UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended September 30, 2023

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

For the transition period from to

Commission file number 001-41068

BAYFIRST FINANCIAL CORP.

(Exact name of registrant as specified in its charter)

Florida	**59-3665079**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
700 Central Avenue St. Petersburg, Florida	**33701**
(Address of Principal Executive Offices)	(Zip Code)

(727) 440-6848

(Registrant's telephone number, including area code)

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

Title of each class	Trading Symbol(s)	Name of each exchange on which registered
Common stock	BAFN	The Nasdaq Stock Market LLC

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 x No o

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate web site, if any, every Interactive Data File required to be submitted and posted 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 and post such files). Yes x No o

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of “large accelerated filer,” “accelerated filer” and “smaller reporting company” in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer	o	Accelerated filer	o
Non-accelerated filer	x	Smaller reporting company	x
		Emerging growth company	x

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 o No ☒

The registrant had outstanding 4,110,650 shares of common stock as of November 6, 2023.

BayFirst Financial Corp.
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Glossary of Acronyms and Abbreviations

The acronyms and abbreviations identified below may be used throughout this Quarterly Report on Form 10-Q or in our other SEC filings. You may find it helpful to refer back to this page while reading this report.

ACL: Allowance for Credit Losses	FDIA: Federal Deposit Insurance Act
AFS: Available for Sale	FDIC: Federal Deposit Insurance Corporation
AIO: Architecture, Infrastructure, and Operations	FFIEC: Federal Financial Institutions Examination Council
ALCO: Asset-Liability Committee	FHLB: Federal Home Loan Bank
ALLL: Allowance for Loan Losses	FNBB: First National Bankers Bank
AOCI: Accumulated Other Comprehensive Income	FRB: Federal Reserve Bank
ASC: FASB Accounting Standards Codification	FVO: Fair Value Option
ASU: FASB Accounting Standards Update	GAAP: Generally Accepted Accounting Principles
BHCA: Bank Holding Company Act of 1956, as amended	HFI: Held for Investment
BOLI: Bank Owned Life Insurance	HTM: Held to Maturity
BSA: Bank Secrecy Act of 1970	IRA: Individual Retirement Account
CAA: Consolidated Appropriations Act	JOBS Act: Jumpstart Our Business Startups Act of 2012
CARES Act: Coronavirus Aid, Relief, and Economic Security Act	LGD: Loss Given Default
CBLR: Community Bank Leverage Ratio	LHFS: Loans Held for Sale
CDARS: Certificate of Deposit Account Registry Services	MMDA: Money Market Deposit Account
CECL: Current Expected Credit Losses	NOW: Negotiable Order of Withdrawal
CEO: Chief Executive Officer	NSPP: Non-Qualified Stock Purchase Plan
CET1: Common Equity Tier 1 Capital	OCC: Office of the Comptroller of the Currency
CFPB: Consumer Financial Protection Bureau	OLC: Officer Loan Committee
C&I: Commercial and Industrial	OREO: Other Real Estate Owned
CIK: Central Index Key	OTTI: Other-Than-Temporary Impairment
COVID-19: Coronavirus Disease 2019	PCAOB: Public Company Accounting Oversight Board
DCLC: Directors’ Credit and Loan Committee	PD: Probability of Default
DEI: Diversity, Equity, and Inclusion	PPP: Paycheck Protection Program
Dodd-Frank Act: Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010	PPPLF: Paycheck Protection Program Liquidity Facility
DRIP: Dividend Reinvestment Plan	QIB: Qualified Institutional Buyer
EGC: Emerging Growth Company	ROU: Right of Use
EPS: Earnings per Share	SBA: Small Business Administration
Equity Plan: The Amended and Restated 2017 Equity Incentive Plan	SEC: U.S. Securities and Exchange Commission
ESG: Environmental, Social, and Governance	SOFR: Secured Overnight Financing Rate
ESOP: Employee Stock Ownership Plan	U.S.: United States
ESPP: Employee Stock Purchase Plan	USDA: United States Department of Agriculture
Exchange Act: Securities Exchange Act of 1934	USDA B&I: United States Department of Agriculture Business and Industry
FASB: Financial Accounting Standards Board	WARM: Weighted Average Remaining Life
FBCA: Florida Business Corporation Act	

BAYFIRST FINANCIAL CORP.
CONSOLIDATED BALANCE SHEETS
(Dollars in thousands, except per share data)

Part I - Financial Information
Item 1. Financial Statements

	September 30, 2023	December 31, 2022
	(Unaudited)	
ASSETS		
Cash and due from banks	$ 4,501	$ 3,649
Interest-bearing deposits in banks	108,052	62,397
Cash and cash equivalents	112,553	66,046
Time deposits in banks	4,631	4,881
Investment securities available for sale, at fair value (amortized cost: $44,569 and $47,374 at September 30, 2023 and December 31, 2022, respectively)	39,683	42,349
Investment securities held to maturity, at amortized cost, net of allowance for credit losses of $19 and $0 (fair value: $2,282 and $4,755 at September 30, 2023 and December 31, 2022, respectively)	2,482	5,002
Nonmarketable equity securities	4,250	4,037
Government guaranteed loans held for sale	1,855	—
Government guaranteed loans held for investment, at fair value	84,178	27,078
Loans held for investment, at amortized cost, net of allowance for credit losses of $13,365 and $9,046 at September 30, 2023 and December 31, 2022, respectively	780,904	692,528
Accrued interest receivable	6,907	4,452
Premises and equipment, net	37,992	35,440
Loan servicing rights	14,216	10,906
Deferred income tax asset	414	980
Right-of-use operating lease assets	2,594	3,177
Bank owned life insurance	25,630	25,159
Other assets	15,292	15,649
Assets from discontinued operations	398	1,211
Total assets	$ 1,133,979	$ 938,895
LIABILITIES AND SHAREHOLDERS' EQUITY		
Liabilities:		
Noninterest-bearing deposits	$ 98,008	$ 93,235
Interest-bearing transaction accounts	267,404	202,656
Savings and money market deposits	350,110	363,053
Time deposits	302,274	136,126
Total deposits	1,017,796	795,070
FRB and FHLB borrowings	—	25,000
Subordinated debentures	5,947	5,992
Notes payable	2,503	2,844
Accrued interest payable	632	704
Operating lease liabilities	2,812	3,538
Accrued expenses and other liabilities	9,409	12,205
Liabilities from discontinued operations	715	1,658
Total liabilities	1,039,814	847,011

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BAYFIRST FINANCIAL CORP.
CONSOLIDATED BALANCE SHEETS CONTINUED
(Dollars in thousands, except per share data)

	September 30, 2023	December 31, 2022
	(Unaudited)	
Shareholders' equity:		
Preferred stock, Series A; no par value,10,000 shares authorized, 6,395 shares issued and outstanding at September 30, 2023 and December 31, 2022; aggregate liquidation preference of $6,395	6,161	6,161
Preferred stock, Series B; no par value,20,000 shares authorized, 3,210 shares issued and outstanding at September 30, 2023 and December 31, 2022; aggregate liquidation preference of $3,210	3,123	3,123
Preferred stock, Series C; no par value,10,000 shares authorized, 1,835 shares issued and outstanding at September 30, 2023 and no shares issued and outstanding at December 31, 2022; aggregate liquidation preference of $1,835 at September 30, 2023	1,835	—
Common stock and additional paid-in capital; no par value,15,000,000 shares authorized, 4,110,650 and 4,042,474 shares issued and outstanding at September 30, 2023 and December 31, 2022, respectively	54,500	53,023
Accumulated other comprehensive loss, net	(3,621)	(3,724)
Unearned compensation	(1,242)	(178)
Retained earnings	33,409	33,479
Total shareholders' equity	94,165	91,884
Total liabilities and shareholders' equity	$ 1,133,979	$ 938,895

See accompanying notes.

BAYFIRST FINANCIAL CORP.
CONSOLIDATED STATEMENTS OF INCOME (UNAUDITED)
(Dollars in thousands, except per share data)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2023	2022	2023	2022
Interest income:				
Loans, including fees	$ 16,032	$ 10,650	$ 45,475	$ 24,812
Interest-bearing deposits in banks and other	1,588	634	4,188	1,234
Total interest income	17,620	11,284	49,663	26,046
Interest expense:				
Deposits	9,055	1,856	21,076	4,133
Borrowings	172	258	1,033	487
Total interest expense	9,227	2,114	22,109	4,620
Net interest income	8,393	9,170	27,554	21,426
Provision for credit losses	3,001	750	7,708	(1,400)
Net interest income after provision for credit losses	5,392	8,420	19,846	22,826
Noninterest income:				
Loan servicing income, net	760	620	2,149	1,508
Gain on sale of government guaranteed loans, net	7,139	7,446	17,576	15,915
Service charges and fees	408	347	1,166	951
Government guaranteed loans fair value gain	4,543	999	11,021	3,510
Other noninterest income	1,829	392	3,152	1,262
Total noninterest income	14,679	9,804	35,064	23,146
Noninterest expense:				
Salaries and benefits	7,912	6,758	23,527	21,177
Bonus, commissions, and incentives	1,406	883	3,515	1,833
Occupancy and equipment	1,262	1,070	3,608	3,010
Data processing	1,526	1,247	4,189	3,486
Marketing and business development	929	662	2,696	2,100
Professional services	816	956	2,587	3,089
Loan origination and collection	1,981	1,068	4,697	2,486
Employee recruiting and development	543	518	1,667	1,653
Regulatory assessments	284	110	615	299
Other noninterest expense	768	886	2,140	2,586
Total noninterest expense	17,427	14,158	49,241	41,719
Income from continuing operations before income taxes	2,644	4,066	5,669	4,253
Income tax expense from continuing operations	674	983	1,415	888
Net income from continuing operations	1,970	3,083	4,254	3,365
Loss from discontinued operations before income taxes	(62)	(5,973)	(275)	(6,706)
Income tax benefit from discontinued operations	(15)	(1,488)	(68)	(1,670)
Net loss from discontinued operations	(47)	(4,485)	(207)	(5,036)
Net income (loss)	1,923	(1,402)	4,047	(1,671)
Preferred stock dividends	208	208	624	624
Net income available to (loss attributable to) common shareholders	$ 1,715	$ (1,610)	$ 3,423	$ (2,295)

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BAYFIRST FINANCIAL CORP.
CONSOLIDATED STATEMENTS OF INCOME (UNAUDITED) CONTINUED
(Dollars in thousands, except per share data)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2023	2022	2023	2022
Basic earnings (loss) per common share:				
Continuing operations	$ 0.43	$ 0.71	$ 0.89	$ 0.68
Discontinued operations	(0.01)	(1.11)	(0.05)	(1.25)
Total basic earnings (loss) per common share	$ 0.42	$ (0.40)	$ 0.84	$ (0.57)
Diluted earnings (loss) per common share:				
Continuing operations	$ 0.42	$ 0.68	$ 0.88	$ 0.67
Discontinued operations	(0.01)	(1.03)	(0.05)	(1.15)
Total diluted earnings (loss) per common share	$ 0.41	$ (0.35)	$ 0.83	$ (0.48)

See accompanying notes.

BAYFIRST FINANCIAL CORP.
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS) (UNAUDITED)
(Dollars in thousands)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2023	2022	2023	2022
Net income (loss)	$ 1,923	$ (1,402)	$ 4,047	$ (1,671)
Net unrealized gains (losses) on investment securities available for sale	(516)	(1,628)	139	(4,530)
Deferred income tax (expense) benefit	134	422	(36)	1,170
Other comprehensive income (loss), net	(382)	(1,206)	103	(3,360)
Comprehensive income (loss)	$ 1,541	$ (2,608)	$ 4,150	$ (5,031)

See accompanying notes.

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BAYFIRST FINANCIAL CORP.
CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY (UNAUDITED)
(Dollars in thousands, except per share data)

	Preferred Stock, Series A	Preferred Stock, Series B	Preferred Stock, Series C	Common Stock and Additional Paid-in Capital	Accumulated Other Comprehensive Income (Loss)	Retained Earnings	Total
Balance at July 1, 2022	$ 6,161	$ 3,123	$ —	$ 51,965	$ (2,574)	$ 34,620	$ 93,295
Net loss	—	—	—	—	—	(1,402)	(1,402)
Issuance of common stock under:							
Non-qualified stock purchase plan	—	—	—	211	—	—	211
Dividend reinvestment plan	—	—	—	84	—	—	84
Exercise of stock options, net	—	—	—	7	—	—	7
Stock-based awards - common stock:							
Restricted stock expense, net of tax impact	—	—	—	66	—	—	66
Stock option expense	—	—	—	114	—	—	114
Other comprehensive loss, net	—	—	—	—	(1,206)	—	(1,206)
Dividends declared on:							
Preferred stock	—	—	—	—	—	(208)	(208)
Common stock ($0.08 per share)	—	—	—	—	—	(324)	(324)
Balance at September 30, 2022	$ 6,161	$ 3,123	$ —	$ 52,447	$ (3,780)	$ 32,686	$ 90,637
Balance at July 1, 2023	$ 6,161	$ 3,123	$ —	$ 52,998	$ (3,239)	$ 32,022	$ 91,065
Net income	—	—	—	—	—	1,923	1,923
Issuance of common stock under:							
Non-qualified stock purchase plan	—	—	—	21	—	—	21
Dividend reinvestment plan	—	—	—	75	—	—	75
Repurchase of common stock	—	—	—	(3)	—	—	(3)
Exercise of stock options, net	—	—	—	(49)	—	—	(49)
Issuance of preferred stock, net	—	—	1,835	—	—	—	1,835
Stock-based awards - common stock:							
Restricted stock expense, net of tax impact	—	—	—	191	—	—	191
Stock option expense	—	—	—	25	—	—	25
Other comprehensive loss, net	—	—	—	—	(382)	—	(382)
Dividends declared on:			—				
Preferred stock	—	—	—	—	—	(208)	(208)
Common stock ($0.08 per share)	—	—	—	—	—	(328)	(328)
Balance at September 30, 2023	$ 6,161	$ 3,123	$ 1,835	$ 53,258	$ (3,621)	$ 33,409	$ 94,165

See accompanying notes.

BAYFIRST FINANCIAL CORP.
CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY (UNAUDITED)
(Dollars in thousands, except per share data)

	Preferred Stock, Series A	Preferred Stock, Series B	Preferred Stock, Series C	Common Stock and Additional Paid-in Capital	Accumulated Other Comprehensive Income (Loss)	Retained Earnings	Total
Balance at January 1, 2022	$ 6,161	$ 3,123	$ —	$ 51,479	$ (420)	$ 35,947	$ 96,290
Net loss	—	—	—	—	—	(1,671)	(1,671)
Issuance of common stock under:							
Non-qualified stock purchase plan	—	—	—	232	—	—	232
Dividend reinvestment plan	—	—	—	167	—	—	167
Repurchase of common stock	—	—	—	(49)	—	—	(49)
Exercise of stock options,net	—	—	—	12	—	—	12
Issuance of common stock, net	—	—	—	13	—	—	13
Stock-based awards - common stock:							
Restricted stock expense, net of tax impact	—	—	—	307	—	—	307
Stock option expense	—	—	—	286	—	—	286
Other comprehensive loss, net	—	—	—	—	(3,360)	—	(3,360)
Dividends declared on:			—				
Preferred stock	—	—	—	—	—	(624)	(624)
Common stock ($0.24 per share)	—	—	—	—	—	(966)	(966)
Balance at September 30, 2022	$ 6,161	$ 3,123	$ —	$ 52,447	$ (3,780)	$ 32,686	$ 90,637
Balance at January 1, 2023	$ 6,161	$ 3,123	$ —	$ 52,845	$ (3,724)	$ 33,479	$ 91,884
Net income	—	—	—	—	—	4,047	4,047
Impact of ASC 326 Adoption	—	—	—	—	—	(2,508)	(2,508)
Issuance of common stock under:							
Non-qualified stock purchase plan	—	—	—	206	—	—	206
Dividend reinvestment plan	—	—	—	159	—	—	159
Issuance of preferred stock, net	—	—	1,835	—	—	—	1,835
Repurchase of common stock	—	—	—	(13)	—	—	(13)
Exercise of stock options, net	—	—	—	(49)	—	—	(49)
Unearned ESOP shares allocation	—	—	—	(329)	—	—	(329)
Stock-based awards - common stock:							
Restricted stock expense, net of tax impact	—	—	—	356	—	—	356
Stock option expense	—	—	—	83	—	—	83
Other comprehensive income, net	—	—	—	—	103	—	103
Dividends declared on:							
Preferred stock	—	—	—	—	—	(624)	(624)
Common stock ($0.24 per share)	—	—	—	—	—	(985)	(985)
Balance at September 30, 2023	$ 6,161	$ 3,123	$ 1,835	$ 53,258	$ (3,621)	$ 33,409	$ 94,165

See accompanying notes.

BAYFIRST FINANCIAL CORP.
CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED) CONTINUED
(Dollars in thousands)

	Nine Months Ended September 30,	
	2023	2022
Cash flows from operating activities:		
Net income from continuing operations	$ 4,254	$ 3,365
Net loss from discontinued operations	(207)	(5,036)
Net income (loss)	4,047	(1,671)
Adjustments to reconcile net income (loss) to net cash from operating activities:		
Depreciation of fixed assets	1,744	1,247
Net securities premium amortization	69	40
Amortization of debt issuance costs	5	5
Amortization of premium on loans purchased, net	182	81
Provision for credit losses	7,708	(1,400)
Accretion of discount on unguaranteed loans	(2,302)	(2,087)
Deferred tax expense (benefit)	1,361	(313)
Origination of government guaranteed loans held for sale	(4,276)	(2,018)
Proceeds from sales of government guaranteed loans held for sale	350,521	268,250
Net gains on sales of government guaranteed loans	(17,576)	(15,915)
Change in fair value of government guaranteed loans held for investment, at fair value	(11,021)	(3,510)
Amortization of loan servicing rights	3,080	2,216
Net gain on sale of other real estate owned	(355)	—
Non-qualified stock purchase plan expense	20	78
Stock based compensation expense	439	515
Income from bank owned life insurance	(471)	(457)
Changes in:		
Accrued interest receivable	(2,455)	(257)
Other assets	883	227
Accrued interest payable	(72)	(90)
Other liabilities	(3,856)	(873)
Net cash provided by operating activities of continuing operations	327,882	249,104
Net cash provided by (used in) operating activities of discontinued operations	(337)	34,333
Net cash provided by operating activities	327,545	283,437
Cash flows from investing activities:		
Purchase of investment securities available for sale	—	(20,326)
Principal payments on investment securities available for sale	2,736	2,234
Purchase of investment securities held to maturity	—	(3,568)
Principal payments on investment securities held to maturity	1	62
Call of investment securities held to maturity	2,500	—
Net (purchase) sale of nonmarketable equity securities	(213)	296
Purchase of time deposits in banks	—	(2,500)
Maturity of time deposits in banks	250	—
Purchase of government guaranteed and consumer loans	(106,413)	(50,689)
Loan (originations) and payments, net	(373,529)	(298,083)
Purchase of premises and equipment	(6,199)	(4,935)
Proceeds on sales of other real estate owned	2,314	—
Net cash used in investing activities	(478,553)	(377,509)

BAYFIRST FINANCIAL CORP.
CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED) CONTINUED
(Dollars in thousands)

	Nine Months Ended September 30,	
	2023	2022
Cash flows from financing activities:		
Net change in deposits	222,726	64,051
Net increase (decrease) in short-term borrowings	(25,000)	28,000
Payments on notes payable	(341)	(341)
Net repayments of PPP Liquidity Facility borrowings	—	(69,654)
Proceeds from issuance of preferred stock, net	1,835	—
Repayment of subordinated debt	(50)	—
Proceeds from issuance of common stock for benefit plans, net	296	424
Common share buyback - redeemed stock	(13)	(49)
Unearned ESOP shares	(329)	—
Dividends paid on common stock	(985)	(966)
Dividends paid on preferred stock	(624)	(624)
Net cash provided by financing activities	197,515	20,841
Net change in cash and cash equivalents	46,507	(73,231)
Cash and cash equivalents, beginning of period	66,046	109,727
Cash and cash equivalents, end of period	$ 112,553	$ 36,496
Supplemental cash flow information		
Interest paid	$ 22,181	$ 4,710
Income taxes paid	2	169
Supplemental noncash disclosures		
Impact to retained earnings from adoption of ASC 326, net of tax	(2,508)	—
Net change in unrealized holding losses on investment securities available for sale, net of tax effect	103	(3,360)
Transfer of available for sale debt securities to held to maturity securities at fair value	—	1,500
Transfer of government guaranteed loans held for investment to loans held for sale	336,914	255,171
Transfer of loans held for investment to OREO	—	53
Transfer of premises and equipment to OREO	(1,903)	—
Recognition of right of use asset and operating lease liability	—	627

See accompanying notes.

NOTE 1 - BASIS OF PRESENTATION

The accompanying unaudited consolidated financial statements include BayFirst Financial Corp. and its wholly owned subsidiary, BayFirst National Bank, together referred to as “the Company”.

These unaudited consolidated financial statements have been prepared in conformity with U.S. generally accepted accounting principles followed within the financial services industry for interim financial information and Article 8 of Regulation S-X. Accordingly, they do not include all of the information or notes required for complete financial statements. The consolidated balance sheet as of December 31, 2022 has been derived from the audited consolidated financial statements of BayFirst Financial Corp. for that period.

The Company currently operates one business segment. In the third quarter of 2022, the Company discontinued the Bank’s nationwide residential mortgage loan segment. The operations of this segment are reported as discontinued operations.

In the opinion of management, all adjustments, consisting of normal and recurring items, considered necessary for a fair presentation of the consolidated financial statements for the interim periods have been included. All significant intercompany accounts and transactions have been eliminated in consolidation. Certain amounts reported in prior periods have been reclassified to conform to current year presentation. These reclassifications did not have a material effect on previously reported net income, shareholders’ equity, or cash flows.

Operating results for the nine month period ended September 30, 2023 are not necessarily indicative of the results that may be expected for the year ending December 31, 2023. These statements should be read in conjunction with the consolidated financial statements and notes thereto for the year ended December 31, 2022.

The Company’s significant accounting policies are described in Note 1 of the Notes to Consolidated Financial Statements for the year ended December 31, 2022 in the Company’s Annual Report filed on Form 10-K as well as changes to accounting policies which are described below. For interim reporting purposes, the Company follows the same basic accounting policies and considers each interim period as an integral part of an annual period.

