REPORT OF INDEPENDENT AUDITORS
AND CONSOLIDATED FINANCIAL STATEMENTS

MOUNTAIN PACIFIC BANCORP, INC. AND SUBSIDIARIES

December 31, 2023 and 2022

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NOTE: This annual report serves as Mountain Pacific Bank's annual disclosure statement under the requirements of the Federal Deposit Insurance Corporation (FDIC). This statement has not been reviewed or confirmed for accuracy or relevance by the FDIC.

Report of Independent Auditors

The Board of Directors and Stockholders
Mountain Pacific Bancorp, Inc., and Subsidiaries

Report on the Audit of the Financial Statements

Opinion

We have audited the consolidated financial statements of Mountain Pacific Bancorp, Inc., and Subsidiaries which comprise the consolidated balance sheets as of December 31, 2023 and 2022, and the related consolidated statements of income, comprehensive income (loss), changes in stockholders' equity, and cash flows for the years then ended, and the related notes to the consolidated financial statements.

In our opinion, the accompanying consolidated financial statements present fairly, in all material respects, the financial position of Mountain Pacific Bancorp, Inc., and Subsidiaries as of December 31, 2023 and 2022, and the results of their operations and their cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Emphasis of Matter

As discussed in Note 1 and 4 to the consolidated financial statements, in 2023, Mountain Pacific Bancorp, Inc., and Subsidiaries adopted new accounting guidance *Accounting Standards Codification Topic 326 Financial Instruments – Credit Losses*. Our opinion is not modified with respect to this matter.

Basis for Opinion

We conducted our audits in accordance with auditing standards generally accepted in the United States of America (GAAS). Our responsibilities under those standards are further described in the Auditor's Responsibilities for the Audit of the Financial Statements section of our report. We are required to be independent of Mountain Pacific Bancorp, Inc., and Subsidiaries and to meet our other ethical responsibilities, in accordance with the relevant ethical requirements relating to our audits. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Responsibilities of Management for the Financial Statements

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

In preparing the financial statements, management is required to evaluate whether there are conditions or events, considered in the aggregate, that raise substantial doubt about Mountain Pacific Bancorp, Inc., and Subsidiaries' ability to continue as a going concern within one year after the date that the financial statements are available to be issued.

Auditor's Responsibilities for the Audit of the Financial Statements

Our objectives are to obtain reasonable assurance about whether the consolidated financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance but is not absolute assurance and therefore is not a guarantee that an audit conducted in accordance with GAAS will always detect a material misstatement when it exists. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control. Misstatements are considered material if there is a substantial likelihood that, individually or in the aggregate, they would influence the judgment made by a reasonable user based on the consolidated financial statements.

In performing an audit in accordance with GAAS, we:

- Exercise professional judgment and maintain professional skepticism throughout the audit.
- Identify and assess the risks of material misstatement of the consolidated financial statements, whether due to fraud or error, and design and perform audit procedures responsive to those risks. Such procedures include examining, on a test basis, evidence regarding the amounts and disclosures in the consolidated financial statements.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of Mountain Pacific Bancorp, Inc., and Subsidiaries' internal control. Accordingly, no such opinion is expressed.
- Evaluate the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluate the overall presentation of the consolidated financial statements.
- Conclude whether, in our judgment, there are conditions or events, considered in the aggregate, that raise substantial doubt about Mountain Pacific Bancorp, Inc., and Subsidiaries' ability to continue as a going concern for a reasonable period of time.

We are required to communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit, significant audit findings, and certain internal control–related matters that we identified during the audit.

Moss Adams LLP

Everett, Washington
March 14, 2024

ASSETS

	December 31, 2023	December 31, 2022
Cash and due from banks	$ 6,828,641	$ 6,965,943
Interest bearing deposits in banks	69,150,000	57,449,274
Total cash and cash equivalents	75,978,641	64,415,217
Investment securities available-for-sale (amortized cost of $24,314,484 and $17,988,352 at December 31, 2023 and 2022, respectively)	22,231,484	15,686,352
Investment securities held-to-maturity	1,000,169	1,001,549
Loans held-for-sale	-	4,320,000
Loans	563,559,911	469,284,201
Less allowance for credit losses on loans	9,648,647	9,721,837
Total loans, net	553,911,264	459,562,364
Premises and equipment, net	10,386,857	10,223,067
Right-of-use assets	1,641,896	1,581,871
Accrued interest receivable	2,724,098	1,686,470
Federal Home Loan Bank (FHLB) stock and Pacific Coast Bankers' Bank (PCBB) stock, at cost	3,001,100	925,100
Other real estate owned (OREO), net	718,158	-
Deferred tax asset, net	3,443,327	3,326,502
Other assets	2,095,401	1,655,313
Total assets	677,132,395	564,383,805

LIABILITIES AND STOCKHOLDERS' EQUITY

	2023	2022
Deposits		
Noninterest-bearing	110,668,764	136,647,818
Interest-bearing	424,764,636	354,101,030
Total deposits	535,433,400	490,748,848
Borrowings	55,000,000	-
Subordinated notes	12,500,000	12,500,000
Accrued interest payable	1,539,203	244,772
Lease liabilities	1,908,752	1,858,410
Other liabilities	4,041,798	2,668,367
Total liabilities	610,423,153	508,020,397
Stockholders' equity		
Common stock, $1 par value, 50,000,000 shares authorized; 6,755,891 and 6,695,766 issued and outstanding at December 31, 2023 and 2022, respectively	6,755,891	6,695,766
Additional paid-in capital	30,857,978	30,233,943
Retained earnings	30,741,373	21,252,699
Accumulated other comprehensive loss, net of tax	(1,646,000)	(1,819,000)
Total stockholders' equity	66,709,242	56,363,408
Total liabilities and stockholder's equity	$ 677,132,395	$ 564,383,805

See accompanying notes.

Mountain Pacific Bancorp, Inc., and Subsidiaries
Consolidated Statements of Income

	Years Ended December 31, 2023	Years Ended December 31, 2022
INTEREST AND DIVIDEND INCOME		
Loans, including fees	$ 33,430,167	$ 24,408,969
Interest-bearing deposits in banks	2,217,023	1,096,947
Investment securities	585,708	314,182
Dividends from FHLB stock and PCBB stock	135,705	54,913
Total interest and dividend income	36,368,603	25,875,011
INTEREST EXPENSE		
Deposits	8,747,091	2,214,839
Borrowings	1,986,147	129,264
Subordinated notes	737,500	737,500
Total interest expense	11,470,738	3,081,603
Net interest income	24,897,865	22,793,408
PROVISION FOR CREDIT LOSSES	1,001,499	1,750,000
Net interest income after provision for credit losses	23,896,366	21,043,408
NONINTEREST INCOME		
Service fees	2,018,716	1,849,758
Insurance income	140,001	79,057
Rental income	400,283	386,922
Gain on sale of loans, net	2,389,936	1,309,641
Total noninterest income	4,948,936	3,625,378
NONINTEREST EXPENSES		
Salaries and employee benefits	10,625,765	9,286,154
Occupancy and equipment	1,284,325	1,100,720
Data processing	836,206	699,387
Advertising and business development	595,305	344,640
Professional fees	628,527	491,139
State and other taxes	456,585	435,100
Regulatory assessments	352,896	476,719
Other real estate owned, net	59,784	-
Other	2,740,909	2,199,927
Total noninterest expenses	17,580,302	15,033,786
INCOME BEFORE PROVISION FOR INCOME TAXES	11,265,000	9,635,000
PROVISION FOR INCOME TAXES	2,300,000	2,020,000
NET INCOME	$ 8,965,000	$ 7,615,000

See accompanying notes.

	Years Ended December 31, 2023	2022
NET INCOME	$ 8,965,000	$ 7,615,000
OTHER COMPREHENSIVE INCOME (LOSS)		
Unrealized holding gain (loss) on securities		
Unrealized holding gain (loss)	219,000	(2,235,000)
Tax (expense) benefit on unrealized holding gain (loss)	(46,000)	467,000
Other comprehensive income (loss)	173,000	(1,768,000)
COMPREHENSIVE INCOME	$ 9,138,000	$ 5,847,000

See accompanying notes.

	Common Stock				Accumulated Other	
	Shares	Amount	Additional Paid-In Capital	Retained Earnings	Comprehensive (Loss) Income	Total Stockholders' Equity
BALANCE, December 31, 2021	6,602,716	$ 6,602,716	$ 29,243,570	$ 13,637,699	$ (51,000)	$ 49,432,985
Net income	-	-	-	7,615,000	-	7,615,000
Other comprehensive loss, net	-	-	-	-	(1,768,000)	(1,768,000)
Restricted stock awards vested	20,625	20,625	(20,625)	-	-	-
Stock options exercised	72,425	72,425	237,288	-	-	309,713
Stock-based compensation expense	-	-	773,710	-	-	773,710
BALANCE, December 31, 2022	6,695,766	6,695,766	30,233,943	21,252,699	(1,819,000)	56,363,408
Adoption of Topic ASC 326	-	-	-	523,674	-	523,674
Net income	-	-	-	8,965,000	-	8,965,000
Other comprehensive income, net	-	-	-	-	173,000	173,000
Restricted stock awards vested	21,875	21,875	(21,875)	-	-	-
Stock options exercised	38,250	38,250	123,106	-	-	161,356
Stock-based compensation expense	-	-	522,804	-	-	522,804
BALANCE, December 31, 2023	6,755,891	$ 6,755,891	$ 30,857,978	$ 30,741,373	$ (1,646,000)	$ 66,709,242

Mountain Pacific Bancorp, Inc., and Subsidiaries
Consolidated Statements of Cash Flows

	Years Ended December 31, 2023	Years Ended December 31, 2022
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income	$ 8,965,000	$ 7,615,000
Adjustments to reconcile net income to net cash flows from operating activities		
Provision for credit losses	1,001,499	1,750,000
Stock-based compensation expense	522,804	773,710
Depreciation and amortization	385,828	362,572
Amortization on investment securities	121,789	109,391
Amortization of right-of-use assets	303,369	276,294
Change in lease liabilities	(313,052)	(290,678)
Gain on sale of loans, net	(2,389,936)	(1,309,641)
Proceeds from sale of loans	40,946,323	27,377,394
Originations of loans held-for-sale	(34,236,387)	(30,387,753)
Deferred federal income taxes	(302,029)	(280,352)
Changes in operating assets and liabilities		
Accrued interest receivable	(1,037,628)	(243,529)
Other assets	(300,884)	377,408
Accrued interest payable	1,294,431	90,501
Other liabilities	1,373,431	(167,373)
Net cash from operating activities	16,334,558	6,052,944
CASH FLOWS FROM INVESTING ACTIVITIES		
Net change in interest-bearing deposits in banks	-	6,001,444
Net change in loans made to customers	(95,716,514)	(598,744)
Purchases of investment securities available-for-sale	(8,249,619)	(1,593,573)
Proceeds from principal paydowns of mortgage-backed securities	1,803,079	2,619,192
Proceeds from sale of other real estate owned	171,630	-
Purchase of FHLB stock	(5,475,500)	(122,600)
Redemption of FHLB stock	3,399,500	980,000
Additions to premises and equipment, net	(549,618)	(179,747)
Net cash from (used in) investing activities	(104,617,042)	7,105,972
CASH FLOWS FROM FINANCING ACTIVITIES		
Net increase (decrease) in deposits	44,684,552	(35,246,112)
Proceeds from exercise of stock options	161,356	309,713
Repayment of borrowings	-	(24,500,000)
Proceeds from new borrowings	55,000,000	-
Net cash from (used in) financing activities	99,845,908	(59,436,399)
NET CHANGE IN CASH AND CASH EQUIVALENTS	11,563,424	(46,277,483)
CASH AND CASH EQUIVALENTS, beginning of year	64,415,217	110,692,700
CASH AND CASH EQUIVALENTS, end of year	$ 75,978,641	$ 64,415,217
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION		
Cash paid during the period for interest	$ 9,438,807	$ 2,256,581
Cash paid during the period for federal income taxes, net of refund	$ 2,160,000	$ 2,685,000
SUPPLEMENTAL DISCLOSURE OF NONCASH ITEMS		
ROU Assets obtained in exchange for Lease Liabilities	363,394	-
Loans transferred to other real estate owned	(889,788)	-

Note 1 – Organization and Summary of Significant Accounting Policies

Nature of operations – Mountain Pacific Bancorp, Inc., a bank holding company, was issued a certificate of incorporation in the state of Washington on April 12, 2018. On June 9, 2018, the Federal Reserve Board granted authority to Mountain Pacific Bancorp, Inc. to become a bank holding company through a reorganization of the ownership interests of Mountain Pacific Bank. Washington Department of Financial Institutions Divisions of Banks approved the articles of share exchange and plan of share exchange and issued a certificate of reorganization on June 29, 2018.

