Report of Independent Auditors
and Financial Statements

**Washington Business Bank**

December 31, 2023 and 2022

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# Report of Independent Auditors

The Board of Directors
Washington Business Bank

## Report on the Audit of the Financial Statements

***Opinion***

We have audited the financial statements of Washington Business Bank, which comprise the statements of financial condition as of December 31, 2023 and 2022, 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.

In our opinion, the accompanying financial statements present fairly, in all material respects, the financial position of Washington Business Bank as of December 31, 2023 and 2022, 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.

***Emphasis of Matter***

As discussed in Note 1 to the financial statements, in 2023, Washington Business Bank adopted new accounting guidance Accounting Standards Codification Topic 326 *Financial Instruments – Credit Losses*. Our opinion is not modified with respect to this matter.

***Basis for Opinion***

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

***Responsibilities of Management for the Financial Statements***

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

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

### *Auditor's Responsibilities for the Audit of the Financial Statements*

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

In performing an audit in accordance with GAAS, we:

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

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

Moss Adams LLP

Everett, Washington
February 16, 2024

# Financial Statements

# Washington Business Bank
## Statements of Financial Condition
## (dollars in thousands)
## December 31, 2023 and 2022

| | 2023 | 2022 |
|---|---|---|
| **ASSETS** | | |
| Cash and due from banks | $ 3,457 | $ 7,891 |
| Federal funds sold | 2,227 | 2,146 |
| Total cash and cash equivalents | 5,684 | 10,037 |
| Interest-bearing deposits in banks | 5,329 | 61 |
| Securities available-for-sale, at fair value (amortized cost $21 and $26 at December 31, 2023 and 2022, respectively) | 21 | 26 |
| Federal Home Loan Bank (FHLB) stock | 449 | 250 |
| Loans receivable | 91,941 | 83,340 |
| Allowance for credit losses | (685) | (670) |
| Net loans | 91,256 | 82,670 |
| Accrued interest receivable | 294 | 237 |
| Premises and equipment, net | 1,629 | 1,672 |
| Other assets | 138 | 34 |
| Total assets | $ 104,800 | $ 94,987 |
| **LIABILITIES AND SHAREHOLDERS' EQUITY** | | |
| LIABILITIES | | |
| Customer deposits | $ 79,977 | $ 77,416 |
| Borrowings | 8,700 | 3,000 |
| Other liabilities | 464 | 392 |
| Total liabilities | 89,141 | 80,808 |
| COMMITMENTS AND CONTINGENCIES (NOTE 8) | | |
| SHAREHOLDERS' EQUITY | | |
| Preferred stock (no par value), 1,000,000 shares authorized, no shares issued or outstanding in 2023 and 2022 | - | - |
| Common stock ($1 par value), 10,000,000 shares authorized, 720,802 and 712,498 shares issued and outstanding in 2023 and 2022, respectively | 721 | 712 |
| Additional paid-in capital | 6,900 | 7,001 |
| Retained earnings | 8,038 | 6,466 |
| Accumulated other comprehensive income, net of tax | - | - |
| Total shareholders' equity | 15,659 | 14,179 |
| Total liabilities and shareholders' equity | $ 104,800 | $ 94,987 |

See accompanying notes.

# Washington Business Bank
## Statements of Income
## (dollars in thousands)
## Years Ended December 31, 2023 and 2022

| | 2023 | 2022 |
|---|---|---|
| INTEREST INCOME | | |
| Loans and fees | $ 5,387 | $ 4,226 |
| Federal funds sold and interest-bearing deposits in banks | 512 | 303 |
| FHLB stock dividends | 24 | 22 |
| Securities available-for-sale | 1 | 1 |
| Total interest income | 5,924 | 4,552 |
| INTEREST EXPENSE | | |
| Deposits | 999 | 216 |
| Borrowings | 151 | 62 |
| Total interest expense | 1,150 | 278 |
| Net interest income | 4,774 | 4,274 |
| PROVISION FOR CREDIT LOSSES | | |
| Provision for credit losses | 15 | - |
| Provision for credit losses on unfunded commitments | 22 | - |
| Total provision for credit losses | 37 | - |
| Net interest income after provision for credit losses | 4,737 | 4,274 |
| NONINTEREST INCOME | | |
| Service charges on deposit accounts | 22 | 23 |
| Debit/ATM interchange | 54 | 64 |
| Other fee income | 10 | 10 |
| Net gain on sale of loans | 27 | - |
| Total noninterest income | 113 | 97 |
| NONINTEREST EXPENSE | | |
| Salaries and employee benefits | 1,761 | 1,693 |
| Occupancy and equipment | 120 | 124 |
| Data processing | 168 | 158 |
| Taxes and regulatory assessment | 135 | 108 |
| Other | 676 | 806 |
| Total noninterest expense | 2,860 | 2,889 |
| Income before provision for income taxes | 1,990 | 1,482 |
| PROVISION FOR INCOME TAXES | 418 | 311 |
| NET INCOME | $ 1,572 | $ 1,171 |
| Earnings per common share | | |
| Basic | $ 2.20 | $ 1.66 |
| Diluted | $ 2.11 | $ 1.58 |

See accompanying notes.