Use of Estimates: To prepare financial statements in conformity with GAAP, management makes estimates and assumptions based on available information. These estimates and assumptions affect the amounts reported in the financial statements and the disclosures provided, and actual results could differ. The most significant estimates relate to the ACL, government guaranteed loan servicing rights, and fair value of government guaranteed loans.

Emerging Growth Company Status: The Company is expected to remain an "emerging growth company," as defined in the JOBS Act, through December 31, 2026. Section 107 of the JOBS Act provides that an emerging growth company can take advantage of an extended transition period when complying with new or revised accounting standards. In other words, an emerging growth company can delay the adoption of certain accounting standards until those standards would otherwise apply to private companies. The Company has elected to take advantage of this extended transition period, which means these financial statements, as well as financial statements they file in the future for as long as the Company remains an emerging growth company, will be subject to all new or revised accounting standards generally applicable to private companies.

Contingencies: Due to the nature of their activities, the Company and its subsidiary are at times engaged in various legal proceedings that arise in the course of normal business, some of which were outstanding as of September 30, 2023. Although the ultimate outcome of all claims and lawsuits outstanding as of September 30, 2023 cannot be ascertained at this time, it is the opinion of management that these matters, when resolved, will not have a material adverse effect on the Company’s results of operations or financial condition.

Adoption of New Accounting Standards:

On January 1, 2023, the Company adopted ASU No. 2016-13 “Financial Instruments – Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments” (“ASU 2016-13”) along with its amendments, which replaces the incurred loss impairment methodology in past standards with the CECL methodology and requires consideration of a broader range of information to determine credit loss estimates. The measurement of expected losses under the CECL methodology is applicable to financial assets measured at amortized cost, as well as unfunded commitments that are considered off-balance sheet credit exposures at the reporting date. The measurement is based on historical experience, current conditions, and reasonable and supportable forecasts and requires enhanced disclosures related to the significant estimates and judgments used in estimating credit losses, as well as the credit quality and underwriting standards of an organization’s portfolio. In addition, ASU 2016-13 amends the accounting for credit losses on available-for-sale debt securities and purchased financial assets with credit deterioration. One such change is to require credit losses to be presented as an allowance rather than as a write-down on available-for-sale debt securities management does not intend to sell.

(Dollars in thousands, except per share data) (Unaudited)

The Company adopted ASC 326 using the modified retrospective method for all financial assets measured at amortized cost and off-balance sheet credit exposures. Results for reporting periods beginning January 1, 2023 and after are presented under ASC 326, while prior period amounts continue to be reported in accordance with previously applicable GAAP. The Company recorded a decrease to retained earnings of $2,508, net of tax, comprised of a $3,107 pretax increase in the ACL for loans and $ 18 for HTM securities combined with a $ 213 pretax increase in reserve on unfunded commitments, as of January 1, 2023 for the cumulative effect of adopting ASC 326.

The pre-tax impact of the January 1, 2023 adoption is summarized in the table below:

Allowance for credit losses	January 1, 2023 As Reported Under ASC 326	December 31, 2022 Pre-ASC 326 Adoption	Impact of ASC 326 Adoption
Assets			
Investment securities HTM - corporate bonds	$ 18	$ —	$ 18
Loans HFI, at amortized cost			
Real estate - residential	2,210	731	1,479
Real estate - commercial	1,569	956	613
Real estate - construction and land	309	28	281
Commercial and industrial	7,298	6,182	1,116
Consumer and other	767	1,090	(323)
Unallocated	—	59	(59)
Loans HFI, at amortized cost total	12,153	9,046	3,107
Liabilities			
Allowance for credit loss for unfunded commitments	724	511	213
Total	$ 12,877	$ 9,557	$ 3,320

ASU 2022-02, “Financial Instruments - Credit Losses (Topic 326)” (“ASU 2022-02”) eliminates the guidance on troubled debt restructurings and requires entities to evaluate all loan modifications to determine if they result in a new loan or a continuation of the existing loan. ASU 2022-02 also requires that entities disclose current-period gross charge-offs by year of origination for loans. The amendments in this Update became effective for the Company on January 1, 2023 for all interim and annual periods. The adoption of the provisions in this Update are applied prospectively and have resulted in additional disclosures concerning modifications of loans to borrowers experiencing financial difficulty, as well as disaggregated disclosure of charge-offs on loans. Please also see Note 5 – Allowance for Credit Losses for added disclosure concerning modifications of loans to borrowers experiencing financial difficulty, as well as current period gross charge-offs on financing receivables by year of origination and class of financing receivable.

Allowance for Credit Losses - Investment Securities :

The ACL on held-to-maturity securities is a contra-asset valuation determined in accordance with ASC 326, which is deducted from the securities' amortized cost basis at the balance sheet date as a result of management's assessment of the net amount expected to be collected. The allowance is measured on a pooled basis for securities with similar risk characteristics using historical credit loss information, adjusted for current conditions and reasonable and supportable forecasts. Securities that are determined to be uncollectible are written off against the allowance.

For available-for-sale securities in an unrealized loss position ("impaired security"), we assess whether 1) we intend to sell the security, or, 2) it is more likely than not that we will be required to sell the security before recovery of its amortized cost basis. Under either of these scenarios above, the security's amortized cost is written down to fair value through a charge to previously recognized allowances or earnings, as applicable. For impaired securities that do not meet these conditions, we assess whether the decline in fair value was due to credit loss or other factors. This assessment considers, among other things: 1) the extent to which the fair value is less than amortized cost, 2) the financial condition and near-term prospects of the issuer, 3) any changes to the rating of the security by a rating agency, and 4) our intent and ability to retain the investment for a period of time sufficient to allow for any anticipated recovery in fair value. If the present value of cash flows expected to be collected is less than the amortized cost basis, a credit loss exists and an ACL is recorded for the credit loss component. Any impairment due to non-credit-related factors that has not been recorded through an ACL is recognized in other comprehensive income (loss). The discount rate used in determining the present value of the expected cash flows is based on the effective interest rate implicit in the security at the date of purchase.

The ACL on investment securities HTM is a contra-asset valuation that is deducted from the carrying amount of investment securities HTM to present the net amount expected to be collected. Investment securities HTM are charged off against the ACL when deemed uncollectible. Adjustments to the ACL are reported in our Consolidated Statements of Income in provision for credit losses. We measure expected credit losses on securities HTM on a collective basis by major security type with each type sharing similar risk characteristics, and consider historical credit loss information that is adjusted for current conditions and reasonable and supportable forecasts. With regard to U.S. Government-sponsored agency and mortgage-backed securities, all these investment securities are issued by a U.S.government-sponsored entity and have an implicit or explicit government guarantee; therefore, no ACL has been recorded for these investment securities. With regard to corporate bonds HTM, we consider the issuer’s bond rating or the average expected default frequency of the similar investment securities based on company size and industry for those investment securities that are not rated. Historical loss rates associated with investment securities having similar grades as those in our portfolio have been insignificant.

Accrued interest receivable is excluded from the amortized costs and fair values of both held-to-maturity and available-for-sale securities and included in accrued interest receivable on the Consolidated Balance Sheets. Investment securities are placed on non-accrual status when principal or interest is contractually past due more than ninety days, or management does not expect full payment of principal and interest. We do not record an ACL for accrued interest receivable on investment securities, as the amounts are written-off when the investment is placed on non-accrual status. There were no non-accrual investment securities in any of the periods presented in the consolidated financial statements.

Allowance for Credit Losses - Loans Held for Investment and Unfunded Commitments :

The ACL is a valuation account that is deducted from the amortized cost basis of loans to present a net amount expected to be collected. The ACL excludes loans held for sale and loans accounted for under the fair value option. Loans are charged-off against the ACL when management believes the uncollectibility of a loan balance is confirmed.

The Company’s ACL on loans is estimated using relevant information, from internal and external sources, relating to past events, current conditions, and reasonable and supportable forecasts. The Company’s historical credit loss experience provides the basis for the estimation of expected credit losses. Management adjusts historical loss information for differences in current risk characteristics such as portfolio risk grading, delinquency levels, or portfolio mix as well as for changes in environmental conditions such as changes in unemployment rates. The ACL on unfunded loan commitments is based on estimates of probability that these commitments will be drawn upon according to historical utilization experience, expected loss severity and loss rates as determined for pooled funded loans. The ACL on unfunded commitments is a liability account included in other liabilities. Management estimates these allowances quarterly.

The ACL is measured on a pooled basis when similar risk characteristics are present in the portfolio. The Company has identified portfolio segments based on loan pools with similar credit risk characteristics, which generally correspond to federal regulatory reporting codes, with separate consideration for the government guaranteed loans. The ACL model utilizes a PD/LGD methodology to measure the expected credit losses on government guaranteed loans and a WARM methodology for the remaining loans. The PD/LGD method estimates losses by utilizing estimated PD, LGD, and individual loan level exposure at default. The WARM model contemplates expected losses at a pool-level, utilizing historical loss information. Portions of government guaranteed loans have a government guarantee for credit losses, therefore, no ACL has been recorded for those loan balances. In order to quantify the credit risk impact of other trends and changes within the loan portfolio, the Company utilizes qualitative adjustments to the modeled estimated loss approaches. These qualitative adjustments include: changes in lending policies, procedures, and strategies; changes in nature and volume of portfolio; staff experience; changes in volume and trends in classified loans, delinquencies, and nonaccrual; concentration risk; trends in underlying collateral value; external factors such as competition, legal, regulatory; changes in quality of the loan review system; and economic conditions. Additionally, the Company uses reasonable and supportable forecasts utilizing data from the Federal Open Market Committee’s median forecasts of change in national GDP and of national unemployment.

Loans that do not share risk characteristics are evaluated on an individual basis and are excluded from the pooled evaluation. This generally occurs when, based on current information and events, it is probable that the Company will be unable to collect all interest and principal payments due according to the originally contracted, or reasonably modified, terms of the loan agreement.

Individually evaluated loans are evaluated for impairment and a portion of the allowance is allocated so that the loan is reported, net, at the present value of estimated future cash flows using the rate implicit in the original loan agreement or at the fair value of collateral if repayment is expected solely from the collateral.

Expected credit losses are estimated over the contractual term of the loan, adjusted for expected prepayments when appropriate. The contractual term excludes expected extensions, renewals, and modifications unless management has a reasonable expectation at the reporting date that a modification will be executed with an individual borrower or the extension or renewal options are included in the contract at the reporting date by the Company.

Past due status of loans is determined based on contractual terms. Commercial and residential loans are placed in nonaccrual status and interest accrual is discontinued if they become 90 days delinquent or there is evidence that the borrower’s ability to make the required payments is impaired. Other consumer and personal loans continue to accrue interest and are typically charged off no later than 120 days past due.

When interest accrual is discontinued, all unpaid accrued interest is reversed unless all or some interest accrued to date is guaranteed by the USDA, in which case the guaranteed amount is not reversed. Management has made the accounting policy election to exclude accrued interest receivable on loans from the estimate of credit losses.

The determination of the appropriate level of the ACL inherently involves a high degree of subjectivity and requires the Company to make significant estimates of current credit risks and future trends, all of which may undergo material changes. Although management believes that the processes in place for assessing the appropriate level of the ACL are robust, such policies and procedures have limitations, including judgment errors in management’s risk analysis, and may not prevent unexpected losses in the future. Moreover, the CECL methodology may create more volatility in the level of our ACL from quarter to quarter as changes in the level of ACL will be dependent upon, among other things, macroeconomic forecasts and conditions, loan portfolio volumes and credit quality. These factors could have a material adverse effect on the Company’s business, financial condition and results of operations.

Preferred Stock Offering:

On September 30, 2023, the Company issued 1,835 shares of 11.0% Series C Cumulative Convertible Preferred Stock through a private offering. These shares have no par value and a liquidation preference of $1 per share plus an amount equal to all accumulated dividends thereon (whether or not declared but without interest) to the date payment of such distribution is made in full. Total gross proceeds from the preferred stock offering were $1,835 through September 30, 2023 which will be used for operating expenses or to contribute capital to BayFirst National Bank to support its growth and operations. An additional 1,995 shares and 1,760 shares were issued on October 18, 2023 and October 31, 2023, respectively. Total gross proceeds from the preferred stock offering currently totals $5,590.

Series C Preferred Shareholders are entitled to receive quarterly cash dividends at 11% per annum (unless the Company has not redeemed the shares by the tenth anniversary of their issuance, in which event the rate is subject to be increased to 12%). The holders of shares of Series C Preferred Stock have the right to convert such shares into shares of common stock at a conversion value equal to the quotient of: (i) the $1 liquidation preference; divided by (ii) the tangible book value per share of common stock, calculated on the basis of the Company’s financial statements, as of the last day of the calendar quarter occurring prior to the date on which a holder exercises the conversion right; provided, however, that tangible book value shall be adjusted to reflect a subsequent quarter end only on the last day of the month succeeding such quarter end.

On the tenth anniversary of the issuance of any Series C Preferred Stock, the Company must redeem such shares; provided, however, that the Company will not be so obligated if it does not have adequate funds to pay the redemption price or is prohibited by law or otherwise from redeeming the shares. The Company may redeem any portion of the outstanding shares of Series C Preferred Stock at any time after the third anniversary of their issuance. The redemption price in either instance will be $1 per share plus an amount equal to all accumulated dividends thereon (whether or not earned or declared but without interest) to the date of payment of such distribution.

(Dollars in thousands, except per share data) (Unaudited)

NOTE 2 – DISCONTINUED OPERATIONS

During the third quarter of 2022, the Company discontinued the Bank's nationwide residential mortgage loan production operations. The decision was based on a number of strategic priorities and other factors, including the precipitous decline in mortgage volumes and the uncertain outlook for mortgage lending over future periods. As a result of these actions, the Company classified the operations of the residential mortgage lending division as discontinued under ASC 205-20. The Consolidated Balance Sheets, Consolidated Statements of Income, and Consolidated Statements of Cash Flows present discontinued operations for the current period and retrospectively for prior periods.

The following is a summary of the assets and liabilities of the discontinued operations of the residential mortgage lending division at September 30, 2023 and December 31, 2022:

	September 30, 2023	December 31, 2022
Assets		
Loans held for sale, at fair value	$ —	$ 449
Loan servicing rights	—	201
Right-of-use operating lease asset	398	559
Accrued interest receivable	—	2
Total assets	$ 398	$ 1,211
Liabilities		
Operating lease liability	$ 715	$ 1,189
Other liabilities	—	469
Total liabilities	$ 715	$ 1,658

The following presents operating results of the discontinued operations of the residential mortgage lending division for the three and nine months ended September 30, 2023 and September 30, 2022:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2023	2022	2023	2022
Interest income	$ —	$ 862	$ 1	$ 2,466
Noninterest income	—	7,116	(2)	30,540
Total net revenue	—	7,978	(1)	33,006
Noninterest expense	62	13,951	274	39,712
Loss from discontinued operations before income taxes	(62)	(5,973)	(275)	(6,706)
Income tax benefit	(15)	(1,488)	(68)	(1,670)
Net loss from discontinued operations	$ (47)	$ (4,485)	$ (207)	$ (5,036)

(Dollars in thousands, except per share data)

NOTE 3 – INVESTMENT SECURITIES

The amortized costs, gross unrealized gains and losses, and estimated fair values of investment securities available for sale and investment securities held to maturity at September 30, 2023 and December 31, 2022 as well as the ACL for investment securities held to maturity at September 30, 2023 are summarized as follows:

September 30, 2023	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Investment securities available for sale:				
Asset-backed securities	$ 8,597	$ 1	$ (71)	$ 8,527
Mortgage-backed securities:				
U.S. Government-sponsored enterprises	3,909	—	(807)	3,102
Collateralized mortgage obligations:				
U.S. Government-sponsored enterprises	20,730	—	(4,011)	16,719
Corporate bonds	11,333	11	(9)	11,335
Total investment securities available for sale	$ 44,569	$ 12	$ (4,898)	$ 39,683

September 30, 2023	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value	ACL
Investment securities held to maturity:					
Mortgage-backed securities:					
U.S. Government-sponsored enterprises	$ 1	$ —	$ —	$ 1	$ —
Corporate bonds	2,500	—	(219)	2,281	19
Total investment securities held to maturity	$ 2,501	$ —	$ (219)	$ 2,282	$ 19

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(Dollars in thousands, except per share data)

December 31, 2022	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Investment securities available for sale:				
Asset-backed securities	$ 9,873	$ —	$ (268)	$ 9,605
Mortgage-backed securities:				
U.S. Government-sponsored enterprises	4,133	—	(693)	3,440
Collateralized mortgage obligations:				
U.S. Government-sponsored enterprises	22,031	—	(3,811)	18,220
Corporate bonds	11,337	—	(253)	11,084
Total investment securities available for sale	$ 47,374	$ —	$ (5,025)	$ 42,349

December 31, 2022	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Investment securities held to maturity:				
Mortgage-backed securities:				
U.S. Government-sponsored enterprises	$ 2	$ —	$ —	$ 2
Corporate bonds	5,000	—	(247)	4,753
Total investment securities held to maturity	$ 5,002	$ —	$ (247)	$ 4,755

The amortized cost and fair value of investment securities as of September 30, 2023 are shown in the table below by contractual maturity. Actual timing may differ from contractual maturities if borrowers have the right to call or prepay obligations with or without call or prepayment penalties.

	Available for Sale		Held to Maturity	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
One to five years	$ 11,333	$ 11,335	$ 1,500	$ 1,384
Five to ten years	—	—	1,000	897
Beyond ten years	33,236	28,348	1	1
Total	$ 44,569	$ 39,683	$ 2,501	$ 2,282

No ACL for investment securities AFS was needed at September 30, 2023. Accrued interest receivable on securities AFS is excluded from the estimate of credit losses and is included in accrued interest receivable in the Consolidated Balance Sheets.

As of September 30, 2023, there were no past due principal and interest payments associated with the HTM securities. There was an ACL of $ 19 on corporate bonds HTM based on applying the long-term historical credit loss rate for similarly rated securities.

The following table presents the activity in the ACL for investment securities HTM by major security type for the three and nine months ended September 30, 2023:

BAYFIRST FINANCIAL CORP.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Dollars in thousands, except per share data)

Corporate Bonds	For the Three Months Ended	For the Nine Months Ended
	September 30, 2023	
Balance at beginning of period	$ 19	$ —
Impact of adopting ASC 326	—	18
Provision for credit losses	—	1
Investment securities charge-offs/recoveries	—	—
Investment securities recoveries	—	—
Balance at end of period	$ 19	$ 19

The following table summarizes investment securities with unrealized losses at September 30, 2023 aggregated by security type and length of time in a continuous unrealized loss position:

September 30, 2023	Less than 12 Months Fair Value	Less than 12 Months Unrealized Losses	12 Months or Longer Fair Value	12 Months or Longer Unrealized Losses	Total Fair Value	Total Unrealized Losses	Number of Securities
Investment securities available for sale:							
Asset-backed securities	$ —	$ —	$ 6,500	$ (71)	$ 6,500	$ (71)	2
Mortgage-backed securities:							
U.S. Government-sponsored enterprises	—	—	3,102	(807)	3,102	(807)	2
Collateralized mortgage obligations:							
U.S. Government-sponsored enterprises	—	—	16,719	(4,011)	16,719	(4,011)	7
Corporate bonds	5,007	(9)	—	—	5,007	(9)	2
Total investment securities available for sale	$ 5,007	$ (9)	$ 26,321	$ (4,889)	$ 31,328	$ (4,898)	13
Investment securities held to maturity:							
Corporate bonds	$ —	$ —	$ 1,781	$ (219)	$ 1,781	$ (219)	2
Total investment securities held to maturity	$ —	$ —	$ 1,781	$ (219)	$ 1,781	$ (219)	2

(Dollars in thousands, except per share data)

The following table summarizes investment securities with unrealized losses at December 31, 2022 aggregated by security type and length of time in a continuous unrealized loss position:

	Less than 12 Months		12 Months or Longer		Total		
December 31, 2022	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Number of Securities
Investment securities available for sale:							
Asset-backed securities	$ 2,156	$ (103)	$ 7,449	$ (165)	$ 9,605	$ (268)	3
Mortgage-backed securities:							
U.S. Government-sponsored enterprises	—	—	3,440	(693)	3,440	(693)	2
Collateralized mortgage obligations:							
U.S. Government-sponsored enterprises	4,188	(383)	14,103	(3,428)	18,291	(3,811)	7
Corporate bonds	11,085	(253)	—	—	11,085	(253)	5
Total investment securities available for sale	$ 17,429	$ (739)	$ 24,992	$ (4,286)	$ 42,421	$ (5,025)	17
Investment securities held to maturity:							
Corporate bonds	$ 4,982	$ (247)	$ —	$ —	$ 4,982	$ (247)	4
Total investment securities held to maturity	$ 4,982	$ (247)	$ —	$ —	$ 4,982	$ (247)	4

No investment securities were pledged as of September 30, 2023 or December 31, 2022, and there were no sales of investment securities during the three and nine months ended September 30, 2023 or during the year ended December 31, 2022.

NOTE 4 – LOANS

Loans held for investment, at amortized cost, at September 30, 2023 and December 31, 2022 were as follows:

	September 30, 2023	December 31, 2022
Real estate:		
Residential	$ 248,973	$ 202,329
Commercial	280,620	231,281
Construction and land	25,339	9,320
Commercial and industrial	174,238	194,643
Commercial and industrial - PPP	15,364	19,293
Consumer and other	39,024	37,288
Loans held for investment, at amortized cost, gross	783,558	694,154
Deferred loan costs, net	12,928	10,740
Discount on government guaranteed loans sold (1)	(6,623)	(5,621)
Premium on loans purchased, net	4,406	2,301
Allowance for credit losses	(13,365)	(9,046)
Loans held for investment, at amortized cost	$ 780,904	$ 692,528

(1) The Company allocates the retained portion of loans sold based on relative fair value of the retained portion and the sold portion, which results in a discount on the retained portion.

BAYFIRST FINANCIAL CORP.
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NOTE 5 - ALLOWANCE FOR CREDIT LOSSES

On January 1, 2023, the Company adopted ASU 2016-13, or CECL, using the modified retrospective method for all of its loans measured at amortized cost. With the adoption of CECL, the Company elected to exclude accrued interest receivable from the amortized cost basis of loans.

