

**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended June 30, 2023

or

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

For the transition period from _____ to _____

Commission File Number: **001-38437**

OP BANCORP

(Exact Name of Registrant as Specified in its Charter)

California

(State or other jurisdiction of
incorporation or organization)

**1000 Wilshire Blvd., Suite 500,
Los Angeles, CA**

(Address of principal executive offices)

81-3114676

(I.R.S. Employer
Identification No.)

90017

(Zip Code)

Registrant's telephone number, including area code: **(213) 892-9999**

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

Title of each class	Trading Symbol(s)	Name of each exchange on which registered
Common Stock, no par value	OPBK	NASDAQ Global Market

Indicate by check mark whether the Registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the Registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes ☒ NO ☐

Indicate by check mark whether the Registrant has submitted electronically every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the Registrant was required to submit such files). Yes ☒ NO ☐

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, smaller reporting company, or an emerging growth company. See the definitions of "large accelerated filer," "accelerated filer," "smaller reporting company," and "emerging growth company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer	☐	Accelerated filer	☐
Non-accelerated filer	☒	Smaller reporting company	☒
Emerging growth company	☒		

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act. ☒

Indicate by check mark whether the Registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). YES ☐ NO ☒

The number of shares outstanding of the Registrant's Common Stock as of August 2, 2023 was 15,129,203.

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Introduction

This Quarterly Report on Form 10-Q is filed by OP Bancorp, a California corporation and a registered bank holding company (“Company”) with respect to its financial condition, results of operations, and business as of June 30, 2023. The Company’s primary business operations are conducted through its wholly owned subsidiary, Open Bank, a California chartered commercial bank (“Bank”), and unless the context requires otherwise, statements about the Company generally are intended to describe the consolidated operations of the Company and the Bank.

Cautionary Note Regarding Forward-Looking Statements

Certain matters set forth herein (including any exhibits hereto) constitute “forward-looking statements” within the meaning of Section 27A of the Securities Act of 1933, as amended, Rule 175 promulgated thereunder, and Section 21E of the Securities Exchange Act of 1934, as amended, Rule 3b-6 promulgated thereunder and are intended to be covered by the safe harbor provisions of the Private Securities Litigation Reform Act of 1995. All statements that are not statements of historical fact are forward-looking, but such statements include comments about the Company’s current business plans and expectations regarding future operating results, as well as management’s statements about expected future events and economic developments. All such statements reflect the current beliefs and expectations of the Company’s executive management based on currently available information and current and expected market conditions. Forward-looking statements can sometimes be identified by the use of forward-looking language, such as “likely result in,” “expects,” “anticipates,” “estimates,” “forecasts,” “projects,” “intends to,” or may include other similar words or phrases, such as “believes,” “plans,” “trend,” “objective,” “continues,” “remains,” or similar expressions, or future or conditional verbs, such as “will,” “would,” “should,” “could,” “may,” “might,” “can,” or similar verbs.

These forward-looking statements are subject to risks and uncertainties that could cause actual results, performance or achievements to differ materially from those projected. These risks and uncertainties, some of which are beyond our control, include, but are not limited to:

- our ability to meet our liquidity needs, particularly as those obligations relate to the ability to fund deposit withdrawals and undrawn lines of credit;
- the effect of recent bank failures, particularly with the impacts of such events on customer confidence in the Bank and in the banking system generally, and the further impacts of the current market uncertainties on the value of our common stock; interest rate fluctuations, which could have an adverse effect on our profitability;
- external economic and/or market factors, such as changes in monetary and fiscal policies and laws, including the interest rate policies of the Federal Reserve, inflation or deflation, changes in the demand for loans, and fluctuations in consumer spending, borrowing and savings habits, which may have an adverse impact on our financial condition;
- business and economic conditions, particularly those affecting the financial services industry and our primary market areas;
- factors that can impact the performance of our loan portfolio, including real estate values and liquidity in our primary market areas, the financial health of our commercial borrowers, and the success of construction projects that we finance;
- our ability to effectively execute our strategic plan and manage our growth;
- liquidity issues, including fluctuations in the fair value and liquidity of the securities we hold for sale and our ability to raise additional capital, if necessary;
- government actions in response to significant economic, political or social events, such as disease outbreaks, domestic or international terrorism, or war or other hostilities, as such government actions restrict our ability to conduct business or that have the effect of reducing our customers’ ability to maintain compliance with their borrowing obligations or that affect their need for deposit liquidity or increased borrowing capacity;
- continued or increasing competition from other financial institutions, credit unions, and non-bank financial services companies, many of which are subject to different regulations than we are;
- challenges arising from unsuccessful attempts to expand into new geographic markets, products, or services;

- liquidity, earnings and other factors that impact the Bank's ability to continue paying dividends to the Company, which would restrict the Company's ability to meet its operating capital needs;
- increased capital requirements imposed by banking regulators, which may require us to raise capital at a time when capital is not available on favorable terms or at all;
- the effectiveness and operation of the internal controls we maintain to address the risks inherent to the business of banking, including but not limited to our ability to detect promptly any physical security breach, employee misfeasance or malfeasance, data security violation, disclosure controls and procedures, or internal control over financial reporting;
- inaccuracies in our assumptions about future events, which could result in material differences between our financial projections and actual financial performance, or which could call into question the adequacy of our reserves for loan and lease losses or various other estimates in our financial statements;
- changes in our management personnel or our inability to retain, motivate and hire qualified management personnel;
- disruptions, security breaches, or other adverse events, failures or interruptions in, or attacks on, our information technology systems;
- disruptions, security breaches, or other adverse events affecting the third-party vendors who perform several of our critical processing functions;
- an inability to keep pace with the rate of technological advances due to a lack of resources to invest in new technologies;
- risks related to potential acquisitions;
- the effects of natural disasters, such as earthquakes, drought, pandemic diseases (such as the coronavirus) or extreme weather events, any of which may affect services we use or affect our customers, employees or third parties with which we conduct business;
- the impact of any claims or legal actions to which we may be subject, including any effect of such events on our reputation;
- compliance with governmental and regulatory requirements relating to banking, consumer protection, securities and tax matters, and our ability to maintain licenses required in connection with commercial mortgage origination, sale and servicing operations;
- changes in federal tax law or policy; and
- our ability to manage and respond to changes in the foregoing.

The foregoing factors should not be construed as exhaustive and should be read together with the other cautionary statements included in this report. Because of these risks and other uncertainties, our actual future results, performance or achievement, or industry results, may be materially different from the results indicated by the forward looking statements in this report. In addition, our past results of operations are not necessarily indicative of our future results. You should read all forward looking statements in the context of the foregoing and should not consider them to be reliable predictions of future events or as assurances of a particular level of performance or intended course of action. Any forward-looking statement speaks only as of the date on which it is made, and we do not undertake any obligation to update or review any forward-looking statement, whether as a result of new information, future developments or otherwise.

PART I - FINANCIAL INFORMATION

Item 1. Financial Statements.

OP BANCORP AND SUBSIDIARY CONSOLIDATED BALANCE SHEETS

(\$ in thousands)	June 30, 2023 (unaudited)	December 31, 2022
ASSETS		
Cash and cash equivalents	\$ 143,761	\$ 82,972
Available-for-sale debt securities, at fair value	202,250	209,809
Other investments	16,183	12,098
Loans held for sale	—	44,335
Loans receivable, net of allowance for credit losses of \$20,802 in 2023 and \$19,241 in 2022	1,695,395	1,659,051
Premises and equipment, net	5,093	4,400
Accrued interest receivable	7,703	7,180
Servicing assets	12,654	12,759
Company owned life insurance	21,913	21,613
Deferred tax assets, net	13,360	14,316
Operating right-of-use assets	9,487	9,097
Other assets	23,902	16,867
Total assets	\$ 2,151,701	\$ 2,094,497
LIABILITIES AND SHAREHOLDERS' EQUITY		
Liabilities		
Deposits:		
Noninterest bearing	\$ 634,745	\$ 701,584
Interest bearing:		
Money market and others	344,162	526,321
Time deposits greater than \$250	416,208	356,197
Other time deposits	464,524	301,669
Total deposits	1,859,639	1,885,771
Federal Home Loan Bank advances	75,000	—
Accrued interest payable	9,354	2,771
Operating lease liabilities	10,486	10,213
Other liabilities	13,452	18,826
Total liabilities	1,967,931	1,917,581
Shareholders' equity		
Preferred stock no par value; 10,000,000 shares authorized; no shares issued or outstanding in 2023 and 2022	—	—
Common stock – no par value; 50,000,000 shares authorized; 15,118,268 and 15,270,344 shares issued and outstanding in 2023 and 2022, respectively	77,464	79,326
Additional paid-in capital	10,297	9,743
Retained earnings	114,177	105,690
Accumulated other comprehensive loss	(18,168)	(17,843)
Total shareholders' equity	183,770	176,916
Total liabilities and shareholders' equity	\$ 2,151,701	\$ 2,094,497