Mountain Pacific Bancorp, Inc.'s (the Company), principal activities are the ownership and management of its wholly owned subsidiaries, Mountain Pacific Bank (the Bank) and Mountain Pacific Insurance Services, Inc (MPIS). The Bank provides a full range of banking services to individual and corporate customers through its headquarters in Everett, and full-service branches in Lynnwood, the Ballard neighborhood of Seattle, Burlington, and Bellingham.

During 2019, the Company formed Mountain Pacific Insurance Services, Inc., a wholly owned subsidiary, which is a specialty surplus lines insurance broker for Bank related insurance products and is licensed to operate in all 50 states. Insurance coverage is underwritten on a brokerage basis.

At periodic intervals, various banking regulatory agencies routinely examine the Company's consolidated financial statements as part of their legally prescribed oversight of the banking system. Based on these examinations, the regulators can direct the Company's consolidated financial statements to be adjusted in accordance with their findings.

Principles of consolidation – The consolidated financial statements include the accounts and transactions of the Company and its subsidiaries. All significant intercompany accounts and transactions have been eliminated in consolidation.

Operating segments – The Company and the Bank are managed as a legal entity and not by lines of business. The Bank's operations include commercial banking services, such as lending activities, deposit products, and other cash management services.

Financial statement presentation and use of estimates – The consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America and reporting practices applicable to the banking industry. In preparing the consolidated financial statements, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities as of the date of the consolidated balance sheets, and revenues and expenses for the period. Actual results could differ from estimated amounts. Material estimates that are particularly susceptible to significant change relate to the determination of the allowance for credit losses, the valuation of collateral dependent loans, fair value of financial instruments, and deferred tax assets and liabilities.

Subsequent events – Subsequent events are events or transactions that occur after the consolidated balance sheet date but before consolidated financial statements are issued. The Company recognizes in the consolidated financial statements the effects of all subsequent events that provide additional evidence about conditions that existed at the date of the consolidated balance sheet, including the estimates inherent in the process of preparing the consolidated financial statements. The Company's consolidated financial statements do not recognize subsequent events that provide evidence about conditions that did not exist at the date of the consolidated balance sheet but arose after the consolidated balance sheet date and before the consolidated financial statements are available to be issued. The Company has evaluated subsequent events through March 14, 2024, which is the date the consolidated financial statements are available to be issued.

Cash and cash equivalents – For purposes of reporting cash flows, cash and cash equivalents include cash on hand, noninterest-bearing amounts due from banks, federal funds sold, and interest-bearing deposits in banks, all with original maturities of three months or less. Generally, federal funds are purchased and sold for one-day periods. The amounts on deposit fluctuate and, at times, may exceed the insured limit by the Federal Deposit Insurance Corporation (FDIC), which potentially subjects the Company to credit risk. Investments in federal funds sold are made with correspondent banks as approved by the Board of Directors.

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

Investment securities - Securities are classified as one of two categories: (1) held-to-maturity (HTM), or (2) available-for-sale (AFS). HTM securities, which management has the intent and ability to hold until maturity, are carried at amortized cost. AFS securities are carried at fair value and unrealized gains and losses are reported as net increases or decreases to accumulated other comprehensive income ("AOCI"). The carrying values of our securities do not include accrued interest receivables and are presented in the consolidated balance sheet within the accrued interest receivable line item. Interest income includes amortization of premiums and discounts. Premiums and discounts are recognized in interest income using the interest method over the period to call date and maturity, respectively.

Impairment
Ongoing Policy
Management no longer evaluates securities for other-than-temporary impairment, as ASC Subtopic 326-30, Financial Instruments – Credit Losses – Available for Sale Debt Securities, changes the accounting for recognizing impairment on available for sale securities. Each reporting period management evaluates impairment where there has been a decline in fair value below the amortized cost basis of a security to determine whether there is a credit loss associated with the decline in fair value. For AFS securities, we assess whether impairment is present on an individual security basis when the fair value of a debt security is less than its amortized cost basis at the balance sheet date. When determining if the fair value of an investment is less than the amortized cost basis, we have elected to exclude accrued interest from the amortized cost basis of the investment. If we have an intent to sell an identified security, or it is more likely than not we will be required to sell the security before recovery of its amortized cost basis, then we recognize an impairment equal to any existing allowance written off against the security.

If we do not have the intent to sell a security, and it is more likely than not that we will not be required to sell a security prior to recovery of its amortized cost basis, then we determine whether there is any impairment attributable to credit-related factors. We analyze certain factors, primarily internal and external credit ratings, to determine if the decline in fair value below the amortized cost basis has resulted from a credit loss or other factors. If a credit impairment is determined to exist, then we measure the amount of credit loss and recognize an allowance for the credit loss. In measuring the credit loss, we generally compare the present value of cash flows expected to be collected from the security to the amortized cost basis of the security. These cash flows are credit adjusted using, among other things, assumptions for default probability and loss severity. Certain other unobservable inputs such as prepayment rate assumptions are also utilized. In addition, certain internal models may be utilized. To determine the credit-related portion of impairment we use the security-specific effective interest rate when estimating the present value of cash flows. If the present value of cash flows is less than the amortized cost basis of the security, then this amount is recorded as an allowance for credit loss, limited to the amount that the fair value is less than the amortized cost basis (i.e., the credit impairment cannot result in the security being carried at an amount lower than its fair value). The assumptions used to estimate the expected cash flows depends on the particular asset class, structure, and credit rating of the security. Declines in fair value that are not recorded in the allowance are recorded in other comprehensive income, net of applicable taxes.

AFS Impairment Conclusions
The Bank did not recognize any impairment on its AFS investment securities portfolio during the year 2023. Unrealized losses relate to changes in interest rates subsequent to purchase and are not attributable to credit. On December 31, 2023, we had not initiated any sales of AFS securities, nor did we have an intent to sell any identified securities with unrealized losses, and we do not believe it is more likely than not we would be required to sell such securities before recovery of their amortized cost basis.

HTM Credit Quality
For HTM securities, management determined that no reserve requirements on the three municipal bonds held-to-maturity totaling $1.0 million primarily due to lack of defaults in Aaa rated municipals which plays a large role in driving the results of the model to calculate the reserve and the size of the securities. HTM securities identified at the time of implementation of current expected credit loss (CECL) are intended to be held until maturity.

Loans – Loans that management has the intent and ability to hold for the foreseeable future or until maturity or pay-off generally are reported at their outstanding principal adjusted for any charge-offs, the allowance for credit losses, and any deferred fees or costs on originated loans. Interest income is accrued on the unpaid principal balance. Loan origination fees, net of certain origination costs, are deferred and recognized as an adjustment of the related loan yield using the interest method.

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

The accrual of interest on loans is discontinued at the time the loan is 90 days delinquent unless the credit is well secured and in process of collection. Past due status is based on contractual terms of the loan. In all cases, loans are placed on nonaccrual or charged off at an earlier date if collection of principal or interest is considered doubtful.

All interest accrued but not collected for loans that are placed on nonaccrual or charged off is reversed against interest income. The interest on these loans is accounted for on a cash basis or cost-recovery method until qualifying for return to accrual. Loans are returned to accrual status when all the principal and interest amounts contractually due are brought current and future payments are reasonably ensured.

Significant concentrations of credit risk – Most of the Bank's business activity is with customers located within Snohomish, King, Skagit, and Whatcom Counties, Washington. The Bank originates commercial, real estate, construction, and consumer loans. Generally, loans are secured by accounts receivable, inventory, deposit accounts, personal property, or real estate. Rights to collateral vary and are legally documented to the extent practicable. Local economic conditions may affect borrowers' ability to meet the stated repayment terms. Approximately 83% of the Bank's loan portfolio is secured by real estate (Note 3). The Bank does not have any significant concentrations to one customer.

New accounting pronouncements – On January 1, 2023, the Bank adopted Accounting Standards Update ("ASU") 2016-13 *Financial Instruments - Credit Losses* (Topic 326): measurement of credit losses on financial instruments, which replaces the incurred loss methodology with an expected loss methodology that is referred to as the current loss (CECL) methodology. The measurement of expected credit losses under the CECL methodology is applicable to financial assets measured at amortized cost, including loan receivables and held-to-maturity debt securities. It also applies to off-balance sheet credit exposures not accounted for as insurance (loan commitments, standby letters of credit, financial guarantees, and other similar instruments) and net investments in leases recognized by a lessor in accordance with Topic 842 on leases. Additionally, Accounting Standards Codification ("ASC") Topic 326 made changes to the accounting for available-for-sale debt securities. 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 or believes that it is more likely than not they will not be required to sell.

The Bank adopted ASC 326 using the modified retrospective method for all financial assets measured at amortized cost, and off-balance-sheet credit exposures. Results for the year ended December 31, 2023, are presented under ASC 326, while prior amounts continue to be reported in accordance with previously applicable GAAP. Effective January 1, 2023, the adoption resulted in a decrease of $797,904 to our allowance for credit losses on loans, an increase of $135,026 to our allowance for unfunded commitments, and a net-of-tax cumulative-effect adjustment of $523,674 to increase the beginning balance of retained earnings. Further information regarding the impact of CECL can be found in Note 3 – Loans and Allowance for Credit Losses.

The Bank adopted ASU 2022-02, Financial Instruments – Credit Losses (Topic 326) Troubled Debt Restructurings and Vintage Disclosures ("ASU 2022-02") prospectively effective January 1, 2023. The amendments in ASU 2022-02 eliminated the recognition and measurement of troubled debt restructurings and enhanced disclosures for loan modifications to borrowers experiencing financial difficulty. The Company did not have any loans that were both experiencing financial difficulties and modified during the year ended December 31, 2023. Additionally, the ASU requires public business entities to disclose current-period gross write-offs by year of origination for financing receivables and net investments in leases. The Company adopted ASU 2022-02 on January 1, 2023 using the prospective transition guidance which allows the entity to continue estimating expected credit losses in accordance with legacy U.S. GAAP for receivables modified in a TDR until the receivables are subsequently modified or settled. Once a legacy TDR is modified after adoption of ASU 2022-02, the prospective transition guidance no longer applies and the impact to the Allowance for Credit Loss (ACL) is recognized in earnings in the period of modification. This is not expected to be material.