The following schedules present the activity in the ACL by loan segment for the three and nine months ended September 30, 2023 and September 30, 2022:

Three Months Ended	Real Estate - Residential	Real Estate - Commercial	Real Estate - Construction and Land	Commercial and Industrial	Consumer and Other	Unallocated	Total
September 30, 2023							
Beginning Balance	$ 2,542	$ 1,889	$ 359	$ 7,011	$ 797	$ —	$ 12,598
Charge-offs	—	(108)	—	(1,542)	(874)	—	(2,524)
Recoveries	8	75	—	114	93	—	290
Provision	131	(298)	121	1,861	1,186	—	3,001
Ending Balance	$ 2,681	$ 1,558	$ 480	$ 7,444	$ 1,202	$ —	$ 13,365
September 30, 2022							
Beginning Balance	$ 589	$ 1,133	$ 38	$ 6,764	$ 1,038	$ 2	$ 9,564
Charge-offs	—	36	—	(697)	(68)	—	(729)
Recoveries	—	13	—	105	36	—	154
Provision	134	(66)	(4)	670	13	3	750
Ending Balance	$ 723	$ 1,116	$ 34	$ 6,842	$ 1,019	$ 5	$ 9,739

	Real Estate - Residential	Real Estate - Commercial	Real Estate - Construction and Land	Commercial and Industrial	Consumer and Other	Unallocated	Total
Nine Months Ended							
September 30, 2023							
Beginning Balance	$ 731	$ 956	$ 28	$ 6,182	$ 1,090	$ 59	$ 9,046
Impact of adopting ASC 326	1,479	613	281	1,116	(323)	(59)	3,107
Charge-offs	—	(108)	—	(4,660)	(2,214)	—	(6,982)
Recoveries	8	77	—	303	219	—	607
Provision	463	20	171	4,503	2,430	—	7,587
Ending Balance	$ 2,681	$ 1,558	$ 480	$ 7,444	$ 1,202	$ —	$ 13,365
September 30, 2022							
Beginning Balance	$ 1,437	$ 2,349	$ 241	$ 9,202	$ 154	$ 69	$ 13,452
Charge-offs	—	(17)	—	(2,667)	(109)	—	(2,793)
Recoveries	—	74	—	365	41	—	480
Provision	(714)	(1,290)	(207)	(58)	933	(64)	(1,400)
Ending Balance	$ 723	$ 1,116	$ 34	$ 6,842	$ 1,019	$ 5	$ 9,739

On January 1, 2023 the Company adopted CECL which significantly changed the credit losses estimation model for loans. The ACL represents management’s best estimate of future lifetime expected losses on its held for investment loan portfolio. The Company calculates its ACL by estimating expected credit losses on a collective basis for loans that share similar risk characteristics. Loans that do not share similar risk characteristics with other loans are evaluated for credit losses on an individual basis. The Company uses a combination of modeled and non-modeled approaches that incorporates current and future economic conditions to estimate lifetime expected losses on a collective basis.

(Dollars in thousands, except per share data)

The Company's ACL model utilizes a PD/LGD methodology to measure the expected credit losses on government guaranteed loans and a WARM methodology for the remaining loans. The PD/LGD method estimates losses by utilizing estimated PD, LGD, and individual loan level exposure at default. The WARM model contemplates expected losses at a pool-level, utilizing historical loss information. Portions of government guaranteed loans have a government guarantee for credit losses, therefore, no ACL has been recorded for those loan balances. In order to quantify the credit risk impact of other trends and changes within the loan portfolio, the Company utilizes qualitative adjustments to the modeled estimated loss approaches. These qualitative adjustments include: changes in lending policies, procedures, and strategies; changes in nature and volume of portfolio; staff experience; changes in volume and trends in classified loans, delinquencies, and nonaccrual; concentration risk; trends in underlying collateral value; external factors such as competition, legal, regulatory; changes in quality of the loan review system; and economic conditions. In addition to this, the Company uses reasonable and supportable forecasts utilizing data from the Federal Open Market Committee's median forecasts of change in national GDP and of national unemployment. The FOMC's forecast for the remainder of the calendar year is used in conjunction with the most recent 4 quarters of historical data from FRED (Federal Reserve Economic Data) to determine changes in certain qualitative factors used in calculating loss rates.

Loans that do not share risk characteristics are evaluated on an individual basis and are excluded from the pooled evaluation. This generally occurs when, based on current information and events, it is probable that the Company will be unable to collect all interest and principal payments due according to the originally contracted, or reasonably modified, terms of the loan agreement.

Individually evaluated loans are evaluated for impairment and a portion of the allowance is allocated so that the loan is reported, net, at the present value of estimated future cash flows using the rate implicit in the original loan agreement or at the fair value of collateral if repayment is expected solely from the collateral.

See Note 1 of the Notes to Consolidated Financial Statements for further discussion of the Company's ACL methodology.

The Company maintains a separate ACL for its off-balance sheet unfunded loan commitments. The ACL on unfunded loan commitments is based on estimates of probability that these commitments will be drawn upon according to historical utilization experience, expected loss severity and loss rates as determined for pooled funded loans. As of September 30, 2023 and December 31, 2022, the ACL for unfunded commitments recorded in other liabilities was $844 and $511, respectively.

The following table presents the activity in the ACL for unfunded commitments for the three and nine months ended September 30, 2023:

	For the Three Months Ended	For the Nine Months Ended
	September 30, 2023	
Balance at beginning of period	$ 844	$ 511
Impact of adopting ASC 326	—	213
Provision for credit losses	—	120
Unfunded commitments charge-offs	—	—
Unfunded commitments recoveries	—	—
Balance at end of period	$ 844	$ 844

(Dollars in thousands, except per share data)

The following tables present the recorded investment in nonaccrual loans and loans past due over 89 days still on accrual by loan segment at September 30, 2023 and December 31, 2022. In the following tables, the recorded investment does not include the government guaranteed balance.

September 30, 2023	Nonaccrual with no ACL	Nonaccrual with ACL	Loans Past Due Over 89 Days Still Accruing
Real estate - residential	$ —	$ 3,588	$ —
Real estate - commercial	—	791	—
Commercial and industrial	—	3,703	317
Consumer and other	—	26	351
Total	$ —	$ 8,108	$ 668

December 31, 2022	Nonaccrual	Loans Past Due Over 89 Days Still Accruing
Real estate - commercial	$ 1,563	$ —
Commercial and industrial	1,854	—
Consumer and other	—	254
Total	$ 3,417	$ 254

A financial asset is considered collateral dependent when the debtor is experiencing financial difficulty and repayment is expected to be provided substantially through the sale or operation of the collateral. Expected credit losses for collateral dependent loans are based on the fair value of the collateral at the reporting date, adjusted for selling costs as appropriate. Significant quarter over quarter changes are reflective of changes in nonaccrual status and not necessarily associated with credit quality indicators like appraised value. The following table presents the amortized cost basis of individually analyzed collateral dependent loans by loan portfolio segment as of September 30, 2023:

	Type of Collateral	ACL
	Business Assets	
Commercial and industrial	$ 1,500	$ 206

The following table presents the aging of the recorded investment in past due gross loans HFI at amortized cost at September 30, 2023 by loan segment:

	30-89 Days Past Due	Greater Than 89 Days Past Due	Total Past Due	Loans Not Past Due [(1)]	Total Loans
Real estate - residential	$ 2,835	$ 3,535	$ 6,370	$ 242,603	$ 248,973
Real estate - commercial	525	786	1,311	279,309	280,620
Real estate - construction and land	—	—	—	25,339	25,339
Commercial and industrial	3,221	3,787	7,008	167,230	174,238
Commercial and industrial - PPP	—	—	—	15,364	15,364
Consumer and other	934	377	1,311	37,713	39,024
Total	$ 7,515	$ 8,485	$ 16,000	$ 767,558	$ 783,558

[(1)] $3,783 of balances 30-89 days past due and $ 2,028 of balances greater than 89 days past due are reported as Loans Not Past Due as a result of the government guarantee. Of those loans, $531 of commercial and industrial PPP loans were delinquent as of September 30, 2023.

(Dollars in thousands, except per share data)

The following table presents the aging of the recorded investment in past due gross loans HFI at amortized cost at December 31, 2022 by loan segment:

	30-89 Days Past Due	Greater Than 89 Days Past Due	Total Past Due	Loans Not Past Due [1]	Total Loans
Real estate - residential	$ 719	$ —	$ 719	$ 201,610	$ 202,329
Real estate - commercial	586	639	1,225	230,056	231,281
Real estate - construction and land	—	—	—	9,320	9,320
Commercial and industrial	2,157	1,760	3,917	190,726	194,643
Commercial and industrial - PPP	—	—	—	19,293	19,293
Consumer and other	669	254	923	36,365	37,288
Total	$ 4,131	$ 2,653	$ 6,784	$ 687,370	$ 694,154

[1] $1,904 of balances 30-89 days past due and $ 4,288 of balances greater than 89 days past due are reported as Loans Not Past Due as a result of the government guarantee, and $1,302 of past due commercial and industrial PPP loans were primarily due to delinquencies from borrowers with only a PPP loan and no other Bank product. These borrowers were non-responsive to requests for forgiveness applications and payments, and applications were subsequently submitted to the SBA for their 100% guarantee purchase from the Bank.

Modifications to Borrowers Experiencing Financial Difficulty

For the three and nine months ended September 30, 2023, there were no loan modifications to borrowers experiencing financial difficulty and no loan modifications that subsequently defaulted during the period.

Troubled Debt Restructurings

At December 31, 2022, the Company had no loans classified as a troubled debt restructuring. See Note 1 for additional discussion on TDRs.

Credit Quality Indicators

Internal risk-rating grades are assigned to loans by lending, credit administration or loan review personnel, based on an analysis of the financial and collateral strength and other credit attributes underlying each loan. Management analyzes the resulting ratings, as well as other statistics and factors such as delinquency, to track the migration performance of the portfolio balances. This analysis is performed at least annually. The Bank uses the following definitions for its risk ratings:

Pass – Loans properly approved, documented, collateralized, and performing which do not reflect an abnormal credit risk.

Special Mention – These credits have potential weaknesses that may, if not checked or corrected, weaken the asset, or inadequately protect the Company's position at some future date. These assets pose elevated risk, but their weakness does not yet justify a "Substandard" classification.

Substandard – These loans are inadequately protected by the current net worth and paying capacity of the obligor or of the collateral pledged, if any. Loans so classified have a well-defined weakness or weaknesses that jeopardize the liquidation of the debt. They are characterized by the distinct possibility that the Bank will sustain some loss if the deficiencies are not corrected.

Doubtful – These loans have all the weaknesses inherent in those classified as 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.

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The table below sets forth credit exposure for the commercial loan portfolio disaggregated by loan segment based on internally assigned risk ratings at September 30, 2023 and gross write offs for the nine months then ended September 30, 2023:

	Term Loans Amortized Cost Basis by Origination Year				Revolving Loans Amortized Cost Basis	Revolving Loans Converted to Term	Total
	2023	2022	2021	Prior			
Real estate - commercial							
Risk Rating							
Pass	$ 77,037	$ 81,500	$ 51,126	$ 66,435	$ 3,350	$ —	$ 279,448
Special mention	—	—	—	381	—	—	381
Substandard	—	195	31	565	—	—	791
Doubtful	—	—	—	—	—	—	—
Total real estate - commercial loans	$ 77,037	$ 81,695	$ 51,157	$ 67,381	$ 3,350	$ —	$ 280,620
Gross write offs	$ —	$ 101	$ —	$ 7	$ —	$ —	$ 108
Real estate - construction and land							
Risk Rating							
Pass	$ 9,574	$ 12,005	$ 3,760	$ —	$ —	$ —	$ 25,339
Special mention	—	—	—	—	—	—	—
Substandard	—	—	—	—	—	—	—
Doubtful	—	—	—	—	—	—	—
Total real estate - construction and land loans	$ 9,574	$ 12,005	$ 3,760	$ —	$ —	$ —	$ 25,339
Gross write offs	$ —	$ —	$ —	$ —	$ —	$ —	$ —
Commercial and industrial							
Risk Rating							
Pass	$ 38,823	$ 46,618	$ 14,787	$ 61,853	$ 8,417	$ —	$ 170,498
Special mention	—	155	—	518	—	—	673
Substandard	—	883	26	2,158	—	—	3,067
Doubtful	—	—	—	—	—	—	—
Total commercial and industrial loans	$ 38,823	$ 47,656	$ 14,813	$ 64,529	$ 8,417	$ —	$ 174,238
Gross write offs	$ 60	$ 1,069	$ 204	$ 3,327	$ —	$ —	$ 4,660
Commercial and industrial - PPP							
Risk Rating							
Pass	$ —	$ 9	$ 222	$ 15,123	$ —	$ —	$ 15,354
Special mention	—	—	—	10	—	—	10
Substandard	—	—	—	—	—	—	—
Doubtful	—	—	—	—	—	—	—

(Dollars in thousands, except per share data)

	Term Loans Amortized Cost Basis by Origination Year				Revolving Loans Amortized Cost Basis	Revolving Loans Converted to Term	Total
	2023	2022	2021	Prior			
Total commercial and industrial - PPP loans	$ —	$ 9	$ 222	$ 15,133	$ —	$ —	$ 15,364
Gross write offs	$ —	$ —	$ —	$ —	$ —	$ —	$ —

The Company considers the performance of the loan portfolio to determine its impact on the ACL. For residential and consumer loan classes, the Company evaluates credit quality based on the aging status of the loan by payment activity. The following table presents the amortized costs at September 30, 2023 in residential and consumer loans based on payment activity as well as gross write offs for the nine months then ended September 30, 2023.

	Term Loans Amortized Cost Basis by Origination Year				Revolving Loans Amortized Cost Basis	Revolving Loans Converted to Term	Total
	2023	2022	2021	Prior			
Real estate - residential							
Payment Performance							
Performing	$ 25,394	$ 86,157	$ 25,040	$ 20,371	$ 88,423	$ —	$ 245,385
Nonperforming	—	600	287	2,381	320	—	3,588
Total real estate - residential loans	$ 25,394	$ 86,757	$ 25,327	$ 22,752	$ 88,743	$ —	$ 248,973
Gross write offs	$ —	$ —	$ —	$ —	$ —	$ —	$ —
Consumer and other							
Payment Performance							
Performing	$ 13,786	$ 22,551	$ 1,268	$ 217	$ 825	$ —	$ 38,647
Nonperforming	—	351	26	—	—	—	377
Total consumer and other loans	$ 13,786	$ 22,902	$ 1,294	$ 217	$ 825	$ —	$ 39,024
Gross write offs	$ 27	$ 2,174	$ 8	$ 5	$ —	$ —	$ 2,214

The table below sets forth credit exposure for the loan portfolio disaggregated by loan segment based on internally assigned risk ratings at December 31, 2022:

	Pass	Special Mention	Substandard	Doubtful	Total Loans
Real estate - residential	$ 202,275	$ —	$ 54	$ —	$ 202,329
Real estate - commercial	227,367	2,351	1,563	—	231,281
Real estate - construction and land	9,320	—	—	—	9,320
Commercial and industrial	192,226	100	2,317	—	194,643
Commercial and industrial - PPP	19,293	—	—	—	19,293
Consumer and other	37,288	—	—	—	37,288
Loans held for investment, at amortized cost	$ 687,769	$ 2,451	$ 3,934	$ —	$ 694,154

(Dollars in thousands, except per share data)

Prior to the adoption of ASC 326 on January 1, 2023, the Company calculated the ALLL using incurred losses methodology. The following tables are disclosures related to loans in prior periods.

The following table presents the balance in the ALLL and the recorded investment in loans by loan segment and based on impairment method at December 31, 2022. The government guaranteed loan balances are included in the collectively evaluated for impairment balances.

	Real Estate-Residential	Real Estate-Commercial	Real Estate - Construction and Land	Commercial and Industrial	Commercial and Industrial - PPP	Consumer and Other	Unallocated	Total
Allowance for loan losses:								
Individually evaluated for impairment	$ —	$ 74	$ —	$ 499	$ —	$ —	$ —	$ 573
Collectively evaluated for impairment	731	882	28	5,683	—	1,090	59	8,473
Total	$ 731	$ 956	$ 28	$ 6,182	$ —	$ 1,090	$ 59	$ 9,046
Loans:								
Individually evaluated for impairment	$ —	$ 1,563	$ —	$ 1,854	$ —	$ —	$ —	$ 3,417
Collectively evaluated for impairment	202,329	229,718	9,320	192,789	19,293	37,288	—	690,737
Total	$ 202,329	$ 231,281	$ 9,320	$ 194,643	$ 19,293	$ 37,288	$ —	$ 694,154

For purposes of the impaired loans by loan segment table above, the unpaid principal balance and recorded investment do not include the government guaranteed balance. The government guaranteed balances of impaired loans at December 31, 2022 were $6,797.

The following table presents information related to impaired loans by loan segment at and for the nine months ended September 30, 2022:

	Unpaid Principal Balance	Recorded Investment	Allowance for Credit Losses Allocated	Average Recorded Investment	Interest Income Recognized	Cash Basis Interest Recognized
With no related allowance recorded:						
Real estate - residential	$ 246	$ 246	$ —	$ 165	$ —	$ —
Real estate - commercial	1,611	1,611	—	2,154	15	15
Subtotal	1,857	1,857	—	2,319	15	15
With an allowance recorded:						
Real estate - commercial	—	—	—	102	—	—
Commercial and industrial	2,388	2,388	949	1,176	—	—
Subtotal	2,388	2,388	949	1,278	—	—
Total	$ 4,245	$ 4,245	$ 949	$ 3,597	$ 15	$ 15

NOTE 6 – FAIR VALUE

Fair value is the exchange price that would be received for an asset or paid to transfer a liability (exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. There are three levels of inputs that may be used to measure fair values:

Level 1 – Quoted prices (unadjusted) for identical assets or liabilities in active markets that the entity has the ability to access at the measurement date.

Level 2 – Significant other observable inputs other than Level 1 prices, such as quoted prices for similar assets or liabilities, quoted prices in markets that are not active, and other inputs that are observable or can be corroborated by observable market data.

Level 3 – Significant unobservable inputs that reflect a Company's own assumptions about the assumptions that market participants would use in pricing an asset or liability.

(Dollars in thousands, except per share data)

A financial instrument's categorization within the valuation hierarchy is based upon the lowest level of input that is significant to the fair value measurement. The following is a description of the valuation methodologies used for instruments measured at fair value, as well as the general classification of such instruments pursuant to the valuation hierarchy.

Investment Securities Available for Sale: The fair values of investment securities available for sale are determined by matrix pricing, which is a mathematical technique used to value debt securities without relying exclusively on quoted prices for the specific investment securities, but rather by relying on the investment securities' relationship to other benchmark quoted investment securities (Level 2). Management obtains the fair values of investment securities available for sale on a monthly basis from a third party pricing service.

Residential Loans Held for Sale: The Company had elected to account for residential loans held for sale at fair value. The fair value of loans held for sale was determined using either actual quoted prices for the assets (Level 1) whenever possible or quoted prices for similar assets, adjusted for specific attributes of that loan (Level 2). The fair value gain (loss) on loans held for sale is included in discontinued operations in the Consolidated Statements of Income.

Government Guaranteed Loans Held for Investment, at Fair Value: The Company has elected to account for certain government guaranteed loans held for investment at fair value. Fair value is calculated based on the present value of estimated future payments (Level 3). The valuation model uses interest rate, prepayment speed, and default rate assumptions that market participants would use in estimating future payments. Whenever available, the present value is validated against available market data.

Mortgage Banking Derivatives: Mortgage banking derivatives used in the ordinary course of business primarily consisted of best efforts forward sales contracts. The fair value of best efforts forward sales contracts was measured using market observable inputs that were adjusted using unobservable inputs including duration, spread, and pull-through rates (Level 3).

Individually Evaluated Loans: Periodically, the Company records non-recurring adjustments to the carrying value of loans based on fair value measurements for partial charge-offs of the uncollectible portions of those loans. Non-recurring adjustments can also include certain impairment amounts for collateral-dependent loans calculated when establishing the ACL. Loans are considered collateral dependent when the Company has determined that foreclosure of the collateral is probable or when a borrower is experiencing financial difficulty and the loan is expected to be repaid substantially through the operation or sale of collateral. A collateral dependent loan's ACL is measured based on the difference between the fair value of the collateral and the amortized cost basis of the loan as of the measurement date. Fair value of the loan's collateral is determined by appraisals, independent valuation, or management's estimation of fair value which is then adjusted for the cost related to liquidation of the collateral. Collateral dependent loans are generally classified as Level 3 based on management's judgment and estimation.

Government Guaranteed Loan Servicing Rights: The fair value of government guaranteed servicing rights is based on a valuation model that calculates the present value of estimated net servicing income. The valuation model incorporates assumptions that market participants would use in estimating future net servicing income. There were no government guaranteed loan servicing rights carried at fair value at September 30, 2023 and December 31, 2022. On a quarterly basis, government guaranteed loan servicing rights are evaluated for impairment based upon the fair value of the rights as compared to the cost. If the carrying amount exceeds fair value, impairment is recorded so that the servicing asset is carried at fair value.

Assets measured at fair value on a recurring basis at September 30, 2023 are summarized below. There were no liabilities carried at fair value on a recurring basis at September 30, 2023.

	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total
Financial assets				
Investment securities available for sale	$ —	$ 39,683	$ —	$ 39,683
Government guaranteed loans held for investment, at fair value	—	—	84,178	84,178

(Dollars in thousands, except per share data)

Assets measured at fair value on a recurring basis at December 31, 2022 are summarized below. There were no liabilities carried at fair value on a recurring basis at December 31, 2022.

	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total
Financial assets				
Investment securities available for sale	$ —	$ 42,349	$ —	$ 42,349
Residential loans held for sale [1]	449	—	—	449
Government guaranteed loans held for investment, at fair value	—	—	27,078	27,078

[1] Classified as assets from discontinued operations or liabilities from discontinued operations on the consolidated balance sheet.

There were no transfers between levels for assets and liabilities recorded at fair value on a recurring basis during the reported periods.

Financial Instruments Recorded Using Fair Value Option

The Company has elected the fair value option for residential loans held for sale. These loans are intended for sale and are classified as assets from discontinued operations on the consolidated balance sheet. The Company believes that the fair value is the best indicator of the resolution of these loans. Interest income from discontinued operations is recorded based on the contractual term of the loan and in accordance with the Company's policy on loans held for investment. There were no residential loans held for sale as of September 30, 2023. None of the loans were 90 days or more past due or on nonaccrual at December 31, 2022.