# Washington Business Bank
## Statements of Comprehensive Income
## (dollars in thousands)
## Years Ended December 31, 2023 and 2022

| | 2023 | 2022 |
|---|---|---|
| NET INCOME | $ 1,572 | $ 1,171 |
| Other comprehensive income | | |
| Unrealized holding gain (loss) on securities available-for-sale (net of tax (benefit) of $0 for 2023 and 2022) | - | - |
| COMPREHENSIVE INCOME | $ 1,572 | $ 1,171 |

See accompanying notes.

# Washington Business Bank
## Statements of Changes in Shareholders' Equity
## (dollars in thousands)
## Years Ended December 31, 2023 and 2022

| | Common Stock | | Additional | Retained | Accumulated Other Comprehensive | Total Shareholders' |
|---|---|---|---|---|---|---|
| | Shares | Amount | Paid-In-Capital | Earnings | Income | Equity |
| BALANCE, December 31, 2021 | 690,878 | $ 691 | $ 6,856 | $ 5,295 | $ - | $ 12,842 |
| Net income | - | - | - | 1,171 | - | 1,171 |
| Unrealized loss on securities, net of tax | - | - | - | - | - | - |
| Vested restricted stock | 5,220 | 5 | (5) | - | | - |
| Repurchased shares | (2,100) | (2) | (37) | - | - | (39) |
| Exercised stock options | 18,500 | 18 | 121 | - | - | 139 |
| Stock-based compensation | - | - | 66 | - | - | 66 |
| BALANCE, December 31, 2022 | 712,498 | 712 | 7,001 | 6,466 | - | 14,179 |
| Adoption of ASU 326 | - | - | - | - | - | - |
| Net income | - | - | - | 1,572 | - | 1,572 |
| Unrealized loss on securities, net of tax | - | - | - | - | - | - |
| Vested restricted stock | 3,900 | 4 | (4) | - | | - |
| Repurchased shares | (14,996) | (15) | (293) | - | - | (308) |
| Exercised stock options | 19,400 | 20 | 146 | - | - | 166 |
| Stock-based compensation | - | - | 50 | - | - | 50 |
| BALANCE, December 31, 2023 | 720,802 | $ 721 | $ 6,900 | $ 8,038 | $ - | $ 15,659 |

See accompanying notes.

# Washington Business Bank
## Statements of Cash Flows
## (dollars in thousands)
## Years Ended December 31, 2023 and 2022

| | 2023 | 2022 |
|---|---|---|
| CASH FLOWS FROM OPERATING ACTIVITIES | | |
| Net income | $ 1,572 | $ 1,171 |
| Adjustments to reconcile net income to net cash from operating activities | | |
| Provision for credit losses | 15 | - |
| Provision for credit losses on unfunded commitments | 22 | - |
| Deferred income tax | (52) | (88) |
| Gain on sale of loans | 27 | - |
| Depreciation and amortization | 73 | 77 |
| Stock-based compensation expense | 50 | 66 |
| Changes in operating assets and liabilities | | |
| Accrued interest payable | 69 | (1) |
| Accrued interest receivable | (56) | 8 |
| Other assets | (48) | 122 |
| Other liabilities | (24) | 9 |
| Net cash from operating activities | 1,648 | 1,364 |
| CASH FLOWS FROM INVESTING ACTIVITIES | | |
| Activity in securities available-for-sale | | |
| Paydowns received | 5 | 7 |
| Proceeds from sale of loans | 679 | - |
| (Increase) decrease in interest-bearing deposits with banks | (5,268) | 9,358 |
| Increase in loans made to customers, net of principal collections | (9,307) | (1,278) |
| (Purchase) redemption of FHLB stock | (199) | 80 |
| Purchases of premises and equipment | (30) | (36) |
| Net cash from investing activities | (14,120) | 8,131 |
| CASH FLOWS FROM FINANCING ACTIVITIES | | |
| Net change in deposits | 2,561 | (12,812) |
| Repayment of FHLB borrowings | (1,000) | (2,000) |
| Advance of FHLB borrowings | 6,700 | - |
| Repurchase of stock | (308) | (39) |
| Proceeds from exercise of stock options | 166 | 139 |
| Net cash from financing activities | 8,119 | (14,712) |
| NET DECREASE IN CASH AND CASH EQUIVALENTS | (4,353) | (5,217) |
| CASH AND CASH EQUIVALENTS, beginning of year | 10,037 | 15,254 |
| CASH AND CASH EQUIVALENTS, end of year | $ 5,684 | $ 10,037 |
| SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION | | |
| Cash paid during the year for | | |
| Taxes | $ 480 | $ 262 |
| Interest | $ 1,082 | $ 279 |

See accompanying notes.