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

Allowance for Credit Losses-Loans – The allowance for credit losses ("allowance" or "ACL") is a contra-asset valuation account, calculated in accordance with ASC 326, that is deducted from the amortized cost basis of loans. The ACL represents an amount which, in management's judgement, is adequate to absorb the lifetime expected credit losses that may be experienced on outstanding loans on the balance sheet date based on the evaluation of the size and current risk characteristics of the loan portfolio, past events, current conditions, reasonable and supportable forecasts of future economic conditions and prepayment experience. The allowance for credit losses is measured and recorded upon the initial recognition of a financial asset. Determination of the adequacy of the allowance is inherently complex and requires the use of significant and moderately subjective estimates. Loans are charged-off against the allowance when deemed uncollectible by management. Expected recoveries do not exceed the aggregate of amounts previously charged-off and expected to be charged-off. Adjustments to the allowance are reported in our income statement as a component of the provision for credit losses. Management has made the accounting policy election to exclude accrued interest receivable on loans from the estimate of credit losses.

The Bank's methodology for estimating the allowance includes: (1) a collective quantified reserve that reflects the Bank's historical default and loss experience adjusted for expected economic conditions throughout a reasonable and supportable period and the Bank's prepayment and curtailment rates; (2) collective qualitative factors based on the risk perceived in concentrations of the loan portfolio, changes in economic conditions, early delinquencies, and factors related to credit administration, including, among others, underwriting standards, loan-to-value ratios and (3) individual allowances on loans where borrowers are experiencing financial difficulty or when the Bank determines that the foreclosure is probable.

In calculating the allowance for credit losses, most loans are segmented into pools based upon similar characteristics and risk profiles. Common characteristics and risk profiles include the type/purpose of loan, underlying collateral, geographical similarity and historical/expected credit loss patterns. In developing these loan pools for the purposes of modeling expected credit losses, we also analyzed the degree of correlation in how loans within each portfolio respond when subjected to varying economic conditions and scenarios as well as other portfolio stress factors. For modeling purposes, our loan portfolio segments include Residential Real Estate, Construction, Commercial & Industrial, Agriculture, Commercial Real Estate-Owner Occupied, Commercial Real Estate-Non-Owner Occupied and Consumer. We periodically reassess each pool to ensure the loans within the pool continue to share similar characteristics and risk profiles and to determine whether further segmentation is necessary. Refer to Note 3 for more details on the Bank's portfolio segments.

The Bank applies the weighted average remaining life method to estimate the allowance on its pooled portfolio segments. The model related to this method utilizes the Company's historical default and loss experience adjusted for future economic forecasts. A reasonable and supportable economic forecast is applied to each of the pools.

In some cases, management may determine that an individual loan is collateral dependent. In such cases, the loans are evaluated for expected credit losses on an individual basis and excluded from the pooled evaluation. Specific allocations of the allowance for credit losses are determined by analyzing the net collateral value of the collateral securing the loan. A loan is considered to be collateral dependent when, based upon management's assessment, the borrower is experiencing financial difficulty and repayment is expected to be provided substantially through the sale of the collateral. In such cases, expected credit losses are based on the fair value of the collateral at the measurement date, adjusted for estimated selling costs if satisfaction of the loan depends on the sale of the collateral. The Bank reevaluates the fair value of collateral supporting collateral dependent loans on an ongoing basis.

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

Management qualitatively adjusts model results for risk factors that are not considered within our modeling processes but are nonetheless relevant in assessing the expected credit losses within our loan pools. These qualitative factor (“Q-Factor”) adjustments may increase management’s estimate of expected credit losses based upon the estimated level of risk within the risk factor. The various risk factors that may be considered in making Q-Factor adjustments include, among other things, the impact of (i) changes in lending policies and procedures, including changes in underwriting standards and practices for collections, write-offs, and recoveries, (ii) actual and expected changes in national, regional, and local economic and business conditions and developments that affect the collectability of the loan pools, (iii) changes in the nature, volume and size of a loan or the loan pools and in the terms of the underlying loans, (iv) changes in the experience, ability, and depth of our lending management and staff, (v) changes in volume and severity of past due financial assets, the volume of nonaccrual assets, and the volume and severity of adversely classified or graded assets, (vi) changes in the quality of our credit review function, (vii) changes in the value of the underlying collateral for loans that are non-collateral dependent, (viii) the existence, growth, and effect of any concentrations of credit, and (ix) other factors such as the regulatory, legal and technological environments; competition; and events such as natural disasters or health pandemics.

Management believes it uses relevant information available to make determinations about the allowance and that it has established the existing allowance in accordance with GAAP. However, the determination of the allowance requires significant judgment, and estimates of expected lifetime losses in the loan portfolio can vary significantly from the amounts actually observed. While management uses available information to recognize expected losses, future additions to the allowance may be necessary based on changes in the loans comprising the portfolio, changes in the current and forecasted economic conditions, changes to the interest rate environment which may directly impact prepayment and curtailment rate assumptions, and changes in the financial condition of borrowers.

Allowance for Credit Losses-Off-Balance-Sheet/Reserve for Unfunded Commitments – The allowance for credit losses on off-balance-sheet credit exposures is a liability account, calculated in accordance with ASC 326, representing expected credit losses over the contractual period for which we are exposed to credit risk resulting from a contractual obligation to extend credit. These obligations include unfunded lines of credit, commitments to extend credit and federal funds sold to correspondent banks and standby letters of credit. No allowance is recognized if we have the unconditional right to cancel the obligation. The allowance is reported as a component of other liabilities in our consolidated balance sheets. Adjustments to the allowance are reported in our income statement as a component of the provision for credit losses. At December 31, 2023 and 2022, the Bank’s reserve for unfunded commitments totaled $345,033 and $60,000, respectively, which is included in other liabilities in the consolidated balance sheet.

Allowance for loan losses (prior to adoption of ASC 326) – The allowance for loan losses is established as losses are estimated to have occurred through a provision for loan losses charged to earnings. Loan losses are charged against the allowance when management believes the uncollectability of a loan balance is confirmed. Subsequent recoveries, if any, are credited to the allowance.

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

The allowance for loan losses is maintained at a level sufficient to provide for probable loan losses based on evaluating known and inherent risks in the loan portfolio and is evaluated on a regular basis by management. The allowance is provided based upon management's continuing analysis of the pertinent factors underlying the quality of the loan portfolio. These factors include changes in the size and composition of the loan portfolio, delinquency levels, actual loan loss experience, current economic conditions, and detailed analysis of individual loans for which full collectability may not be ensured. The detailed analysis includes techniques to estimate the fair value of loan collateral and the existence of potential alternative sources of repayment. The allowance consists of specific, general, and unallocated components. The specific component relates to loans that are classified as impaired. For such loans classified as impaired, an allowance is established when the discounted cash flows (or collateral value or observable market price) of the impaired loan is lower than the carrying value of that loan. The general component covers nonimpaired loans and is based on historical loss experience adjusted for qualitative factors. An unallocated component is maintained to cover uncertainties that could affect management's estimate of probable losses. The unallocated component of the allowance reflects the margin of imprecision inherent in the underlying assumptions used in the methodologies for estimating specific and general losses in the portfolio. The appropriateness of the allowance for loan losses is estimated based upon these factors and trends identified by management at the time the consolidated financial statements are prepared. This evaluation is inherently subjective, as it requires estimates that are susceptible to significant revision as more information becomes available.

A loan is considered impaired when, based on current information and events, it is probable that the Bank will be unable to collect the scheduled payments of principal or interest when due according to the contractual terms of the loan agreement. Factors considered by management in determining impairment include payment status, collateral value, and the probability of collecting scheduled principal and interest payments when due. Loans that experience insignificant payment delays and payment shortfalls generally are not classified as impaired. Management determines the significance of payment delays and payment shortfalls on a case-by-case basis, taking into consideration all of the circumstances surrounding the loan and the borrower, including the length of the delay, the reasons for the delay, the borrower's prior payment record, and the amount of the shortfall in relation to the principal and interest owed. Impairment is measured by either the present value of expected future cash flows discounted at the loan's effective interest rate, the loan's obtainable market price, or the fair value of the collateral, if the loan is collateral dependent. For such loans that are also classified as impaired, an allowance is established when the discounted cash flows (or collateral value or observable market price) of the impaired loan are lower than the carrying value of that loan. Large groups of smaller-balance loans are excluded from this analysis and collectively evaluated for impairment.

A troubled debt restructuring is a loan to a borrower that is experiencing financial difficulty that has been modified from its original terms and conditions in such a way that the Bank is granting the borrower a concession of some kind. The Bank has granted a variety of concessions to borrowers in the form of loan modifications. Troubled debt restructurings are included in the impaired loan disclosures.

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

Loan sales recognition – The Bank originates loans through the Small Business Administration (SBA) and United States Department of Agriculture (USDA) and sometimes sells the guaranteed portions. Loans held for sale consist of the guaranteed portion of SBA and USDA loans that the Bank intends to sell after origination and are reflected at the lower of aggregate cost of fair value. The Bank retains the servicing on the sold guaranteed portion of SBA and USDA loans. The Bank receives a fee for servicing the loan. The Bank recognizes a sale on loans if the transferred portion (or portions) and any portion that continues to be held by the transferor are participating interests.

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

To determine the gain or loss on sale of loans, the Bank's investment in the loan is allocated among the retained portion of the loan, the servicing retained, and the sold portion of the loan, based on the relative fair market value of each portion. The gain or loss on the sold portion of the loan is based on the difference between the sale proceeds and the allocated investment in the sold portion of the loan. A discount is recorded against the carrying value of the retained portion of the loan to offset the fair value allocation of the retained portion.

SBA servicing assets – The Bank accounts for SBA servicing rights as separately recognized servicing rights and initially measures them at fair value. Fair value is based on market prices for comparable servicing contracts, when available, or alternatively, is based on a valuation model that calculates the present value of estimated future net servicing income. The Bank subsequently measures each SBA servicing asset using the amortization method. Under the amortization method, servicing assets are amortized into noninterest income in proportion to, and over the period of, estimated net servicing income. The amortized assets are assessed for impairment or increased obligation, at the loan level, based on the fair value at each reporting date. As of December 31, 2023 and 2022, SBA servicing assets are included in other assets on the consolidated balance sheets.

Federal Home Loan Bank (FHLB) stock – As a member of the FHLB system, the Bank is required to maintain a minimum investment level in FHLB stock based on specific percentages of the Bank's outstanding loans, total assets, or FHLB advances. This security is carried at cost, classified as a restricted security, and periodically evaluated for impairment based on ultimate recovery of par value. Both cash and stock dividends are reported as income. Management determined there was no impairment at December 31, 2023 and 2022. The Bank had $2,811,100 and $735,100 of FHLB stock at December 31, 2023 and 2022, respectively.

Pacific Coast Bankers' Bank (PCBB) stock – PCBB stock represents an investment by the Bank in the capital stock of PCBB of $190,000 at both December 31, 2023 and 2022, and is carried at cost, classified as a restricted security, and periodically evaluated for impairment. Both cash and stock dividends are reported as income.

Premises and equipment – Premises and equipment, including leasehold improvements, are stated at cost less accumulated depreciation or amortization, which is computed on the straight-line method over the estimated useful lives of the related assets, which range from 3 to 39 years. Assets are reviewed for impairment when events indicate their carrying value may not be recoverable. If management determines impairment exists, the asset is reduced with an offsetting charge to expense.

Other real estate owned – Assets acquired through, or in lieu of, loan foreclosure are held-for-sale and are initially recorded at the lower of cost or estimated fair value at the date of foreclosure. Losses arising from the acquisition of property, in full or partial satisfaction of loans, are charged to the allowance for credit losses. Subsequent to foreclosure, valuations are periodically performed by management and the assets are carried at the lower of carrying amount or fair value less cost to sell. Revenue and expenses from operations and changes in the valuation allowance are included in net expenses from other real estate owned on the statements of income. Gains/losses on the sale of OREO are included in noninterest income and are generally recognized when the performance obligation is complete. This is typically at delivery of control over the property to the buyer at time of each real estate closing.