The aggregate fair value, contractual balance, and gain at December 31, 2022 for residential loans held for sale from discontinued operations were as follows:

	December 31, 2022
Aggregate fair value	$ 449
Contractual balance	434
Gain	$ 15

The total amount of interest income from discontinued operations and losses from changes in fair value included in earnings for the nine months ended September 30, 2023 and September 30, 2022 for residential loans held for sale from discontinued operations were as follows:

	Nine Months Ended September 30, 2023	Nine Months Ended September 30, 2022
Interest income	$ 1	$ 2,466
Change in fair value	(15)	(3,784)
Total loss	$ (14)	$ (1,318)

The Company also elected the fair value option for certain of its government guaranteed loans held for investment as the Company believed that fair value was the best indicator of the resolution of those loans at that time. Depending on market conditions and liquidity needs of the Company, management determines whether it is advantageous to hold or sell government guaranteed loans on a loan-by-loan basis. The portion of these loans guaranteed by the government are generally readily marketable in the secondary market and the portion of the loans that are not guaranteed may be sold periodically to other third party financial institutions. Interest income on these loans is recorded based on the contractual term of the loan and in accordance with the Company's policy on other loans held for investment.

(Dollars in thousands, except per share data)

The aggregate fair value, contractual balance, and gain at September 30, 2023 and December 31, 2022 for government guaranteed loans held for investment, at fair value, were as follows:

	September 30, 2023	December 31, 2022
Aggregate fair value	$ 84,178	$ 27,078
Contractual balance	80,320	26,201
Gain	$ 3,858	$ 877

The total amount of gains and losses from changes in fair value and interest income included in earnings for the nine months ended September 30, 2023 and September 30, 2022 for government guaranteed loans held for investment, at fair value, were as follows:

	Nine Months Ended September 30,	
	2023	2022
Interest income	$ 3,151	$ 1,112
Change in fair value	11,021	3,510
Total gain (loss)	$ 14,172	$ 4,622

Changes in fair value for government guaranteed loans held for investment, at fair value, were included in Government guaranteed loans fair value gain on the Consolidated Statements of Income.

The table below presents a reconciliation of government guaranteed loans held for investment, at fair value, which were valued on a recurring basis and used significant unobservable inputs (Level 3) for the nine months ended September 30, 2023 and September 30, 2022:

	Nine Months Ended September 30,	
	2023	2022
Balance of government guaranteed loans held for investment at fair value, beginning of period	$ 27,078	$ 9,614
New government guaranteed originations at fair value	143,535	53,697
Loans sold	(90,120)	(38,722)
Principal payments	(7,336)	(3,108)
Charge-offs	—	(26)
Total gains during the period	11,021	3,510
Balance of government guaranteed loans held for investment at fair value, end of period	$ 84,178	$ 24,965

The Company’s valuation of government guaranteed loans held for investment, at fair value, was supported by an analysis prepared by an independent third party and approved by management. The approach to determine fair value involved several steps: 1) identifying each loan’s unique characteristics, including balance, payment type, term, coupon, age, and principal and interest payment; 2) projecting these loan level characteristics for the life of each loan; and 3) performing discounted cash flow modeling.

(Dollars in thousands, except per share data)

The following table provides information about the valuation techniques and unobservable inputs used in the valuation of government guaranteed loans held for investment, at fair value, interest rate lock commitments, and best efforts forward sales contracts falling within Level 3 of the fair value hierarchy at September 30, 2023 and December 31, 2022:

	Fair Value	Valuation Technique	Unobservable Inputs	Range (Weighted Average)
September 30, 2023				
Government guaranteed loans held for investment,	$ 84,178	Discounted	Discount rate	7.34%-10.84% (8.59%)
at fair value		cash flow	Conditional prepayment rate	9.04%-13.29% (11.20%)
December 31, 2022				
Government guaranteed loans held for investment,	$ 27,078	Discounted	Discount rate	5.50%-10.00% (8.00%)
at fair value		cash flow	Conditional prepayment rate	8.66%-10.15% (8.95%)

The significant unobservable inputs impacting the fair value measurement of government guaranteed loans held for investment, at fair value, include discount rates and conditional prepayment rates. Increases in discount rates or prepayment rates would result in a lower fair value measurement. Although the prepayment rate and discount rate are not directly interrelated, they generally move in opposite directions. The discount rates and conditional prepayment rates were weighted by the relative principal balance outstanding of these loans.

Assets measured at fair value on a nonrecurring basis at September 30, 2023 are summarized below:

	Fair Value	Valuation Technique(s)	Significant Unobservable Input(s)	Discount % Amount
Individually evaluated loans	$ 1,294	Discounted appraisals, estimated net realizable value of collateral	Collateral discounts	10%

Assets measured at fair value on a nonrecurring basis at December 31, 2022 are summarized below:

	Fair Value	Valuation Technique(s)	Significant Unobservable Input(s)	Discount % Amount
Impaired loans	$ 1,355	Discounted appraisals, estimated net realizable value of collateral	Collateral discounts	10%

(Dollars in thousands, except per share data)

Fair Value of Financial Instruments

The carrying values and estimated fair values of financial instruments not carried at fair value, at September 30, 2023 and December 31, 2022 are as follows:

		September 30, 2023		December 31, 2022	
	Level	Carrying Value	Fair Value	Carrying Value	Fair Value
Assets:					
Cash and cash equivalents	1	$ 112,553	$ 112,553	$ 66,046	$ 66,046
Time deposits in banks	2	4,631	4,542	4,881	4,714
Investment securities held to maturity	2	2,482	2,282	5,002	4,755
Nonmarketable equity securities, at cost	2	4,250	4,250	5,537	5,537
Government guaranteed loans held for sale	2	1,855	1,959	—	—
Loans held for investment, at amortized cost	3	780,904	755,116	692,528	687,365
Accrued interest receivable [(1)]	2	6,907	6,907	4,454	4,454
Government guaranteed loan servicing rights	3	14,216	15,339	10,906	13,051
Mortgage loan servicing rights [(2)]	3	—	—	201	201
Liabilities:					
Noninterest-bearing deposits	2	$ 98,008	$ 98,008	$ 93,235	$ 93,235
Interest-bearing transaction accounts	2	267,404	267,404	202,656	202,656
Savings and money market deposits	2	350,110	350,110	363,053	363,053
Time deposits	2	302,274	295,703	136,126	134,564
FRB and FHLB borrowings	2	—	—	25,000	25,000
Subordinated debentures	2	5,947	4,959	5,992	5,270
Notes payable	2	2,503	2,482	2,844	2,843
Accrued interest payable	2	632	632	704	704

[(1)] Includes balances of $2 classified as assets from discontinued operations on the consolidated balance sheet as of December 31, 2022.

[(2)] Classified as assets from discontinued operations on the consolidated balance sheet.

NOTE 7 – GOVERNMENT GUARANTEED LOAN SERVICING ACTIVITIES

At September 30, 2023 and December 31, 2022, the principal balance of government guaranteed loans, excluding PPP loans, retained by the Company was $373,719 and $300,219, respectively, of which $176,062 and $139,587 represented the guaranteed portion of the loans. Loans serviced for others are not included in the accompanying Consolidated Balance Sheets. The unpaid principal balances of government guaranteed loans serviced for others requiring recognition of a servicing asset were $825,723 and $660,600 at September 30, 2023 and December 31, 2022, respectively.

(Dollars in thousands, except per share data)

Activity for government guaranteed loan servicing rights for the three and nine months ended September 30, 2023 and September 30, 2022 follows:

	Three Months Ended		Nine Months Ended	
	September 30, 2023	September 30, 2022	September 30, 2023	September 30, 2022
Beginning of period	$ 12,820	$ 7,760	$ 10,906	$ 6,407
Additions	2,543	2,918	6,390	5,741
Amortization	(1,147)	(746)	(3,080)	(2,216)
End of period	$ 14,216	$ 9,932	$ 14,216	$ 9,932

The fair value of government guaranteed loan servicing rights was $ 15,339 and $13,051 at September 30, 2023 and December 31, 2022, respectively. Fair value was determined using a weighted average discount rate of 15.25% and a weighted average prepayment speed of 10.71% at September 30, 2023. Fair value was determined using a weighted average discount rate of 14.88% and a weighted average prepayment speed of 9.93% at December 31, 2022. The government guaranteed loan servicing rights are amortized over the life of a loan on a loan-by-loan basis.

The following table presents the components of net gain on sale of government guaranteed loans, excluding sale of PPP loans, for the three and nine months ended September 30, 2023 and September 30, 2022:

	Three Months Ended		Nine Months Ended	
	September 30, 2023	September 30, 2022	September 30, 2023	September 30, 2022
Gain on sale of guaranteed government guaranteed loans	$ 4,596	$ 4,685	$ 11,998	$ 10,723
Loss on sale of unguaranteed government guaranteed loans	—	(63)	(797)	(411)
Costs recognized on sale of government guaranteed loans	—	(94)	(15)	(138)
Fair value of servicing rights created	2,543	2,918	6,390	5,741
Gain on sale of government guaranteed loans, net	$ 7,139	$ 7,446	$ 17,576	$ 15,915

NOTE 8 - PREMISES AND EQUIPMENT

Premises and equipment at September 30, 2023 and December 31, 2022 were as follows:

	September 30, 2023	December 31, 2022
Land and improvements	$ 6,392	$ 4,488
Building and improvements	21,978	13,131
Leasehold improvements	3,302	2,833
Furniture, fixtures, and equipment	7,062	6,520
Fixed assets in process	6,226	14,716
Total premises and equipment	44,960	41,688
Accumulated depreciation and amortization	(6,968)	(6,248)
Net premises and equipment [1]	$ 37,992	$ 35,440

[1]There were no premises and equipment assets classified as assets from discontinued operations as of September 30, 2023 or December 31, 2022.

Depreciation and amortization expense including expense from discontinued operations was $ 616 and $509 for the three months ended September 30, 2023 and September 30, 2022, respectively, and $1,744 and $1,505 for the nine months ended September 30, 2023 and September 30, 2022, respectively.

(Dollars in thousands, except per share data)

NOTE 9 – LEASES

For the three and nine months ended September 30, 2023 and September 30, 2022, the components of total lease cost and supplemental information related to operating leases were as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2023	2022	2023	2022
Operating lease cost	$ 509	$ 387	$ 1,097	$ 1,159
Short-term lease cost	(224)	190	(204)	463
Total lease cost, net [1]	$ 285	$ 577	$ 893	$ 1,622

[1] Includes lease costs reported as discontinued operations of $ 44 and $232 for the three months ended September 30, 2023 and September 30, 2022, respectively, and $131 and $847 for the nine months ended September 30, 2023 and September 30, 2022, respectively.

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2023	2022	2023	2022
Cash flows related to operating lease liabilities	$ 281	$ 388	$ 965	$ 1,156
Right-of-use assets obtained in exchange for new operating lease liabilities	—	627	—	627

At September 30, 2023, the weighted average discount rate of operating leases was 2.34% and the weighted average remaining life of operating leases was 3.35 years.

The future minimum lease payments for operating leases, subsequent to September 30, 2023, as recorded on the balance sheet, are summarized as follows:

2023	$ 197
2024	1,216
2025	1,029
2026	832
2027	413
Thereafter	—
Total undiscounted lease payments	$ 3,687
Less: imputed interest	(160)
Net lease liabilities	$ 3,527

Impairment of ROU Assets

ROU assets from operating leases are subject to the impairment guidance in ASC 360, *Property, Plant, and Equipment,* and are reviewed for impairment when indicators of impairment are present. ASC 360 requires three steps to identify, recognize and measure impairment. If indicators of impairment are present (Step 1), the Company performs a recoverability test (Step 2) comparing the sum of the estimated undiscounted cash flows attributable to the ROU asset in question to the carrying amount. The Company estimates the fair value of the ROU asset and recognizes an impairment loss when the carrying amount exceeds the estimated fair value (Step 3).

During 2022, the Company closed leased mortgage lending offices as part of its discontinuance of the nationwide residential lending operation. The mortgage lending offices were evaluated as outlined above to determine whether the operating leases were impaired. As part of the recoverability test, the Company elected to exclude operating lease liabilities from the carrying amount of the asset group. The undiscounted future cash flows used in the recoverability test were based on assumptions made by the Company rather than market participant assumptions. Since an election was made to exclude operating lease liabilities from the asset or asset group, all future cash lease payments for the lease were also excluded. In addition, the Company elected to exclude operating lease liabilities from the estimated fair value, consistent with the recoverability test. When determining the fair value of the ROU asset, the Company estimated what market participants would pay to lease the assets assuming the highest and best use in the assets' current forms.

Based on the analysis, the Company concluded that the ROU assets for these offices were impaired and had a remaining ROU carrying value of $ 398 as of September 30, 2023. The analyses resulted in no additional impairment for the nine months ended September 30, 2023.

NOTE 10 – OTHER BORROWINGS

At September 30, 2023, the Company had no borrowings from the FHLB and FRB. There were $ 25,000 of borrowings at 4.50% from the FRB and no borrowings from the FHLB at December 31, 2022.

The Bank is a member of the FHLB of Atlanta, which provides short- and long-term funding collateralized by mortgage-related assets to its members. FHLB short-term borrowings bear interest at variable rates set by the FHLB. Any a dvances that the bank were to obtain would be secured by a blanket lien on $274,900 of real estate-related loans as of September 30, 2023. Based on this collateral and the Company's holdings of FHLB stock, the Company was eligible to borrow up to
$156,472 from the FHLB at September 30, 2023.

In addition, the Bank has a secured line of credit with the Federal Reserve Bank of Atlanta which was secured by $ 59,636 of commercial loans as of September 30, 2023. FRB short-term borrowings bear interest at variable rates based on the Federal Open Market Committee's target range for the federal funds rate. Based on this collateral, the Company was eligible to borrow up to $40,089 from the FRB at September 30, 2023.

In June 2021, the Company issued $ 6,000 of Subordinated Debentures (the "Debentures") that mature June 30, 2031 and are redeemable after 5 years. The Debentures carry interest at a fixed rate of 4.50% per annum for the initial 5 years of term and carry interest at a floating rate for the final 5 years of term. Under the debt agreements, the floating rates are based on a SOFR benchmark plus 3.78% per annum. The balance of Subordinated Debentures outstanding at the Company, net of offering costs, amounted to $5,947 and $5,992 at September 30, 2023 and December 31, 2022, respectively.

The Company has a term note with quarterly principal and interest payments with interest at Prime (8.50% at September 30, 2023). The note matures on March 10, 2029 and the balance of the note was $2,503 and $2,844 at September 30, 2023 and December 31, 2022, respectively. The note is secured by 100% of the stock of the Bank and requires the Company to comply with certain loan covenants during the term of the note. As of September 30, 2023, the Company was in compliance with all financial debt covenants.

NOTE 11 – STOCK-BASED COMPENSATION

The Equity Plan governs the Company's restricted stock grants and stock options. Total compensation cost charged against income related to the Equity Plan was $167 and $186 for the three months ended September 30, 2023 and September 30, 2022, respectively, and $ 486 and $609 for the nine months ended September 30, 2023 and September 30, 2022, respectively.

Restricted Stock

The Company awarded shares of restricted common stock to certain employees and non-employee directors for which compensation expense is recognized ratably over the vesting period of the awards based on the fair value of the stock at issue date.

(Dollars in thousands, except per share data)

A summary of changes in the Company's nonvested restricted shares for the nine months ended September 30, 2023 follows:

	Shares	Weighted-Average Grant-Date Fair Value, per share
Nonvested at January 1, 2023	22,000	$ 21.52
Granted	46,175	18.30
Vested	(13,935)	(20.01)
Forfeited	(1,865)	(19.38)
Nonvested at September 30, 2023	52,375	$ 18.75

At September 30, 2023, there was $598 of total unrecognized compensation cost related to nonvested restricted shares granted under the Equity Plan that is expected to be recognized over a weighted average period of 2.9 years. The total fair value of shares vested during the nine months ended September 30, 2023 and September 30, 2022 was $252 and $177, respectively.

Stock Options

The Equity Plan permits the grant of stock options to the Company's employees and non-employee directors for up to 15% of the total number of shares of Company common stock issued and outstanding, up to 1,500,000 shares. Option awards are granted with an exercise price equal to the market price of the Company's common stock at the date of grant. The market price of the Company's common stock is the closing sales price of the Common Stock on Nasdaq on the date of the grant. Those option awards generally have a vesting period of 5 years for employees and 3 years for non-employee directors and have 10-year contractual terms.

The fair value of each option award is estimated on the date of grant using a closed form option valuation (Black-Scholes) model that uses the assumptions noted in the table below. Expected volatility is based on an average of historical volatility of peer financial institutions. The expected term of options granted represents the period of time that options granted are expected to be outstanding, which takes into account that the options are not transferable. The risk-free interest rate for the expected term of the option is based on the U.S. Treasury yield curve in effect at the time of grant.

A summary of the activity in the Equity Plan for the nine months ended September 30, 2023 follows:

	Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term (in years)	Aggregate Intrinsic Value
Outstanding at January 1, 2023	405,688	$ 15.67		
Exercised	(30,375)	(15.71)		
Forfeited	(7,980)	(15.51)		
Outstanding at September 30, 2023	367,333	$ 15.67	5.93	$ —
Vested and exercisable at September 30, 2023	323,022	$ 15.79	5.78	$ —

There were no options granted during the three and nine months ended September 30, 2023 or September 30, 2022. Total unrecognized compensation cost related to nonvested stock options granted under the Equity Plan was $81 at September 30, 2023. This cost is expected to be recognized over a weighted average period of 1.58 years.

NOTE 12 – OTHER BENEFIT PLANS

The Company has established a stock dividend reinvestment and stock purchase plan. Under the DRIP, eligible shareholders can voluntarily purchase stock with their dividend or can make additional stock purchases. During the nine months ended September 30, 2023, 10,589 shares were purchased at an average price of $14.98. During the nine months ended September 30, 2022, 9,776 shares were purchased at an average price of $ 17.07.

All employees and Directors are eligible to participate in the NSPP. Expense recognized in relation to the NSPP for the nine months ended September 30, 2023 and September 30, 2022 was $20 and $78, respectively.

The Company has a Salary Continuation Agreement (the “Agreement”) with an executive officer. In accordance with the Agreement, the executive will receive an annual benefit of $25 for twenty years following separation of service. The liability recorded for the Agreement was $ 347 and $336 at September 30, 2023 and December 31, 2022, respectively, and the related expense for the nine months ended September 30, 2023 and September 30, 2022 was $11 and $57, respectively. Payments are expected to begin in 2024 upon retirement of the CEO on December 31, 2023.

The Company has a 401(k) plan that covers all employees subject to certain age and service requirements. The Company contributes 3% of each employee’s salary each pay period as a safe harbor contribution. The Company may also match employee contributions each year at the discretion of the Board of Directors. Expense recognized in relation to the 401(k) plan was $678 and $1,333 for the nine months ended September 30, 2023 and September 30, 2022, respectively. The discontinuation of the nationwide residential lending division during 2022 triggered a partial plan termination and all affected employees were 100% vested in the Company’s contributions into the plan.

The Company has an ESOP for eligible employees. Each year, the Company’s Board of Directors may approve a discretionary percentage of employees’ salaries to be contributed to the ESOP for eligible employees. In 2021, the ESOP trust acquired 14,154 shares of the Company’s stock. As this is a leveraged plan, unallocated shares are distributed to employees annually. There were 11,323 unallocated shares with a fair value of $127 remaining as of September 30, 2023. The ESOP trust’s outstanding loan, which is secured by the unallocated shares, bears a fixed interest rate equal to Prime Rate as of the note date, which was 3.25%. The note requires an annual payment of principal and interest through December 2026. The Company’s ESOP, which is internally leveraged, does not report the loan receivable extended to the ESOP as an asset and does not report the ESOP debt due to the Company.

The discontinuation of the nationwide residential lending division during 2022 triggered a partial plan termination and all affected employees were 100% vested in the Company’s contributions into the ESOP. As a result of the exit of affected participants from the plan, the plan acquired 23,383 shares of the Company’s stock. As this is a leveraged plan, unallocated shares are distributed to employees annually. There were 23,383 unallocated shares with a fair value of $263 remaining as of September 30, 2023. The ESOP trust was issued a five year loan bearing an interest rate equal to Prime Rate as of the note date, which was 8.25% and adjusts annually as of the first day of each succeeding calendar year to reflect the Prime Rate as of the first business day of the calendar year. The note requires an annual payment of principal and interest through December 2027. The Company’s ESOP, which is internally leveraged, does not report the loan receivable extended to the ESOP as an asset and does not report the ESOP debt due to the Company.

The Board did not approve any contributions in 2022 and has not approved any in 2023. There was no expense related to the ESOP for the nine months ended September 30, 2023 and September 30, 2022.

NOTE 13 - INCOME TAXES

The Company and its subsidiaries are subject to U.S. federal income tax. In the ordinary course of business, they are routinely subject to audit by the Internal Revenue Service. Currently, the Company is subject to examination by taxing authorities for the 2020 tax return year and forward.

(Dollars in thousands, except per share data)

A reconciliation of expected income tax expense (benefit) using the federal statutory rate of 21% for the three and nine months ended September 30, 2023 and September 30, 2022 and actual income tax expense (benefit) is as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2023	2022	2023	2022
Federal tax based on federal corporate statutory rate	$ 555	$ 854	$ 1,190	$ 893
State tax, net of federal effect	81	187	173	132
Changes resulting from:				
BOLI income	(6)	(20)	(18)	(32)
Other, net	44	(38)	70	(105)
Income tax expense from continuing operations	674	983	1,415	888
Income tax (benefit) from discontinued operations	(15)	(1,488)	(68)	(1,670)
Total income tax expense (benefit)	$ 659	$ (505)	$ 1,347	$ (782)

NOTE 14 – REGULATORY MATTERS

Banks and bank holding companies are subject to regulatory capital requirements administered by federal banking agencies. Capital adequacy guidelines and, additionally for banks, prompt corrective action regulations, involve quantitative measures of assets, liabilities, and certain off-balance sheet items calculated under regulatory accounting practices. Capital amounts and classifications are also subject to qualitative judgments by regulators. Failure to meet capital requirements can initiate regulatory action. Management believes that the Bank met all capital adequacy requirements to which it was subject at September 30, 2023 and December 31, 2022.

Prompt corrective action regulations provide five classifications: well capitalized, adequately capitalized, undercapitalized, significantly undercapitalized, and critically undercapitalized, although these terms are not used to represent overall financial condition. If adequately capitalized, regulatory approval is required to accept brokered deposits. If undercapitalized, capital distributions are limited, as is asset growth and expansion, and capital restoration plans are required. At September 30, 2023 and December 31, 2022, the most recent regulatory notifications categorized the Bank as well capitalized under the regulatory framework for prompt corrective action. There are no conditions or events since that notification that management believes have changed the institution's classification.

