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

FORM 10-Q

☒ **QUARTERLY REPORT PURSUANT TO SECTION 13 OF 15(d) OR THE SECURITIES EXCHANGE ACT OF 1934**

For the quarterly period ended September 30, 2023

OR

☐ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

Commission File Number 001-39242

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

California **(State or other jurisdiction of incorporation or organization)**	**82-1751097** **(I.R.S. Employer Identification No.)**

1300 Clay Street, Suite 500
Oakland, California 94612
(Address of principal executive offices)

(510) 457-3737
(Registrant's telephone number, including area code)

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

Common Stock, No Par Value **(Title of class)**	**CALB** **(Trading Symbol)**	**NASDAQ Global Select Market** **(Name of exchange on which registered)**

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 the 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 is a shell company (as defined in Rule 12b-2 of the Act).

YES ☐ NO ☒

Number of shares outstanding of the registrant's common stock as of November 1, 2023: 8,394,962

CALIFORNIA BANCORP
INDEX TO QUARTERLY REPORT ON FORM 10-Q
FOR THE QUARTER ENDED SEPTEMBER 30, 2023

PART 1 – FINANCIAL INFORMATION

Item 1. Financial Statements

CALIFORNIA BANCORP
CONSOLIDATED STATEMENTS OF FINANCIAL CONDITION (UNAUDITED)
(Dollar amounts in thousands)

	September 30, 2023	December 31, 2022
ASSETS:		
Cash and due from banks	$ 17,128	$ 16,686
Federal funds sold	181,854	215,696
Total cash and cash equivalents	198,982	232,382
Investment securities:		
Available for sale, at fair value	44,227	47,012
Held to maturity, at amortized cost, net of allowance for credit losses of $ 81 and $0 at September 30, 2023 and December 31, 2022, respectively	105,017	108,866
Total investment securities	149,244	155,878
Loans, net of allowance for credit losses of $ 15,921 and $17,005 at September 30, 2023 and December 31, 2022, respectively	1,558,506	1,578,456
Premises and equipment, net	2,432	3,072
Bank owned life insurance (BOLI)	25,697	25,127
Goodwill and other intangible assets	7,442	7,472
Accrued interest receivable and other assets	41,614	39,828
Total assets	$ 1,983,917	$ 2,042,215
LIABILITIES AND SHAREHOLDERS' EQUITY:		
Deposits		
Non-interest bearing	$ 686,723	$ 811,671
Interest bearing	1,020,358	980,069
Total deposits	1,707,081	1,791,740
Junior subordinated debt securities	54,256	54,152
Accrued interest payable and other liabilities	32,465	24,069
Total liabilities	1,793,802	1,869,961
Commitments and Contingencies (Note 5)		
Shareholders' equity		
Common stock, no par value; 40,000,000 shares authorized; 8,395,483 and 8,332,479 issued and outstanding at September 30, 2023 and December 31, 2022, respectively	112,656	111,257
Retained earnings	78,824	62,297
Accumulated other comprehensive loss, net of taxes	(1,365)	(1,300)
Total shareholders' equity	190,115	172,254
Total liabilities and shareholders' equity	$ 1,983,917	$ 2,042,215

The accompanying notes are an integral part of these unaudited consolidated financial statements.

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CALIFORNIA BANCORP
CONSOLIDATED STATEMENTS OF INCOME (UNAUDITED)
(Dollar amounts in thousands, except per share data)

	Three Months Ended September 30, 2023	Three Months Ended September 30, 2022	Nine Months Ended September 30, 2023	Nine Months Ended September 30, 2022
Interest income				
Loans	$ 23,804	$ 19,084	$ 69,752	$ 50,268
Federal funds sold	2,814	867	6,811	1,283
Investment securities	1,476	1,217	4,241	3,247
Total interest income	28,094	21,168	80,804	54,798
Interest expense				
Deposits	8,961	1,672	22,476	3,274
Borrowings and subordinated debt	555	1,133	2,348	2,412
Total interest expense	9,516	2,805	24,824	5,686
Net interest income	18,578	18,363	55,980	49,112
Provision for credit losses	314	800	1,116	2,675
Net interest income after provision for credit losses	18,264	17,563	54,864	46,437
Non-interest income				
Service charges and other fees	1,003	1,237	2,733	3,260
Gain on the sale of loans	—	—	—	1,393
Other	291	247	803	759
Total non-interest income	1,294	1,484	3,536	5,412
Non-interest expense				
Salaries and benefits	8,238	7,415	23,945	21,654
Premises and equipment	1,155	1,275	3,503	3,844
Professional fees	411	524	1,332	1,662
Data processing	633	744	1,942	1,951
Other	1,414	1,259	4,575	3,841
Total non-interest expense	11,851	11,217	35,297	32,952
Income before provision for income taxes	7,707	7,830	23,103	18,897
Provision for income taxes	2,306	2,308	6,812	5,458
Net income	$ 5,401	$ 5,522	$ 16,291	$ 13,439
Earnings per common share				
Basic	$ 0.64	$ 0.66	$ 1.95	$ 1.62
Diluted	$ 0.64	$ 0.66	$ 1.93	$ 1.60
Average common shares outstanding	8,390,138	8,322,529	8,366,584	8,298,269
Average common and equivalent shares outstanding	8,455,917	8,405,669	8,438,444	8,394,439

The accompanying notes are an integral part of these unaudited consolidated financial statements.

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CALIFORNIA BANCORP
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (UNAUDITED)
(Dollar amounts in thousands)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2023	2022	2023	2022
Net Income	$ 5,401	$ 5,522	$ 16,291	$ 13,439
Other comprehensive income (loss)				
Unrealized gains (losses) on securities available for sale, net	(10)	(1,006)	2	(1,788)
Unrealized losses on securities transferred from available for sale to held to maturity, net	—	—	—	(281)
Reclassification adjustment for securities transferred from available for sale to held to maturity in prior year, net	—	—	(61)	—
Amortization of unrealized losses on securities transferred from available for sale to held to maturity, net	(3)	2	(4)	6
Tax effect	3	299	(2)	615
Total other comprehensive loss	(10)	(705)	(65)	(1,448)
Total comprehensive income	$ 5,391	$ 4,817	$ 16,226	$ 11,991

The accompanying notes are an integral part of these unaudited consolidated financial statements.

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CALIFORNIA BANCORP
CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY (UNAUDITED) - PART I
(Dollars in thousands)

	Common Stock		Retained	Accumulated Other Comprehensive Income	Total Shareholders'
	Shares	Amount	Earnings	(Loss)	Equity
Balance at December 31, 2022	8,332,479	$111,257	$62,297	$ (1,300)	$ 172,254
Adoption of new accounting standard	—	—	334	—	334
Stock awards issued and related compensation expense	34,560	631	—	—	631
Shares withheld to pay taxes on stock based compensation	(12,139)	(285)	—	—	(285)
Stock options exercised	478	6	—	—	6
Net income	—	—	5,451	—	5,451
Other comprehensive income	—	—	—	170	170
Balance at March 31, 2023	8,355,378	$111,609	$68,082	$ (1,130)	$ 178,561
Adoption of new accounting standard	—	—	(99)	—	(99)
Stock awards issued and related compensation expense	32,558	611	—	—	611
Shares withheld to pay taxes on stock based compensation	(4,164)	(53)	—	—	(53)
Net income	—	—	5,440	—	5,440
Other comprehensive loss	—	—	—	(225)	(225)
Balance at June 30, 2023	8,383,772	$112,167	$73,423	$ (1,355)	$ 184,235
Stock awards issued and related compensation expense	14,201	538	—	—	538
Shares withheld to pay taxes on stock based compensation	(3,015)	(56)	—	—	(56)
Stock options exercised	525	7	—	—	7
Net income	—	—	5,401	—	5,401
Other comprehensive loss	—	—	—	(10)	(10)
Balance at September 30, 2023	8,395,483	$112,656	$78,824	$ (1,365)	$ 190,115

The accompanying notes are an integral part of these unaudited consolidated financial statements.

CALIFORNIA BANCORP
CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS’ EQUITY (UNAUDITED) - PART II
(Dollars in thousands)

	Common Stock		Retained	Accumulated Other Comprehensive Income	Total Shareholders’
	Shares	Amount	Earnings	(Loss)	Equity
Balance at December 31, 2021	8,264,300	$109,473	$41,189	$ 92	$ 150,754
Stock awards issued and related compensation expense	11,513	494	—	—	494
Shares withheld to pay taxes on stock based compensation	(7,459)	(173)	—	—	(173)
Stock options exercised	4,200	55	—	—	55
Shares withheld to pay exercise price on stock options	(1,653)	(34)	—	—	(34)
Net income	—	—	3,673	—	3,673
Other comprehensive loss	—	—	—	(198)	(198)
Balance at March 31, 2022	8,270,901	$109,815	$44,862	$ (106)	$ 154,571
Stock awards issued and related compensation expense	43,855	539	—	—	539
Shares withheld to pay taxes on stock based compensation	(3,153)	(65)	—	—	(65)
Stock options exercised	7,350	42	—	—	42
Shares withheld to pay exercise price on stock options	(1,792)	(42)	—	—	(42)
Net income	—	—	4,244	—	4,244
Other comprehensive loss	—	—	—	(545)	(545)
Balance at June 30, 2022	8,317,161	$110,289	$49,106	$ (651)	$ 158,744
Stock awards issued and related compensation expense	14,314	586	—	—	586
Shares withheld to pay taxes on stock based compensation	(3,694)	(89)	—	—	(89)
Net income	—	—	5,522	—	5,522
Other comprehensive loss	—	—	—	(705)	(705)
Balance at September 30, 2022	8,327,781	$110,786	$54,628	$ (1,356)	$ 164,058

The accompanying notes are an integral part of these unaudited consolidated financial statements.

CALIFORNIA BANCORP
CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)
(Dollar amounts in thousands)

	Nine Months Ended September 30, 2023	Nine Months Ended September 30, 2022
Cash flows from operating activities:		
Net income	$ 16,291	$ 13,439
Adjustments to reconcile net income to net cash provided by (used for) operating activities:		
Provision for credit losses	1,116	2,675
Provision for deferred taxes	(206)	(1,383)
Depreciation	718	1,168
Deferred loan fees (costs), net	728	(182)
Stock based compensation, net	1,386	1,292
Increase in cash surrender value of life insurance	(528)	(497)
Discount on retained portion of sold loans, net	(27)	(27)
Gain on sale of loans	—	(1,393)
Net changes in accrued interest receivable and other assets	(1,938)	1,954
Net changes in accrued interest payable and other liabilities	8,450	(1,894)
Net cash provided by operating activities	25,990	15,152
Cash flows from investing activities:		
Purchase of investment securities	—	(78,780)
Proceeds from principal payments on investment securities	6,156	21,859
Proceeds from sale of loans	—	37,271
Net decrease (increase) in loans	20,164	(247,304)
Capital calls on low income tax credit investments	(273)	(438)
(Purchase) redemption of Federal Home Loan Bank stock	(675)	455
Purchase of premises and equipment	(74)	(145)
Purchase of bank-owned life insurance policies	(42)	(46)
Net cash provided by (used for) investing activities	25,256	(267,128)
Cash flows from financing activities:		
Net (decrease) increase in customer deposits	(84,659)	28,940
Paydown of long term borrowing, net	—	(56,387)
Proceeds from short term and overnight borrowings, net	—	50,000
Proceeds from exercised stock options, net	13	21
Net cash (used for) provided by financing activities	(84,646)	22,574
Decrease in cash and cash equivalents	(33,400)	(229,402)
Cash and cash equivalents, beginning of period	232,382	470,456
Cash and cash equivalents, end of period	$ 198,982	$ 241,054
Supplemental disclosure of cash flow information:		
Securities transferred from available for sale to the held to maturity classification	$ —	$ 49,889
Recording of right to use assets and operating lease liabilities	$ 6,127	$ —
Cash paid during the year for:		
Interest	$ 22,502	$ 6,089
Income taxes	$ —	$ 5,303

The accompanying notes are an integral part of these unaudited consolidated financial statements.

CALIFORNIA BANCORP

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

1. NATURE OF OPERATIONS

Organization

California BanCorp (the “Company”), a California corporation headquartered in Oakland, California, is the bank holding company for its wholly-owned subsidiary California Bank of Commerce (the “Bank”), which offers a broad range of commercial banking services to closely held businesses and professionals located throughout Northern California. The Bank has a full-service branch located in Contra Costa County and 4 loan production offices located in Alameda County, Contra Costa County, Sacramento County, and Santa Clara County.

Basis of Presentation

The accompanying unaudited consolidated financial statements have been prepared in accordance with the instructions to Form 10-Q and, therefore, do not include all footnotes as would be necessary for a fair presentation of financial position, results of operations and comprehensive income, changes in shareholders’ equity and cash flows in conformity with accounting principles generally accepted in the United States of America (“GAAP”). However, these interim unaudited consolidated financial statements reflect all adjustments (consisting solely of normal recurring adjustments and accruals) which, in the opinion of management, are necessary for a fair presentation of financial position, results of operations and comprehensive income, changes in shareholders’ equity and cash flows for the interim periods presented. These unaudited consolidated financial statements have been prepared on a basis consistent with, and should be read in conjunction with, the audited consolidated financial statements as of and for the year ended December 31, 2022, and the notes thereto, included in the Company’s Annual Report on Form 10-K for the year ended December 31, 2022 filed with the Securities and Exchange Commission (the “SEC”), under the Securities and Exchange Act of 1934, as amended (the “Exchange Act”). The unaudited consolidated financial statements include the accounts of the Company and its subsidiaries. All intercompany accounts and transactions have been eliminated.

The results of operations for the three and nine months ended September 30, 2023 are not necessarily indicative of the results of operations that may be expected for any other interim period or for the year ending December 31, 2023.

The Company’s accounting and reporting policies conform to GAAP and to general practices within the banking industry.