Income taxes – The provision for income tax is recorded under the liability method. Deferred tax assets and liabilities are reflected at currently enacted income tax rates applicable to the period in which the deferred tax assets or liabilities are expected to be realized or settled. As changes in tax laws or rates are enacted, deferred tax assets and liabilities are adjusted through the provision for income taxes. Deferred taxes result from temporary differences in the recognition of certain income and expense amounts between the Company's consolidated financial statements and its tax return. Deferred tax assets are reduced by a valuation allowance if, based on the weight of evidence available, it is more likely than not that some portion or all of a deferred tax asset will not be realized.

Financial instruments – In the ordinary course of business, the Company enters into off-balance-sheet financial instruments consisting of commitments to extend credit, commercial letters of credit, standby letters of credit, and financial guarantees. Such financial instruments are recorded in the consolidated financial statements when they are funded or related fees are incurred or received.

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

Advertising costs – The Company expenses advertising costs as they are incurred. Total advertising expense was $187,264 and $124,778 for the years ended December 31, 2023 and 2022, respectively.

Comprehensive income (loss) – Accounting principles generally require that recognized revenue, expenses, gains, and losses be included in net income. Certain changes in assets and liabilities, such as unrealized gains and losses on available-for-sale investments, are reported as a separate component of the stockholders' equity section of the consolidated balance sheets. Accumulated other comprehensive loss consists of only one component: unrealized gains or losses on investment securities available-for-sale.

Stock-based compensation plan – Compensation cost is recognized for stock options and restricted stock awards issued to employees and directors, based on the fair value of these awards at the date of grant. A Black-Scholes model is utilized to estimate the fair value of stock options, while a third-party valuation of the Company's common stock at the grant date is used for restricted stock awards.

Compensation cost is recognized over the required service period, generally defined as the vesting period. For awards with graded vesting, compensation cost is recognized on a straight-line basis over the requisite service period for the entire award. The Company's accounting policy is to recognize forfeitures as they occur.

Earnings per common share – Basic earnings per common share (EPS) are computed by dividing net income by the weighted-average number of common shares outstanding during the period. Diluted earnings per common share reflect the weighted-average potential dilution that could occur if all potentially dilutive shares or other commitments to issue common stock were exercised or converted into common stock using the treasury stock method.

Fair value measurements – Fair values of financial instruments are estimated using relevant market information and other assumptions as disclosed in a separate note. Fair value estimates involve uncertainties and matters of significant judgment regarding interest rates, credit risk, prepayments, and other factors, especially in the absence of broad markets for particular items. Changes in assumptions or in market conditions could significantly affect these estimates.

Fair value is defined as the exit price, the price that would be received for an asset or paid to transfer a liability, in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date under current market conditions. It also establishes a consistent framework for measuring fair value and expands disclosure requirements about fair value measurements. In determining fair value, the Company maximizes the use of observable inputs and minimizes the use of unobservable inputs.

Valuation inputs refer to the assumptions market participants would use in pricing a given asset or liability using one of the three valuation techniques within the fair value hierarchy. Inputs can be observable or unobservable. Observable inputs are those assumptions that market participants would use in pricing the particular asset or liability. These inputs are based on market data and are obtained from a source independent of the Company.

Unobservable inputs are assumptions based on the Company's own information or estimate of assumptions used by market participants in pricing the asset or liability. Unobservable inputs are based on the best and most current information available on the measurement date.

All inputs, whether observable or unobservable, are ranked in accordance with a prescribed fair value hierarchy that gives the highest ranking to quoted prices (unadjusted) in active markets for identical assets or liabilities (Level 1) and the lowest ranking to unobservable inputs (Level 3). Fair values for assets or liabilities classified as Level 2 are based on one or a combination of the following factors: (i) quoted prices for similar assets; (ii) observable inputs for the asset or liability, such as interest rates or yield curves; or (iii) inputs derived principally from or corroborated by observable market data.

There were no transfers between Level 2, and Level 3 during 2023 and 2022.

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

Revenue recognition – The Company recognizes revenue in accordance with ASC 606, *Revenue from Contracts with Customers,"* which (i) creates a single framework for recognizing revenue from contracts with customers that fall within its scope and (ii) revises when it is appropriate to recognize a gain (loss) from the transfer of nonfinancial assets, such as OREO. To determine revenue recognition for arrangements that an entity determines are within the scope of Topic 606, the Company performs the following five steps: (i) identify the contract(s) with a customer; (ii) identify the performance obligations in the contract; (iii) determine the transaction price; (iv) allocate the transaction price to the performance obligations in the contract; and (v) recognize revenue when (or as) the Company satisfies a performance obligation. Most of the Company's revenues come from interest income including loans and securities, that are outside the scope of ASC 606. The Company's services that fall within the scope of ASC 606 are presented within non-interest income and are recognized as revenue as the Company satisfies its obligation to the customer.

Service Fees – The Bank earns fees from its deposit customers for account maintenance, transaction-based activity, and overdraft services. Account maintenance fees consist primarily of account fees and analyzed account fees charged on deposit accounts monthly. The performance obligation is satisfied, and the fees are recognized monthly as the service period is completed. Transaction-based fees on deposit accounts are charged to deposit customers for

specific services provided to the customer, such as non-sufficient funds fees, overdraft fees, and wire fees. The performance obligation is completed as the transaction occurs and the fees are recognized at the time each specific service is provided to the customer.

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

Reclassifications – Certain reclassifications have been made to the prior-year consolidated financial statements to be in accordance with the current-year presentation with no effect on net income or total stockholder's equity. Interest bearing deposits in banks has been reclassified into cash and cash equivalents for the years ending December 31, 2023 and 2022.

Note 2 – Investment Securities

Amortized cost and estimated fair values of investment securities are summarized as follows:

December 31, 2023	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Available-for-sale securities				
Obligations of U.S. agencies	$ 1,500,000	$ -	$ (130,000)	$ 1,370,000
Agency mortgage-backed securities	13,688,101	-	(1,410,000)	12,278,101
Agency collateralized mortgage obligations	1,774,160	-	(257,000)	1,517,160
SBA participation certificates	2,177,386	-	(322,000)	1,855,386
Municipal Bonds	5,174,837	36,000	-	5,210,837
	$ 24,314,484	$ 36,000	$ (2,119,000)	$ 22,231,484
Held to maturity securities				
Municipal bonds	$ 1,000,169	$ -	$ (12,773)	$ 987,396
December 31, 2022				
Available-for-sale securities				
Obligations of U.S. agencies	$ 1,500,000	$ -	$ (172,000)	$ 1,328,000
Agency mortgage-backed securities	11,966,640	-	(1,635,000)	10,331,640
Agency collateralized mortgage obligations	2,001,990	-	(273,000)	1,728,990
SBA participation certificates	2,519,722	41,000	(263,000)	2,297,722
	$ 17,988,352	$ 41,000	$ (2,343,000)	$ 15,686,352
Held to maturity securities				
Municipal bonds	$ 1,001,549	$ -	$ (3,199)	$ 998,350

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

	Available-for-Sale		Held to Maturity	
	Amortized Cost	Estimated Fair Value	Amortized Cost	Estimated Fair Value
1 to 5 years	$ 4,734,228	$ 4,582,878	$ 363,001	$ 317,901
More than 5 years	19,580,256	17,648,606	637,168	669,495
	$ 24,314,484	$ 22,231,484	$ 1,000,169	$ 987,396

There are $24,392,346 in investment securities pledged to secure borrowings with the Federal Reserve Discount Window and Bank Term Funding Program at December 31, 2023 and there were no investment securities pledged at December 31, 2022.

Note 2 – Investment Securities (continued)

Information pertaining to investment securities with gross unrealized losses aggregated by investment category and length of time that individual securities have been in a continuous loss position is as follows:

	Less Than 12 Months		Greater Than 12 Months	
	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value
December 31, 2023				
Available-for-sale securities				
Obligations of U.S. agencies	$ -	$ -	$ (130,000)	$ 1,370,000
Agency mortgage-backed securities	(18,000)	3,027,837	(1,392,000)	9,250,264
Agency collateralized mortgage obligations	-	-	(257,000)	1,517,160
SBA participation certificates	(75,000)	600,218	(247,000)	1,255,167
	$ (93,000)	$ 3,628,055	$ (2,026,000)	$ 13,392,591
December 31, 2022				
Available-for-sale securities				
Obligations of U.S. agencies	$ -	$ -	$ (172,000)	$ 1,328,000
Agency mortgage-backed securities	(256,000)	2,657,768	(1,379,000)	7,673,872
Agency collateralized mortgage obligations	(16,000)	335,235	(257,000)	1,393,755
SBA participation certificates	(26,000)	1,136,479	(237,000)	230,161
	$ (298,000)	$ 4,129,482	$ (2,045,000)	$ 10,625,788

There were two securities in an unrealized loss position less than 12 months and twenty securities in an unrealized loss position greater than 12 months on December 31, 2023. There were eleven securities in an unrealized loss position less than 12 months and nine securities in an unrealized loss position greater than 12 months on December 31, 2022. Unrealized losses have not been recognized into income because management does not intend to sell and does not expect it will be required to sell the investments. The unrealized loss is largely due to changes in market conditions and interest rates, rather than credit quality. The fair value is expected to recover as the underlying securities in the portfolio approach maturity date and market conditions improve. There was no credit impairment recorded for the years ended December 31, 2023 and 2022.

There were no securities sold in 2023 or 2022.

Note 3 – Loans

The Bank adopted ASU 2016-13 effective January 1, 2023. Upon adoption, the Bank changed its loan segments for the purposes of the calculation of the ACL. Prior to January 1, 2023, the Bank's loan segments were based on a combination of loan purpose and loan collateral. Effective January 1, 2023, and thereafter, the Bank's loan segments are primarily based on loan collateral.

Note 3 – Loans (continued)

The following table presents the new loan segmentation under ASU 2016-13.

	2023
Residential Real Estate	$ 98,609,862
Construction	50,681,562
Commercial & Industrial	61,567,810
Agriculture	27,099,524
CRE - OO	116,679,639
CRE - NOO	208,816,559
Consumer	2,001,930
Total Loans	$ 565,456,886
Less deferred loan fees, net	(1,896,976)
Less allowance for credit losses	(9,648,647)
Total loans, net	$ 553,911,264

The following table presents the Bank's loan segments as of December 31, 2022, under both the ACL and legacy segmentation.

ACL Segmentation	2022	Legacy Segmentation	2022
Residential Real Estate	$ 79,217,631	Residential 1-4 family	$ 65,304,532
Construction	55,116,155	Residential multi-family	23,546,251
Commercial & Industrial	58,530,417	Residential construction,	
Agriculture	28,804,775	1-4 family and multifamily	24,362,206
CRE - OO	92,465,157	Home equity loans and lines of credit	12,059,101
CRE - NOO	154,610,257	Commercial & Industrial loans (C&I)	60,412,205
Consumer	1,958,310	Agriculture*	25,004,523
		Commercial real estate (CRE)	
		Land/development and construction	26,444,575
		Income property - owner-occupied (OOC)	99,606,660
		Income property - nonowner-occupied (NOC)	133,348,933
		Consumer	613,717
Total Loans	$ 470,702,703	Total Loans	$ 470,702,703
Less deferred loan fees, net	(1,418,502)	Less deferred loan fees, net	(1,418,502)
Less allowance for credit losses	(9,721,837)	Less allowance for loan losses	(9,721,837)
Total loans, net	$ 459,562,364	Total loans, net	$ 459,562,364

Our disclosures below reflect these changes made in 2023 to conform with the adoption of ASC 326, Financial Instruments – Credit Losses, using the modified retrospective approach. Accordingly, prior period was not modified to conform to the current period presentation. The adoption of ASC 326 requires certain tables to be presented at amortized cost, however, for the year ended December 31, 2023, the difference between amortized cost and principal balance is immaterial and therefore the applicable tables below reflect principal balances.