## 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 midsized 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 credit losses.

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, 2024, which is the date the financial statements are available to be issued.

**Application of new accounting guidance in 2023**

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

The Bank adopted ASC 326 using the modified retrospective method for all financial assets measured at amortized cost and off-balance-sheet credit exposures. Results for reporting periods beginning after January 1, 2023, are presented under ASC 326. The adoption resulted in no change to the allowance for credit losses (ACL), the allowance for unfunded commitments and letters of credit, or to the beginning balance of retained earnings.

**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, 2023 and 2022.

**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 categorized as available-for-sale are generally held for investment purposes (to maturity), although unanticipated future events may result in the sale of some securities. Securities available-for-sale are carried at fair value, with unrealized holding gains and losses reported in other comprehensive income, net of tax. There are no held-to-maturity securities at December 31, 2023 and 2022.

Interest income includes amortization of purchase premium or discount. Premiums and discounts on securities are amortized on the level-yield 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 no longer evaluates securities for other-than-temporary impairment, as ASC Subtopic 326-30, *Financial Instruments – Credit Losses – Available-for-Sale Debt Securities*, changes the accounting for recognizing impairment on available-for-sale and held to maturity debt securities. Each quarter management evaluates impairment where there has been a decline in fair value below the amortized cost basis of a security to determine whether there is a credit loss associated with the decline in fair value. Management considers the nature of the collateral, potential future changes in collateral values, default rates, delinquency rates, third-party guarantees, credit ratings, interest rate changes since purchase, volatility of the security's fair value, and historical loss information for financial assets secured with similar collateral, among other factors. Credit losses are calculated individually, rather than collectively, using a discounted cash flow method, whereby management compares the present value of expected cash flows with the amortized cost basis of the security. The credit loss component is recognized through the provision for credit losses on the statements of income.

**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, 2023 and 2022, and is carried at par value ($15 per share), which reasonably approximates fair value and is included in other assets.

**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, 2023 or 2022.

**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. Loans are generally limited by state banking regulations to 20% of the Bank's shareholders' equity, excluding accumulated other comprehensive income. At December 31, 2023 and 2022, $41,593 and $40,821, respectively, of loans receivable were made for commercial real estate and development 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 credit losses on available for sale securities** – For available for sale securities in an unrealized loss position, management first assesses whether it intends to sell, or is more likely than not to be required to sell, the security before recovery of its amortized cost basis. If either of the criteria regarding intent or requirement to sell is met, the security's amortized cost basis is written down to fair value through income. For debt securities available for sale that do not meet the aforementioned criteria, the Bank evaluates whether the decline in fair value has resulted from credit losses or other factors. In making this assessment, management considers the extent to which fair value is less than amortized cost, any changes to the rating of the security by a rating agency, and adverse conditions specifically related to the security, among other factors. If this assessment indicates that a credit loss exists, the present value of cash flows expected to be collected from the security are compared to the amortized cost basis of the security. If the present value of cash flows expected to be collected is less than the amortized cost basis, a credit loss exists and an ACL is recorded for the credit loss, limited by the amount that the fair value is less than the amortized cost basis.

Changes in the ACL are recorded as a provision for (or reversal of) credit loss expense. Losses are charged against the allowance when management believes the uncollectibility of an available-for-sale security is confirmed or when either of the criteria regarding intent or requirement to sell is met. Accrued interest receivable on available-for-sale debt securities is not included in the estimate of credit losses.

**Allowance for credit losses on loans** – The allowance for credit losses on loans is a valuation account that is deducted from the loans' amortized cost basis to present the net amount expected to be collected on the loans. Loans are charged off against the allowance when management believes the uncollectibility of a loan balance is confirmed and recoveries are credited to the allowance when received. In the case of recoveries, amounts may not exceed the aggregate of amounts previously charged off.

Management utilizes relevant available information, from internal and external sources, relating to past events, current conditions, historical loss experience, and reasonable and supportable forecasts. Historical credit loss experience provides the basis for the estimation of expected credit losses. Adjustments to historical loss information are made for differences in the current loan-specific risk characteristics such as differences in underwriting standards, portfolio mix, delinquency level, or term as well as for changes in environmental conditions, such as changes in unemployment rates, property values, or other relevant factors. Accrued interest receivable is excluded from the estimate of credit losses for loans.

