



REPORT OF INDEPENDENT AUDITORS  
AND FINANCIAL STATEMENTS

**WASHINGTON BUSINESS BANK**

December 31, 2020 and 2019

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## **Report of Independent Auditors**

Board of Directors  
Washington Business Bank

### **Report on the Financial Statements**

We have audited the accompanying financial statements of Washington Business Bank, which comprise the statements of financial condition as of December 31, 2020 and 2019, and the related statements of income, comprehensive income, changes in 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 entity'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 entity'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 Washington Business Bank as of December 31, 2020 and 2019, 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*  
Everett, Washington  
February 16, 2021

## Washington Business Bank

### Statements of Financial Condition (dollars in thousands)

#### ASSETS

	December 31,	
	2020	2019
Cash and due from banks	\$ 909	\$ 882
Federal funds sold	2,011	1,605
Total cash and cash equivalents	2,920	2,487
Interest-bearing deposits in banks	8,202	7,151
Securities available-for-sale, at fair value	43	68
Federal Home Loan Bank (FHLB) stock	349	305
Loans receivable	95,162	79,486
Allowance for loan losses	(668)	(638)
Net loans	94,494	78,848
Accrued interest receivable	293	224
Premises and equipment, net	1,755	1,766
Other assets	294	247
Total assets	\$ 108,350	\$ 91,096

#### LIABILITIES AND SHAREHOLDERS' EQUITY

LIABILITIES		
Customer deposits	\$ 83,088	\$ 75,369
Accrued interest payable	26	32
Borrowings	13,443	5,010
Other liabilities	381	333
Total liabilities	96,938	80,744
COMMITMENTS AND CONTINGENCIES (NOTE 8)		
SHAREHOLDERS' EQUITY		
Preferred stock (no par value), 1,000,000 shares authorized, no shares issued or outstanding in 2020 and 2019	-	-
Common stock (\$1 par value), 10,000,000 shares authorized, 667,269 and 673,809 shares issued and outstanding in 2020 and 2019, respectively	667	674
Additional paid-in capital	6,866	7,151
Retained earnings	3,878	2,526
Accumulated other comprehensive income, net of tax	1	1
Total shareholders' equity	11,412	10,352
Total liabilities and shareholders' equity	\$ 108,350	\$ 91,096

# Washington Business Bank

## Statements of Income (dollars in thousands)

	Years Ended December 31,	
	2020	2019
<b>INTEREST INCOME</b>		
Loans and fees	\$ 4,638	\$ 4,457
Federal funds sold and interest-bearing deposits in banks	47	236
Dividends	22	22
Securities available-for-sale	2	2
Total interest income	4,709	4,717
<b>INTEREST EXPENSE</b>		
Deposits	587	893
Borrowings	161	129
Total interest expense	748	1,022
Net interest income	3,961	3,695
<b>PROVISION FOR LOAN LOSSES</b>	30	20
Net interest income after provision for loan losses	3,931	3,675
<b>NONINTEREST INCOME</b>		
Service charges on deposit accounts	24	30
Debit/ATM interchange	49	48
Other fee income	6	6
Net gain on sale of loans	-	5
Total noninterest income	79	89
<b>NONINTEREST EXPENSE</b>		
Salaries and employee benefits	1,379	1,484
Occupancy and equipment	123	111
Data processing	130	136
Taxes and regulatory assessment	108	83
Other	559	595
Total noninterest expense	2,299	2,409
Income before provision for income taxes	1,711	1,355
<b>PROVISION FOR INCOME TAXES</b>	359	285
<b>NET INCOME</b>	\$ 1,352	\$ 1,070
<b>Earnings per common share</b>		
Basic	\$ 2.02	\$ 1.59
Diluted	\$ 1.86	\$ 1.43

**Washington Business Bank**  
**Statements of Comprehensive Income (dollars in thousands)**

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	Years Ended December 31,	
	<u>2020</u>	<u>2019</u>
NET INCOME	\$ 1,352	\$ 1,070
Other comprehensive income		
Unrealized holding gain (loss) on securities available-for-sale (net of tax provision (benefit) of \$0 for 2020 and 2019)	<u>-</u>	<u>1</u>
COMPREHENSIVE INCOME	<u>\$ 1,352</u>	<u>\$ 1,071</u>

## Washington Business Bank

### Statements of Changes in Shareholders' Equity (dollars in thousands)

	Common Stock		Additional Paid-In-Capital	Retained Earnings	Accumulated Other Comprehensive Income	Total Shareholders' Equity
	Shares	Amount				
BALANCE, December 31, 2018	668,157	\$ 668	\$ 7,288	\$ 1,456	\$ -	\$ 9,412
Net income	-	-	-	1,070	-	1,070
Unrealized gain on securities, net of tax	-	-	-	-	1	1
Vested restricted stock	6,780	7	(7)	-	-	-
Repurchased shares	(27,748)	(28)	(376)	-	-	(404)
Exercised stock options	26,700	27	175	-	-	202
Stock-based compensation	-	-	71	-	-	71
BALANCE, December 31, 2019	673,889	674	7,151	2,526	1	10,352
Net income	-	-	-	1,352	-	1,352
Vested restricted stock	5,890	6	(6)	-	-	-
Repurchased shares	(33,510)	(34)	(467)	-	-	(501)
Exercised stock options	21,000	21	118	-	-	139
Stock-based compensation	-	-	70	-	-	70
BALANCE, December 31, 2020	667,269	\$ 667	\$ 6,866	\$ 3,878	\$ 1	\$ 11,412

## Washington Business Bank

### Statements of Cash Flows (dollars in thousands)

	Years Ended December 31,	
	2020	2019
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>		
Net income	\$ 1,352	\$ 1,070
Adjustments to reconcile net income to net cash from operating activities		
Provision for loan losses	30	20
Deferred income tax	117	-
Net gain on sale of loans	-	(5)
Depreciation and amortization	68	75
Stock-based compensation expense	70	71
Changes in operating assets and liabilities		
Accrued interest payable	(6)	(43)
Accrued interest receivable	(69)	(1)
Other assets	(164)	(15)
Other liabilities	48	101
	1,446	1,273
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>		
Activity in securities available-for-sale		
Maturities, prepayments, and calls	25	19
Increase in interest-bearing deposits with banks	(1,051)	(4,886)
Increase in loans made to customers, net of principal collections	(15,676)	(3,421)
Purchase of FHLB stock	(44)	(11)
Purchases of premises and equipment	(57)	(51)
	(16,803)	(8,350)
<b>CASH FLOWS FROM FINANCING ACTIVITIES</b>		
Net increase in deposits	7,719	3,010
Repayment of FHLB borrowings	-	(2,000)
Advances of FHLB borrowings	1,000	2,000
Advances of FRB borrowings	7,433	10
Repurchase of stock	(501)	(404)
Proceeds from exercise of stock options	139	202
	15,790	2,818
<b>NET INCREASE (DECREASE) IN CASH</b>	433	(4,259)
<b>CASH AND CASH EQUIVALENTS, beginning of year</b>	2,487	6,746
<b>CASH AND CASH EQUIVALENTS, end of year</b>	\$ 2,920	\$ 2,487
<b>SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION</b>		
Cash paid during the year for		
Taxes	\$ 380	\$ 290
Interest	\$ 753	\$ 1,065



# Washington Business Bank

## Notes to Financial Statements

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### Note 1 – Summary of Significant Accounting Policies

**Nature of operations** – Washington Business Bank (the Bank) operates one full-service branch in Thurston County, Washington. The Bank is a state-chartered bank that provides loan and deposit services to customers who are predominately small and mid-sized businesses and middle-income individuals in western Washington. The Bank is subject to significant competition from other financial institutions. The Bank is also subject to the regulations of certain federal and state of Washington agencies and undergoes periodic examinations by those regulatory authorities.