For the remainder of this document, all tables showing 2023 data will be presented under the ACL segmentation based on loan collateral, and all 2022 data will be presented under the legacy segmentation.

The Bank pledged certain commercial, multi-family, 1-4 family residential loans and agri-business loans as collateral for purposes of borrowings with the FHLB. Loans totaling $193,171,081 and $48,332,842 were pledged to the FHLB at December 31, 2023 and 2022, respectively.

Note 3 – Loans (continued)

The Bank pledged certain construction loans as collateral for the Borrower in Custody program with purposes of borrowings with the Discount Window at the Federal Reserve. Loans totaling $17,537,771 were pledged to the Borrower in Custody program at December 31, 2023 and no loans were pledged at December 31, 2022.

Past due loans – The following table presents past due loans, net of partial loan charge-offs, by type as of December 31:

2023	30 - 59 Days Past Due	60 - 89 Days Past Due	90 Days or More Past Due	Total Past Due	Current	Total Loans
Residential Real Estate	$ -	$ -	$ -	$ -	$ 98,609,862	$ 98,609,862
Construction	-	-	-	-	50,681,562	50,681,562
Commercial & Industrial	-	-	-	-	61,567,810	61,567,810
Agriculture	-	-	112,500	112,500	26,987,024	27,099,524
CRE - OO	-	-	-	-	116,679,639	116,679,639
CRE - NOO	-	-	-	-	208,816,559	208,816,559
Consumer	-	-	-	-	2,001,930	2,001,930
	$ -	$ -	$ 112,500	$ 112,500	$ 565,344,386	$ 565,456,886

2022	30 - 59 Days Past Due	60 - 89 Days Past Due	90 Days or More Past Due	Total Past Due	Current	Total Loans
Residential 1-4 family	$ -	$ -	$ -	$ -	$ 65,304,532	$ 65,304,532
Residential multi-family	-	-	-	-	23,546,251	23,546,251
Residential construction, 1-4 family and multifamily	-	-	-	-	24,362,206	24,362,206
Home equity loans and lines of credit	-	-	-	-	12,059,101	12,059,101
C & I loans	-	-	-	-	60,412,205	60,412,205
Agriculture	53,300	-		53,300	24,951,223	25,004,523
CRE land/development and construction	-	-	-	-	26,444,575	26,444,575
CRE income property - OOC	-	-	272,697	272,697	99,333,963	99,606,660
CRE income property - NOC	-	-	-	-	133,348,933	133,348,933
Consumer	-	-	-	-	613,717	613,717
	$ 53,300	$ -	$ 272,697	$ 325,997	$ 470,376,706	$ 470,702,703

The following table presents the amortized cost of nonaccrual loans at December 31, 2023:

	Nonaccrual with no Allowance for Credit Losses	Nonaccrual with Allowance for Credit Losses	Total Nonaccrual	Loans Past Due Over 90 Days Still Accruing
Agriculture	$ 1,253,203	$ -	$ 1,253,203	$ -
CRE - OO	540,950	-	540,950	-
CRE - NOO	4,602,399	-	4,602,399	-
Total	$ 6,396,552	$ -	$ 6,396,552	$ -

Note 3 – Loans (continued)

The following table presents the recorded investment in nonaccrual loans at December 31, 2022:

Agriculture	$ 1,190,703
CRE income property - OOC	886,099
CRE income property - NOC	5,067,240
	$ 7,144,042

There was $65,342 of interest income recognized on nonaccrual loans as of December 31, 2023 and $102,899 of interest income recognized on nonaccrual loans as of December 31, 2022. There were no loans 90 days past due accruing interest as of December 31, 2022.

Credit quality indicator – Federal regulations provide for the classification of lower quality loans and other assets, such as debt and equity securities, as substandard, doubtful, or loss. An asset is considered substandard if it is inadequately protected by the current net worth and pay capacity of the borrower or of any collateral pledged. Substandard assets include those characterized by the distinct possibility that the Bank will sustain some loss if the deficiencies are not corrected. Assets classified as doubtful have all the weaknesses inherent in those classified substandard, with the added characteristic that the weaknesses present make collection or liquidation in full highly questionable and improbable on the basis of currently existing facts, conditions, and values. Assets classified as loss are those considered uncollectible and of such little value that their continuance as assets without the establishment of a specific loss reserve is not warranted.

Risk ratings are assigned to each loan. These numeric ratings range in value from 1 to 10 and are based on the following criteria:

1. Ratings of 1-5 indicate low to minimal credit risk (pass).

2. Rating of 6 indicates an average to above average credit risk with adequate repayment capacity when prolonged periods of adversity do not exist (watch).

3. Rating of 7 indicates potential weaknesses and higher credit risk requiring greater attention by Bank personnel and management to help prevent further deterioration (special mention).

4. Rating of 8 indicates a loss is possible if loan weaknesses are not corrected (substandard).

5. Rating of 9 indicates loss is highly probable; however, the amount of the loss has not yet been determined (doubtful).

6. Rating of 10 indicates the loan is uncollectible and, when identified, is charged off (loss).

Periodically, all loans are reviewed to assess the ability of the borrowers to service all interest and principal obligations and, as a result, the risk rating may be adjusted accordingly. Risk ratings should be reviewed and updated whenever appropriate, with more periodic reviews as the risk and dollar value of loss on the loan increases. In the event that full collection of principal and interest is not reasonably ensured, the loan is appropriately downgraded and, if warranted, placed on nonaccrual status even though the loan may be current as to principal and interest payments. Additionally, loans that are individually evaluated require an impairment analysis to assess the amount of allowance associated with the individually evaluated or collateral dependent loans.

Note 3 – Loans (continued)

The following table represents the principal balance, net of charge-offs of loans classified by internally assigned grade as of December 31, 2023:

	Term Loans Amortized Cost Basis by Origination Year						Revolving Loans Amortized Cost Basis	
December 31, 2023	2023	2022	2021	2020	2019	Prior		Total
Residential Real Estate								
Pass	$ 24,429,213	$ 19,098,658	$ 22,513,262	$ 4,845,967	$ 3,570,197	$ 8,447,820	$ 14,620,722	$ 97,525,839
Special mention	-	-	-	-	-	386,215	-	386,215
Substandard	-	-	-	-	-	-	697,808	697,808
Total Residential Real Estate	24,429,213	19,098,658	22,513,262	4,845,967	3,570,197	8,834,035	15,318,530	98,609,862
Construction								
Pass	30,001,990	7,615,067	10,438,164	2,230,460	210,167	32,278	-	50,528,126
Special mention	-	-	-	-	-	153,436	-	153,436
Total Construction	30,001,990	7,615,067	10,438,164	2,230,460	210,167	185,714	-	50,681,562
Commercial & Industrial								
Pass	4,945,437	9,655,562	7,243,451	7,703,511	341,424	3,878,981	23,397,379	57,165,745
Special mention	-	-	-	-	9,897	664,557	637,080	1,311,534
Substandard	-	-	17,023	137,064	1,211,095	1,725,349	-	3,090,531
Total Commercial & Industrial	4,945,437	9,655,562	7,260,474	7,840,575	1,562,416	6,268,887	24,034,459	61,567,810
Agriculture								
Pass	2,127,245	2,563,712	5,340,303	5,390,926	1,460,868	6,949,576	-	23,832,630
Special mention	-	-	-	334,311	-	536,783	-	871,094
Substandard	-	112,500	-	-	-	2,283,300	-	2,395,800
Total Agriculture	2,127,245	2,676,212	5,340,303	5,725,237	1,460,868	9,769,659	-	27,099,524
CRE - OO								
Pass	22,933,989	12,342,774	20,452,010	16,472,010	10,191,321	23,312,082	1,359,208	107,063,394
Special mention	-	2,255,421	-	-	1,489,218	3,082,573	-	6,827,212
Substandard	-	-	-	189,325	2,599,708	-	-	2,789,033
Total CRE - OO	22,933,989	14,598,195	20,452,010	16,661,335	14,280,247	26,394,655	1,359,208	116,679,639
CRE - NOO								
Pass	38,876,617	28,873,541	33,457,949	33,223,167	19,740,050	29,087,092	343,606	183,602,022
Special mention	-	-	3,465,451	-	-	3,354,163	-	6,819,614
Substandard	-	-	-	5,176,345	12,455,679	762,899	-	18,394,923
Total CRE - NOO	38,876,617	28,873,541	36,923,400	38,399,512	32,195,729	33,204,154	343,606	208,816,559
Consumer								
Pass	1,364,295	484,483	-	10,648	-	116,922	25,582	2,001,930
Total Consumer	1,364,295	484,483	-	10,648	-	116,922	25,582	2,001,930
Total loans	124,678,786	83,001,718	102,927,613	75,713,734	53,279,624	84,774,026	41,081,385	565,456,886
Total loans								
Pass	124,678,786	80,633,797	99,445,139	69,876,689	35,514,027	71,824,751	39,746,497	521,719,686
Special mention	-	2,255,421	3,465,451	334,311	1,499,115	8,177,727	637,080	16,369,105
Substandard	-	112,500	17,023	5,502,734	16,266,482	4,771,548	697,808	27,368,095
Total loans	$ 124,678,786	$ 83,001,718	$ 102,927,613	$ 75,713,734	$ 53,279,624	$ 84,774,026	$ 41,081,385	$ 565,456,886

Note 3 – Loans (continued)

The following table represents the principal balance of loans classified by internally assigned grade as of December 31, 2022 by type of loans:

	Pass/Watch	Special Mention	Substandard	Doubtful	Loss	Total
Residential 1-4 family	$ 65,304,532	$ -	$ -	$ -	$ -	$ 65,304,532
Residential multi-family	23,546,251	-	-	-	-	23,546,251
Residential construction, 1-4 family and multifamily	24,362,206	-	-	-	-	24,362,206
Home equity loans and lines of credit	12,059,101	-	-	-	-	12,059,101
C & I loans	58,943,677	89,007	1,379,521	-	-	60,412,205
Agriculture	22,635,283	35,940	2,333,300	-	-	25,004,523
CRE land/development and construction	26,267,275	177,300	-	-	-	26,444,575
CRE income property - OOC	94,271,741	635,709	4,640,710	58,500	-	99,606,660
CRE income property - NOC	108,122,883	7,614,936	17,611,114	-	-	133,348,933
Consumer	613,717	-	-	-	-	613,717
	$ 436,126,666	$ 8,552,892	$ 25,964,645	$ 58,500	$ -	$ 470,702,703

In 2023, there were no modifications made to borrowers experiencing financial difficulty.

Loans classified as troubled debt restructurings (TDRs) totaled $1,226,642 at December 31, 2022. There were no newly restructured TDR loans during 2022, and no TDR's that defaulted within 12 months of the modification date.

