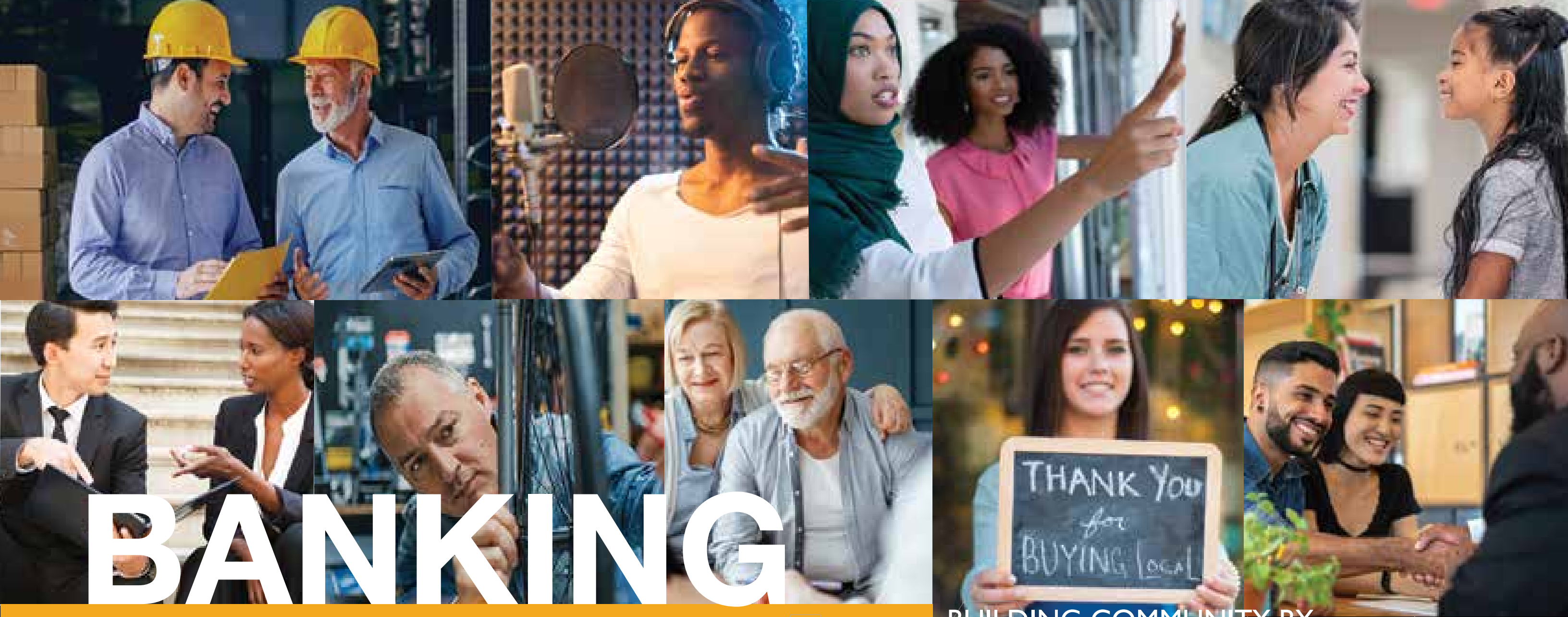

BANKING WITH SHARED VALUES

BUILDING COMMUNITY BY STRENGTHENING OUR LOCAL ECONOMY

2019 ANNUAL REPORT

Community BANK OF THE BAY

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Community BANK OF THE BAY

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2020 Shareholder Letter

Dear Community Bank of the Bay Shareholder:

In our 2017 shareholder letter we introduced a plan that we called CBB 20-20. CBB 20-20 laid out our strategy for growing the bank to $500 million by 2020. This plan would effectively double the size of the bank in three years. We are pleased to report our progress.

Our Bank ended 2019 with total assets of $493.4 million, an increase of $102.7 million, or 26.3% from the prior year. Deposits ended at $399.2 million, up $72.9 million or 22.3%, and loans ended the year at $399.7 million, up $84.3 million, or 26.7%.

Net income available to common shareholders increased 47.8% to a record $4.07 million for the year 2019, compared to $2.76 million in 2018.

Importantly, along with balance sheet and net income growth, the Bank continued to improve its asset quality in 2019. Nonperforming loans at December 31, 2019 totaled just $93 thousand, and represented only 0.02% of total loans, compared to 0.14% of total loans at December 31, 2018. Allowance for loan losses, as a percentage of total loans, was 1.03% at December 31, 2019, compared to 1.08%, at December 31, 2018. After excluding $32.6 million of loans that are fully guaranteed by agencies of the United States or the State of California, the allowance for loan losses, as a percentage of total loans, was 1.12% at December 31, 2019.

In addition to reporting the prior year's financial performance, this letter would normally discuss organizational and tactical changes. We would detail accomplishments, initiatives, personnel changes and how we believe they could combine to position the Bank for the coming year; but frankly, as we turn our attention to the disruption caused by the COVID-19 pandemic, actions in 2019 now seem rather distant. Everything has changed, and we must now be able to adjust in order to manage through what will surely be an extremely fluid situation. We believe that we are taking appropriate action to protect our staff and the Bank, while continuing to serve our clients.

Because of California's ongoing Shelter in Place order we will need to delay our annual shareholder meeting that was scheduled for May 20, 2020. We will monitor the situation and communicate an alternative date, and possibly an alternative method of holding the meeting as soon as practical.

We will end this brief letter by simply reiterating what the audited financial statements for December 31, 2019 show, that the Bank entered 2020, and more importantly, the pandemic event with a strong balance sheet, including a tier 1 leverage ratio that is more than two times what the FDIC considers as “Well Capitalized”, and an extremely well performing credit portfolio. We expect to provide updated and expanded financial information on these and other relevant metrics in our upcoming Q1 2020 Earnings Report. We will issue this report as soon as possible in April, 2020.

Until then, we wish you and your families’ good health - and the wherewithal to deal with whatever may come. This pandemic and our response to it has resulted in unusual and trying times, but we are confident that we will get through it together.

Thank you again for your investment in Community Bank of the Bay. All of us at the Bank and on the board appreciate your continued support.

Sincerely,

William S. Keller
President & CEO

William E. Purcell
Chairman of the Board

COMMUNITY BANK OF THE BAY

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MOSSADAMS

Report of Independent Auditors

The Board of Directors and Shareholders
Community Bank of the Bay

Report on the Financial Statements

We have audited the accompanying financial statements of Community Bank of the Bay (the Bank), which comprise the balance sheets as of December 31, 2019 and 2018, and the related statements of income, comprehensive income, shareholders' equity, and cash flows for the years then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

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

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

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

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Community Bank of the Bay as of December 31, 2019 and 2018, and the results of its operations and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Moss Adams LLP

San Francisco, California
March 31, 2020

Financial Statements

Community Bank of the Bay
Balance Sheets
December 31, 2019 and 2018

ASSETS

	2019	2018
Cash and due from banks	$ 53,673,456	$ 19,978,404
Federal funds sold	276,714	276,138
Total cash and cash equivalents	53,950,170	20,254,542
Interest-bearing deposits in banks	12,057,702	27,432,534
Available-for-sale investment securities	15,728,106	20,904,724
Loans, less allowance for loan losses of $4,105,843 in 2019 and $3,399,863 in 2018	398,288,627	312,650,661
Premises and equipment, net	1,433,642	342,332
Bank-owned life insurance	4,371,927	4,255,252
Interest receivable and other assets	7,974,418	4,931,443
Total assets	$ 493,804,592	$ 390,771,488

LIABILITIES AND SHAREHOLDERS' EQUITY

	2019	2018
Deposits		
Non-interest bearing	$ 133,743,537	$ 103,910,571
Interest bearing	265,503,592	222,442,652
Total deposits	399,247,129	326,353,223
Interest payable and other liabilities	3,990,624	1,742,616
Other borrowings	34,500,000	15,000,000
Total liabilities	437,737,753	343,095,839
Commitments and contingencies (Note 12)		
Shareholders' equity		
Preferred stock, no par value; 10,000,000 shares authorized; no shares issued and outstanding in 2019 and 2018	-	-
Class A common stock, voting, no par value; 10,000,000 shares authorized; 8,657,594 and 8,130,922 shares issued and outstanding in 2019 and 2018, respectively	49,253,145	45,184,526
Class B common stock, non-voting, no par value; 10,000,000 shares authorized; 56,844 shares issued and outstanding in 2019 and 2018	1,421,100	1,421,100
Retained earnings	5,290,490	1,217,874
Accumulated other comprehensive gain (loss), net of taxes	102,104	(147,851)
Total shareholders' equity	56,066,839	47,675,649
Total liabilities and shareholders' equity	$ 493,804,592	$ 390,771,488

See accompanying notes and report of independent auditors.

Community Bank of the Bay
Statements of Income
Years Ended December 31, 2019 and 2018

	2019	2018
INTEREST INCOME		
Interest and fees on loans	$ 20,302,305	$ 14,613,438
Interest on investment securities	508,766	474,876
Interest on federal funds sold	576	489
Interest on deposits in banks	1,069,865	905,870
Total interest income	21,881,512	15,994,673
INTEREST EXPENSE		
Interest expense on deposits	3,342,150	1,952,058
Interest on borrowings	605,053	286,567
Total interest expense	3,947,203	2,238,625
Net interest income	17,934,309	13,756,048
PROVISION FOR LOAN LOSSES	600,000	300,000
Net interest income after provision for loan losses	17,334,309	13,456,048
NON-INTEREST INCOME		
Service charges	203,181	229,538
Government grant	245,547	466,681
Gain on sale of loans, net	-	445,881
Other income	519,732	458,395
Total non-interest income	968,460	1,600,495
NON-INTEREST EXPENSE		
Salaries and employee benefits	6,940,649	6,122,434
Stock option expense	449,357	357,748
Occupancy and equipment	1,819,306	1,592,103
Other expenses	3,141,330	2,822,724
Total non-interest expense	12,350,642	10,895,009
Net operating income before provision for income taxes	5,952,127	4,161,534
INCOME TAX EXPENSE	1,879,511	1,334,613
NET INCOME	4,072,616	2,826,921
DIVIDENDS ON PREFERRED STOCK	-	71,726
NET INCOME AVAILABLE TO COMMON SHAREHOLDERS	$ 4,072,616	$ 2,755,195
NET INCOME PER SHARE – BASIC	$ 0.48	$ 0.40
NET INCOME PER SHARE – DILUTED	$ 0.46	$ 0.38

See accompanying notes and report of independent auditors.