Use of Estimates

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statements, and the reported amounts of revenues and expenses during the reporting periods presented. Actual results may differ from those estimates used in the Consolidated Financial Statements and related notes. Material estimates that are particularly susceptible to significant changes in the near term include estimates relating to: the determination of the allowance for credit losses; certain assets and liabilities carried at fair value; and accounting for income taxes.

Reclassifications

Certain prior balances in the unaudited consolidated financial statements may have been reclassified to conform to current year presentation. These reclassifications had no effect on prior year net income or shareholders’ equity.

Subsequent Events

Management has reviewed all events through the date the unaudited consolidated financial statements were filed with the SEC and concluded that no event required any adjustment to the balances presented.

Goodwill

Goodwill impairment exists when a reporting unit's carrying value exceeds its fair value, which is determined through a qualitative assessment whether it is more likely than not that the fair value of equity of the reporting unit exceeds the carrying value ("Step Zero").

The Company completed an interim impairment analysis of goodwill as of September 30, 2023 and determined there was no impairment.

Earnings Per Share ("EPS")

Basic earnings per common share represents the amount of earnings for the period available to each share of common stock outstanding during the reporting period. Basic EPS is computed based upon net income divided by the weighted average number of common shares outstanding during the period. In determining the weighted average number of shares outstanding, vested restricted stock units are included. Diluted EPS represents the amount of earnings for the period available to each share of common stock outstanding including common stock that would have been outstanding assuming the issuance of common shares for all dilutive potential common shares outstanding during each reporting period. Diluted EPS is computed based upon net income divided by the weighted average number of common shares outstanding during each period, adjusted for the effect of dilutive potential common shares, such as restricted stock awards and units, calculated using the treasury stock method.

	Three months ended September 30,		Nine months ended September 30,	
(Dollars in thousands, except per share data)	2023	2022	2023	2022
Net income available to common shareholders	$ 5,401	$ 5,522	$ 16,291	$ 13,439
Weighted average basic common shares outstanding	8,390,138	8,322,529	8,366,584	8,298,269
Add: dilutive potential common shares	65,779	83,140	71,860	96,170
Weighted average diluted common shares outstanding	8,455,917	8,405,669	8,438,444	8,394,439
Basic earnings per share	$ 0.64	$ 0.66	$ 1.95	$ 1.62
Diluted earnings per share	$ 0.64	$ 0.66	$ 1.93	$ 1.60

Adoption of New Accounting Standards and Related Accounting Policies

On January 1, 2023, the Company adopted ***ASU 2022-02, Financial Instruments—Credit Losses (Topic 326)***. The amendments in this update eliminate the accounting guidance and related disclosures for Troubled Debt Restructurings (TDRs) by creditors in Subtopic 310-40, Receivables—Troubled Debt Restructurings by Creditors, while enhancing disclosure requirements for certain loan refinancings and restructurings by creditors when a borrower is experiencing financial difficulty and requiring an entity to disclose current-period gross write-offs by year of origination for financing receivables and net investments in leases within the scope of Subtopic 326-20, Financial Instruments—Credit Losses—Measured at Amortized Cost. The adoption of this accounting guidance did not have a material impact on the Company's Consolidated Financial Statements.

On January 1, 2023, the Company adopted ***ASU 2016-13 Financial Instruments – Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments (ASC 326)***. This standard replaced the incurred loss methodology with an expected loss methodology that is referred to as the current expected credit loss ("CECL") methodology. CECL requires an estimate of credit losses for the remaining estimated life of the financial asset using historical experience, current conditions, and reasonable and supportable forecasts and generally applies to financial assets measured at amortized cost, including loan receivables and held-to-maturity debt securities, and some off-balance sheet credit exposures such as unfunded commitments to extend credit. Financial assets measured at amortized cost will be presented at the net amount expected to be collected by using an allowance for credit losses ("ACL").

The Company adopted ASC 326, and all related subsequent amendments thereto, using the modified retrospective approach for all financial assets measured at amortized cost and off-balance sheet credit exposures. The transition adjustment of the adoption of CECL included a decrease in the allowance for credit losses on loans of $1.8 million, which is presented as a reduction to net loans outstanding, and an increase in the allowance for credit losses on unfunded loan commitments of $1.4 million, which is recorded within other liabilities. Additionally, the Company recorded an allowance for credit losses for held to maturity securities of $110,000, which is presented as a reduction to held to maturity securities outstanding. The Company recorded a net increase to retained earnings of $334,000 as of January 1, 2023 for the cumulative effect of adopting CECL, which reflects the transition adjustments noted above. Results for reporting periods beginning after January 1, 2023 are presented under CECL while prior period amounts continue to be reported in accordance with previously applicable accounting standards ("Incurred Loss").

The following accounting policies have been updated/implemented in connection with the adoption of CECL and should be read in conjunction with the significant accounting policies contained in our 2022 Form 10-K filed on March 24, 2023.

- *Allowance for Credit Losses on Loans*

  The ACL on loans represents the Company's estimate of expected lifetime credit losses for its loans at the time of origination or acquisition and is maintained at a level deemed appropriate by management to provide for expected lifetime credit losses in the portfolio as of the date of the consolidated statements of financial condition. The ACL on loans is a valuation account that is deducted from the amortized cost basis of loans to present the net amount expected to be collected. Amortized cost does not include accrued interest, which management elected to exclude for the estimate of expected credit losses. The ACL on loans is increased by the provision for credit losses on loans, which is charged against current period operating results, and decreased by reversals of credit loss provisions as well as loan charge-offs, net of recoveries.

  Management's determination of the ACL on loans is based on an evaluation of the composition of the loan portfolio, current economic conditions, historical loan loss experience, reasonable and supportable forecasts, and other risk factors. Loans with similar risk characteristics are collectively assessed within pools (or segments).

  The discounted cash flow ("DCF") method is the primary credit loss estimation methodology used by the Company and involves estimating future cash flows for each individual loan and discounting them back to their present value using the loan's contractual interest rate, which is adjusted for any net deferred fees, costs, premiums, or discounts existing at the loan's origination or acquisition date (also referred to as the effective interest rate). The DCF method also considers factors such as loan term, prepayment or curtailment assumptions, and other relevant economic factors that could affect future cash flows. By discounting the cash flows, the method incorporates the time value of money and reflects the credit risk inherent in the loan.

  The Company utilizes a forecast period of one year and then reverts to the mean of historical loss rates on a straight-line basis over the following one-year period. The Company considers economic forecasts of national gross domestic product, unemployment rates from the Federal Open Market Committee, and the House Price Index to inform the model for loss estimation. Historical loss rates used in the quantitative model were derived using both the Bank's and peer bank data obtained from publicly-available sources.

  Additionally, management considers qualitative and environmental factors that are likely to cause estimated credit losses within the Company's existing portfolio to differ from historical loss (or peer) experience. Qualitative and environmental factors may include: consideration in trends of delinquencies, nonaccrual loans, and charged-off loans; trends in underlying collateral; effects in changes of lending policy and underwriting; regional and local economic trends; and conditions and concentrations of credit.

- *Allowance for Credit Losses on Off-Balance Sheet Credit Exposures*

  The Company maintains an ACL on unfunded loan commitments and other off-balance sheet credit exposures, if applicable, as part of other liabilities and accrued expenses in the consolidated statements of financial condition. Adjustments to the ACL on off-balance sheet credit exposures are made through a charge to provision for credit losses in the Company's consolidated statements of income. The ACL on unfunded loan commitments is estimated by loan segment at each balance sheet date under the current expected credit loss model using the same methodologies as portfolio loans, taking into consideration the likelihood that funding will occur as well as any third-party guarantees.

- *Allowance for Credit Losses on Available for Sale Securities*

  For available for sale securities in an unrealized loss position, the Company initially assesses whether it intends to sell, or it is more likely than not that it will be required to sell, the security before recovery of its amortized cost basis. If either of the criteria regarding intent or requirement to sell is met, the security's amortized cost is written down to fair value through income. For available for sale securities that do not meet this criteria, the Company evaluates whether the decline in fair value has resulted from credit losses or other factors. If a credit loss exists an allowance for credit losses is recorded, through a charge to the provision to credit losses, to the extent that the fair value is less than the amortized cost basis. Accrued interest receivable on available for sale securities is excluded from the estimate of credit losses. The Company did not have any available for sale securities that required an ACL at September 30, 2023.

- *Allowance for Credit Losses on Held to Maturity Securities*

  The Company measures expected credit losses on held to maturity investment securities on a collective basis by major security type. Accrued interest receivable on held to maturity investment securities is excluded from the estimate of credit losses. The estimate of expected credit losses considers historical credit loss information that is adjusted for current conditions and reasonable and supportable forecasts. Changes in the ACL for held to maturity securities are recorded through the provision for credit losses in the consolidated statements of income.

2. INVESTMENT SECURITIES

The following table summarizes the amortized cost and estimated fair value of securities available for sale and held to maturity at September 30, 2023 and December 31, 2022.

(Dollars in thousands)	Amortized Cost	Gross Unrealized / Unrecognized Gains	Gross Unrealized / Unrecognized Losses	Estimated Fair Value
At September 30, 2023:				
Mortgage backed securities	$ 16,193	$ 7	$ (1,025)	$ 15,175
Government agencies	29,888	—	(836)	29,052
Total available for sale securities	$ 46,081	$ 7	$ (1,861)	$ 44,227
Mortgage backed securities	$ 57,873	$ —	$ (8,663)	$ 49,210
Government agencies	3,075	—	(672)	2,403
Corporate bonds	44,069	—	(4,810)	39,259
Total held to maturity securities, net	$105,017	$ —	$ (14,145)	$ 90,872
At December 31, 2022:				
Mortgage backed securities	$ 18,629	$ 26	$ (897)	$ 17,758
Government agencies	29,809	—	(1,043)	28,766
Corporate bonds	430	58	—	488
Total available for sale securities	$ 48,868	$ 84	$ (1,940)	$ 47,012
Mortgage backed securities	$ 61,363	$ —	$ (7,647)	$ 53,716
Government agencies	3,083	—	(627)	2,456
Corporate bonds	44,420	30	(3,739)	40,711
Total held to maturity securities	$108,866	$ 30	$ (12,013)	$ 96,883

The Company did not purchase any investment securities during the nine months ended September 30, 2023. The Company purchased 8 available for sale securities for $36.0 million and 11 held to maturity securities for $ 42.8 million during the nine months ended September 30, 2022. The Company did not sell any investment securities during the nine months ended September 30, 2023 and 2022.

The following table summarizes the scheduled maturities of our available for sale and held to maturity investment securities as of September 30, 2023.

	Available for Sale		Held to Maturity	
(Dollars in thousands)	Amortized Cost	Fair Value	Amortized Cost	Fair Value
Less that one year	$ 21,693	$ 21,345	$ 15,562	$ 15,322
One to five years	14,919	14,351	19,971	19,554
Five to ten years	—	—	19,647	16,279
Beyond ten years	1,533	1,407	20,444	15,378
Securities not due at a single maturity date	7,936	7,124	29,393	24,339
Total investment securities	$ 46,081	$ 44,227	$ 105,017	$ 90,872

The amortized cost and fair value of debt securities are shown by contractual maturity. Expected maturities may differ from contractual maturities if borrowers have the right to call or prepay obligations with or without call or prepayment penalties. As such, certain securities are not included in the specific maturity categories above and instead are shown separately as securities not due at a single maturity date.

Management monitors the credit quality of the investment portfolio through the use of credit ratings by major credit agencies and analysis of issuer financial information, if available. Additionally, securities issued by government-sponsored agencies, such as FNMA, FHLMC and SBA, have explicit credit guarantees by the United States Federal Government which protect us from credit losses on the contractual cash flows of the securities. The following table reflects the amortized cost and fair value of available for sale and held to maturity securities as of September 30, 2023, aggregated by credit quality indicators.

	Available for Sale		Held to Maturity	
(Dollars in thousands)	Amortized Cost	Fair Value	Amortized Cost	Fair Value
Aaa	$ 29,888	$ 29,052	$ 11,519	$ 8,861
Aa1/Aa2/Aa3	—	—	3,075	2,403
A1/A2	—	—	7,971	6,429
BBB	—	—	1,588	1,209
Not rated	16,193	15,175	80,864	71,970
Total investment securities	$ 46,081	$ 44,227	$ 105,017	$ 90,872

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At September 30, 2023 and December 31, 2022, the Company had 54 securities in an unrealized loss position. The following table summarizes the unrealized losses for those investment securities, at the respective reporting dates, aggregated by major security type and length of time in a continuous unrealized loss position.

	Less Than 12 Months		More Than 12 Months		Total	
(Dollars in thousands)	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
At September 30, 2023:						
Mortgage backed securities	$ —	$ —	$ 13,320	$ (1,025)	$ 13,320	$ (1,025)
Government agencies	—	—	29,052	(836)	29,052	(836)
Total available for sale securities	$ —	$ —	$ 42,372	$ (1,861)	$ 42,372	$ (1,861)
Mortgage backed securities	$ —	$ —	$ 49,210	$ (8,663)	$ 49,210	$ (8,663)
Government agencies	—	—	2,403	(672)	2,403	(672)
Corporate bonds	7,661	(19)	31,598	(4,791)	39,259	(4,810)
Total held to maturity securities	$ 7,661	$ (19)	$ 83,211	$ (14,126)	$ 90,872	$ (14,145)
At December 31, 2022:						
Mortgage backed securities	$ 10,920	$ (537)	$ 4,347	$ (360)	$ 15,267	$ (897)
Government agencies	28,765	(1,043)	—	—	28,765	(1,043)
Total available for sale securities	$ 39,685	$ (1,580)	$ 4,347	$ (360)	$ 44,032	$ (1,940)
Mortgage backed securities	$ 32,271	$ (5,244)	$ 21,445	$ (2,403)	$ 53,716	$ (7,647)
Government agencies	—	—	2,456	(627)	2,456	(627)
Corporate bonds	14,607	(1,143)	22,880	(2,596)	37,487	(3,739)
Total held to maturity securities	$ 46,878	$ (6,387)	$ 46,781	$ (5,626)	$ 93,659	$ (12,013)

At September 30, 2023, management determined that it did not intend to sell any available for sale investment securities with unrealized losses, and it is unlikely that the Company will be required to sell any of those securities with unrealized losses before recovery of their amortized cost. No allowances for credit losses have been recognized, individually or collectively, on available for sale securities in an unrealized loss position, as management does not believe any of the securities are impaired due to reasons of credit quality at September 30, 2023.