The following table presents the principal balance, net of charge-offs of collateral dependent loans by class of loans as of December 31, 2023:

	Real Estate	Other Non-Real Estate Assets	Total
Commercial & Industrial	$ -	$ 381,578	$ 381,578
Agriculture	-	1,289,142	1,289,142
CRE - OO	540,950	-	540,950
CRE - NOO	7,042,747	-	7,042,747
	$ 7,583,697	$ 1,670,720	$ 9,254,417

Note 3 – Loans (continued)

The following table presents loans individually evaluated for impairment by class of loans as of December 31, 2022:

	Recorded Investments (Loan Balance Less Charge-off)	Unpaid Principal Balance	Related Allowance	Average Investment in Impaired Loans	Interest Income Recognized
With allowance recorded					
CRE income property - OOC	$ 907,650	$ 907,650	$ 68,161	$ 888,751	$ 93,384
C & I loans	105,688	105,988	90,884	111,098	4,160
	1,013,338	1,013,638	159,045	999,849	97,544
With no allowance recorded					
Agriculture	1,226,642	1,226,642	-	1,267,042	2,506
CRE income property - OOC	58,500	134,296	-	134,395	7,190
CRE income property - NOC	7,565,100	7,565,100	-	7,804,127	134,437
	8,850,242	8,926,038	-	9,205,564	144,133
Total	$ 9,863,580	$ 9,939,676	$ 159,045	$ 10,205,413	$ 241,677

The following table presents the balance in the allowance for loan losses and the recorded investment in loans by class and based on impairment method as of December 31, 2022:

	Allowance for Loan Losses			Loans Receivable		
	Ending Balance	Ending Balance Individually Evaluated for Impairment	Ending Balance Collectively Evaluated for Impairment	Ending Balance	Ending Balance Individually Evaluated for Impairment	Ending Balance Collectively Evaluated for Impairment
Residential 1-4 family	$ 792,338	$ -	$ 792,338	$ 65,304,532	$ -	$ 65,304,532
Residential multi-family	255,249	-	255,249	23,546,251	-	23,546,251
Residential construction, 1-4 family and multifamily	1,012,321	-	1,012,321	24,362,206	-	24,362,206
Home equity loans and lines of credit	100,824	-	100,824	12,059,101	-	12,059,101
C & I loans	857,720	90,884	766,836	60,412,205	422,751	59,989,454
Agriculture	690,464	-	690,464	25,004,523	1,226,642	23,777,881
CRE land/development and construction	338,412	-	338,412	26,444,575	-	26,444,575
CRE income property - OOC	2,836,201	68,161	2,768,040	99,606,660	5,377,167	94,229,493
CRE income property - NOC	2,738,090	-	2,738,090	133,348,933	8,238,736	125,110,197
Consumer	100,218	-	100,218	613,717	-	613,717
	$ 9,721,837	$ 159,045	$ 9,562,792	$ 470,702,703	$ 15,265,296	$ 455,437,407

Note 3 – Loans (continued)

The following table presents the activity in the allowance for credit losses by class for the years ended December 31, 2023, and 2022:

2023	Beginning Balance prior to adoption of ASC 326	Impact of adopting ASC 326	Provision for Credit Losses	Charge-offs	Recoveries	Ending Balance
Residential Real Estate	$ 1,253,621	$ 416,060	$ 84,651	$ -	$ -	$ 1,754,332
Construction	917,601	622,326	61,961	-	-	1,601,888
Commercial & Industrial	1,475,326	(715,108)	99,621	-	-	859,839
Agriculture	708,000	(503,425)	47,808	(52,135)	101,526	301,774
CRE - OO	2,020,627	295,132	136,442	-	-	2,452,201
CRE - NOO	3,242,441	(869,929)	218,945	(42,567)	61,424	2,610,314
Consumer	104,221	(42,960)	7,038	-	-	68,299
	$ 9,721,837	$ (797,904)	$ 656,466	$ (94,702)	$ 162,950	$ 9,648,647

2022	Beginning Balance	Provision for Loan Losses	Charge-offs	Recoveries	Ending Balance
Residential 1-4 family	$ 659,599	$ 132,739	$ -	$ -	$ 792,338
Residential multi-family	212,488	42,761	-	-	255,249
Residential construction, 1-4 family and multifamily	842,728	169,593	-	-	1,012,321
Home equity loans and lines of credit	83,933	16,891	-	-	100,824
C & I loans	1,256,325	252,825	(688,431)	37,000	857,719
Agriculture	574,792	115,672	-		690,464
CRE land/development and construction	281,719	56,694	-	-	338,413
CRE income property - OOC	2,421,602	487,328	(75,796)	3,067	2,836,201
CRE income property - NOC	2,279,382	458,708	-	-	2,738,090
Consumer	83,429	16,789	-	-	100,218
	$ 8,695,997	$ 1,750,000	$ (764,227)	$ 40,067	$ 9,721,837

The following table represents the gross charge-offs as of December 31, 2023 by type of loans:

	Term Loans by Origination Year						
	2023	2022	2021	2020	2019	Prior	Total
Commercial & Industrial	$ -	$ 52,135	$ -	$ -	$ -	$ -	$ 52,135
CRE - OO	-	-	42,567	-	-	-	42,567
Total loans	$ -	$ 52,135	$ 42,567	$ -	$ -	$ -	$ 94,702

Note 4 – Premises and Equipment

Premises and equipment at December 31 are classified as follows:

	2023	2022
Land and buildings	$ 11,155,627	$ 11,155,627
Leasehold improvements	2,165,126	1,751,519
Furniture, fixtures, and office equipment	1,626,104	1,511,889
	14,946,857	14,419,035
Accumulated depreciation and amortization	(4,560,000)	(4,195,968)
	$ 10,386,857	$ 10,223,067

Depreciation and amortization expenses for these assets totaled $385,828 and $362,572 for the years ended at December 31, 2023 and 2022, respectively.

Note 5 – Leases

The Bank has operating leases for its branches. The maturities of these leases vary through 2029. The Bank's leases generally exclude extension clauses until it is reasonably certain the Bank will exercise the option.

The components of lease cost (included in occupancy and equipment expense on the consolidated statements of income) are as follows for the year ended December 31 (in thousands):

	2023	2022
Lease cost		
Minimum rent payments	$ 379,170	$ 352,293
Other operating costs	(22,519)	(16,452)
	$ 356,651	$ 335,841

The following table provides supplemental information related to operating leases for the purpose of the measurement of lease liabilities at or for the year ended December 31 (dollars in thousands):

	2023	2022
Operating cash flows from operating leases	$ 379,170	$ 352,293
Weighted average remaining lease term	4.58 years	5.40 years
Weighted average discount rate	3.11%	2.71%

The Bank's leases typically do not contain a discount rate implicit in the lease contract. As an alternative, the Bank uses the incremental borrowing rate at the date the lease begins.

Note 5 – Leases (continued)

The following table presents minimum lease payments under the terms of the leases for future years ending December 31, 2023 (in thousands):

2024	$	436,076
2025		426,436
2026		439,226
2027		415,830
2028 and thereafter		331,097
Total lease payments		2,048,665
Less imputed interest		(139,913)
Total	$	1,908,752

A portion of the Bank's owned premises are leased to unaffiliated third parties. Minimum rental receipts under sublease agreements for future years ending December 31 are as follows:

2024	$	413,021
2025		422,011
2026		431,625
2027		432,063
2028 and thereafter		1,841,040
Total lease payments	$	3,539,760

Note 6 – Other Real Estate Owned

The following table presents the activity in other real estate owned for the year ending December 31, 2023. There was no activity in other real estate owned during the year ended December 31, 2022.

		2023
Balance, beginning of year	$	-
Transfer		889,788
Sales		(171,630)
Ending balance	$	718,158

Note 7 – Servicing Assets

Loans serviced for others totaled $97,948,856 and $82,725,534 at December 31, 2023 and 2022, respectively. The fair value of servicing assets held at December 31, 2023 and 2022, were $1,749,144 and $1,373,464, respectively.

Note 7 – Servicing Assets (continued)

Changes in the balance of the servicing assets were as follows for the years ended December 31:

	2023	2022
Balance, beginning of year	$ 1,081,258	$ 1,149,009
Additions	742,452	419,361
Amortization	(631,141)	(487,112)
Balance, end of year	$ 1,192,569	$ 1,081,258

The projected amortized expense of the servicing asset is an estimate. The amortization expense for future periods was calculated by applying the same quantitative factors, such as servicing asset prepayment assumptions that were used to determine current year amortization expense. These factors are inherently subject to significant fluctuations, primarily due to the effect that changes in interest rates have on loan prepayment experience. Accordingly, any projection of servicing asset amortization in future periods is limited by the conditions that existed at the time the calculations were performed and may not be indicative of actual amortization expense that will be recorded in future periods.

The key economic assumptions used in determining the fair value of the servicing asset as of December 31 are as follows:

	2023	2022
Discount rate	15.62%	16.38%
Expected weighted-average life	3.69 years	4.34 years
Constant prepayment rate	20.16%	17.89%

Projected amortization expense at December 31, 2023, is estimated to be as follows:

2024	$ 416,584
2025	298,238
2026	198,572
2027	128,283
2028	78,221
Thereafter	72,671
Carrying value of servicing asset	$ 1,192,569

The following represents servicing fees earned in connection with the servicing asset and is included in the accompanying consolidated financial statements as a component of noninterest income for the years ended December 31:

	2023	2022
Servicing fees	$ 742,001	$ 766,484

Late fees associated with the servicing asset are immaterial for the years ended December 31, 2023 and 2022.

Note 8 – Deposits

Deposits as of December 31 consisted of the following:

	2023	2022
Demand accounts		
Noninterest-bearing	$ 110,668,764	$ 136,647,818
Interest-bearing	94,613,479	74,852,067
Savings accounts	9,123,208	12,637,806
Money market accounts	160,599,416	213,389,175
Certificates of deposit	160,428,533	53,221,982
	$ 535,433,400	$ 490,748,848

At December 31, 2023, scheduled maturities of certificates of deposit are as follows:

2024	$ 137,784,274
2025	16,427,818
2026	2,197,086
2027	1,441,939
2028	2,577,416
	$ 160,428,533

At December 31, 2023, scheduled maturities of brokered certificates of deposits, included in the above table, are as follows:

2024	$ 16,403,000
2025	3,467,000
	19,870,000

Certificates of deposit that met or exceeded the $250,000 federally insured limit were $66,453,904 and $16,796,084 at December 31, 2023 and 2022, respectively. All brokered certificates of deposit are FDIC insured at December 31, 2023 and there were no brokered certificates of deposit at December 31, 2022.

Note 9 – Credit Arrangements

Borrowings – The Bank has line-of-credit agreements with separate unaffiliated banks totaling $40,000,000. These two lines-of-credit provide for lending at the corresponding bank's federal fund rates. There were no borrowings outstanding on either of these lines at December 31, 2023 and 2022.

The Bank is a member of the FHLB of Des Moines and, as such, has a committed credit line of up to 45% of total eligible assets, subject to certain collateral requirements. Borrowings generally provide interest at the then-current published rates. At December 31, 2023 and 2022, loans pledged to the FHLB equated to a borrowing capacity after indebtedness of $79,588,312 and $35,848,638, respectively. At December 31, 2023 and 2022, the Bank had $55,000,000 and $0 of borrowings, respectively, outstanding with the FHLB, with fixed rates ranging from 3.81% to 4.10% under these agreements. The borrowings had a weighted-average interest rate of 3.89% and 0% as of December 31, 2023, and 2022, respectively. Current borrowings are collateralized by pledged loans (Note 3).

Note 9 – Credit Arrangements (continued)

FHLB advances of $55,000,000 as of December 31, 2023, will mature in 2028.

In 2023, the Bank renewed their eligibility as a borrower at the Federal Reserve Discount Window, which also granted access to the Bank Term Funding Program announced by the Federal Reserve Bank in March 12, 2023. To participate in the Discount Window, the bank pledged certain construction loans through the Borrower-in-Custody program with a collateral value of $15,037,076. The Bank also pledged securities with a collateral value of $5,553,707 to the Discount Window and pledged securities with a collateral value of $18,757,346 to the Bank Term Funding Program (Note 2).

There were no outstanding borrowings with the Discount Window or the Bank Term Funding Program as of December 31, 2023.

Subordinated Notes – On October 1, 2020, the Company issued unsecured subordinated term notes (the 2020 Subordinated Notes) in the aggregate principal amount of $5,000,000 due October 1, 2027 (maturity date), pursuant to the Subordinated Loan Agreements with various investors, three of which are Directors of the Company.