Community Bank of the Bay
Statements of Comprehensive Income
Years Ended December 31, 2019 and 2018

	2019	2018
NET INCOME	$ 4,072,616	$ 2,826,921
CHANGE IN UNREALIZED GAINS AND LOSSES ON SECURITIES AVAILABLE FOR SALE	354,546	(88,504)
INCOME TAX EXPENSE (BENEFIT)	(104,516)	26,090
TOTAL OTHER COMPREHENSIVE INCOME (LOSS), NET OF TAX	249,955	(62,414)
COMPREHENSIVE INCOME	$ 4,322,571	$ 2,764,507

Community Bank of the Bay
Statement of Shareholders' Equity
Years Ended December 31, 2019 and 2018

	Preferred Stock	Class A Common Stock		Class B Common Stock		(Accumulated Deficit) Retained Earnings	Accumulated Other Comprehensive Income / (Loss)	Total Shareholders' Equity
		Shares	Amount	Shares	Amount			
BALANCES, January 1, 2018	$ 4,060,000	6,582,787	$ 33,841,525	56,844	$ 1,421,100	$ (1,537,321)	$ (85,437)	$ 37,699,867
Issue of shares, net of offering costs	-	1,533,333	10,928,562	-	-	-	-	10,928,562
Stock option exercised	-	14,802	56,691	-	-	-	-	56,691
Stock option expense	-	-	357,748	-	-	-	-	357,748
Redemption of Preferred Stock	(4,060,000)	-	-	-	-	-	-	(4,060,000)
Dividend paid on preferred stock	-	-	-	-	-	(71,726)	-	(71,726)
Net income	-	-	-	-	-	2,826,921	-	2,826,921
Other comprehensive loss	-	-	-	-	-	-	(62,414)	(62,414)
BALANCES, December 31, 2018	-	8,130,922	45,184,526	56,844	1,421,100	1,217,874	(147,851)	47,675,649
Issue of shares, net of offering costs	-	444,256	3,308,245	-	-	-	-	3,308,245
Stock option exercised	-	82,416	311,017	-	-	-	-	311,017
Stock option expense	-	-	449,357	-	-	-	-	449,357
Net income	-	-	-	-	-	4,072,616	-	4,072,616
Other comprehensive income	-	-	-	-	-	-	249,955	249,955
BALANCES, December 31, 2019	$ -	8,657,594	$ 49,253,145	56,844	$ 1,421,100	$ 5,290,490	$ 102,104	$ 56,066,839

Community Bank of the Bay
Statements of Cash Flows
Years Ended December 31, 2019 and 2018

	2019	2018
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income	$ 4,072,616	$ 2,826,921
Adjustments to reconcile net income to net cash from operating activities:		
Provision for loan losses	600,000	300,000
Change in deferred loan origination fees, net	307,075	438,834
Depreciation and amortization	189,532	183,493
Net amortization of premiums and discounts on investments available-for-sale	93,295	83,972
Proceeds from the sale of loans held for sale	-	4,829,158
Originations of loans held for sale	-	(2,841,382)
Gain on sale of loans, net	-	(445,881)
Stock option expense	449,357	357,748
Increase in cash surrender value of bank owned life insurance	(116,675)	(115,699)
Increase in interest receivable and other assets	(3,579,494)	(1,469,565)
Increase in interest payable and other liabilities	2,143,417	858,158
Net cash provided by operating activities	4,159,123	5,005,757
CASH FLOWS FROM INVESTING ACTIVITIES		
Proceeds from sold, called, and matured available-for-sale investment securities	3,750,000	1,250,000
Proceeds from principal repayments from available-for-sale investment securities	3,715,047	2,611,634
Purchases of available-for-sale investment securities	(2,027,178)	(10,000,423)
Purchase of FHLB stock	484,800	337,600
Decrease (Increase) in interest-bearing deposits in banks	15,374,832	(3,347,187)
Net increase in loans	(86,545,041)	(80,033,080)
Purchases of premises and equipment	(1,229,123)	(73,114)
Net cash used in investing activities	(66,476,663)	(89,254,570)

	2019	2018
CASH FLOWS FROM FINANCING ACTIVITIES		
Net increase in demand, interest bearing, and savings deposits	53,680,415	56,177,269
Net increase in time deposits	19,213,491	12,970,841
Proceeds from other borrowings	19,500,000	15,000,000
Issue of common stock	3,331,920	11,499,997
Stock offering cost	(23,675)	(571,435)
Dividends paid on preferred stock	-	(71,726)
Redemption of preferred stock	-	(4,060,000)
Proceeds from exercise of stock options	311,017	56,691
Net cash provided by financing activities	96,013,168	91,001,637
NET INCREASE IN CASH AND CASH EQUIVALENTS	33,695,628	6,752,824
CASH AND CASH EQUIVALENTS, beginning of year	20,254,542	13,501,718
CASH AND CASH EQUIVALENTS, end of year	$ 53,950,170	$ 20,254,542
SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION:		
Cash paid during the year for:		
Interest expense	$ 3,403,084	$ 2,078,480
Income taxes	$ 2,560,000	$ 1,150,000
Non-cash investing and financing activities:		
Net change in unrealized loss on available-for-sale securities	$ (354,546)	$ 88,504
Recognition of right of use assets and lease liabilities	$ 2,701,253	$ -

NOTE 1 – ORGANIZATION AND NATURE OF BUSINESS

Community Bank of the Bay (the Bank) is a California state chartered bank that commenced banking operations on July 22, 1996. The Bank provides a range of banking services to individuals and businesses in the greater San Francisco Bay area, especially businesses employing residents of low and moderate income neighborhoods. The Bank's primary source of revenue is generated from providing loans to customers who are predominately small and middle market businesses and individuals residing in the surrounding areas.

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The accounting and reporting policies of the Bank conform to accounting principles generally accepted in the United States of America and prevailing practices within the banking industry.

Use of Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions. These estimates and assumptions affect the reported amounts of assets and liabilities at the date of the financial statements and reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

The allowance for loan losses is the most significant accounting estimate reflected in the Bank's financial statements. The allowance for loan losses includes charges to reduce the recorded balances of loans receivable to their estimated net realizable value, as appropriate. The allowance is based on estimates, and ultimate losses may vary from current estimates. These estimates for losses are based on individual assets and their related cash flow forecasts, sales values, independent appraisals, the volatility of certain real estate markets, and concern for disposing of real estate in distressed markets. Although management of the Bank believes the estimates underlying the calculation of specific allowances are reasonable, there can be no assurances that the Bank could ultimately realize these values. In addition to providing valuation allowances on specific assets where a decline in value has been identified, the Bank establishes general valuation allowances for losses based on the overall portfolio composition, general market conditions, concentrations, and prior loss experience.

Other significant management judgments and accounting estimates reflected in the Bank's financial statements include:

- Decisions regarding the timing and placement of loans on non-accrual;
- Determination, recognition, and measurement of impaired loans;
- Determination and evaluation of deferred tax assets and liabilities;
- Determination of the fair value of stock option awards; and
- Determination of the fair value of financial instruments.

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Concentrations of Credit Risk

Assets and liabilities that subject the Bank to concentrations of credit risk consist of loans and deposits. Most of the Bank's customers are located within Alameda and Contra Costa counties and the surrounding areas. The Bank's primary lending products are discussed in Note 5 to the financial statements. The Bank did not have any significant concentrations in its business with any one customer or industry. The Bank obtains what it believes to be sufficient collateral to secure potential losses on loans. The extent and value of collateral varies are based upon the details underlying each loan agreement.

As of December 31, 2019 and 2018, the Bank had cash deposits at other financial institutions in excess of FDIC insured limits. However, as the Bank places these deposits with major financial institutions and monitors the financial condition of these institutions, management believes the risk of loss to be minimal.

Cash and Cash Equivalents

For purposes of the statements of cash flows, the Bank considers cash, due from banks, federal funds sold, and securities purchased under agreements to resell to be cash equivalents. All have original maturities of three months or less.

Interest-Bearing Deposits with Banks

Interest-bearing deposits with banks includes money market accounts and time deposits with original maturities greater than ninety days. These deposits are carried at cost, which approximates fair value.

Available-for-Sale Investment Securities

Available-for-sale securities are reported at fair value, with unrealized gains and losses excluded from earnings and reported, net of taxes, as accumulated other comprehensive income (loss) within shareholders' equity.

Management determines the appropriate classification of its investment securities at the time of purchase and may only change the classification in certain limited circumstances. At December 31, 2019 and 2018, all of the Bank's investments were classified as available-for-sale.

Gains and losses on the sale of investment securities are computed using the specific identification method. Interest earned on investment securities is reported in interest income, net of applicable adjustments for accretion of discounts and amortization of premiums.

Investments with fair values that are less than amortized cost are considered impaired. Impairment may result from either a decline in the financial condition of the issuing entity or, in the case of fixed interest rate investments, from rising interest rates. At each financial statement date, management assesses each investment to determine if impaired investments are temporarily impaired or if the impairment is other than temporary. This assessment includes a determination of whether the Bank intends to sell the security, or if it is more likely than not that the Bank will be required to sell the security before recovery of its amortized cost basis less any current-period credit losses.

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

For debt securities that are considered other than temporarily impaired and that the Bank does not intend to sell and will not be required to sell prior to recovery of the amortized cost basis, the amount of impairment is separated into the amount that is credit related (credit loss component) and the amount due to all other factors. The credit loss component is recognized in earnings and is calculated as the difference between the security's amortized cost basis and the present value of its expected future cash flows. The remaining difference between the security's fair value and the present value of the future expected cash flows is deemed to be due to factors that are not credit related and is recognized in other comprehensive income (loss).

Investment in Federal Home Loan Bank Stock

In order to borrow from the Federal Home Loan Bank (FHLB), the Bank is required to maintain an investment in FHLB capital stock. The investment of $1,715,600 and $1,230,800 at December 31, 2019 and 2018, respectively, is carried at cost, redeemable at par, at the discretion of the FHLB, and included in interest receivable and other assets on the balance sheets. FHLB stock is periodically evaluated for impairment based on ultimate recovery of par value.

Loans and Loan Fees

Loans are reported at their principal outstanding balance net of charge-offs. Loan origination fees and certain direct loan origination costs are deferred and the net amounts are amortized to interest income by a method that approximates a level yield over the contractual life of the underlying loans.

Income Recognition on Loans

Interest on loans, other than discounted installment loans, is credited to income based on the principal amount outstanding on a daily basis. Interest on discounted installment loans is recognized by a method which approximates the effective interest method. Interest accruals are discontinued on certain loans when collection of principal or interest is considered doubtful, or when a loan becomes contractually past due by 90 days or more with respect to interest or principal. When a loan is placed on non-accrual status, all interest previously accrued but not collected is reversed against current period interest income. Income on such loans is then recognized only to the extent that cash is received and where the future collection of principal is probable. Interest accruals are resumed on such loans when, in the judgment of management, the loans are estimated to be fully collectible as to both principal and interest.