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

**Financial statement presentation and use of estimates** – The financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America and practices within the banking industry. Preparation of financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities, as of the date of the statements of financial condition, and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates. Material estimates that are particularly susceptible to significant change in the near term relate to the determination of the allowance for loan losses, fair value of stock options and awards, and valuation of deferred tax assets.

All dollar amounts are stated in thousands, except per-share amounts.

**Subsequent events** – Subsequent events are events or transactions that occur after the statements of financial condition date but before the financial statements are issued. The Bank recognizes in the financial statements the effects of all subsequent events that provide additional evidence about conditions that existed at the date of the statements of financial condition, including the estimates inherent in the process of preparing the financial statements. The Bank's financial statements do not recognize subsequent events that provide evidence about conditions that did not exist at the date of the statements of financial condition but arose after the statements of financial condition date and before the financial statements are available to be issued.

The Bank has evaluated subsequent events through February 16, 2021, which is the date the financial statements are issued.

**Cash and cash equivalents** – For purposes of reporting cash flows, cash and cash equivalents include cash, due from banks, and federal funds sold, all with maturities of three months or less. The Bank, at times, may have cash deposits at other financial institutions in excess of Federal Deposit Insurance Corporation (FDIC)-insured limits.

There was no reserve requirement with the Federal Reserve Bank (FRB) at December 31, 2020 and 2019.

**Note 1 – Summary of Significant Accounting Policies (continued)**

**Interest-bearing deposits in banks** – Interest-bearing deposits with other financial institutions mature within one year and are carried at cost. The balances in these accounts may fluctuate and, at times, exceed the insured limit set by the FDIC, which potentially subjects the Bank to credit risk. The Bank has not experienced any losses in such accounts.

**Investment securities** – Investment securities are classified as held-to-maturity and carried at amortized cost when management has the positive intent and ability to hold them to maturity. Investment securities are classified as available-for-sale when they might be sold before maturity. Securities available-for-sale are carried at fair value, with unrealized holding gains and losses reported in other comprehensive income, net of tax.

Interest income includes amortization of purchase premium or discount. Premiums and discounts on securities are amortized on the level-yield to call date method, except for mortgage backed securities where prepayments are anticipated. Gains and losses on sales are recorded on the trade date and determined using the specific identification method.

Management evaluates securities for other-than-temporary impairment (OTTI) on at least a quarterly basis, and more frequently when economic or market conditions warrant such an evaluation. For securities in an unrealized loss position, management considers the extent and duration of the unrealized loss, and the financial condition and near-term prospects of the issuer. Management also assesses whether it intends to sell, or it is more likely than not that it will be required to sell, a security in an unrealized loss position before recovery of its amortized cost basis. If either of the criteria regarding intent or requirement to sell is met, the entire difference between amortized cost and fair value is recognized as impairment through earnings. For debt securities that do not meet the aforementioned criteria, the amount of impairment is split into two components as follows: 1) OTTI related to credit loss, which must be recognized in the income statement, and 2) other-than-temporary impairment related to other factors, which is recognized in other comprehensive income. The credit loss is defined as the difference between the present value of the cash flows expected to be collected and the amortized cost basis. For equity securities, the entire amount of impairment is recognized through earnings.

**Federal Home Loan Bank stock** – The Bank, as a member of the Federal Home Loan Bank of Des Moines (FHLB) system, is required to maintain an investment in capital stock of the FHLB in an amount equal to the greater of 1% of its outstanding home loans or 5% of advances from the FHLB. The Bank's investment in FHLB stock is a restricted investment carried at par value (\$100 per share), which approximates its fair value. No ready market exists for the FHLB stock, and it has no quoted market value; however, the Bank may request redemption at par value of any stock in excess of the amount the Bank is required to hold. Stock redemptions are made at the discretion of the FHLB.

**Pacific Coast Bankers' Bank stock** – Pacific Coast Bankers' Bank (PCBB) stock represents an investment by the Bank in the capital stock of PCBB of \$60 at December 31, 2020 and 2019, and is carried at par value (\$15 per share), which reasonably approximates fair value and is included in other assets.

# Washington Business Bank

## Notes to Financial Statements

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### Note 1 – Summary of Significant Accounting Policies (continued)

**Loans held-for-sale** – Loans originated and intended for sale in secondary markets are carried at the lower of cost or estimated market value in the aggregate. Net unrealized losses are recognized through a valuation allowance by charges to income. Gains or losses on the sale of such loans are based on the specific identification method. There were no loans held-for-sale at December 31, 2020 or 2019.

**Loan sales recognition** – The Bank recognizes a sale on loans if the transferred portion (or portions) and any portion that continues to be held by the transferor are participating interests. Participating interest is defined as a portion of a financial asset that (a) conveys proportionate ownership rights with equal priority to each participating interest holder, (b) involves no recourse (other than standard representations and warranties), and (c) does not entitle any participating interest holder to receive cash before any other participating interest holder. The transfer of the participating interest (or participating interests) must also meet the conditions for surrender of control.

**Loans receivable** – Loans receivable that management has the intent and ability to hold for the foreseeable future or until maturity or payoff are reported at their outstanding principal balances and adjusted for any charge-offs, the allowance for loan losses, any deferred fees or costs on originated loans, and unamortized premiums or discounts on purchased loans. Loan fees and certain direct loan origination costs are deferred, and the net fee or cost is recognized as an adjustment to interest income using the interest method. Because some loans may not be repaid in full, an allowance for loan losses is recorded.

Credit risk represents the possibility of sustaining a loss because the other parties to the financial obligation fail to perform in accordance with the terms of the contract. The Bank's exposure to credit loss primarily relates to cash and due from banks, FHLB stock, loans receivable, and investment securities.

Most of the Bank's business activity is with customers in the state of Washington. Investments in state and municipal securities involve governmental entities primarily within the state. Loans are generally limited by state banking regulations to 20% of the Bank's shareholders' equity, excluding accumulated other comprehensive income. At December 31, 2020 and 2019, \$2,617 and \$2,667, respectively, of loans receivable were made for land development, acquisition, and construction purposes.

**Interest income recognition on loans** – Interest income on loans is accrued over the term of the loans based on the principal outstanding. The accrual of interest on loans is discontinued when, in management's opinion, the borrower may be unable to meet payments as they become due, as well as when required by regulatory provision. Past-due status is based on contractual terms of loans. When interest accrual is discontinued, all unpaid accrued interest is reversed. Loans are returned to accrual status when all the principal and interest amounts contractually due are brought current and future payments are reasonably assured.

