0	0	41,508	(3,992)	41,508	(3,992)
Asset backed securities	19	2,123	(8)	32,535	(1,403)	34,658	(1,411)
Total temporarily impaired securities	<u>199</u>	<u>\$ 52,079</u>	<u>\$ (465)</u>	<u>\$ 336,756</u>	<u>\$ (29,679)</u>	<u>\$ 388,835</u>	<u>\$ (30,144)</u>

For available-for-sale debt securities in an unrealized loss position, management evaluates whether the decline in fair value is a reflection of credit deterioration or other factors. In performing this evaluation, management considers the extent which fair value has fallen below amortized cost, changes in ratings by rating agencies, and other information indicating a deterioration in repayment capacity of either the underlying issuer or the borrowers providing repayment capacity in a securitization. If management's evaluation indicates that a credit loss exists then a present value of the expected cash flows is calculated and compared to the amortized cost basis of the security in question and to the degree that the amortized cost basis exceeds the present value an allowance for credit loss ("ACL") is established, with the caveat that the maximum amount of the reserve on any individual security is the difference between the fair value and amortized cost balance of the security in question. Any unrealized loss that has not been recorded through an ACL is recognized in other comprehensive income.

[Table of Contents](#)

The unrealized losses are due primarily to rising market yields and not due to credit deterioration. As such, no ACL on available-for-sale securities has been established as of December 31, 2023. The Company does not intend to sell the securities and it is not likely that the Company will be required to sell the securities before the earlier of the forecasted recovery or the maturity of the underlying investment security.

The amortized cost and estimated fair value of debt securities at December 31, 2023, by contractual maturity or call date, are shown below. Expected maturities will differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

(dollars in thousands)

	Amortized Cost	Fair Value
Available-for-sale securities:		
Due in one year or less	\$ 101,428	\$ 96,439
Due after one year through five years	145,914	144,650
Due after five years through ten years	219,804	203,685
Due after ten years	78,128	73,304
	<u>\$ 545,274</u>	<u>\$ 518,078</u>

Debt securities have been classified in the financial statements as available for sale. The amortized cost and estimated fair values of debt securities as of December 31, 2022 are as follows:

(dollars in thousands)

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Available-for-sale securities:				
U.S. agencies	\$ 94,142	\$ 18	\$ (5,439)	\$ 88,721
Collateralized mortgage obligations	5,094	0	(483)	4,611
Municipalities	361,643	1,017	(31,079)	331,581
SBA pools	2,358	10	(6)	2,362
Corporate debt	47,512	0	(5,452)	42,060
Asset backed securities	60,313	11	(2,221)	58,103
	<u>\$ 571,062</u>	<u>\$ 1,056</u>	<u>\$ (44,680)</u>	<u>\$ 527,438</u>

[Table of Contents](#)

The following tables detail the gross unrealized losses and fair values aggregated of debt securities by investment category and length of time that individual securities have been in a continuous unrealized loss position at December 31, 2022.

(dollars in thousands)

Description of Securities	Number of Securities	Less than 12 months		12 months or more		Total	
		Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
U.S. agencies	52	\$ 81,936	(4,451)	3,972	(988)	\$ 85,908	\$ (5,439)
Collateralized mortgage obligations	5	4,278	(431)	333	(52)	4,611	(483)
Municipalities	132	216,154	(16,782)	46,348	(14,297)	262,502	(31,079)
SBA pools	4	0	0	975	(6)	975	(6)
Corporate debt	14	30,971	(3,041)	11,089	(2,411)	42,060	(5,452)
Asset backed securities	24	36,275	(1,669)	14,043	(552)	50,318	(2,221)
Total temporarily impaired securities	231	\$ 369,614	\$ (26,374)	\$ 76,760	\$ (18,306)	\$ 446,374	\$ (44,680)

The Company recognized gross realized gains of \$ 13,000 and \$0 during 2023 and 2022, respectively, on certain available-for-sale securities that were called. The Company sold twenty-four available-for-sale securities in 2023 and recorded a corresponding gain on sale of \$ 143,000, as compared to no sales in 2022.

Securities carried at \$288,199,000 and \$242,023,000 at December 31, 2023 and 2022, respectively, were pledged to secure deposits of public funds.

NOTE 4 — LOANS

The Company's customers are primarily located in Stanislaus, San Joaquin, Tuolumne, Sacramento, Placer, Inyo, and Mono Counties. As of December 31, 2023, approximately 88% of the Company's loans are commercial real estate loans which includes construction loans. Approximately 6% of the Company's loans are for general commercial uses including professional, retail, and small business. Additionally, 3% of the Company's loans are for residential real estate and other consumer loans. The remaining 3% are agriculture loans.

Loan totals were as follows:

(in thousands)	December 31, 2023	December 31, 2022
Commercial real estate:		
Construction and land	\$ 63,060	\$ 44,423
Multi-family	54,045	52,665
Owner occupied	210,407	206,960
Non-owner occupied	470,052	402,077
Farmland	96,188	86,501
Commercial and industrial	65,218	68,364
Consumer	31,687	33,591
Agriculture	25,922	21,177
Total loans	1,016,579	915,758
Less:		
Deferred loan fees and costs, net	(1,406)	(1,255)
Allowance for credit losses	(10,896)	(9,468)
Net loans	<u>\$ 1,004,277</u>	<u>\$ 905,035</u>

Loan Origination/Risk Management. The Company has certain lending policies and procedures in place that are designed to maximize loan income within an acceptable level of risk. Management reviews and approves these policies and procedures on a regular basis. A reporting system supplements the review process by providing management with frequent reports related to loan production, loan quality, concentrations of credit, loan delinquencies and non-performing and potential problem loans. Diversification in the loan portfolio is a means of managing risk associated with fluctuations in economic conditions.

Commercial and industrial loans are underwritten after evaluating and understanding the borrower's ability to operate profitably and prudently expand its business. Underwriting standards are designed to promote relationship banking rather than transactional banking. Once it is determined that the borrower's management possesses sound ethics and solid business acumen, the Company's management examines current and projected cash flows to determine the ability of the borrower to repay their obligations as agreed. Commercial and industrial loans are primarily made based on the identified cash flows of the borrower and secondarily on the underlying collateral provided by the borrower. The cash flows of borrowers, however, may not be as expected and the collateral securing these loans may fluctuate in value. Most commercial and industrial loans are secured by the assets being financed or other business assets such as accounts receivable or inventory and may incorporate a personal guarantee; however, some short-term loans may be made on an unsecured basis. In the case of loans secured by accounts receivable, the availability of funds for the repayment of these loans may be substantially dependent on the ability of the borrower to collect amounts due from its customers.

Commercial real estate loans are subject to underwriting standards and processes similar to commercial and industrial loans, in addition to those of real estate loans. These loans are viewed primarily as cash flow loans and secondarily as loans secured by real estate. Commercial real estate lending typically involves higher loan principal amounts and the repayment of these loans is generally largely dependent on the successful operation of the property securing the loan or the business conducted on the property securing the loan. Commercial real estate loans may be more adversely affected by conditions in the real estate markets or in the general economy. The properties securing the Company's commercial real estate portfolio are diverse in terms of type and geographic location. This diversity helps reduce the Company's exposure to adverse economic events that affect any single market or industry. Management monitors and evaluates commercial real estate loans based on collateral, geography and risk grade criteria. As a general rule, the Company avoids financing single-purpose projects unless other underwriting factors are present to help mitigate risk. The Company also utilizes third-party experts to provide insight and guidance about economic conditions and trends affecting market areas it serves. In addition, management tracks the level of owner-occupied commercial real estate loans versus non-owner occupied loans. At December 31, 2023, approximately 35% of the outstanding principal balance of the Company's commercial real estate loans were secured by owner-occupied properties.

[Table of Contents](#)

With respect to loans to developers and builders that are secured by non-owner occupied properties that the Company may originate from time to time, the Company generally requires the borrower to have had an existing relationship with the Company and have a proven record of success. Construction loans are underwritten utilizing feasibility studies, independent appraisal reviews, sensitivity analysis of absorption and lease rates and financial analysis of the developers and property owners. Construction loans are generally based upon estimates of costs and value associated with the complete project. These estimates may be inaccurate. Significant events can affect the construction industry, including: the inherent volatility of real estate markets and vulnerability to delays due to weather, change orders, inability to obtain construction permits, labor or material shortages, and price changes. Construction loans often involve the disbursement of substantial funds with repayment substantially dependent on the success of the ultimate project. Sources of repayment for these types of loans may be pre-committed permanent loans from approved long-term lenders, sales of developed property or an interim loan commitment from the Company until permanent financing is obtained. These loans are closely monitored by on-site inspections and are considered to have higher risks than other real estate loans due to their ultimate repayment being sensitive to interest rate changes, governmental regulation of real property, general economic conditions and the availability of long-term financing.

The Company originates consumer loans utilizing a computer-based credit scoring analysis to supplement the underwriting process. To monitor and manage consumer loan risk, policies and procedures are developed and modified, as needed, jointly by line and staff personnel. This activity, coupled with relatively small loan amounts that are spread across many individual borrowers, minimizes risk. Additionally, trend and outlook reports are reviewed by management on a regular basis. Underwriting standards for home equity loans follow bank policy, which include, but are not limited to, a maximum loan-to-value percentage of 80%, a maximum housing and total debt ratio of 36% and 42%, respectively and other specified credit and documentation requirements.

The Company maintains an independent loan review function that validates the credit risk program on a periodic basis. Results of these reviews are presented to management. The loan review process complements and reinforces the risk identification and assessment decisions made by lenders and credit personnel, as well as the Company's policies and procedures.

Non-Accrual and Past Due Loans. Loans are considered past due if the required principal and interest payments have not been received as of the date such payments were due. Loans are placed on non-accrual status when, in management's opinion, the borrower may be unable to meet payment obligations as they become due, as well as when required by regulatory provisions. Loans may be placed on non-accrual status regardless of whether or not such loans are considered past due. When interest accrual is discontinued, all unpaid accrued interest is reversed. Interest income is subsequently recognized only to the extent cash payments are received in excess of principal due. Loans are returned to accrual status when all the principal and interest amounts contractually due are brought current and future payments are reasonably assured.

As of December 31, 2023 and 2022, there were no loans classified as non-accrual loans.