See accompanying notes to unaudited consolidated financial statements

OP BANCORP AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF INCOME (unaudited)

(\$ in thousand, except per share data)	Three Months Ended June 30,		Six Months Ended June 30,	
	2023	2022	2023	2022
INTEREST INCOME				
Interest and fees on loans	\$ 27,288	\$ 19,108	\$ 53,299	\$ 36,365
Interest on available-for-sale debt securities	1,562	703	3,128	1,233
Other interest income	1,252	337	2,269	494
Total interest income	30,102	20,148	58,696	38,092
Interest expense				
Interest on deposits	11,920	1,069	22,302	1,723
Interest on borrowings	930	—	1,250	—
Total interest expense	12,850	1,069	23,552	1,723
Net interest income	17,252	19,079	35,144	36,369
Provision for (reversal of) credit losses	—	996	(338)	1,337
Net interest income after provision for credit losses	17,252	18,083	35,482	35,032
NONINTEREST INCOME				
Service charges on deposits	573	427	991	815
Loan servicing fees, net of amortization	595	654	1,441	1,101
Gain on sale of loans	2,098	3,873	4,668	7,111
Other income	339	405	800	548
Total noninterest income	3,605	5,359	7,900	9,575
NONINTEREST EXPENSE				
Salaries and employee benefits	7,681	7,109	14,933	12,766
Occupancy and equipment	1,598	1,489	3,168	2,867
Data processing and communication	546	492	1,096	985
Professional fees	381	364	740	688
FDIC insurance and regulatory assessments	420	192	887	399
Promotion and advertising	159	165	321	354
Directors' fees	210	190	371	367
Foundation donation and other contributions	594	852	1,347	1,667
Other expenses	711	650	1,345	1,072
Total noninterest expense	12,300	11,503	24,208	21,165
INCOME BEFORE INCOME TAX EXPENSE	8,557	11,939	19,174	23,442
Income tax expense	2,466	3,459	5,549	6,810
NET INCOME	\$ 6,091	\$ 8,480	\$ 13,625	\$ 16,632
EARNINGS PER SHARE - BASIC	\$ 0.39	\$ 0.55	\$ 0.88	\$ 1.08
EARNINGS PER SHARE - DILUTED	\$ 0.39	\$ 0.54	\$ 0.88	\$ 1.07

See accompanying notes to unaudited consolidated financial statements

OP BANCORP AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (unaudited)

(\$ in thousands)	Three Months Ended June 30,		Six Months Ended June 30,	
	2023	2022	2023	2022
Net income	\$ 6,091	\$ 8,480	\$ 13,625	\$ 16,632
Other comprehensive loss				
Change in unrealized loss on available-for-sale debt securities	(3,565)	(5,243)	(461)	(13,881)
Tax effect	1,055	1,550	136	4,104
Total other comprehensive loss	(2,510)	(3,693)	(325)	(9,777)
Comprehensive income	\$ 3,581	\$ 4,787	\$ 13,300	\$ 6,855

See accompanying notes to unaudited consolidated financial statements

OP BANCORP AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY (unaudited)

	Common Stock		Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Loss	Total Shareholders' Equity
(\$ in thousands, except per share data)	Shares Outstanding	Amount				
Three Months Ended						
Balance at April 1, 2023	15,286,558	\$ 79,475	\$ 10,056	\$ 109,908	\$ (15,658)	\$ 183,781
Net income	—	—	—	6,091	—	6,091
Other comprehensive loss	—	—	—	—	(2,510)	(2,510)
Stock issued under stock-based compensation plans	53,204	—	(73)	—	—	(73)
Stock-based compensation, net	—	—	314	—	—	314
Repurchase of common stock	(221,494)	(2,011)	—	—	—	(2,011)
Cash dividends declared (\$0.12 per share)	—	—	—	(1,822)	—	(1,822)
Balance at June 30, 2023	<u>15,118,268</u>	<u>\$ 77,464</u>	<u>\$ 10,297</u>	<u>\$ 114,177</u>	<u>\$ (18,168)</u>	<u>\$ 183,770</u>
Balance at April 1, 2022						
15,137,808	\$ 78,718	\$ 8,860	\$ 85,694	\$ (7,281)	\$ 165,991	
Net income	—	—	—	8,480	—	8,480
Other comprehensive loss	—	—	—	—	(3,693)	(3,693)
Stock issued under stock-based compensation plans	51,395	—	(79)	—	—	(79)
Stock-based compensation, net	—	—	308	—	—	308
Cash dividends declared (\$0.12 per share)	—	—	—	(1,515)	—	(1,515)
Balance at , June 30, 2022	<u>15,189,203</u>	<u>\$ 78,718</u>	<u>\$ 9,089</u>	<u>\$ 92,659</u>	<u>\$ (10,974)</u>	<u>\$ 169,492</u>
Six Months Ended						
Balance at January 1, 2023	15,270,344	\$ 79,326	\$ 9,743	\$ 105,690	\$ (17,843)	\$ 176,916
Cumulative effect related to adoption of ASC 326, net of tax	—	—	—	(1,484)	—	(1,484)
Adjusted balance at January 1, 2023	15,270,344	79,326	9,743	104,206	(17,843)	175,432
Net income	—	—	—	13,625	—	13,625
Other comprehensive loss	—	—	—	—	(325)	(325)
Stock issued under stock-based compensation plans	146,408	720	(84)	—	—	636
Stock-based compensation, net	—	—	638	—	—	638
Repurchase of common stock	(298,484)	(2,582)	—	—	—	(2,582)

Cash dividends declared(\$0.24 per share)	—	—	—	(3,654)	—	(3,654)
Balance at June 30, 2023	15,118,268	77,464	10,297	114,177	(18,168)	\$ 183,770
Balance at January 1, 2022	15,137,808	\$ 78,718	\$ 8,645	\$ 79,056	\$ (1,197)	\$ 165,222
Net income	—	—	—	16,632	—	16,632
Other comprehensive loss	—	—	—	—	(9,777)	(9,777)
Stock issued under stock-based compensation plans	51,395	—	(79)	—	—	(79)
Stock-based compensation, net	—	—	523	—	—	523
Cash dividends declared (\$0.22 per share)	—	—	—	(3,029)	—	(3,029)
Balance at June 30, 2022	15,189,203	78,718	9,089	92,659	(10,974)	\$ 169,492

See accompanying notes to unaudited consolidated financial statements

OP BANCORP AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF CASH FLOWS (unaudited)

(\$ in thousands)	Six Months Ended June 30,	
	2023	2022
Cash flows from operating activities		
Net income	\$ 13,625	\$ 16,632
Adjustments to reconcile net income to net cash and cash equivalents provided by operating activities:		
(Reversal of) provision for credit losses	(338)	1,337
Depreciation and amortization of premises and equipment	673	671
Amortization of net premiums on securities	131	414
Amortization of servicing assets	2,074	2,161
Accretion of net discounts on loans	(1,304)	(2,584)
Amortization of low income housing partnerships	723	374
Stock-based compensation	638	602
Deferred income taxes	1,092	(859)
Gain on sale of loans	(4,668)	(7,111)
Earnings on company owned life insurance	(300)	(183)
Net change in fair value of equity investment with readily determinable fair value	(1)	293
Origination of loans held for sale	(40,139)	(68,245)
Proceeds from sales of loans held for sale	87,173	90,928
Net change in:		
Accrued interest receivable	(523)	532
Other assets	(6,780)	2,473
Accrued interest payable	6,583	53
Other liabilities	(4,907)	(2,885)
Net cash provided by operating activities	53,752	34,603
Cash flows from investing activities		
Net change in loans receivable	(17,685)	(32,483)
Proceeds from matured, called, or paid-down securities available for sale	12,614	18,853
Purchase of company owned life insurance	—	(10,000)
Purchase of loans	(18,501)	(138,007)
Purchase of available-for-sale debt securities	(5,647)	(57,518)
Purchase of equity investments	(39)	—
Purchase of Federal Home Loan Bank stock	(4,044)	(1,477)
Purchase of premises and equipment, net	(1,366)	(808)
Investment in low income housing partnerships	(1,563)	(374)
Net cash used in investing activities	(36,231)	(221,814)
Cash flows from financing activities		
Net change in deposits	(26,132)	207,557
Cash received from stock option exercises	720	—
Proceeds from Federal Home Loan Bank advances	75,000	—
Repurchase of common stock	(2,582)	—
Cash dividend paid on common stock	(3,654)	(3,029)
Payments related to tax-withholding for vested restricted stock awards	(84)	(79)
Net cash provided by financing activities	43,268	204,449
Net change in cash and cash equivalents	60,789	17,238
Cash and cash equivalents at beginning of period	82,972	115,459

Cash and cash equivalents at end of period	\$	143,761	\$	132,697
Supplemental cash flow information:				
Cash paid during the period for				
Income taxes	\$	7,305	\$	7,947
Interest		16,969		1,670
Supplemental non-cash disclosure:				
Initial recognition of right-of-use assets	\$	1,369	\$	—

See accompanying notes to unaudited consolidated financial statements

OP BANCORP AND SUBSIDIARY
NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

Note 1. Business and Basis of Presentation

OP Bancorp is a California corporation that was formed to acquire 100% of the voting equity of Open Bank (the “Bank”) and commenced operation as a bank holding company on June 1, 2016. This transaction was treated as an internal reorganization as all shareholders of the Bank became shareholders of OP Bancorp. OP Bancorp has no operations other than ownership of the Bank. The Bank is a California state-chartered and FDIC-insured financial institution, which began its operations on June 10, 2005. Headquartered in downtown Los Angeles, California, OP Bancorp operates primarily in the traditional banking business arena that includes accepting deposits and making loans and investments. OP Bancorp’s primary deposit products are demand and time deposits, and the primary lending products are commercial business loans to small to medium sized businesses. OP Bancorp is operating with ten full-service branches.