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Allowance for Loan Losses

The allowance for loan losses is established through a provision for loan losses charged to operations. The adequacy of the allowance for loan losses is periodically evaluated by the Bank in order to maintain the allowance at a level that, in the opinion of management, is adequate to absorb losses inherent in existing loans. Management's evaluation of the adequacy of the allowance is based on a consideration of the Bank's historical loss experience, known and inherent risks in the loan portfolio, including adverse circumstances that may affect the ability of the borrower to repay interest and/or principal, the estimated value of any underlying collateral, and an analysis of the levels and trends of delinquencies and charge-offs. Actual results could differ from those estimates.

When a loan or portion of a loan is determined to be uncollectible, the portion deemed uncollectible is charged against the allowance and subsequent recoveries, if any, are credited to the allowance.
The allowance consists of specific, general, and unallocated components. The specific component relates to loans that are classified as impaired. Impaired loans, as defined, are measured based on the present value of expected future cash flows discounted at the loan's effective interest rate or the fair value of the collateral, if the loan is collateral dependent. The general component relates to non-impaired loans and is based on historical loss experience adjusted for qualitative factors. An unallocated component may be 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.

A loan is considered impaired if, 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.

Troubled Debt Restructuring

In situations where, for economic or legal reasons related to a borrower's financial difficulties, the Bank grants a concession to the borrower that it would not otherwise consider, the related loan is classified as a troubled debt restructuring. The Bank measures any loss on the troubled debt restructuring in accordance with the guidance concerning impaired loans set forth above. Additionally, loans modified in troubled debt restructurings are generally placed on non-accrual status at the time of restructuring. These loans are returned to accrual status after the borrower demonstrates performance with the modified terms for a sustained period of time (generally six months) and has the capacity to continue to perform in accordance with the modified terms of the restructured debt.

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Loans Held for Sale

The Bank has originated government guarantied loans to customers under the Small Business Administration (SBA) program. The SBA provides guaranties of 75% to 90% of each loan. For some of these loans, the Bank sells the guarantied portion of the loan to a third party and retains the unguarantied portion in its own portfolio. Loans held for sale include government loans and are reported at the lower of cost or fair value. Fair value is based on what secondary markets are currently offering for portfolios with similar characteristics. Gains or losses on the sale of loans that are held for sale are recognized at the time of the sale, subject to the expiration of any warranty or recourse provisions, and determined by the difference between net sale proceeds and the net book value of the loans less the estimated fair value of any retained mortgage servicing rights and estimated discount recognized against the retained portion of the loan.

Servicing Assets

Periodically, the Bank sells loans and retains the servicing rights. The gain or loss on sale of loans depends in part on the previous carrying amount of the financial assets involved in the transfer, allocated between the assets sold and the retained interests based on their relative fair value at the date of transfer. To obtain fair values, quoted market prices are used, if available. However, quotes are generally not available for retained interests, so the Bank generally estimates fair value based on the present value of future expected cash flows using management's best estimates of the key assumptions – credit losses, prepayment speeds, forward yield curves, and discount rates commensurate with the risks involved.

The Bank measures servicing assets initially at fair value and amortizes the servicing rights in proportion to, and over the period of, estimated net servicing revenues. Management assesses servicing rights for impairment as of each financial reporting date. Fair value adjustments that encompass market-driven valuation changes and the runoff in value that occurs from the passage of time are each separately reported. Total servicing assets included in other assets were $310,148 and $387,643 at December 31, 2019 and 2018, respectively. The Bank evaluated the servicing asset for impairment at December 31, 2019 and 2018 and determined that no valuation allowance was needed.

The Bank services loans that have been participated with other financial institutions totaling $26,455,879 and $27,664,826 as of December 31, 2019 and 2018, respectively. Control over these loans was surrendered without recourse and, therefore, the sold balances are not included on the Bank's balance sheets.

Transfers of Financial Assets

Transfers of financial assets 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 rights (free of conditions that prevent it from taking advantage of that right, beyond a more than trivial benefit to the transferor) 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.

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

The Bank sells certain portions of government guarantied loans in the secondary market. These sales are recorded by the Bank when control is surrendered and any warranty period or recourse provision expires. There were no warranty or recourse provisions outstanding at December 31, 2019 for loans previously sold.

Premises and Equipment

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

Leasehold improvements	5 years
Furniture, fixtures, and equipment	3 – 7 years

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

Leases

The Bank enters into leases in the normal course of business, primarily related to office space and bank branches. The Bank's leases have remaining terms ranging from three to six years, some of which include renewal options to extend the lease for up to five years. The Bank's leases do not include residual value guarantees or covenants. The Bank includes lease extension and termination options in the lease term if, after considering relevant economic factors, it is reasonably certain the Bank will exercise the option. In addition, the Bank has elected to account for any non-lease components in its real estate leases as part of the associated lease component. The Bank has also elected not to recognize leases with original lease terms of 12 months or less (short-term leases) on the Bank's balance sheet.

Leases are classified as operating or finance leases at the lease commencement date. Lease expense for operating leases and short-term leases is recognized on a straight-line basis over the lease term. Right-of-use assets represent our right to use an underlying asset for the lease term and lease liabilities represent our obligation to make lease payments arising from the lease. Right-of-use assets and lease liabilities are recognized at the lease commencement date based on the estimated present value of lease payments over the lease term. The Bank uses its incremental borrowing rate at lease commencement to calculate the present value of lease payments when the rate implicit in a lease is not known. The Bank's incremental borrowing rate is based on the FHLB amortizing advance rate, adjusted for the lease term and other factors for similar assets and credit quality.

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Bank-Owned Life Insurance

The Bank has purchased insurance on the lives of Bank executives. The policies accumulate asset values to meet future liabilities including payment of employee benefits such as split dollar life insurance agreements, which provide an insurance benefit to the family of the individual on whom the policy is held.

The cash surrender value of policies is recorded as an asset on the balance sheets. Increases in the cash surrender value are recorded as other non-interest income in the statements of income.

Income Taxes

The Bank uses the asset and liability method to account for income taxes. Under such method, deferred tax assets and liabilities are recognized for the future tax consequences of differences between financial statement carrying amounts of existing assets and liabilities and their respective tax basis (temporary differences). Deferred tax assets and liabilities are reflected at currently enacted income tax rates applicable to the year 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 in the year of enactment.

A valuation allowance is established to the extent that it is more likely than not that the benefits associated with the deferred tax assets will not be fully realized.

The Bank had no unrecognized tax benefits at December 31, 2019 and 2018.

The Bank recognizes interest accrued and penalties related to unrecognized tax benefits in tax expense. During the years ended December 31, 2019 and 2018, the Bank recognized no interest and penalties.

With few exceptions, the Bank is no longer subject to examinations by U.S. federal taxing authorities for years ended before December 31, 2016, and by state authorities for years ended before December 31, 2015.

Comprehensive Income

Comprehensive income includes net income and other comprehensive income (loss). The Bank's primary source of comprehensive income (loss) is unrealized gains and losses on securities available for sale. Reclassification adjustments result from gains or losses on securities that are realized and included in net income of the current period that also had been included in other comprehensive income as unrealized holding gains or losses in the period in which they arose. Total comprehensive income and the components of accumulated other comprehensive income (loss) are presented in the statements of comprehensive income.

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Stock-Based Compensation

The Bank recognizes compensation expense for awards of stock options to employees and directors based on the grant-date fair value of those awards. The fair value of each option granted is estimated on the date of grant using the Black-Scholes options-pricing model. The assumptions used in this model include an estimate of expected volatility, which is based on the historical volatility of the price of similar bank stocks, and an estimate of the expected option term, which is based on consideration of the vesting period and contractual term of the option. In addition, the Bank estimates the number of options expected to be forfeited based on historical forfeiture rates. The risk-free interest rates are equal to the U.S. Treasury yield at the time of the grant and commensurate with the expected term of the grant. Expense is recognized over the vesting period of the options. The Bank's stock compensation plan and related assumptions used in determining the fair value of awards are discussed in Note 13.

Advertising Costs

The Bank expenses advertising costs as they are incurred. Advertising expense was $182,694 and $173,862 for the years ended December 31, 2019 and 2018, respectively.

Net Income per Share

Basic net income per share amounts are computed by dividing net income available to common shareholders by the weighted average number of common shares outstanding during the year. Diluted earnings per share reflects the potential dilution that could occur if securities or other contracts to issue common stock, such as stock options, result in the issuance of common stock which share in the earnings of the Bank. The treasury stock method is applied to determine the dilutive effect of stock options when computing diluted earnings per share. However, dilutive earnings per share amounts are not presented when a net loss occurs because the conversion of potential common stock is anti-dilutive.

Revenue Recognition

Service charges on deposit accounts

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

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Debit and ATM interchange fee income, net

Debit and ATM interchange income represent 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 credit and debit card are recorded on a net basis with the interchange income.

Merchant fee income

Merchant fee income represents fees earned by the Bank for card payment services provided to its merchant customers. The Bank has a contract with a third party to provide card payment services to merchants that contract for those services. The third-party provider passes the payments made by the merchants through to the Bank. The Bank, in turn, pays the third-party provider for the services it provides to the merchants.

Fair Value of Financial Instruments

The Bank utilizes fair value measurements to record fair value adjustments to certain assets and liabilities and to determine fair value disclosures. The Bank groups assets and liabilities at fair value in a three-level valuation hierarchy for disclosure of fair value measurement. The valuation hierarchy is based on the transparency of inputs to the valuation of an asset or liability as of the measurement date.

In general, fair values determined by Level 1 inputs utilize quoted prices (unadjusted) in active markets for identical assets or liabilities that the Bank has the ability to access. Fair values determined by Level 2 inputs utilize inputs other than quoted prices included in Level 1 that are observable for the asset or liability, either directly or indirectly. Level 2 inputs include quoted prices for similar assets and liabilities in active markets, and inputs other than quoted prices that are observable for the asset or liability, such as interest rates and yield curves that are observable at commonly quoted intervals. Level 3 inputs are unobservable inputs for the asset or liability, and include situations where there is little, if any, market activity for the asset or liability.

In certain cases, the inputs used to measure fair value may fall into different levels of the fair value hierarchy. In such cases, the level in the fair value hierarchy within which the fair value measurement in its entirety falls has been determined based on the lowest level input that is significant to the fair value measurement in its entirety. The Bank's assessment of the significance of a particular input to the fair value measurement in its entirety requires judgment, and considers factors specific to the asset or liability. Some fair value measurements, such as available-for-sale securities, are performed on a recurring basis, while others such as other real estate owned and impaired loans are performed on a non-recurring basis.