The Company measures expected credit losses on held to maturity securities collectively by major security type sharing similar risk characteristics, and considers historical credit loss information that is adjusted for current conditions along with reasonable and supportable forecasts. As of September 30, 2023, the Company determined that an allowance for credit losses of $81,000 was required for held to maturity securities. The allowance for credit losses pertained to corporate bonds and was presented as a reduction to the amortized cost of held to maturity securities outstanding.

The following table presents the balance and activity in the allowance for credit losses on held to maturity securities for the three and nine months ended September 30, 2023.

	September 30, 2023	
(Dollars in thousands)	Three Months Ended	Nine Months Ended
Beginning balance	$ 58	$ —
Adoption of new accounting standard	—	110
Provision for credit losses	23	(29)
Net charge-offs	—	—
Balance at September 30, 2023	$ 81	$ 81

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On a quarterly basis, the Company utilizes a comprehensive risk assessment which includes an external rating methodology to identify, measure, and monitor risks associated with our held to maturity loan portfolio. The provision for credit losses in the third quarter of 2023 was primarily driven by an increase in the risk of default pertaining to certain securities in the held to maturity portfolio, and was identified as part of the comprehensive quarterly analysis.

3. LOANS AND ALLOWANCE FOR CREDIT LOSSES

Outstanding loans as of September 30, 2023 and December 31, 2022 are summarized below. Certain loans have been pledged to secure borrowing arrangements (see Note 4).

(Dollars in thousands)	September 30, 2023	December 31, 2022
Commercial and industrial	$ 633,902	$ 634,535
Real estate - other	858,611	848,241
Real estate - construction and land	40,003	63,730
SBA	4,415	7,220
Other	36,184	39,695
Total loans, gross	1,573,115	1,593,421
Deferred loan origination costs, net	1,312	2,040
Allowance for credit losses	(15,921)	(17,005)
Total loans, net	$ 1,558,506	$ 1,578,456

The Company categorizes its loan portfolio into risk categories based on relevant information about the ability of borrowers to service their debt such as: current financial information, historical payment experience, credit documentation, public information, and current economic trends, among other factors. The Company analyzes loans individually to classify the loans as to credit risk. The Company uses the following definitions for risk ratings:

Special Mention: A Special Mention credit has potential weaknesses that require management’s close attention. If left uncorrected, these potential weaknesses may result in the deterioration of the repayment prospects for the asset or in the Company’s credit position at some future date. Special Mention assets are not adversely classified and do not expose the Company to sufficient risk to warrant adverse classification.

Substandard: Substandard credits are inadequately protected by the current sound worth and paying capacity of the obligor or of the collateral pledged, if any. Assets so classified must have a well-defined weakness or weaknesses that jeopardize liquidation of the debt. They are characterized by the distinct possibility that the Company will sustain some loss if the deficiencies are not corrected.

Doubtful: A Doubtful credit has all the weaknesses inherent in Substandard, with the added characteristic that the weaknesses make collection or liquidation in full, on the basis of currently known facts, conditions and values, highly questionable and improbable.

Loans not meeting the criteria above that are analyzed individually, as part of the above described process, are considered to be pass-rated loans.

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The following table reflects the Company's recorded investment in loans by credit quality indicators and by year of origination as of September 30, 2023.

(Dollars in thousands)	Term Loans by Year of Origination 2023	2022	2021	Prior	Revolving	Total
Commercial and industrial						
Pass	$60,791	$124,822	$ 65,445	$ 84,021	$221,977	$ 557,056
Special mention	880	31,209	2,723	5,868	27,516	68,196
Substandard	—	1,883	780	567	5,420	8,650
Total	$61,671	$157,914	$ 68,948	$ 90,456	$254,913	$ 633,902
Current period gross charge-offs	$ —	$ 136	$ —	$ 20	$ 247	$ 403
Real estate - other						
Pass	$22,188	$186,251	$209,378	$310,626	$ 94,336	$ 822,779
Special mention	—	14,924	10,210	6,948	—	32,082
Substandard	—	—	—	3,750	—	3,750
Total	$22,188	$201,175	$219,588	$321,324	$ 94,336	$ 858,611
Current period gross charge-offs	$ —	$ —	$ —	$ —	$ —	$ —
Real estate - construction and land						
Pass	$ 2,949	$ 10,949	$ 24,439	$ —	$ —	$ 38,337
Special mention	—	—	—	1,666	—	1,666
Substandard	—	—	—	—	—	—
Total	$ 2,949	$ 10,949	$ 24,439	$ 1,666	$ —	$ 40,003
Current period gross charge-offs	$ —	$ —	$ —	$ —	$ —	$ —
SBA						
Pass	$ —	$ 758	$ 60	$ 2,677	$ 127	$ 3,622
Special mention	—	—	—	141	—	141
Substandard	—	—	—	652	—	652
Total	$ —	$ 758	$ 60	$ 3,470	$ 127	$ 4,415
Current period gross charge-offs	$ —	$ —	$ —	$ —	$ —	$ —
Other						
Pass	$ 10	$ 1,612	$ —	$ 34,017	$ 545	$ 36,184
Special mention	—	—	—	—	—	—
Substandard	—	—	—	—	—	—
Total	$ 10	$ 1,612	$ —	$ 34,017	$ 545	$ 36,184
Current period gross charge-offs	$ —	$ —	$ —	$ —	$ —	$ —
Total						
Pass	$85,938	$324,392	$299,322	$431,341	$316,985	$1,457,978
Special mention	880	46,133	12,933	14,623	27,516	102,085
Substandard	—	1,883	780	4,969	5,420	13,052
Total	$86,818	$372,408	$313,035	$450,933	$349,921	$1,573,115
Current period gross charge-offs	$ —	$ 136	$ —	$ 20	$ 247	$ 403

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The following table reflects the loan portfolio allocated by the Company's credit quality indicators as of December 31, 2022.

(Dollars in thousands)	Commercial and Industrial	Real Estate Other	Real Estate Construction and Land	SBA	Other	Total
As of December 31, 2022:						
Grade:						
Pass	$ 613,395	$840,993	$ 62,031	$6,132	$39,695	$1,562,246
Special Mention	18,157	2,602	—	490	—	21,249
Substandard	2,983	4,646	1,699	598	—	9,926
Total	$ 634,535	$848,241	$ 63,730	$7,220	$39,695	$1,593,421

The increase in loans classified as special mention at September 30, 2023 compared to December 31, 2022 was primarily the result of the Company's heightened monitoring in response to current economic and operating trends.

The following table reflects an aging analysis of the loan portfolio by the time past due at September 30, 2023 and December 31, 2022.

(Dollars in thousands)	30 Days	60 Days	90+ Days	Nonaccrual	Current	Total
As of September 30, 2023:						
Commercial and industrial	$ —	$ —	$ —	$ 1,183	$ 632,719	$ 633,902
Real estate - other	—	—	—	—	858,611	858,611
Real estate - construction and land	—	—	—	—	40,003	40,003
SBA	—	—	—	53	4,362	4,415
Other	—	—	—	—	36,184	36,184
Total loans, gross	$ —	$ —	$ —	$ 1,236	$1,571,879	$1,573,115
As of December 31, 2022:						
Commercial and industrial	$ —	$ —	$ —	$ 1,028	$ 633,507	$ 634,535
Real estate - other	3,160	—	—	—	845,081	848,241
Real estate - construction and land	—	—	—	—	63,730	63,730
SBA	—	—	—	222	6,998	7,220
Other	—	—	—	—	39,695	39,695
Total loans, gross	$3,160	$ —	$ —	$ 1,250	$1,589,011	$1,593,421

The Company measures expected credit losses on a pooled basis when similar risk characteristics exist. Loans that do not share risk characteristics are evaluated on an individual basis. When management determines that foreclosure is probable and the borrower is experiencing financial difficulty, the expected credit losses are based on the fair value of collateral at the reporting dated and adjusted for selling costs as appropriate.

At September 30, 2023 and December 31, 2022, the Company determined that certain loans did not share risk characteristics with other loans in the portfolio and therefore evaluated these loans for expected credit losses/impairment on an individual basis. The loans individually evaluated were classified as nonaccrual and were all collateral dependent. For collateral dependent loans, the Company has adopted the practical expedient under ASC 326 to measure the allowance for credit losses based on the fair value of collateral. The allowance for credit losses is calculated on an individual loan basis based on the shortfall between the fair value of the loan's collateral, which is adjusted for liquidation costs/discounts, and amortized cost. If the fair value of the collateral exceeds the amortized cost, no allowance is required. None of the individually evaluated loans required an allowance for credit losses as of the respective reporting dates.

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The following table reflects the recorded investment and unpaid principal balance for loans individually evaluated for expected credit losses/impairment as of September 30, 2023 and December 31, 2022 under ASC 326 and the previous accounting standard, respectively.

(Dollars in thousands)	Recorded Investment	Unpaid Principal Balance	Average Recorded Investment
As of September 30, 2023:			
Commercial and industrial	$ 1,183	$ 1,319	$ 1,183
SBA	53	689	138
Total individually evaluated loans	$ 1,236	$ 2,008	$ 1,321
As of December 31, 2022:			
Commercial and industrial	$ 1,028	$ 1,678	$ 1,028
SBA	222	896	227
Total individually evaluated loans	$ 1,250	$ 2,574	$ 1,255

The recorded investment in loans individually evaluated for expected credit losses/impairment excludes interest receivable and net deferred origination costs due to their immateriality.

The following table reflects the amortized cost of individually evaluated loans by type of collateral as of September 30, 2023 and December 31, 2022.

(Dollars in thousands)	Residential Property	Business Assets	Total Nonaccrual Loans
As of September 30, 2023:			
Commercial and industrial	$ —	$ 1,183	$ 1,183
SBA	53	—	53
Total individually evaluated loans	$ 53	$ 1,183	$ 1,236
As of December 31, 2022:			
Commercial and industrial	$ —	$ 1,028	$ 1,028
SBA	222	—	222
Total individually evaluated loans	$ 222	$ 1,028	$ 1,250

The following table reflects nonaccrual loans and the related allowance for credit losses by portfolio segment as of September 30, 2023 under ASC 326 and nonaccrual loans as of December 31, 2022 under the previous accounting standard, respectively.

	CECL			Incurred Loss
	September 30, 2023			December 31, 2022
(Dollars in thousands)	Nonaccrual Loans with No Allowance	Nonaccrual Loans with an Allowance	Total Nonaccrual Loans	Nonaccrual Loans
Commercial and industrial	$ 1,183	$ —	$ 1,183	$ 1,028
SBA	53	—	53	222
Total individually evaluated loans	$ 1,236	$ —	$ 1,236	$ 1,250

Prior to the adoption of ASC 326 on January 1, 2023, the Company calculated the allowance for loan losses under the incurred loss methodology. The following table reflects information related to loans individually and collectively evaluated for impairment and related allowance for loan losses as of December 31, 2022.

(Dollars in thousands)	Commercial and Industrial	Real Estate Other	Real Estate Construction and Land	SBA	Other	Total
As of December 31, 2022:						
Gross loans:						
Loans individually evaluated for impairment	$ 1,028	$ —	$ —	$ 222	$ —	$ 1,250
Loans collectively evaluated for impairment	633,507	848,241	63,730	6,998	39,695	1,592,171
Total gross loans	$ 634,535	$848,241	$ 63,730	$7,220	$39,695	$1,593,421
Allowance for loan losses:						
Loans individually evaluated for impairment	$ —	$ —	$ —	$ —	$ —	$ —
Loans collectively evaluated for impairment	10,620	5,322	884	132	47	17,005
Total allowance for loan losses	$ 10,620	$ 5,322	$ 884	$ 132	$ 47	$ 17,005

Interest forgone on nonaccrual loans totaled $62,000 and $25,000 for the three months ended September 30, 2023 and 2022, respectively. Interest forgone on nonaccrual loans totaled $150,000 and $60,000 for the nine months ended September 30, 2023 and 2022, respectively. There was no interest recognized on a cash-basis on loans individually evaluated for expected credit losses/impairment during the three and nine months ended September 30, 2023 and 2022 under ASC 326 and the previous accounting standard, respectively.

The following tables reflect the changes in, and allocation of, the allowance for credit losses and allowance for loan losses by portfolio segment for the three and nine months ended September 30, 2023 and 2022. The provision for credit losses of $121,000 for the third quarter of 2023 was primarily the result of changes in the forecast assumptions utilized in the CECL model along with a specific reserve pertaining to a previously charged-off SBA loan for which the SBA is unlikely to cover the portion participated to another lender, offset by net recoveries during the quarter of $78,000. In addition to changes in forecast assumptions and the above-mentioned specific reserve, the provision for credit losses of $925,000 for the nine months ended September 30, 2023 was impacted by the recognition of net charge-offs during the period of $169,000.