The accompanying unaudited Consolidated Financial Statements and notes thereto of the Company have been prepared in accordance with the rules and regulations of the Securities and Exchange Commission (“SEC”) for Form 10-Q and conform to practices within the banking industry and include all of the information and disclosures required by accounting principles generally accepted in the United States of America (“GAAP”) for interim financial reporting. The accompanying unaudited Consolidated Financial Statements reflect all adjustments (consisting only of normal recurring adjustments), which are necessary for a fair presentation of the financial results for the interim periods presented, including eliminating intercompany transactions and balances. Certain items on the Consolidated Financial Statements and notes for prior years have been reclassified to conform to the 2023 presentation. The results of operations for the interim periods are not necessarily indicative of the results for the full year. These interim unaudited financial statements should be read in conjunction with the audited Consolidated Financial Statements and the notes thereto included in the Company’s Annual Report on Form 10-K for the year ended December 31, 2022 (“2022 Annual Report on Form 10-K”). Descriptions of our significant accounting policies are included in Note 1. Summary of Significant Accounting Policies in the Notes to Consolidated Financial Statements in the 2022 Annual Report on Form 10-K.

New Accounting Pronouncements Adopted

Financial Accounting Standards Board (“FASB”) Accounting Standards Update (“ASU”) 2016-13, *Financial Instruments — Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments*. The Company adopted ASU 2016-13 using a modified retrospective approach on January 1, 2023 without electing the fair value option on eligible financial instruments under ASU 2019-05. The Company replaced the current incurred loss accounting model with the Current Expected Credit Losses (“CECL”) approach for financial instruments measured at amortized cost and other commitments to extend credit. CECL requires the immediate recognition of estimated credit losses expected to occur over the estimated remaining life of the asset. The forward-looking concept of CECL requires loss estimates to consider historical experience, current conditions and reasonable and supportable forecasts.

The adoption of this ASU increased the allowance for credit losses by \$1.9 million and allowance for off-balance sheet commitments by \$184 thousand. The Company also recorded a deferred tax assets of \$624 thousand and a decrease to opening retained earnings of \$1.5 million on January 1, 2023. The increase to allowance for credit losses was primarily longer duration of home mortgage loans, offset primarily by shorter duration of commercial and industrial (“C&I”) loans. The Company did not record an allowance for credit losses on the Company’s available-for-sale debt securities as a result of this adoption. Disclosures for periods after January 1, 2023 are presented in accordance with ASC 326 while prior period amounts continue to be reported in accordance with previously applicable standards and the accounting policies.

The following table illustrates the impact of ASU 2016-13:

(\$ in thousands)	January 1, 2023, Adoption Date		
	As Reported	Pre-ASU 2016-13	Impact
Assets:			
Loans:			
Commercial real estate	\$ 7,826	\$ 6,951	\$ 875
SBA—real estate	1,369	1,607	(238)
SBA—non-real estate	65	207	(142)
C&I	1,323	1,643	(320)
Home mortgage	10,579	8,826	1,753
Consumer	3	7	(4)
Allowance for credit losses on loans	\$ 21,165	\$ 19,241	\$ 1,924
Liabilities:			
Allowance for credit losses on off-balance sheet commitments	\$ 446	\$ 262	\$ 184

FASB issued ASU 2022-02, Financial Instruments - *Credit Losses (Topic 326): Troubled Debt Restructurings and Vintage Disclosures*. ("ASU 2022-02"). ASU 2022-02 eliminates the accounting guidance for troubled debt restructurings in Accounting Standards Codification ("ASC") Subtopic 310-40, Receivables - Troubled Debt Restructurings by Creditors, while enhancing disclosure requirements for certain loan refinancing and restructurings by creditors when a borrower is experiencing financial difficulty. Additionally, ASU 2022-02 requires entities to disclose current-period gross write-offs by year of origination for financing receivables and net investments in leases within the scope of ASC Subtopic 326-20, Financial Instruments - Credit Losses - Measured at Amortized Cost. The Company adopted ASU 2022-02 on January 1, 2023, and the adoption of ASU 2022-02 did not have a significant impact on its consolidated financial statements.

Recently Issued Accounting Pronouncements under Evaluation

In March 2023, the FASB issued ASU 2023-02, *Investments - Equity Method and Joint Ventures (Topic 323): Accounting for Investments in Tax Credit Structures Using the Proportional Amortization Method*. This ASU permits reporting entities to elect to account for tax equity investments, regardless of the tax credit program for which the income tax credits are received, using the proportional amortization method if certain conditions are met. Under the proportional amortization method, an entity amortizes the initial cost of the investment in proportion to the income tax credits and other income tax benefits received and recognizes the net amortization and income tax credits and other income tax benefits in the income statement as a component of income tax expense. A reporting entity makes an accounting policy election to apply the proportional amortization method on a tax-credit-program-by-tax-credit-program basis rather than electing to apply the proportional amortization method at the reporting entity level or to individual investments. This ASU also requires specific disclosures of investments that generate income tax credits and other income tax benefits from a tax credit program for which the entity has elected to apply the proportional amortization method. The updated guidance is effective for fiscal years beginning after December 15, 2023. The Company is currently evaluating the impact of this new standard on its consolidated financial statements and the adoption is not expected to have a significant impact on the consolidated financial statements.

Note 2. Securities

The following table summarizes the amortized cost, the corresponding amounts of gross unrealized gains and losses, and estimated fair value of available-for-sale ("AFS") debt securities as of June 30, 2023 and December 31, 2022:

(\$ in thousands)	June 30, 2023			
	Amortized Cost	Gross Unrealized Gain	Gross Unrealized Loss	Fair Value
U.S. Government agencies or sponsored agency securities:				
Residential mortgage-backed securities	\$ 51,660	\$ —	\$ (5,328)	\$ 46,332
Residential collateralized mortgage obligations	170,707	—	(20,576)	150,131
Municipal securities-tax exempt	5,677	110	—	5,787
Total AFS debt securities	<u>\$ 228,044</u>	<u>\$ 110</u>	<u>\$ (25,904)</u>	<u>\$ 202,250</u>

(\$ in thousands)	December 31, 2022			
	Amortized Cost	Gross Unrealized Gain	Gross Unrealized Loss	Fair Value
U.S. Government agencies or sponsored agency securities:				
Residential mortgage-backed securities	\$ 55,189	\$ —	\$ (5,425)	\$ 49,764
Residential collateralized mortgage obligations	179,953	1	(19,909)	160,045
Total AFS debt securities	<u>\$ 235,142</u>	<u>\$ 1</u>	<u>\$ (25,334)</u>	<u>\$ 209,809</u>

There were no sales of AFS debt securities during the three and six months ended June 30, 2023 and 2022.

The amortized cost and estimated fair value of AFS debt securities as of June 30, 2023, by contractual maturity, are shown below:

(\$ in thousands)	Amortized Cost	Fair Value
After one year through five years	\$ 1,684	\$ 1,598
After five years through ten years	3,769	3,377
After ten years	222,591	197,275
Total AFS debt securities	<u>\$ 228,044</u>	<u>\$ 202,250</u>

Expected maturities may differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties. As of June 30, 2023 and December 31, 2022, there were no holdings of securities of any one issuer, other than the U.S. Government and its agencies, in an amount greater than 10% of shareholders' equity.