The following table analyzes past due loans, segregated by class of loans, as of December 31, 2023 (in thousands):

	30-59 Days Past Due	60-89 Days Past Due	90 Days or More Past Due	Total Past Due	Current	Total	90 Days or More Past Due and Still Accruing
December 31, 2023							
Commercial real estate:							
Construction and land	\$ 0	\$ 0	\$ 0	\$ 0	\$ 63,060	\$ 63,060	\$ 0
Multi-family	0	0	0	0	54,045	54,045	0
Owner occupied	0	0	0	0	210,407	210,407	0
Non-owner occupied	0	0	0	0	470,052	470,052	0
Farmland	0	0	0	0	96,188	96,188	0
Commercial and industrial	0	0	0	0	65,218	65,218	0
Consumer	0	0	0	0	31,687	31,687	0
Agriculture	0	0	0	0	25,922	25,922	0
Total	<u>\$ 0</u>	<u>\$ 0</u>	<u>\$ 0</u>	<u>\$ 0</u>	<u>\$ 1,016,579</u>	<u>\$ 1,016,579</u>	<u>\$ 0</u>

The following table analyzes past due loans, segregated by class of loans, as of December 31, 2022 (in thousands):

	30-59 Days Past Due	60-89 Days Past Due	90 Days or More Past Due	Total Past Due	Current	Total	90 Days or More Past Due and Still Accruing
December 31, 2022							
Commercial real estate:							
Construction and land	\$ 0	\$ 0	\$ 0	\$ 0	\$ 44,423	\$ 44,423	\$ 0
Multi-family	0	0	0	0	52,665	52,665	0
Owner occupied	0	0	0	0	206,960	206,960	0
Non-owner occupied	0	0	0	0	402,077	402,077	0
Farmland	0	0	0	0	86,501	86,501	0
Commercial and industrial	0	0	0	0	68,364	68,364	0
Consumer	0	0	0	0	33,591	33,591	0
Agriculture	0	0	0	0	21,177	21,177	0
Total	<u>\$ 0</u>	<u>\$ 0</u>	<u>\$ 0</u>	<u>\$ 0</u>	<u>\$ 915,758</u>	<u>\$ 915,758</u>	<u>\$ 0</u>

Collateral Dependent Loans. Management's evaluation as to the ultimate collectability of loans includes estimates regarding future cash flows from operations and the value of property, real and personal, pledged as collateral. These estimates are affected by changing economic conditions and the economic prospects of borrowers. Prior to January 1, 2023, before CECL was adopted, collateral dependent loans are loans in which repayment is expected to be provided solely by the underlying collateral and there are no other available and reliable sources of repayment. Under CECL, loans can be determined to be collateral dependent if foreclosure of the loan's underlying collateral is probable or as a practical expedient if the borrower is experiencing financial difficulties and the repayment is expected to be provided substantially through the operation or sale of the collateral. Loans are written down to the lower of cost or fair value of underlying collateral, less estimated costs to sell. The Company had no collateral dependent loans as of December 31, 2023. Prior to the adoption of ASU 2016-13 on January 1, 2023, there were no impaired loans as of December 31, 2022.

Loan Modification Disclosures Pursuant to ASU 2022-02 - The Company may agree to different types of concessions when modifying a loan. There were no loan modifications to borrowers experiencing financial difficulty, including principal forgiveness, rate reductions, payment deferral or term extension, during the year ended December 31, 2023.

TDR Disclosures Prior to the Adoption of ASU 2022-02 - At December 31, 2022, there were no loans classified as troubled debt restructurings, and therefore there were no loans modified as troubled debt restructurings within the previous twelve months and for which there was a payment default during the twelve months ended December 31, 2022. A loan is considered to be in payment default once it is ninety days contractually past due under the modified terms.

Loan Risk Grades— Quality ratings (Risk Grades) are assigned to all commitments and stand-alone notes. Risk grades define the basic characteristics of commitments or stand-alone note in relation to their risk. All loans are graded using a system that maximizes the loan quality information contained in loan review grades, while ensuring that the system is compatible with the grades used by bank examiners.

The Company grades loans using the following letter system:

- 1 Exceptional Loan
- 2 Quality Loan
- 3A Better Than Acceptable Loan
- 3B Acceptable Loan
- 3C Marginally Acceptable Loan
- 4 (W) Watch Acceptable Loan
- 5 Special Mention Loan
- 6 Substandard Loan
- 7 Doubtful Loan
- 8 Loss

1. Exceptional Loan - Loans with A+ credits that contain very little, if any, risk. Grade 1 loans are considered Pass. To qualify for this rating, the following characteristics must be present:

- A high level of liquidity and whose debt-servicing capacity exceeds expected obligations by a substantial margin.
- Where leverage is below average for the industry and earnings are consistent or growing without severe vulnerability to economic cycles.
- Also included in this rating (but not mandatory unless one or more of the preceding characteristics are missing) are loans that are fully secured and properly margined by our own time instruments or U.S. blue chip securities. To be properly margined, cash collateral must be equal to, or greater than, 110% of the loan amount.

2. Quality Loan - Loans with excellent sources of repayment that conform in all respects to bank policy and regulatory requirements. These are also loans for which little repayment risk has been identified. No credit or collateral exceptions. Grade 2 loans are considered Pass. Other factors include:

- Unquestionable debt-servicing capacity to cover all obligations in the ordinary course of business from well-defined primary and secondary sources.
- Consistent strong earnings.
- A solid equity base.

3A. Better than Acceptable Loan - In the interest of better delineating the loan portfolio's true credit risk for reserve allocation, further granularity has been sought by splitting the grade 3 category into three classifications. The distinction between the three are bank-defined guidelines and represent a further refinement of the regulatory definition of a pass, or grade 3 loan. Grade 3A is characterized by:

- Strong earnings with no loss in last three years and ample cash flow to service all debt well above policy guidelines.
- Long term experienced management with depth and defined management succession.
- The loan has no exceptions to policy.
- Loan-to-value on real estate secured transactions is 10% to 20% less than policy guidelines.
- Very liquid balance sheet that may have cash available to pay off our loan completely.
- Little to no debt on balance sheet.

3B. Acceptable Loan - 3B loans are simply defined as all loans that are less qualified than 3A loans and are stronger than 3C loans. These loans are characterized by acceptable sources of repayment that conform to bank policy and regulatory requirements. Repayment risks are acceptable for these loans. Credit or collateral exceptions are minimal, are in the process of correction, and do not represent repayment risk. These loans:

- Are those where the borrower has average financial strengths, a history of profitable operations and experienced management.
- Are those where the borrower can be expected to handle normal credit needs in a satisfactory manner.

3C. Marginally Acceptable Loan - 3C loans have similar characteristics as that of 3Bs with the following additional characteristics:

- Requires collateral.
- A credit facility where the borrower has average financial strengths, but usually lacks reliable secondary sources of repayment other than the subject collateral.
- Other common characteristics can include some or all of the following: minimal background experience of management, lacking continuity of management, a start-up operation, erratic historical profitability (acceptable reasons-well identified), lack of or marginal sponsorship of guarantor, and government guaranteed loans.

4(W). Watch Acceptable Loan - Watch grade will be assigned to any credit that is adequately secured and performing but monitored for a number of indicators. These characteristics may include:

- Any unexpected short-term adverse financial performance from budgeted projections or a prior period's results (i.e., declining profits, sales, margins, cash flow, or increased reliance on leverage, including adverse balance sheet ratios, trade debt issues, etc.).
- Any managerial or personal problems with company management, decline in the entire industry or local economic conditions, or failure to provide financial information or other documentation as requested.
- Issues regarding delinquency, overdrafts, or renewals.
- Any other issues that cause concern for the company.
- Loans to individuals or loans supported by guarantors with marginal net worth and/or marginal collateral.
- Weaknesses that are identified are short-term in nature.
- Loans in this category are usually accounts the Bank would want to retain providing a positive turnaround can be expected within a reasonable time frame. Grade 4(W) loans are considered Pass.

5. Special Mention Loan - A special mention extension of credit is defined as having potential weaknesses that deserve management's close attention. If left uncorrected, these potential weaknesses may, at some future date result in the deterioration of the repayment prospects for the credit or the institution's credit position. Extensions of credit that might be detailed in this category include the following:

- The lending officer may be unable to properly supervise the credit because of an inadequate loan or credit agreement.
- Questions exist regarding the condition of and/or control over collateral.
- Economic or market conditions may unfavorably affect the obligor in the future.
- A declining trend in the obligor's operations or an imbalanced position in the balance sheet exists, but not to the point that repayment is jeopardized.

6. Substandard Loan - A "substandard" extension of credit is inadequately protected by the current sound worth and paying capacity of the obligor or of the collateral pledged, if any. Extensions of credit so classified must have a well-defined weakness or weaknesses that jeopardize the liquidation of the debt. They are characterized by the distinct possibility that the Bank will sustain some loss if the deficiencies are not corrected. Loss potential, while existing in the aggregate amount of substandard credits, does not have to exist in individual extensions of credit classified as substandard.

7. Doubtful Loan - An extension of credit classified as "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 values, highly questionable and improbable. The possibility of loss is extremely high but because of certain important and reasonably specific pending factors that may work to the advantage of and strengthen the credit, its classification as an estimated loss is deferred until its more exact status may be determined. Pending factors may include a proposed merger or acquisition, liquidation proceedings, capital injection, perfecting liens on additional collateral or refinancing plans. The entire loan need not be classified as doubtful when collection of a specific portion appears highly probable. An example of proper use of the doubtful category is the case of a company being liquidated, with the trustee-in-bankruptcy indicating a minimum disbursement of 40 percent and a maximum of 65 percent to unsecured creditors, including the Bank. In this situation, estimates are based on liquidation value appraisals with actual values yet to be realized. By definition, the only portion of the credit that is doubtful is the 25 percent difference between 40 and 65 percent.

A proper classification of such a credit would show 40 percent substandard, 25 percent doubtful, and 35 percent loss. A credit classified as doubtful should be resolved within a 'reasonable' period of time. Reasonable is generally defined as the period between examinations. In other words, a credit classified as doubtful at an examination should be cleared up before the next exam. However, there may be situations that warrant continuation of the doubtful classification a while longer.

8. Loss - Extensions of credit classified as "loss" are considered uncollectible and of such little value that their continuance as bankable assets is not warranted. This classification does not mean that the credit has absolutely no recovery or salvage value, but rather that it is not practical or desirable to defer writing off, even though partial recovery may be affected in the future. It should not be the Company's practice to attempt long-term recoveries while the credit remains on the books. Losses should be taken in the period in which they surface as uncollectible.

As of December 31, 2023 and 2022, there are no loans that are classified with risk grades of 8- Loss.

The risk grades are reviewed every month, at a minimum and on an as-needed basis depending on the specific circumstances of the loan.

[Table of Contents](#)

The following table summarizes loan risk grade totals by class and year of origination as of December 31, 2023. Risk grades 1 through 4(W) have been aggregated in the "Pass" line.