(Dollars in thousands)	Commercial and Industrial	Real Estate Other	Real Estate Construction and Land	SBA	Other	Total
Three months ended September 30, 2023:						
Beginning balance	$ 10,803	$ 2,970	$ 737	$ 40	$1,172	$15,722
Provision for credit losses	272	(66)	(351)	452	(186)	121
Charge-offs	(156)	—	—	—	—	(156)
Recoveries	196	—	—	38	—	234
Ending balance	$ 11,115	$ 2,904	$ 386	$ 530	$ 986	$15,921
Alowance for credit losses / gross loans	1.75%	0.34%	0.96%	12.00%	2.72%	1.01%
Net recoveries (charge-offs) / gross loans	0.01%	0.00%	0.00%	0.86%	0.00%	0.00%
Three months ended September 30, 2022:						
Beginning balance	$ 9,526	$ 5,243	$ 907	$ 273	$ 8	$15,957
Provision for loan losses	699	(70)	90	57	24	800
Charge-offs	—	—	—	(202)	—	(202)
Recoveries	—	—	—	—	—	—
Ending balance	$ 10,225	$ 5,173	$ 997	$ 128	$ 32	$16,555
Alowance for loan losses / gross loans	1.59%	0.63%	1.39%	1.49%	0.08%	1.04%
Net recoveries (charge-offs) / gross loans	0.00%	0.00%	0.00%	-2.36%	0.00%	-0.01%
Nine months ended September 30, 2023						
Beginning balance	$ 10,620	$ 5,322	$ 884	$ 132	$ 47	$17,005
Adoption of new accounting standard	(1,566)	(1,725)	1	(91)	1,541	(1,840)
Provision for credit losses	2,268	(693)	(499)	451	(602)	925
Charge-offs	(403)	—	—	—	—	(403)
Recoveries	196	—	—	38	—	234
Ending balance	$ 11,115	$ 2,904	$ 386	$ 530	$ 986	$15,921
Alowance for credit losses / gross loans	1.75%	0.34%	0.96%	12.00%	2.72%	1.01%
Net recoveries (charge-offs) / gross loans	-0.03%	0.00%	0.00%	0.86%	0.00%	-0.01%
Nine months ended September 30, 2022						
Beginning balance	$ 8,552	$ 4,524	$ 681	$ 309	$ 15	$14,081
Provision for loan losses	1,672	649	316	21	17	2,675
Charge-offs	—	—	—	(202)	—	(202)
Recoveries	1	—	—	—	—	1
Ending balance	$ 10,225	$ 5,173	$ 997	$ 128	$ 32	$16,555
Alowance for loan losses / gross loans	1.59%	0.63%	1.39%	1.49%	0.08%	1.04%
Net recoveries (charge-offs) / gross loans	0.00%	0.00%	0.00%	-2.36%	0.00%	-0.01%

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Modifications Made to Borrowers Experiencing Financial Difficulty

The allowance for credit losses incorporates an estimate of lifetime expected credit losses and is recorded on each asset upon asset origination or acquisition. The starting point for the estimate of the allowance for credit losses is historical loss information, which includes losses from modifications of receivables to borrowers experiencing financial difficulty. The Company uses a probability of default/loss given default model to determine the allowance for credit losses. An assessment of whether a borrower is experiencing financial difficulty is made on the date of a modification.

The effect of most modifications made to borrowers experiencing financial difficulty is already included in the allowance for credit losses because of the measurement methodologies used to estimate the allowance, therefore a change to the allowance for credit losses is generally not recorded upon modification.

In some cases, the Company will modify a certain loan by providing multiple types of concessions. Typically, one type of concession, such as a term extension, is granted initially. If the borrower continues to experience financial difficulty, another concession, such as an interest rate reduction or principal forgiveness, may be granted. Upon the Company's determination that a modified loan (or a portion of a loan) has subsequently been deemed uncollectible, the loan (or a portion of that loan) is written off. Therefore, the amortized cost basis of the loan is reduced by the uncollectible amount and the allowance for credit losses is adjusted by the same amount.

At September 30, 2023, the Company had one loan with a recorded investment or commitment with terms that had been modified due to the borrower experiencing financial difficulties. This loan had no payments that were considered past due as of the reporting date. The following table reflects the type of concession granted and the financial effect of the modification.

(Dollars in thousands)	Amortized Cost	% of Total Portfolio Segment	Financial Effect
SBA	$ 50	1.13%	Term Extension - extended forbearance expiration from March 31, 2023 to April 1, 2024
Total modified loans	$ 50		

The Company had no loan modifications resulting from a borrower experiencing financial difficulties with a subsequent payment default within twelve months following the modification during the three and nine months ended September 30, 2023.

4. BORROWING ARRANGEMENTS

The Company has a borrowing arrangement with the Federal Reserve Bank of San Francisco (FRB) under which advances are secured by portions of the Bank's loan and investment securities portfolios. The Company's credit limit varies according to the amount and composition of the assets pledged as collateral. At September 30, 2023, amounts pledged and available borrowing capacity under such limits were approximately $392.2 million and $302.9 million, respectively. At December 31, 2022, amounts pledged and available borrowing capacity under such limits were approximately $484.1 million and $393.0 million, respectively.

The Company has a borrowing arrangement with the Federal Home Loan Bank (FHLB) under which advances are secured by portions of the Bank's loan portfolio. The Company's credit limit varies according to its total assets and the amount and composition of the loan portfolio pledged as collateral. At September 30, 2023, amounts pledged and available borrowing capacity under such limits were approximately $414.0 million and $368.5 million, respectively. At December 31, 2022, amounts pledged and available borrowing capacity under such limits were approximately $386.1 million and $335.1 million, respectively.

Under Federal Funds line of credit agreements with several correspondent banks, the Company can borrow up to $ 123.0 million. There were no borrowings outstanding under these arrangements at September 30, 2023 and December 31, 2022.

The Company maintains a revolving line of credit with a commitment of $ 3.0 million for a six-month term at a rate of Prime plus 0.40%. At September 30, 2023 and December 31, 2022, no borrowings were outstanding under this line of credit.

The Company issued $20.0 million in subordinated debt on September 30, 2020. The subordinated debt has a fixed interest rate of 5.00% for the first 5 years and a stated maturity of September 30, 2030. After the fifth year, the interest rate changes to a quarterly variable rate equal to then current three-month term SOFR plus 0.488%. The subordinated debt was recorded net of related issuance costs of $ 300,000. At September 30, 2023 and December 31, 2022, the balance remained at $20.0 million, net of the remaining unamortized issuance cost.

The Company issued an additional $35.0 million in subordinated debt on August 17, 2021. The subordinated debt has a fixed interest rate of 3.50% for the first 5 years and a stated maturity of September 1, 2031. After the fifth year, the interest rate changes to a quarterly variable rate equal to then current three-month term SOFR plus 0.286%. The subordinated debt was recorded net of related issuance costs of $760,000. At September 30, 2023 and December 31, 2022, the balance remained at $ 35.0 million, net of the remaining unamortized issuance cost.

5. COMMITMENTS AND CONTINGENT LIABILITIES

Financial Instruments with Off-Balance Sheet Risk

The Company is a party to financial instruments with off-balance sheet risk in the normal course of business in order to meet the financing needs of its customers and to reduce its own exposure to fluctuations in interest rates. The Company's exposure to credit loss in the event of nonperformance by the other party for commitments to extend credit is represented by the contractual amount of those instruments. The Company uses the same credit policies in making commitments as it does for loans included on the balance sheet.

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Since some 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 of the borrower. Collateral held varies, but may include accounts receivable, inventory, and deeds of trust on residential real estate and income-producing commercial properties.

At September 30, 2023 and December 31, 2022, the Company had outstanding unfunded commitments for loans of approximately $643.4 million and $644.1 million, respectively.

The outstanding unfunded commitments for loans at September 30, 2023 was comprised of fixed rate commitments of approximately $43.0 million and variable rate commitments of approximately $600.4 million. The following table reflects the interest rate and maturity ranges for the unfunded fixed rate loan commitments as of September 30, 2023.

(Dollars in thousands)	Due in One Year Or Less	Over One Year But Less Than Five Years	Over Five Years	Total
Unfunded fixed rate loan commitments:				
Interest rate less than or equal to 4.00%	$19,346	$ 3,217	$ 47	$22,610
Interest rate between 4.00% and 5.00%	—	6,781	144	6,925
Interest rate greater than or equal to 5.00%	9,457	2,225	1,823	13,505
Total unfunded fixed rate loan commitments	$28,803	$ 12,223	$ 2,014	$43,040

The Company records an allowance for credit losses on off-balance sheet credit exposures, unless the commitments to extend credit are unconditionally cancelable, through a charge to provision for credit losses in the Company's income statements. The allowance for credit losses on off-balance sheet credit exposures is estimated by loan segment at each balance sheet date under the current expected credit loss model using the same methodologies as portfolio loans, taking into consideration the likelihood that funding will occur as well as any third-party guarantees. The allowance for credit losses related to unfunded commitments is included in other liabilities on the Company's consolidated balance sheets and was $2.0 million and $430,000 at September 30, 2023 and December 31, 2022, respectively.

The following table presents the balance and activity in the allowance for credit losses for unfunded loan commitments for the three and nine months ended September 30, 2023.

	September 30, 2023	
(Dollars in thousands)	Three Months Ended	Nine Months Ended
Beginning balance	$ 1,877	$ 430
Adoption of new accounting standard	—	1,397
Provision for credit losses	170	220
Balance at September 30, 2023	$ 2,047	$ 2,047

Operating Leases

The Company leases various office premises under long-term operating lease agreements. These leases expire between 2023 and 2030, with certain leases containing either three, five, or seven-year renewal options.

The following table reflects the quantitative information for the Company's leases for the nine months ended, and as of, September 30, 2023.

(Dollars in thousands)	September 30, 2023
Operating lease cost (cost resulting from lease payments)	$ 1,483
Operating lease - operating cash flows (fixed payments)	$ 1,142
Operating lease right-of-use assets (other assets)	$ 9,219
Operating lease liabilities (other liabilities)	$ 11,023
Weighted average lease term - operating leases	4.3 years
Weighted average discount rate - operating leases	4.99%

The following table reflects the minimum commitments under these non-cancellable leases, before considering renewal options, as of September 30, 2023.

(Dollars in thousands)	September 30, 2023
2023	$ 510
2024	2,414
2025	2,486
2026	2,451
2027	1,402
Thereafter	3,140
Total undiscounted cash flows	12,403
Discount on cash flows	(1,380)
Total lease liability	$ 11,023

Rent expense included in premises and equipment expense totaled $ 502,000 and $469,000 for the three months ended September 30, 2023 and 2022, respectively. Rent expense included in premises and equipment expense totaled $1.5 million for the nine months ended September 30, 2023 and 2022, respectively.

Contingencies

The Company is involved in legal proceedings arising from normal business activities. Management, based upon the advice of legal counsel, believes the ultimate resolution of all pending legal actions will not have a material effect on the Company's financial position or results of operations.

Correspondent Banking Agreements

The Company maintains funds on deposit with other federally insured financial institutions under correspondent banking agreements. Insured financial institution deposits up to $250,000 are fully insured by the FDIC under the FDIC's general deposit insurance rules.

At September 30, 2023, uninsured deposits at financial institutions were approximately $ 407,000. At December 31, 2022, uninsured deposits at financial institutions were approximately $2.9 million.

6. FAIR VALUE MEASUREMENTS

Fair Value Hierarchy

The Company groups its assets and liabilities measured at fair value in three levels, based on the markets in which the assets and liabilities are traded and the reliability of the assumptions used to determine fair value. Valuations within these levels are based upon:

Level 1 - Quoted market prices for identical instruments traded in active exchange markets.

Level 2 - Quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active, and model-based valuation techniques for which all significant assumptions are observable or can be corroborated by observable market data.

Level 3 - Model-based techniques that use at least one significant assumption not observable in the market. These unobservable assumptions reflect the Company's estimates of assumptions that market participants would use on pricing the asset or liability. Valuation techniques include management judgment and estimation which may be significant.

Management monitors the availability of observable market data to assess the appropriate classification of financial instruments within the fair value hierarchy. Changes in economic conditions or model-based valuation techniques may require the transfer of financial instruments from one fair value level to another. In such instances, the transfer is reported at the beginning of the reporting period.

Management evaluates the significance of transfers between levels based upon the nature of the financial instrument and size of the transfer relative to total assets, total liabilities or total earnings.

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The carrying amounts and estimated fair values of financial instruments at September 30, 2023 and December 31, 2022 are as follows:

(Dollars in thousands)	Carrying Amount	Fair Value Measurements Level 1	Level 2	Level 3	Total
As of September 30, 2023:					
Financial assets:					
Cash and cash equivalents	$ 198,982	$ 198,982	$ —	$ —	$ 198,982
Investment securities:					
Available for sale	44,227	—	44,227	—	44,227
Held to maturity	105,017		83,675	7,197	90,872
Loans, net	1,558,506	—	—	1,478,998	1,478,998
Accrued interest receivable	9,020	—	1,096	7,924	9,020
Financial liabilities:					
Deposits	$ 1,707,081	$ 1,387,376	$ 320,344	$ —	$ 1,707,720
Subordinated debt	54,256	—	—	49,803	49,803
Accrued interest payable	4,024	—	3,922	102	4,024
As of December 31, 2022:					
Financial assets:					
Cash and due from banks	$ 232,382	$ 232,382	$ —	$ —	$ 232,382
Investment securities:					
Available for sale	47,012	—	47,012	—	47,012
Held to maturity	108,866		89,433	7,450	96,883
Loans, net	1,578,456		—	1,519,903	1,519,903
Accrued interest receivable	7,769	—	926	6,843	7,769
Financial liabilities:					
Deposits	$ 1,791,740	$ 1,520,502	$ 271,178	$ —	$ 1,791,680
Subordinated debt	54,152	—	—	49,027	49,027
Accrued interest payable	1,678	—	1,007	671	1,678

These estimates do not reflect any premium or discount that could result from offering the Company's entire holdings of a particular financial instrument for sale at one time, nor do they attempt to estimate the value of anticipated future business related to the instruments. In addition, the tax ramifications related to the realization of unrealized gains and losses can have a significant effect on fair value estimates and have not been considered in any of these estimates.

The methods and assumptions used to estimate fair values are described as follows:

Cash and Due from banks - The carrying amounts of cash and short-term instruments approximate fair values and are classified as Level 1.