The following table presents the fair value and the associated gross unrealized losses on AFS debt securities by length of time those individual securities in each category have been in a continuous loss as of June 30, 2023 and December 31, 2022:

(\$ in thousands)	June 30, 2023					
	Less Than 12 Months		12 Months or Longer		Total	
	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
U.S. Government agencies or sponsored agency securities:						
Residential mortgage-backed securities	\$ 15,116	\$ (707)	\$ 31,216	\$ (4,621)	\$ 46,332	\$ (5,328)
Residential collateralized mortgage obligations	53,637	(1,194)	96,494	(19,382)	150,131	(20,576)
Total AFS debt securities	\$ 68,753	\$ (1,901)	\$ 127,710	\$ (24,003)	\$ 196,463	\$ (25,904)

(\$ in thousands)	December 31, 2022					
	Less Than 12 Months		12 Months or Longer		Total	
	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
U.S. Government agencies or sponsored agency securities:						
Residential mortgage-backed securities	\$ 26,347	\$ (1,485)	\$ 23,417	\$ (3,940)	\$ 49,764	\$ (5,425)
Residential collateralized mortgage obligations	81,320	(3,888)	71,604	(16,021)	152,924	(19,909)
Total AFS debt securities	\$ 107,667	\$ (5,373)	\$ 95,021	\$ (19,961)	\$ 202,688	\$ (25,334)

As a result of the Company's adoption of ASU 2016-03 on January 1, 2023, available-for-sale debt securities are measured at fair value and are subject to impairment testing. A security is impaired if the fair value of the security is less than its amortized cost basis. When an available-for-sale debt security is considered impaired, the Company must determine if the decline in fair value has resulted from a credit-related loss or other factors and then, (1) recognize an allowance for credit losses by a charge to earnings for the credit-related component of the decline in fair value, and (2) recognize in other comprehensive income (loss) any non-credit related components of the fair value decline. If the amount of the amortized cost basis expected to be recovered increases in a future period, the valuation reserve would be reduced, but not more than the amount of the current existing reserve for that security.

The unrealized losses were primarily attributable to interest rate movement, not credit quality. The Company believes that the gross unrealized losses presented in the previous tables are temporary and no credit losses are expected. As a result, the Company expects full collection of the carrying amount of these securities, does not intend to sell the securities in an unrealized loss position, and it was more-likely-than-not the Company will not have to sell these securities prior to recovery of amortized cost. Accordingly, for available-for-sale debt securities, the Company did not record allowance for credit losses on January 1, 2013 and did not have allowance for credit losses as of June 30, 2023.

As of June 30, 2023 or December 31, 2022, there were no pledged securities to secure public deposits, borrowing and letters of credit from Federal Home Loan Bank ("FHLB") and the Board of Governors of the Federal Reserve System, and for other purposes required or permitted by law.

The following table presents the other investment securities, which are included in Other investments on the Consolidated Balance Sheets as of June 30, 2023 and December 31, 2022:

(\$ in thousands)	June 30, 2023	December 31, 2022
FHLB stock	\$ 12,527	\$ 8,483
Pacific Coast Bankers Bank ("PCBB") stock	190	190
Mutual fund - Community Reinvestment Act ("CRA") qualified	3,370	3,330
Time deposits placed in other banks	96	95
Total other investments	\$ 16,183	\$ 12,098

The Company has equity investment in a mutual fund with readily determinable fair value of \$3.4 million and \$3.3 million, as of June 30, 2023 and December 31, 2022, respectively, which is measured at fair value with changes in fair value recorded in net income. The Company invested in the mutual fund for CRA purposes. For the mutual fund, the Company recorded a \$53 thousand loss and a \$120 thousand loss for the three months ended June 30, 2023 and 2022, respectively, and a \$1 thousand gain and a \$293 thousand loss for the six months ended June 30, 2023 and 2022, respectively. The gains (losses) of the mutual fund are included in Other income in the Consolidated Statements of Income.

Note 3. Loans and Allowance for Credit Losses on Loans

Loans Receivable

The following table presents the composition of the loan portfolio as of June 30, 2023 and December 31, 2022:

(\$ in thousands)	June 30, 2023	December 31, 2022
Commercial real estate	\$ 847,863	\$ 842,208
SBA—real estate	224,476	221,340
SBA—non-real estate	14,309	13,377
C&I	112,160	116,951
Home mortgage	516,226	482,949
Consumer	1,163	1,467
Gross loans receivable	1,716,197	1,678,292
Allowance for credit losses	(20,802)	(19,241)
Loans receivable, net ⁽¹⁾	\$ 1,695,395	\$ 1,659,051

⁽¹⁾ Includes net deferred loan costs/(fees) and unamortized premiums/(unaccreted discounts) of \$(381) thousand and \$160 thousand as of June 30, 2023 and December 31, 2022, respectively.

No loans were outstanding to related parties as of June 30, 2023 and December 31, 2022.

Allowance for Credit Losses on Loans

The Company employs a modeled approach that takes into account current and future economic conditions to estimate lifetime expected losses on a collective basis. With the adoption of CECL, the Company elected not to consider accrued interest receivable in its estimated credit losses because the Company writes off uncollectible accrued interest receivable in a timely manner. The Company considers writing off accrued interest amounts once the amounts become 90 days past due to be considered within a timely manner. The Company has elected to write off accrued interest receivable by reversing interest income. The Company uses transition matrices to develop the Probability of Default ("PD") and Loss Given Default ("LGD") approach, incorporating quantitative factors and qualitative considerations in the calculation of the allowance for credit losses for collectively assessed loans. The model provides forecasts of PD and LGD based on national unemployment rates using regression analysis. The Company incorporates future economic conditions using a weighted multiple scenario approach: baseline and adverse. The Company applies a reasonable and supportable period of one year for the baseline scenario and two years for the adverse scenario, after which loss assumptions revert to historical loss information through a one-year reversion period for the baseline scenario and a two-year reversion period for the adverse scenario.

In order to quantify the credit risk impact of other trends and changes within the loan portfolio, the Company utilizes qualitative adjustments to the modeled estimated loss approaches. The parameters for making adjustments are established under a Credit Risk Matrix that provides different possible scenarios for each of the factors listed below. The Credit Risk Matrix and the possible scenarios enable the Bank to qualitatively adjust the loss rates. This matrix considers the following nine factors, which are patterned after the guidelines provided under the Federal Financial Institutions Examination Council Interagency Policy Statement on the Allowance for Credit Losses, updated to reflect the adoption of CECL:

- Changes in lending policies and procedures, including changes in underwriting standards and practices for collection, charge-offs, and recoveries;
- Actual and expected changes in national and local economic and business conditions and developments in which the institution operates that affect the collectivity of loans;
- Changes in the nature and volume of the loan portfolio;
- Changes in the experience, ability, and depth of lending management and staff;
- Changes in the volume and severity of past due loans, the volume of nonaccrual loans, and the volume and severity of adversely classified loans;
- Changes in the quality of the credit review function;
- Changes in the value of the underlying collateral for loans that are not collateral-dependent;
- The existence, growth, and effect of any concentrations of credit, and
- The effect of other external factors, such as the regulatory, legal and technological environments; competition; and events such as natural disasters.

For loans that do not share similar risk characteristics such as nonaccrual loans above \$250 thousand, the Company evaluates these loans on an individual basis in accordance with ASC 326. Such nonaccrual loans are considered to have different risk profiles than performing loans and are therefore evaluated individually. The Company elected to collectively assess nonaccrual loans with balances below \$250 thousand along with the performing and accrual loans, in order to reduce the operational burden of individually assessing small nonaccrual loans with immaterial balances. For individually assessed loans, the allowance for credit losses is measured using either 1) the present value of future cash flows discounted at the loan's effective interest rate; or 2) the fair value of the collateral, if the loan is collateral-dependent. For the collateral-dependent loans, the Company obtains a new appraisal to determine the fair value of collateral. The appraisals are based on an "as-is" valuation. To ensure that appraised values remain current, the Company obtains updated appraisals every twelve months from a qualified independent appraiser. If the fair value of the collateral is less than the amortized balance of the loan, the Company recognizes an allowance for credit losses with a corresponding charge to the provision for credit losses.

The Company maintains a separate allowance for credit losses for its off-balance sheet commitments. The Company uses an estimated funding rate to allocate an allowance to undrawn exposures. This funding rate is used as a credit conversion factor to capture how much undrawn lines of credit can potentially become drawn at any point. The funding rate is determined based on a look-back period of 8 quarters. Credit loss is not estimated for off-balance sheet commitments that are unconditionally cancellable by the Company.