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Recent Accounting Pronouncements and Adoption of New Accounting Standards

On January 1, 2019, the Bank adopted ASU No 2016-02, Leases (Topic 842). The new standard required lessees and lessors to recognize lease assets and lease liabilities on the balance sheet and disclose key information about leasing arrangements. ASU 2016-02 was effective on January 1, 2019. ASU 2016-02 provides for a modified retrospective transition approach requiring lessees to recognize and measure leases on the balance sheet at the beginning of either the earliest period presented or as of the beginning of the period of adoption with the option to elect certain practical expedients. We have elected to apply ASU 2016-02 as of the beginning of the period of adoption (January 1, 2019) and have not restated comparative periods. We have elected to apply several of the available practical expedients, including:

- Carry-over of historical lease determination and lease classification conclusions.
- Carry-over of historical initial direct cost balances for existing leases.
- Accounting for lease and non-lease components in contracts in which the Bank is a lease as a single lease component.

Our operating leases relate primarily to office space and bank branches As a result of implementing ASU 2016-02, we recognized an operating lease right-of-use asset of $2,450,452 and an operating lease liability of $2,450,542 on January 1, 2019, with no impact on our statement of income or statement of cash flows compared to the prior lease accounting model. These amounts were determined based on the present value of remaining minimum lease payments, discounted using the Bank's incremental borrowing rate as of the date of adoption. The right-of-use asset and operating lease liability are included in other assets and other liabilities, respectively, in the balance sheets. For additional information, see Note 7 – Leases.

In June 2016, the FASB issued ASU No. 2016-13, *Financial Instruments – Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments*. The ASU will require the earlier recognition of credit losses on loans and other financial instruments based on an expected loss model, replacing the incurred loss model that is currently in use. Under the new guidance, an entity will measure all expected credit losses for financial instruments held at the reporting date based on historical experience, current conditions, and reasonable and supportable forecasts. The expected loss model will apply to loans and leases, unfunded lending commitments, held-to-maturity debt securities and other debt instruments measured at amortized cost. The impairment model for available-for-sale debt securities will require the recognition of credit losses through a valuation allowance when fair value is less than amortized cost, regardless of whether the impairment is considered to be other-than-temporary. The FASB has deferred the effective date of this ASU to fiscal years beginning on or after December 15, 2022, including interim periods within those fiscal years for public business entities. The Bank is currently evaluating the impact of this ASU on the financial statements.

Reclassification and Presentation

Certain balances in the 2018 presentation have been reclassified to conform to the 2019 presentation. This reclassification had no impact on net earnings, total assets, total liabilities, or shareholders' equity.

NOTE 3 – CASH AND DUE FROM BANKS

Cash and due from banks includes balances with the Federal Reserve Bank and other correspondent banks. The average reserve requirements are based on a percentage of the Bank's deposit liabilities. In addition, the Federal Reserve Bank requires the Bank to maintain a certain minimum balance at all times. At December 31, 2019 and 2018, the Bank's cash balances were sufficient to comply with this reserve requirement and, therefore, no such reserve balances were required to be held with the Federal Reserve Bank.

NOTE 4 – AVAILABLE-FOR-SALE INVESTMENT SECURITIES

The amortized cost and estimated fair value of available-for-sale securities as of December 31, 2019 are as follows:

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Mortgage-backed securities	$ 9,409,292	$ 139,355	$ (10,037)	$ 9,538,610
CMOs	6,173,958	19,349	(3,811)	6,189,496
	$ 15,583,250	$ 158,704	$ (13,848)	$ 15,728,106

The amortized cost and estimated fair value of available-for-sale securities as of December 31, 2018 are as follows:

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Mortgage-backed securities	$ 10,064,735	$ 15,974	$ (79,744)	$ 10,000,965
Treasuries	3,743,647	-	(2,334)	3,741,313
CMOs	7,306,032	-	(143,586)	7,162,446
	$ 21,114,414	$ 15,974	$ (225,664)	$ 20,904,724

The Bank had no proceeds from the sales of investment securities during the years ended December 31, 2019 and 2018. There were no gross realized gains or losses during 2019 and 2018.

Available-for-sale investment securities with unrealized losses at December 31, 2019 and 2018 are summarized and classified according to the duration of the loss period as follows:

NOTE 4 – AVAILABLE-FOR-SALE INVESTMENT SECURITIES (CONTINUED)

2019

	Less than 12 months		12 months or more		Total	
	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
Mortgage-backed securities	$ 3,242,368	$ (10,037)	$ -	$ -	$ 3,242,368	$ (10,037)
CMOs	519,613	(870)	182,452	(2,941)	702,065	(3,811)
	$ 3,761,981	$ (10,907)	$ 182,452	$ (2,941)	$ 3,944,433	$ (13,848)

2018

	Less than 12 months		12 months or more		Total	
	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
Mortgage-backed securities	$ 292,250	$ (4,395)	$ 4,304,368	$ (75,349)	$ 4,596,618	$ (79,744)
Treasuries	3,741,313	(2,334)	-	-	3,741,313	(2,334)
CMOs	-	-	7,162,446	(143,586)	7,162,446	(143,586)
	$ 4,033,563	$ (6,729)	$ 11,466,814	$ (218,935)	$ 15,500,377	$ (225,664)

Certain investment securities shown above currently have fair values less than amortized cost and, therefore, contain unrealized losses. The Bank does not have the intent to sell the investments that are temporarily impaired, and it is more likely than not that the Bank will not be required to sell those investments before recovery of the amortized cost basis. The Bank has evaluated these securities and has determined that the decline in value is no other than temporary and is related to the change in market interest rates since purchase. The decline in value is not related to any company or industry specific event. These temporary unrealized losses relate principally to current interest rates for similar types of securities. In analyzing an issuer's financial condition, management considers whether the securities are issued by the federal government or its agencies, whether downgrades by bond rating agencies have occurred, and the results of reviews of the issuer's financial condition.

There were 14 and 31 investment securities with unrealized losses at December 31, 2019 and 2018, respectively. The Bank anticipates full recovery of amortized cost with respect to these securities at maturity or sooner in the event of a more favorable market interest rate environment.

The amortized cost and estimated fair value of available-for-sale investment securities at December 31, 2019 by contractual maturity are shown below. Expected maturities will differ from contractual maturities because the issuers of the securities may have the right to call or prepay obligations with or without call or prepayment penalties.

	Amortized Cost	Estimated Fair Value
Due after five years through ten years	$ 15,583,250	$ 15,728,106

NOTE 5 – LOANS AND THE ALLOWANCE FOR LOAN LOSSES

Outstanding loans, by class, are summarized as follows:

	December 31, 2019	December 31, 2018
Commercial	$ 126,928,332	$ 88,532,024
Commercial real estate		
Non-owner occupied	138,696,742	125,725,333
Owner occupied	75,930,614	60,112,871
Construction and land	45,164,478	22,569,217
Consumer and other	16,523,344	19,606,631
	403,243,510	316,546,076
Deferred loan fees and costs, net	(849,040)	(495,552)
Allowance for loan losses	(4,105,843)	(3,399,863)
	$ 398,288,627	$ 312,650,661

Salaries and employee benefits totaling $765,151 and $730,233 have been deferred as loan origination costs for the years ended December 31, 2019 and 2018, respectively.

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

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

NOTE 5 – LOANS AND THE ALLOWANCE FOR LOAN LOSSES (CONTINUED)

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

With respect to loans to developers and builders that are secured by non-owner occupied properties that the Bank may originate from time to time, the Bank generally requires the borrower to have had an existing relationship with the Bank and have a proven record of success. Construction loans are underwritten utilizing feasibility studies, independent appraisal reviews, sensitivity analysis of absorption and lease rates, and financial analysis of the developers and property owners. Construction loans are generally based upon estimates of costs and value associated with the completed project. These estimates may be inaccurate. Construction loans often involve the disbursement of substantial funds with repayment substantially dependent on the success of the ultimate project.

Sources of repayment for these types of loans may be pre-committed permanent loans from approved long-term lenders, sales of developed property, or an interim loan commitment from the Bank until permanent financing is obtained. These loans are closely monitored by on-site inspections and are considered to have higher risks than other real estate loans due to their ultimate repayment being sensitive to interest rate changes, governmental regulation of real property, general economic conditions, and the availability of long-term financing.

Consumer loans primarily consist of home equity lines of credit and loans and other personal loans. The Bank originates consumer loans utilizing credit history information, debt-to-income ratio, and loan-to-value ratio analysis. The Bank also evaluates the consumer's liquid assets and their ability to supplement cash flow for debt payment. To monitor and manage consumer loan risk, policies and procedures are developed and modified, as needed. This activity, coupled with relatively small loan amounts that are spread across many individual borrowers, minimizes risk. Underwriting standards for home equity loans include, but are not limited to, a maximum loan-to-value percentage of 80%, collection remedies, the number of such loans a borrower can have at one time, and documentation requirements. Personal loans are nearly evenly split between mobile home loans along with a small number of direct auto loans and installment loans. Personal unsecured loans are offered to consumers with additional underwriting procedures in place, including net worth and borrower's verified liquid assets analysis. In general, personal loans usually have a higher degree of risk than other types of loans.

NOTE 5 – LOANS AND THE ALLOWANCE FOR LOAN LOSSES (CONTINUED)

The Bank utilizes an independent third party loan review consultant to review and validate the credit risk program on a periodic basis. Results of these reviews are presented to management and the Bank's Board of Directors. The loan review process complements and reinforces the risk identification and assessment decisions made by lenders and credit personnel, as well as the Bank's policies and procedures.

The following tables summarizes the credit quality indicators related to the Bank's loans, by class, as of December 31, 2019 and 2018:

December 31, 2019	Pass	Special Mention	Substandard	Doubtful	Totals
Commercial	$ 125,883,780	$ 454,839	$ 589,713	$ -	$ 126,928,332
Commercial real estate					
Non-owner occupied	135,337,163	3,359,579		-	138,696,742
Owner occupied	74,100,232	1,830,382		-	75,930,614
Construction and land	43,714,478		1,450,000	-	45,164,478
Consumer and other	16,523,344	-	-	-	16,523,344
Total	$ 395,558,997	$ 5,644,800	$ 2,039,713	$ -	$ 403,243,510

December 31, 2018	Pass	Special Mention	Substandard	Doubtful	Totals
Commercial	$ 86,255,026	$ 572,748	$ 1,704,250	$ -	$ 88,532,024
Commercial real estate					
Non-owner occupied	125,725,333	-	-	-	125,725,333
Owner occupied	57,909,951	-	2,202,920	-	60,112,871
Construction and land	19,732,237	-	2,836,980	-	22,569,217
Consumer and other	19,606,631			-	19,606,631
Total	$ 309,229,178	$ 572,748	$ 6,744,150	$ -	$ 316,546,076

NOTE 5 – LOANS AND THE ALLOWANCE FOR LOAN LOSSES (CONTINUED)

As a part of the on-going monitoring of the credit quality of the Bank's loan portfolio, management monitors certain credit quality indicators including trends related to risk grade classifications, concentrations, net charge-offs, non-performing loans, and general economic conditions.