In February 2019, the federal bank regulatory agencies issued a final rule that revised certain capital regulations under ASU 2016-13, Financial Instruments - Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments, and included a transition option that allows banking organizations to phase in, over a three year period, the day one adverse effects of adoption on their regulatory capital ratios (three year transition option). In connection with the adoption of ASC 326 on January 1, 2021, the Company recognized an after-tax cumulative effect reduction to retained earnings. The

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Company elected to adopt the three year transition option and the deferral has been applied in capital ratios presented below. Actual and required capital amounts and ratios for the Bank are presented below at September 30, 2023:

	Actual		Required for Capital Adequacy Purposes		To be Well Capitalized Under Prompt Corrective Action Regulations	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
Total Capital						
(to Risk Weighted Assets)	$ 109,171	13.47 %	$ 64,858	8.00 %	$ 81,072	10.00 %
Tier 1 Capital						
(to Risk Weighted Assets)	$ 99,010	12.21 %	$ 48,643	6.00 %	$ 64,858	8.00 %
Common Equity Tier 1 Capital						
(to Risk Weighted Assets)	$ 99,010	12.21 %	$ 36,482	4.50 %	$ 52,697	6.50 %
Tier 1 Capital						
(to Average Assets)	$ 99,010	9.16 %	$ 43,258	4.00 %	$ 54,072	5.00 %

Actual and required capital amounts and ratios for the Bank are presented below at December 31, 2022:

	Actual		Required for Capital Adequacy Purposes		To be Well Capitalized Under Prompt Corrective Action Regulations	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
Total Capital						
(to Risk Weighted Assets)	$ 108,307	15.00 %	$ 57,767	8.00 %	$ 72,209	10.00 %
Tier 1 Capital						
(to Risk Weighted Assets)	$ 99,269	13.75 %	$ 43,325	6.00 %	$ 57,767	8.00 %
Common Equity Tier 1 Capital						
(to Risk Weighted Assets)	$ 99,269	13.75 %	$ 32,494	4.50 %	$ 46,936	6.50 %
Tier 1 Capital						
(to Average Assets)	$ 99,269	10.79 %	$ 36,816	4.00 %	$ 46,020	5.00 %

Dividend Restrictions

Banking regulations limit the amount of dividends that may be paid. Approval by regulatory authorities is required if the effect of dividends declared would cause the regulatory capital of the Bank to fall below specified minimum levels. Approval is also required if dividends declared exceed the net profits of the Bank for that year combined with the retained net profits for the preceding two years.

(Dollars in thousands, except per share data)

NOTE 15 – MORTGAGE BANKING ACTIVITIES - DISCONTINUED OPERATIONS

The following table presents the components of the residential loan fee income from discontinued operations for the three and nine months ended September 30, 2023 and September 30, 2022:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2023	2022	2023	2022
Net gain realized on sale of residential loans held for sale	$ —	$ 5,988	$ 13	$ 19,295
Net change in fair value recognized on residential loans held for sale	—	(1,745)	(15)	(3,784)
Net change in fair value recognized on interest rate lock commitments	—	(1,094)	—	(1,362)
Net change in fair value recognized on mandatory and best efforts forward sales contracts	—	2,940	—	12,514
Mortgage banking fees	—	1,022	—	3,851
Residential loan fee income from discontinued operations	$ —	$ 7,111	$ (2)	$ 30,514

Prior to the discontinuance of the nationwide mortgage operations, the Company entered into interest rate lock commitments, which were commitments to originate loans where the interest rate on the loan was determined prior to funding and the clients had locked into that interest rate. The Company then locked in the loan and interest rate with an investor and committed to deliver the loan if settlement occurred ("best efforts") or committed to deliver the locked loan in a binding ("mandatory") delivery program with an investor. It was the Company's practice to enter into forward commitments for the future delivery of residential mortgage loans when interest rate lock commitments were entered into in order to economically hedge the effect of changes in interest rates resulting from its commitments to fund the loans. Interest rate lock commitments and mandatory commitments to deliver loans to investors were considered derivatives.

There were no mortgage banking derivatives outstanding as of September 30, 2023. The following table reflects the amount and fair value of mortgage banking derivatives included in the assets and liabilities from discontinued operations on the Consolidated Balance Sheets at December 31, 2022:

	December 31, 2022	
	Notional Amount	Fair Value
Included in other assets from discontinued operations:		
Best efforts forward sales contracts	$ 221	$ —

NOTE 16 – LOAN COMMITMENTS AND OTHER RELATED ACTIVITIES

Some financial instruments, such as loan commitments, credit lines, and letters of credit, are issued to meet customer financing needs. These are agreements to provide credit or to support the credit of others, as long as conditions established in the contract are met, and usually have expiration dates. Commitments may expire without being used. Off-balance sheet risk to credit loss exists up to the face amount of these instruments, although material losses are not anticipated. The same credit policies that are used for loans are used to make such commitments, including obtaining collateral at exercise of the commitment.

The contractual amounts of financial instruments with off-balance sheet risk at September 30, 2023 and December 31, 2022 were as follows:

	September 30, 2023	December 31, 2022
Unfunded loan commitments	$ 20,459	$ 23,512
Unused lines of credit	169,634	134,366
Standby letters of credit	61	244

(Dollars in thousands, except per share data)

All unused lines of credit at September 30, 2023 and December 31, 2022 were variable rate lines of credit and the majority of unfunded loan commitments at September 30, 2023 and December 31, 2022 were commitments to fund variable rate loans. Unfunded loan commitments are generally entered into for periods of 90 days or less.

The Company maintains an ACL for its off-balance sheet loan commitments which is calculated by loan type using estimated line utilization rates based on historical usage. Loss rates for outstanding loans is applied to the estimated utilization rates to calculate the ACL for off-balance sheet loan commitments. At September 30, 2023 and December 31, 2022, ACL for off-balance sheet loan commitments totaled $844 and $511, respectively.

NOTE 17 – EARNINGS PER COMMON SHARE

The following table sets forth the computation of basic and diluted earnings per common share for the three and nine months ended September 30, 2023 and September 30, 2022:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2023	2022	2023	2022
Basic:				
Income from continuing operations	$ 1,970	$ 3,083	$ 4,254	$ 3,365
Loss from discontinued operations	(47)	(4,485)	(207)	(5,036)
Net income (loss)	1,923	(1,402)	4,047	(1,671)
Less: Preferred stock dividends	208	208	624	624
Net income available to (loss attributable to) common shareholders	$ 1,715	$ (1,610)	$ 3,423	$ (2,295)
Weighted average common shares outstanding	4,105,014	4,028,212	4,096,584	4,015,476
Basic earnings (loss) per common share:				
Continuing operations	$ 0.43	$ 0.71	$ 0.89	$ 0.68
Discontinued operations	(0.01)	(1.11)	(0.05)	(1.25)
Total	$ 0.42	$ (0.40)	$ 0.84	$ (0.57)
Diluted:				
Income from continuing operations	$ 1,970	$ 3,083	$ 4,254	$ 3,365
Loss from discontinued operations	(47)	(4,485)	(207)	(5,036)
Net income (loss)	1,923	(1,402)	4,047	(1,671)
Less: Preferred stock dividends	208	208	624	624
Add: Series B preferred stock dividends	64	64	193	193
Net income available to (loss attributable to) common shareholders	$ 1,779	$ (1,546)	$ 3,616	$ (2,102)
Weighted average common shares outstanding for basic earnings per common share	4,105,014	4,028,212	4,096,584	4,015,476
Add: Dilutive effects of conversion of Series B preferred stock to common stock	250,690	270,743	253,626	270,743
Add: Dilutive effects of assumed exercises of stock options and warrants	—	42,163	4,098	62,961
Average shares and dilutive potential common shares	4,355,704	4,341,118	4,354,308	4,349,180
Diluted earnings (loss) per common share:				
Continuing operations	$ 0.42	$ 0.68	$ 0.88	$ 0.67
Discontinued operations	(0.01)	(1.03)	(0.05)	(1.15)
Total	$ 0.41	$ (0.35)	$ 0.83	$ (0.48)

(Dollars in thousands, except per share data)

The following securities outstanding at September 30, 2023 and September 30, 2022 have been excluded from the calculation of weighted average shares outstanding as their effect on the calculation of earnings (loss) per share is antidilutive:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2023	2022	2023	2022
Common stock options	367,461	0	374,802	0

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

The following discussion is an analysis of the results of operations for the three and nine months ended September 30, 2023 and September 30, 2022 and financial condition as of September 30, 2023 and December 31, 2022. This discussion and analysis should be read in conjunction with the consolidated financial statements and related notes.

In addition to the historical information contained herein, this Form 10-Q includes "forward-looking statements" within the meaning of such term in the Private Securities Litigation Reform Act of 1995. These statements are subject to many risks and uncertainties, including, but not limited to, the effects of health crises, global military hostilities, or climate changes, including its effects on the economic environment, its customers and its operations, as well as any changes to federal, state or local government laws, regulations or orders in connection with them; the ability of the Company to implement its strategy and expand its banking operations; changes in interest rates and other general economic, business and political conditions, including changes in the financial markets or global military hostilities; changes in business plans as circumstances warrant; risks related to mergers and acquisitions; changes in benchmark interest rates used to price loans and deposits, changes in tax laws, regulations and guidance; and other risks detailed from time to time in filings made by the Company with the SEC. Readers should note that the forward-looking statements included herein are not a guarantee of future events, and that actual events may differ materially from those made in or suggested by the forward-looking statements.

Forward-looking statements generally can be identified by the use of forward-looking terminology such as "will," "propose," "may," "plan," "seek," "expect," "intend," "estimate," "anticipate," "believe," "continue," or similar terminology. Any forward-looking statements presented herein are made only as of the date of this document, and the Company does not undertake any obligation to update or revise any forward-looking statements to reflect changes in assumptions, the occurrence of unanticipated events, or otherwise.

Overview

The following discussion and analysis presents the financial condition and results of operations on a consolidated basis. However, because the Company conducts all of its material business operations through the Bank, the discussion and analysis relates to activities primarily conducted at the subsidiary level. The following discussion should be read in conjunction with the consolidated financial statements.

As a one-bank holding company, the Company generates most of its revenue from interest on loans and gain-on-sale income derived from the sale of government guaranteed loans into the secondary market. The primary source of funding for its loans is deposits. The Company is dependent on noninterest income, which is derived primarily from net gain on the sales of the guaranteed portion of government guaranteed loans. The largest expenses are interest on those deposits and borrowings, professional fees, and salaries and commissions plus related employee benefits. The Company measures its performance through its net interest income after provision for credit losses, return on average assets, and return on average common equity, while maintaining appropriate regulatory leverage and risk-based capital ratios.

Application of Critical Accounting Policies and Estimates

The preparation of consolidated financial statements in accordance with GAAP requires the Company to make estimates and judgments that affect reported amounts of assets, liabilities, income and expenses and related disclosure of contingent assets and liabilities. The Company bases those estimates on historical experience and on various other assumptions that are believed to be reasonable under current circumstances, results of which form the basis for making judgments about the carrying value of certain assets and liabilities that are not readily available from other sources. Estimates are evaluated on an ongoing basis. Actual results may differ from these estimates.

Accounting policies, as described in detail in the notes to the Company’s consolidated financial statements, are an integral part of the Company’s consolidated financial statements. A thorough understanding of these accounting policies is essential when reviewing the Company’s reported results of operations and financial position. Management believes that the critical accounting policies and estimates listed below require the Company to make difficult, subjective or complex judgments about matters that are inherently uncertain. At September 30, 2023, the most critical of these significant accounting policies in understanding the estimates and assumptions involved in preparing the consolidated financial statements were the policies related to the ACL, and fair value measurement of investment securities, government guaranteed servicing rights, and government guaranteed loans held for investment at fair value, which are discussed more fully below.

Allowance for Credit Losses

The ACL is calculated with the objective of maintaining a reserve sufficient to absorb estimated losses. Management's determination of the appropriateness of the allowance is based on periodic evaluations of the loan portfolio, lending-related commitments, and other relevant factors. This evaluation is inherently subjective as it requires numerous estimates, including the loss for internal risk ratings, collateral values, and the amounts and timing of expected future cash flows. The Company’s ACL on loans is estimated using relevant information, from internal and external sources, relating to past events, current conditions, and reasonable and supportable forecasts. In addition, management may include qualitative adjustments intended to capture the impact of other uncertainties in the lending environment such as underwriting standards, current economic and political conditions, and other factors affecting the credit quality. Changes to one or more of the estimates used could result in a different estimated ACL.

Fair Value Measurements

Investments and certain government guaranteed loans are recorded at fair value on a recurring basis. Additionally, from time to time, other assets and liabilities may be recorded at fair value on a nonrecurring basis, such as impaired loans, other real estate, government guaranteed servicing rights, and certain other assets and liabilities. Fair value is an estimate of the exchange price that would be received to sell an asset or paid to transfer a liability in an orderly transaction (i.e., not a forced transaction, such as a liquidation or distressed sale) between market participants at the measurement date and is based on the assumptions market participants would use when pricing an asset or liability. Fair value measurement and disclosure guidance establishes a three-level hierarchy for disclosure of assets and liabilities recorded at fair value. Valuations generated from model-based techniques that use at least one significant assumption not observable in the market are considered Level 3 and reflect estimates of assumptions market participants would use in pricing the asset or liability.

Changes in these estimates that are likely to occur from period to period, or the use of different estimates that the Company could have reasonably used in the current period, could have a material impact on the Company’s financial position or results of operation.

Further, the Company is an emerging growth company. The JOBS Act exempts emerging growth companies from being required to comply with new or revised financial accounting standards until private companies are required to comply with the new or revised financial accounting standards. The JOBS Act provides that an emerging growth company can elect to opt out of the extended transition period and comply with the requirements that apply to non-emerging growth companies but any such election to opt out is irrevocable. The Company has elected to take advantage of this extended transition period. This means that when a standard is issued or revised and it has different application dates for public or private companies, the Company, as an emerging growth company, can adopt the new or revised standard at the time private companies do so. This may make the Company’s financial statements not comparable with those of public companies which are neither an emerging growth company nor an emerging growth company which has opted out of using the extended transition period because of the potential differences in accounting standards used.

Recent Developments

Preferred Stock Offering. On September 30, 2023, the Company issued 1,835 shares of 11.0% Series C Cumulative Convertible Preferred Stock. These shares have no par value and a liquidation preference of $1,000 per share plus an amount equal to all accumulated dividends thereon (whether or not earned or declared but without interest) to the date payment of such distribution is made in full. An additional 1,995 shares and 1,760 shares were issued on October 18, 2023 and October 31, 2023, respectively. Total gross proceeds from the preferred stock offering currently totals $5.59 million, which will be used for operating expenses or to contribute capital to BayFirst National Bank to support its growth and operations.

Fourth Quarter Common Stock Dividend. On October 24, 2023, BayFirst's Board of Directors declared a fourth quarter 2023 cash dividend of $0.08 per common share, payable December 15, 2023 to common shareholders of record as of December 1, 2023. This dividend marks the 30th consecutive quarterly cash dividend paid since BayFirst initiated cash dividends in 2016.

Fourth Quarter Preferred Series A Stock Dividend. BayFirst's Board of Directors declared a quarterly cash dividend of $22.50 on the Series A Preferred Stock. The dividend will be payable January 2, 2024 to shareholders of record as of October 16, 2023. The amount and timing of the dividend is in accordance with the terms of the Series A Preferred Stock.

Fourth Quarter Preferred Series B Stock Dividend. BayFirst's Board of Directors declared a quarterly cash dividend of $20.00 on the Series B Convertible Preferred Stock. The dividend will be payable January 2, 2024 to shareholders of record as of October 16, 2023. The amount and timing of the dividend is in accordance with the terms of the Series B Convertible Preferred Stock.

Fourth Quarter Preferred Series C Stock Dividend. BayFirst's Board of Directors declared a quarterly cash dividend of $27.50 on the Series C Cumulative Convertible Preferred Stock. The dividend will be payable January 2, 2024 to shareholders of record as of October 16, 2023. The amount and timing of the dividend is in accordance with the terms of the Series C Cumulative Convertible Preferred Stock.

Selected Financial Data - Unaudited

	As of and for the Three Months Ended			As of and for the Nine Months Ended	
(Dollars in thousands, except for share data)	**9/30/2023**	**6/30/2023**	**9/30/2022**	**9/30/2023**	**9/30/2022**
Income Statement Data:					
Net interest income	$ 8,393	$ 10,108	$ 9,170	$ 27,554	$ 21,426
Provision for credit losses[(1)]	3,001	2,765	750	7,708	(1,400)
Noninterest income	14,679	10,937	9,804	35,064	23,146
Noninterest expense	17,427	16,402	14,158	49,241	41,719
Income tax expense (benefit)	674	461	983	1,415	888
Net income from continuing operations	1,970	1,417	3,083	4,254	3,365
Net loss from discontinued operations	(47)	(32)	(4,485)	(207)	(5,036)
Net income (loss)	1,923	1,385	(1,402)	4,047	(1,671)
Preferred stock dividends	208	208	208	624	624
Net income available to (loss attributable to) common shareholders	$ 1,715	$ 1,177	$ (1,610)	$ 3,423	$ (2,295)
Balance Sheet Data:					
Average loans held for investment, excluding PPP loans	$ 841,920	$ 824,460	$ 663,716	$ 804,993	$ 582,432
Average loans held for investment at amortized cost, excluding PPP loans	773,749	763,854	625,129	746,876	554,177
Average total assets	1,088,517	1,064,068	939,847	1,041,131	897,588
Average common shareholders' equity	81,067	80,310	83,014	80,080	83,408
Total loans held for investment	878,447	836,704	680,805	878,447	680,805
Total loans held for investment, excluding PPP loans	863,203	821,016	658,669	863,203	658,669
Total loans held for investment, excluding government guaranteed loan balances	687,141	638,148	520,408	687,141	520,408
Allowance for credit losses[(1)]	13,365	12,598	9,739	13,365	9,739
Total assets	1,133,979	1,087,399	930,275	1,133,979	930,275
Common shareholders' equity	82,725	81,460	81,032	82,725	81,032

(Dollars in thousands, except for share data)	As of and for the Three Months Ended 9/30/2023	6/30/2023	9/30/2022	As of and for the Nine Months Ended 9/30/2023	9/30/2022
Per Share Data:					
Basic earnings (loss) per common share	$ 0.42	$ 0.29	$ (0.40)	$ 0.84	$ (0.57)
Diluted earnings (loss) per common share	$ 0.41	$ 0.29	$ (0.35)	$ 0.83	$ (0.48)
Dividends per common share	$ 0.08	$ 0.08	$ 0.08	$ 0.24	$ 0.24
Book value per common share	$ 20.12	$ 19.85	$ 20.10	$ 20.12	$ 20.10
Tangible book value per common share [2]	$ 20.12	$ 19.85	$ 20.10	$ 20.12	$ 20.10
Performance Ratios:					
Return on average assets[3]	0.71 %	0.52 %	(0.60)%	0.52 %	(0.25)%
Return on average common equity[3]	8.46 %	5.86 %	(7.76)%	5.70 %	(3.67)%
Net interest margin	3.36 %	4.18 %	4.63 %	3.89 %	3.90 %
Dividend payout ratio	19.15 %	27.89 %	(20.02)%	28.72 %	(41.99)%
Asset Quality Data:					
Net charge-offs	$ 2,234	$ 2,253	$ 575	$ 6,375	$ 2,313
Net charge-offs/average loans held for investment at amortized cost, excluding PPP[3]	1.15 %	1.18 %	0.37 %	1.14 %	0.56 %
Nonperforming loans	$ 10,393	$ 8,606	$ 10,267	$ 10,393	$ 10,267
Nonperforming loans (excluding government guaranteed balance)	$ 8,776	$ 6,590	$ 4,015	$ 8,776	$ 4,015
Nonperforming loans/total loans held for investment	1.18 %	1.03 %	1.51 %	1.18 %	1.51 %
Nonperforming loans (excluding gov't guaranteed balance)/total loans held for investment	1.00 %	0.79 %	0.59 %	1.00 %	0.59 %
ACL/Total loans held for investment at amortized cost [1]	1.68 %	1.61 %	1.48 %	1.68 %	1.48 %
ACL/Total loans held for investment at amortized cost, excluding PPP loans[1]	1.72 %	1.64 %	1.54 %	1.72 %	1.54 %
Other Data:					
Full-time equivalent employees	307	302	524	307	524
Banking centers	10	9	8	10	8

[1] Prior to January 1, 2023, the incurred loss methodology was used to estimate credit losses. Beginning with that date, credit losses are estimated using the CECL methodology.

[2] See section entitled "GAAP Reconciliation and Management Explanation of Non-GAAP Financial Measures" below for a reconciliation to most comparable GAAP equivalent.

[3] Annualized

GAAP Reconciliation and Management Explanation of Non-GAAP Financial Measures

Some of the financial measures included in this report are not measures of financial condition or performance recognized by GAAP. These non-GAAP financial measures include tangible common shareholders' equity and tangible book value per common share. The management team uses these non-GAAP financial measures in its analysis of its performance, and they believe that providing this information to financial analysts and investors allows them to evaluate capital adequacy.

The following presents these non-GAAP financial measures along with their most directly comparable financial measures calculated in accordance with GAAP:

Tangible Common Shareholders' Equity and Tangible Book Value Per Common Share

	As of		
(Dollars in thousands, except for share data)	**September 30, 2023**	**June 30, 2023**	**September 30, 2022**
	(Unaudited)	*(Unaudited)*	*(Unaudited)*
Total shareholders' equity	$ 94,165	$ 91,065	$ 90,637
Less: Preferred stock liquidation preference	(11,440)	(9,605)	(9,605)
Total equity available to common shareholders	82,725	81,460	81,032
Less: Goodwill	—	—	—
Tangible common shareholders' equity	$ 82,725	$ 81,460	$ 81,032
Common shares outstanding	4,110,650	4,103,834	4,031,937
Tangible book value per common share	$ 20.12	$ 19.85	$ 20.10

Results of Operations

BayFirst's operating results depend on its net interest income, which is the difference between interest income on interest-earning assets and interest expense on interest-bearing liabilities, consisting primarily of deposits. Net interest income is determined by the difference between yields earned on interest-earning assets and rates paid on interest-bearing liabilities ("interest rate spread") and the relative amounts of interest-earning assets and interest-bearing liabilities. The interest rate spread is affected by regulatory, economic, and competitive factors which influence interest rates, loan demand, and deposit flows. In addition, its operating results can be affected by the level of nonperforming assets, as well as the level of the noninterest income and the noninterest expenses, such as salaries and employee benefits, and occupancy and equipment costs, as well as income taxes.