The allowance for credit losses is measured on a collective (pool) basis when similar risk characteristics exist. The Company has segmented the portfolio based on traditional loan portfolio types and measures the allowance for credit losses under the weighted average remaining life method for all segments. The weighted average remaining life uses an average annual charge-off rate applied to the contractual term, further adjusted for estimated prepayments to determine the unadjusted historical charge-off rate for the remaining balance of assets.

Loans that do not share risk characteristics are evaluated on an individual basis. Loans evaluated individually are not also included in the collective evaluation. When management determines foreclose is probable or when the borrower is experiencing financial difficulty at the reporting date and repayment is expected to be provided substantially through the operation or sale of the collateral, expected credit losses are based on the fair value of the collateral at the reporting date, adjusted for selling costs. When the discounted cash flow method is used to determine the allowance for credit losses, management adjusts the effective interest rate used to discount expected cash flows to incorporate expected prepayments.

**Contractual term** – Expected credit losses are estimated over the contractual term of loans, adjusted for expected prepayments when appropriate. The contractual term excludes expected extensions, renewals, and modifications unless either of the following applies: management has a reasonable expectation at the reporting date that an extension or renewal option are included in the original or modified contract at the reporting date and are not unconditionally cancellable by the Company.

**Allowance for credit losses on off-balance-sheet credit exposures** – The Company estimates expected credit losses over the contractual period in which the Company is exposed to credit risk via a contractual obligation to extend credit unless that obligation is unconditionally cancellable by the Company. The allowance for credit losses on off-balance sheet credit exposure is adjusted through a provision for credit loss expense. The estimate includes consideration of the likelihood that funding will occur and an estimate of expected credit losses on commitments expected to be funded over its estimated life. The estimate utilizes the same factors and assumptions as the allowance for credit losses on loans and is applied at the same collective cohort level.

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.

**Collateral-dependent, nonaccrual, and charged-off loans** – Where the primary and/or expected source of repayment of a specific loan is believed to be the future liquidation of available collateral, impairment will generally be measured based upon expected future collateral proceeds, net of disposition expenses including sales commissions as well as other costs potentially necessary to the asset(s) (i.e., past due taxes, liens, etc.). Estimates of future collateral proceeds will be based upon available appraisals, reference to recent valuations of comparable properties, use of consultants or other professionals with relevant market and/or property-specific knowledge, and any other sources of information believed appropriate by management under the specific circumstances.

Where the primary and/or expected source of repayment of a specific loan is believed to be the receipt of principal; and interest payments from the borrower and/or the refinancing of the loan by another creditor, the ACL will generally be measured based upon the present value of expected proceeds discounted at the contractual interest rate. Expected refinancing proceeds may be estimated from review of term sheets actually received by the borrower from other creditors.

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 all delinquent interest and principal become current under the terms of the loan agreement 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 $0 in other real estate owned at December 31, 2023 and 2022, which is included within other assets on the statement of financial condition.

**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 EPS 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 Bank 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 Bank 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 Bank.

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

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

There were no transfers between Level 1, Level 2, and Level 3 during 2023 or 2022.

**Revenue recognition** – The Bank recognizes revenue in accordance with ASC 606, *Revenue from Contracts with Customers*, *as amended* (ASC 606), 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 ASC 606, the Bank 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 Bank satisfies a performance obligation. The majority of the Bank's revenues come from interest income including loans and securities, that are outside the scope of ASC 606. The Bank's services that fall within the scope of ASC 606 are presented within noninterest income and are recognized as revenue as the Bank satisfies its obligation to the customer. Services within the scope of ASC 606 are described below.

All of the Bank's revenue from contracts with customers in the scope of ASC 606 is reported 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. Completion typically occurs 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 nonsufficient 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.

**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, 2023 and 2022, there were no amounts reclassed 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 $19 and $2 for the years ended December 31, 2023 and 2022, 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:

| **December 31, 2023** | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Fair Value |
|---|---|---|---|---|
| Agency mortgage-backed securities and collateralized mortgage obligations | $ 21 | $ - | $ - | $ 21 |
| **December 31, 2022** | | | | |
| Agency mortgage-backed securities and collateralized mortgage obligations | $ 26 | $ - | $ - | $ 26 |

At December 31, 2023 and 2022, 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, 2023 and 2022.

There was no allowance for credit losses on securities available for sale at December 31, 2023.

**Note 3 – Loans Receivable**

The following table presents the principal balance of loans receivable at December 31:

| | 2023 | 2022 |
|---|---|---|
| Commercial | $ 33,620 | $ 25,670 |
| Real estate | | |
| Commercial | 41,593 | 40,821 |
| Multi-family | 2,566 | 2,553 |
| Residential: 1–4 family | 14,114 | 13,079 |
| Total real estate | 58,273 | 56,453 |
| Construction | 210 | 1,387 |
| | 92,103 | 83,510 |
| Less net deferred loan origination fees | (162) | (170) |
| Loans receivable, net | $ 91,941 | $ 83,340 |

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 $18,008 and $17,769 were pledged to the FHLB at December 31, 2023 and 2022, respectively. There were $10,033 and $9,929 in loans pledged to the FRB at December 31, 2023 and 2022, respectively (Note 6).