The following table summarizes the activity in the allowance for credit losses on loans by portfolio segment for the three and six months ended June 30, 2023 and 2022:

(\$ in thousands)	Commercial Real Estate	SBA— Real Estate	SBA —Non- Real Estate	C&I	Home Mortgage	Consumer	Total
Three Months Ended June 30, 2023							
Beginning balance	\$ 6,784	\$ 1,218	\$ 67	\$ 1,270	\$ 11,472	\$ 3	\$ 20,814
Provision for (reversal of) credit losses	—	—	—	—	—	—	—
Charge-offs	—	—	(20)	—	—	—	(20)
Recoveries	—	—	8	—	—	—	8
Ending balance	\$ 6,784	\$ 1,218	\$ 55	\$ 1,270	\$ 11,472	\$ 3	\$ 20,802
Three Months Ended June 30, 2022							
Beginning balance	\$ 6,480	\$ 1,750	\$ 169	\$ 3,492	\$ 4,768	\$ 13	\$ 16,672
Provision for (reversal of) credit losses	1,263	43	(61)	(1,390)	1,145	(4)	996
Charge-offs	—	—	(18)	—	—	—	(18)
Recoveries	—	7	45	—	—	—	52
Ending balance	\$ 7,743	\$ 1,800	\$ 135	\$ 2,102	\$ 5,913	\$ 9	\$ 17,702

(\$ in thousands)	Commercial Real Estate	SBA— Real Estate	SBA —Non- Real Estate	C&I	Home Mortgage	Consumer	Total
Six Months Ended June 30, 2023							
Beginning balance	\$ 6,951	\$ 1,607	\$ 207	\$ 1,643	\$ 8,826	\$ 7	\$ 19,241
Impact of CECL adoption	875	(238)	(142)	(320)	1,753	(4)	1,924
(Reversal of) provision for credit losses	(951)	(140)	(7)	(53)	893	—	(258)
Charge-offs	(91)	(11)	(34)	—	—	—	(136)
Recoveries	—	—	31	—	—	—	31
Ending balance	\$ 6,784	\$ 1,218	\$ 55	\$ 1,270	\$ 11,472	\$ 3	\$ 20,802
Six Months Ended June 30, 2022							
Beginning balance	\$ 8,150	\$ 2,022	\$ 199	\$ 2,848	\$ 2,891	\$ 13	\$ 16,123
(Reversal of) provision for credit losses ⁽¹⁾	(407)	(215)	(108)	(746)	3,022	(5)	1,541
Charge-offs	—	(14)	(18)	—	—	—	(32)
Recoveries	—	7	62	—	—	1	70
Ending balance	\$ 7,743	\$ 1,800	\$ 135	\$ 2,102	\$ 5,913	\$ 9	\$ 17,702

⁽¹⁾ Excludes reversal of uncollectible accrued interest receivable of \$205 thousand for the six months ended June 30, 2022.

The following table presents the allowance for credit losses on loans and recorded investment (not including accrued interest receivable) by portfolio segment and impairment methodology as of June 30, 2023 and December 31, 2022:

(\$ in thousands)	Individually Evaluated for Impairment	Collectively Evaluated for Impairment	Total
As of June 30, 2023			
Allowance for credit losses:			
Commercial real estate	\$ —	\$ 6,784	\$ 6,784
SBA—real estate	57	1,161	1,218
SBA—non-real estate	—	55	55
C&I	—	1,270	1,270
Home mortgage	—	11,472	11,472
Consumer	—	3	3
Total	\$ 57	\$ 20,745	\$ 20,802
Loans ⁽¹⁾ :			
Commercial real estate	\$ —	\$ 847,863	\$ 847,863
SBA—real estate ⁽²⁾	4,362	220,114	224,476
SBA—non-real estate	—	14,309	14,309
C&I	—	112,160	112,160
Home mortgage	2,305	513,921	516,226
Consumer	—	1,163	1,163
Total	\$ 6,667	\$ 1,709,530	\$ 1,716,197
As of December 31, 2022			
Allowance for credit losses:			
Commercial real estate	\$ —	\$ 6,951	\$ 6,951
SBA—real estate	—	1,607	1,607
SBA—non-real estate	—	207	207
C&I	279	1,364	1,643
Home mortgage	—	8,826	8,826
Consumer	—	7	7
Total	\$ 279	\$ 18,962	\$ 19,241
Loans ⁽¹⁾ :			
Commercial real estate	\$ —	\$ 842,208	\$ 842,208
SBA—real estate	423	220,917	221,340
SBA—non-real estate	—	13,377	13,377
C&I	279	116,672	116,951
Home mortgage	—	482,949	482,949
Consumer	—	1,467	1,467
Total	\$ 702	\$ 1,677,590	\$ 1,678,292

⁽¹⁾ Excludes accrued interest receivables of \$6.8 million and \$6.4 million as of June 30, 2023 and December 31, 2022, respectively.

⁽²⁾ Individually evaluated loans of \$4.4 million include guaranteed portion of SBA loans of \$3.6 million as of June 30, 2023.

The following table presents the recorded investment in impaired loans and the specific allowance for loan losses as of December 31, 2022.

(\$ in thousands)	Unpaid Principal Balance	December 31, 2022 ⁽¹⁾		
		Recorded Investment With No Allowance	Recorded Investment With Allowance	Related Allowance
SBA—real estate	\$ 423	\$ 423	\$ —	\$ —
C&I	279	—	279	279
Total	\$ 702	\$ 423	\$ 279	\$ 279

⁽¹⁾ The difference between the unpaid principal balance (net of partial charge-offs) and the recorded investment in the loans was not considered to be material

Collateral-dependent loans are loans where repayment is expected to be provided solely by the sale of the underlying collateral and there are no other available and reliable sources of repayment. The estimated credit losses for these loans are based on the collateral's fair value less selling costs. In most cases, the Company records a partial charge-off to reduce the loan's carrying value to the collateral's fair value less selling costs at the time of foreclosure. As of June 30, 2023, there were \$6.7 million of collateral-dependent loans which are primarily secured by residential and commercial real estate, as well as equipment. The allowance for credit losses allocated to these loans as of June 30, 2023 was \$57 thousand.

The following table represents the amortized cost basis of collateral-dependent loans by class of loans as of June 30, 2023, for which repayment is expected to be obtained through the sale of the underlying collateral.

(\$ in thousands)	Hotel / Motel	Gas Station	Single-Family Residential	Total
As of June 30, 2023				
SBA—real estate ⁽¹⁾	\$ 424	\$ 3,938	\$ —	\$ 4,362
Home mortgage	—	—	2,305	2,305
Total	\$ 424	\$ 3,938	\$ 2,305	\$ 6,667

⁽¹⁾ Includes guaranteed portion of SBA loans of \$3.6 million as of June 30, 2023.

The following table presents the recorded investment in nonaccrual loans and loans past due 90 or more days and still accruing interest, by portfolio as of June 30, 2023 and December 31, 2022:

(\$ in thousands)	Nonaccrual Loans with a Related Allowance for Credit Losses	Nonaccrual Loans without a Related Allowance for Credit Losses	Total Nonaccrual Loans	90 or More Days Past Due & Still Accruing	Total ⁽¹⁾
As of June 30, 2023					
SBA—real estate	\$ 5,056	\$ 423	\$ 5,479	\$ —	\$ 5,479
SBA—non-real estate	182	351	533	246	779
C&I	—	—	—	—	—
Home mortgage	249	2,305	2,554	—	2,554
Total	\$ 5,487	\$ 3,079	\$ 8,566	\$ 246	\$ 8,812
As of December 31, 2022					
SBA—real estate			\$ 423	\$ —	\$ 423
SBA—non-real estate			657	442	1,099
C&I			279	—	279
Home mortgage			1,280	—	1,280
Total			\$ 2,639	\$ 442	\$ 3,081

⁽¹⁾ Includes guaranteed portion of SBA loans of \$5.4 million and \$1.0 million as of June 30, 2023 and December 31, 2022, respectively.

Nonaccrual loans and loans past due 90 or more days and still accruing interest include both homogeneous loans that are collectively and individually evaluated for impairment and individually classified impaired loans.

The following table represents the aging analysis of the recorded investment in past due loans as of June 30, 2023 and December 31, 2022:

(\$ in thousands)	30-59 Days Past Due	60-89 Days Past Due	> 90 Days Past Due	Total Past Due ⁽¹⁾	Loans Not Past Due	Total ⁽²⁾
As of June 30, 2023						
Commercial real estate	\$ —	\$ —	\$ —	\$ —	\$ 847,863	\$ 847,863
SBA—real estate	851	198	5,056	6,105	218,371	224,476
SBA—non-real estate	157	80	597	834	13,475	14,309
C&I	200	—	—	200	111,960	112,160
Home mortgage	3,216	1,370	1,462	6,048	510,178	516,226
Consumer	—	—	—	—	1,163	1,163
Total	\$ 4,424	\$ 1,648	\$ 7,115	\$ 13,187	\$ 1,703,010	\$ 1,716,197
As of December 31, 2022						
Commercial real estate	\$ —	\$ —	\$ —	\$ —	\$ 842,208	\$ 842,208
SBA—real estate	199	175	—	374	220,966	221,340
SBA—non-real estate	117	49	381	547	12,830	13,377
C&I	—	—	441	441	116,510	116,951
Home mortgage	1,707	1,522	342	3,571	479,378	482,949
Consumer	—	—	—	—	1,467	1,467
Total	\$ 2,023	\$ 1,746	\$ 1,164	\$ 4,933	\$ 1,673,359	\$ 1,678,292

⁽¹⁾ Includes guaranteed portion of SBA loans of \$5.3 million as of June 30, 2023.

⁽²⁾ Excludes accrued interest receivables of \$6.8 million and \$6.4 million as of June 30, 2023 and December 31, 2022, respectively.

Loan Modifications to Borrowers Experiencing Financial Difficulty: On January 1, 2023, the Company adopted ASU 2022-02, “Financial Instruments - Credit Losses (Topic 326): Troubled Debt Restructurings and Vintage

Disclosures", which eliminated the accounting guidance for troubled debt restructurings ("TDRs") while enhancing disclosure requirements for certain loan refinancing and restructurings by creditors when a borrower is experiencing financial difficulty. This guidance was applied on a prospective basis. Upon adoption of this guidance, the Company no longer establishes a specific reserve for modifications to borrowers experiencing financial difficulty, unless those loans do not share the same risk characteristics with other loans in the portfolio. Provided that is not the case, these modifications are included in their respective cohort and the allowance for credit losses is estimated on a pooled basis consistent with the other loans with similar risk characteristics.