(in thousands)	As of December 31, 2023							
	Term Loans Amortized Cost Basis by Origination Year							
Risk Grade Ratings	2023	2022	2021	2020	2019	Prior	Revolving Loans	Total
Commercial real estate - Construction & land								
Pass	\$ 16,237	\$ 42,670	\$ 1,259	\$ 0	\$ 1,244	\$ 1,650	\$ 0	\$ 63,060
Total commercial real estate - construction & land	16,237	42,670	1,259	0	1,244	1,650	0	63,060
Commercial real estate - Multi-family								
Pass	3,803	6,976	8,711	3,473	6,780	24,302	0	54,045
Total commercial real estate - multi-family	3,803	6,976	8,711	3,473	6,780	24,302	0	54,045
Commercial real estate - Owner occupied								
Pass	10,031	40,666	48,377	25,642	14,341	57,971	251	197,279
Special mention	0	0	7,683	0	0	289	530	8,502
Substandard	0	0	0	0	4,626	0	0	4,626
Total commercial real estate - owner occupied	10,031	40,666	56,060	25,642	18,967	58,260	781	210,407
Commercial real estate - Non-owner occupied								
Pass	78,417	71,236	81,386	43,531	44,413	145,073	1,879	465,935
Special mention	0	0	0	0	0	4,117	0	4,117
Total commercial real estate - non-owner occupied	78,417	71,236	81,386	43,531	44,413	149,190	1,879	470,052
Commercial real estate - Farmland								
Pass	14,377	10,393	1,667	15,392	6,551	31,610	15,717	95,707
Special mention	0	0	0	0	0	481	0	481
Total commercial real estate - farmland	14,377	10,393	1,667	15,392	6,551	32,091	15,717	96,188
Commercial and Industrial								
Pass	10,967	11,268	9,608	6,018	4,384	2,239	20,502	64,986
Special mention	0	0	0	139	0	6	0	145
Substandard	0	0	0	0	0	87	0	87
Total commercial and industrial	10,967	11,268	9,608	6,157	4,384	2,332	20,502	65,218
Consumer								
Pass	1,234	5,042	4,104	2,213	2,074	7,555	8,529	30,751
Special mention	0	0	0	0	0	0	890	890
Substandard	0	0	0	0	0	46	0	46
Total consumer	1,234	5,042	4,104	2,213	2,074	7,601	9,419	31,687
Agriculture								
Pass	3,032	1,707	1,309	0	214	488	18,984	25,734
Special mention	0	0	0	0	0	0	188	188
Total agriculture	3,032	1,707	1,309	0	214	488	19,172	25,922
Total by Risk Category								
Pass	138,098	189,958	156,421	96,269	80,001	270,888	65,862	997,497
Special mention	0	0	7,683	139	0	4,893	1,608	14,323
Substandard	0	0	0	0	4,626	133	0	4,759
Total	\$ 138,098	\$ 189,958	\$ 164,104	\$ 96,408	\$ 84,627	\$ 275,914	\$ 67,470	\$1,016,579

[Table of Contents](#)

The following table summarizes loan risk grade totals by class and year of origination as of December 31, 2022. Risk grades 1 through 4(W) have been aggregated in the "Pass" line.

(in thousands)	As of December 31, 2022							
	Term Loans Amortized Cost Basis by Origination Year							
Risk Grade Ratings	2022	2021	2020	2019	2018	Prior	Revolving Loans	Total
Commercial real estate - Construction & land								
Pass	\$ 27,101	\$ 12,351	\$ 1,148	\$ 1,791	\$ 0	\$ 2,032	\$ 0	\$ 44,423
Total commercial real estate - construction & land	27,101	12,351	1,148	1,791	0	2,032	0	44,423
Commercial real estate - Multi-family								
Pass	7,115	9,285	4,335	6,962	3,874	21,094	0	52,665
Total commercial real estate - multi-family	7,115	9,285	4,335	6,962	3,874	21,094	0	52,665
Commercial real estate - Owner occupied								
Pass	41,709	49,820	26,969	14,891	14,122	50,689	500	198,700
Special mention	0	7,959	0	0	301	0	0	8,260
Total commercial real estate - owner occupied	41,709	57,779	26,969	14,891	14,423	50,689	500	206,960
Commercial real estate - Non-owner occupied								
Pass	55,503	82,180	46,911	46,613	51,557	111,324	2,521	396,609
Special mention	0	0	0	0	0	743	0	743
Substandard	0	0	0	4,725	0	0	0	4,725
Total commercial real estate - non-owner occupied	55,503	82,180	46,911	51,338	51,557	112,067	2,521	402,077
Commercial real estate - Farmland								
Pass	10,831	2,531	16,315	7,375	9,114	25,514	14,821	86,501
Total commercial real estate - farmland	10,831	2,531	16,315	7,375	9,114	25,514	14,821	86,501
Commercial and Industrial								
Pass	11,697	15,746	9,851	5,892	2,242	1,651	19,412	66,491
Special mention	0	0	208	90	47	123	1,155	1,623
Substandard	0	0	0	0	0	0	250	250
Total commercial and industrial	11,697	15,746	10,059	5,982	2,289	1,774	20,817	68,364
Consumer								
Pass	5,230	4,702	3,414	2,168	2,307	6,171	8,649	32,641
Special mention	0	0	0	0	0	0	899	899
Substandard	0	0	0	0	0	51	0	51
Total consumer	5,230	4,702	3,414	2,168	2,307	6,222	9,548	33,591
Agriculture								
Pass	1,676	1,850	0	387	0	651	16,613	21,177
Total agriculture	1,676	1,850	0	387	0	651	16,613	21,177
Total by Risk Category								
Pass	160,862	178,465	108,943	86,079	83,216	219,126	62,516	899,207
Special mention	0	7,959	208	90	348	866	2,054	11,525
Substandard	0	0	0	4,725	0	51	250	5,026
Total	\$ 160,862	\$ 186,424	\$ 109,151	\$ 90,894	\$ 83,564	\$ 220,043	\$ 64,820	\$ 915,758

[Table of Contents](#)

The following table details activity in the ACL by portfolio segment for the years ended December 31, 2023 and 2022. Allocation of a portion of the allowance to one category of loans does not preclude its availability to absorb losses in other categories.

Allowance for Credit Losses
For the Years Ended December 31, 2023 and 2022

(in thousands)

Year Ended December 31,	CRE Construction & Land	CRE Multi- family	CRE Owner occupied	CRE Non- owner occupied	CRE Farmland	Commercial and Industrial	Consumer	Agriculture	Total
2023									
Beginning balance	\$ 1,055	\$ 479	\$ 1,798	\$ 4,211	\$ 830	\$ 612	\$ 311	\$ 172	\$ 9,468
CECL day-one adjustments	338	23	103	25	12	102	(120)	(137)	346
Charge-offs	0	0	0	0	0	(12)	(40)	0	(52)
Recoveries	139	0	0	0	0	12	13	0	164
Provision for (reversal of) credit losses	(305)	165	(96)	569	626	(64)	63	12	970
Ending balance	<u>\$ 1,227</u>	<u>\$ 667</u>	<u>\$ 1,805</u>	<u>\$ 4,805</u>	<u>\$ 1,468</u>	<u>\$ 650</u>	<u>\$ 227</u>	<u>\$ 47</u>	<u>\$ 10,896</u>
Year Ended December 31,									
2022									
Beginning balance	\$ 728	\$ 502	\$ 2,141	\$ 5,105	\$ 858	\$ 746	\$ 352	\$ 306	\$ 10,738
Charge-offs	0	0	0	0	0	0	(53)	0	(53)
Recoveries	123	0	0	0	0	0	10	0	133
Provision for (reversal of) credit losses	204	(23)	(343)	(894)	(28)	(134)	2	(134)	(1,350)
Ending balance	<u>\$ 1,055</u>	<u>\$ 479</u>	<u>\$ 1,798</u>	<u>\$ 4,211</u>	<u>\$ 830</u>	<u>\$ 612</u>	<u>\$ 311</u>	<u>\$ 172</u>	<u>\$ 9,468</u>

The following table details the allowance for credit losses and ending gross loan balances as of December 31, 2023 and 2022, summarized by collective and individual evaluation methods of impairment.

(in thousands)

	CRE Construction & Land	CRE Multi- family	CRE Owner occupied	CRE Non- owner occupied	CRE Farmland	Commercial and Industrial	Consumer	Agriculture	Total
December 31, 2023									
Allowance for credit losses for loans:									
Individually evaluated for impairment	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0
Collectively evaluated for impairment	1,227	667	1,805	4,805	1,468	650	227	47	10,896
	<u>\$ 1,227</u>	<u>\$ 667</u>	<u>\$ 1,805</u>	<u>\$ 4,805</u>	<u>\$ 1,468</u>	<u>\$ 650</u>	<u>\$ 227</u>	<u>\$ 47</u>	<u>\$ 10,896</u>
Ending gross loan balances:									
Individually evaluated for impairment	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0
Collectively evaluated for impairment	63,060	54,045	210,407	470,052	96,188	65,218	31,687	25,922	1,016,579
	<u>\$ 63,060</u>	<u>\$ 54,045</u>	<u>\$ 210,407</u>	<u>\$ 470,052</u>	<u>\$ 96,188</u>	<u>\$ 65,218</u>	<u>\$ 31,687</u>	<u>\$ 25,922</u>	<u>\$ 1,016,579</u>
December 31, 2022									
Allowance for credit losses for loans:									
Individually evaluated for impairment	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0
Collectively evaluated for impairment	1,055	479	1,798	4,211	830	612	311	172	9,468
	<u>\$ 1,055</u>	<u>\$ 479</u>	<u>\$ 1,798</u>	<u>\$ 4,211</u>	<u>\$ 830</u>	<u>\$ 612</u>	<u>\$ 311</u>	<u>\$ 172</u>	<u>\$ 9,468</u>
Ending gross loan balances:									
Individually evaluated for impairment	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0
Collectively evaluated for impairment	44,423	52,665	206,960	402,077	86,501	68,364	33,591	21,177	915,758
	<u>\$ 44,423</u>	<u>\$ 52,665</u>	<u>\$ 206,960</u>	<u>\$ 402,077</u>	<u>\$ 86,501</u>	<u>\$ 68,364</u>	<u>\$ 33,591</u>	<u>\$ 21,177</u>	<u>\$ 915,758</u>

The following table presents gross charge-offs for the year ended December 31, 2023 by portfolio class and origination year (dollars in thousands):

(in thousands)	Year ended December 31, 2023							
	Term Loans Charged-off by Origination Year							
Chargeoffs	2023	2022	2021	2020	2019	Prior	Revolving Loans	Total
Commercial real estate:								
Construction & land	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0
Multi-family	0	0	0	0	0	0	0	0
Owner occupied	0	0	0	0	0	0	0	0
Non-owner occupied	0	0	0	0	0	0	0	0
Farmland	0	0	0	0	0	0	0	0
Commercial and industrial	0	0	12	0	0	0	0	12
Consumer	0	0	0	0	0	0	40	40
Agriculture	0	0	0	0	0	0	0	0
Total	<u>\$ 0</u>	<u>\$ 0</u>	<u>\$ 12</u>	<u>\$ 0</u>	<u>\$ 0</u>	<u>\$ 0</u>	<u>\$ 40</u>	<u>\$ 52</u>

Changes in the allowance for undisbursed loan commitments were as follows:

(in thousands)	YEARS ENDED DECEMBER 31,	
	2023	2022
Balance, beginning of year	\$ 546	\$ 469
CECL day-one adjustment	547	0
(Reversal of) provision charged to operations for off balance sheet	(484)	77
Balance, end of year	<u>\$ 609</u>	<u>\$ 546</u>

The method for calculating the allowance for unfunded loan commitments is based on applying an estimated funding rate to the unfunded loan commitment balance to determine a projected cashflow schedule. Then the quantitative loan loss rate from each loan pool, as calculated in the DCF model described above, is used to calculate the allowance for unfunded loan commitments which is recorded included in interest payable and other liabilities on the consolidated balance sheet.