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

**Allowance for credit losses** – The Bank has an established methodology to determine the adequacy of the allowance for credit losses that assesses the risks and losses expected in the Company's portfolio. For purposes of determining the allowance for credit losses, the Company segments certain loans in its portfolio by product type.

The following tables present, by portfolio segment, the changes in the allowance for credit losses for the years ended December 31, 2023 and 2022, and the amount of loans evaluated for impairment individually and collectively.

| **2023** | Commercial | Real Estate | Construction | Total |
|---|---|---|---|---|
| Allowance | | | | |
| Balance, beginning of the period, prior to the adoption of ASC 326 | $ 198 | $ 451 | $ 21 | $ 670 |
| Impact of adopting ASC 326 | - | - | - | - |
| Charge-offs | - | - | - | - |
| Recoveries | - | - | - | - |
| Provision | 379 | (366) | 2 | 15 |
| Balance, end of the period | $ 577 | $ 85 | $ 23 | $ 685 |
| **2022** | | | | |
| Allowance | | | | |
| Balance, beginning of the period | $ 202 | $ 441 | $ 27 | $ 670 |
| Charge-offs | - | - | - | - |
| Recoveries | - | - | - | - |
| Provision | (4) | 10 | (6) | - |
| Balance, end of the period | $ 198 | $ 451 | $ 21 | $ 670 |
| Ending balance individually evaluated for impairment | $ - | $ - | $ - | $ - |
| Ending balance collectively evaluated for impairment | $ 198 | $ 451 | $ 21 | $ 670 |
| Loans | | | | |
| Ending balance | $ 25,670 | $ 56,453 | $ 1,387 | $ 83,510 |
| Ending balance individually evaluated for impairment | $ - | $ - | $ - | $ - |
| Ending balance collectively evaluated for impairment | $ 25,670 | $ 56,453 | $ 1,387 | $ 83,510 |

**Allowance for credit losses on unfunded loan commitments –** The Bank maintains an allowance for off-balance sheet commitments related to unfunded loans and lines of credit, which is included in other liabilities on the statement of financial condition. The allowance for unfunded commitments was $22,000 at December 31, 2023, an increase compared to $0 at the adoption of CECL on January 1, 2023.

**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 the loans categorized as "Pass" are 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.

A summary of the remaining risk categories are as follows:

**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.

Management has assigned a risk rating to individual loans based on the above criteria, as the table below presents:

| (dollars in thousands) | Term Loans Amortized Cost Basis by Origination Year 2023 | 2022 | 2021 | Prior | Revolving Loans Amortized Cost Basis | Revolving Loans Amortized Cost Basis Converted to Term | Total |
|---|---|---|---|---|---|---|---|
| Commercial | | | | | | | |
| Pass | $ 19,687 | $ 4,184 | $ 1,251 | $ 5,943 | $ 2,448 | $ - | $ 33,513 |
| Watch | - | - | - | - | - | - | - |
| Substandard | - | - | - | 107 | - | - | 107 |
| Total commercial | 19,687 | 4,184 | 1,251 | 6,050 | 2,448 | - | 33,620 |
| Real estate | | | | | | | |
| Pass | 7,241 | 6,314 | 11,125 | 33,593 | - | - | 58,273 |
| Watch | - | - | - | - | - | - | - |
| Substandard | - | - | - | - | - | - | - |
| Total real estate | 7,241 | 6,314 | 11,125 | 33,593 | - | - | 58,273 |
| Construction | | | | | | | |
| Pass | 210 | - | - | - | - | - | 210 |
| Watch | - | - | - | - | - | - | - |
| Substandard | - | - | - | - | - | - | - |
| Total construction | 210 | - | - | - | - | - | 210 |
| Total loans | $ 27,138 | $ 10,498 | $ 12,376 | $ 39,643 | $ 2,448 | $ - | $ 92,103 |
| Total loans | | | | | | | |
| Pass | $ 27,138 | $ 10,498 | $ 12,376 | $ 39,536 | $ 2,448 | $ - | $ 91,996 |
| Watch | - | - | - | - | - | - | - |
| Substandard | - | - | - | 107 | - | - | 107 |
| Total loans | $ 27,138 | $ 10,498 | $ 12,376 | $ 39,643 | $ 2,448 | $ - | $ 92,103 |