**Allowance for loan losses** – An allowance for loan losses is a valuation allowance for probable incurred credit losses. The allowance for loan losses is increased by a provision for loan losses charged to expense and decreased by charge-offs (net of recoveries). The allowance is based on ongoing, monthly assessments of the probable and estimable losses inherent in the loan portfolio. The Bank's methodology for assessing the appropriateness of the allowance consists of several key elements.

**Note 1 – Summary of Significant Accounting Policies (continued)**

The allowance for loan losses is based upon management's periodic review of the collectability of the loan in relation to historical experience, the nature and volume of the loan portfolio, adverse situations that may affect the borrower's ability to repay, estimated value of any underlying collateral, and prevailing economic conditions. This evaluation is inherently subjective because it requires estimates that are susceptible to significant revision as updated information becomes available. Additionally, loans are subject to examination by state and federal regulators who, based upon their judgment, may require the Bank to make additional provisions or adjustments to the allowance for loan losses.

Specific reserves are established in cases where management has identified significant conditions or circumstances related to a loan that management believes indicate the probability that a loss has been incurred. Impaired loans consist of loans receivable that are not expected to be repaid in accordance with their contractual terms. Smaller balance loans are excluded from this analysis. In addition to impaired loans, any loans risk rated as substandard, doubtful, or loss are individually evaluated for impairment. All other loans are generally evaluated collectively for purposes of estimating the allowance for loan losses.

To determine the balance of the allowance account, loans are pooled by portfolio segment and losses are modeled using historical experience and qualitative factors over the loss emergence period. The following portfolio segments are used: commercial loans, real estate loans, construction loans, and consumer loans.

Each loan segment inherently contains differing credit risk profiles depending on the unique aspects of that segment. For example, real estate construction loans carry a risk that a project under development might not be completed as planned or that the original cost estimate might be insufficient. In all cases, management believes the credit risk for all loans is similarly dependent on essentially the same factors, including the financial strength of the borrower, the cash flow available to service maturing debt obligations, the condition and value of underlying collateral, the financial strength of any guarantors, and other factors. Management exercises judgment in determining the estimation method that fits the credit risk characteristics of each portfolio segment but generally relies on underlying collateral values, projected cash flows, and other available borrower information.

The establishment of the allowance for loan losses relies on a consistent process that requires multiple layers of management review and judgment and responds to changes in economic conditions, customer behavior, and collateral value, among other influences. From time to time, events or economic factors may affect the loan portfolio, causing management to provide additional amounts or to release balances from the allowance for loan losses.

Management monitors differences between estimated and actual incurred loan losses. This monitoring process includes periodic assessments by senior management of loan portfolios and the models used to estimate incurred losses in those portfolios. Additions to the allowance for loan losses are made by charges to the provision for loan losses. Credit exposures deemed to be uncollectible are charged against the allowance for loan losses. Recoveries of previously charged-off amounts are credited to the allowance for loan losses.

The ultimate recovery of all loans is susceptible to future market factors beyond the Bank's control. These factors may result in losses or recoveries differing significantly from those provided in the financial statements.

# Washington Business Bank

## Notes to Financial Statements

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### Note 1 – Summary of Significant Accounting Policies (continued)

**Impaired, nonaccrual, and charged-off loans** – Loans are considered impaired when, based on current information and events, it is probable that the Bank will be unable to collect all amounts due in accordance with the original contractual terms of the loan agreement, including scheduled principal and interest payments. Impairment is evaluated in total for smaller balance loans of similar nature and on an individual loan basis for other loans. If a loan is impaired, a specific valuation allowance is allocated, if necessary, so that the loan is reported net at the present value of estimated future cash flows using the loan's existing rate or at the fair value of collateral if repayment is expected to come from the collateral. Interest payments on impaired loans are typically applied to principal unless collectability of the principal amount is reasonably assured, in which case interest is recognized on a cash basis.

Impaired loans, or portions thereof, are charged off when deemed uncollectible. The Bank's charge-off policies are treated similarly in each segment of the loan portfolio. When a loan reaches 90 days past due, it is generally considered impaired. The loan is placed on nonaccrual and a specific reserve is allocated after an impairment analysis is performed by management and deemed necessary.

The Bank generally places loans on nonaccrual status when the full and timely collection of interest and principal becomes uncertain, part of the principal balance has been charged off and no restructuring has occurred, or the loans reach three months past due for all loan classes. When the Bank places a loan on nonaccrual status, the Bank reverses the accrued unpaid interest receivable against interest income and accounts for the loan on the cash or cost recovery method until it qualifies for return to accrual status. Generally, the Bank returns a loan to accrual status when (a) all delinquent interest and principal become current under the terms of the loan agreement or (b) a formal restructuring has occurred, and continued payment is reasonably assured, generally after six months of payment history.

The Bank has determined that the entire balance of a loan is contractually delinquent for all classes if the minimum payment is not received by the specified due date on the customer's statement. Interest and fees continue to accrue on past-due loans until the date the loan goes into nonaccrual status, if applicable.

**Premises and equipment** – Premises and equipment are stated at cost less accumulated depreciation, which is computed on the straight-line method over the estimated useful lives of the assets. Gains or losses on dispositions are reflected in earnings. Assets are reviewed for impairment when events indicate that their carrying value may not be recoverable. If management determines impairment exists, the assets are reduced with an offsetting charge to expense.

**Other real estate owned** – Real estate properties acquired through or in lieu of loan foreclosure are initially recorded at fair value less estimated selling cost at the date of foreclosure. Any write-downs based on the asset's fair value at the date of acquisition are charged to the allowance for loan losses. After foreclosure, valuations are periodically performed by management and property held-for-sale is carried at the lower of the new cost basis or fair value less costs to sell. Impairment losses on property to be held and used are measured as the amount by which the carrying amount of a property exceeds its fair value. Costs of significant property improvements are capitalized, whereas costs relating to holding property are expensed. Valuations are periodically performed by management, and any subsequent write-downs are recorded as a charge to operations, if necessary, to reduce the carrying value of a property to the lower of its cost or fair value less cost to sell. The Bank had \$71 in other real estate owned at December 31, 2020 and 2019, which is included within other assets on the statement of financial condition.

**Note 1 – Summary of Significant Accounting Policies (continued)**

**Income taxes** – The Bank records its provision for income taxes under the liability method. Deferred tax assets and liabilities are reflected at currently enacted income tax rates applicable to the period in which the deferred tax assets or liabilities are expected to be realized or settled. As changes in tax laws or rates are enacted, deferred tax assets and liabilities are adjusted through the provision for income taxes.

Deferred taxes result from temporary differences in the recognition of certain income and expense amounts between the Bank's financial statements and its tax return. The principal items giving rise to these differences include net operating losses, valuation adjustments on foreclosed properties, and allowance for credit losses. The Bank's policy is to recognize interest and penalties associated with income tax matters in income tax expense.

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

**Stock-based compensation** – Stock-based compensation cost is recognized at the grant-date fair value and is based on awards that are ultimately expected to vest. The cost is recognized over the period during which an employee is required to provide services in exchange for the award. The tax benefit resulting from tax deductions in excess of the compensation cost recognized is classified as a financing activity in the statements of cash flows. The fair value of stock options is determined using the Black-Scholes valuation model.