The Company is dependent on noninterest income, which is derived primarily from net gain on the sales of the guaranteed portion of government guaranteed loans, as well as fair value adjustments for certain loans which management has elected the fair value option. While the Company retains some of its government guaranteed loans on the balance sheet, the Company may sell both the guaranteed balance of its government guaranteed loans, as well as a percentage of the unguaranteed portions of such loans.

In the second quarter of 2022, the Bank discontinued its primary consumer direct residential mortgage business line. In the third quarter of 2022, management decided to discontinue the nationwide residential lending business. As a result of the discontinuance, the nationwide residential line of business was reclassified as a discontinued operation and reported in the financial statements as such.

Net Income

The Company had net income for the three months ended September 30, 2023 of $1.9 million, or $0.41 per diluted common share, compared to net loss for the three months ended September 30, 2022 of $1.4 million, or $0.35 per diluted common share. The increase of $3.3 million was due to an increase in gain on sale of government guaranteed loans of $3.5 million, an increase in other noninterest income of $1.4 million, and a decrease of $4.4 million in the net loss on discontinued operations. This was partially offset by a decrease in net interest income of $0.8 million, an increase of $2.3 million in provision for credit losses and an increase in noninterest expense of $3.3 million. In the third quarter of 2022, the Company made the strategic decision to discontinue the Bank's nationwide residential mortgage operations which resulted in the net loss from discontinued operations.

In the first nine months of 2023, net income was $4.0 million, or $0.83 per diluted common share, an increase of $5.7 million from the net loss of $1.7 million, or $0.48 per diluted common share, for the first nine months of 2022. The increase was primarily the result of higher interest income from continuing operations of $23.6 million, an increase of $7.5 million in government guaranteed loan fair value gains, an increase in other noninterest income of $1.9 million, an increase of $1.7 million in gain on sale of government guaranteed loans, and a decrease of $4.8 million in net loss from discontinued operations. This was partially offset by an increase of $16.9 million in interest expense on deposits, an increase of $9.1 million in provision for credit losses, and an increase of $7.5 million in noninterest expense.

Net Interest Income

Net interest income from continuing operations was $8.4 million in the three months ended September 30, 2023, a decrease of $0.8 million or 8.5% from $9.2 million in the three months ended September 30, 2022. The decrease was mainly due to higher interest expense on deposits of $7.2 million, partially offset by an increase in loan interest income, including fees, of $5.4 million. The margin compression was primarily from higher deposit interest expense during the current quarter, specifically the Company's 6%, 13-month time deposit special, which ended on August 31, 2023. The additional time deposits, which replaced other non-core funding, will fund current and future small dollar SBA loans currently earning Prime plus 4.75%. Although time deposit balances increased in the third quarter, $71 million of time deposits are maturing in the fourth quarter of 2023, the majority of which are not expected to renew.

Net interest margin including discontinued operations decreased to 3.36% for the third quarter of 2023, which represented a decrease of 128 basis points from 4.63% for the third quarter of 2022.

Net interest income from continuing operations was $27.6 million for the nine months ended September 30, 2023, an increase of $6.1 million or 28.6% from $21.4 million for the nine months ended September 30, 2022. The increase was mainly due to an increase in loan interest income, including fees, of $20.7 million, partially offset by an increase in deposit interest expense of $16.9 million.

Net interest margin including discontinued operations decreased slightly to 3.89% for the nine months ended September 30, 2023, compared to 3.90% for the nine months ended September 30, 2022.

Average Balance Sheet and Analysis of Net Interest Income

The following table sets forth, for the periods indicated, information regarding: (i) the total dollar amount of interest and dividend income of BayFirst from interest-earning assets and the resultant average yields; (ii) the total dollar amount of interest expense on interest-bearing liabilities and the resultant average cost; (iii) net interest income; (iv) interest rate spread; (v) net interest margin; and (vi) ratio of average interest-earning assets to average interest-bearing liabilities. Loans in nonaccrual status, for the purposes of the following computations, are included in the average loan balances. FRB, FHLB, and FNBB restricted equity holdings are included in other interest-earning assets. The Company did not have a significant amount of tax-exempt assets.

	Three Months Ended September 30,					
	2023			2022		
(Dollars in thousands)	Average Balance	Interest	Yield	Average Balance	Interest	Yield
Interest-earning assets:						
Investment securities	$ 43,383	$ 465	4.25 %	$ 50,196	$ 316	2.50 %
Loans, excluding PPP [(1)] [(2)]	841,920	15,992	7.54	723,284	11,371	6.24
PPP loans	15,418	40	1.03	28,102	141	1.99
Other	91,749	1,123	4.86	57,583	318	2.19
Total interest-earning assets	992,470	17,620	7.04	859,165	12,146	5.61
Noninterest-earning assets	96,047			80,682		
Total assets	$ 1,088,517			$ 939,847		
Interest-bearing liabilities:						
NOW, MMDA and savings	$ 633,657	$ 6,390	4.00	$ 587,331	$ 1,290	0.87
Time deposits	235,100	2,665	4.50	97,693	566	2.30
Other borrowings	15,714	172	4.34	44,929	258	2.28
Total interest-bearing liabilities	884,471	9,227	4.14	729,953	2,114	1.15
Demand deposits	100,734			106,846		
Noninterest-bearing liabilities	12,600			10,429		
Shareholders' equity	90,712			92,619		
Total liabilities and shareholders' equity	$ 1,088,517			$ 939,847		
Net interest income		$ 8,393			$ 10,032	
Interest rate spread			2.90			4.46
Net interest margin [(3)]			3.36			4.63
Ratio of average interest-earning assets to average interest-bearing liabilities	112.21 %			117.70 %		

[(1)] Includes nonaccrual loans.

[(2)] Includes no residential loans held for sale from discontinued operations as of September 30, 2023 and $59,568 at an average yield of 5.74% of residential loans held for sale from discontinued operations as of September 30, 2022.

[(3)] Net interest margin represents net interest income divided by average total interest-earning assets.

(Dollars in thousands)	For the Nine Months Ended September 30, 2023 Average Balance	2023 Interest	2023 Yield	2022 Average Balance	2022 Interest	2022 Yield
Interest-earning assets:						
Investment securities	$ 44,888	$ 1,398	4.16 %	$ 42,474	$ 642	2.02 %
Loans, excluding PPP [1] [2]	805,049	45,346	7.53	654,604	26,398	5.39
PPP loans	17,337	130	1.00	40,566	880	2.90
Other	80,522	2,790	4.63	82,239	592	0.96
Total interest-earning assets	947,796	49,664	7.01	819,883	28,512	4.65
Noninterest-earning assets	93,335			77,705		
Total assets	$ 1,041,131			$ 897,588		
Interest-bearing liabilities:						
NOW, MMDA and savings	$ 620,237	$ 15,598	3.36	$ 613,613	$ 3,350	0.73
Time deposits	186,827	5,478	3.92	54,714	783	1.91
PPPLF advances	—	—	—	7,577	20	0.35
Other borrowings	30,325	1,033	4.55	22,177	467	2.82
Total interest-bearing liabilities	837,389	22,109	3.53	698,081	4,620	0.88
Demand deposits	101,661			99,234		
Noninterest-bearing liabilities	12,383			7,260		
Shareholders' equity	89,698			93,013		
Total liabilities and shareholders' equity	$ 1,041,131			$ 897,588		
Net interest income		$ 27,555			$ 23,892	
Interest rate spread			3.48			3.77
Net interest margin [3]			3.89			3.90
Ratio of average interest-earning assets to average interest-bearing liabilities	113.18 %			117.45 %		

[1] Includes nonaccrual loans.

[2] Includes $56 at an average yield of 2.02% and $72,172 at an average yield of 4.57% of residential loans held for sale from discontinued operations as of September 30, 2023 and September 30, 2022, respectively.

[3] Net interest margin represents net interest income divided by average total interest-earning assets.

Rate/Volume Analysis

The table below presents the effects of volume and rate changes on interest income and expense for the periods indicated. Changes in volume are changes in the average balance multiplied by the previous period's average rate. Changes in rate are changes in the average rate multiplied by the average balance from the previous period. The net changes attributable to the combined impact of both rate and volume have been allocated proportionately to the changes due to volume and the changes due to rate. Loans in nonaccrual status, for the purpose of the following computations, are included in the average loan balances. FRB, FHLB, and FNBB restricted equity holdings are included in other interest-earning assets. The Company did not have a significant amount of tax-exempt assets.

(Dollars in thousands)	Rate	Volume	Total
Three Months Ended September 30, 2023 vs. September 30, 2022:			
Interest-earning assets:			
Investment securities	$ 197	$ (48)	$ 149
Loans, excluding PPP	2,585	2,036	4,621
PPP loans	(52)	(49)	(101)
Other interest-earning assets	541	264	805
Total interest-earning assets	3,271	2,203	5,474
Interest-bearing liabilities:			
NOW, MMDA and savings	4,990	110	5,100
Time deposits	850	1,249	2,099
Other borrowings	145	(231)	(86)
Total interest-bearing liabilities	5,985	1,128	7,113
Net change in net interest income	$ (2,714)	$ 1,075	$ (1,639)

(Dollars in thousands)	Rate	Volume	Total
Nine Months Ended September 30, 2023 vs. September 30, 2022:			
Interest-earning assets:			
Investment securities	$ 718	$ 38	$ 756
Loans, excluding PPP [(1)]	11,998	6,950	18,948
PPP loans	(400)	(350)	(750)
Other interest-earning assets	2,211	(13)	2,198
Total interest-earning assets	14,527	6,625	21,152
Interest-bearing liabilities:			
NOW, MMDA, and savings	12,211	37	12,248
Time deposits	1,422	3,273	4,695
PPPLF advances	—	(20)	(20)
Other borrowings	355	211	566
Total interest-bearing liabilities	13,988	3,501	17,489
Net change in net interest income	$ 539	$ 3,124	$ 3,663

[(1)] Includes $1 and $2,466 of interest income on residential loans held for sale from discontinued operations as of September 30, 2023 and September 30, 2022, respectively.

Provision for Credit Losses

The provision for credit losses is charged to operations to adjust the total allowance to a level deemed appropriate by management and is based upon the volume and type of lending the Bank conducts, industry standards, the amount of nonperforming loans, general economic conditions, particularly as they relate to its market area, economic forecasts, and other factors that may affect the ability to collect on the loans in its portfolio.

The Company recorded a provision for credit losses on loans in the three months ended September 30, 2023 of $3.0 million primarily due to net charge-offs and net loan growth. This compared to a provision of $0.8 million under the incurred loss methodology for the three months ended September 30, 2022. During the three months ended September 30, 2023, $2.2 million of net charge offs in loans were recorded compared to $0.6 million during the three months ended September 30, 2022.

The Company recorded a provision for credit losses for the nine months ended September 30, 2023 of $7.7 million compared to a $1.4 million negative provision under the incurred loss methodology for the nine months ended September 30, 2022. The increase of $9.1 million in the provision for credit losses expense was primarily due to loan growth, higher charge-offs, and the Company having reduced its ALLL under the incurred loss methodology in 2022 from the historic high levels reached in 2020 at the onset of the COVID-19 pandemic. During the nine months ended

September 30, 2023, net loan charge offs totaled $6.4 million compared to $2.3 million during the nine months ended September 30, 2022. Net charge-offs for the first three quarters of 2023 were elevated by $1.9 million due to the performance from a purchased portfolio of unsecured consumer loans. This portfolio currently has $0.9 million of loans 30-89 days past due and $0.4 million of loans 90+ days past due. The Company stopped purchasing these loans at the end of 2022 and the portfolio balances have decreased from $29.4 million to $19.6 million since the beginning of 2023.

The ACL was $13.4 million at September 30, 2023 and $9.7 million using the incurred losses methodology at September 30, 2022.

Noninterest Income

The following table presents noninterest income from continuing operations for the three and nine months ended September 30, 2023 and September 30, 2022.

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
(Dollars in thousands)	**2023**	**2022**	**2023**	**2022**
Noninterest income:				
Loan servicing income, net	$ 760	$ 620	$ 2,149	$ 1,508
Gain on sale of government guaranteed loans, net	7,139	7,446	17,576	15,915
Service charges and fees	408	347	1,166	951
Government guaranteed loan fair value gain	4,543	999	11,021	3,510
Government guaranteed loan packaging fees	1,158	208	2,076	496
Other noninterest income	671	184	1,076	766
Total noninterest income	$ 14,679	$ 9,804	$ 35,064	$ 23,146

Noninterest income from continuing operations was $14.7 million during the three months ended September 30, 2023, an increase of $4.9 million or 49.7%, from $9.8 million during the three months ended September 30, 2022. The increase was the result of increases in fair value gains related to held for investment government guaranteed loans of $3.5 million and higher government guaranteed loan packaging fees of $1.0 million.

Noninterest income from continuing operations was $35.1 million for the nine months ended September 30, 2023, an increase of $11.9 million or 51.5% from $23.1 million for the nine months ended September 30, 2022. The increase was primarily due to higher gains on the sale of government guaranteed loans of $1.7 million, a $7.5 million increase in fair value gains related to held for investment government guaranteed loans, and an increase in government guaranteed loan packaging fees of $1.6 million. The increase in fair value gains related to held for investment government guaranteed loans was primarily related to an increase in the volume of loans held at fair value. As of September 30, 2023, the Company had $84.2 million compared to $25.0 million at September 30, 2022.

Noninterest Expense

The following table presents noninterest expense from continuing operations for the three and nine months ended September 30, 2023 and September 30, 2022.

(Dollars in thousands)	For the Three Months Ended September 30, 2023	For the Three Months Ended September 30, 2022	For the Nine Months Ended September 30, 2023	For the Nine Months Ended September 30, 2022
Noninterest expense:				
Salaries and benefits	$ 7,912	$ 6,758	$ 23,527	$ 21,177
Bonus, commissions, and incentives	1,406	883	3,515	1,833
Occupancy and equipment	1,262	1,070	3,608	3,010
Data processing	1,526	1,247	4,189	3,486
Marketing and business development	929	662	2,696	2,100
Professional services	816	956	2,587	3,089
Loan origination and collection	1,981	1,068	4,697	2,486
Employee recruiting and development	543	518	1,667	1,653
Regulatory assessments	284	110	615	299
Director compensation	147	177	438	514
Liability and fidelity bond insurance	148	119	403	349
ATM and interchange	154	133	359	293
Telecommunication	90	99	275	273
Other noninterest expense	229	358	665	1,157
Total noninterest expense	$ 17,427	$ 14,158	$ 49,241	$ 41,719

Noninterest expense from continuing operations was $17.4 million durin g the three months ended September 30, 2023, an increase of $3.3 million or 23.1% from $14.2 million during the three months ended September 30, 2022. The increase was primarily due to higher compensation costs of $1.7 million and higher loan origination expense of $0.9 million.

Noninterest expense was $49.2 million during the nine months ended September 30, 2023, an increase of $7.5 million or 18.0% from $41.7 million for the nine months ended September 30, 2022. The increase was primarily the result of higher compensation costs and loan origination and collection expense.

Discontinued Operations

Net loss on discontinued operations was $47 thousand in the three months ended September 30, 2023, which was a $4.4 million favorable change from a net loss of $4.5 million in the three months ended September 30, 2022. The loss in the third quarter of 2023 was partially due to lagging facilities costs as we seek to sublease vacant space. The $4.4 million decrease in the net loss from the year-ago quarter was primarily due to a decrease in noninterest expense of $13.9 million, partially offset by decreases in residential loan fee income of $7.1 million, interest income of $0.9 million, and income tax benefit of $1.5 million. In the third quarter of 2022, the Company recognized $3.7 million of restructuring charges from the discontinuation of the residential mortgage operations which was recorded to noninterest expense.

Net loss from discontinued operations was $207 thousand for the nine months ended September 30, 2023, which was a $4.8 million reduction from a net loss of $5.0 million for the nine months ended September 30, 2022. The majority of the discontinued loss in 2022 was recorded in the third quarter of 2022. As such, the net loss from discontinued operations for the first nine months of 2022 included restructuring charges of $4.3 million and the discontinued loss in the first nine months of 2023 represented a modest amount of trailing expenses from the discontinuation.

Income Taxes

Income tax expense from continuing operations was $674 thousand for the three months ended September 30, 2023, a decrease of $309 thousand from income tax expense of $983 thousand for the three months ended September 30, 2022. The decrease was primarily due to the decrease in pre-tax earnings from continuing operations. Income tax benefit from discontinued operations was $15 thousand for the three months ended September 30, 2023, compared to income tax benefit of $1.5 million for the three months ended September 30, 2022. The change was primarily due to the decrease in pre-tax loss from discontinued operations.

Income tax expense from continuing operations was $1.4 million for the nine months ended September 30, 2023, an increase of $0.5 million from income tax expense of $0.9 million for the nine months ended September 30, 2022. The increase was primarily due to the increase in pre-tax earnings from continuing operations. Income tax benefit from discontinued operations was $68 thousand for the nine months ended September 30, 2023, a change of $1.6 million from income tax benefit of $1.7 million for the nine months ended September 30, 2022. The change was primarily due to the decrease in pre-tax loss from discontinued operations.

At September 30, 2023, the Company had $2.7 million of federal net operating loss carryforward and $0.4 million of state net operating loss carryforward. The net operating loss carryforwards do not expire. At September 30, 2022, the Company had $2.4 million of federal net operating loss carryforward and $0.4 million of state net operating loss carryforward.

The effective income tax rate was 24.97% for the nine months ended September 30, 2023 and 31.88% for the nine months ended September 30, 2022.

Financial Condition

Investment Securities

The following table presents the fair value of the Company's investment securities portfolio classified as available for sale as of September 30, 2023 and December 31, 2022.

(Dollars in thousands)	September 30, 2023	December 31, 2022
Investment securities available for sale:		
Asset-backed securities	$ 8,527	$ 9,605
Mortgage-backed securities:		
U.S. Government-sponsored enterprises	3,102	3,440
Collateralized mortgage obligations:		
U.S. Government-sponsored enterprises	16,719	18,220
Corporate bonds	11,335	11,084
Total investment securities available for sale	$ 39,683	$ 42,349

The net unrealized loss on the investment securities AFS at September 30, 2023, was $4.9 million compared with a net unrealized loss on investment securities AFS of $5.0 million at December 31, 2022. The change in unrealized loss on investment securities AFS from December 31, 2022 to September 30, 2023 was primarily due to the change in the interest rate environment.

The following table presents the amortized cost of the Company's investment securities portfolio classified as held to maturity as of September 30, 2023 and December 31, 2022.

(Dollars in thousands)	September 30, 2023	December 31, 2022
Investment securities held to maturity:		
Mortgage-backed securities:		
U.S. Government-sponsored enterprises	$ 1	$ 2
Corporate bonds	2,500	5,000
Total investment securities held to maturity	$ 2,501	$ 5,002

There was a $19 thousand ACL on the corporate bonds HTM as of September 30, 2023 and no ACL as of December 31, 2022. The net unrealized loss on the investment securities HTM at September 30, 2023, was $219 thousand compared with a net unrealized loss on investment securities HTM of $247 thousand at December 31, 2022.

No investment securities were pledged as of September 30, 2023 or December 31, 2022, and there were no sales of investment securities during the three and nine months ended September 30, 2023 or three and nine months ended September 30, 2022.

The investment securities available for sale presented in the following tables are reported at amortized cost and by contractual maturity as of September 30, 2023 and December 31, 2022. Actual timing may differ from contractual maturities if borrowers have the right to call or prepay obligations with or without call or prepayment penalties. Additionally, residential mortgage-backed securities and collateralized mortgage obligations receive monthly principal payments, which are not reflected below.

	September 30, 2023							
	One year or less		One to five years		Five to ten years		After ten years	
(Dollars in thousands)	Amortized Cost	Average Yield	Amortized Cost	Average Yield	Amortized Cost	Average Yield	Amortized Cost	Average Yield
Asset-backed securities	$ —	— %	$ —	— %	$ —	— %	$ 8,597	6.37 %
Mortgage-backed securities:								
U.S. Government-sponsored enterprises	—	—	—	—	—	—	3,909	1.56
Collateralized mortgage obligations:								
U.S. Government-sponsored enterprises	—	—	—	—	—	—	20,730	1.84
Corporate bonds	—	—	11,333	6.37	—	—	—	—
Total investment securities available for sale	$ —	— %	$ 11,333	6.37 %	$ —	— %	$ 33,236	2.98 %

	December 31, 2022							
	One year or less		One to five years		Five to ten years		After ten years	
(Dollars in thousands)	Amortized Cost	Average Yield	Amortized Cost	Average Yield	Amortized Cost	Average Yield	Amortized Cost	Average Yield
Asset-backed securities	$ —	— %	$ —	— %	$ —	— %	$ 9,873	5.40 %
Mortgage-backed securities:								
U.S. Government-sponsored enterprises	—	—	—	—	—	—	4,133	1.55
Collateralized mortgage obligations:								
U.S. Government-sponsored enterprises	—	—	—	—	—	—	22,031	1.89
Corporate bonds	—	—	9,981	3.70	1,356	4.34	—	—
Total investment securities available for sale	$ —	— %	$ 9,981	3.70 %	$ 1,356	4.34 %	$ 36,037	2.81 %

The investment securities held to maturity presented in the following tables are reported at amortized cost and by contractual maturity as of September 30, 2023 and December 31, 2022. Actual timing may differ from contractual maturities if borrowers have the right to call or prepay obligations with or without call or prepayment penalties. Additionally, residential mortgage-backed securities receive monthly principal payments, which are not reflected below.