The following table represents credit exposures by risk category for the years ended December 31, 2023 and 2022. The use of various categories to grade loans permits management's use of migration analysis to estimate a portion of credit risk.

| | Exceptional | Quality | Average | Below Average | Watch | Substandard | Total |
|---|---|---|---|---|---|---|---|
| Commercial | $ 748 | $ 71 | $ 21,282 | $ 3,557 | $ 12 | $ - | $ 25,670 |
| Real estate | | | | | | | |
| Commercial | - | 9,517 | 26,004 | 5,009 | 291 | - | 40,821 |
| Multi-family | - | - | 2,553 | - | - | - | 2,553 |
| Residential 1-4 family | - | 256 | 9,078 | 3,345 | 400 | - | 13,079 |
| Total real estate | - | 9,773 | 37,635 | 8,354 | 691 | - | 56,453 |
| Construction | - | - | 128 | 1,259 | - | - | 1,387 |
| | $ 748 | $ 9,844 | $ 59,045 | $ 13,170 | $ 703 | $ - | $ 83,510 |

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, 2023 or 2022.

**Past-due loans receivable by class** – The following table includes an aging analysis of the outstanding amortized cost and principal balance of past-due loans receivable as of December 31, 2023 and 2022, respectively. There were no loans and two loans delinquent greater than 90 days and still accruing interest at December 31, 2023 and 2022, respectively.

| **2023** | 30 - 59 Days Past Due | 60 - 89 Days Past Due | 90 Days or More Past Due | Total Past Due | Current | Total Loans |
|---|---|---|---|---|---|---|
| Commercial | $ - | $ - | $ - | $ - | $ 33,620 | $ 33,620 |
| Real estate | | | | | | |
| Commercial | - | - | - | - | 41,593 | 41,593 |
| Multi-family | - | - | - | - | 2,566 | 2,566 |
| Residential 1-4 family | - | - | - | - | 14,114 | 14,114 |
| Total real estate | - | - | - | - | 58,273 | 58,273 |
| Construction | - | - | - | - | 210 | 210 |
| | $ - | $ - | $ - | $ - | $ 92,103 | $ 92,103 |

| **2022** | 30 - 59 Days Past Due | 60 - 89 Days Past Due | 90 Days or More Past Due | Total Past Due | Current | Total Loans | Nonaccrual Loans |
|---|---|---|---|---|---|---|---|
| Commercial | $ - | $ 12 | $ - | $ 12 | $ 25,658 | $ 25,670 | $ - |
| Real estate | | | | | | | |
| Commercial | - | 291 | - | 291 | 40,530 | 40,821 | - |
| Multi-family | - | - | - | - | 2,553 | 2,553 | - |
| Residential 1-4 family | - | 400 | - | 400 | 12,679 | 13,079 | - |
| Total real estate | - | 691 | - | 691 | 55,762 | 56,453 | - |
| Construction | - | - | - | - | 1,387 | 1,387 | - |
| | $ - | $ 703 | $ - | $ 703 | $ 82,807 | $ 83,510 | $ - |

**Nonaccrual loans** – There were no loans on nonaccrual status as of December 31, 2023. Additionally, there were no loans past due over 89 days still accruing interest.

**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 year ended December 31, 2022.

**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 modified loans or troubled debt restructurings at December 31, 2023 or 2022, respectively. No loans were modified in 2022 as TDRs.

**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.

| | 2023 | | 2022 | |
|---|---|---|---|---|
| Outstanding at beginning of year | $ | 1,419 | $ | 731 |
| New loan advances | | - | | 812 |
| Loan repayments | | (223) | | (124) |
| Outstanding at end of year | $ | 1,196 | $ | 1,419 |

**Note 4 – Premises and Equipment**

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

| | 2023 | | 2022 | |
|---|---|---|---|---|
| Land | $ | 437 | $ | 437 |
| Building | | 2,005 | | 1,987 |
| Furniture and fixtures | | 172 | | 170 |
| Equipment | | 685 | | 674 |
| Software | | 124 | | 124 |
| | | 3,423 | | 3,392 |
| Less accumulated depreciation and amortization | | 1,794 | | 1,720 |
| | $ | 1,629 | $ | 1,672 |

**Note 5 – Customer Deposits**

The composition of deposits at December 31 is as follows:

| | 2023 | | 2022 | |
|---|---|---|---|---|
| Demand deposits, noninterest-bearing | $ | 23,848 | $ | 27,401 |
| NOW and money market accounts | | 24,734 | | 34,948 |
| Savings deposits | | 4,325 | | 5,131 |
| Time certificates | | 27,070 | | 9,936 |
| | $ | 79,977 | $ | 77,416 |

The aggregate amount of time certificates of $250 and over was approximately $5,240 and $810 as of December 31, 2023 and 2022, respectively.