Investment Securities - Since quoted prices are generally not available for identical securities, fair values are calculated based on market prices of similar securities on similar dates, resulting in Level 2 classification. For securities where market prices of similar securities are not available, fair values are calculated using discounted cash flows or other market indicators, resulting in Level 3 classification.

FHLB, IBFC, PCBB Stock - It is not practical to determine the fair value of these correspondent bank stocks due to restrictions placed on their transferability.

Loans - Fair values of loans for September 30, 2023 and December 31, 2022 are estimated on an exit price basis with contractual cash flow, prepayments, discount spreads, credit loss and liquidity premium assumptions. Loans with similar characteristics such as prepayment rates, terms and rate indexed are aggregated for purposes of the calculations. Loans are generally classified using Level 3 inputs.

Loans individually evaluated for expected credit losses/impairment—Certain loans are individually evaluated on a quarterly basis for additional expected credit losses/impairment and adjusted accordingly. The fair value of loans that are individually evaluated with specific allocations of the allowance for credit losses that are secured by real property is generally based on recent real estate appraisals. These appraisals may utilize a single valuation approach or a combination of approaches including comparable sales and the income approach. Adjustments are routinely made in the appraisal process by the independent appraisers to adjust for differences between the comparable sales and income data available. Such adjustments are usually significant and typically result in a Level 3 classification of the inputs for determining fair value. The methods utilized to estimate the fair value of individually evaluated loans do not necessarily represent an exit price.

Deposits - The fair values disclosed for demand deposits (e.g., interest and non-interest checking, passbook 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 amount) resulting in Level 1 classification. The carrying amounts of variable rate and fixed-term money market accounts approximate their fair values at the reporting date resulting in Level 1 classification. For time certificates of deposit, the estimated remaining cash flows were discounted, based on current rates for similar instruments in market, to determine the fair value (premium)/discount and accordingly are classified as Level 2.

FHLB Advances - FHLB Advances are included in Other Borrowings. Fair values for FHLB Advances are estimated using discounted cash flow analyses using interest rates offered at each reporting date by correspondent banks for advances with similar maturities resulting in Level 3 classification.

Senior Notes - Fair values for senior notes are estimated using a discounted cash flow calculation based on current rates for similar types of debt, which may be unobservable, and by considering recent trading activity of similar instruments in the market, which may be inactive. Accordingly, senior notes are classified within the Level 3 classification.

Junior Subordinated Debt Securities - Fair values for subordinated debt are calculated based on their respective terms and discounted to the date of the valuation. A market rate based on recent debt offerings by peer banks, which may be unobservable, is used to discount the cash flows until the repricing date and the subsequent cash flows are discounted at Prime plus 2%. Additionally, the Company considers recent trading activity of similar instruments in the market, which may be inactive. Accordingly, junior subordinated debt securities are classified within the Level 3 classification.

Accrued Interest Receivable - The carrying amounts of accrued interest receivable approximate fair value resulting in a Level 2 classification for accrued interest receivable on investment securities and a Level 3 classification for accrued interest receivable on loans since investment securities are generally classified using Level 2 inputs and loans are generally classified using Level 3 inputs.

Accrued Interest Payable - The carrying amounts of accrued interest payable approximate fair value resulting in a Level 2 classification, since accrued interest payable is from deposits that are generally classified using Level 2 inputs.

Off Balance Sheet Instruments - Fair values for off-balance sheet, credit-related financial instruments are based on fees currently charged to enter into similar agreements, as well as considering the remaining terms of the agreements and the counterparties' credit standing. The fair value of commitments is not material.

Assets Recorded at Fair Value on a Recurring Basis

The Company is required or permitted to record the following assets at fair value on a recurring basis as of September 30, 2023 and December 31, 2022.

(Dollars in thousands)	Fair Value	Level 1	Level 2	Level 3
As of September 30, 2023:				
Investments available for sale:				
Mortgage backed securities	$ 15,175	$ —	$ 15,175	$ —
Government agencies	29,052	—	29,052	—
Total assets measured at fair value on a recurring basis	$ 44,227	$ —	$ 44,227	$ —
As of December 31, 2022:				
Investments available for sale:				
Mortgage backed securities	$ 17,758	$ —	$ 17,758	$ —
Government agencies	28,766	—	28,766	—
Corporate bonds	488	—	488	—
Total assets measured at fair value on a recurring basis	$ 47,012	$ —	$ 47,012	$ —

Fair values for available-for-sale investment securities are based on quoted market prices for exact or similar securities. During the periods presented, there were no significant transfers in or out of Levels 1 and 2 and there were no changes in the valuation techniques used. Additionally, there were no assets measured at fair value on a recurring basis using significant unobservable inputs (Level 3) at September 30, 2023 and December 31, 2022.

Assets Recorded at Fair Value on a Non-Recurring Basis

The Company may be required, from time to time, to measure certain assets at fair value on a non-recurring basis. These include assets that are measured at the lower of cost or market value that were recognized at fair value which was below cost at the reporting date. The following table summarizes impaired loans measured at fair value on a non-recurring basis as of September 30, 2023 and December 31, 2022.

	Carrying	Fair Value Measurements		
(Dollars in thousands)	Amount	Level 1	Level 2	Level 3
As of September 30, 2023:				
Individually evaluated loans - Commercial	$ 1,183	$ —	$ —	$ 1,183
Individually evaluated loans - SBA	53	—	—	53
Total assets measured at fair value on a non-recurring basis	$ 1,236	$ —	$ —	$ 1,236
As of December 31, 2022:				
Impaired loans - Commercial	$ 1,028	$ —	$ —	$ 1,028
Impaired loans - SBA	222	—	—	222
Total assets measured at fair value on a non-recurring basis	$ 1,250	$ —	$ —	$ 1,250

The fair value of individually evaluated loans is based upon independent market prices, estimated liquidation values of loan collateral or appraised value of the collateral as determined by third-party independent appraisers, less selling costs. Level 3 fair value measurement includes other real estate owned that has been measured at fair value upon transfer to foreclosed assets and loans collateralized by real property and other business asset collateral where a specific reserve has been established or a charge-off has been recorded. The unobservable inputs and qualitative information about the unobservable inputs are based on management's best estimates of appropriate discounts in arriving at fair value. Increases or decreases in any of those inputs could result in a significantly lower or higher fair value measurement. For example, a change in either direction of actual loss rates would have a directionally opposite change in the calculation of the fair value of individually evaluated loans.

Item 2. Management’s Discussion and Analysis of Financial Condition and Results of Operations

The following is a discussion of our financial condition at September 30, 2023 and December 31, 2022 and our results of operations for the three and nine months ended September 30, 2023 and 2022, and should be read in conjunction with our audited consolidated financial statements set forth in our Annual Report on Form 10-K for the year ended December 31, 2022 that was filed with the Securities and Exchange Commission (the “SEC”) on March 24, 2023 (our “Annual Report”) and with the accompanying unaudited notes to consolidated financial statements set forth in this Quarterly Report on Form 10-Q for the quarterly period ended September 30, 2023 (this “Report”). Because we conduct all of our material business operations through our bank subsidiary, California Bank of Commerce, the discussion and analysis relates to activities primarily conducted by the Bank.

Forward Looking Statements

Statements contained in this Report that are not historical facts or that discuss our expectations, beliefs or views regarding future events, such as our future operations or future financial performance, or financial or other trends in our business or in the markets in which we operate, and our future plans constitute “forward-looking statements” within the meaning of Section 27A of the Securities Act of 1933, as amended (the “Securities Act”), and Section 21E of the Securities Exchange Act of 1934, as amended (the “Exchange Act”). Forward-looking statements can be identified by the fact that they do not relate strictly to historical or current facts. Often, they include words such as “believe,” “expect,” “anticipate,” “intend,” “plan,” “estimate,” “project,” “forecast,” or words of similar meaning, or future or conditional verbs such as “will,” “would,” “should,” “could,” or “may.” The information contained in such forward-looking statements is based on current information available to us and on assumptions that we make about future economic and market conditions and other events over which we do not have control. In addition, our business and the markets in which we operate are subject to a number of risks and uncertainties. Such risks and uncertainties, and the occurrence of events in the future or changes in circumstances that had not been anticipated, could cause our financial condition or actual operating results in the future to differ materially from our expected financial condition or operating results that are set forth in the forward-looking statements contained in this Report and could, therefore, also affect the price performance of our shares.

In addition to the risk of incurring loan losses and provision for credit losses, which is an inherent risk of the banking business, these risks and uncertainties include, but are not limited to, the following: deteriorating economic conditions and macroeconomic factors such as unemployment rates and the volume of bankruptcies, as well as changes in monetary, fiscal or tax policy, any of which could cause us to incur losses and adversely affect our results of operations in the future; the risk that the credit quality of our borrowers declines; potential declines in the value of the collateral for secured loans; the risk of a recession in the United States economy, and domestic or international economic conditions, which could cause us to incur credit losses and adversely affect our results of operations in the future; changes in prevailing interest rates, which may adversely affect our interest margins, net interest income and the value of our investment securities; the risk that we will not be able to manage our liquidity, interest rate or operational risks effectively, in which event our operating results or financial condition could be harmed; risks associated with seeking new client relationships and maintaining existing client relationships; the impacts of inflation; and the prospect of changes in government regulation of banking and other financial services organizations, which could impact our costs of doing business and restrict our ability to take advantage of business and growth opportunities. Readers of this Report are encouraged to review the additional information regarding these and other risks and uncertainties to which our business is subject that is contained in Part I, Item 1A of our Annual Report and in Part II, Item 1A of this Report, as such information may be updated from time to time in subsequent filings we may make with the SEC. We urge you to read those risk factors in conjunction with your review of the following discussion and analysis of our results of operations for the three and nine months ended, and our financial condition at, September 30, 2023.

Due to the risks and uncertainties we face, readers are cautioned not to place undue reliance on the forward-looking statements contained in this Report, which speak only as of the date of this Report, or to make predictions about future performance based solely on historical financial performance. We also disclaim any obligation to update forward-looking statements contained in this Report as a result of new information, future events or otherwise, except as may otherwise be required by law.

Overview

California BanCorp (the “Company,” “we” or “us”), a California corporation headquartered in Oakland, California, is the bank holding company for its wholly-owned subsidiary California Bank of Commerce (the “Bank”). The Bank has a full service branch in California located in Contra Costa County and 4 loan production offices in California located in Alameda County, Contra Costa County, Sacramento County, and Santa Clara County.

Critical Accounting Policies

Our unaudited consolidated financial statements are prepared in accordance with GAAP and with general practices within the financial services industry. Application of these principles requires management to make complex and subjective estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. We base our estimates on historical experience and on various other assumptions that we believe to be reasonable under current circumstances. These assumptions form the basis for our judgments about the carrying values of assets and liabilities that are not readily available from independent, objective sources. We evaluate our estimates on an ongoing basis. Use of alternative assumptions may have resulted in significantly different estimates. Actual results may differ from these estimates.

Our most significant accounting policies are described in Note 1 to our audited financial statements for the year ended December 31, 2022, included in our Annual Report on Form 10-K and in Note 1 to our unaudited financial statements, which are included elsewhere in this Quarterly Report on Form 10-Q.

Results of Operations – Three Months Ended September 30, 2023 and 2022:

Overview

For the three months ended September 30, 2023 and September 30, 2022, net income was $5.4 million and $5.5 million, respectively, representing a decrease of $121,000, or 2%. Compared to the same period last year, net interest income after the provision for credit losses increased by $701,000, which was offset by a decrease in non-interest income of $190,000 and an increase in non-interest expense of $634,000.

Net Interest Income and Margin

Net interest income, the difference between interest earned on loans and investments and interest paid on deposits and borrowings, is the principal component of the Company’s earnings. Net interest income is affected by changes in the nature and volume of earning assets and interest-bearing liabilities held during the quarter, the rates earned on such assets and the rates paid on interest bearing liabilities.

Net interest income for the three months ended September 30, 2023, was $18.6 million, an increase of $215,000, or 1% from $18.4 million for the same period in 2022. The increase in net interest income was primarily attributable to the rising interest rate environment combined with a more favorable mix of higher yielding earning assets offset, in part, by an increase in the cost of total deposits. Net interest margin decreased by 8 basis points to 3.86% for the three months ended September 30, 2023, compared to 3.94% for the three months ended September 30, 2022.

Average total interest-earning assets were $1.91 billion in the third quarter of 2023 compared to $1.85 billion for the same period during 2022. The increase in total interest-earning assets was primarily due to growth of the loan portfolio combined with increased liquidity generated from growth in the deposit portfolio. For the quarter ended September 30, 2023, the yield on average earning assets increased 129 basis points to 5.83% from 4.54% for the quarter ended September 30, 2022. The yield on total average gross loans in the three months ended September 30, 2023 was 6.09%, representing an increase of 112 basis points compared to 4.97% in the same period one year earlier. For the three months ended September 30, 2023 compared to the same period in 2022, the yield on average federal funds sold increased 323 basis points to 5.35% from 2.12%, and the yield on average investment securities increased 95 basis points to 3.90% from 2.95%.

For the three months ended September 30, 2023, average loans increased $28.3 million, or 2%, from the quarter ended September 30, 2022 while average interest-bearing deposit balances increased $151.2 million, or 18%, from the same quarter in the prior year. Average non-interest bearing deposits for the third quarter of 2023 decreased $23.9 million, or 3%, from the same period in the prior year. The average loan to deposit ratio for the third quarter of 2023 was 90.25% compared to 95.69% for the third quarter of 2022.

Of the $28.3 million increase in average loan balances year over year, average commercial and real estate loans increased by $19.3 million and $33.7 million, respectively, as a result of organic growth. These increases were offset by a decrease in average construction and land loans of $15.1 million, a decrease in SBA loans of $5.2 million, and a decrease in other loans of $4.4 million.