At December 31, 2023 and 2022, loans carried at \$1,016,579,000 and \$915,758,000, respectively, were pledged as collateral on advances from the Federal Home Loan Bank.

NOTE 5 — PREMISES AND EQUIPMENT

Major classifications of premises and equipment are summarized as follows:

(in thousands)	DECEMBER 31,	
	2023	2022
Land	\$ 5,195	\$ 5,195
Building	10,874	10,790
Leasehold improvements	5,417	5,357
Furniture, fixtures, and equipment	5,087	4,735
Branch construction work-in-process	1,494	239
	28,067	26,316
Less accumulated depreciation	(12,202)	(11,016)
	<u>\$ 15,865</u>	<u>\$ 15,300</u>

Depreciation expense was \$1,329,000 and \$1,312,000 for the years ended December 31, 2023 and 2022, respectively.

NOTE 6 — INTEREST RECEIVABLE AND OTHER ASSETS

Interest receivable and other assets are summarized as follows:

(in thousands)	DECEMBER 31,	
	2023	2022
Restricted equity securities	\$ 5,956	\$ 5,236
Interest income receivable on loans	2,866	2,465
Interest income receivable on investments	5,520	5,465
Investments in limited partnerships	13,684	14,582
Lease right of use asset	6,853	7,755
Prepaid expenses and other	1,397	1,537
	<u>\$ 36,276</u>	<u>\$ 37,040</u>

NOTE 7 — DEPOSITS

Deposit totals were as follows:

(in thousands)	DECEMBER 31,	
	2023	2022
Demand	\$ 1,099,830	\$ 1,202,321
Money market deposit accounts	363,386	405,797
Savings	131,796	165,994
Time deposits \$250,000 and under	33,399	24,712
Time deposits over \$250,000	22,123	15,473
Total deposits	<u>\$ 1,650,534</u>	<u>\$ 1,814,297</u>

Time deposits issued and their remaining maturities at December 31, 2023, are as follows (in thousands):

Year ending December 31,	
2024	\$ 49,275
2025	4,983
2026	985
2027	279
2028	0
	<u>\$ 55,522</u>

NOTE 8 — FHLB ADVANCES

At December 31, 2023, the Company had no outstanding advances from the Federal Home Loan Bank ("FHLB"). Unused and available advances totaled \$333,083,000 at December 31, 2023. Loans carried at \$1,016,579,000 as of December 31, 2023, were pledged as collateral on advances from the Federal Home Loan Bank.

At December 31, 2022, the Company had no outstanding advances from the Federal Home Loan Bank ("FHLB"). Unused and available advances totaled \$322,369,000 at December 31, 2022. Loans carried at \$915,758,000 as of December 31, 2022, were pledged as collateral on advances from the Federal Home Loan Bank.

NOTE 9 — INTEREST ON DEPOSITS

Interest on deposits was comprised of the following:

(in thousands)	YEARS ENDED DECEMBER 31,	
	2023	2022
Savings and other deposits	\$ 4,266	\$ 1,015
Time deposits over \$250,000	222	46
Time deposits \$250,000 and under	375	58
	<u>\$ 4,863</u>	<u>\$ 1,119</u>

NOTE 10 — INCOME TAXES

The provision for income taxes consists of the following:

(in thousands)	YEARS ENDED DECEMBER 31,	
	2023	2022
Current		
Federal	\$ 6,215	\$ 3,364
State	4,213	2,934
	10,428	6,298
Deferred		
Federal	(739)	294
State	(231)	195
	(970)	489
	<u>\$ 9,458</u>	<u>\$ 6,787</u>

[Table of Contents](#)

The components of the Company's deferred tax assets and liabilities (included in accrued interest and other assets on the consolidated balance sheets), is shown below:

(in thousands)

	DECEMBER 31,	
	2023	2022
Deferred tax assets:		
Allowance for credit losses	\$ 3,221	\$ 2,800
Restricted stock expense	106	129
Accrued vacation	167	184
Accrued salary continuation liability	1,717	1,600
Deferred compensation	77	78
Core deposit intangible	95	90
Merger Costs	55	63
Reserve for undisbursed commitments	180	162
State income tax	885	616
Holding company organization fees	1	1
Accumulated depreciation	49	0
Unrealized loss on securities available for sale	8,040	12,897
	<u>14,593</u>	<u>18,620</u>
Deferred tax liabilities:		
Prepaid expenses	(92)	(79)
FHLB dividends	(144)	(144)
Accumulated depreciation	0	(193)
Accrued bonus	(6)	(6)
Deferred loan costs	(347)	(372)
Goodwill Amortization	(522)	(457)
Limited partner investment in small business equity fund	(235)	(235)
	<u>(1,346)</u>	<u>(1,486)</u>
Net deferred income tax asset	<u>\$ 13,247</u>	<u>\$ 17,134</u>

Management has assessed the realizability of deferred tax assets and believes it is more likely than not that all deferred tax assets will be realized in the normal course of operations. Accordingly, these assets have not been reduced by a valuation allowance.

The Company periodically reviews its income tax positions based on tax laws and regulations and financial reporting considerations, and records adjustments as appropriate. This review takes into consideration the status of current taxing authorities' examinations of the Company's tax returns, recent positions taken by the taxing authorities on similar transactions.

The Company had no liabilities for unrecognized tax benefits as of December 31, 2023 and 2022.

The effective tax rate for 2023 and 2022 differs from the current Federal statutory income tax rate as follows:

	YEARS ENDED DECEMBER 31,	
	2023	2022
Federal statutory income tax rate	21.0%	21.0%
State taxes, net of federal tax benefit	8.6%	8.6%
Tax exempt interest on municipal securities and loans	-5.0%	-5.9%
Other	-1.1%	-0.8%
Effective tax rate	23.5%	22.9%

Oak Valley Bancorp files a consolidated return in the U.S. Federal tax jurisdiction and a combined report in the State of California tax jurisdiction. None of the entities are subject to examination by taxing authorities for years before 2020 for U.S. federal or for years before 2019 for California.

NOTE 11 — STOCK OPTION PLAN

The Company currently has one equity based incentive plan, the Oak Valley Bancorp 2018 Stock Plan. The 2018 Stock Plan provides for awards in the form of incentive stocks, non-statutory stock options, stock appreciation rights and restrictive stocks. Under the 2018 Plan, the Company is authorized to issue 607,500 shares of its common stock to key employees and directors as incentive and non-qualified stock options, respectively, at a price equal to the fair value on the date of grant. The Plan provides that the options are exercisable in equal increments over a five-year period from the date of grant or over any other schedule approved by the Board of Directors. All incentive stock options expire no later than ten years from the date of grant. As of December 31, 2023, 463,199 shares were available to be issued under the 2018 Stock Plan pursuant to new grants.

For the years ended December 31, 2023 and 2022, there were no stock options outstanding at any time and therefore no stock option exercises in either year. All outstanding stock options became fully vested during 2014 and therefore there is no remaining unrecognized stock option compensation expense.

A summary of the status of the Company's restricted stock and changes during the years ended December 31, 2023 and 2022 are presented below.

	DECEMBER 31, 2023		DECEMBER 31, 2022	
	Shares	Weighted Average Grant Date Fair Value	Shares	Weighted Average Grant Date Fair Value
Unvested at beginning of year	82,023	\$ 18.43	87,850	\$ 18.50
Issued	43,446	\$ 26.46	27,047	\$ 18.86
Vested	(32,178)	\$ 19.08	(31,074)	\$ 19.06
Forfeited	(300)	\$ 17.85	(1,800)	\$ 17.69
Unvested at end of year	92,991	\$ 21.96	82,023	\$ 18.43

The Company issued 43,446 shares of restricted stock in 2023 with a weighted average fair value of \$ 26.46 per share. For the year ended December 31, 2023, total compensation expense recorded in the consolidated statements of income related to restricted stock awards was \$ 533,000, with an offsetting tax benefit of \$158,000, as this expense is deductible for income tax purposes. The Company recorded a tax benefit of \$ 73,000 to income tax expense to adjust for the full tax deduction of the vested restricted stock, which is equal to the fair value on the vesting date, as the tax benefit from the restricted stock expense is based on the grant date fair value. As of December 31, 2023, there was \$1,647,000 of total unrecognized compensation cost related to restricted stock awards which is expected to be recognized over a weighted-average period of 3.67 years. During 2023, shares of restricted stock awards totaling 32,178 with a fair value of \$861,000, based on the vested date of each award, were vested and became unrestricted.

The Company issued 27,047 shares of restricted stock in 2022 with a weighted average fair value of \$ 18.86 per share. For the year ended December 31, 2022, total compensation expense recorded in the consolidated statements of income related to restricted stock awards was \$ 622,000, with an offsetting tax benefit of \$184,000, as this expense is deductible for income tax purposes. The Company recorded an additional tax expense of \$ 3,000 to income tax expense to adjust for the full tax deduction of the vested restricted stock, which is equal to the fair value on the vesting date, as the tax benefit from the restricted stock expense is based on the grant date fair value. As of December 31, 2022, there was \$1,037,000 of total unrecognized compensation cost related to restricted stock awards which is expected to be recognized over a weighted-average period of 3.23 years. During 2022, shares of restricted stock awards totaling 31,074 with a fair value of \$582,000, based on the vested date of each award, were vested and became unrestricted.