(Dollars in thousands)	September 30, 2023							
	One year or less		One to five years		Five to ten years		After ten years	
	Amortized Cost	Average Yield	Amortized Cost	Average Yield	Amortized Cost	Average Yield	Amortized Cost	Average Yield
Mortgage-backed securities:								
U.S. Government-sponsored enterprises	$ —	— %	$ —	— %	$ —	— %	$ 1	2.45 %
Corporate bonds	—	—	1,500	4.38	1,000	4.38	—	—
Total investment securities held to maturity	$ —	— %	$ 1,500	4.38 %	$ 1,000	4.38 %	$ 1	2.45 %

(Dollars in thousands)	December 31, 2022							
	One year or less		One to five years		Five to ten years		After ten years	
	Amortized Cost	Average Yield	Amortized Cost	Average Yield	Amortized Cost	Average Yield	Amortized Cost	Average Yield
Mortgage-backed securities:								
U.S. Government-sponsored enterprises	$ —	— %	$ —	— %	$ —	— %	$ 2	2.65 %
Corporate bonds	—	—	4,000	5.79	1,000	4.38	—	—
Total investment securities held to maturity	$ —	— %	$ 4,000	5.79 %	$ 1,000	4.38 %	$ 2	2.65 %

Loan Portfolio Composition

The Company offers a variety of products designed to meet the credit needs of our borrowers. Our lending activities primarily consist of government guaranteed loans, real estate loans, commercial business loans, residential mortgage, and consumer loans. Senior management and loan officers have continued to develop new sources of loan referrals, particularly among centers of local influence and real estate professionals, and have also enjoyed repeat business from loyal customers in the markets the Bank serves. The Bank has no concentration of credit in any industry that represents 10% or more of its loan portfolio. The following table sets forth the composition of its loan portfolio, including LHFS as of the dates indicated.

(Dollars in thousands)	September 30, 2023 Amount	September 30, 2023 % of Total	December 31, 2022 Amount	December 31, 2022 % of Total
Residential loans held for sale from discontinued operations	$ —		$ 449	
Government guaranteed loans, held for sale	$ 1,855		$ —	
Government guaranteed loans held for investment, at fair value	$ 84,178		$ 27,078	
Loans held for investment, at amortized cost:				
Residential real estate	$ 248,973	31.8 %	$ 202,329	29.1 %
Commercial real estate	280,620	35.8	231,281	33.3
Construction and land	25,339	3.2	9,320	1.3
Commercial and industrial	174,238	22.2	194,643	28.0
Commercial and industrial – PPP	15,364	2.0	19,293	2.8
Consumer and other	39,024	5.0	37,288	5.5
Loans held for investment, at amortized cost, gross	783,558	100.0 %	694,154	100.0 %
Discount on government guaranteed loans sold	(6,623)		(5,621)	
Premium on loans purchased, net	4,406		2,301	
Deferred loan costs, net	12,928		10,740	
Allowance for credit losses [1]	(13,365)		(9,046)	
Loans held for investment, at amortized cost, net	$ 780,904		$ 692,528	

[1] Prior to January 1, 2023, the incurred loss methodology was used to estimate credit losses. Beginning with that date, credit losses are estimated using the CECL methodology.

During the nine months ended September 30, 2023, the Bank originated approximately $159.7 million in loans through conventional lending channels and $402.5 million in loans through CreditBench (its government guaranteed lending function). In addition, the Bank sold guaranteed balances of $316.3 million and unguaranteed balances of $10.9 million of government guaranteed loans. The Bank purchased $106.4 million of government guaranteed loans. Of the loans purchased during the year, $58.2 million have already been sold or paid off.

During the nine months ended September 30, 2022, the Bank originated approximately $206.8 million in loans through conventional lending channels, $276.9 million through CreditBench, and $886.6 million through the Residential Mortgage Lending Division, which is a discontinued operation. Additionally, the Bank sold guaranteed balances of $233.1 million and unguaranteed balances of $13.8 million of government guaranteed loans. The Bank purchased $16.6 million of government guaranteed loans and $34.1 million of unsecured consumer loans.

Loan Maturity/Rate Sensitivity

The following table shows the contractual maturities of our loans at September 30, 2023. Loan balances in this table include loans held for investment at fair value, loans held for investment at amortized cost, discount on retained balances of loans sold, premium and discount on loans purchased, and deferred loan costs, net.

(Dollars in thousands)	Due in One Year or Less	Due After One Year to Five Years	Due After Five Years to 15 Years	Due After 15 Years	Total
Real estate:					
Residential	$ 1,914	$ 1,465	$ 14,727	$ 231,342	$ 249,448
Commercial	14,186	1,407	40,447	257,228	313,268
Construction and land	5,561	2,797	86	16,894	25,338
Commercial and industrial	7,992	23,398	195,175	7,941	234,506
Commercial and industrial - PPP	810	14,433	—	—	15,243
Consumer and other	1,763	30,025	7,939	917	40,644
Total loans held for investment	$ 32,226	$ 73,525	$ 258,374	$ 514,322	$ 878,447

The following table shows the loans with contractual maturities of greater than one year that have fixed or adjustable interest rates at September 30, 2023.

(Dollars in thousands)	Fixed Interest Rate	Adjustable Interest Rate
Real estate:		
Residential	$ 59,504	$ 188,030
Commercial	12,530	286,552
Construction and land	—	19,777
Commercial and industrial	9,981	216,533
Commercial and industrial - PPP	14,433	—
Consumer and other	17,275	21,606
Total loans held for investment	$ 113,723	$ 732,498

Credit Risk

The Bank's primary business is making commercial, consumer, and real estate loans. This activity inevitably has risks for potential credit losses, the magnitude of which depends on a variety of economic factors affecting borrowers, which are beyond its control. The Bank has developed policies and procedures for evaluating the overall quality of its credit portfolio and the timely identification of potential problem loans. Management's judgment as to the adequacy of the allowance is based upon a number of assumptions about the economic environment that it believes impacts credit quality as of the balance sheet date that it believes to be reasonable, but which may or may not prove accurate. Thus, there can be no assurance that charge-offs in future periods will not exceed the ACL, or that additional increases in the ACL will not be required.

Allowance for Credit Losses. In accordance with changes in generally accepted accounting principles, the Company adopted the new credit loss accounting standard known as CECL on January 1, 2023. At the time of adoption, the ACL for loans increased by $3.1 million to 1.73% of loans, the reserve on unfunded commitments increased $213 thousand, and an $18 thousand reserve was established for held to maturity investment securities.These one-time increases resulted in an after tax decrease to capital of $2.5 million, with no impact to earnings. Under CECL, the ACL is based on projected credit losses rather than on incurred losses.

The Bank must maintain an adequate ACL based on a comprehensive methodology that assesses the probable losses inherent in its loan portfolio. The Bank maintains an ACL based on a number of quantitative and qualitative factors, including levels and trends of past due and nonaccrual loans, asset classifications, loan grades, change in volume and mix of loans, collateral value, historical loss experience, size and complexity of individual credits, and economic conditions. In addition to this, the Company uses reasonable and supportable forecasts utilizing data from the Federal Open Market Committee's median forecasts of change in national GDP and of national unemployment. Provisions for credit losses are provided on both a specific and general basis. Specific allowances are provided for individual loans that do not share similar risk characteristics with instruments evaluated using a collective (pooled) basis. General valuation allowances are determined by loan pools with a further evaluation of various quantitative and qualitative factors noted above.

The Bank periodically reviews the assumptions and formulates methodologies by which changes are made to the specific and general valuation ACL in an effort to refine such allowances in light of the current status of the factors described above.

All nonaccrual loans and modifications to loans for borrowers experiencing financial difficulty are reviewed to determine if the loans share the same risk characteristics as the pooled loans. If the loan does not share the same risk characteristics, the loan is evaluated individually for credit losses. Specific allocation of reserves for individually evaluated loans considers the value of the collateral, the financial condition of the borrower, and industry and current economic trends. The Bank reviews the collateral value, cash flow, and tertiary support on each individually evaluated credit. Any deficiency outlined by a real estate collateral evaluation analysis, or cash flow shortfall, is accounted for through a specific allocation for the loan.

Prior to January 1, 2023, the incurred loss methodology was used to estimate credit losses. Beginning with that date, the credit losses are estimated using the CECL methodology.

Nonperforming Assets. At September 30, 2023, the Company had $8.8 million in nonperforming assets, excluding government guaranteed loan balances, and their ACL represented 1.68% of total loans held for investment at amortized cost. At September 30, 2022, the Company had $4.1 million in nonperforming assets, excluding government guaranteed loan balances, and their ALLL represented 1.48% of total loans held for investment at amortized cost. Total loans held for investment at September 30, 2023 and September 30, 2022 included government guaranteed loans and loans measured at fair value, which had no reserves allocated to them. ACL as a percentage of loans held for investment at amortized cost, not including government guaranteed loan balances, was 2.03% under CECL at September 30, 2023, compared to 1.90% under the incurred loss method at September 30, 2022.

The following table sets forth certain information on nonaccrual loans and foreclosed assets, the ratio of such loans and foreclosed assets to total assets as of the dates indicated, and certain other related information.

(Dollars in thousands)	September 30, 2023	September 30, 2022
Nonperforming loans (government guaranteed balances)	$ 1,617	$ 6,252
Nonperforming loans (unguaranteed balances)	8,776	4,015
Total nonperforming loans	10,393	10,267
OREO	—	56
Total nonperforming assets	$ 10,393	$ 10,323
Nonperforming loans as a percentage of total loans held for investment	1.18 %	1.51 %
Nonperforming loans (excluding government guaranteed balances) to total loans held for investment	1.00 %	0.59 %
Nonperforming assets as a percentage of total assets	0.92 %	1.11 %
Nonperforming assets (excluding government guaranteed balances) to total assets	0.77 %	0.44 %
ACL to nonperforming loans	128.60 %	94.86 %
ACL to nonperforming loans (excluding government guaranteed balances)	152.29 %	242.57 %

The following table sets forth information with respect to activity in the ACL for loans for the periods shown:

(Dollars in thousands)	At and for the Three Months Ended September 30,		At and for the Nine Months Ended September 30,	
	2023	2022	2023	2022
Allowance at beginning of period	$ 12,598	$ 9,564	$ 9,046	$ 13,452
Impact of adopting ASC 326	—	—	3,107	—
Charge-offs:				
Commercial real estate	(108)	36	(108)	(17)
Commercial and industrial	(1,542)	(697)	(4,660)	(2,667)
Consumer and other	(874)	(68)	(2,214)	(109)
Total charge-offs	(2,524)	(729)	(6,982)	(2,793)
Recoveries:				
Commercial real estate	75	13	77	74
Commercial and industrial	114	105	303	365
Consumer and other	93	36	219	41
Total recoveries	290	154	607	480
Net charge-offs	(2,234)	(575)	(6,375)	(2,313)
Provision for credit losses	3,001	750	7,587	(1,400)
Allowance at end of period	$ 13,365	$ 9,739	$ 13,365	$ 9,739
Net charge-offs to average loans held for investment at amortized cost (annualized)	1.13 %	0.35 %	1.11 %	0.52 %
Allowance as a percent of total loans held for investment at amortized cost	1.68 %	1.48 %	1.68 %	1.48 %
Allowance as a percent of loans held for investment at amortized cost, not including government guaranteed loans	2.03 %	1.90 %	2.03 %	1.90 %
Allowance as a percent of nonperforming loans	128.60 %	94.86 %	128.60 %	94.86 %
Total loans held for investment	$ 878,447	$ 680,805	$ 878,447	$ 680,805
Average loans held for investment at amortized cost	$ 789,167	$ 653,231	$ 764,213	$ 594,743
Nonperforming loans (including government guaranteed balances)	$ 10,393	$ 10,267	$ 10,393	$ 10,267
Nonperforming loans (excluding government guaranteed balances)	$ 8,776	$ 4,015	$ 8,776	$ 4,015
Guaranteed balance of government guaranteed loans	$ 191,306	$ 160,397	$ 191,306	$ 160,397

The following table details net charge-offs to average loans outstanding by loan category for the three months ended September 30, 2023 and September 30, 2022.

	Three Months Ended September 30, 2023			Three Months Ended September 30, 2022		
(Dollars in thousands)	**Net (Charge-off) Recovery**	**Average Loans HFI**	**Net (Charge-off) Recovery Ratio**	**Net (Charge-off) Recovery**	**Average Loans HFI**	**Net (Charge-off) Recovery Ratio**
Residential real estate	$ 8	$ 228,539	0.01 %	$ —	$ 131,536	— %
Commercial real estate	(33)	326,051	(0.04)	49	276,226	0.07
Commercial and industrial	(1,428)	248,096	(2.30)	(592)	219,005	(1.08)
Commercial and industrial - PPP	—	15,418	—	—	28,102	—
Consumer and other	(781)	39,234	(7.96)	(32)	36,949	(0.35)
Total loans held for investment	$ (2,234)	$ 857,338	(1.04) %	$ (575)	$ 691,818	(0.33) %

The following table details net charge-offs to average loans outstanding by loan category for the nine months ended September 30, 2023 and September 30, 2022.

	Nine Months Ended September 30, 2023			Nine Months Ended September 30, 2022		
(Dollars in thousands)	**Net (Charge-off) Recovery**	**Average Loans HFI**	**Net (Charge-off) Recovery Ratio**	**Net (Charge-off) Recovery**	**Average Loans HFI**	**Net (Charge-off) Recovery Ratio**
Residential real estate	$ 8	$ 209,934	0.01 %	$ —	$ 102,486	— %
Commercial real estate	(31)	299,972	(0.01)	57	246,341	0.03
Commercial and industrial	(4,357)	258,043	(2.25)	(2,302)	211,950	(1.45)
Commercial and industrial - PPP	—	17,337	—	—	40,566	—
Consumer and other	(1,995)	37,044	(7.18)	(68)	21,655	(0.42)
Total loans held for investment	$ (6,375)	$ 822,330	(1.03) %	$ (2,313)	$ 622,998	(0.50) %

Asset quality remained stable in the third quarter of 2023. T he Company recorded a provision for credit losses for the nine months ended September 30, 2023 of $7.7 million compared to a $1.4 million negative provision under the incurred loss methodology for the nine months ended September 30, 2022. The increase of $9.1 million in the provision for credit losses expense was primarily due to the loan growth, higher charge-offs, and the Company reduced its ALLL in 2022 from the historic high levels reached in 2020 at the onset of the pandemic.

Nonperforming assets to total assets, excluding government guaranteed loan balances, were 0.77% as of September 30, 2023, as compared to 0.44% as of September 30, 2022.

SBA and Other Government Guaranteed Loans

The following table sets forth, for the periods indicated, information regarding the SBA and other government guaranteed lending activity, excluding PPP loans.

(Dollars in thousands)	At and for the Nine Months Ended September 30,	
Government Guaranteed, Excluding PPP	**2023**	**2022**
Number of loans originated	1,968	825
Amount of loans originated	$ 402,528	$ 276,583
Average loan size originated	$ 205	$ 335
Government guaranteed loan balances sold	$ 316,333	$ 233,105
Government unguaranteed loan balances sold	$ 10,937	$ 13,803
Total government guaranteed loans	$ 373,719	$ 286,798
Government guaranteed loan balances	$ 176,062	$ 138,261
Government unguaranteed loan balances	$ 197,657	$ 148,537
Government guaranteed loans serviced for others	$ 825,723	$ 616,419

The Bank makes government guaranteed loans throughout the United States. The following table sets forth, at the dates indicated, information regarding the geographic disbursement of its government guaranteed loan portfolio. The “All Other” category includes states with less than 5% in any period presented.

	September 30,			
	2023		2022	
(Dollars in thousands)	**Amount**	**% of Total**	**Amount**	**% of Total**
Florida	$ 131,928	35 %	$ 89,373	31 %
California	45,121	12	31,930	11
Tennessee	28,395	8	18,672	7
Texas	23,710	6	21,478	7
All Other	144,565	39	125,345	44
Total government guaranteed loans, excluding PPP loans	$ 373,719	100 %	$ 286,798	100 %

Deposits

General. In addition to deposits, sources of funds available for lending and for other purposes include loan repayments and proceeds from the sales of loans. Loan repayments are a relatively stable source of funds, while deposit inflows and outflows are influenced significantly by general interest rates and market conditions. Borrowings, as well as available lines of credit, may be used on a short-term basis to compensate for reductions in other sources, such as deposits at less than projected levels.

Deposits. Deposits are sourced principally from within its primary service area of Pinellas, Hillsborough, Manatee, Pasco, and Sarasota Counties, Florida. The Bank offers a wide selection of deposit instruments including demand deposit accounts, NOW accounts, money-market accounts, regular savings accounts, certificate of deposit accounts, and retirement savings plans (such as IRA accounts).

Certificate of deposit rates are set to encourage longer maturities as cost and market conditions will allow. Deposit account terms vary, with the primary differences being the minimum balance required, the time period the funds must remain on deposit, and the interest rate.

The Bank emphasizes commercial banking relationships in an effort to increase demand deposits as a percentage of total deposits. Deposit interest rates are set by management at least monthly or more often if conditions require it, based on a review of loan demand, recent cash flows and a survey of rates among competitors.

Brokered deposits. At times, the Bank has brokered time deposit and non-maturity deposit relationships available to diversify its funding sources. Brokered deposits offer several benefits relative to other funding sources, such as: maturity structures which cannot be duplicated in the current retail market, deposit gathering outside the market of the existing deposit base, the unsecured nature of these liabilities, and the ability to quickly generate funds. The Bank's internal policy limits the use of brokered deposits as a funding source to no more than 15% of total assets. The Company's ability to accept or renew brokered deposits is contingent upon the Bank maintaining a capital level of "well capitalized." At September 30, 2023 and December 31, 2022, the Company had $167 thousand and $746 thousand, respectively, of brokered deposits.

The amount of each of the following categories of deposits, at the dates indicated, are as follows:

(Dollars in thousands)	**September 30, 2023**		**December 31, 2022**	
Noninterest-bearing deposits	$ 98,008	9.6 %	$ 93,235	11.8 %
Interest-bearing transaction accounts	267,404	26.3	202,656	25.5
Money market accounts	333,250	32.7	345,200	43.4
Savings	16,860	1.7	17,853	2.2
Subtotal	715,522	70.3	658,944	82.9
Total time deposits	302,274	29.7	136,126	17.1
Total deposits	$ 1,017,796	100.0 %	$ 795,070	100.0 %

At September 30, 2023, the Company held approximately $152.5 million of deposits that exceeded the FDIC insurance limit which was 15% of total deposits.

The following table provides information on the maturity distribution of the time deposits exceeding the FDIC insurance limit of $250 thousand as of September 30, 2023.

(Dollars in thousands)	
Three months or less	$ 27,073
Over three months through six months	11,668
Over six months through 12 months	16,581
Over 12 months	61,480
Total	$ 116,802

Deposits increased $222.7 million or 28.01% during the first nine months of 2023, with growth in t ransaction accounts (noninterest bearing and interest bearing transaction accounts) of $69.5 million or 23.5% and time deposit balance of $166.1 million, or 122.1%. Savings and money market account balances decreased $12.9 million during the same period. The time deposit balance increase included a small increase of $6.4 million in short-term Certificate of Deposit Account Registry Service ("CDARS") and listing service balances. There were $244.1 million or 80.8% of total time deposits that mature within the next 18 months.

Other Borrowings

At September 30, 2023, the Company had no borrowings from the FHLB and FRB. There was $25.0 million of borrowings at 4.50% from the FRB and no borrowings from the FHLB at December 31, 2022.

The Bank is a member of the FHLB of Atlanta, which provides short- and long-term funding collateralized by mortgage-related assets to its members. FHLB short-term borrowings bear interest at variable rates set by the FHLB. Any a dvances that the bank were to obtain would be secured by a blanket lien on $274.9 million of real estate-related loans as of September 30, 2023. Based on this collateral and the Company's holdings of FHLB stock, the Company was eligible to borrow up to $156.5 million from the FHLB at September 30, 2023.

In addition, the Bank has a line of credit with the Federal Reserve Bank of Atlanta which was secured by $59.6 million of commercial loans as of September 30, 2023. FRB short-term borrowings bear interest at variable rates based on the Federal Open Market Committee's target range for the federal funds rate. Based on this collateral, the Company was eligible to borrow up to $40.1 million from the FRB at September 30, 2023.

In June 2021, the Company issued $6.0 million of Subordinated Debentures (the "Debentures") that mature June 30, 2031 and are redeemable after 5 years. The Debentures carry interest at a fixed rate of 4.50% per annum for the initial 5 years of term and carry interest at a floating rate for the final 5 years of term. Under the debt agreements, the floating rates are based on a SOFR benchmark plus 3.78% per annum. The balance of Subordinated Debentures outstanding at the Company, net of offering costs, amounted to $5.9 million and $6.0 million at September 30, 2023 and December 31, 2022, respectively.

The Company has a term note with quarterly principal and interest payments with interest at Prime (8.50% at September 30, 2023). The note matures on March 10, 2029 and the balance of the note was $2.5 million and $2.8 million at September 30, 2023 and December 31, 2022, respectively. The note is secured by 100% of the stock of the Company and requires the Company to comply with certain loan covenants during the term of the note. As of September 30, 2023, the Company was in compliance with all financial debt covenants.

Capital Resources

Shareholders' equity is influenced primarily by earnings, dividends, the Company's sales and repurchases of its common and preferred stock, and changes in accumulated other comprehensive income caused primarily by fluctuations in unrealized gains or losses, net of taxes, on available for sale investment securities.

Shareholders' equity increased $2.3 million to $94.2 million at September 30, 2023 as compared to $91.9 million at December 31, 2022. The increase was primarily due to net income of $4.0 million and the issuance of preferred stock of $1.8 million. This was partially offset by the implementation of the new credit loss accounting standard. As a result of the accounting change, equity was reduced by $2.5 million.

The Company strives to maintain an adequate capital base to support its activities in a safe and sound manner while at the same time attempting to maximize shareholder value. Management assesses capital adequacy against the risk inherent in the balance sheet, recognizing that unexpected loss is the common denominator of risk and that common equity has the greatest capacity to absorb unexpected loss.

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

In 2020, the Federal banking regulatory agencies adopted a rule to simplify the methodology for measuring capital adequacy for smaller, uncomplicated banks. This CBLR is calculated as the ratio of tangible equity capital divided by average total consolidated assets. CBLR tangible equity is defined as total equity capital, prior to including minority interests, and excluding accumulated other comprehensive income, deferred tax assets arising from net operating loss and tax credit carryforwards, goodwill, and other intangible assets (other than mortgage servicing assets). Under the proposal, a qualifying organization may elect to use the CBLR framework if its CBLR is greater than 9%. The Bank elected not to use the CBLR framework.

At September 30, 2023 and December 31, 2022, the Bank's capital ratios were in excess of the requirement to be "well capitalized" under the regulatory guidelines.