**Fair value measurements** – The Company recognizes fair values of financial instruments in accordance with ASC 825-10, *Financial Instruments – Overall, Recognition and Measurement of Financial Assets and Financial Liabilities*, which requires use of the exit price notion when measuring the fair value of financial instruments for disclosure purposes. Fair value is defined as the exit price, the price that would be received for an asset or paid to transfer a liability, in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date under current market conditions. It also establishes a consistent framework for measuring fair value and expands disclosure requirements about fair value measurements. In determining fair value, the Company maximizes the use of observable inputs and minimizes the use of unobservable inputs.

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

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

# Washington Business Bank

## Notes to Financial Statements

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### Note 1 – Summary of Significant Accounting Policies (continued)

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

There were no transfers between Level 1, Level 2, and Level 3 during 2020 or 2019.

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

All of the Bank's revenue from contracts with customers in the scope of ASC 606 is recognized in noninterest income except for gains/losses on the sale of other real estate owned. Gains/losses on the sale of other real estate owned are included in noninterest expense and are generally recognized when the performance obligation is complete. This is typically at delivery of control over the property to the buyer at time of each real estate closing.

**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.

**Debit and ATM interchange fee income and expenses** – 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 debit card are recorded on a net basis with the interchange income.

## Washington Business Bank Notes to Financial Statements

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### Note 1 – Summary of Significant Accounting Policies (continued)

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

**Comprehensive income** – Accounting principles generally require including recognized revenue, expenses, gains, and losses in net income. Certain changes in assets and liabilities, such as unrealized gains and losses on available-for-sale securities, are reported as a separate component of the equity section of the statement of financial condition. Such items, along with net income, are the only components of comprehensive income. For the years ended December 31, 2020 and 2019, there were no amounts reclassified out of accumulated comprehensive income, and ending components of accumulated comprehensive income consisted of changes to the unrealized gains and losses of securities available-for-sale.

**Advertising costs** – Advertising costs are expensed as incurred. Total advertising expense was \$6 and \$10 for the years ended December 31, 2020 and 2019, respectively.

### Note 2 – Securities Available-for-Sale

Securities have been classified as available-for-sale according to management's intent. The amortized cost of securities and their approximate fair value are as follows:

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
<b>December 31, 2020</b>				
Agency mortgage-backed securities and collateralized mortgage obligations	\$ 41	\$ 2	\$ -	\$ 43
<b>December 31, 2019</b>				
Agency mortgage-backed securities and collateralized mortgage obligations	\$ 66	\$ 2	\$ -	\$ 68

At December 31, 2020 and 2019, there were no investments with contractual maturities or securities with an unrealized loss. Additionally, there were no sales of investment securities during the years ended December 31, 2020 and 2019.



## Washington Business Bank

### Notes to Financial Statements

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#### Note 3 – Loans Receivable

Loans consisted of the following at December 31:

	<u>2020</u>	<u>2019</u>
Commercial	\$ 40,518	\$ 27,042
Real estate		
Commercial	38,335	35,843
Multi-family	500	841
Residential - 1-4 family	<u>13,518</u>	<u>13,301</u>
Total real estate	52,353	49,985
Construction	2,617	2,667
Consumer	<u>-</u>	<u>1</u>
	95,488	79,695
Less net deferred loan origination fees	<u>326</u>	<u>209</u>
Loans receivable	<u>\$ 95,162</u>	<u>\$ 79,486</u>

On March 27, 2020, the Coronavirus Aid, Relief, and Economic Security Act (CARES Act) was signed by the President of the United States. During the year ended December 31, 2020, the Bank participated in the Paycheck Protection Program (PPP), under the CARES Act, whereby loans to small businesses are made and those loans are subject to the regulatory requirements that would require forbearance of loan payments for a specified time or that would limit the ability to pursue all available remedies in the event of a loan default. The above table includes \$9,777 of PPP loans administered by the U.S Small Business Administration (SBA) within the Commercial loan segment as of December 31, 2020.

The Bank pledged certain commercial, multi-family, 1-4 family residential, and land loans as collateral for purposes of borrowings with the FHLB and FRB. Loans totaling \$22,901 and \$11,280 were pledged to the FHLB at December 31, 2020 and 2019, respectively. There were \$18,312 and \$10,758 in loans pledged to the FRB at December 31, 2020 and 2019, respectively (Note 6).

Reflected in the allowance for loan loss methods previously described is an amount for imprecision or uncertainty that incorporates the range of probable outcomes inherent in estimates used for the allowance, which may change from period to period. This amount is the result of management's judgment of risks inherent in the portfolios, economic uncertainties, historical loss experience, and other subjective factors, including industry trends, calculated to better reflect the Bank's view of risk in each loan portfolio. No single statistic or measurement determines the adequacy of the allowance for loan loss. Changes in the allowance for loan loss and the related provision expense can materially affect net income.

## Washington Business Bank Notes to Financial Statements

### Note 3 – Loans Receivable (continued)

The following tables present, by portfolio segment, the changes in the allowance for loan losses for the years ended December 31 and the amount of loans evaluated for impairment individually and collectively.

<b>2020</b>	<u>Commercial</u>	<u>Real Estate</u>	<u>Construction</u>	<u>Consumer</u>	<u>Total</u>
<b>Allowance</b>					
Balance, beginning of the period	\$ 270	\$ 349	\$ 19	\$ -	\$ 638
Charge-offs	-	-	-	-	-
Recoveries	-	-	-	-	-
Provision	30	-	-	-	30
	<u>\$ 300</u>	<u>\$ 349</u>	<u>\$ 19</u>	<u>\$ -</u>	<u>\$ 668</u>
Balance, end of the period	<u>\$ 300</u>	<u>\$ 349</u>	<u>\$ 19</u>	<u>\$ -</u>	<u>\$ 668</u>
Ending balance individually evaluated for impairment	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>
Ending balance collectively evaluated for impairment	<u>\$ 300</u>	<u>\$ 349</u>	<u>\$ 19</u>	<u>\$ -</u>	<u>\$ 668</u>
<b>Loans</b>					
Ending balance	<u>\$ 40,518</u>	<u>\$ 52,353</u>	<u>\$ 2,617</u>	<u>\$ -</u>	<u>\$ 95,488</u>
Ending balance individually evaluated for impairment	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>
Ending balance collectively evaluated for impairment	<u>\$ 40,518</u>	<u>\$ 52,353</u>	<u>\$ 2,617</u>	<u>\$ -</u>	<u>\$ 95,488</u>
<b>2019</b>					
<b>Allowance</b>					
Balance, beginning of the period	\$ 253	\$ 339	\$ 19	\$ -	\$ 611
Charge-offs	-	-	-	-	-
Recoveries	7	-	-	-	7
Provision	10	10	-	-	20
	<u>\$ 270</u>	<u>\$ 349</u>	<u>\$ 19</u>	<u>\$ -</u>	<u>\$ 638</u>
Balance, end of the period	<u>\$ 270</u>	<u>\$ 349</u>	<u>\$ 19</u>	<u>\$ -</u>	<u>\$ 638</u>
Ending balance individually evaluated for impairment	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>
Ending balance collectively evaluated for impairment	<u>\$ 270</u>	<u>\$ 349</u>	<u>\$ 19</u>	<u>\$ -</u>	<u>\$ 638</u>
<b>Loans</b>					
Ending balance	<u>\$ 27,042</u>	<u>\$ 49,985</u>	<u>\$ 2,667</u>	<u>\$ 1</u>	<u>\$ 79,695</u>
Ending balance individually evaluated for impairment	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>
Ending balance collectively evaluated for impairment	<u>\$ 27,042</u>	<u>\$ 49,985</u>	<u>\$ 2,667</u>	<u>\$ 1</u>	<u>\$ 79,695</u>