Scheduled maturities of time certificates are as follows:

| | | |
|---|---|---|
| 2024 | $ | 23,579 |
| 2025 | | 2,911 |
| 2026 | | 284 |
| 2027 | | - |
| 2028 | | 296 |
| | $ | 27,070 |

Included within time certificates were brokered deposits of $6,089 and $553 as of December 31, 2023 and 2022, respectively.

Deposits from certain related parties of the Bank, principally directors, officers, and their affiliates, at December 31, 2023 and 2022, amounted to approximately $8,845 and $9,505, 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 $7,267 and $6,977 at December 31, 2023 and 2022, respectively. There was $0 outstanding balances under this credit arrangement at December 31, 2023 and 2022.

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, 2023 and 2022.

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, 2023 and 2022, was approximately $4,036 and $10,500, 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.

At December 31, 2023, the Bank had $8,700 of fixed-rate borrowings outstanding with the FHLB, with fixed rates ranging from 0.89% to 5.58% under these agreements. The contractual maturities of FHLB advances at December 31, 2023, are as follows:

| | | |
|---|---|---|
| 2024 | $ | 5,700 |
| 2025 | | 3,000 |
| | $ | 8,700 |

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

| | 2023 | 2022 |
|---|---|---|
| Average balance during the year | $ 5,417 | $ 4,500 |
| Average interest rate during the year | 3.74% | 1.24% |
| Maximum month-end balance during the year | 6,000 | 5,000 |
| Weighted-average rate at year-end | 4.40% | 1.12% |

**Note 7 – Income Taxes**

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

| | 2023 | 2022 |
|---|---|---|
| Current | $ 470 | $ 399 |
| Deferred | (52) | (88) |
| | $ 418 | $ 311 |

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):

| | 2023 | | 2022 | |
|---|---|---|---|---|
| | Amount | Percent | Amount | Percent |
| Federal income tax at statutory rate | $ 418 | 21% | $ 311 | 21% |
| Equity compensation | - | 0% | (13) | -1% |
| Other | - | 0% | 13 | 1% |
| | $ 418 | 21% | $ 311 | 21% |

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

| | 2023 | 2022 |
|---|---|---|
| Deferred tax assets | | |
| Stock-based compensation expense | $ 7 | $ 10 |
| Allowance for loan losses | 89 | 77 |
| Total deferred tax assets | 96 | 87 |
| Deferred tax liabilities | | |
| Deferred income | (63) | (108) |
| Accumulated depreciation | (13) | (12) |
| Cash basis reporting | (4) | (3) |
| Total deferred tax liabilities | (80) | (123) |
| Net deferred tax assets (liabilities) | $ 16 | $ (36) |

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, 2023 and 2022.

### 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:

| | 2023 | 2022 |
|---|---|---|
| Commitments to extend credit | $ 3,679 | $ 3,907 |

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.

## 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 internal revenue service (IRS). At management's discretion, the Bank can make a matching contribution. The Bank contributed $43 and $40 for the years ended December 31, 2023 and 2022, respectively.

## 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 or grants of restricted shares of common stock. The maximum term of these awards is 10 years.

The exercise price of each option equals the fair market value as calculated using the Black Scholes model on the grant date. A share award is a 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. Both share awards and restricted share units are valued using the stock price on the date of grant.

**Stock options** – A summary of the status of the Bank's stock options as of and for the year ended December 31, 2023, is presented below:

| | Shares | Weighted-Average Exercise Price | Weighted-Average Contractual Life (Years) |
|---|---|---|---|
| Outstanding at beginning of year | 48,400 | $ 8.81 | 1.14 |
| Exercised | (19,400) | 8.52 | |
| Expired | - | - | |
| Outstanding at end of year | 29,000 | $ 9.00 | 0.47 |
| Exercisable at end of year | 29,000 | $ 9.00 | 0.47 |

**Restricted share awards** – A summary of the status of the Bank's restricted share awards as of December 31, 2023, and changes during the year ended is presented below:

| | Shares | Weighted-Average Grant-Date Fair Value per Share |
|---|---|---|
| Nonvested at beginning of year | 10,020 | $ 13.10 |
| Granted | 5,250 | 22.25 |
| Vested | (3,900) | 16.48 |
| Nonvested at end of year | 11,370 | $ 16.16 |

The total fair value of shares vested during the years ended December 31, 2023 and 2022, was $64 and $78, respectively.

Compensation expense recorded in the financial statements for stock-based plans for the years ended December 31, 2023 and 2022, totaled $50 and $66, respectively. Unrecognized compensation expense totaled $167 as of December 31, 2023, all of which is attributed to restricted share awards. The weighted-average period over which this remaining compensation cost will be recognized is 2.26 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, 2023, 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, 2023, the most recent notification from the Bank's regulator categorized the Bank as well capitalized under the regulatory framework for prompt corrective action. There are no conditions or events since that notification that management believes have changed the Bank's category.