Of the $151.2 million increase in average interest-bearing deposit balances year over year, $119.7 million was attributable to time deposits and $42.8 million was attributable to money market and savings accounts, offset by a decrease in demand accounts of $11.3 million. The cost of interest-bearing deposits was 3.54% during the quarter ended September 30, 2023 compared to 0.78% in the same quarter one year earlier. In addition, the overall cost of average total deposit balances increased by 165 basis points to 2.07% in the third quarter of 2023 compared to 0.42% in the third quarter of 2022.

The following table shows the composition of average earning assets and average funding sources, average yields and rates, and the net interest margin for the quarters ended September 30, 2023 and 2022.

	Three months ended September 30,					
	2023			2022		
(Dollars in thousands)	Average Balance	Yields or Rates	Interest Income/ Expense	Average Balance	Yields or Rates	Interest Income/ Expense
ASSETS						
Interest earning assets:						
Loans (1)	$1,551,708	6.09%	$23,804	$1,523,442	4.97%	$19,084
Federal funds sold	208,725	5.35%	2,814	162,314	2.12%	867
Investment securities	150,322	3.90%	1,476	163,486	2.95%	1,217
Total interest earning assets	1,910,755	5.83%	28,094	1,849,242	4.54%	21,168
Noninterest-earning assets:						
Cash and due from banks	20,351			20,153		
All other assets (2)	62,041			60,832		
TOTAL	$1,993,147			$1,930,227		
LIABILITIES AND SHAREHOLDERS' EQUITY						
Interest-bearing liabilities:						
Deposits:						
Demand	$ 28,766	0.33%	$ 24	$ 40,044	0.08%	$ 8
Money market and savings	642,909	2.95%	4,775	600,100	0.62%	938
Time	332,662	4.96%	4,162	213,001	1.35%	726
Other	54,235	4.06%	555	154,101	2.92%	1,133
Total interest-bearing liabilities	1,058,572	3.57%	9,516	1,007,246	1.10%	2,805
Noninterest-bearing liabilities:						
Demand deposits	715,079			738,951		
Accrued expenses and other liabilities	30,665			21,094		
Shareholders' equity	188,831			162,936		
TOTAL	$1,993,147			$1,930,227		
Net interest income and margin (3)		3.86%	$18,578		3.94%	$18,363

(1) Nonperforming loans are included in average loan balances. No adjustment has been made for these loans in the calculationof yields. Interest income on loans includes amortization of net deferred loan (costs) fees of $(82,000) and $100,000, respectively.
(2) Other noninterest-earning assets includes the allowance for credit losses of $15.8 million and $16.0 million, respectively.
(3) Net interest margin is net interest income divided by total interest-earning assets.

The following table shows the effect of the interest differential of volume and rate changes for the quarters ended September 30, 2023 and 2022. The change in interest due to both rate and volume has been allocated in proportion to the relationship of absolute dollar amounts of change in each.

	Three Months Ended September 30, 2023 vs. 2022		
	Increase (Decrease) Due to Change in:		
(Dollars in thousands)	Average Volume	Average Rate	Net Change
Interest income:			
Loans	$ 434	$ 4,286	$ 4,720
Federal funds sold	626	1,321	1,947
Investment securities	(129)	388	259
Interest expense:			
Deposits			
Demand	(9)	25	16
Money market and savings	318	3,519	3,837
Time	1,497	1,939	3,436
Other borrowings	(1,022)	444	(578)
Net interest income	$ 147	$ 68	$ 215

Interest Income

Interest income increased by $6.9 million in the third quarter of 2023 compared to the same period of 2022, primarily due to an increase in the prime rate which generated higher yields on our loan portfolio. The prime rate at September 30, 2023 and September 30, 2022 was 8.50% and 6.25%, respectively. Interest earned on our loan portfolio of $23.8 million in the third quarter of 2023 represented an increase of $4.7 million, or 25%, compared to $19.1 million for the third quarter of 2022.

Additionally, the Company benefited from a more favorable mix of other earning assets. Interest earned on federal funds sold of $2.8 million for the three months ended September 30, 2023 compared to $867,000 for the same period in the prior year. Interest earned on investment securities of $1.5 million for the three months ended September 30, 2023 compared to $1.2 million for the three months ended September 30, 2022.

Interest Expense

Interest expense increased by $6.7 million in the third quarter of 2023 compared to the same period of 2022, primarily due to the effect of increased rates paid on interest-bearing deposits and other borrowings, combined with a higher level of interest-bearing deposits. The average rate paid on interest-bearing liabilities in the third quarter of 2023 compared to the same period one year earlier increased 247 basis point to 3.57% from 1.10%.

Provision for Credit Losses

The provision for credit losses of $314,000 for the three months ended September 30, 2023 was comprised of $121,000 pertaining to the ACL on loans, $170,000 pertaining to the ACL for unfunded loan commitments, and $23,000 pertaining to the ACL for held to maturity securities.

The provision for credit losses on loans of $314,000 for the third quarter of 2023 compared to a provision for loan losses of $800,000 for the third quarter of 2022. The Company had loan charge-offs of $156,000 and recoveries of $234,000 during the third quarter of 2023, compared to loan charge-offs of $202,000 and no recoveries during the third quarter of 2022. The allowance for credit losses on loans as a percentage of outstanding loans was 1.01% at September 30, 2023 and 1.07% at December 31, 2022. On January 1, 2023, the Company adopted the current expected losses (CECL) accounting standard (ASC 326). The Company’s allowance for credit losses on loans was 0.95% upon adoption of the standard on January 1, 2023.

Non-interest Income

The following table reflects the major components of the Company's non-interest income for the three months ended September 30, 2023 and 2022.

	Three Months Ended September 30,		Increase (Decrease)	
(Dollars in thousands)	2023	2022	Amount	Percent
Service charges and other fees	$ 1,003	$ 1,237	$ (234)	-19%
Earnings on BOLI	179	167	12	7%
Other	112	80	32	40%
Total non-interest income	$ 1,294	$ 1,484	$ (190)	-13%

Non-interest income decreased by $190,000, or 13% in the third quarter of 2023, compared to the third quarter of 2022. The decrease was primarily due to a decrease in service charges and other fee income related to fewer prepayment penalties assessed on loans.

Non-interest Expense

The following table reflects the major components of the Company's non-interest expense for the three months ended September 30, 2023 and 2022.

	Three Months Ended September 30,		Increase (Decrease)	
(Dollars in thousands)	2023	2022	Amount	Percent
Salaries and benefits	$ 8,238	$ 7,415	$ 823	11%
Premises and equipment	1,155	1,275	(120)	-9%
Professional fees	411	524	(113)	-22%
Data processing	633	744	(111)	-15%
Other	1,414	1,259	155	12%
Total non-interest expense	$ 11,851	$ 11,217	$ 634	6%

Non-interest expense was $11.9 million and $11.2 million for the three months ended September 30, 2023 and 2022, respectively. Excluding capitalized loan origination costs, non-interest expense for the third quarter of 2023 was $12.5 million compared to $12.3 million for the third quarter of 2022, representing an increase of $200,000, or 2%. The increase in non-interest expense, excluding capitalized origination costs, from the third quarter of 2022 was primarily due to an increase in salaries and benefits related to investments to support the continued growth of the business.

For the three months ended September 30, 2023 and 2022, the Company's efficiency ratio, the ratio of non-interest expense to revenues, was 59.64% and 56.52%, respectively.

Provision for Income Taxes

Income tax expense was $2.3 million for both the third quarter of 2023 and for the same period in prior year. The effective tax rates for those time periods were 29.9% and 29.5%, respectively.

Results of Operations – Nine Months Ended September 30, 2023 and 2022:

Overview

For the nine months ended September 30, 2023 and September 30, 2022, net income was $16.3 million and $13.4 million, respectively, representing an increase of $2.9 million, or 21%. Compared to the same period last year, net interest income after the provision for credit losses increased by $8.4 million, which was offset by a decrease in non- interest income of $1.9 million, an increase in non-interest expense of $2.3 million and an increase in the provision for income taxes of $1.3 million.

Net Interest Income and Margin

Net interest income for the nine months ended September 30, 2023, was $56.0 million, an increase of $6.9 million, or 14% from $49.1 million for the same period in 2022. The increase in net interest income was primarily attributable to the rising interest rate environment combined with a more favorable mix of higher yielding earning assets offset, in part, by an increase in the cost of total deposits. Net interest margin increased by 34 basis points to 3.94% for the nine months ended September 30, 2023, compared to 3.60% for the nine months ended September 30, 2022.

Average total interest-earning assets were $1.90 billion in the nine months ended September 30, 2023 compared to $1.83 billion for the same period during 2022. The increase in total interest-earning assets was primarily due to growth of the loan portfolio. For the nine months ended September 30, 2023, the yield on average earning assets increased 167 basis points to 5.68% from 4.01% for the nine months ended September 30, 2022. The yield on total average gross loans for the nine months ended September 30, 2023 was 5.94%, representing an increase of 132 basis points compared to 4.62% in the same period one year earlier. For the nine months ended September 30, 2023 compared to the same period in 2022, the yield on federal funds sold increased 430 basis points to 5.09 % from 0.79%, and the yield on average investment securities increased 93 basis points to 3.72% from 2.79%.

For the nine months ended September 30, 2023, average loans increased $116.7 million, or 8%, from the nine months ended September 30, 2022 while average interest-bearing deposit balances increased $115.1 million, or 13%, from the same period in the prior year. Average non-interest bearing deposits for the first nine months of 2023 decreased $17.6 million, or 2%, from the same period in the prior year. The average loan to deposit ratio for the nine months ended September 30, 2023 was 92.31% compared to 90.65% for the nine months ended September 30, 2022.

Of the $116.7 million increase in average loan balances year over year, average commercial and real estate loans increased by $73.0 million and $82.5 million, respectively, as a result of organic growth. These increases were partially offset by a decrease in average SBA loans of $27.0 million primarily due to PPP loan forgiveness and a decrease in other loans of $15.1 million primarily due to the sale of a portion of our solar loan portfolio.

Of the $115.1 million increase in average interest-bearing deposit balances year over year, $150.8 million was attributable to time deposits, offset by a decrease in money market and savings accounts of $26.5 million, and a decrease in demand accounts of $9.2 million. The cost of interest-bearing deposits was 3.06% during the nine months ended September 30, 2023 compared to 0.51% for the same period one year earlier. In addition, the overall cost of average total deposit balances increased by 150 basis points to 1.77% during the nine months ended September 30, 2023 compared to 0.27% during the nine months ended September 30, 2022.

The following table shows the composition of average earning assets and average funding sources, average yields and rates, and the net interest margin for the nine months ended September 30, 2023 and 2022.

	Nine months ended September 30,					
	2023			2022		
(Dollars in thousands)	Average Balance	Yields or Rates	Interest Income/ Expense	Average Balance	Yields or Rates	Interest Income/ Expense
ASSETS						
Interest earning assets:						
Loans (1)	$1,570,411	5.94%	$69,752	$1,453,741	4.62%	$50,268
Federal funds sold	178,948	5.09%	6,811	217,008	0.79%	1,283
Investment securities	152,574	3.72%	4,241	155,423	2.79%	3,247
Total interest earning assets	1,901,933	5.68%	80,804	1,826,172	4.01%	54,798
Noninterest-earning assets:						
Cash and due from banks	19,227			19,550		
All other assets (2)	62,679			61,939		
TOTAL	$1,983,839			$1,907,661		
LIABILITIES AND SHAREHOLDERS' EQUITY						
Interest-bearing liabilities:						
Deposits:						
Demand	$ 31,029	0.19%	$ 43	$ 40,214	0.08%	$ 25
Money market and savings	626,318	2.49%	11,672	652,849	0.45%	2,185
Time	323,148	4.45%	10,761	172,284	0.83%	1,064
Other	71,782	4.37%	2,348	125,108	2.58%	2,412
Total interest-bearing liabilities	1,052,277	3.15%	24,824	990,455	0.77%	5,686
Noninterest-bearing liabilities:						
Demand deposits	720,694			738,273		
Accrued expenses and other liabilities	27,827			20,848		
Shareholders' equity	183,041			158,085		
TOTAL	$1,983,839			$1,907,661		
Net interest income and margin (3)		3.94%	$55,980		3.60%	$49,112

(1) Nonperforming loans are included in average loan balances. No adjustment has been made for these loans in the calculation of yields. Interest income on loans includes amortization of net deferred loan (costs) fees of $(482,000) and $501,000, respectively.
(2) Other noninterest-earning assets includes the allowance for credit losses of $16.1 million and $15.0 million, respectively.
(3) Net interest margin is net interest income divided by total interest-earning assets.

The following table shows the effect of the interest differential of volume and rate changes for the nine months ended September 30, 2023 and 2022. The change in interest due to both rate and volume has been allocated in proportion to the relationship of absolute dollar amounts of change in each.

	Nine Months Ended September 30, 2023 vs. 2022		
	Increase (Decrease) Due to Change in:		
(Dollars in thousands)	Average Volume	Average Rate	Net Change
Interest income:			
Loans	$ 5,182	$ 14,302	$ 19,484
Federal funds sold	(1,449)	6,977	5,528
Investment securities	(79)	1,073	994
Interest expense:			
Deposits			
Demand	(13)	31	18
Money market and savings	(494)	9,981	9,487
Time	5,024	4,673	9,697
Other borrowings	(1,744)	1,680	(64)
Net interest income	$ 881	$ 5,987	$ 6,868

Interest Income

Interest income increased by $26.0 million for the nine months ended September 30, 2023 compared to the same period of 2022, primarily due to an increase in the prime rate which generated higher yields on our loan portfolio combined with PPP loans that were forgiven by the SBA being replaced with higher yielding commercial and real estate other loans, partially offset by a decrease in amortization of net fees collected on PPP loans. The prime rate at September 30, 2023 and September 30, 2022 was 8.50% and 6.25%, respectively. The average prime rate for the nine months ended September 30, 2023 and 2022 was 8.09% and 4.20%, respectively. Interest earned on our loan portfolio of $69.8 million for the nine months ended September 30, 2023 represented an increase of $19.5 million, or 39%, compared to $50.3 million for the same period in 2022.