# Washington Business Bank

## Notes to Financial Statements

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### Note 3 – Loans Receivable (continued)

**Credit quality information** – The Bank’s internal risk categories are based on a variety of detailed factors obtained during loan underwriting and subsequent loan review procedures. A summary of these risk categories is described as follows:

**Exceptional loans** – Excellent and well documented primary and secondary sources of repayment. Excellent capital levels and management with significant industry experience and succession plans. More than adequately secured loans with no loss exposure.

**Quality loans** – Strong sources of primary and secondary repayment; loans comply in all respects to Bank policy and applicable regulations. Better than average capital levels with proven, experienced management. Acceptable collateral with above average loan-to-value ratios resulting in no loss exposure.

**Average loans** – Adequate sources of repayment as evidenced by an average level of earnings, debt service coverage, and capital levels compared with industry peer groups. Experienced management in most critical roles of the organization. Acceptable collateral in quality and amount that results in no loss exposure.

**Below average loans** – Below average sources of repayment, with marginal identifiable risk of collection. Modest secondary source of repayment provides limited support. Below average capital levels compared with peer group, and management may be untested or lack depth. Below average collateral position that may have limited liquidation value. Minimal loss exposure expected based on consideration of all relevant factors.

**Watch list loans** – These loans are typically of higher quality than substandard or doubtful loans but have been determined to have identified potential weaknesses in debt service coverage, collateral value, or other factors and are rated watch list in order to receive special attention and review by the Bank’s credit department. These loans are consistently reviewed and regraded monthly. This grade is intended to correspond with a “Pass” rating used by regulators.

**Substandard loans** – These loans are inadequately protected by the paying capacity of the borrower, current sound net worth, or pledged collateral. A substandard loan typically has one or more well defined weaknesses that could jeopardize the repayment of the debt.

**Doubtful loans** – Loans with weaknesses inherent in the substandard classification for which collection and liquidation in full is questionable.

**Loss** – This rating is assigned to loans considered uncollectible and of such little value that their continuance as an active bank-owned asset is not warranted. These loans are immediately charged off.

## Washington Business Bank Notes to Financial Statements

### Note 3 – Loans Receivable (continued)

The following table represents credit exposures by risk category for the years ended December 31, 2020 and 2019. The use of various categories to grade loans permits management's use of migration analysis to estimate a portion of credit risk.

<b>2020</b>	Exceptional	Quality	Average	Below Average	Watch	Substandard	Total
Commercial	\$ 709	\$ 135	\$ 22,650	\$ 16,937	\$ 87	\$ -	\$ 40,518
Real estate							
Commercial	-	8,398	25,588	3,750	599	-	38,335
Multi-family	-	-	500	-	-	-	500
Residential 1-4 family	-	294	8,635	4,589	-	-	13,518
Total real estate	-	8,692	34,723	8,339	599	-	52,353
Construction	-	-	878	1,739	-	-	2,617
Consumer	-	-	-	-	-	-	-
	<u>\$ 709</u>	<u>\$ 8,827</u>	<u>\$ 58,251</u>	<u>\$ 27,015</u>	<u>\$ 686</u>	<u>\$ -</u>	<u>\$ 95,488</u>
<b>2019</b>							
Commercial	\$ 707	\$ 655	\$ 21,211	\$ 4,063	\$ 406	\$ -	\$ 27,042
Real estate							
Commercial	-	7,349	25,969	1,933	-	592	35,843
Multi-family	-	-	841	-	-	-	841
Residential 1-4 family	-	-	9,464	3,837	-	-	13,301
Total real estate	-	7,349	36,274	5,770	-	592	49,985
Construction	-	-	1,750	917	-	-	2,667
Consumer	-	-	-	1	-	-	1
	<u>\$ 707</u>	<u>\$ 8,004</u>	<u>\$ 59,235</u>	<u>\$ 10,751</u>	<u>\$ 406</u>	<u>\$ 592</u>	<u>\$ 79,695</u>

The Bank's internal risk grading system is based on experiences with similarly graded loans. Category ratings are reviewed periodically at the segment level, at which time management analyzes the resulting scores, as well as other external statistics and factors, to track the migration of loan performance. Credit quality details are generally updated annually using information obtained from the Bank's internal loan review processes, from regulatory examinations, and from external loan review consultants. Loans that trend upward toward higher levels generally have a lower loss factor associated with that category, whereas loans that migrate toward lower ratings generally will result in a higher loss factor being applied to those related loan balances. There were no loans classified as doubtful or loss at December 31, 2020 or 2019.

# Washington Business Bank

## Notes to Financial Statements

### Note 3 – Loans Receivable (continued)

**Past-due loans receivable by class** – The following table includes an aging analysis of the outstanding principal balance of past-due loans receivable as of December 31, 2020 and 2019. There were no loans delinquent greater than 90 days and still accruing interest at December 31, 2020 and 2019.

	30 - 59 Days Past Due	60 - 89 Days Past Due	90 Days or More Past Due	Total Past Due	Current	Total Loans	Nonaccrual Loans
<b>2020</b>							
Commercial	\$ 253	\$ 6	\$ -	\$ 259	\$ 40,259	\$ 40,518	\$ -
Real estate							
Commercial	301	-	-	301	38,034	38,335	-
Multi-family	-	-	-	-	500	500	-
Residential 1-4 family	-	-	-	-	13,518	13,518	-
Total real estate	301	-	-	301	52,052	52,353	-
Construction	-	269	-	269	2,348	2,617	-
Consumer	-	-	-	-	-	-	-
	<u>\$ 554</u>	<u>\$ 275</u>	<u>\$ -</u>	<u>\$ 829</u>	<u>\$ 94,659</u>	<u>\$ 95,488</u>	<u>\$ -</u>
<b>2019</b>							
Commercial	\$ -	\$ 9	\$ -	\$ 9	\$ 27,033	\$ 27,042	\$ -
Real estate							
Commercial	-	288	-	288	35,555	35,843	-
Multi-family	-	-	-	-	841	841	-
Residential 1-4 family	-	-	-	-	13,301	13,301	-
Total real estate	-	288	-	288	49,697	49,985	-
Construction	-	-	-	-	2,667	2,667	-
Consumer	-	-	-	-	1	1	-
	<u>\$ -</u>	<u>\$ 297</u>	<u>\$ -</u>	<u>\$ 297</u>	<u>\$ 79,398</u>	<u>\$ 79,695</u>	<u>\$ -</u>

**Impaired loans** – The average balances are calculated based on the quarter-end balances of the loans of the period reported. The Bank has no impaired loans at or during the years ended December 31, 2020 and 2019.