As of the dates indicated, the Bank met all capital adequacy requirements to which it is subject. The Bank's actual capital amounts and percentages are as shown in the table below:

	Actual			Minimum[(1)]			Well Capitalized[(2)]		
(Dollars in thousands)		Amount	Percent		Amount	Percent		Amount	Percent
As of September 30, 2023									
Total Capital (to risk-weighted assets)	$	109,171	13.47 %	$	64,858	8.00 %	$	81,072	10.00 %
Tier 1 Capital (to risk-weighted assets)		99,010	12.21		48,643	6.00		64,858	8.00
Common Equity Tier 1 Capital (to risk-weighted assets)		99,010	12.21		36,482	4.50		52,697	6.50
Tier 1 Capital (to total assets)		99,010	9.16		43,258	4.00		54,072	5.00
As of December 31, 2022									
Total Capital (to risk-weighted assets)		108,307	15.00		57,767	8.00		72,209	10.00
Tier 1 Capital (to risk-weighted assets)		99,269	13.75		43,325	6.00		57,767	8.00
Common Equity Tier 1 Capital (to risk-weighted assets)		99,269	13.75		32,494	4.50		46,936	6.50
Tier 1 Capital (to total assets)		99,269	10.79		36,816	4.00		46,020	5.00

(1) Minimum to be considered "adequately capitalized" under Basel III Capital Adequacy.

(2) Minimum to be considered "well capitalized" under Prompt Corrective Actions Provisions.

Off-Balance Sheet Arrangements

The Bank is a party to financial instruments with off-balance sheet risk in the normal course of business. These financial instruments primarily include unfunded loan commitments, unfunded lines of credit, and standby letters of credit. The Bank uses these financial instruments to meet the financing needs of its customers. These financial instruments involve, to varying degrees, elements of credit, interest rate, and liquidity risk. These do not present unusual risks and management does not anticipate any accounting losses that would have a material effect on the Bank.

A summary of the amounts of the Bank's financial instruments, with off-balance sheet risk as of the dates indicated, is as follows:

(Dollars in thousands)		September 30, 2023		December 31, 2022
Unfunded loan commitments	$	20,459	$	23,512
Unused lines of credit		169,634		134,366
Standby letters of credit		61		244
Total	$	190,154	$	158,122

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. Management evaluates each customer's credit worthiness on a case-by-case basis. The amount of collateral obtained if deemed necessary by the Bank upon extension of credit is based on management's credit evaluation of the customer.

Standby letters-of-credit are conditional lending commitments that the Bank issues to guarantee the performance of a customer to a third party and to support private borrowing arrangements. Essentially, letters of credit have expiration dates within one year of the issue date. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending credit. The Bank may hold collateral supporting those commitments.

In general, loan commitments and letters of credit are made on the same terms, including with respect to collateral, as outstanding loans. Each customer's creditworthiness and the collateral required are evaluated on a case-by-case basis.

The Company maintains an ACL for its off-balance sheet loan commitments which is calculated by loan type using estimated line utilization rates based on historical usage. Loss rates for outstanding loans is applied to the estimated utilization rates to calculate the ACL for off-balance sheet loan commitments. At September 30, 2023 and December 31, 2022, ACL for off-balance sheet loan commitments totaled $844 thousand and $511 thousand, respectively.

Contractual Obligations

In the ordinary course of its operations, the Company enters into certain contractual obligations. Total contractual obligations at September 30, 2023 were $314.4 million, an increase of $139.5 million from $174.9 million at December 31, 2022. The increase was primarily due to an increase in time deposits of $166.1 million of which $4.3 million came from short-term CDARS brokered deposits.

The following tables present our contractual obligations as of September 30, 2023 and December 31, 2022.

	Contractual Obligations as of September 30, 2023				
(Dollars in thousands)	Less than One Year	One to Three Years	Three to Five Years	Over Five Years	Total
Operating lease obligations	$ 1,117	$ 1,951	$ 619	$ —	$ 3,687
Short-term borrowings	—	—	—	—	—
Long-term borrowings	456	912	912	223	2,503
Subordinated notes	—	—	—	5,947	5,947
Time deposits	160,251	141,497	526	—	302,274
Total	$ 161,824	$ 144,360	$ 2,057	$ 6,170	$ 314,411

	Contractual Obligations as of December 31, 2022				
(Dollars in thousands)	Less than One Year	One to Three Years	Three to Five Years	Over Five Years	Total
Operating lease obligations	$ 1,450	$ 2,267	$ 1,245	$ —	$ 4,962
Short-term borrowings	25,000	—	—	—	25,000
Long-term borrowings	456	912	912	564	2,844
Subordinated notes	50	—	—	5,942	5,992
Time deposits	120,240	15,587	299	—	136,126
Total	$ 146,740	$ 17,854	$ 1,544	$ 8,786	$ 174,924

Liquidity

Liquidity management is the process by which the Bank manages the flow of funds necessary to meet its financial commitments on a timely basis and at a reasonable cost to take advantage of earnings enhancement opportunities. These financial commitments include withdrawals by depositors, credit commitments to borrowers, expenses of the operations, and capital expenditures. The Bank generally maintains a liquidity ratio of liquid assets to total assets of at least 7.0%. Liquid assets include cash and due from banks, federal funds sold, interest-bearing deposits with banks and unencumbered investment securities available for sale. The on-balance sheet liquidity ratio at September 30, 2023 was 13.99%, as compared to 12.58% at December 31, 2022.

During 2022, the Bank paid quarterly dividends totaling $1.75 million to BayFirst. During the first two quarters of 2023, the Bank paid quarterly dividends totaling $1.75 million to BayFirst. In the third quarter of 2023, BayFirst issued 1,835 shares of 11.0% Series C Cumulative Convertible Preferred Stock with gross proceeds of $1.8 million of which $1.3 million of the capital was injected to the Bank to support its growth and operations. Prior to 2021, the Bank retained its earnings to support its growth. BayFirst's liquidity had historically been dependent solely on funds received from the issuance and sale of subordinated debt and preferred stock. BayFirst's liquidity needs are to make interest payments on its debt obligations, dividends on shares of its Series A Preferred Stock, Series B Convertible Preferred Stock, Series C Cumulative Convertible Preferred Stock, and common stock, and payment of certain operating expenses. As of September 30, 2023, BayFirst Financial Corp. held $498 thousand in cash and cash equivalents.

The Company expects that all the liquidity needs, including the contractual commitments can be met by currently available liquid assets and cash flows. In the event any unforeseen demand or commitments were to occur, the Company would access the borrowing capacity with the FHLB, FRB, and lines of credit with other financial institutions. The Company does not rely on investment securities as the main source of liquidity and does not foresee the need to sell investment securities for cash flow purposes. In addition, the Company has the ability to obtain wholesale deposits as another source of liquidity. The Company expects that the currently available liquid assets and the ability to borrow from the FHLB, FRB, and other financial institutions would be sufficient to satisfy the liquidity needs without any material adverse effect on the Company's liquidity.

A description of BayFirst's and the Bank's debt obligations is set forth above under the heading "Other Borrowings."

Item 3. Quantitative and Qualitative Disclosures About Market Risk

Market Risk and Interest Rate Sensitivity

Market risk is the risk of loss from adverse changes in market prices and rates. Market risk arises primarily from interest-rate risk inherent in loan and deposit taking activities. To that end, the Company actively monitors and manages its interest-rate risk exposure. The measurement of market risk associated with financial instruments is meaningful only when all related and offsetting on- and off-balance sheet transactions are aggregated, and the resulting net positions are identified. Disclosures about the fair value of financial instruments, which reflect changes in market prices and rates, should also be considered.

The objective in managing interest-rate risk is to minimize the adverse impact of changes in interest rates on net interest income and capital, while adjusting the asset-liability structure to obtain the maximum yield-cost spread on that structure. The Company relies primarily on its asset-liability structure to control interest rate risk. A sudden or substantial increase in interest rates may impact its earnings, to the extent that the interest rates borne by assets and liabilities do not change at the same rate, to the same extent, or on the same basis.

The Company established a comprehensive interest rate risk management policy which is administered by management's Asset-Liability Committee. The policy establishes risk limits, which are quantitative measures of the percentage change in net interest income (net interest income at risk) and the fair value of equity capital (economic value of equity at risk) resulting from a hypothetical change in interest rates for maturities from one day to 30 years. Management measures the potential adverse impacts that changing interest rates may have on its short-term earnings, long-term value, and liquidity with computer-generated simulation analysis. The simulation model is designed to capture call features and interest rate caps and floors embedded in investment and loan contracts. As with any method of analyzing interest rate risk, there are certain shortcomings inherent in the interest rate modeling methodology used. When interest rates change, actual movements in different categories of interest-earning assets and interest-bearing liabilities, loan prepayments, and withdrawals of time and other deposits, may deviate significantly from the assumptions used in modeling. The methodology does not measure the impact that higher rates may have on borrowers' ability to service their debts, or the impact of rate changes on demand for loan and deposit products.

To minimize the potential for adverse effects of changes in interest rates on the results of the operations, the Company monitors assets and liabilities to better match the maturities and repricing terms of the interest-earning assets and interest-bearing liabilities. To do this, the Company (i) emphasizes the origination of adjustable-rate and variable-rate loans to be held for investment; (ii) maintains a stable core deposit base; and (iii) maintains a significant portion of liquid assets (cash, interest-bearing deposits with other banks, and available for sale investment securities).

Management regularly reviews its exposure to changes in interest rates. Among the factors they consider are changes in the mix of interest-earning assets and interest-bearing liabilities, interest rate spreads and repricing periods. ALCO reviews, on at least a quarterly basis, its interest rate risk position.

The interest rate risk position is measured and monitored at the Bank using net interest income simulation models and economic value of equity sensitivity analysis that captures both short-term and long-term interest-rate risk exposure.

Modeling the sensitivity of net interest income and the economic value of equity to changes in market interest rates is highly dependent on numerous assumptions incorporated into the modeling process. The models used for these measurements rely on estimates of the potential impact that changes in interest rates may have on the value and prepayment speeds on all components of its loan portfolio, investment portfolio, as well as embedded options and cash flows of other assets and liabilities. Balance sheet growth assumptions are also included in the simulation modeling process. The analysis provides a framework as to what the overall sensitivity position is as of the most recent reported position and the impact that potential changes in interest rates may have on net interest income and the economic value of its equity.

Net interest income simulation involves forecasting net interest income under a variety of interest rate scenarios including instantaneous shocks.

The estimated impact on the net interest income as of September 30, 2023 and December 31, 2022, assuming immediate parallel moves in interest rates, is presented in the table below.

	September 30, 2023		December 31, 2022	
Change in rates	**Following 12 months**	**Following 24 months**	**Following 12 months**	**Following 24 months**
+400 basis points	16.6 %	15.0 %	11.0 %	11.9 %
+300 basis points	13.8	13.6	9.4	10.5
+200 basis points	8.5	8.5	5.4	6.1
+100 basis points	3.2	3.4	1.3	1.8
-100 basis points	(4.8)	(4.8)	(3.8)	(4.4)
-200 basis points	(9.6)	(5.4)	(8.3)	(9.5)

Management strategies may impact future reporting periods, as the actual results may differ from simulated results due to the timing, magnitude, and frequency of interest rate changes, the difference between actual experience and the characteristics assumed, as well as changes in market conditions. Market-based prepayment speeds are factored into the analysis for loan and investment securities portfolios. Rate sensitivity for transactional deposit accounts is modeled based on both historical experience and external industry studies.

The Company uses economic value of equity sensitivity analysis to understand the impact of interest rate changes on long-term cash flows, income, and capital. Economic value of equity is based on discounting the cash flows for all balance sheet instruments under different interest rate scenarios.

The table below presents the change in the economic value of equity as of September 30, 2023 and December 31, 2022, assuming immediate parallel shifts in interest rates. Changes noted between the two periods reflect recent enhancements in the asset/liability modeling, including projected values for non-maturity deposits in changing interest rate environments.

Change in rates	September 30, 2023	December 31, 2022
+400 basis points	(3.2) %	(12.7) %
+300 basis points	(1.8)	(9.5)
+200 basis points	(1.8)	(7.0)
+100 basis points	(1.9)	(4.3)
-100 basis points	(0.3)	2.6
-200 basis points	(1.2)	5.0

Item 4. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

An evaluation of the Company's disclosure controls and procedures (as defined in Rules 13(a)-15(e) and 15(d)-15(e) of the Exchange Act), was carried out under the supervision and with the participation of the Company's Chief Executive Officer and Chief Financial Officer as of September 30, 2023, the last day of the period covered by this Quarterly Report. The Company's Chief Executive Officer and Chief Financial Officer concluded that the disclosure controls and procedures were effective as of September 30, 2023, in ensuring that the information required to be disclosed in the reports the Company files or submits under the Exchange Act is (i) accumulated and communicated to management (including the Company's Chief Executive Officer and Chief Financial Officer) as appropriate to allow timely decisions regarding required disclosures, and (ii) recorded, processed, summarized, and reported within the time periods specified in the SEC's rules and forms.

Changes in Internal Control Over Financial Reporting

There have not been any changes in the Company’s internal control over financial reporting (as such term is defined in Rule 13a-15(f) under the Exchange Act) during the fiscal period to which this report relates that have materially affected, or are reasonably likely to materially affect, the Company’s internal control over financial reporting.

Part II

Item 1. Legal Proceedings

In the normal course of business, the Company is named or threatened to be named as a defendant in various lawsuits, none of which they expect to have a material effect on the Company. However, given the nature, scope and complexity of the extensive legal and regulatory landscape applicable to its business (including laws and regulations governing consumer protection, fair lending, fair labor, privacy, information security, anti-money laundering and anti-terrorism), the Company, like all banking organizations, is subject to heightened legal and regulatory compliance and litigation risk. There are no material pending legal proceedings, other than ordinary routine litigation incidental to the business, to which the Company is a party or to which its property is the subject.

Item 1A. Risk Factors

In addition to the risk factor discussed below and the other information set forth in this report, you should carefully consider the factors discussed under "Part I--Item 1A--Risk Factors" in the Company's Form 10-K for the year ended December 31, 2022. These factors could materially and adversely affect the Company's business, financial condition, liquidity, results of operations and capital position, and could cause its actual results to differ materially from its historical results or the results contemplated by the forward-looking statements contained in this report.

Loss of deposits or a change in deposit mix could increase our funding costs and adversely affect our performance.

Deposits are a low cost and stable source of funding. We compete with banks and other financial institutions for deposits and as a result, the Company could lose deposits in the future, clients may shift their deposits into higher cost products, or the Company may need to raise interest rates to avoid deposit attrition. Funding costs may also increase if deposits lost are replaced with wholesale funding. Higher funding costs reduce our net interest margin, net interest income, and net income. In recent months, the environment for maintaining and growing deposits has become more challenging. This is partially attributable to the FRB reducing the size of its balance sheet through quantitative tightening and continues to increase interest rates giving depositors an incentive to move deposits to money market funds and other higher-yielding alternatives. In addition, recent unusually high levels of withdrawals from other, larger banks, which in some cases has resulted in bank failure, may result in similar withdrawal patterns at the Company. Should we experience any of these events, we may need to rely on higher cost wholesale funding, which would adversely affect our financial performance and net income.

The Florida property insurance market is in crises and the inability of our borrowers to obtain insurance on properties securing our loans may adversely affect the value of the collateral, the performance of our loan portfolio, and our ability to make loans secured by real estate.

Florida is susceptible to hurricanes, tropical storms and related flooding and wind damage and other similar weather events. Such events can disrupt operations, result in damage to properties and negatively affect the local economies in our markets. As a result of the potential for such weather events, many of our customers have incurred significantly higher insurance premiums, or been unable to secure insurance, on their properties. This may adversely affect real estate sales and values in our markets and leave our borrowers without funds to repay their loans in the event of destructive weather events. Such events could result in a decline in loan originations, a decline in the value or destruction of properties securing loans and a decrease in credit quality, negatively impacting our business and results of operations.

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

Issuer Purchases of Equity Securities

Share Buyback Program. On February 28, 2023, the Board of Directors approved the Company’s 2023 Stock Repurchase Program (“Repurchase Program”). The Repurchase Program permits the Company to repurchase up to $1,000,000 of the Company’s issued and outstanding common stock. The Repurchase Program will continue until the earlier of: (i) the date an aggregate of $1,000,000 of common stock has been repurchased; (ii) December 31, 2023; or (iii) the termination of the plan by the Board of Directors.

The Inflation Reduction Act of 2022 created a new nondeductible 1% excise tax on repurchases of corporate stock by certain publicly traded corporations or their specified affiliates after December 31, 2022. The tax is imposed on the fair value of the stock of a covered corporation that is repurchased in a given year, less the fair market value of any stock issued in that year. A “covered corporation” is any domestic corporation whose stock is traded on an established securities market, such as Nasdaq. The excise tax applies to all of the stock of a covered corporation regardless of whether the corporation has profits or losses. The act contains several exceptions to the excise tax, including, but not limited to, any repurchase of stock: in which the total value of the repurchased stock in a given year does not exceed $1,000,000; that is contributed to an employer sponsored retirement plan or other similar stock compensation plan; that is taxed as a dividend. The impact of the Inflation Reduction Act of 2022 on our consolidated financial statements will be dependent on the extent of stock repurchases made in future periods.

The following table sets forth information regarding the Company’s repurchase of shares of its outstanding common stock during the three months ended September 30, 2023.

Period	Number of Shares	Average Price Paid Per Share	Cumulative Number of Shares Purchased as Part of Publicly Announced Plans or Programs	Approximate Dollar Value of Shares That May Yet be Purchased Under the Plans or Programs
July 1-31, 2023	—	$ —	750	$ 989,203
August 1-31, 2023	150	13.50	900	$ 987,178
September 1-30, 2023	—	—	900	$ 987,178
Total	150	$ 13.50		

Under applicable state law, Florida corporations are not permitted to retain treasury stock. As such, the price paid for the repurchased shares reduces the amount of common stock on the consolidated balance sheet. As of September 30, 2023, total shares repurchased for $12,822 had been redeemed since the Repurchase Program was implemented. The repurchased shares remain authorized, unissued shares.

Item 3. Defaults Upon Senior Securities

None.

Item 4. Mine Safety Disclosures

Not applicable.

Item 5. Other Information

None.

ITEM 6. EXHIBITS

(a) Exhibits.

Exhibit Number	Exhibit Name
3.1	Amended and Restated Articles of Incorporation
3.2	Bylaws
3.3	Amendment to Bylaws, dated August 22, 2019
3.4	Amendment to Articles of Incorporation, dated September 7, 2023
4.1	Form of common stock certificate
4.2	Form of Series A Preferred Stock certificate
4.3	Form of Series B Convertible Preferred Stock certificate
4.4	Form of Series C Cumulative Convertible Preferred Stock certificate
31.1	Principal Executive Officer's Certification required by Rule 13(a)-14(a) - filed herewith
31.2	Principal Financial Officer's Certification required by Rule 13(a)-14(a) - filed herewith
32.1	Principal Executive Officer's Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 - filed herewith
32.2	Principal Financial Officer's Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 - filed herewith
101	Financial information from the Company's Quarterly Report on Form 10-Q for the quarterly period ended September 30, 2023, formatted in iXBRL interactive data files pursuant to Rule 405 of Regulation S-T: (i) Consolidated Balance Sheets; (ii) Consolidated Statements of Income; (iii) Consolidated Statements of Comprehensive Income; (iv) Consolidated Statements of Shareholders' Equity; (v) Consolidated Statements of Cash Flows; and (vi) Notes to the Consolidated Financial Statements – filed herewith.
104	Cover Page Interactive Data File (formatted as Inline XBRL and contained in Exhibit 101)

SIGNATURES

Pursuant to the requirements of Sections 13 or 15(d) 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.

BAYFIRST FINANCIAL CORP.

Date:	November 13, 2023
By:	/s/ Anthony N. Leo
	Anthony N. Leo
	Chief Executive Officer (principal executive officer)
Date:	November 13, 2023
By:	/s/ Scott J. McKim
	Scott J. McKim
	Chief Financial Officer (principal financial officer)

CERTIFICATIONS REQUIRED BY

RULE 13a-14(a) OR RULE 15d-14(a)

AS ADOPTED PURSUANT TO SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002

I, Anthony N. Leo, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q (the “Report”) of BayFirst Financial Corp., Inc. (the “Registrant”);
2. Based on my knowledge, this Report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this Report;
3. Based on my knowledge, the financial statements, and other financial information included in this Report, fairly present in all material respects the financial condition, results of operations and cash flows of the Registrant as of, and for, the periods presented in this Report;
4. The Registrant’s other certifying officer(s) 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 13(a)-15(f) and 15(d)-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) 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
    c) 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
    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(s) 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 Registrant’s 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.

BAYFIRST FINANCIAL CORP.

Date: November 13, 2023

By: /s/ Anthony N. Leo
Anthony N. Leo
Chief Executive Officer
(principal executive officer)

CERTIFICATIONS REQUIRED BY

RULE 13a-14(a) OR RULE 15d-14(a)

AS ADOPTED PURSUANT TO SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002

I, Scott J. McKim, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q (the "Report") of BayFirst Financial Corp., Inc. (the "Registrant");
2. Based on my knowledge, this Report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this Report;
3. Based on my knowledge, the financial statements, and other financial information included in this Report, fairly present in all material respects the financial condition, results of operations and cash flows of the Registrant as of, and for, the periods presented in this Report;
4. The Registrant's other certifying officer(s) 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 13(a)-15(f) and 15(d)-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) 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
    c) 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
    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(s) 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 Registrant's 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.

BAYFIRST FINANCIAL CORP.

Date: November 13, 2023

By: /s/ Scott J. McKim
Scott J. McKim
Chief Financial Officer
(principal financial officer)

CERTIFICATIONS PURSUANT TO

18 U.S.C. SECTION 1350,

AS ADOPTED PURSUANT TO

SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

I, Anthony N. Leo, Chief Executive Officer of BayFirst Financial Corp. (the “Company”) certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that to the best of my knowledge:

1) The Quarterly Report on Form 10-Q of the Company for the quarter period ended September 30, 2023 (the “Report”) fully complies with the requirements of Sections 13(a) or 15(d) 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.

BAYFIRST FINANCIAL CORP.

Date: November 13, 2023

By: /s/ Anthony N. Leo
Anthony N. Leo
Chief Executive Officer
(principal executive officer)

CERTIFICATIONS PURSUANT TO

18 U.S.C. SECTION 1350,

AS ADOPTED PURSUANT TO

SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

I, Scott J. McKim, Chief Financial Officer of BayFirst Financial Corp. (the “Company”) certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that to the best of my knowledge:

1) The Quarterly Report on Form 10-Q of the Company for the quarter period ended September 30, 2023 (the “Report”) fully complies with the requirements of Sections 13(a) or 15(d) 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.

BAYFIRST FINANCIAL CORP.

Date: November 13, 2023

By: /s/ Scott J. McKim
Scott J. McKim
Chief Financial Officer
(principal financial officer)