The Bank uses a risk grading system to assign a risk grade to each of its loans. Loans are graded on a scale of 1 to 9, with grades 1 to 5 being termed pass loans and grades 6, 7, 8, and 9 being termed special mention, substandard, doubtful, and loss, respectively. A description of the general characteristics of the nine grades is as follows:

Pass (grades 1-5) **–** These loans generally conform to the Bank's underwriting criteria and evidence an acceptable level of credit risk.

Special Mention (grade 6) **–** These loans have weaknesses that require management's close attention. These weaknesses expose the Bank to a sufficient degree of risk to warrant classification. If left uncorrected, these weaknesses will result in deterioration of the loan's repayment prospects or the borrower's credit position at a future date. Loans in this category are currently protected, but are potentially weak. The loans may (particularly in the short term) constitute a greater than average credit risk, but do not presently expose the Bank to a sufficient degree of risk to warrant adverse classification. This is a temporary classification pending identification of improvement or deterioration in the criticized asset.

Substandard (grade 7) **–** Substandard loans are inadequately protected by the current net worth and financial capacity of the borrower or the collateral pledged, if any. Loans so classified have a well-defined weakness or weaknesses that jeopardize the liquidation of the debt. They are characterized by the distinct possibility that the Bank will sustain some loss if the deficiencies are not corrected. Loss potential, while existing in the aggregate amount of substandard loans, does not have to exist in individual loans classified substandard.

Doubtful (grade 8) **–** Loans classified doubtful have all the weaknesses inherent in those classified as substandard with the added characteristic that the weaknesses make collection in full, on the basis of currently existing facts, conditions, and values, highly questionable and improbable. The probability of loss is extremely high but because of certain important and reasonably specific pending factors which may work to strengthen (or weaken) the loan, its classification as an estimated loss is deferred until its more exact status may be determined. Pending factors that may necessitate a doubtful classification include bankruptcy or liquidation procedures, capital injection, or perfecting liens on additional collateral refinancing plans. The Bank considers doubtful to be a temporary classification and will only classify an asset, or portion of an asset, as such when information is not available to conclude as to classification or more clearly define the potential for loss.

Loss (grade 9) **–** Assets classified loss are considered uncollectible and of such little value that their continuance as assets is not warranted. This classification does not mean that an asset has absolutely no recovery or salvage value, but rather that it is not practical or desirable to defer writing off a basically worthless asset even though partial recovery may be affected in the future. Losses are taken in the period in which they are identified as uncollectible.

NOTE 5 – LOANS AND THE ALLOWANCE FOR LOAN LOSSES (CONTINUED)

Age Analysis of Past Due Loans

The age analysis of past due loans by class as of December 31, 2019 consisted of the following:

	30-59 Days Past Due	60-89 days Past Due	Greater Than 90 Days	Total Past Due	Current	Total Loans	Recorded Investment > 90 days and Accruing
Commercial	$ -	$ -	$ 93,006	$ 93,006	$126,835,326	$ 126,928,332	$ -
Commercial real estate							
Non-owner occupied	-	-	-	-	138,696,742	138,696,742	-
Owner occupied	-	-	-	-	75,930,614	75,930,614	-
Construction and land	-	-	-	-	45,164,478	45,164,478	-
Consumer and other	-	-	-	-	16,523,344	16,523,344	-
Total	$ -	$ -	$ 93,006	$ 93,006	$403,150,504	$ 403,243,510	$ -

The age analysis of past due loans by class as of December 31, 2018 consisted of the following:

	30-59 Days Past Due	60-89 Days Past Due	Greater Than 90 Days	Total Past Due	Current	Total Loans	Recorded Investment > 90 Days and Accruing
Commercial	$ 948,513	$ -	$453,695	$ 1,402,208	$ 87,129,816	$ 88,532,024	$ -
Commercial real estate							
Non-owner occupied	-	-	-	-	125,725,333	125,725,333	-
Owner occupied	-	-	-	-	60,112,871	60,112,871	-
Construction and land	-	-	-	-	22,569,217	22,569,217	-
Consumer and other	-	-	300,000	300,000	19,306,631	19,606,631	-
Total	$ 948,513	$ -	$753,695	$ 1,702,208	$314,843,868	$ 316,546,076	$ -

NOTE 5 – LOANS AND THE ALLOWANCE FOR LOAN LOSSES (CONTINUED)

Information related to impaired loans by class as of December 31, 2019 and for the year then ended consisted of the following:

	Commercial	Commercial Real Estate Non-Owner Occupied	Commercial Real Estate Owner Occupied	Construction and Land	Consumer and other	Total
Recorded investment in impaired loans:						
With no specific allowance recorded	$ 92,938	$ -	$ -	$ -	$ 565,879	$ 658,817
With a specific allowance recorded	68	-	-	-	-	68
Total recorded investment in impaired loans	$ 93,006	$ -	$ -	$ -	$ 565,879	$ 658,885
Unpaid principal balance of impaired loans:						
With no specific allowance recorded	$ 240,868	$ -	$ -	$ -	$ 565,879	$ 806,747
With a specific allowance recorded	194	-	-	-	-	194
Total unpaid principal balance of impaired loans	$ 241,062	$ -	$ -	$ -	$ 565,879	$ 806,941
Specific allowance	$ 68	$ -	$ -	$ -	$ -	$ 68
Average recorded investment in impaired loans during the year	$ 275,112	$ -	$ -	$ -	$ 631,619	$ 906,731
Interest income recognized in impaired loans during the year	$ 148,055	$ -	$ -	$ -	$ 65,470	$ 213,525

Information related to impaired loans by class as of December 31, 2018 and for the year then ended consisted of the following:

	Commercial	Commercial Real Estate Non-Owner Occupied	Commercial Real Estate Owner Occupied	Construction and Land	Consumer and other	Total
Recorded investment in impaired loans:						
With no specific allowance recorded	$ 261,692	$ -	$ -	$ -	$ 593,825	$ 855,517
With a specific allowance recorded	266,905	-	-	-	-	266,905
Total recorded investment in impaired loans	$ 528,597	$ -	$ -	$ -	$ 593,825	$ 1,122,422
Unpaid principal balance of impaired loans:						
With no specific allowance recorded	$ 303,179	$ -	$ -	$ -	$ 668,737	$ 971,916
With a specific allowance recorded	329,072	-	-	-	-	329,072
Total unpaid principal balance of impaired loans	$ 632,251	$ -	$ -	$ -	$ 668,737	$ 1,300,988
Specific allowance	$ 11,688	$ -	$ -	$ -	$ -	$ 11,688
Average recorded investment in impaired loans during the year	$ 623,944	$ -	$ -	$ -	$ 606,723	$ 1,230,667
Interest income recognized in impaired loans during the year	$ 177,533	$ -	$ -	$ -	$ 74,913	$ 252,446

NOTE 5 – LOANS AND THE ALLOWANCE FOR LOAN LOSSES (CONTINUED)

Year-end non-accrual loans, segregated by class, are as follows:

	December 31, 2019	December 31, 2018
Commercial	$ 93,006	$ 528,597
Commercial real estate		
Non-owner occupied	-	-
Owner occupied	-	-
Construction and land	-	-
Consumer and other	-	593,825
	$ 93,006	$ 1,122,422

Changes in the allowance for loan losses, by class, for the year ended December 31, 2019 were as follows:

	Commercial	Commercial Real Estate	Construction and Land	Consumer and other	Unallocated	Total
Allowance for credit losses						
Beginning balance	$ 634,295	$ 1,908,841	$ 276,769	$ 94,485	$ 485,473	$ 3,399,863
Charge-offs	(1,082)	-	-	-	-	(1,082)
Recoveries	107,062	-	-	-	-	107,062
Provision (benefit)	134,005	234,465	88,996	(12,335)	154,869	600,000
Ending balance	$ 874,280	$ 2,143,306	$ 365,765	$ 82,150	$ 640,342	$ 4,105,843
Period-end amount allocated to:						
Loans individually evaluated for impairment	$ 68	$ -	$ -	$ -	$ -	$ 68
Loans collectively evaluated for impairment	874,212	2,143,306	365,765	82,150	640,342	4,105,775
Ending balance	$ 874,280	$ 2,143,306	$ 365,765	$ 82,150	$ 640,342	$ 4,105,843
Loans						
Individually evaluated for impairment	$ 93,006	$ -	$ -	$ 565,879	$ -	$ 658,885
Collectively evaluated for impairment	126,835,326	214,627,356	45,164,478	15,957,465	-	402,584,625
Ending balance	$ 126,928,332	$ 214,627,356	$ 45,164,478	$ 16,523,344	$ -	$403,243,510

NOTE 5 – LOANS AND THE ALLOWANCE FOR LOAN LOSSES (CONTINUED)

Changes in the allowance for loan losses, by class, for the year ended December 31, 2018 were as follows:

	Commercial	Commercial Real Estate	Construction and Land	Consumer and other	Unallocated	Total
Allowance for credit losses						
Beginning balance	$ 1,276,658	$ 1,338,822	$ 672,983	$ 185,355	$ -	$ 3,473,818
Charge-offs	(634,877)	-	-	-	-	(634,877)
Recoveries	253,813	7,109	-	-	-	260,922
Provision (benefit)	(261,299)	562,910	(396,214)	(90,870)	485,473	300,000
Ending balance	$ 634,295	$ 1,908,841	$ 276,769	$ 94,485	$ 485,473	$ 3,399,863
Period-end amount allocated to:						
Loans individually evaluated for impairment	$ 11,668	$ -	$ -	$ -	$ -	$ 11,668
Loans collectively evaluated for impairment	622,627	1,908,841	276,769	94,485	485,473	3,388,195
Ending balance	$ 634,295	$ 1,908,841	$ 276,769	$ 94,485	$ 485,473	$ 3,399,863
Loans						
Individually evaluated for impairment	$ 528,597	$ -	$ -	$ 593,825	$ -	$ 1,122,422
Collectively evaluated for impairment	88,003,427	185,838,204	22,569,217	19,012,806	-	315,423,654
Ending balance	$ 88,532,024	$ 185,838,204	$ 22,569,217	$ 19,606,631	$ -	$316,546,076

NOTE 5 – LOANS AND THE ALLOWANCE FOR LOAN LOSSES (CONTINUED)

The following table summarizes loans to customers whose loan terms were modified in troubled debt restructurings during the years ended December 31, 2019 and 2018:

	December 31, 2019		
	Number of Contracts	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment
Troubled Debt Restructurings			
Commercial	2	$ 136,931	$ 136,931
	2	$ 136,931	$ 136,931

	December 31, 2018		
	Number of Contracts	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment
Troubled Debt Restructurings			
Commercial	2	$ 137,699	$ 137,699
	2	$ 137,699	$ 137,699

During 2019 and 2018, there were two loans that were modified and considered troubled debt restructurings because specific interest rate concessions or payment term concessions were granted to the borrower. The Bank had no obligations to lend additional funds on the restructured loans as of December 31, 2019 and 2018.