**Modifications** – A modification of a loan constitutes a troubled debt restructuring (TDR) when a borrower is experiencing financial difficulty and the modification constitutes a concession. The Bank offers and participates in various types of concessions when modifying a loan. There were no troubled debt restructurings at December 31, 2020 or 2019. No loans were modified in 2020 or 2019 as TDRs.

## Washington Business Bank Notes to Financial Statements

### Note 3 – Loans Receivable (continued)

**Related party loans** – Certain related parties of the Bank, principally Bank directors and their associates, are loan customers of the Bank in the ordinary course of business.

	2020	2019
Outstanding at beginning of year	\$ 1,583	\$ 1,538
New loan advances	771	751
Loan repayments	(941)	(706)
Outstanding at end of year	\$ 1,413	\$ 1,583

### Note 4 – Premises and Equipment

Components of premises and equipment at December 31 are as follows:

	2020	2019
Land	\$ 437	\$ 437
Building	1,987	1,987
Furniture and fixtures	168	168
Equipment	619	610
Software	115	67
	3,326	3,269
Less accumulated depreciation and amortization	1,571	1,503
	\$ 1,755	\$ 1,766

### Note 5 – Customer Deposits

The composition of deposits at December 31 is as follows:

	2020	2019
Demand deposits, noninterest-bearing	\$ 20,570	\$ 13,932
NOW and money market accounts	23,032	14,891
Savings deposits	18,970	16,873
Time certificates	20,516	29,673
	\$ 83,088	\$ 75,369

The aggregate amount of time certificates of \$250 and over was approximately \$2,843 and \$3,765 as of December 31, 2020 and 2019, respectively.

## Washington Business Bank

### Notes to Financial Statements

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#### Note 5 – Customer Deposits (continued)

Scheduled maturities of time certificates are as follows:

2021	\$	13,761
2022		4,097
2023		955
2024		530
2025		1,173
		<hr/>
	\$	20,516
		<hr/>

Included within time certificates were brokered deposits of \$2,334 and \$2,305 as of December 31, 2020 and 2019, respectively.

Deposits from certain related parties of the Bank, principally directors, officers, and their affiliates, at December 31, 2020 and 2019, amounted to approximately \$7,649 and \$5,865, respectively.

#### Note 6 – FHLB and other Borrowings and Credit Arrangements

The Bank has a committed line of credit through the FRB of San Francisco for a discounted rate based on the type of loans pledged as collateral (Note 3). Loans pledged to the FRB equated to a borrowing capacity of \$5,408 and \$5,683 at December 31, 2020 and 2019. There was \$0 and \$10 outstanding balances under this credit arrangement at December 31, 2020 and 2019, respectively.

The Bank also utilized the Federal Reserve Bank's Paycheck Protection Program Liquidity Facility (the PPPLF) to fund PPP loans during the year ended December 31, 2020. These advances had an interest rate of 0.35%. The Company has not obtained any other new borrowing lines or other new sources of liquidity other than the PPPLF program during the year ended December 31, 2020. The Company had \$7,443 outstanding in PPPLF as of December 31, 2020, which mature in April 2022, and has pledged with loans as required by the terms of the PPPLF.

The Bank also has a line-of-credit agreement with an unaffiliated bank totaling \$5,000. This line provides for lending at the bank's federal fund rates. There were no borrowings outstanding on this line at December 31, 2020 and 2019.

The Bank is a member of the FHLB, which entitles it to certain benefits including a variety of borrowing options. Credit capacity is determined by the FHLB based on a number of factors, including amount of eligible collateral. The Bank's available borrowing capacity at December 31, 2020 and 2019, was approximately \$10,013 and \$1,288, respectively, with interest payable at the then stated rate. The FHLB borrowing facilities are additionally collateralized by a blanket pledge of the Bank's assets.

## Washington Business Bank Notes to Financial Statements

### Note 6 – FHLB and other Borrowings and Credit Arrangements (continued)

At December 31, 2020, the Bank had \$6,000 of fixed-rate borrowings outstanding with the FHLB, with fixed rates ranging from 0.89% to 2.93% under these agreements. The contractual maturities of FHLB advances at December 31, 2020, are as follows:

2021	\$ 1,000
2022	2,000
2023	1,000
2024	2,000
	<u>6,000</u>
	<u>\$ 6,000</u>

The maximum and average outstanding balances and average interest rates on advances from the FHLB were as follows:

	<u>2020</u>	<u>2019</u>
Average balance during the year	\$ 4,583	\$ 3,500
Average interest rate during the year	1.82%	2.73%
Maximum month-end balance during the year	6,000	5,000
Weighted-average rate at year-end	1.68%	2.56%

### Note 7 – Income Taxes

The components of the provision for income taxes are as follows at December 31:

	<u>2020</u>	<u>2019</u>
Current	\$ 242	\$ 285
Deferred	117	-
	<u>\$ 359</u>	<u>\$ 285</u>

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

	<u>2020</u>		<u>2019</u>	
	Amount	Percent	Amount	Percent
Federal income tax at statutory rate	\$ 359	21%	\$ 285	21%
Equity compensation	(2)	0%	(2)	0%
Other	2	0%	2	0%
	<u>\$ 359</u>	<u>21%</u>	<u>\$ 285</u>	<u>21%</u>



## Washington Business Bank

### Notes to Financial Statements

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#### Note 7 – Income Taxes (continued)

The tax effects of temporary differences that give rise to significant portions of deferred tax assets and liabilities at December 31 are as follows:

	<u>2020</u>	<u>2019</u>
Deferred tax assets		
Stock-based compensation expense	\$ 21	\$ 48
Allowance for loan losses	77	71
Cash basis reporting	-	6
Write-downs on other real estate owned	1	1
	<u>99</u>	<u>126</u>
Deferred tax liabilities		
Deferred income	(142)	(66)
Accumulated depreciation	(8)	
Cash basis reporting	(6)	-
	<u>(156)</u>	<u>(66)</u>
Net deferred tax (liabilities) assets	<u>\$ (57)</u>	<u>\$ 60</u>

The Bank's income tax filings are subject to audit by various taxing authorities. The Bank's policy is to recognize income tax-related interest and penalties in income tax expense. The Bank incurred no interest and penalties for the years ended December 31, 2020 and 2019.

#### Note 8 – Commitments and Contingencies

The Bank is party to financial instruments with off-balance-sheet risk in the normal course of business to meet the financing needs of its customers. These financial instruments include commitments to extend credit and standby letters of credit, primarily at variable interest rates. These instruments involve, to varying degrees, elements of credit risk in excess of the amount recognized on the statements of financial condition.

The Bank's exposure to credit loss in the event of nonperformance 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 conditional obligations as it does for on-balance-sheet instruments.