The Bank's actual capital amounts and ratios are also presented in the following table. Management believes, as of December 31, 2023, 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 | |
|---|---|---|---|---|---|---|---|---|
| **December 31, 2023** | Amount | Ratio | Amount | Ratio | Amount | Ratio | Amount | Ratio |
| Total risk-based capital (to risk-weighted assets) | $ 16,373 | 19.43% | $ 6,743 | 8.00% | $ 8,850 | 10.50% | $ 8,429 | 10.00% |
| Tier I capital (to risk-weighted assets) | 15,657 | 18.58% | 5,057 | 6.00% | 7,164 | 8.50% | 6,743 | 8.00% |
| Common equity Tier 1 capital (to risk-weighted assets) | 15,657 | 18.58% | 3,793 | 4.50% | 5,900 | 7.00% | 5,479 | 6.50% |
| Tier I capital (to adjusted average assets) | 15,657 | 15.23% | 4,112 | 4.00% | 6,682 | 6.50% | 5,140 | 5.00% |
| **December 31, 2022** | | | | | | | | |
| Total risk-based capital (to risk-weighted assets) | $ 14,858 | 20.03% | $ 5,935 | 8.00% | $ 7,790 | 10.50% | $ 7,419 | 10.00% |
| Tier I capital (to risk-weighted assets) | 14,179 | 19.11% | 4,452 | 6.00% | 6,306 | 8.50% | 5,935 | 8.00% |
| Common equity Tier 1 capital (to risk-weighted assets) | 14,179 | 19.11% | 3,339 | 4.50% | 5,194 | 7.00% | 4,823 | 6.50% |
| Tier I capital (to adjusted average assets) | 14,179 | 14.66% | 3,868 | 4.00% | 6,286 | 6.50% | 4,835 | 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, 2023, 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.

**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 |
|---|---|---|---|---|
| **2023** | | | | |
| Agency mortgage-backed securities and collateralized mortgage obligations | $ 21 | $ - | $ 21 | $ - |
| **2022** | | | | |
| Agency mortgage-backed securities and collateralized mortgage obligations | $ 26 | $ - | $ 26 | $ - |

**Assets reported at fair value on a nonrecurring basis** – There were no assets reported at fair valued measures on a nonrecurring basis as of December 31, 2023 or 2022.

Carrying amounts and estimated fair values of financial instruments, as of December 31 are as follows:

| | Carrying | Estimated Fair Value Level | | |
|---|---|---|---|---|
| **December 31, 2023** | Amount | Level 1 | Level 2 | Level 3 |
| Financial assets | | | | |
| Cash and due from banks | $ 3,457 | $ 3,457 | $ - | $ - |
| Federal funds sold | 2,227 | 2,227 | - | - |
| Interest-bearing deposits in other financial institutions | 5,329 | 5,329 | - | - |
| Securities available-for-sale | 21 | - | 21 | - |
| Loans receivable, net | 91,256 | - | - | 89,497 |
| Federal Home Loan Bank stock | 449 | 449 | - | - |
| Financial liabilities | | | | |
| Time deposits | 27,070 | - | 22,449 | - |
| Borrowings | 8,700 | - | 8,751 | - |
| **December 31, 2022** | | | | |
| Financial assets | | | | |
| Cash and due from banks | $ 7,891 | $ 7,891 | $ - | $ - |
| Federal funds sold | 2,146 | 2,146 | - | - |
| Interest-bearing deposits in other financial institutions | 61 | 61 | - | - |
| Securities available-for-sale | 26 | - | 26 | - |
| Loans receivable, net | 82,670 | - | - | 81,593 |
| Federal Home Loan Bank stock | 250 | 250 | - | - |
| Accrued interest receivable | 237 | 237 | - | - |
| Financial liabilities | | | | |
| Demand, savings, money market, and NOW | 67,480 | 67,480 | - | - |
| Time deposits | 9,936 | - | 9,914 | - |
| Accrued interest payable | 4 | 4 | - | - |
| Borrowings | 3,000 | - | 3,113 | - |

### 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):

| | 2023 | 2022 |
|---|---|---|
| Net income | $ 1,572 | $ 1,171 |
| Basic weighted-average common shares outstanding | 716,252 | 704,466 |
| Plus incremental dilutive options and awards outstanding | 28,635 | 37,865 |
| Diluted weighted-average common shares outstanding | 744,887 | 742,331 |
| Basic earnings per share of common stock | $ 2.20 | $ 1.66 |
| Diluted earnings per share of common stock | $ 2.11 | $ 1.58 |

There were no antidilutive options and awards for 2023 and 2022.

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