NOTE 12 — EARNINGS PER SHARE

EPS are based upon the weighted average number of common shares outstanding during each year. The following table shows: (1) weighted average basic shares, (2) effect of dilutive securities related to stock options and non-vested restricted stock, and (3) weighted average diluted shares. Basic EPS are calculated by dividing net income by the weighted average number of common shares outstanding during each period, excluding dilutive stock options and unvested restricted stock awards. Diluted EPS are calculated using the weighted average diluted shares. The total dilutive shares included in annual diluted EPS is a year-to-date weighted average of the total dilutive shares included in each quarterly diluted EPS computation under the treasury stock method. We have two forms of outstanding common stock: common stock and unvested restricted stock awards. Holders of restricted stock awards receive non-forfeitable dividends at the same rate as common stockholders and they both share equally in undistributed earnings. Therefore, under the two-class method the difference in EPS is not significant for these participating securities.

The Company's calculation of EPS including basic EPS, which does not consider the effect of common stock equivalents and diluted EPS, which considers all dilutive common stock equivalents is as follows:

	YEAR ENDED DECEMBER 31, 2023		
	Income (Numerator)	Weighted Avg Shares (Denominator)	Per-Share Amount
(dollars in thousands)			
Basic EPS:			
Net income	\$ 30,848	8,193,874	\$ 3.76
Effect of dilutive securities:			
Non-vested restricted stock	—	37,018	
Total dilutive shares		37,018	
Diluted EPS:			
Net income per diluted share	\$ 30,848	8,230,892	\$ 3.75
	YEAR ENDED DECEMBER 31, 2022		
	Income (Numerator)	Weighted Avg Shares (Denominator)	Per-Share Amount
(dollars in thousands)			
Basic EPS:			
Net income	\$ 22,902	8,169,078	\$ 2.80
Effect of dilutive securities:			
Non-vested restricted stock	—	35,691	
Total dilutive shares		35,691	
Diluted EPS:			
Net income per diluted share	\$ 22,902	8,204,769	\$ 2.79

NOTE 13 — COMMITMENTS AND CONTINGENT LIABILITIES

The Company is obligated for rental payments under certain operating lease agreements, some of which contain renewal options and escalation clauses that provide for increased rentals. Total rental expense for the years ended December 31, 2023 and 2022, was \$1,523,000 and \$1,295,000, respectively.

We have historically entered into a number of lease arrangements under which we are the lessee. We have elected the practical expedient to rely on our original lease classification at the commencement of each lease contract, and not reassess the lease classifications upon the adoption of ASU No. 2016-02, *Leases (Topic 842)* on the effective date of January 1, 2019. Therefore, all of the Company's leases are determined to be operating leases. The other practical expedients the Company adopted are: (1) combining lease and non-lease components into a single liability amount and (2) leases with fair values of less than \$5,000 were not included as they are not considered to be material. The Company does not have any short-term leases in which the original term at commencement is twelve months or less and therefore there is no impact of short-term leases on the initial ROU or lease liability recorded on January 1, 2019.

Most of our office leases include one or more optional renewal periods. The Company has not elected the hindsight practical expedient and therefore potential payments related to future lease renewal options are not reflected in the ROU asset and lease liability. Generally, all of the lease contracts have annual rent payment increases, some of which are based on the Consumer Price Index and others are fixed increases that are set forth within the contracts. The majority of our lease contracts are gross leases, in which a single monthly payment includes the lessor's property and casualty insurance costs, property taxes, and common area maintenance associated with the property.

The Company determined the operating lease liability for new lease agreements and renewal options in 2022 and 2023 by calculating the present value of future cash payments, excluding any future renewal options as it was not reasonably certain that they will be exercised. A discount rate was applied to the cash obligation schedule to calculate the present value of the operating lease liability. The discount rate was based on our incremental borrowing rate through our line of credit with the FHLB, for the borrowing term that was equal to the term of each lease. As of December 31, 2023, the weighted average remaining term of the lease contracts was 7.5 years, and the weighted average discount rate used to calculate the present value of the operating lease liability was 2.94%. As of December 31, 2022, the weighted average remaining term of the lease contracts was 8.2 years, and the weighted average discount rate used to calculate the present value of the operating lease liability was 2.80%. The operating lease liability totaled \$7,159,000 and \$8,007,000 as of December 31, 2023 and 2022, respectively, and is included in interest payable and other liabilities in the condensed consolidated balance sheet. The ROU asset totaled \$6,853,000 and \$7,755,000 as of December 31, 2023 and 2022, respectively, is recorded in interest receivable and other assets on the condensed consolidated balance sheet.

At December 31, 2023, the future minimum commitments under these operating leases are as follows (in thousands):

Year ending December 31,		
2024	\$	1,400
2025		1,254
2026		1,025
2027		864
2028		828
Thereafter		2,892
	\$	8,263
Reconciling items:		
Present value discount		(1,104)
Present value of lease liabilities	\$	<u>7,159</u>

The Company is a party to financial instruments with off-balance-sheet risk in the normal course of business to meet the financing needs of its customers. These financial instruments include commitments to extend credit in the form of loans or through standby 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 sheet. The contract amounts of those instruments reflect the extent of involvement the Company has in particular classes of financial instruments.

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

Financial instruments at December 31, 2023 whose contract amounts represent credit risk:

(in thousands)	Contract Amount
Undisbursed loan commitments	\$ 163,413
Checking reserve	1,334
Equity lines	17,973
Standby letters of credit	3,613
	\$ 186,333

Commitments to extend credit, including undisbursed loan commitments and equity lines, are agreements to lend to a customer 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 Company evaluates each customer's creditworthiness on a case-by-case basis. The amount of collateral obtained, if deemed necessary by the Company upon extension of credit, is based on management's credit evaluation. Collateral held varies but may include accounts receivable, inventory, property, plant, equipment and income-producing commercial properties.

Checking reserves are lines of credit associated consumer deposit accounts that meet qualification standards for extension of credit if the deposit account were to become overdraft.

Standby letters of credit are conditional commitments issued by the Company to guarantee the performance of a customer to a third party. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loan facilities to customers.

NOTE 14 — FINANCIAL INSTRUMENTS AND FAIR VALUE MEASUREMENTS

Fair values of financial instruments — The consolidated financial statements include various estimated fair value information as of December 31, 2023 and 2022. Such information, which pertains to the Company's financial instruments, does not purport to represent the aggregate net fair value of the Company. Further, the fair value estimates are based on various assumptions, methodologies, and subjective considerations, which vary widely among different financial institutions and which are subject to change.

We determine the fair values of our financial instruments based on the fair value hierarchy established under applicable accounting guidance which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value:

Level 1: Inputs to the valuation methodology are quoted prices (unadjusted) for identical assets or liabilities in active markets.

Level 2: Inputs to the valuation methodology include quoted prices for similar assets and liabilities in active markets and inputs that are observable for the asset or liability, either directly or indirectly, for substantially the full term of the financial instrument.

Level 3: Inputs to the valuation methodology are unobservable and significant to the fair value measurement.

In certain cases, the inputs used to measure fair value may fall into different levels of the fair value hierarchy. In such cases, the level in the fair value hierarchy within which the fair value measurement in its entirety falls has been determined based on the lowest level input that is significant to the fair value measurement in its entirety. The Company's assessment of the significance of a particular input to the fair value measurement in its entirety requires judgment and considers factors specific to the asset or liability. Transfers between levels of the fair value hierarchy are recognized on the actual date of the event or circumstance that caused the transfer, which generally corresponds with the Company's quarterly valuation process. There were no transfers between levels during the years ended December 31, 2023 and 2022.

[Table of Contents](#)

Following is a description of valuation methodologies used for assets and liabilities in the tables below:

Restricted Equity Securities— The carrying amounts of the stock the Company owns in Federal Reserve Bank (“FRB”) and Federal Home Loan Bank (“FHLB”) approximate their fair value and are considered a level 2 valuation.

Deposit liabilities — The fair values estimated for demand deposits (interest and non-interest checking, savings, and certain types of money market accounts) are, by definition, equal to the amount payable on demand at the reporting date (i.e. their carrying amounts). The carrying amounts for variable-rate, fixed-term money market accounts and certificates of deposit approximate their fair values at the reporting date. Fair values for fixed-rate certificates of deposit are estimated using a discounted cash flow calculation that applies interest rates currently being offered on certificates to a schedule of the aggregate expected monthly maturities on time deposits. The fair value of deposits is determined by the Company’s internal assets and liabilities modeling system that accounts for various inputs such as decay rates, rate floors, FHLB yield curve, maturities and current rates offered on new accounts. Fair value on deposits is considered a level 3 valuation.

Off-balance-sheet instruments — Fair values for the Bank’s off-balance-sheet lending commitments are based on fees currently charged to enter into similar agreements, taking into account the remaining terms of the agreements and the credit standing of the counterparties. The Company considers the Bank’s off balance sheet instruments to be a level 3 valuation.

The estimated fair values of the Company’s financial instruments not measured at fair value as of December 31, 2023 were as follows:

(in thousands)	Carrying Amount	Fair Value	Hierarchy Valuation Level
Financial assets:			
Cash and cash equivalents	\$ 216,568	\$ 216,568	1
Restricted equity securities	5,956	5,956	2
Loans, net	1,004,277	917,242	3
Interest receivable	8,386	8,386	2
Financial liabilities:			
Deposits	(1,650,534)	(1,649,808)	3
Interest payable	(128)	(128)	2
Off-balance-sheet assets (liabilities):			
Commitments and standby letters of credit		(1,863)	3

The estimated fair values of the Company’s financial instruments not measured at fair value as of December 31, 2022 were as follows:

(in thousands)	Carrying Amount	Fair Value	Hierarchy Valuation Level
Financial assets:			
Cash and cash equivalents	\$ 429,633	\$ 429,633	1
Restricted equity securities	5,236	5,236	2
Loans, net	905,035	853,224	3
Interest receivable	7,930	7,930	2
Financial liabilities:			
Deposits	(1,814,297)	(1,813,136)	3
Interest payable	(22)	(22)	2
Off-balance-sheet assets (liabilities):			
Commitments and standby letters of credit		(2,124)	3

[Table of Contents](#)

The following table presents the carrying value of recurring and nonrecurring financial instruments that were measured at fair value and that were still held in the consolidated balance sheets at each respective period end, by level within the fair value hierarchy as of December 31, 2023 and 2022.