Interest recognized for cash payments received on non-accrual loans was not significant for the years ended December 31, 2019 and 2018. At December 31, 2019 and 2018, there were no loans over 90 days past due that were still accruing interest.

There were no troubled debt restructurings in 2019 and 2018 that subsequently defaulted.

NOTE 6 – PREMISES AND EQUIPMENT

Premises and equipment consisted of the following:

	December 31, 2019	December 31, 2018
Leasehold improvements	$ 430,531	$ 398,054
Furniture, fixtures, and equipment	1,963,671	767,025
	2,394,202	1,165,079
Less accumulated depreciation and amortization	(960,560)	(822,747)
	$ 1,433,642	$ 342,332

Depreciation and amortization included in occupancy and equipment expense totaled $137,813 and $127,570 for the years ended December 31, 2019 and 2018, respectively.

NOTE 7 – LEASES

The Bank leases certain facilities where it conducts its operations on a month-to-month basis. The Bank has entered into term leases for its Danville, San Mateo, and Oakland locations. The Bank is responsible for common area maintenance, taxes, and insurance to the extent these exceed the base year amounts. The leases expire between February 2023 and November 2026.

Right-of-use assets and lease liabilities are $2,701,253 and $2,701,253, respectively, as of December 31, 2019 and are considered operating leases and are included in other assets and other liabilities, respectively. The Bank had no finance leases or short-term leases as of December 31, 2019.

The right-of-use asset represents our right to use an underlying asset during the lease term. Operating lease liabilities represent our obligation to make lease payments arising from the lease. Right-of-use assets and operating lease liabilities are recognized based on the present value of the remaining lease payments using a discount rate that represents our incremental borrowing rate at the date of implementation of the new accounting standard.

Our operating leases have one 5-year extension option at the then fair market value. As these extension options are not reasonably certain of exercise, they are not included in the lease term.

The minimum rental payments shown below are given for the existing lease obligations and are not a forecast of future rental expense. The Bank recognized rent expense of $781,724 and $633,906 for the years ended December 31, 2019 and 2018, respectively. Rent expense is included in Occupancy and Equipment expense on the Statements of Income.

NOTE 7 – LEASES (CONTINUED)

Additional information regarding our operating leases is summarized below for the year ended December 31, 2019:

Cash paid for amounts included in the measurement of lease liabilities for operating leases	$ 486,237
Right-of-use assets obtained in exchange for lease liabilities	$ 2,701,253
Weighted average remaining lease term in months	59
Weighted average discount rate	2.60%

Future undiscounted lease payments for operating leases with initial terms of one year or more as of December 31, 2019 are as follows:

	Payments
2020	$ 600,727
2021	627,154
2022	644,836
2023	564,032
2024	265,363
2025	122,606
Thereafter	114,446
Total undiscounted lease payments	2,939,164
Less: imputed interest	(237,911)
Net Lease Liabilities	$ 2,701,253

NOTE 8 – INTEREST-BEARING DEPOSITS

Interest-bearing deposits consisted of the following:

	December 31,	
	2019	2018
NOW accounts	$ 22,359,302	$ 26,530,479
Money market	157,524,835	130,732,546
Savings	4,897,963	3,671,626
Time, under $250,000	27,504,507	14,676,654
Time, $250,000 or more	53,216,985	46,831,347
	$ 265,503,592	$ 222,442,652

Aggregate annual maturities of time deposits are as follows:

Years Ending December 31,	
2020	$ 72,665,055
2021	3,719,577
2022	3,192,771
2023	422,629
2024	721,460
	$ 80,721,492

Interest expense related to interest-bearing deposits consisted of the following:

	Years Ended December 31,	
	2019	2018
NOW accounts	$ 20,486	$ 26,199
Money market	1,802,703	1,258,702
Savings	6,771	3,908
Time	1,512,190	663,249
	$ 3,342,150	$ 1,952,058

NOTE 9 – FHLB ADVANCES AND LINES OF CREDIT

FHLB Advances

During 2006, the Bank entered into an arrangement with the FHLB under which it may borrow, on either a short-term or long-term basis, up to 25% of its assets provided that adequate collateral has been pledged. No investment securities were pledged at December 31, 2019 or 2018, respectively. Loans with an unpaid principal balance of $166,793,901 and $103,179,462 were pledged at December 31, 2019 and 2018, respectively. Collateralized borrowing capacity at the FHLB was $92,734,905 and $56,790,008 as of December 31, 2019 and 2018, respectively.

The Bank utilized $16,500,000 and $10,900,000 of its collateralized borrowing capacity for Letters of Credit at December 31, 2019 and 2018, respectively, and had $34,500,000 and $15,000,000 long term outstanding borrowings from the FHLB as of December 31, 2019 and 2018, respectively. Net remaining borrowing capacity at the FHLB was $41,734,905 and $30,890,008 as of December 31, 2019 and 2018, respectively.

Annual maturities and interest rates of FHLB advances are as follows:

Years Ending December 31,	Rate(%)	Current Par ($)
2020	2.4475	$ 2,000,000
2021	2.0453	9,000,000
2022	2.6680	4,000,000
2023	2.0400	9,500,000
2024	2.0700	10,000,000
		$ 34,500,000

Lines of Credit

The Bank has three unsecured available lines of credit totaling $16,500,000 with three of its correspondent banks. There were no borrowings outstanding under these arrangements at December 31, 2019 and 2018, respectively.

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NOTE 10 – INCOME TAXES

Income tax expense for the years ended December 31, 2019 and 2018, consists of the following:

	2019	2018
Current		
Federal	$ 1,396,354	$ 947,522
State	797,633	487,464
	2,193,987	1,434,986
Deferred		
Federal	(205,956)	(71,260)
State	(108,520)	(29,113)
	(314,476)	(100,373)
Income tax expense	$ 1,879,511	$ 1,334,613

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

	2019		2018	
	Amount	Percent	Amount	Percent
Tax at statutory rate	$ 1,249,946	21%	$ 873,922	21%
State income tax	528,794	9%	362,098	9%
Change in federal tax rate	6,750	0%	-	0%
Bank owned life insurance	(24,502)	-1%	(24,297)	-1%
Equity compensation	49,004	1%	37,019	1%
Other	69,519	1%	85,871	1%
	$ 1,879,511	31%	$ 1,334,613	31%

NOTE 10 – INCOME TAXES (CONTINUED)

Deferred tax assets (liabilities) are comprised of the following:

		2019		2018
Deferred tax assets				
Net operating loss carryforwards	$	56,551	$	71,575
Allowance for loan losses		1,096,285		918,903
Right-to-use lease liability		798,588		-
Unrealized losses on available-for-sale investment securities		-		61,992
Nonaccrual loan interest		108,182		28,913
Non-qualified stock options		296,445		267,129
State income tax		150,446		100,896
Other		82,065		81,304
Total deferred tax assets		2,588,562		1,530,712
Deferred tax liabilities				
Depreciation on premises and equipment		(28,917)		(24,767)
Unrealized gains on available-for-sale investment securities		(42,825)		-
Deferred loan costs		(261,235)		(259,064)
Right-to-use lease asset		(798,588)		-
Other		(14,499)		(14,499)
		(1,146,064)		(298,330)
Net deferred income tax asset	$	1,442,498	$	1,232,382

The tax benefit of net operating losses, temporary differences, and credit carryforwards are recorded as an asset to the extent that management assesses that realization is "more likely than not." Realization of the future tax benefits is dependent on the Bank's ability to generate sufficient taxable income within the carryforward period. During the years ended December 31, 2019 and 2018, the valuation allowance remained at $0.

The Bank has usable net operating loss carryforwards of approximately $269,291 for federal tax purposes that begin to expire in 2025. The Tax Reform Act of 1986 and the California Conformity Act of 1987 imposes substantial restrictions on the utilization of net operating loss carryforwards when an "ownership change," as defined in the Internal Revenue Code, has occurred. Some of the Bank's federal and state net operating losses have each been limited to usage of approximately $71,500 annually due to ownership changes.

NOTE 11 – RELATED PARTY TRANSACTIONS

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

The Bank's related party loans are summarized below:

	December 31,			
		2019		2018
Aggregate amount outstanding, beginning of year	$	2,200,000	$	77,896
New loans, advances, or additions during year		3,886,861		3,200,000
Repayments during year		(1,912,403)		(1,077,896)
Aggregate amount outstanding, end of year	$	4,174,458	$	2,200,000
Unused loan commitments	$	1,400,000	$	3,500,000

Related party deposits amounted to $13,309,688 and $7,946,360 as of December 31, 2019 and 2018, respectively.

NOTE 12 – COMMITMENTS AND CONTINGENCIES

Financial Instruments with Off-Balance-Sheet Risk

The Bank is a party to financial instruments with off-balance-sheet risk in the normal course of business in order to meet the financing needs of its customers and to reduce its own exposure to fluctuations in interest rates. These financial instruments consist of commitments to extend credit and standby letters of credit. These instruments involve, to varying degrees, elements of credit and interest rate risk in excess of the amount recognized in the balance sheets.

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

At December 31, 2019 and 2018, the Bank had commitments to extend credit of approximately $74,338,783 and $54,199,891, respectively. There were $628,300 in standby letters of credit issued at December 31, 2019 and 2018, respectively.

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Since some of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. The Bank evaluates each customer's creditworthiness on a case-by-case basis.

NOTE 12 – COMMITMENTS AND CONTINGENCIES (CONTINUED)

The amount of collateral obtained, if deemed necessary by the Bank upon extension of credit, is based on management's credit evaluation of the borrower. Collateral held varies, but may include accounts receivable, inventory, and deeds of trust on residential real estate and income-producing commercial properties.

Standby Letters of Credit

Standby letters of credit are conditional commitments issued by the Bank to guarantee the performance or financial obligation of a customer to a third party. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loans to customers.

Contingencies

The Bank is subject to legal proceedings and claims that arise in the ordinary course of business. In the opinion of management, the amount of ultimate liability with respect to such actions will not materially affect the financial position or results of operations of the Bank.

NOTE 13 – SHAREHOLDERS' EQUITY

Preferred Stock

In January 2009, the Bank issued 1,747 shares of Series a, fixed rate non-cumulative perpetual preferred stock to the U.S. Treasury as part of the Treasury's Capital Purchase Program (CPP). The non-cumulative preferred stock was carried at liquidation value of $1,000 per share, must be redeemed after ten years, and carried a fixed dividend rate of 5% with dividends payable quarterly. In September 2010, the Bank redeemed 1,747 shares of Series A preferred stock and issued 4,060 shares of Series A-1, fixed rate non-cumulative perpetual preferred stock issued as part of the Treasury's Community Development Capital Initiative (CDCI). The newly issued shares carried an initial fixed dividend rate of 2% increasing to 9% after eight years, with dividends payable quarterly. In October, 2018, the Bank redeemed the 4,060 shares of Series A-1 preferred stock. As of December 31, 2019 and 2018, the Bank had no shares of preferred stock issued and outstanding.