A summary of the Bank's commitments at December 31 is as follows:

	<u>2020</u>	<u>2019</u>
Commitments to extend credit	<u>\$ 4,411</u>	<u>\$ 3,412</u>
Standby letters of credit	<u>\$ -</u>	<u>\$ 80</u>

**Note 8 – Commitments and Contingencies (continued)**

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. Because many of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. The Bank evaluates each customer's creditworthiness on a case-by-case basis. The amount of collateral obtained, if deemed necessary by the Bank upon extension of credit, is based on management's credit evaluation of the party. Collateral held varies but may include accounts receivable, inventory, property and equipment, residential real estate, and income-producing commercial properties.

Standby letters of credit are conditional commitments issued by the Bank to guarantee the performance of a customer to a third party. Those guarantees are issued primarily to support public and private borrowing arrangements. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loan facilities to customers. Collateral held varies, as specified above, and is required in instances where the Bank deems it necessary.

Because of the nature of its activities, the Bank may be subject to legal actions that arise in the ordinary course of business. In the opinion of management, liabilities arising from these claims, if any, will not have a material effect on the financial position of the Bank.

The Bank has entered into agreements with executive officers that provide for payouts contingent upon a change in control.

On March 11, 2020, the World Health Organization assessed the COVID-19 outbreak and characterized it as a pandemic. Subsequent to the declaration of the pandemic, a variety of federal, state, and local governments have taken actions in response to the pandemic. The duration and intensity of the impact of COVID-19 and resulting impact to the Bank is unknown.

**Note 9 – Retirement Plan**

The Bank has established a 401(k) plan to which employees can elect to defer a portion of their pay, up to a maximum allowed by the IRS. At management's discretion, the Bank can make a matching contribution. The Bank contributed \$39 for the years ended December 31, 2020 and 2019.

**Note 10 – Stock Incentive Plans**

During April 2014, the shareholders approved the Bank's 2014 Stock Incentive Plan (the Plan). Awards up to 150,000 shares under the plan may be granted to any director, officer, employee, or other person providing services to the Bank. Awards may consist of stock options, grants of restricted shares of common stock, or grants of restricted share units. There were 84,000 shares remaining in the Plan at December 31, 2020, available to grant for options or restricted stock. The maximum term of these awards is 10 years.

The exercise price of each option equals the fair market value of the Bank's stock on the date of grant. An award of restricted shares is an outright grant of shares that are subject to vesting requirements, which, if not satisfied, result in the forfeiture of the shares.

Restricted share units are rights to acquire shares upon satisfaction of vesting requirements, with the underlying shares not issued or outstanding until such vesting requirements are satisfied.

## Washington Business Bank

### Notes to Financial Statements

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#### Note 10 – Stock Incentive Plans (continued)

**Stock options** – The fair value of each option grant is estimated on the date of grant, based on the Black-Scholes option pricing model.

A summary of the status of the Bank’s stock options as of and for the year ended December 31, 2020, is presented below:

	<u>Shares</u>	<u>Weighted-Average Exercise Price</u>	<u>Weighted-Average Contractual Life (Years)</u>
Outstanding at beginning of year	<u>129,100</u>	<u>\$ 7.83</u>	<u>2.65</u>
Exercised	<u>(21,000)</u>	<u>6.63</u>	
Outstanding at end of year	<u>108,100</u>	<u>\$ 8.03</u>	<u>1.97</u>
Exercisable at end of year	<u>108,100</u>	<u>\$ 8.03</u>	<u>1.97</u>

**Restricted share awards** – A summary of the status of the Bank’s restricted stock units as of December 31, 2020, and changes during the year ended is presented below:

	<u>Shares</u>	<u>Weighted-Average Grant-Date Fair Value per Share</u>
Nonvested at beginning of year	18,150	\$ 12.73
Vested	<u>(5,890)</u>	<u>13.48</u>
Nonvested at end of year	<u>12,260</u>	<u>\$ 12.37</u>

The total fair value of shares vested during the years ended December 31, 2020 and 2019, was \$79 and \$98, respectively. Restricted share units are valued using the fair value as determined by a valuation specialist.

Compensation expense recorded in the financial statements for stock-based plans for the years ended December 31, 2020 and 2019, totaled \$70 and \$71, respectively. Unrecognized compensation expense totaled \$135 as of December 31, 2020, all of which is attributed to restricted share awards. The weighted-average period over which this remaining compensation cost will be recognized is 1.90 years.

**Note 11 – Regulatory Matters**

The Bank is subject to various regulatory capital requirements administered by the federal banking agencies. Failure to meet minimum capital requirements can initiate certain mandatory—and possibly additional discretionary—actions by regulators that, if undertaken, could have a direct material effect on the Bank’s financial statements. Under capital adequacy guidelines on the regulatory framework for prompt corrective action, the Bank must meet specific capital adequacy 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 classification is also subject to qualitative judgments by the regulators about components, risk weightings, and other factors.

Quantitative measures established by regulation to ensure capital adequacy require the Bank to maintain minimum amounts and ratios (set forth in the following table) of Tier 1 capital (as defined in the regulations) to total average assets (as defined), minimum ratios of Tier 1 and total capital (as defined) to risk-weighted assets (as defined), and common equity Tier 1 capital.

Washington Business Bank is periodically examined by the FDIC and the Department of Financial Institutions of the State of Washington. As of December 31, 2020, the Bank is categorized as well capitalized under the regulatory framework. To be categorized as well capitalized, the Bank must maintain minimum amounts and ratios (set forth in the following table) of total and Tier I capital (as defined in the regulations) to risk-weighted assets (as defined), of Tier I capital (as defined) to average assets (as defined), and Common equity Tier 1 capital.

As of December 31, 2020, the most recent notification from the Bank’s regulator categorized the Bank as well capitalized under the regulatory framework for prompt corrective action. To be categorized as well capitalized, the Bank must maintain minimum total risk-based, Tier 1 risk-based, common equity Tier 1, and Tier 1 leverage ratios, as set forth in the following table. There are no conditions or events since that notification that management believes have changed the Bank’s category.

# Washington Business Bank

## Notes to Financial Statements

### Note 11 – Regulatory Matters (continued)

The Bank's actual capital amounts and ratios are also presented in the following table. Management believes, as of December 31, 2020, that the Bank meets all capital requirements to which it is subject.

	Actual		For Capital Adequacy Purposes		For Capital Adequacy with Capital Buffer		To Be Well Capitalized Under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio	Amount	Ratio
<b>December 31, 2020</b>								
Total risk-based capital (to risk-weighted assets)	\$ 12,088	15.47%	\$ 6,252	8.00%	\$ 8,205	10.50%	\$ 7,815	10.00%
Tier I capital (to risk-weighted assets)	11,411	14.60%	4,689	6.00%	6,642	8.50%	6,252	8.00%
Common equity Tier 1 capital (to risk-weighted assets)	11,411	14.60%	3,517	4.50%	5,470	7.00%	5,079	6.50%
Tier I capital (to adjusted average assets)	11,411	10.55%	4,324	4.00%	7,027	6.50%	5,406	5.00%
<b>December 31, 2019</b>								
Total risk-based capital (to risk-weighted assets)	\$ 10,998	15.15%	\$ 5,809	8.00%	\$ 7,625	10.50%	\$ 7,262	10.00%
Tier I capital (to risk-weighted assets)	10,351	14.25%	4,357	6.00%	6,172	8.50%	5,809	8.00%
Common equity Tier 1 capital (to risk-weighted assets)	10,351	14.25%	3,268	4.50%	5,083	7.00%	4,720	6.50%
Tier I capital (to adjusted average assets)	10,351	11.43%	3,623	4.00%	5,888	6.50%	4,529	5.00%

The federal banking agencies substantially amended the regulatory risk-based capital rules applicable to the Bank in 2015. The amendments implemented the "Basel III" regulatory capital reforms and changes required by the Dodd-Frank Act. The rule includes a minimum common equity Tier 1 capital (CET1) to risk-weighted assets ratio of 4.5% of risk-weighted assets, a minimum Tier 1 capital to risk-weighted assets of 6.0%, and a minimum leverage ratio of 4.0%. The required minimum ratio of total capital to risk-weighted assets is 8.0%.