(in thousands)

Fair Value Measurements at December 31, 2023 Using				
	December 31, 2023	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets and liabilities measured on a recurring basis:				
Available-for-sale securities:				
U.S. agencies	\$ 80,259	\$ 0	\$ 80,259	\$ 0
Collateralized mortgage obligations	8,664	0	8,664	0
Municipalities	328,908	0	328,908	0
SBA pools	1,395	0	1,395	0
Corporate debt	43,517	0	43,517	0
Asset backed securities	55,335	0	55,335	0
Equity Securities:				
Mutual fund	\$ 3,132	\$ 3,132	\$ 0	\$ 0
Assets and liabilities measured on a non-recurring basis:				
	N/A			

Fair Value Measurements at December 31, 2022 Using				
	December 31, 2022	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets and liabilities measured on a recurring basis:				
Available-for-sale securities:				
U.S. agencies	\$ 88,721	\$ 0	\$ 88,721	\$ 0
Collateralized mortgage obligations	4,611	0	4,611	0
Municipalities	331,581	0	331,581	0
SBA pools	2,362	0	2,362	0
Corporate debt	42,060	0	42,060	0
Asset backed securities	58,103	0	58,103	0
Equity Securities:				
Mutual fund	\$ 2,990	\$ 2,990	\$ 0	\$ 0
Assets and liabilities measured on a non-recurring basis:				
	N/A			

Available-for-sale and equity securities - Investment securities are recorded at fair value on a recurring basis. Fair value measurement is based upon quoted market prices, if available. If quoted market prices are not available, fair values are measured using independent pricing models or other model-based valuation techniques such as the present value of future cash flows, adjusted for the security's credit rating, prepayment assumptions, and other factors such as credit loss assumptions. Level 1 securities include those traded on an active exchange, such as the New York Stock Exchange, U.S. Treasury securities that are traded by dealers or brokers in active over-the-counter markets and money market funds. Level 2 securities include mortgage-backed securities issued by government sponsored entities, municipal bonds and corporate debt securities. Securities classified as Level 3 include asset-backed securities in less liquid markets where significant inputs are unobservable.

Loans Evaluated Individually - The Company does not record portfolio loans at fair value on a recurring basis. However, periodically, a loan is evaluated individually and is reported at the fair value of the underlying collateral, less estimated costs to sell, if repayment is expected solely from the collateral. If the collateral value is not sufficient, a specific reserve is recorded. Collateral values are estimated using a combination of observable inputs, including recent appraisals, and unobservable inputs based on customized discounting criteria. Due to the significance of unobservable inputs, fair values of individually evaluated collateral dependent loans have been classified as Level 3.

There have been no significant changes in the valuation techniques during the year ended December 31, 2023.

NOTE 15 — RELATED PARTY TRANSACTIONS

The Company, in the normal course of business, makes loans and receives deposits from its directors, officers, principal shareholders, and their associates. In management's opinion, these transactions are on substantially the same terms as comparable transactions with other customers of the Company. Loans to directors, officers, shareholders, and affiliates are summarized below:

(in thousands)	YEARS ENDED DECEMBER 31,	
	2023	2022
Aggregate amount outstanding, beginning of year	\$ 4,055	\$ 5,622
New loans or advances during year	9,061	10,066
Repayments during year	(2,070)	(11,633)
Aggregate amount outstanding, end of year	<u>\$ 11,046</u>	<u>\$ 4,055</u>

Related party deposits totaled \$10,533,000 and \$13,564,000 at December 31, 2023 and 2022, respectively.

From time to time, some of the Company's Directors, directly or through affiliates, may perform services for the Bank. These activities are performed in the ordinary course of the Bank's business and are subject to strict compliance with the policies outlined below. In 2023, the Company made payments totaling \$250,000 to Crown Painting and Design Studio 120, companies affiliated with a Director's daughter, for renovation and design work performed in connection with various projects and maintenance on the Bank's branches. In 2022, the Company made payments totaling \$782,000 to these same related party companies for similar services. Except for such payments, no other material services or activities were performed for purposes of Item 404(a) of Regulation S-K under the Exchange Act.

NOTE 16 — PROFIT SHARING PLAN

The profit sharing plan to which both the Company and eligible employees contribute was established in 1995. To be eligible, employees must complete six months of service and be 21 years of age or older. Bank contributions are voluntary and at the discretion of the Board of Directors. Contributions were approximately \$1,060,000 and \$921,000 for the years ended December 31, 2023 and 2022, respectively.

NOTE 17 — RESTRICTIONS ON DIVIDENDS

Under current California State banking laws, the Bank may not pay cash dividends in an amount that exceeds the lesser of retained earnings of the Bank or the Bank's net earnings for its last three fiscal years (less the amount of any distributions to shareholders made during that period). If the above requirements are not met, cash dividends may only be paid with the prior approval of the Commissioner of the Department of Financial Protection and Innovation, in an amount not exceeding the Bank's net earnings for its last fiscal year or the amount of its net earnings for its current fiscal year. Accordingly, the future payment of cash dividends will depend on the Bank's earnings and its ability to meet its capital requirements.

NOTE 18 — OTHER POST-RETIREMENT BENEFIT PLANS

Certain officers have entered into salary continuation agreements with the Company (the "Salary Continuation Agreements"). Under the Salary Continuation Agreements, the participants will be provided with a fixed annual retirement benefit for ten to twenty years after retirement. The Company is also responsible for certain pre-retirement death benefits under the Salary Continuation Agreements. In connection with the implementation of the Salary Continuation Agreements, the Company purchased single premium life insurance policies on the life of each of the officers covered under the Salary Continuation Agreements. The Company is the owner and partial beneficiary of these life insurance policies. The assets of the Salary Continuation Agreements, under Internal Revenue Service regulations, are owned by the Company and are available to satisfy the Company's general creditors. In connection with the purchase of the life insurance policies, the Company entered into split-dollar life insurance agreements with each of the insured officers, which pays the officers' beneficiaries a pre-determined death benefit amount as set forth in the agreement, with the remainder of the death benefit paid to the Company.

During December 2001, the Company adopted a director retirement plan ("DRP"). Under the DRP, the participants will be provided with a fixed annual retirement benefit for ten years after retirement. The Company is also responsible for certain pre-retirement death benefits under the DRP. In connection with the implementation of the DRP, the Company purchased single premium life insurance policies on the life of each director covered under the DRP. The Company is the owner and partial beneficiary of these life insurance policies. The assets of the DRP, under Internal Revenue Service regulations, are the property of the Company and are available to satisfy the Company's general creditors.

Future compensation under both types of arrangements is earned for services rendered through retirement. The Company accrues for the salary continuation liability based on anticipated years of service and vesting schedules provided under the arrangements. The Company's current benefit liability is determined based on vesting and the present value of the benefits at a corresponding discount rate. The discount rate used is an equivalent rate for investment-grade bonds with lives matching those of the service periods remaining for the salary continuation contracts, which average approximately ten years. At December 31, 2023 and 2022, \$5,808,000 and \$5,413,000, respectively, has been accrued to date, and is included in other liabilities on the consolidated balance sheets.

The combined cash surrender value of all Bank-owned life insurance policies was \$ 31,506,000 and \$30,218,000 at December 31, 2023 and 2022, respectively.

NOTE 19 — REGULATORY MATTERS

The Company is regulated by the FRB and is subject to the securities registration and public reporting regulations of the Securities and Exchange Commission. As a California state-chartered bank, the Company's banking subsidiary is subject to primary supervision, examination and regulation by the California Department of Financial Protection and Innovation (DFPI) and the Federal Reserve Board. The Federal Reserve Board is the primary federal regulator of state member banks. The Bank is also subject to regulation by the FDIC, which insures the Bank's deposits as permitted by law. Management is not aware of any recommendations of regulatory authorities or otherwise which, if they were to be implemented, would have a material effect on the Company's or Bank's liquidity, capital resources, or operations.

The U.S. Basel III rules contain capital standards regarding the composition of capital, minimum capital ratios and counter-party credit risk capital requirements. The Basel III rules also include a definition of common equity Tier 1 capital and require that certain levels of such common equity Tier 1 capital be maintained. The rules also include a capital conservation buffer, which imposes a common equity requirement above the new minimum that can be depleted under stress and could result in restrictions on capital distributions and discretionary bonuses under certain circumstances, as well as a new standardized approach for calculating risk-weighted assets. Under the Basel III rules, we must maintain a ratio of common equity Tier 1 capital to risk-weighted assets of at least 4.5%, a ratio of Tier 1 capital to risk-weighted assets of at least 6%, a ratio of total capital to risk-weighted assets of at least 8% and a minimum Tier 1 leverage ratio of 4.0%. In addition to the preceding requirements, all financial institutions subject to the Rules, including both the Company and the Bank, are required to establish a "conservation buffer," consisting of common equity Tier 1 capital, which is at least 2.5% above each of the preceding common equity Tier 1 capital ratio, the Tier 1 risk-based ratio and the total risk-based ratio. An institution that does not meet the conservation buffer will be subject to restrictions on certain activities including payment of dividends, stock repurchases and discretionary bonuses to executive officers. The conservation buffer became fully effective on January 1, 2019.

[Table of Contents](#)

Failure to meet minimum capital requirements can trigger regulatory actions that could have a material adverse effect on the Company's financial statements and operations. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Company and Bank must meet specific capital guidelines that rely on quantitative measures of assets, liabilities and certain off-balance-sheet items as calculated under regulatory accounting practices. The Company's and Bank's amounts and classification are also subject to qualitative judgments by the regulators about components, risk weightings, and other factors.

The Company and Bank's actual capital amounts and ratios at December 31, 2023 and 2022, are presented in the following table.