Additionally, the Company benefited from a more favorable mix of other earning assets. Interest earned on federal funds sold of $6.8 million for the nine months ended September 30, 2023 compared to $1.3 million for the same period in the prior year. Interest earned on investment securities of $4.2 million for the nine months ended September 30, 2023 compared to $3.2 million for the same period in the prior year.

Interest Expense

Interest expense increased by $19.1 million for the nine months ended September 30, 2023 compared to the same period of 2022, primarily due to the effect of increased rates paid on interest-bearing deposits, combined with a higher level of interest-bearing deposits. The average rate paid on interest-bearing liabilities for the nine months ended September 30, 2023 compared to the same period one year earlier increased 238 basis point to 3.15% from 0.77%.

Provision for Credit Losses

The provision for credit losses of $1.1 million for the nine months ended September 30, 2023 was comprised of $925,000 pertaining to the ACL on loans and $220,000 pertaining to the ACL for unfunded loan commitments, partially offset by a release of reserves pertaining to the ACL for held to maturity securities of $29,000.

The provision for credit losses on loans of $1.1 million for the nine months ended September 30, 2023 compared to a provision for loan losses of $2.7 million for the same period in the prior year. The Company had net loan charge-offs of $169,000 and $201,000 during the nine months ended September 30, 2023 and 2022, respectively. The allowance for credit losses on loans as a percentage of outstanding loans was 1.01% at September 30, 2023 and 1.07% at December 31, 2022. On January 1, 2023, the Company adopted the current expected losses (CECL) accounting standard (ASC 326). The Company’s allowance for credit losses on loans was 0.95% upon adoption of the standard on January 1, 2023.

Noninterest Income

The following table reflects the major components of the Company's noninterest income for the nine months ended September 30, 2023 and 2022.

(Dollars in thousands)	Nine Months Ended September 30, 2023	2022	Increase (Decrease) Amount	Percent
Service charges and other fees	$ 2,733	$ 3,260	$ (527)	-16%
Gain on sale of SBA loans	—	1,393	(1,393)	100%
Earnings on BOLI	528	497	31	6%
Other	275	262	13	5%
Total non-interest income	$ 3,536	$ 5,412	$ (1,876)	-35%

Noninterest income decreased by $1.9 million, or 35%, for the nine months ended September 30, 2023, compared to the nine months ended of 2022. The decrease was primarily attributable to a gain of $1.4 million recognized on the sale of a portion of our solar loan portfolio in the prior year and a decrease of $527,000 pertaining to service charges and other fees.

Noninterest Expense

The following table reflects the major components of the Company's noninterest expense for the nine months ended September 30, 2023 and 2022.

(Dollars in thousands)	Nine Months Ended September 30, 2023	2022	Increase (Decrease) Amount	Percent
Salaries and benefits	$23,945	$21,654	$2,291	11%
Premises and equipment	3,503	3,844	(341)	-9%
Professional fees	1,332	1,662	(330)	-20%
Data processing	1,942	1,951	(9)	0%
Other	4,575	3,841	734	19%
Total non-interest expense	$35,297	$32,952	$2,345	7%

Non-interest expense was $35.3 million and $33.0 million for the nine months ended September 30, 2023 and 2022, respectively. Excluding capitalized loan origination costs, non-interest expense for the nine months ended September 30, 2023 was $37.3 million compared to $36.1 million for the nine months ended September 30, 2022, representing an increase of $1.2 million, or 3%.

Salaries and benefits for the nine months ended September 30, 2023 were $23.9 million, representing an increase of $2.3 million, or 11%, compared to $21.6 million for the nine months ended September 30, 2022. The increase in salaries and benefits expense was primarily due to an increase in salaries and benefits related to investments to support the continued growth of the business combined with a reduction in capitalized loan origination costs.

For the nine months ended September 30, 2023 and 2022, the Company's efficiency ratio, the ratio of non-interest expense to revenues, was 59.31% and 60.44%, respectively.

Provision for Income Taxes

Income tax expense was $6.8 million and $5.5 million for the nine months ended September 30, 2023 and 2022. The effective tax rates for those time periods were 29.5% and 28.9%, respectively.

Financial Condition:

Overview

Total assets of the Company were $1.98 billion as of September 30, 2023 compared to $2.04 billion as of December 31, 2022. The decrease in total assets from year-end was primarily due to slower loan growth and decreased liquidity related to a reduction in non-interest bearing deposits.

Loan Portfolio

Our loan portfolio consists almost entirely of loans to customers who have a full banking relationship with us. Gross loan balances decreased by $20.3 million, or 1%, from December 31, 2022 to September 30, 2023 primarily due to a reduction in the commercial and industrial, construction and land, SBA and other loan portfolios, partially offset by an increase in real estate other loans due to organic growth.

The loan portfolio at September 30, 2023 and December 31, 2022 was comprised of approximately 40% of commercial and industrial loans. In addition, commercial real estate loans comprised 55% of our loans at September 30, 2023 and 53% at December 31, 2022. Our loans are generated by our relationship managers and executives. Our senior management is actively involved in the lending, underwriting, and collateral valuation processes. Higher dollar loans or loan commitments are also approved through a bank loan committee comprised of executives and outside board members.

The following table reflects the composition of the Company's loan portfolio and the percentage distribution at September 30, 2023 and December 31, 2022.

(Dollars in thousands)	September 30, 2023	December 31, 2022
Commercial and industrial	$ 633,902	$ 634,535
Real estate - other	858,611	848,241
Real estate - construction and land	40,003	63,730
SBA	4,415	7,220
Other	36,184	39,695
Total loans, gross	1,573,115	1,593,421
Deferred loan origination costs, net	1,312	2,040
Allowance for credit losses	(15,921)	(17,005)
Total loans, net	$ 1,558,506	$ 1,578,456
Commercial and industrial	40%	40%
Real estate - other	55%	53%
Real estate - construction and land	3%	4%
SBA	0%	1%
Other	2%	2%
Total loans, gross	100%	100%

The following table shows the maturity distribution for total loans outstanding as of September 30, 2023. The maturity distribution is grouped by remaining scheduled principal payments that are due within one year, after one but within five years, after five years but within fifteen years, or after fifteen years. The principal balances of loans are indicated by both fixed and variable rate categories.

(Dollars in thousands)	Due in One Year Or Less	Over One Year But Less Than Five Years	Over Five Years But Less Than Fifteen Years	Over Fifteen Years	Total
Commercial and industrial	$180,569	$349,172	$ 104,161	$ —	$ 633,902
Real estate - other	51,460	423,190	372,551	11,410	858,611
Real estate - construction and land	38,463	520	1,020	—	40,003
SBA	193	992	2,417	813	4,415
Other	592	1,764	—	33,828	36,184
Total loans, gross	$271,277	$775,638	$ 480,149	$ 46,051	$1,573,115

(Dollars in thousands)	Loans With Fixed Rates (1)	Loans With Variable Rates	Total
Commercial and industrial	$172,911	$460,991	$ 633,902
Real estate - other	581,614	276,997	858,611
Real estate - construction and land	3,571	36,432	40,003
SBA	137	4,278	4,415
Other	35,582	602	36,184
Total loans, gross	$793,815	$779,300	$1,573,115

(1) Excludes variable rate loans on floors

Nonperforming Assets

Nonperforming assets are comprised of loans on nonaccrual status, loans 90 days or more past due and still accruing interest, and other real estate owned. We had no other real estate owned at September 30, 2023. A loan is placed on nonaccrual status if there is concern that principal and interest may not be fully collected or if the loan has been past due for a period of 90 days or more, unless the obligation is both well secured and in process of legal collection. When loans are placed on nonaccrual status, all interest previously accrued but not collected is reversed against current period interest income. Income on nonaccrual loans is subsequently recognized only to the extent that cash is received and the loan’s principal balance is deemed collectible. Loans are returned to accrual status when they are brought current with respect to principal and interest payments and future payments are reasonably assured.

The following table presents information regarding the Company’s nonperforming and modified loans as of September 30, 2023 and December 31, 2022.

(Dollars in thousands)	September 30, 2023	December 31, 2022
Nonaccrual loans	$ 1,236	$ 1,250
Loans over 90 days past due and still accruing	—	—
Total nonperforming loans	1,236	1,250
Foreclosed assets	—	—
Total nonperforming assets	$ 1,236	$ 1,250
Modified loans	$ 50	$ —
Nonperforming loans / gross loans	0.08%	0.08%
Allowance for credit losses / nonperforming loans	1288.11%	1360.40%

Allowance for Credit Losses

Effective January 1, 2023, the Company adopted the Current Expected Credit Losses (CECL) Methodology for estimating the allowance for credit losses. Our allowance for credit losses is maintained at a level management believes is adequate to account for expected credit losses in the loan portfolio as of the reporting date. We determine the allowance based on a quarterly evaluation of risk.

Our allowance is established through charges to the provision for credit losses. Loans, or portions of loans, deemed to be uncollectible are charged against the allowance. Recoveries of previously charged-off amounts are credited to our allowance for credit losses. The allowance is decreased by the reversal of prior provisions when the total allowance balance is deemed excessive for the risks inherent in the portfolio. The allowance for credit losses balance is neither indicative of the specific amounts of future charge-offs that may occur, nor is it an indicator of any future loss trends.

The following tables provide information on the activity within the allowance for credit losses as of and for the periods indicated.

(Dollars in thousands)	Commercial and Industrial	Real Estate Other	Real Estate Construction and Land	SBA	Other	Total
Three months ended September 30, 2023:						
Beginning balance	$ 10,803	$ 2,970	$ 737	$ 40	$ 1,172	$ 15,722
Provision for credit losses	272	(66)	(351)	452	(186)	121
Charge-offs	(156)	—	—	—	—	(156)
Recoveries	196	—	—	38	—	234
Ending balance	$ 11,115	$ 2,904	$ 386	$ 530	$ 986	$ 15,921
Alowance for credit losses / gross loans	1.75%	0.34%	0.96%	12.00%	2.72%	1.01%
Net recoveries (charge-offs) / gross loans	0.01%	0.00%	0.00%	0.86%	0.00%	0.00%
Three months ended September 30, 2022:						
Beginning balance	$ 9,526	$ 5,243	$ 907	$ 273	$ 8	$ 15,957
Provision for loan losses	699	(70)	90	57	24	800
Charge-offs	—	—	—	(202)	—	(202)
Recoveries	—	—	—	—	—	—
Ending balance	$ 10,225	$ 5,173	$ 997	$ 128	$ 32	$ 16,555
Alowance for loan losses / gross loans	1.59%	0.63%	1.39%	1.49%	0.08%	1.04%
Net recoveries (charge-offs) / gross loans	0.00%	0.00%	0.00%	-2.36%	0.00%	-0.01%

(Dollars in thousands)	Commercial and Industrial	Real Estate Other	Real Estate Construction and Land	SBA	Other	Total
Nine months ended September 30, 2023						
Beginning balance	$ 10,620	$ 5,322	$ 884	$ 132	$ 47	$ 17,005
Adoption of new accounting standard	(1,566)	(1,725)	1	(91)	1,541	(1,840)
Provision for credit losses	2,268	(693)	(499)	451	(602)	925
Charge-offs	(403)	—	—	—	—	(403)
Recoveries	196	—	—	38	—	234
Ending balance	$ 11,115	$ 2,904	$ 386	$ 530	$ 986	$ 15,921
Alowance for credit losses / gross loans	1.75%	0.34%	0.96%	12.00%	2.72%	1.01%
Net recoveries (charge-offs) / gross loans	-0.03%	0.00%	0.00%	0.86%	0.00%	-0.01%
Nine months ended September 30, 2022						
Beginning balance	$ 8,552	$ 4,524	$ 681	$ 309	$ 15	$ 14,081
Provision for loan losses	1,672	649	316	21	17	2,675
Charge-offs	—	—	—	(202)	—	(202)
Recoveries	1	—	—	—	—	1
Ending balance	$ 10,225	$ 5,173	$ 997	$ 128	$ 32	$ 16,555
Alowance for loan losses / gross loans	1.59%	0.63%	1.39%	1.49%	0.08%	1.04%
Net recoveries (charge-offs) / gross loans	0.00%	0.00%	0.00%	-2.36%	0.00%	-0.01%

Investment Portfolio

Our investment portfolio is comprised of debt securities. We use two classifications for our investment portfolio: available for sale and held to maturity. Securities that we have the positive intent and ability to hold to maturity are classified as “held to maturity securities” and reported at amortized cost. Securities not classified as held to maturity securities are classified as “investment securities available for sale” and reported at fair value.

During the first quarter of 2022, the Company re-designated certain securities previously classified as available for sale to the held to maturity classification. The re-designated securities consisted of mortgage backed securities and government agencies with a total carrying value of $49.9 million at December 31, 2022. At the time of re-designation the securities included $281,000 of pretax unrealized losses in other comprehensive income which is being amortized over the remaining life of the securities in a manner consistent with the amortization of a premium or discount.

Our investments provide a source of liquidity as they can be pledged to support borrowed funds or can be liquidated to generate cash proceeds. The investment portfolio is also a significant resource to us in managing interest rate risk, as the maturity and interest rate characteristics of this asset class can be readily changed to match changes in the loan and deposit portfolios. The majority of our investment portfolio is comprised of mortgage backed securities, government agency securities, and corporate bonds.

The following table reflects the amortized cost and fair market values for the total portfolio for each of the categories of investments in our securities portfolio as of September 30, 2023 and December 31, 2022.