Modifications to borrowers experiencing financial difficulty may include interest rate reductions, principal or interest forgiveness, other than insignificant payment deferrals, other than insignificant term extensions, and other actions intended to minimize economic loss and to avoid foreclosure or repossession of collateral. The disclosure below provide information on loan modification to borrowers experiencing financial difficulty. No charge-offs of previously modified loans were recorded for the three and six months ended June 30, 2023.

The following table presents the amortized cost of modified loans and the financial effects of the modification as of June 30, 2023 by loan class and modification type:

(\$ in thousands)	Interest Only	Total	Percentage to Each Loan Type
As of June 30, 2023			
SBA—non-real estate	\$ 139	\$ 139	0.99 %
Total	\$ 139	\$ 139	0.99 %

The Company tracks the performance of modified loans. A modified loan may become delinquent and may result in a payment default (generally 90 days past due) subsequent to modification. There were no loans that received a modification during the three and six months ended June 30, 2023 that subsequently defaulted.

The following table presents the performance of loans that were modified as of June 30, 2023 since the adoption of ASU 2022-02 on January 1, 2023:

(\$ in thousands)	Current	Total
As of June 30, 2023		
SBA—non-real estate	\$ 139	\$ 139
Total	\$ 139	\$ 139

The Company had no additional commitments to lend to borrowers whose loans were modified as of June 30, 2023.

Credit Quality Indicators: The Company categorizes loans into risk categories based on relevant information about the ability of borrowers to service their debt such as: current financial information, historical payment experience, credit documentation, public information, and current economic trends, among other factors. For consumer loans, a credit grade is established at inception, and generally only adjusted based on performance. The Company analyzes loans individually by classifying the loans as to credit risk. This analysis is performed on a quarterly basis. The Company uses the following definitions for risk ratings:

Special Mention—Loans classified as special mention have a potential weakness that deserves management's close attention. If left uncorrected, these potential weaknesses may result in deterioration of the repayment prospects for the loan or of the Company's credit position at some future date.

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

Doubtful—Loans classified as doubtful have all the weaknesses inherent in those classified as substandard, with the added characteristic that the weaknesses make collection or liquidation in full, on the basis of currently existing facts, conditions, and values, highly questionable and improbable.

Loans not meeting the criteria above that are analyzed individually as part of the above described process are considered to be pass-rated loans.

The following table presents the loan portfolio's amortized cost by loan type, risk rating and year of origination as of as of June 30, 2023:

	June 30, 2023								
	Term Loans by Origination Year						Revolving Loans	Total ⁽¹⁾	
(\$ in thousands)	2023	2022	2021	2020	2019	Prior			
<u>Commercial real estate</u>									
Pass	\$ 47,055	\$ 213,706	\$ 151,119	\$ 98,413	\$ 146,211	\$ 180,349	\$ 11,010	\$ 847,863	
Special mention	—	—	—	—	—	—	—	—	
Substandard	—	—	—	—	—	—	—	—	
Doubtful	—	—	—	—	—	—	—	—	
Subtotal	\$ 47,055	\$ 213,706	\$ 151,119	\$ 98,413	\$ 146,211	\$ 180,349	\$ 11,010	\$ 847,863	
Current period charge-offs	\$ —	\$ —	\$ —	\$ —	\$ 91	\$ —	\$ —	\$ 91	
<u>SBA— real estate</u>									
Pass	\$ 9,680	\$ 47,869	\$ 27,462	\$ 27,817	\$ 30,354	\$ 72,144	\$ —	\$ 215,326	
Special mention	—	1,045	—	—	939	925	—	2,909	
Substandard	—	—	5,056	—	—	1,185	—	6,241	
Doubtful	—	—	—	—	—	—	—	—	
Subtotal	\$ 9,680	\$ 48,914	\$ 32,518	\$ 27,817	\$ 31,293	\$ 74,254	\$ —	\$ 224,476	
Current period charge-offs	\$ —	\$ —	\$ 11	\$ —	\$ —	\$ —	\$ —	\$ 11	
<u>SBA—non-real estate</u>									
Pass	\$ 3,040	\$ 2,917	\$ 531	\$ 2,085	\$ 1,018	\$ 3,965	\$ —	\$ 13,556	
Special mention	—	—	—	—	—	—	—	—	
Substandard	—	—	—	—	—	477	—	477	
Doubtful	—	—	—	—	—	276	—	276	
Subtotal	\$ 3,040	\$ 2,917	\$ 531	\$ 2,085	\$ 1,018	\$ 4,718	\$ —	\$ 14,309	
Current period charge-offs	\$ —	\$ —	\$ —	\$ —	\$ —	\$ 34	\$ —	\$ 34	
<u>C&I</u>									
Pass	\$ 9,284	\$ 24,277	\$ 26,291	\$ 6,246	\$ 4,955	\$ 2,773	\$ 38,134	\$ 111,960	
Special mention	—	—	—	—	—	—	—	—	
Substandard	—	—	—	—	—	—	200	200	
Doubtful	—	—	—	—	—	—	—	—	
Subtotal	\$ 9,284	\$ 24,277	\$ 26,291	\$ 6,246	\$ 4,955	\$ 2,773	\$ 38,334	\$ 112,160	
Current period charge-offs	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —	
<u>Home mortgage</u>									
Pass	\$ 51,276	\$ 318,076	\$ 80,294	\$ 20,087	\$ 9,794	\$ 34,145	\$ —	\$ 513,672	
Special mention	—	—	—	—	—	—	—	—	
Substandard	—	904	873	777	—	—	—	2,554	
Doubtful	—	—	—	—	—	—	—	—	
Subtotal	\$ 51,276	\$ 318,980	\$ 81,167	\$ 20,864	\$ 9,794	\$ 34,145	\$ —	\$ 516,226	

Current period charge-offs	\$	—	\$	—	\$	—	\$	—	\$	—	\$	—	\$	—	\$	—
Consumer																
Pass	\$	5	\$	—	\$	—	\$	—	\$	126	\$	35	\$	997	\$	1,163
Special mention		—		—		—		—		—		—		—		—
Substandard		—		—		—		—		—		—		—		—
Doubtful		—		—		—		—		—		—		—		—
Subtotal	\$	5	\$	—	\$	—	\$	—	\$	126	\$	35	\$	997	\$	1,163
Current period charge-offs	\$	—	\$	—	\$	—	\$	—	\$	—	\$	—	\$	—	\$	—
Total loans																
Pass	\$	120,340	\$	606,845	\$	285,697	\$	154,648	\$	192,458	\$	293,411	\$	50,141	\$	1,703,540
Special mention		—		1,045		—		—		939		925		—		2,909
Substandard		—		904		5,929		777		—		1,662		200		9,472
Doubtful		—		—		—		—		—		276		—		276
Subtotal	\$	120,340	\$	608,794	\$	291,626	\$	155,425	\$	193,397	\$	296,274	\$	50,341	\$	1,716,197
Current period charge-offs	\$	—	\$	—	\$	11	\$	—	\$	91	\$	34	\$	—	\$	136

(1) Excludes accrued interest receivables of \$6.8 million as of June 30, 2023.

The following table presents the loan portfolio's amortized cost by loan type and risk rating of as of December 31, 2022:

(\$ in thousands)	Pass	Special Mention	Substandard	Doubtful	Total ⁽¹⁾
As of December 31, 2022					
Commercial real estate	\$ 841,645	\$ 563	\$ —	\$ —	\$ 842,208
SBA—real estate	220,348	—	992	—	221,340
SBA—non-real estate	12,897	—	480	—	13,377
C&I	116,396	—	279	276	116,951
Home mortgage	481,669	—	1,280	—	482,949
Consumer	1,467	—	—	—	1,467
Total	\$ 1,674,422	\$ 563	\$ 3,031	\$ 276	\$ 1,678,292

(1) Excludes accrued interest receivables of \$6.8 million and \$6.4 million as of June 30, 2023 and December 31, 2022, respectively..

Note 4. Premises and Equipment

The following table presents information regarding the premises and equipment as of June 30, 2023 and December 31, 2022:

(\$ in thousands)	June 30, 2023	December 31, 2022
Leasehold improvements	\$ 8,754	\$ 7,998
Furniture and fixtures	4,408	3,983
Equipment and others	3,468	3,288
Total premises and equipment	16,630	15,269
Accumulated depreciation	(11,537)	(10,869)
Total premises and equipment, net	\$ 5,093	\$ 4,400

Total depreciation expense included in occupancy and equipment expenses was \$338 thousand and \$341 thousand for the three months ended June 30, 2023 and 2022, respectively, and \$673 thousand and \$671 thousand for the six months ended June 30, 2023 and 2022, respectively.