(in thousands)

	Actual		Regulatory Minimum	
	Amount	Ratio	Amount	Ratio
Capital ratios for Bank:				
As of December 31, 2023				
Total capital (to Risk- Weighted Assets)	\$ 193,005	14.7%	\$ 137,819	>10.5%
Tier I capital (to Risk- Weighted Assets)	\$ 181,500	13.8%	\$ 111,567	>8.5%
Common Equity Tier 1 Capital (to Risk Weighted Assets)	\$ 181,500	13.8%	\$ 91,879	>7.0%
Tier I capital (to Average Assets)	\$ 181,500	9.6%	\$ 75,303	>4.0%
As of December 31, 2022				
Total capital (to Risk- Weighted Assets)	\$ 163,593	12.4%	\$ 138,578	>10.5%
Tier I capital (to Risk- Weighted Assets)	\$ 153,579	11.6%	\$ 112,182	>8.5%
Common Equity Tier 1 Capital (to Risk Weighted Assets)	\$ 153,579	11.6%	\$ 92,386	>7.0%
Tier I capital (to Average Assets)	\$ 153,579	7.6%	\$ 81,286	>4.0%
Capital ratios for the Company:				
As of December 31, 2023				
Total capital (to Risk- Weighted Assets)	\$ 193,280	14.7%	\$ 137,835	>10.5%
Tier I capital (to Risk- Weighted Assets)	\$ 181,775	13.9%	\$ 111,851	>8.5%
Common Equity Tier 1 Capital (to Risk Weighted Assets)	\$ 181,775	13.9%	\$ 91,890	>7.0%
Tier I capital (to Average Assets)	\$ 181,775	9.7%	\$ 75,306	>4.0%
As of December 31, 2022				
Total capital (to Risk- Weighted Assets)	\$ 163,810	12.4%	\$ 138,584	>10.5%
Tier I capital (to Risk- Weighted Assets)	\$ 153,796	11.7%	\$ 112,187	>8.5%
Common Equity Tier 1 Capital (to Risk Weighted Assets)	\$ 153,796	11.7%	\$ 92,389	>7.0%
Tier I capital (to Average Assets)	\$ 153,796	7.6%	\$ 81,289	>4.0%

NOTE 20 – PARENT ONLY CONDENSED FINANCIAL STATEMENTS
CONDENSED BALANCE SHEETS

(dollars in thousands)

	December 31, 2023	December 31, 2022
ASSETS		
Cash	\$ 167	\$ 165
Investment in bank subsidiary	165,817	126,409
Other assets	153	53
Total assets	<u>\$ 166,137</u>	<u>\$ 126,627</u>
LIABILITIES AND SHAREHOLDERS' EQUITY		
Other liabilities	\$ 45	\$ 1
Total liabilities	<u>\$ 45</u>	<u>\$ 1</u>
Shareholders' equity		
Common stock, no par value; 50,000,000 shares authorized, 8,293,168 and 8,257,894 shares issued and outstanding at December 31, 2023 and 2022, respectively	25,435	25,435
Additional paid-in capital	5,512	5,190
Retained earnings	154,301	126,728
Accumulated other comprehensive loss, net of tax	(19,156)	(30,727)
Total shareholders' equity	<u>166,092</u>	<u>126,626</u>
Total liabilities and shareholders' equity	<u>\$ 166,137</u>	<u>\$ 126,627</u>

OAK VALLEY BANCORP
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**NOTE 20 – PARENT ONLY CONDENSED FINANCIAL STATEMENTS (CONTINUED)****CONDENSED STATEMENTS OF INCOME**

(dollars in thousands)	Year Ended December 31,	
	2023	2022
INCOME		
Dividends declared by subsidiary	\$ 2,896	\$ 2,724
Total income	2,896	2,724
EXPENSES		
Salary expense	146	136
Employee benefit expense	533	623
Legal expense	62	44
Other operating expenses	91	108
Total expenses	832	911
Income before equity in undistributed income of subsidiary	2,064	1,813
Equity in undistributed net income of subsidiary	28,465	20,826
Income before income tax benefit	30,529	22,639
Income tax benefit	319	263
Net income	<u>\$ 30,848</u>	<u>\$ 22,902</u>

OAK VALLEY BANCORP
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 20 – PARENT ONLY CONDENSED FINANCIAL STATEMENTS (CONTINUED)

CONDENSED STATEMENTS OF CASH FLOWS

(dollars in thousands)	YEAR ENDED DECEMBER 31,	
	2023	2022
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	\$ 30,848	\$ 22,902
Adjustments to reconcile net income to net cash from operating activities:		
Undistributed net income of subsidiary	(28,465)	(20,826)
Stock based compensation	533	623
Increase (decrease) in other liabilities	44	(1)
Increase in other assets	(101)	(8)
Net cash from operating activities	2,859	2,690
CASH FLOWS FROM FINANCING ACTIVITIES:		
Shareholder cash dividends paid	(2,896)	(2,724)
Inter-company dividend from bank subsidiary	250	250
Tax withholding payments on vested restricted shares surrendered	(211)	(121)
Net cash used in financing activities	(2,857)	(2,595)
NET INCREASE IN CASH AND CASH EQUIVALENTS	2	95
CASH AND CASH EQUIVALENTS, beginning of period	165	70
CASH AND CASH EQUIVALENTS, end of period	\$ 167	\$ 165
SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION:		
Cash paid during the year for income taxes	\$ 10,449	\$ 3,910

CONSENT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

We consent to the incorporation by reference in the Registration Statements (No. 333-158201 and 333-225950) on Form S-8 of Oak Valley Bancorp of our reports dated April 1, 2024, relating to the consolidated financial statements of Oak Valley Bancorp, appearing in this Annual Report on Form 10-K of Oak Valley Bancorp for the year ended December 31, 2023.

/s/ RSM US LLP

San Francisco, CA
April 1, 2024

CERTIFICATION PURSUANT TO RULE 13a-14(a)/15d-14(a) AS ADOPTED PURSUANT TO SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002

I, Christopher M. Courtney, Chief Executive Officer, certify that:

1. I have reviewed this annual report on Form 10-K of Oak Valley Bancorp (the Registrant);
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the Registrant as of, and for, the periods presented in this report;
4. The Registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the Registrant and have:
 - (a) designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the Registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - (b) designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - (c) evaluated the effectiveness of the Registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - (d) disclosed in this report any change in the Registrant's internal control over financial reporting that occurred during the Registrant's most recent fiscal quarter (the Registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the Registrant's internal control over financial reporting; and
5. The Registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the Registrant's auditors and the audit committee of Registrant's Board of Directors:
 - (a) all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting, which are reasonably likely to adversely affect the Registrant's ability to record, process, summarize and report financial information; and
 - (b) any fraud, whether or not material, that involves Management or other employees who have a significant role in the Registrant's internal control over financial reporting.

Dated: April 1, 2024

/s/ Christopher M. Courtney
Christopher M. Courtney
Chief Executive Officer

CERTIFICATION PURSUANT TO RULE 13a-14(a)/15d-14(a) AS ADOPTED PURSUANT TO SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002

I, Jeffrey A. Gall, Chief Financial Officer, certify that:

1. I have reviewed this annual report on Form 10-K of Oak Valley Bancorp (the Registrant);
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the Registrant as of, and for, the periods presented in this report;
4. The Registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the Registrant and have:
 - (a) designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the Registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - (b) designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - (c) evaluated the effectiveness of the Registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - (d) disclosed in this report any change in the Registrant's internal control over financial reporting that occurred during the Registrant's most recent fiscal quarter (the Registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the Registrant's internal control over financial reporting; and
5. The Registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the Registrant's auditors and the audit committee of Registrant's Board of Directors:
 - (a) all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting, which are reasonably likely to adversely affect the Registrant's ability to record, process, summarize and report financial information; and
 - (b) any fraud, whether or not material, that involves Management or other employees who have a significant role in the Registrant's internal control over financial reporting.

Dated: April 1, 2024

/s/ Jeffrey A. Gall
Jeffrey A. Gall
Chief Financial Officer

CERTIFICATION PURSUANT TO 18 U.S.C. SECTION 1350 AS ADOPTED PURSUANT TO SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the annual report on Form 10-K of Oak Valley Bancorp (the Registrant) for the year ended December 31, 2023, as filed with the Securities and Exchange Commission, the undersigned hereby certify pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

- 1) such Form 10-K fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- 2) the information contained in such Form 10-K fairly presents, in all material respects, the financial condition and results of operations of the Registrant.

Dated: April 1, 2024

/s/ Christopher M. Courtney
Christopher M. Courtney
Chief Executive Officer

Dated: April 1, 2024

/s/ Jeffrey A. Gall
Jeffrey A. Gall
Chief Financial Officer

This certification accompanies each report pursuant to section 906 of the Sarbanes Oxley Act of 2002 and shall not, except to the extent required by the Sarbanes Oxley Act of 2002, be deemed filed by the Registrant for purposes of section 18 of the Securities and Exchange Act of 1934, as amended.

**OAK VALLEY BANCORP
CLAWBACK POLICY**

The following clawback policy (the "Policy") of Oak Valley Bancorp, a California corporation, (the "Company") requires the recovery of erroneously awarded compensation in order to satisfy the requirements of Nasdaq Stock Market LLC ("Nasdaq") Listing Rule 5608 (the "Listing Standards") and to satisfy the requirements of Rule 10D-1 ("Rule 10D-1"), as adopted by the Securities and Exchange Commission (the "SEC") pursuant to the Securities Exchange Act of 1934 (the "Exchange Act") to implement Section 954 of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010.

Section 1. Definitions. As used in this Policy, the following definitions shall apply:

(a) "Applicable Period" means the three completed fiscal years prior to the earlier of (i) the date the Company's board of directors, a board committee, or officer(s) authorized to take such action if board action is not required, concludes, or reasonably should have concluded, that the Company is required to prepare a Restatement or (ii) the date a court, regulator, or other legally authorized body directs the Company to prepare a Restatement. In addition to the last three completed fiscal years described in the preceding sentence, the Applicable Period includes any transition period (that results from a change in the Company's fiscal year) within or immediately following those three completed fiscal years; provided, however, a transition period between the last day of the Company's previous fiscal year end and the first day of its new fiscal year that comprises a period of nine to 12 months would be deemed a completed fiscal year for purposes of the Applicable Period.

(b) "Committee" means the compensation committee of the Board of Directors of the Company.

(c) "Covered Executive" means all of the Company's current and former executive officers, as determined by the Committee, in accordance with the Listing Standards and Rule 10D-1 and the definition of executive officer as defined in Rule 10D-1(d).

(d) "Erroneously Awarded Compensation" means the amount of Incentive-Based Compensation received by a Covered Executive that exceeds the amount of Incentive-Based Compensation that otherwise would have been received had it been determined based on the restated financial statements.

(e) "Incentive-Based Compensation" means all compensation (including cash bonuses or other cash incentive awards (including any deferred element thereof), and vested and unvested equity awards, including options, restricted stock and restricted stock units, performance stock unit awards and performance stock awards) from the Company or a subsidiary of the Company that is granted, earned, or vested based wholly or in part upon the attainment of a Financial Reporting Measure. For the avoidance of doubt, Incentive-Based Compensation does not include annual salary, compensation awarded based on completion of a specified period of service, or compensation awarded based on subjective standards, strategic measures, or operational measures, unless also based on attainment of a Financial Reporting Measure.

(f) "Financial Reporting Measures" are measures that are determined and presented in accordance with the accounting principles used in preparing the Company's financial statements, and any measures that are derived wholly or in part from such measures, including stock price and total shareholder return.

(g) "Restatement" means an accounting restatement of the Company's financial statements due to material noncompliance with any financial reporting requirement under the federal securities laws, including any required accounting restatement to correct an error in previously issued financial statements that is material to the previously issued financial statements, or that would result in a material misstatement if the error were corrected in the current period or left uncorrected in the current period.