The Subordinated Notes bear interest at an annual fixed interest rate of 5.0% until September 30, 2025, and floating from October 1, 2025, until maturity at the 90-day average secured overnight financing rate (SOFR) plus 4.75%, payable by the Company quarterly in arrears beginning March 31, June 30, September 30, and December 31 of each year, commencing on the first such date commencing on December 31, 2020 and on the maturity date. Debt issuance costs were not significant.

On December 21, 2018, the Company issued unsecured subordinated term notes (the 2018 Subordinated Notes) in the aggregate principal amount of $7,500,000 due December 31, 2025 (maturity date), pursuant to the Subordinated Loan Agreements with various investors, two of which are Directors of the Company. The Subordinated Notes bear interest at an annual interest rate of 6.50%, payable by the Company quarterly in arrears beginning March 31, June 30, September 30, and December 31, of each year, (each, a “Fixed Interest Payment Date” until December 31, 2023). Thereafter, the Company will pay interest in arrears on the principal amount of the Note at a variable rate equal to three-month LIBOR plus 250 basis points (as noted in the agreement). Since LIBOR was discontinued June 30, 2023, the Company used good faith in selecting a reasonable substitute rate that the Company determined is most comparable to the three-month LIBOR plus 250 basis points rate. Debt issuance costs were not significant.

The Subordinated Notes may be prepaid at the Company’s option and with regulatory approval at any time on or after five years after the closing date of October 1st or December 31st of each respective series or at any time upon certain events, such as a change in the regulatory capital treatment of the Subordinated Notes or the interest on the Subordinated Notes no longer being deductible by the Company for United States federal income tax purposes.

Note 10 – Federal Income Taxes

The components of the federal income tax expense are as follows at December 31:

	2023	2022
Current	$ 2,602,029	$ 2,300,352
Deferred	(302,029)	(280,352)
	$ 2,300,000	$ 2,020,000

Note 10 – Federal Income Taxes (continued)

Reconciliation of the provision for income tax expense based on the statutory income tax rate to actual income tax expense is provided as follows:

	2023		2022	
	Amount	Percent	Amount	Percent
Federal income tax at statutory rate	$ 2,365,650	21.0%	$ 2,023,350	21.0%
Tax exempt interest	(71,193)	-0.63%	(104,914)	-1.09%
Permanent Items	53,749	0.48%	5,873	0.06%
Equity compensation	58,874	0.52%	49,195	0.51%
Other	(107,080)	-0.95%	46,496	0.48%
	$ 2,300,000	20.42%	$ 2,020,000	20.96%

The following are the significant components of the Company's deferred tax assets and liabilities at December 31:

	2023	2022
Deferred tax asset		
Allowance for credit losses	$ 1,917,194	$ 1,850,797
Net operating loss carryforward	717,443	806,568
Organization expenditures	8,093	8,949
Nonaccrual interest	240,284	167,831
Unrealized losses on securities	436,300	482,300
Deferred lease liability	400,838	390,266
Accrued Expenses	213,271	181,389
Equity Compensation	140,174	120,672
Other	160,848	92,612
SBA loan discount	218,248	213,462
Subtotal	4,452,693	4,314,846
Deferred tax liabilities		
Deferred loan costs	191,671	229,866
SBA servicing asset	250,439	227,064
Property and equipment depreciation	222,458	199,221
Deferred right-of-use asset	344,798	332,193
Subtotal	1,009,366	988,344
Net deferred tax asset	$ 3,443,327	$ 3,326,502

Pursuant to Sections 382 and 383 of the Internal Revenue Code, annual use of net operating loss and credit carryforwards may be limited in the event a cumulative change in ownership of more than 50% occurs within a three-year period. The Bank determined such an ownership change occurred as of December 12, 2011, as a result of the exercise of stock warrants. This ownership change results in annual limitations on the use of net operating loss carryforwards and limits the Bank's ability to fully utilize its deferred tax assets. The Bank's net operating loss deferred tax asset has been reduced to account for Section 382 limitations.

The Bank has federal net operating loss carryforwards of approximately $3.4 million at December 31, 2023, after the consideration of any Section 382 limits. Federal net operating loss carryforwards, to the extent not used, will begin to expire in 2029.

Note 10 – Federal Income Taxes (continued)

At December 31, 2023 and 2022, the Company had no unrecognized tax benefits. The Company recognizes interest accrued and penalties related to unrecognized tax benefits in tax expense. During the years ended December 31, 2023 and 2022, the Company recognized no interest and penalties. The Company files income tax returns in the U.S. federal jurisdiction.

Note 11 – Employee Benefits

The Company has a 401(k) defined contribution plan (the 401k Plan) for those employees who meet the eligibility requirements set forth in the 401(k) Plan. Eligible employees can contribute up to 100% of compensation subject to certain limits based on federal tax laws. The 401(k) Plan also allows for employer matching contributions equal to 100% up to the first 3%, and 50% up to the next 2% of compensation. Matching contributions vest immediately. The Company's contribution for the years ended December 31, 2023 and 2022, was $289,488 and $226,362, respectively.

Note 12 – Stockholders' Equity

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

Quantitative measures established by regulation to ensure capital adequacy require the Bank to maintain minimum amounts and ratios (set forth in the following table) of total, common equity Tier I, and Tier I capital (as defined in the regulations) to risk-weighted assets (as defined), and of Tier I (as defined) capital to average assets (as defined). As of December 31, 2023 management believes that the Company and the Bank meet all capital adequacy requirements to which it is subject.

To be categorized as adequately capitalized, the Bank must maintain minimum total risk-based, common equity Tier I risk-based, Tier I risk-based, and Tier I leverage ratios, as set forth in the table. The institution is well capitalized under the prompt corrective action provisions.

As of December 31, 2023, the most recent notification from the FDIC categorized the Bank as well capitalized under the regulatory framework for prompt corrective action. To be categorized as well capitalized, an institution must maintain minimum total risk-based, common equity Tier I risk-based, Tier I risk-based, and Tier I leverage ratios, as set forth in the following table. There are no conditions or events since the notification that management believes have changed the Bank's category. The Company's consolidated assets are less than $3 billion at the beginning of the year, therefore consolidated ratios are not required to be disclosed.

Note 12 – Stockholders' Equity (continued)

The Bank's actual capital amounts and ratios as of December 31 are also presented in the table.

	Actual		For Capital Adequacy Purposes		For Capital Adequacy with Capital Buffer		To Be Well Capitalized Under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio	Amount	Ratio
As of December 31, 2023								
Total capital								
(to risk-weighted assets)	$ 82,454,000	13.69%	$ 48,176,720	≥ 8.00%	$ 63,231,945	≥ 10.50%	$ 60,220,900	≥ 10.00%
Tier I capital								
(to risk-weighted assets)	74,889,000	12.44%	36,132,540	≥ 6.00%	51,187,765	≥ 8.50%	48,176,720	≥ 8.00%
Common equity Tier 1 capital								
(to risk-weighted assets)	74,889,000	12.44%	27,099,405	≥ 4.50%	42,154,630	≥ 7.00%	39,143,585	≥ 6.50%
Tier I capital (to average assets)	74,889,000	11.24%	26,684,400	≥ 4.00%	N/A		33,355,500	≥ 5.00%
As of December 31, 2022								
Total capital								
(to risk-weighted assets)	$ 70,446,000	14.19%	$ 39,709,920	≥ 8.00%	$ 52,119,270	≥ 10.50%	$ 49,637,400	≥ 10.00%
Tier I capital								
(to risk-weighted assets)	64,192,000	12.93%	29,782,440	≥ 6.00%	42,191,790	≥ 8.50%	39,709,920	≥ 8.00%
Common equity Tier 1 capital								
(to risk-weighted assets)	64,192,000	12.93%	22,336,830	≥ 4.50%	34,746,180	≥ 7.00%	32,264,310	≥ 6.50%
Tier I capital (to average assets)	64,192,000	11.64%	22,088,280	≥ 4.00%	N/A		27,610,350	≥ 5.00%

Under the Basel III rules, the Bank must hold a capital conservation buffer of 2.5% above the adequately capitalized risk-based capital ratios. The net unrealized gain or loss on available-for-sale securities is not included in computing regulatory capital.

Note 13 – Stock-Based Compensation Plan

The Company has a stockholder approved plan, the 2017 Mountain Pacific Bancorp Inc. Plan (the "Plan") as amended, is authorized to issue 2,000,000 shares, of which 200,000 may be issued as restricted stock awards. The Plan is to promote the best interest of the Company by providing an incentive to those key employees who contribute to its success. The Plan permits the grant of incentive stock options for employees, nonqualified stock options for directors, and restricted stock awards for directors. As of December 31, 2023, 571,525 shares remained available to grant out of the Plan of which 97,500 are available for restricted stock awards. The Plan will expire in 2027. There was no compensation cost capitalized and no income tax benefits realized on these stock-based compensation arrangements in 2023 or 2022.

Stock option plan – Incentive stock and nonqualified stock option awards are generally granted with an exercise price equal to the grant date fair value; those option awards generally vest and become exercisable in incremental percentages from one to five years of continuous service from the grant date and expire after 10 years. Certain option and share awards provide for accelerated vesting upon death of the optionee or if there is a change in control (as defined in the Plan).

Note 13 – Stock-Based Compensation Plan (continued)

The fair value of each option award is estimated on the date of grant using the Black-Scholes-Merton valuation model that uses the assumptions noted in the following table. Expected volatilities are based on historical volatility of the Company's stock and other factors. The expected term of options granted was evaluated by a calculation that factored in the contractual term and vesting period, and considered different employee segments. The risk-free interest rate for periods within the contractual life of the option is based on the U.S. Treasury yield curve in effect at the time of grant.

	2023	2022
Risk-free interest rate	3.79-3.85%	1.26-1.44%
Dividend yield rate	0.00%	0.00%
Expected volatility	35-38%	35-37%
Expected term (in years)	5.8-6.6 years	5.8-6.6 years

A summary of incentive and nonqualified stock option activity is presented below:

	Granted Options for Common Stock	Weighted-Average Exercise Price of Shares Under Plan	Weighted-Average Remaining Contractual Term (Years)
Outstanding at December 31, 2022	1,272,675	$ 5.54	
Granted	145,000	8.78	
Exercised	(38,250)	4.22	
Forfeited	(42,500)	5.01	
Outstanding at December 31, 2023	1,336,925	$ 5.94	4.54
Options exercisable at December 31, 2023	831,850	$ 5.04	5.99

The weighted-average grant-date fair value of options granted was $3.04 and $2.96 for each of the years ended December 31, 2023 and 2022, respectively. As of December 31, 2023 there was $973,635 of total unrecognized compensation cost related to incentive and nonqualified stock options granted under the Plan. That cost is expected to be recognized over a weighted-average period of 3.17 years. There were no tax benefits realized from the exercise of options in 2023 or 2022.

Note 13 – Stock-Based Compensation Plan (continued)

Restricted stock awards – Restricted stock awards vest over one to three years from the date of grant. The fair value of restricted stock awards is determined based on the most recent stock valuation on the grant date. A summary of nonvested restricted stock awards activity is presented below:

	Shares	Weighted-Average Grant-Date Fair Value
Nonvested at December 31, 2022	38,750	$ 7.12
Granted	22,500	8.78
Vested	(21,875)	7.02
Forfeited	-	-
Nonvested at December 31, 2023	39,375	$ 8.12

As of December 31, 2023, there was $193,593 of total unrecognized compensation cost related to restricted stock awards granted under the Plan. That cost is expected to be recognized over a weighted-average period of approximately 1.69 years.