Note 5. Servicing Assets

The Company recognizes the right to service SBA loans for others as servicing assets when the servicing income the Company receives is more than adequate compensation. Servicing assets are accounted for using the amortization method. Under this method, the Company amortizes the servicing assets over the period of the economic life of the assets arising from estimated net servicing revenue.

The Company periodically stratifies its servicing assets into groupings based on risk characteristics and assesses each group for impairment based on fair value. Based on the results of the impairment test, there was no valuation allowance for impairment as of June 30, 2023 and December 31, 2022.

The following table presents an analysis of the changes in activity for loan servicing assets during the three and six months ended June 30, 2023 and 2022:

(\$ in thousands)	Three Months Ended June 30, 2023		Six Months Ended June 30, 2023	
	2023	2022	2023	2022
Beginning balance	\$ 12,898	\$ 12,341	\$ 12,759	\$ 12,720
Additions from loans sold with servicing retained	869	1,357	1,969	2,149
Amortized to expense	(1,113)	(990)	(2,074)	(2,161)
Ending balance	\$ 12,654	\$ 12,708	\$ 12,654	\$ 12,708

The fair value of the servicing assets was \$18.2 million as of June 30, 2023, which was determined using discount rates ranging from 3.75% to 10.50% and prepayment speeds ranging from 12.40% to 12.90%, depending on the stratification of the specific assets.

The fair value of the servicing assets was \$15.2 million as of June 30, 2022, which was determined using discount rates ranging from 5.17% to 11.42% and prepayment speeds ranging from 15.00% to 15.50% depending on the stratification of the specific assets.

Note 6. Deposits

Time deposits that exceed the FDIC insurance limit of \$250 thousand as of June 30, 2023 and December 31, 2022 were \$416.2 million and \$356.2 million, respectively.

The following table presents the scheduled contractual maturities of time deposits as of June 30, 2023:

(\$ in thousands)	
Remainder of 2023	\$ 459,991
2024	380,099
2025	22,985
2026	17,268
2027 and thereafter	389
Total	\$ 880,732

Deposits from principal officers, directors, and their affiliates as of June 30, 2023 and December 31, 2022 were \$1.1 million and \$810 thousand, respectively.

The Company had estimated uninsured deposits of \$1.09 billion, or 58.7% of total deposits, and \$1.14 billion, or 60.3% of total deposits, as of June 30, 2023 and December 31, 2022, respectively.

Note 7. Borrowing Arrangements

As of June 30, 2023, the Company had \$75.0 million advances from FHLB with a weighted average interest rate of 4.22% and a weighted average remaining term of 1.7 years. The Company has a letter of credit with the FHLB in the amount of \$67.0 million to secure a public deposit as of both June 30, 2023 and December 31, 2022.

The Company had available borrowing capacity from the following institutions as of June 30, 2023:

(\$ in thousands)		
FHLB	\$	400,543
Federal Reserve Bank		172,316
Pacific Coast Bankers Bank		50,000
Zions Bank		25,000
First Horizon Bank		25,000
Total	\$	672,859

The Company has pledged approximately \$1.30 billion and \$1.24 billion of loans as collateral for these lines of credit as of June 30, 2023 and December 31, 2022, respectively.

Note 8. Income Taxes

The Company's income tax expense was \$2.5 million and \$3.5 million for the three months ended June 30, 2023 and 2022, respectively, and \$5.5 million and \$6.8 million for the six months ended June 30, 2023 and 2022, respectively. The effective income tax rate was 28.8% and 29.0% for the three months ended June 30, 2023 and 2022, respectively, and 28.9% and 29.1% for the six months ended June 30, 2023 and 2022, respectively.

The Company is subject to U.S. Federal income tax as well as various state taxing jurisdictions. The Company is no longer subject to examination by Federal taxing authorities for tax years prior to 2019 and for state taxing authorities for tax years prior to 2018.

There were no significant unrealized tax benefits recorded as of June 30, 2023 and 2022, and the Company does not expect any significant increase in unrealized tax benefits in the next twelve months.

Note 9. Commitments and Contingencies

Off-Balance-Sheet Credit Risk: In the normal course of business, the Company enters into commitments to extend credit such as loan commitments and standby letters of credits ("SBLC"s). These commitments expose the Company to varying degrees of credit and market risk and are subject to the same credit and market risk limitation reviews as those instruments recorded on the Consolidated Balance Sheets. Loan commitments represent arrangements to lend funds or provide liquidity subject to specified contractual conditions. Standby letters of credit are conditional commitments issued by the Company to guarantee the performance of a customer to a third party. These commitments generally have fixed expiration dates or contain termination clauses in the event the customer's credit quality deteriorates. Since many of the commitments are expected to expire without being drawn upon, the commitment amounts do not necessarily represent future funding requirements.

The Company applies the same credit underwriting criteria to extend loans and commitments to customers. Each customer's credit worthiness is evaluated on a case-by-case basis. Collateral may be obtained based on management's assessment of a customer's credit. Collateral may include securities, accounts receivable, inventory, property, plant and equipment, and income producing commercial or other properties.

The following table presents the distribution of undisbursed credit-related commitments as of June 30, 2023 and December 31, 2022:

(\$ in thousands)	June 30, 2023	December 31, 2022
Loan commitments	\$ 288,429	\$ 265,110
Standby letter of credit	5,959	5,286
Commercial letter of credit	—	451
Total undisbursed credit related commitments	\$ 294,388	\$ 270,847

The majority of these off-balance sheet commitments have a variable interest rate. Management does not anticipate any material losses as a result of these transactions.

Investments in low-income housing partnership: The Company invests in qualified affordable housing partnerships.

The following table shows the balance of the investments in low-income housing partnerships and the total unfunded commitments related to the investments in low-income housing partnerships as of June 30, 2023 and December 31, 2022:

(\$ in thousands)	June 30, 2023	December 31, 2022
Investments in low-income housing partnerships	\$ 11,489	\$ 12,212
Unfunded commitments to fund investments for low-income housing partnerships	7,185	8,748

These balances are reflected in the other assets and other liabilities lines on the Consolidated Balance Sheets. The Company expects to finish fulfilling these commitments during the year ending 2039.

Under the proportional amortization method, the Company amortizes the initial cost of the investment in proportion to the tax credit and other benefits received and recognizes the amortization in income tax expense on the Consolidated Statements of Income. The Company recognized amortization expense of \$362 thousand and \$187 thousand for the three months ended June 30, 2023 and 2022, respectively, and \$723 thousand and \$374 thousand for the six months ended June 30, 2023 and 2022, respectively. Additionally, the Company recognized tax credits and other benefits from the investments in low-income housing partnerships of \$456 thousand and \$160 thousand for the three months ended June 30, 2023 and 2022, respectively, and \$912 thousand and \$320 thousand, respectively, for the six months ended June 30, 2023 and 2022, respectively.

Note 10. Stock-Based Compensation

The Company has three stock-based compensation plans currently in effect as of June 30, 2023, as described further below. Total compensation cost that has been charged against earnings for these plans for the three months ended June 30, 2023 and 2022 was \$314 thousand and \$308 thousand, respectively, and \$638 thousand and \$523 thousand for the six months ended June 30, 2023 and 2022, respectively.

2005 Plan: In 2005, the Board of Directors and shareholders of the Bank approved a stock option plan for the benefit of directors and employees of the Bank (the “2005 Plan”). The 2005 Plan was assumed by the Company in 2016 at the time of the bank holding company reorganization. Under the 2005 Plan, the Bank was authorized to grant options to purchase up to 770,000 shares of the Company’s common stock.

The exercise prices of the options may not be less than 100% of the fair value of the Company’s common stock at the date of grant. The options, when granted, vest either immediately or ratably over five years from the date of the grant and expire after ten years if not exercised. The 2005 Plan expired in 2015, and no future grants can be made under the 2005 Plan.

A summary of the transactions under the 2005 Plan for the six months ended June 30, 2023 is as follows:

(\$ in thousands, except share data)	Number of Options Outstanding	Weighted Average Exercise Price	Aggregate Intrinsic Value
Outstanding, as of January 1, 2023	30,000	\$ 6.18	\$ 149
Options granted	—	—	—
Options exercised	—	—	—
Options forfeited	—	—	—
Options expired	—	—	—
Outstanding, as of June 30, 2023	30,000	\$ 6.18	\$ 67
Fully vested and expected to vest	30,000	\$ 6.18	\$ 67
Vested	30,000	\$ 6.18	\$ 67

No tax benefits or expenses were realized from restricted stock units under the 2010 Plan for the three and six months ended June 30, 2023 and 2022.

The weighted average remaining contractual term of stock options outstanding under the 2005 Plan as of June 30, 2023 was 0.2 year. The weighted average remaining contractual term of stock options that were exercisable as of June 30, 2023 was 0.2 year. All of the stock options that are outstanding under the 2005 Plan were fully vested as of June 30, 2023.