Section 2. Recovery Event If the Company is required to prepare a Restatement, then, as determined by the Committee, the Covered Executive's unsettled Incentive-Based Compensation will be subject to forfeiture, and the Covered Executive's settled Incentive-Based Compensation will be subject to recoupment, subject to the following:

(a) The forfeiture or recoupment of the Incentive-Based Compensation will apply to a recipient of Incentive-Based Compensation if the recipient of the Incentive-Based Compensation was a Covered Executive at any time during the performance period for such Incentive-Based Compensation. This Policy applies to Incentive-Based Compensation received by a Covered Executive after beginning services as a Covered Executive, and any subsequent changes in a Covered Executive's employment status, including retirement or termination of employment, do not affect the Company's rights to recover Erroneously Awarded Compensation pursuant to this Policy.

(b) The amount to be forfeited or recouped will equal the Erroneously Awarded Compensation. The Committee will take actions necessary to recover the Erroneously Awarded Compensation reasonably promptly following a Restatement. Where the amount of Erroneously Awarded Compensation is not subject to mathematical recalculation directly from the information the Restatement, the amount must be based on a reasonable estimate of the effect of the Restatement on stock price or total shareholder return upon which the Incentive-Based Compensation was granted, vested, paid or settled. The Company will maintain documentation of the determination of that reasonable estimate and provide such documentation to Nasdaq. The amount of the Erroneously Awarded Compensation shall not be reduced based on, or otherwise calculated with regard to, any taxes paid by the Covered Executive with respect to such amounts.

(c) This Policy shall only apply to Incentive-Based Compensation that was received (or would have been settled in the absence of an elective deferral of payment by the individual) during, or in respect of, the Applicable Period and that was received (or would have been settled in the absence of an elective deferral of payment by the individual) during the period while the Company has a class of securities listed on a national securities exchange or a national securities association. For purposes of this Policy, Incentive-Based Compensation shall be deemed to have been received during the fiscal period in which the financial reporting measure specified in the applicable Incentive-Based Compensation is attained, even if such Incentive-Based Compensation is paid or granted after the end of such fiscal period. The Company's obligation to recover erroneously awarded compensation is not dependent on if or when the restated financial statements are filed.

Section 3. Impracticability The Company shall recover any Erroneously Awarded Compensation unless the conditions set forth in clauses (a), (b) or (c) of the following sentence are met and such recovery would be impracticable, as determined by the Committee in accordance with Rule 10D-1 and the Listing Standards. No recovery shall be required if:

(a) the direct expense paid to a third party to assist in enforcing this Policy would exceed the amount to be recovered; *provided* that before concluding that it would be impractical to recover any amount of Erroneously Awarded Compensation based on this clause (i), the Company shall make a reasonable attempt to recover such Erroneously Awarded Compensation, document such reasonable attempt(s) and provide such documentation to Nasdaq;

(b) recovery would violate home country law where that law was adopted prior to November 28, 2022; *provided* that before concluding that it would be impractical to recover any amount of Erroneously Awarded Compensation based on this clause (ii), the Company shall obtain an opinion of home country counsel, acceptable to Nasdaq, that recovery would result in such violation, and shall provide such opinion to Nasdaq; or

(c) recovery would likely cause an otherwise tax-qualified retirement plan, under which benefits are broadly available to employees of the Company or a subsidiary, to fail to meet the requirements of Section 401(a)(13) or Section 411(a) of the Internal Revenue Code.

Section 4. Method of Clawback. The Committee shall determine, in its sole discretion, the method of recovering any Erroneously Awarded Compensation pursuant to this Policy, which may include, without limitation:

- (a) requiring reimbursement of cash Erroneously Awarded Compensation previously paid;
- (b) seeking recovery of any gain realized on the vesting, exercise, settlement, sale, transfer, or other disposition of any equity-based awards;
- (c) offsetting the recouped amount from any compensation otherwise owed by the Company or any subsidiary to the Covered Executive;
- (d) cancelling outstanding vested or unvested equity awards; and/or

(e) taking any other remedial and recovery action, as determined by the Committee; provided, however that any such action pursuant to subsections (a) through (e) shall be subject to applicable law and shall be subject to compliance with Section 409A of the Internal Revenue Code.

Section 5. Suspension of Outstanding Incentive-Based Compensation.

(a) After a determination by the Committee that a Restatement may have occurred, the Committee may suspend all Incentive-Based Compensation that the Committee determines may be forfeited under this Policy or otherwise subject to offset pursuant to Section 4, in which case and subject to the terms of this Section, Incentive-Based Compensation subject to the suspension: (i) if unvested, will not vest, and (ii) otherwise will not be distributed or permitted to be exercised or otherwise settled. In the event the term of an option award will expire during a period of suspension, the Covered Executive will be permitted to exercise the option before it expires; however settlement of the option award following such exercise will remain suspended and the securities otherwise deliverable upon settlement shall remain subject to forfeiture under the terms of this Policy.

(b) Following suspension of Incentive-Based Compensation under subsection (a) of this Section 5, the Committee will determine as promptly as practicable whether the suspended Incentive-Based Compensation is to be forfeited or whether the suspension of the Incentive-Based Compensation is to be ended. For Incentive-Based Compensation that are ultimately not forfeited, the following provisions will apply upon the Committee's determination to lift the suspension:

(i) Unvested awards that would not otherwise have vested during the suspension by their original terms will be thereafter subject to vesting under their original terms;

(ii) Unvested awards that otherwise would have vested during the suspension will vest as soon as practicable and otherwise consistent with their original terms;

(iii) Cash awards such as annual bonus withheld during the suspension will be immediately payable;

(iv) In no event will distribution of cash or shares be made to a Covered Executive with respect to Incentive-Based Compensation if, by reason of termination of employment or otherwise, the Covered Executive would have forfeited the Incentive-Based Compensation if the Incentive-Based Compensation had not been suspended; and

(v) Distribution or settlement of Incentive-Based Compensation will be made no later than the latest date on which such distribution or settlement would be required to avoid additional tax by reason of Section 409A of the Internal Revenue Code; provided, however, that if such distribution or settlement occurs during a period when such Incentive-Based Compensation remains suspended pursuant to this Section 5, then the after-tax proceeds of such distribution or settlement shall be held in escrow until such time as such Incentive-Based Compensation is no longer subject to a suspension or such amounts are determined to have been forfeited by the Committee.

Section 6. Committee Administration and Discretion. The authority to manage the operation and administration of this Policy is vested in the Committee. This authority includes the obligation to determine (i) whether a Restatement has occurred for the purposes of this Policy, Rule 10D-1 and the Listing Standards and (ii) the amount of Erroneously Awarded Compensation. The Committee may retain and rely upon the advice and determinations of legal counsel, accountants and other relevant experts to operate and administer this Policy. Any interpretation of this Policy by the Committee and any decision made by it with respect to this Policy will be final, binding and conclusive on all persons.

Section 7. No Indemnification. The Company shall not indemnify any current or former Covered Executive against the loss of Erroneously Awarded Compensation, and shall not pay, or reimburse any Covered Executives for premiums, for any insurance policy to fund such executive's potential repayment obligations.

Section 8. Notice. Before the Committee determines to seek recovery pursuant to this Policy, it shall provide the Covered Executive with written notice and the opportunity to be heard at a meeting of the Committee or the Board (either in person or via telephone).

Section 9. Effective Date. This Policy is effective as of October 17, 2023 (the "Effective Date"). The terms of this Policy shall apply to any Incentive-Based Compensation that is received by a Covered Executive on or after October 2, 2023, even if such Incentive-Based Compensation was approved, awarded or granted to the Covered Executive prior to October 2, 2023. Subject to applicable law, the Committee may effect forfeiture or recoupment under this Policy from any amount of compensation approved, awarded, granted, payable or paid to the Covered Executive prior to, on or after the Effective Date.

Section 10. Amendment and Interpretation. The Committee may amend this Policy from time to time in its discretion, and shall amend this Policy as it deems necessary, appropriate or advisable to reflect the regulations adopted by the SEC and to comply with any rules or standards adopted by a national securities exchange on which the Company's securities are then listed. The Committee is authorized to interpret and construe this Policy and to make all determinations necessary, appropriate, or advisable for the administration of this Policy. It is intended that this Policy be interpreted in a manner that is consistent with the requirements of Rule 10D-1 and any applicable rules or standards adopted by the SEC and any national securities exchange on which the Company's securities are then listed.

Section 11. Other Recoupment Rights. The Committee intends that this Policy will be applied to the fullest extent of the law. The Committee may require that any employment agreement, equity award agreement, or similar agreement entered into, amended or restated on or after the Effective Date shall, as a condition to the grant of any benefit thereunder, require a Covered Executive to agree to abide by the terms of this Policy and the application of this Policy to any award made prior to the Effective Date. Any right of recoupment under this Policy is in addition to, and not in lieu of, any other remedies or rights of recoupment that may be available to the Company pursuant to the terms of any other recoupment or recoupment policy, any similar policy in any employment agreement, equity award agreement, or similar agreement and any other legal remedies available to the Company.

Section 12. Successors. This Policy shall be binding and enforceable against all Covered Executives and their beneficiaries, heirs, executors, administrators or other legal representatives.

Section 13. Disclosure Obligations. The Company shall file all disclosures with respect to this Policy required by applicable SEC filings and rules.

Section 14. Entire Agreement. To the extent inconsistent with this Policy, this Policy supersedes all prior contracts, agreements and understandings, written or oral, with any Covered Executive. In the event any contract, agreement or understanding with any Covered Executive is inconsistent with the terms of this Policy, the terms of this Policy shall govern.

Acknowledgement

October 18, 2023

I acknowledge that I have received a copy of the Oak Valley Bancorp Clawback Policy (the "Policy") and agree to its application to me as a Covered Executive for all forms of Incentive-Based Compensation (IBC), as defined in the Policy. I understand that my receipt of grants of equity or IBC on or after the effective date of the Policy is conditioned on my agreement to the terms of the Policy.

I also agree that the Policy, as it may be amended from time to time, applies to my IBC, regardless of whether it is granted on, before, or after the date on which this Policy was adopted by the Company or the date that I sign this acknowledgement letter. The Policy supersedes any prior contract or agreement with the Company, and in the event any such contract or agreement is inconsistent with the Policy, the terms of the Policy shall govern.

I further agree and acknowledge that the IBC subject to the Policy are voluntary programs, that I have chosen to accept such IBC understanding that such IBC are subject to forfeiture and recoupment as set forth in the Policy, and I specifically agree to such forfeiture and recoupment. If I elect not to accept any future IBC subject to the Policy or to otherwise agree to the terms of the Policy, I agree to notify Human Resources in writing within 10 days after receiving notice of a grant of IBC that I am rejecting such grant.

Signed Digitally by each Executive Officer