(Dollars in thousands)	Amortized Cost	Gross Unrealized / Unrecognized Gains	Gross Unrealized / Unrecognized Losses	Estimated Fair Value
At September 30, 2023:				
Mortgage backed securities	$ 16,193	$ 7	$ (1,025)	$ 15,175
Government agencies	29,888	—	(836)	29,052
Total available for sale securities	$ 46,081	$ 7	$ (1,861)	$ 44,227
Mortgage backed securities	$ 57,873	$ —	$ (8,663)	$ 49,210
Government agencies	3,075	—	(672)	2,403
Corporate bonds	44,069	—	(4,810)	39,259
Total held to maturity securities, net	$ 105,017	$ —	$ (14,145)	$ 90,872
At December 31, 2022:				
Mortgage backed securities	$ 18,629	$ 26	$ (897)	$ 17,758
Government agencies	29,809	—	(1,043)	28,766
Corporate bonds	430	58	—	488
Total available for sale securities	$ 48,868	$ 84	$ (1,940)	$ 47,012
Mortgage backed securities	$ 61,363	$ —	$ (7,647)	$ 53,716
Government agencies	3,083	—	(627)	2,456
Corporate bonds	44,420	30	(3,739)	40,711
Total held to maturity securities	$ 108,866	$ 30	$ (12,013)	$ 96,883

The Company adopted ASC 326 on January 1, 2023 and, as a result, records an allowance for credit losses on investment securities. No allowances for credit losses have been recognized, individually or collectively, on available for sale securities in an unrealized loss position, as management does not believe any of the securities are impaired due to reasons of credit quality at September 30, 2023. As of September 30, 2023, the Company determined that an allowance for credit losses of $81,000 was required for held to maturity securities. The allowance for credit losses pertained to corporate bonds and was presented as a reduction to the amortized cost of held to maturity securities outstanding.

Deposits

Our deposits are primarily generated through core customer relationships, related predominantly to business relationships. Many of our business customers maintain high levels of liquid balances in their demand deposit accounts and use the Bank's treasury management services. At September 30, 2023, approximately 95% of commercial relationships held deposits at the Bank, primarily in operating accounts, and there were no significant industry concentrations. An additional source of deposits is periodically obtained through third-party brokers. At September 30, 2023 and December 31, 2022, the Company held wholesale brokered time deposits of $241.1 million and $180.3 million, respectively.

The Company is also a participant in the Certificate of Deposit Account Registry Service (CDARS), IntraFi Network (ICS), and Reich & Tang Deposit Solutions (R&T) network, all of which provide reciprocal deposit placement services to fully qualify large customer deposits for FDIC insurance among other participating banks. At September 30, 2023 and December 31, 2022, the Company had $494.5 million and $46.9 million of reciprocal deposits, respectively. At September 30, 2023 insured deposits represented 61% of the total deposit portfolio and uninsured deposits represented 39% of the total deposit portfolio, compared to insured deposits of 32% of the total deposit portfolio and uninsured deposits of 68% of the total deposit portfolio at December 31, 2022.

At September 30, 2023, approximately 40% of our deposits were in noninterest-bearing demand deposits. The balance of our deposits at September 30, 2023 were held in interest-bearing demand, savings and money market accounts and time deposits. Approximately 41% of total deposits were held in interest-bearing demand, savings and money market deposit accounts at September 30, 2023, which provide our customers with interest and liquidity. Time deposits comprised the remaining 19% of our deposits at September 30, 2023.

The following table provides a comparative distribution of our deposits by outstanding balance as well as by percentage of total deposits at the dates indicated.

(Dollars in thousands)	Balance	% of Total
At September 30, 2023:		
Demand noninterest-bearing	$ 686,723	40%
Demand interest-bearing	28,533	2%
Money market and savings	672,119	39%
Time	319,706	19%
Total deposits	$ 1,707,081	100%
At December 31, 2022:		
Demand noninterest-bearing	$ 811,671	45%
Demand interest-bearing	37,815	2%
Money market and savings	671,016	38%
Time	271,238	15%
Total deposits	$ 1,791,740	100%

The aggregate amount of time deposits in excess of the FDIC insurance limit was $34.8 million and $43.6 million at September 30, 2023 and December 31, 2022, respectively. The following table reflects the aggregate maturities of those deposits as of the respective reporting periods.

(Dollars in thousands)	September 30, 2023	December 31, 2022
3 months or less	$ 28,782	$ 33,344
Over 3 months through 6 months	6,059	10,254
Over 6 months through 12 months	—	—
Over 12 months	—	—
Total uninsured time deposits	$ 34,841	$ 43,598

Liquidity

Our primary source of funding is deposits from our core banking relationships. However, the majority of the Bank’s deposits are transaction accounts or money market accounts that are payable on demand. Additionally, a small number of customers represent a large portion of the Bank’s deposits, as evidenced by the fact that approximately 18% of deposits were represented by the 10 largest depositors at both September 30, 2023 and December 31, 2022. We strive to manage our liquidity in a manner that enables us to meet expected and unexpected liquidity needs under both normal and adverse conditions. The Bank maintains significant on-balance sheet and off-balance liquidity sources, including a marketable securities portfolio, the ability to supplement core deposits with brokered time deposits combined with the stability provided by utilizing reciprocal deposit networks (see “Deposits”, page 42), and our borrowing capacity through various secured and unsecured sources. Our borrowing capacity includes lines of credit with the FRB, FHLB, and correspondent banks that enable us to borrow funds as described in Note 4 to the consolidated financial statements included in Item 1 of this Report.

Capital Resources

We are subject to various regulatory capital requirements administered by federal and state banking regulators. Our capital management consists of providing equity to support our current operations and future growth. Failure to meet minimum regulatory capital requirements may result in mandatory and possible additional discretionary actions by regulators that, if undertaken, could have a direct material effect on our financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, we must meet specific capital guidelines that involve quantitative measures of our assets, liabilities and off-balance sheet items as calculated under regulatory accounting policies. At September 30, 2023 and December 31, 2022, we were in compliance with all applicable regulatory capital requirements, including the capital conservation buffer, and the Bank's capital ratios exceeded the minimums necessary to be considered ''well-capitalized'' for purposes of the FDIC's prompt corrective action regulations. At September 30, 2023, the capital conservation buffer was 4.76%.

At September 30, 2023, the Bank had a Tier 1 risk-based capital ratio of 11.85%, a total capital to risk-weighted assets ratio of 12.76%, and a leverage ratio of 11.75%. At December 31, 2022, the Bank had a Tier 1 risk-based capital ratio of 10.54%, a total capital to risk-weighted assets ratio of 11.40%, and a leverage ratio of 10.23%.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

As a smaller reporting company, we are not required to provide the information required by this item.

Item 4. Controls and Procedures

Management of the Company, with the participation of its Chief Executive Officer and Chief Financial Officer, conducted an evaluation of the effectiveness as of September 30, 2023 of the Company's disclosure controls and procedures, as defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act. In designing and evaluating the disclosure controls and procedures, management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives, and management was required to apply judgment in evaluating its controls and procedures. Based on this evaluation, the Company's Chief Executive Officer and Chief Financial Officer concluded that the Company's disclosure controls and procedures were effective as of the end of the fiscal quarter covered by this Form 10-Q.

Changes in Internal Control over Financial Reporting

There was no change in the Company's internal control over financial reporting that occurred during the Company's last fiscal quarter that has materially affected, or is reasonably likely to materially affect, such controls.

PART II – OTHER INFORMATION

Item 1. Legal Proceedings

From time to time, we are party to legal actions that are routine and incidental to our business. Given the nature, scope and complexity of the extensive legal and regulatory landscape applicable to our business, we, like all banking organizations, are subject to heightened regulatory compliance and legal risk. However, based on available information, management does not expect the ultimate disposition of any or a combination of these actions to have a material adverse effect on our business, financial condition and results of operation.

Item 1A. Risk Factors

We disclosed certain risks and uncertainties that we face under the caption “Risk Factors” in Item 1A of Part I of our Annual Report on Form 10-K for the year ended December 31, 2022, which we filed with the SEC on March 24, 2023. The information presented below provides an update to, and should be read in conjunction with, the risk factors and other information contained in our 2022 Form 10-K.

Adverse developments affecting the banking industry have eroded customer confidence in the banking system and could have a material effect on our operations and/or stock price.

The recent high-profile failures of several depository institutions have negatively impacted customer confidence in the safety and soundness of some regional and community banks. As a result, we face that risk that customers may prefer to maintain deposits with larger financial institutions or invest in short-term fixed income securities instead of deposits with the Bank, either of which could materially adversely impact our liquidity, cost of funding, capital, and results of operations. In response to the failures of other depository institutions, we may face increased regulation and supervisory oversight, higher capital or liquidity requirements or a heightened risk of regulatory enforcement activities, any of which could have a material impact on our business. Further, our costs of deposit insurance may increase as a result of these bank failures and the resulting losses to the FDIC’s Deposit Insurance Fund. In addition, concerns about the banking industry’s operating environment and the public trading prices of bank holding companies are often correlated, particularly during times of financial stress, which could adversely impact the trading price of our common stock.

If we are required to sell securities to meet liquidity needs, we could realize significant losses.

As a result of increases in interest rates over the last year, the market values of previously issued government and other debt securities have declined significantly, resulting in unrealized losses in our securities portfolio. While we do not expect or intend to sell these securities, if we were required to sell these securities to meet liquidity needs, we may incur significant losses, which could impair our capital and financial condition and adversely affect our results of operations. Further, while we have taken actions to maximize our sources of liquidity, there is no guarantee that such sources will be available or sufficient in the event of sudden liquidity needs.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

None

Item 3. Defaults upon Senior Securities

None

Item 4. Mine Safety Disclosures

Not Applicable

Item 5. Other Information

None

Item 6. Exhibits

Exhibit Number	Description of Exhibit
3.1	Articles of Incorporation of California BanCorp (incorporated by reference to Exhibit 3.1 to the Company's Registration Statement on Form 10 filed with the Commission on March 4, 2020)
3.2	Amended and Restated Bylaws of California Bancorp (incorporated by reference to Exhibit 3.2 to the Company's Registration Statement on Form 10 filed with the Commission on March 4, 2020)
31.1	Certification of Principal Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
31.2	Certification of Principal Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
32.1	Certification of Principal Executive Officer Pursuant to Section 906 of the Public Company Accounting Reform and Investor Protections Act of 2002
32.2	Certification of Principal Financial Officer Pursuant to Section 906 of the Public Company Accounting Reform and Investor Protections Act of 2002
101.INS	Inline XBRL Instance Document (the instance document does not appear in the Interactive Data File because its XBRL tags are embedded within the Inline XBRL document)
101.SCH	Inline XBRL Taxonomy Extension Schema Document
101.CAL	Inline XBRL Taxonomy Extension Calculation Linkbase Document
101.DEF	Inline XBRL Taxonomy Extension Definition Linkbase Document
101.LAB	Inline XBRL Taxonomy Extension Labels Linkbase Document
101.PRE	Inline XBRL Taxonomy Extension Presentation Linkbase Document
104	Cover Page Interactive Data File (formatted as Inline XBRL and contained in Exhibit 101)

Signatures

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

	California BanCorp
Dated: November 9, 2023	By: /s/ Steven E. Shelton Steven E. Shelton Chief Executive Officer (Principal Executive Officer)
Dated: November 9, 2023	By: /s/ Thomas A. Sa Thomas A. Sa President and Chief Financial Officer (Principal Financial and Accounting Officer)

EXHIBIT 31.1

CERTIFICATION OF CHIEF EXECUTIVE OFFICER
PURSUANT TO SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002

I, Steven E. Shelton, certify that:

1. I have reviewed this periodic report on Form 10-Q of California BanCorp.

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 the registrants' board of directors (or persons performing the equivalent functions):

   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: November 9, 2023

/s/ Steven E. Shelton
Steven E. Shelton
Chief Executive Officer

EXHIBIT 31.2

CERTIFICATION OF CHIEF FINANCIAL OFFICER
PURSUANT TO SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002

I, Thomas A. Sa, certify that:

1. I have reviewed this periodic report on Form 10-Q of California BanCorp.

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 the registrants' board of directors (or persons performing the equivalent functions):

    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: November 9, 2023

/s/ Thomas A. Sa
Thomas A. Sa
President and Chief Financial Officer

EXHIBIT 32.1

CERTIFICATION OF CHIEF EXECUTIVE OFFICER
PURSUANT TO SECTION 906 OF THE
PUBLIC COMPANY ACCOUNTING REFORM AND INVESTOR PROTECTION ACT OF 2002

In connection with the periodic report of California BanCorp (the “Company”) on Form 10-Q for the period ended September 30, 2023, as filed with the Securities and Exchange Commission (the “Report”), I, Steven E. Shelton, Chief Executive Officer of the Company, hereby certify as of the date hereof, solely for purposes of Title 18, Chapter 63, Section 1350 of the United States Code, that:

(1) the Report fully complies with the requirements of section 13(a) or 15(d), as applicable, of the Securities Exchange Act of 1934; and

(2) the information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

This Certification has not been, and shall not be deemed, “filed” with the Securities and Exchange Commission.

Dated: November 9, 2023

/s/ Steven E. Shelton
Steven E. Shelton
Chief Executive Officer

EXHIBIT 32.2

CERTIFICATION OF CHIEF FINANCIAL OFFICER
PURSUANT TO SECTION 906 OF THE
PUBLIC COMPANY ACCOUNTING REFORM AND INVESTOR PROTECTION ACT OF 2002

In connection with the periodic report of California Bancorp (the "Company") on Form 10-Q for the period ended September 30, 2023, as filed with the Securities and Exchange Commission (the "Report"), I, Thomas A. Sa, President and Chief Financial Officer of the Company, hereby certify as of the date hereof, solely for purposes of Title 18, Chapter 63, Section 1350 of the United States Code, that:

(1) the Report fully complies with the requirements of section 13(a) or 15(d), as applicable, of the Securities Exchange Act of 1934; and

(2) the information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

This Certification has not been, and shall not be deemed, "filed" with the Securities and Exchange Commission.

Dated: November 9, 2023

/s/ Thomas A. Sa
Thomas A. Sa
President and Chief Financial Officer