Note 14 – Related Party Transactions

Certain directors, executive officers, and principal stockholders are Bank customers and have had banking transactions with the Bank. All loans and commitments included in such transactions were made in compliance with applicable laws on substantially the same terms (including interest rates and collateral) as those prevailing at the time for comparable transactions with other persons and do not involve more than the normal risk of collectability or present any other unfavorable features. The following summarizes these transactions with directors, executive officers, principal stockholders, and companies with which they are associated at December 31:

	2023	2022
Beginning balance	$ 7,035,229	$ 7,421,446
New loans	6,369	259,654
Repayments	(547,865)	(645,871)
Ending balance	$ 6,493,733	$ 7,035,229
Deposits	$ 12,823,442	$ 10,970,095

Three directors were investors in the Company's subordinated debt offering in 2020. Two directors were investors in the Company's subordinated debt offering in 2018. Rates and terms are consistent for all investors.

From time to time, a director may purchase a participating interest in certain lending relationships with the Bank. At December 31, 2023, there are no such participations outstanding, and three directors were equally involved in a single participation for $880,000 as of December 31, 2022.

Note 15 – Commitments and Contingencies

The Company is a party to financial instruments with off-balance-sheet risk in the normal course of business to meet the financing needs of its customers and to reduce its own exposure to fluctuations in interest rates. These financial instruments include commitments to extend credit, standby letters of credit, and financial guarantees. Those instruments involve, to varying degrees, elements of credit and interest rate risk in excess of the amount recognized in the balance sheets. The contract or notional amounts of those instruments reflect the extent of the Company's involvement in particular classes of financial instruments.

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

Commitments to extend credit and financial guarantees – 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. Because many of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. The Company's experience has been that approximately 81% of loan commitments are drawn upon by customers. The Company evaluates customers' creditworthiness on a case-by-case basis and follows the Bank's normal credit policies. The amount of collateral obtained, if it is deemed necessary by the Bank upon extension of credit, is based on management's credit evaluation of the counterparty. Collateral held varies but may include accounts receivable, inventory, property, plant and equipment, income-producing commercial properties, and other real estate.

The distribution of commitments to extend credit approximates the distribution of loans outstanding. Commercial and standby letters of credit were granted primarily to commercial borrowers. The Company, as a matter of policy, does not extend credit in excess of 20% of Tier 2 capital, or approximately $17.2 million, to any single borrower or group of related borrowers.

Standby letters of credit and financial guarantees written are conditional commitments issued by the Company to guarantee the performance of a customer to a third party. Those guarantees are primarily issued to support public and private borrowing arrangements, including commercial paper, bond financing, and similar transactions. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loan facilities to customers. The Company maintains various levels of collateral supporting those commitments for which collateral is deemed necessary.

The Company has not been required to perform on any financial guarantees. The Company has not incurred any losses on its commitments in 2023 or 2022.

A summary of the notional amounts of the Company's financial instruments with off-balance-sheet risk at December 31 follows:

	2023	2022
Commitments to extend credit	$ 136,120,985	$ 112,273,583
Standby letters of credit	$ 1,489,127	$ 989,127

Legal contingencies – Various legal claims also arise from time to time in the normal course of business that, in the opinion of management, will have no material effect on the Company's consolidated financial statements.

Note 16 – Fair Value of Financial Instruments

Fair value is the price to sell an asset or transfer a liability in an orderly transaction between market participants in the Company's principal market. The Company has established and documented its process for determining the fair values of its assets and liabilities, where applicable. Fair value is based on quoted market prices, when available, for identical or similar assets or liabilities. In the absence of quoted market prices, management determines the fair value of the Company's assets and liabilities using valuation models or third-party pricing services, both of which rely on market-based parameters when available, such as interest rate yield curves, option volatilities and credit spreads, or unobservable inputs. Unobservable inputs may be based on management's judgment, assumptions, and estimates related to credit quality, liquidity, interest rates, and other relevant inputs.

Valuation adjustments, such as those pertaining to counterparty and the Company's own credit quality and liquidity, may be necessary to ensure that assets and liabilities are recorded at fair value. Credit valuation adjustments are made when market pricing is not indicative of the counterparty's credit quality.

Any changes to valuation methodologies are reviewed by management to ensure that they are relevant and justified. Valuation methodologies are refined as more market-based data becomes available.

There are three levels of inputs that may be used to measure fair values:

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

Level 2 – Either (i) quoted prices for similar assets or liabilities; (ii) observable inputs, such as interest rates or yield curves; or (iii) inputs derived principally from or corroborated by observable market data.

Level 3 – Unobservable inputs.

The hierarchy gives the highest ranking to Level 1 inputs and the lowest ranking to Level 3 inputs. The level in the fair value hierarchy within which the fair value measurement in its entirety falls is determined based on the lowest level input that is significant to the overall fair value measurement.

Qualitative disclosures of valuation techniques

Investment securities – Where quoted prices are available in an active market, securities are classified as Level 1. Level 1 instruments include highly liquid government bonds, securities issued by the U.S. Treasury, and exchange-traded equity securities. If quoted prices are not available, management determines fair value using pricing models, quoted prices of similar securities, or discounted cash flows. Such instruments are classified as Level 2. In certain cases, where there is limited activity in the market for a particular instrument, assumptions must be made to determine its fair value. Such instruments are classified as Level 3.

Note 16 – Fair Value of Financial Instruments (continued)

Assets measured at fair value on a recurring basis – Assets are considered to be fair valued on a recurring basis if fair value is measured regularly (i.e., daily, weekly, monthly, or quarterly). The following table shows the Company's assets and liabilities measured at fair value on a recurring basis:

	Level 1	Level 2	Level 3	Total
2023				
Obligations of U.S. agencies	$ -	$ 1,370,000	$ -	$ 1,370,000
Agency mortgage-backed securities	-	12,278,101	-	12,278,101
Agency collateralized mortgage obligations	-	1,517,160	-	1,517,160
SBA participation certificates	-	1,855,386	-	1,855,386
Municipal Bonds	-	5,210,837	-	5,210,837
2022				
Obligations of U.S. agencies	$ -	$ 1,328,000	$ -	$ 1,328,000
Agency mortgage-backed securities	-	10,331,640	-	10,331,640
Agency collateralized mortgage obligations	-	1,728,990	-	1,728,990
SBA participation certificates	-	2,297,722	-	2,297,722

Assets measured at fair value on a nonrecurring basis – Assets are considered to be fair valued on a nonrecurring basis if the fair value measurement of the instrument does not necessarily result in a change in the amount recorded on the balance sheets. Generally, nonrecurring valuation is the result of the application of other accounting pronouncements that require assets or liabilities to be assessed for impairment or recorded at the lower of cost or fair value.

The following table presents the Company's assets measured at fair value on a nonrecurring basis:

	Level 1	Level 2	Level 3	Total
December 31, 2023				
Collateral dependent loans	$ -	$ -	$ 9,163,537	$ 9,163,537
Other real estate owned	-	-	718,158	718,158
December 31, 2022				
Impaired loans	$ -	$ -	$ 9,863,580	$ 9,863,580

Valuations of collateral dependent loans are periodically performed by management, and the fair value of the loans is carried at the fair value of the underlying collateral less cost to foreclose, sell, and carry the collateral. Fair value of the underlying collateral is determined by an appraisal performed by a qualified independent appraiser. Other real estate owned is valued in a similar manner as collateral dependent loans.

Note 16 – Fair Value of Financial Instruments (continued)

Quantitative information about Level 3 fair value measurements – The range and weighted average of the significant unobservable inputs used to fair value Level 3 nonrecurring assets during the years ending December 31, 2023 and 2022, along with the valuation techniques used, are shown in the following table:

	Fair Value at December 31, 2023*	Valuation Technique	Unobservable Input	Range[1]
Collateral dependent loans	$ 9,163,537	Market comparable	Adjustment to appraisal value	0% - 10% (5%)
OREO	718,158	Market comparable	Adjustment to appraisal value	0% - 10%

*Net of charge-offs and reserves
[1] Discount for selling costs.

	Fair Value at December 31, 2022	Valuation Technique	Unobservable Input	Range[1]
Impaired loans	$ 9,863,580	Market comparable	Adjustment to appraisal value	0% - 10% (5%)

[1] Discount for selling costs.

Carrying amounts and estimated fair values of financial instruments, not previously presented, as of December 31, 2023 are as follows:

	Carrying Amount	Estimated Fair Value	Fair Value Level Level 1	Level 2	Level 3
Financial assets					
Cash and cash equivalents	$ 75,978,641	$ 75,978,641	$ 75,978,641	$ -	$ -
Interest-bearing deposits in banks	69,150,000	69,150,000	69,150,000	-	-
Securities available-for-sale	22,231,484	22,231,484	-	22,231,484	-
Securities held-to-maturity	1,000,169	987,396	-	987,396	-
Loans receivable	563,559,911	537,636,155	-	-	537,636,155
Servicing asset	1,192,582	1,749,144	-	-	1,749,144
Financial liabilities					
Time deposits	160,428,533	159,496,134	-	159,496,134	-
Borrowings	55,000,000	51,920,000	-	51,920,000	-
Subordinated notes	12,500,000	12,500,000	-	12,750,000	-

Note 16 – Fair Value of Financial Instruments (continued)

Carrying amounts and estimated fair values of financial instruments, not previously presented, as of December 31, 2022 are as follows:

	Carrying Amount	Estimated Fair Value	Fair Value Level Level 1	Level 2	Level 3
Financial assets					
Cash and cash equivalents	$ 6,965,943	$ 6,965,943	$ 6,965,943	$ -	$ -
Interest-bearing deposits in banks	57,449,274	57,449,274	57,449,274	-	-
Securities available-for-sale	15,686,352	15,686,352	-	15,686,352	-
Securities held-to-maturity	1,001,549	998,350	-	998,350	-
Loans receivable	469,284,201	445,350,707	-	-	445,350,707
Loans held for sale	4,320,000	4,320,000	-	-	4,320,000
Servicing asset	1,081,258	1,373,464	-	-	1,373,464
Financial liabilities					
Time deposits	53,221,982	51,524,406	-	51,524,406	-
Borrowings	-	-	-	-	-
Subordinated notes	12,500,000	12,500,000	-	12,500,000	-

Note 17 – Earnings Per Common Share

The following table presents a reconciliation of the components used to compute basic and diluted earnings per common share:

	2023	2022
Net income	$ 8,965,000	$ 7,615,000
Basic weighted-average common shares outstanding	6,755,891	6,695,766
Plus dilutive incremental shares	373,733	421,222
Diluted weighted-average common shares outstanding	$ 7,129,624	$ 7,116,988
Basic earnings per common share	$ 1.33	$ 1.14
Diluted earnings per common share	$ 1.26	$ 1.07

There were no antidilutive options or restricted stock awards for the year ended December 31, 2023 or 2022.

Note 18 – Subsequent Events

The Company has evaluated subsequent events through the filing of this Audited Financial Statements, and determined the following events described below.

Subordinated Notes – In January 2024, the Board of Directors approved the Bank to redeem the existing 2018 Subordinated Notes totaling $7,500,000 and approved a new Subordinated Debt Issuance for $7,500,000 at the initial rate of 7.00% per annum (computed on the basis of a 360-day year of twelve 30-day months) from January 2, 2024 until December 31, 2028 on March 31, June 30, September 30 and December 31 of each year (each, a "Fixed Interest Payment Date"). Thereafter, the Company will pay interest in arrears on the principal amount of the Note at a variable rate equal to the 90-Day Average Secured Overnight Financing Rate ("SOFR") plus 475 basis points (computed on the basis of a 360-day year of twelve 30-day months) payable each March 31, June 30, September 30 and December 31 (each a "Floating Interest Payment Date").

Purchase of Real Estate – On February 28, 2024, the Company purchased a building located in Ballard. The purchase price was $6,075,000. The Company is planning an extensive remodel of the building. Once completed, the Company plans to move its Ballard Branch two miles to the new location. The completion of the remodel and the move is expected to occur in early 2025.