The Bank paid dividends totaling $0 and $71,726, respectively, during each of the years ended December 31, 2019 and 2018, after receiving approval from the Department of Business Oversight (DBO) and their shareholders.

Stock Issuance

In June 2019 and October 2018, the Bank completed private placements to institutions and accredited investors of 444,256 and 1,533,333 shares of Series A common stock resulting in proceeds to the Bank, net of offering costs, of $3,308,245 and $10,928,562, respectively.

NOTE 13 – SHAREHOLDERS' EQUITY (CONTINUED)

Dividend Restrictions

Upon declaration by the Board of Directors, all shareholders of record will be entitled to receive dividends. The California Financial Code provides that, unless the Bank receives prior approval from the California Commissioner of Financial Institutions, the total amount of dividend payments a California state-chartered bank can make in any calendar year cannot exceed the lesser of: (1) the Bank's retained earnings or (2) the Bank's net income for its last three fiscal years, less distributions made to shareholders during the same three-year period. As discussed above, the Bank received approval from the DBO to make dividend payments on the Series A-1 preferred stock during 2018.

Earnings per Share

Earnings per share (EPS) is calculated based on the weighted average common shares outstanding during the period. Basic EPS excludes dilution and is calculated by dividing net income available to common shareholders by the weighted average common shares outstanding. Diluted EPS reflects the potential dilution that could occur if securities or other contracts to issue common stock were exercised or converted into common stock.

	Year Ended December 31, 2019		
	Income (Numerator)	Shares (Denominator)	Per-Share Amount
Basic EPS:			
Net income available to common shareholders	$ 4,072,616	8,484,383	$ 0.48
Effect of dilutive securities:			
Stock options		343,486	
Diluted EPS:			
Net income available to common shareholders plus assumed conversions	$ 4,072,616	8,827,869	$ 0.46

	Year Ended December 31, 2018		
	Income (Numerator)	Shares (Denominator)	Per-Share Amount
Basic EPS:			
Net income available to common shareholders	$ 2,755,195	6,908,057	$ 0.40
Effect of dilutive securities:			
Stock options		359,179	
Diluted EPS:			
Net income available to common shareholders plus assumed conversions	$ 2,755,195	7,267,236	$ 0.38

NOTE 13 – SHAREHOLDERS' EQUITY (CONTINUED)

Stock Option Plan

The Bank's 2001 Stock Option Plan expired during 2011. The Bank has option grants still outstanding under that Plan. During 2012, the Board of Directors and shareholders approved the adoption of the Community Bank of the Bay 2012 Stock Option Plan. The plan includes both non-statutory stock options, which may be granted to directors, employees, and consultants, and incentive stock options, which may be granted to employees. The price of non-statutory and incentive stock options may not be less than 100%, respectively, of the fair market value of the common stock on the date of the grant.

However, if an individual at the time of the grant owns stock representing more than 10% of the voting rights of all classes of the stock, then the price of the stock options may not be less than 110% of the fair market value of the common stock on the date of the grant. The term of stock options is determined by the Board of Directors, but may not exceed ten years from the date of the grant unless, in the case of an incentive stock option, an individual at the time of grant owns stock representing more than 10% of the voting rights of all classes of the stock, then the maximum term is five years. Shares of the Bank's common stock reserved under this plan amounted to 1,236,572 and 1,324,338 as of December 31, 2019 and 2018, respectively.

The fair value of each option granted is estimated on the date of grant using the Black-Scholes options-pricing model with the following weighted-average assumptions used for grants in 2019 and 2018, respectively: no expected dividends; expected volatility between 52.75% and 54.87% in 2019 and 30.42% and 54.67% in 2018; risk-free interest rates between 2.04% and 2.36% in 2019 and 2.63% and 2.96% in 2018; and expected options term of ten years.

The following table summarizes information about stock options outstanding at December 31, 2019:

	Shares	Weighted Average Exercise Price
Outstanding at beginning of period	1,195,039	$ 4.55
Granted	60,000	$ 7.50
Exercised	(82,416)	$ 3.77
Forfeited / canceled / expired	(30,881)	$ 6.61
Outstanding at end of period	1,141,742	$ 4.82

NOTE 13 – SHAREHOLDERS' EQUITY (CONTINUED)

The following table summarizes information about stock options outstanding at December 31, 2018:

	Shares	Weighted Average Exercise Price
Outstanding at beginning of period	995,691	$ 3.94
Granted	480,500	$ 6.66
Exercised	(14,802)	$ 3.84
Forfeited / canceled / expired	(266,350)	$ 5.65
Outstanding at end of period	1,195,039	$ 4.55

The Bank recognized $449,357 and $357,748 in stock option expense for the years ended December 31, 2019 and 2018, respectively. There is approximately $861,978 and $1,103,479 in unrecognized compensation cost remaining as of December 31, 2019 and 2018, respectively, which is expected to be recognized over a weighted-average period of 3.26 years and 3.67 years, respectively.

The Bank had 537,918 and 566,302 incentive stock options and 603,824 and 628,737 non-statutory stock options outstanding as of December 31, 2019 and 2018, respectively.

A summary of options outstanding follows:

	Year Ended December 31, 2019	Year Ended December 31, 2018
Weighted-average fair value of options granted during the year	$ 4.91	$ 3.35
Intrinsic value of options exercised	$ 260,471	$ 50,462
Options exercisable at year end	836,248	783,070
Weighted-average exercise price	$ 4.13	$ 3.80
Intrinsic value	$ 2,579,792	$ 2,347,579
Weighted-average remaining contractual life	4.08 Years	4.31 Years
Options outstanding at year end	1,141,742	1,195,039
Weighted-average exercise price	$ 4.82	$ 4.66
Intrinsic value	$ 2,766,793	$ 2,622,783
Weighted-average remaining contractual life	5.22 Years	5.87 Years

NOTE 14 – REGULATORY MATTERS

The Bank is subject to various regulatory capital requirements administered by the FDIC. Failure to meet these minimum capital requirements can initiate certain mandatory – and possibly additional discretionary – actions by regulators that, if undertaken, could have a direct material effect on the Bank's financial statements. Under capital adequacy guidelines and the regulatory framework for Prompt Corrective Action (PCA), the Bank must meet specific capital guidelines that involve quantitative measures of the Bank's assets, liabilities, and certain off-balance-sheet items as calculated under regulatory accounting practices. The Bank's capital amounts and 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 of Common Equity Tier 1, Total, and Tier 1 capital to risk-weighted assets, and of Tier 1 capital to average assets. Each of these components is defined in the regulations. Management believes that the Bank met all capital adequacy requirements as of December 31, 2019 and 2018.

To be categorized as well-capitalized, the Bank must maintain minimum total risk-based, Tier 1 risk-based, and Tier 1 leverage ratios as set forth in the following table:

	Actual		For Capital Adequacy Purposes		To be well Capitalized under PCA	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
December 31, 2019:						
Common equity Tier 1						
(to risk-weighted assets)	$ 55,655,000	13.62%	$ 18,382,950	≥ 4.5%	$ 24,510,600	≥ 6.5%
Total risk-based capital						
(to risk-weighted assets)	$ 59,842,000	14.65%	$ 32,680,800	≥ 8.0%	$ 40,851,000	≥ 10.0%
Tier 1 capital						
(to risk-weighted assets)	$ 55,655,000	13.62%	$ 16,340,400	≥ 4.0%	$ 24,510,600	≥ 6.0%
Tier 1 capital						
(to average assets)	$ 55,655,000	11.57%	$ 19,255,160	≥ 4.0%	$ 24,068,950	≥ 5.0%
December 31, 2018:						
Common equity Tier 1						
(to risk-weighted assets)	$ 47,435,000	14.04%	$ 15,199,965	≥ 4.5%	$ 20,266,620	≥ 6.5%
Total risk-based capital						
(to risk-weighted assets)	$ 50,917,000	15.07%	$ 27,022,160	≥ 8.0%	$ 33,777,700	≥ 10.0%
Tier 1 capital						
(to risk-weighted assets)	$ 47,435,000	14.04%	$ 13,511,080	≥ 4.0%	$ 20,266,620	≥ 6.0%
Tier 1 capital						
(to average assets)	$ 47,435,000	12.06%	$ 15,746,840	≥ 4.0%	$ 19,683,550	≥ 5.0%

NOTE 15 – GOVERNMENT GRANT

The Bank was awarded $245,547 and $466,681, respectively, in 2019 and 2018, by the United States Treasury Department in recognition of its community development activities under the Bank Enterprise Award Program (the BEA). Management believes that the Bank has complied, in all material aspects, with all of the covenants and requirements under the BEA agreement and that it is not, and has not been, in default with any of the terms, requirements, or minimum levels of qualified activities of such agreement.

NOTE 16 – NON-INTEREST INCOME AND REVENUE FROM CONTRACTS WITH CUSTOMERS

All of the Bank's revenue from contracts with customers within the scope of ASC 606 is recognized in non-interest income. Revenues that fall within the scope of ASC 606 include service charges and fee income and revenue from various sources included in other income. Certain non-interest income streams such as BEA awards and fees associated with SBA servicing rights are not within the scope of the new guidance.

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 on a monthly basis. The performance obligation is satisfied, and the fees are recognized on a monthly basis as the service period is completed. Transaction-based fees on deposit accounts are charged to deposit customers for specific services provided to the customer, such as non-sufficient funds fees, overdraft fees, and wire fees. The performance obligation is completed as the transaction occurs, and the fees are recognized at the time each specific service is provided to the customer. Premiums on the sale of loans are recognized when the loan is sold, and performance obligation is complete. Other income includes income from various sources and is recognized when the performance obligation is complete.

Non-interest income consisted of the following for the years ended December 31:

	2019	2018
Service charges and fee income	$ 203,181	$ 229,538
BEA awards	245,547	466,681
Premiums on sale of loans	-	445,881
Change in cash surrender value of BOLI	116,676	115,699
Loan document and packaging fees	112,582	113,850
SBA servicing income	91,485	105,238
Other	198,989	123,608
Total non-interest income	$ 968,460	$ 1,600,495

NOTE 17 – OTHER EXPENSES

Other expenses consisted of the following for the years ended December 31:

	2019	2018
Professional fees	$ 845,423	$ 628,002
Data processing	574,501	476,602
Sundry losses	19,861	326,407
Loan related expenses	401,551	237,828
Advertising	182,694	173,862
Title company deposit expenses	182,704	157,409
Donations	69,850	102,179
Insurance	81,560	76,017
Regulatory assessments	154,315	61,769
Other operating expenses	628,871	582,649
Total other expenses	$ 3,141,330	$ 2,822,724

NOTE 18 – EMPLOYEE BENEFITS

Defined Contribution Plan

The Bank adopted a 401(k) defined contribution plan effective January 1, 1997. All employees of the Bank may participate in the plan upon completion of certain eligibility requirements. The Bank matches employee's contributions on a discretionary basis. The Bank made contributions of $193,223 and $178,145 for the years ended December 31, 2019 and 2018, respectively.