The amended rules also established a "capital conservation buffer" of 2.5% above the new regulatory minimum capital ratios, and resulted in the following phased-in minimum ratios: (i) a common equity Tier 1 capital ratio of 7.0%; (ii) a Tier 1 capital ratio of 8.5%; and (iii) a total capital ratio of 10.5%. An institution will be subject to limitations on paying dividends, engaging in share repurchases, and paying discretionary bonuses if its capital level falls below the buffer amount. These limitations established a maximum percentage of eligible retained income that could be utilized for such actions. The net unrealized gain or loss on available-for-sale securities is not included in computing regulatory capital. Management believes as of December 31, 2020, that the Bank meets all capital adequacy requirements to which it is subject.

**Note 12 – Fair Value Measurements**

Accounting Standards Codification (ASC) Topic 820, *Fair Value Measurements*, establishes a three-level valuation hierarchy for disclosure of fair value measurements and enhances disclosure requirements for fair value measurements. Fair value is defined as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date.

The three levels are defined as follows:

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

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

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

Following is a description of the valuation methodologies used to measure and report fair value of financial and nonfinancial assets and liabilities, as well as the general classification of such instruments pursuant to the valuation hierarchy:

**Securities available-for-sale** – The Bank reports securities available-for-sale at fair value on a recurring basis. The fair value of the Bank’s securities available-for-sale are determined using Level 2 inputs, which are derived from quoted prices for identical or similar assets in markets that are active or not active, i.e., markets in which there are a few transactions for the asset, the prices are not current, or price quotations vary substantially either over time or among market makers, or in which little information is released publicly.

**Other real estate owned** – Other real estate owned consists principally of properties acquired through foreclosure and is carried at the lower of cost or estimated market value less selling costs. Any write-downs based on the asset’s fair value at the date of acquisition is charged to the allowance for loan losses. After foreclosure, management periodically performs valuations such that the real estate is carried at the lower of its new cost basis or fair value, net of estimated costs to sell.

**Assets reported at fair value on a recurring basis** – The following table presents the balances of assets reported at fair value measured on a recurring basis at December 31:

	Total	Level 1	Level 2	Level 3
<b>2020</b>				
Agency mortgage-backed securities and collateralized mortgage obligations	\$ 43	\$ -	\$ 43	\$ -
<b>2019</b>				
Agency mortgage-backed securities and collateralized mortgage obligations	\$ 68	\$ -	\$ 68	\$ -

# Washington Business Bank

## Notes to Financial Statements

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### Note 12 – Fair Value Measurements (continued)

**Assets reported at fair value on a nonrecurring basis** – The following table represents the balances of assets reported at fair value measured on a nonrecurring basis at December 31, excluding any assets whose fair value exceeds historical cost:

	Fair Value Measurements Using		
	Quoted Prices in Active Markets for Identical Assets Level 1	Significant Other Observable Inputs Level 2	Significant Unobservable Inputs Level 3
<b>December 31, 2020</b>			
Other real estate owned	\$ -	\$ -	\$ 71
<b>December 31, 2019</b>			
Other real estate owned	\$ -	\$ -	\$ 71

**Quantitative information about Level 3 fair value measurements** – The range and weighted average of the significant unobservable inputs used to fair value Level 3 nonrecurring assets during the years ending December 31, 2020 and 2019, along with the valuation techniques used, are shown in the following table:

	Fair Value at December 31, 2020	Valuation Technique	Unobservable Input	Range (Weighted Average) <sup>1</sup>
Other real estate owned	\$ 71	Market comparable	Adjustment to appraisal value	7% - 10% (7.8%)

<sup>1</sup> Discount to appraised value.

	Fair Value at December 31, 2019	Valuation Technique	Unobservable Input	Range (Weighted Average) <sup>1</sup>
Other real estate owned	\$ 71	Market comparable	Adjustment to appraisal value	7% - 10% (7.8%)

<sup>1</sup> Discount to appraised value.

## Washington Business Bank Notes to Financial Statements

### Note 12 – Fair Value Measurements (continued)

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

	Carrying Amount	Estimated Fair Value Level		
		Level 1	Level 2	Level 3
<b>December 31, 2020</b>				
Financial assets				
Cash and due from banks	\$ 909	\$ 909	\$ -	\$ -
Federal funds sold	2,011	2,011	-	-
Interest-bearing deposits in other financial institutions	8,202	8,202	-	-
Securities available-for-sale	43	-	43	-
Loans receivable, net	94,494	-	-	94,619
Federal Home Loan Bank stock	349	349	-	-
Accrued interest receivable	293	293	-	-
Financial liabilities				
Demand, savings, money market, and NOW	62,572	62,572	-	-
Time deposits	20,516	-	20,542	-
Accrued interest payable	26	26	-	-
Borrowings	13,443	-	13,334	-
<b>December 31, 2019</b>				
Financial assets				
Cash and due from banks	\$ 882	\$ 882	\$ -	\$ -
Federal funds sold	1,605	1,605	-	-
Interest-bearing deposits in other financial institutions	7,151	7,151	-	-
Securities available-for-sale	68	-	68	-
Loans receivable, net	78,848	-	-	78,488
Federal Home Loan Bank stock	305	305	-	-
Accrued interest receivable	224	224	-	-
Financial liabilities				
Demand, savings, money market, and NOW	45,696	45,696	-	-
Time deposits	29,673	-	29,846	-
Accrued interest payable	32	32	-	-
Borrowings	5,010	-	4,965	-



## Washington Business Bank

### Notes to Financial Statements

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#### Note 13 – Earnings Per Share

The following table presents a reconciliation of the components used to compute basic and diluted earnings per share (dollars in thousands, except per-share amounts):

	<u>2020</u>	<u>2019</u>
Net income	<u>\$ 1,352</u>	<u>\$ 1,070</u>
Basic weighted-average common shares outstanding	669,530	674,352
Plus dilutive options and awards outstanding	<u>56,976</u>	<u>73,870</u>
Diluted weighted-average common shares outstanding	<u>726,506</u>	<u>748,222</u>
Basic earnings per share of common stock	<u>\$ 2.02</u>	<u>\$ 1.59</u>
Diluted earnings per share of common stock	<u>\$ 1.86</u>	<u>\$ 1.43</u>

There were no antidilutive options and awards for 2020 and 2019.