NOTE 19 – DISCLOSURES ABOUT FAIR VALUE OF FINANCIAL INSTRUMENTS

Fair values of financial instruments are management's estimates of the values at which instruments could be exchanged in a transaction between willing parties. These estimates are subjective and may vary significantly from amounts that would be realized in actual transactions. Further, the tax ramifications related to the realization of the unrealized gains and losses can have a significant effect on the fair value estimates and have not been considered in any of these estimates.

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NOTE 19 – DISCLOSURES ABOUT FAIR VALUE OF FINANCIAL INSTRUMENTS (CONTINUED)

The estimated fair values of the Bank's financial instruments as of December 31 are approximately as follows:

		2019		2018	
	Fair Value Hierarchy	Carrying Amounts	Estimated Fair Values	Carrying Amounts	Estimated Fair Values
Financial assets:					
Cash and cash equivalents	Level 1	$ 53,950,170	$ 53,950,170	$ 20,254,542	$ 20,254,542
Interest bearing deposits in banks	Level 2	12,057,702	12,057,702	27,432,534	27,237,290
Securities available-for-sale	Level 2	15,728,106	15,728,106	20,904,724	20,904,724
FHLB stock	Level 2	1,715,600	1,715,600	1,230,800	1,230,800
Loans	Level 3	398,288,627	401,435,243	312,650,661	314,559,000
Interest receivable	Level 2	1,271,431	1,271,431	1,025,568	1,025,568
Financial liabilities:					
Non-maturity deposits	Level 2	318,525,637	321,159,000	264,845,222	266,511,000
Time deposits	Level 2	80,721,492	80,957,000	61,508,001	61,067,000
Secured borrowings	Level 2	34,500,000	34,861,000	15,000,000	14,903,000
Interest payable	Level 2	140,208	140,208	201,142	201,142
Off-balance-sheet liabilities:					
Undisbursed loan commitments	Level 3	-	743,388	-	541,999

The following table presents information about the Bank's assets and liabilities measured at fair value on a recurring basis as of December 31, 2019 and 2018. These tables indicate the fair value hierarchy of the valuation techniques utilized by the Bank to determine such fair value.

Description of Assets	December 31, 2019	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Available-for-sale securities:				
Mortgage-backed securities	$ 9,538,610	$ -	$ 9,538,610	$ -
CMOs	6,189,496	-	6,189,496	-
Total	$ 15,728,106	$ -	$ 15,728,106	$ -

NOTE 19 – DISCLOSURES ABOUT FAIR VALUE OF FINANCIAL INSTRUMENTS (CONTINUED)

Description of Assets	December 31, 2018	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Available-for-sale securities:				
Mortgage-backed securities	$ 10,000,965	$ -	$ 10,000,965	$ -
Treasuries	3,741,313		3,741,313	
CMOs	7,162,446	-	7,162,446	-
Total	$ 20,904,724	$ -	$ 20,904,724	$ -

Transfers between levels in the fair value hierarchy are recognized on the actual date of the event or circumstances that caused the transfer, which generally corresponds to the Bank's quarterly valuation process.

Fair value measurements for impaired loans are based on either collateral values supported by appraisals or observed market prices. Any loss recognized on impaired loans is not recorded directly as an adjustment to current earnings but rather as an adjustment component in determining the overall adequacy of the allowance for loan losses. Such adjustments to the estimated fair value of impaired loans may result in increases or decreases to the provision for loan losses recorded in current earnings. The following methods and assumptions were used to estimate the fair value of each class of financial instrument for which it is practicable to estimate that value:

Cash and Cash Equivalents

For short-term instruments, including cash and due from banks, the carrying amount is a reasonable estimate of fair value.

Interest-Bearing Deposits in Banks

Represents time deposits held at other financial institutions. The fair values are estimated using a discounted cash flow calculation that applies interest rates currently being offered on certificates to a schedule of aggregated expected monthly maturities.

Securities

Fair values for investment securities are based on quoted market prices when available or through the use of alternative approaches, such as a matrix or model pricing, when market quotes are not readily accessible or available.

NOTE 19 – DISCLOSURES ABOUT FAIR VALUE OF FINANCIAL INSTRUMENTS (CONTINUED)

FHLB Stock and Other Investments

For FHLB stock and other investments, the carrying amount is a reasonable estimate of fair value.

Loans

For variable rate loans that reprice frequently and with no significant change in credit risk, fair values are based on carrying values. The fair values for fixed rate loans are estimated using discounted cash flow analysis, using interest rates currently being offered for loans with similar terms to borrowers of similar credit quality. The carrying amount of interest receivable approximates its fair value. The Bank's allowance for loan and lease losses is a reasonable estimate of the valuation allowance needed to adjust computed fair values for the quality of certain loans in the portfolio.

Interest Receivable and Payable

For interest receivable and payable, the carrying amount is estimated to be the fair value.

Impaired Loans

The Bank utilizes current appraisals and applies discount factors estimated and modeled for consistency by management to arrive at the estimate of fair value for all collateral dependent loans.

Deposit Liabilities

The fair values disclosed for non-maturity deposits (e.g., interest and non-interest checking, statement savings, and money market accounts) are, by definition, equal to the amount payable at the reporting date (i.e., their carrying amounts). The fair values for fixed-rate certificates of deposit are estimated using a discounted cash flow calculation that applies interest rates currently being offered on certificates to a schedule of aggregated expected monthly maturities on time deposits. The carrying amount of interest payable approximates its fair value.

FHLB Borrowings

The fair value of the borrowings is calculated based on the discounted value of the contractual cash flows using current rates at which such borrowings can currently be obtained.

Commitments to Extend Credit

The fair value of commitments is estimated using the fees currently charged to enter into similar agreements, taking into account the remaining terms of the agreements and the present creditworthiness of the counterparties. For fixed-rate loan commitments, fair value also considers the difference between current levels of interest rates and the committed rates.

NOTE 19 – DISCLOSURES ABOUT FAIR VALUE OF FINANCIAL INSTRUMENTS (CONTINUED)

Limitations

Fair value estimates are made at a specific point in time, based on relevant market information and other information about the financial instrument. These estimates do not reflect any premium or discount that could result from offering for sale at one time the Bank's entire holdings of a particular financial instrument.

NOTE 20 – SUBSEQUENT EVENTS

The Bank has evaluated the effects of subsequent events that have occurred after the period ending December 31, 2019 and through March 31, 2020, which is the date the financial statements were available to be issued.

Subsequent to year-end, an outbreak of a novel coronavirus (COVID-19) occurred in the United States, along with various other countries globally. On March 11, 2020, the World Health Organization assessed the novel coronavirus outbreak and characterized it as a pandemic. Subsequent to the declaration of a pandemic, a variety of federal, state, and local governments have taken actions in response, which have ranged by jurisdiction, but are generally expected to result in a variety of negative economic consequences, the scope of which are not currently known or quantifiable. In addition, the Federal Open Market Committee of the United States Federal Reserve System lowered the federal funds target rate by 1.50%, reduced the rate for discount window loans, and took other actions to promote the stability of the financial system.

The duration and intensity of the impact of the coronavirus and resulting impact to the Bank is unknown. A broad-based reduction in interest rates may reduce the Bank's interest income and/or net interest margin, may result in increased prepayments of loans, and may cause customers to withdraw deposits, impacting the Bank's liquidity. A reduction in economic output or a recession in the U.S. economy, both of which appear probable as a result of the pandemic, may also result in a decreased valuation of many of the Bank's assets.

Management Team

William S. Keller
PRESIDENT & CEO / DIRECTOR

Mukhtar Ali
CHIEF CREDIT OFFICER

Daniel A. Northway
CHIEF FINANCIAL OFFICER

Kay Adler
CHIEF OPERATING OFFICER

Chaula M. Pandya
SVP,
CHIEF TECHNOLOGY OFFICER

Mark Roach
SVP,
CHIEF BANKING OFFICER

John Norawong
SVP,
DIRECTOR OF BANKING

Margie Perry
SVP,
CHIEF CUSTOMER
EXPERIENCE OFFICER

Board of Directors

William E. Purcell
CHAIRMAN OF THE BOARD

Sam Hedgpeth
VICE CHAIRMAN

Eddie C. Cheung
DIRECTOR

Tracey A. Enfantino
DIRECTOR

Raymond J. Figone
DIRECTOR

Dimitri V. Koroslev
DIRECTOR

Ben Mackovak
DIRECTOR

Patricia Remch
DIRECTOR

Kenneth G. Seideman
DIRECTOR

Frank Tsai
DIRECTOR

Gunter M. Unruh
DIRECTOR EMERITUS

Values Are Not Words. They Are Who We Are.

"The staff is so great. Every time I come in everyone is so nice and helpful!"

Dona Gomez, Board Member, Longfellow Community Association (Oakland)

"(CBB helped us purchase) a 4,000 sq ft unit. We established a business incubator, and provided low rents to three new businesses. That's community banking!"

Rev. Kenneth Chambers
West Side Missionary Baptist Church
Executive Director, Interfaith Council of Alameda County (ICAC)

"Such a super-responsive and supportive team; (they) take the time to help our startup continue to accelerate and succeed!"

Taariq Lewis
CEO and Founder of Aquila, Inc.

"CBB provides incredible client service and completely understands our business needs."

Uri Eliahu, GE
President
ENGEO Incorporated

"In today's world, we are grateful for the outstanding service provided by our bankers at CBB…and we feel confident that our money is safe with their 5-star Bauer Financial rating."

Tim Clemen,
Chief Financial Officer
Dublin Management Company

"(CBB) always takes the time to make sure all our financial reporting is on track. Being a customer of Community Bank of the Bay is like doing business with concerned, caring, genuine extended family members."

Dominick Chirichillo
Owner & Winemaker
Domenico Winery

"Community Bank of the Bay has simplified the banking of our four corporations and more than one hundred trusts accounts. Having confidence in knowing that (CBB) is on top of everything has allowed (us) to focus on quality and growth."

Chris T. Rontal, CFO
Cardoza Properties, Inc.

Banking on a Better Future.

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155 Bovet Road
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San Mateo, CA 94402
(650) 389-1010 p
(650) 638-1460 f

OAKLAND
180 Grand Avenue
Suite 120 & 1550
Oakland, CA 94612
(510) 433-5400 p
(510) 433-5431 f

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Rose Garden Shopping Center
740 Camino Ramon
Danville, CA 94526
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