2010 Plan: In 2010, the Board of Directors of the Bank approved a new equity incentive plan for granting stock options and restricted stock awards to key employees, officers, and non-employee directors of the Bank (the “2010 Plan”). In 2013, the 2010 Plan was amended and approved by the shareholders to increase the number of shares authorized to be issued under from 1,350,000 shares to 2,500,000 shares of common stock. The 2010 Plan was assumed by the Company in 2016 at the time of the bank holding company reorganization.

The exercise prices of stock options granted under the plan may not be less than 100% of the fair value of the Company’s stock at the date of grant. The options, when granted, vest ratably over five years from the date of the grant and expire after ten years if not exercised. The 2010 Plan expired in August 2020, and no further grants can be made under the 2010 Plan.

Restricted stock awards issued under the 2010 Plan may or may not be subject to vesting provisions. Owners of the restricted stock awards shall have all of the rights of a shareholder including the right to vote the shares and to all dividends (cash or stock). Compensation expense related to restricted stock awards will be recognized over the vesting period of the awards based on the fair value of the Company’s common stock at the issue date.

A summary of the stock options outstanding under the 2010 Plan for the six months ended June 30, 2023 is as follows:

(\$ in thousands, except share data)	Number of Options Outstanding	Weighted Average Exercise Price	Aggregate Intrinsic Value
Outstanding, as of January 1, 2023	150,000	\$ 8.00	\$ 474
Options granted	—	—	—
Options exercised	(90,000)	8.00	—
Options forfeited	—	—	—
Options expired	—	—	—
Outstanding, as of June 30, 2023	60,000	\$ 8.00	\$ 26
Fully vested and expected to vest	60,000	\$ 8.00	\$ 26
Vested	60,000	\$ 8.00	\$ 26

Information related to stock options exercised under the 2010 Plan for the periods indicated follows:

(\$ in thousands)	Three Months Ended June 30,		Six Months Ended June 30,	
	2023	2022	2023	2022
Intrinsic value of options exercised	\$ —	\$ —	\$ 186	\$ —
Cash received from option exercises	—	—	720	—
Tax (provision) benefit realized from option exercised	—	—	(3)	—

The weighted average remaining contractual term of stock options outstanding as of June 30, 2023 was 0.8 years. The weighted average remaining contractual term of stock options that were exercisable as of June 30, 2023 was 0.8 years.

A summary of the changes in the Company's non-vested restricted stock awards under the 2010 Plan for the six months ended June 30, 2023 is as follows:

(\$ in thousands, except share data)	Shares Issued	Weighted Average Grant Date Fair Value	Aggregate Intrinsic Value
Non-vested, as of January 1, 2023	14,500	\$ 8.66	\$ 162
Awards granted	—	—	—
Awards vested	—	—	—
Awards forfeited	—	—	—
Non-vested, as of June 30, 2023	14,500	\$ 8.66	\$ 122

No tax benefits or expenses were realized from restricted stock units under the 2010 Plan for the three and six months ended June 30, 2023 and 2022.

As of June 30, 2023, the Company had approximately \$26 thousand of unrecognized compensation cost related to unvested restricted stock awards under the 2010 Plan. The Company expects to recognize these costs over a weighted average period of 1.0 years.

2021 Plan: In 2021, the Board of Directors of the Company approved a new equity incentive plan for granting stock options and restricted stock awards to key employees, officers, and non-employee directors of the Company and the Bank (the “2021 Plan”). The 2021 Plan was approved by the Company’s shareholders at the 2021 Annual Meeting. The number of shares authorized to be issued under the 2021 Plan was 1,500,000 shares of the Company’s common stock.

The exercise prices of stock options granted under the plan may not be less than 100.00% of the fair value of the Company's stock at the date of grant. There are no stock options granted under the 2021 Plan as of June 30, 2023.

Restricted stock awards issued under the 2021 Plan may or may not be subject to vesting provisions. Owners of the restricted stock awards shall have all rights of a shareholder including the right to vote the shares and to all dividends (cash or stock). Compensation expense related to restricted stock awards will be recognized over the vesting period of the awards based on the fair value of the Company's common stock at the issue date.

A summary of the changes in the Company's non-vested restricted stock awards under the 2021 Plan for the six months ended June 30, 2023 is as follows:

(\$ in thousands, except share data)	Shares Issued	Weighted Average Grant Date Fair Value	Aggregate Intrinsic Value
Non-vested, as of January 1, 2023	317,366	\$ 11.60	\$ 3,542
Awards granted	35,047	8.25	
Awards vested	(66,062)	10.31	
Awards forfeited	(6,000)	12.90	
Non-vested, as of June 30, 2023	280,351	\$ 11.46	\$ 2,363

Information related to vested restricted stock awards under the 2021 Plan for the periods indicated follows:

(\$ in thousands)	Three Months Ended June 30,		Six Months Ended June 30,	
	2023	2022	2023	2022
Tax (provision) benefit realized from awards vested	\$ (32)	\$ 12	\$ (34)	\$ 12

There were 1,111,190 shares available for future grants of either stock options or restricted stock awards under the 2021 Plan as of June 30, 2023. The Company had approximately \$2.4 million of unrecognized compensation cost related to unvested restricted stock awards under the 2021 Plan as of June 30, 2023. The Company expects to recognize these costs over a weighted average period of 2.1 years.

Note 11. Fair Value of Financial Instruments

Fair value is defined as the price that would be received to sell an asset or the price that would be paid to transfer a liability on the measurement date and is determined using an exit price in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants. The Company uses fair value measurements to record fair value adjustments to certain assets and liabilities and to determine fair value disclosures. Assets and liabilities recorded at fair value on a recurring basis, such as AFS securities and equity investments. Additionally, from time to time, the Company records fair value adjustments on a nonrecurring basis. These nonrecurring adjustments typically involve application of lower of cost or fair value accounting and write-downs of individual assets.

The Company classifies its assets and liabilities recorded at fair value as one of the following three categories and a financial instrument's level within the fair value hierarchy is based on the lowest level of input significant to the fair value measurement:

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

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

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

Assets and Liabilities Measured at Fair Value on a Recurring Basis

Following is a description of the valuation methodologies used for instruments measured at fair value on a recurring basis, as well as the general classification of such instruments pursuant to the valuation hierarchy.

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

Other Investment: The Company has an equity investment with readily determinable fair value. The fair value for the equity investment with readily determinable fair value is obtained from unadjusted quoted prices in active markets on the date of measurement and classified as Level 1.

Assets and liabilities measured at fair value on a recurring basis as of June 30, 2023 and December 31, 2022 are summarized below:

(\$ in thousands)	Fair Value Measure on a Recurring Basis			
	Total Fair Value	Quoted Prices in Active Markets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
June 30, 2023				
U.S. Government agencies or sponsored agency securities:				
Residential mortgage-backed securities	\$ 46,332	\$ —	\$ 46,332	\$ —
Residential collateralized mortgage obligations	150,131	—	150,131	—
Municipal securities-tax exempt	5,787	—	5,787	—
Other investments:				
Mutual fund - CRA qualified	3,370	3,370	—	—
December 31, 2022				
U.S. Government agencies or sponsored agency securities:				
Residential mortgage-backed securities	\$ 49,764	\$ —	\$ 49,764	\$ —
Residential collateralized mortgage obligations	160,045	—	160,045	—
Other investments:				
Mutual fund - CRA qualified	3,330	3,330	—	—

There were no transfers of assets or liabilities between the Level 1 and Level 2 classifications for the three and six months ended June 30, 2023 or 2022.

Assets and Liabilities Measured at Fair Value on a Nonrecurring Basis

The Company may be required, from time to time, to measure certain assets at fair value on a nonrecurring basis in accordance with GAAP. These adjustments to fair value usually result from application of lower of cost or fair value and write-downs of individual assets.

Collateral-dependent loans: Collateral-dependent loans are loans where repayment is expected to be provided solely by the sale of the underlying collateral and there are no other available and reliable sources of repayment. Prior to the adoption of ASU 2016-13, impaired loans were evaluated and valued at the time the loan was identified as impaired, at the lower of cost or fair value. Fair value for both collateral-dependent and impaired loans are measured based on the value of the collateral securing these loans and are classified at a Level 3 in the fair value hierarchy. Collateral may include real estate, or business assets including equipment, inventory and accounts receivable. The value of real estate collateral is determined based on an appraisal by qualified licensed appraisers hired by the Company. The value of business equipment

is based on an appraisal by qualified licensed appraisers hired by the Company if significant, or the equipment's net book value on the business' financial statements. Inventory and accounts receivable collateral are valued based on independent field examiner review or aging reports. Appraisals may utilize a single valuation approach or a combination of approaches including comparable sales and the income approach. Adjustments are routinely made in the appraisal process by the independent appraisers to adjust for differences between the comparable sales and income data available for similar loans and collateral underlying such loans. Appraised values are reviewed by management using historical knowledge, market considerations, and knowledge of the client and client's business.

The following table presents the fair value hierarchy and fair value of assets that were still held and had fair value adjustments measured on a nonrecurring basis as of June 30, 2023 and December 31, 2022:

(\$ in thousands)	Fair Value Measure on a Nonrecurring Basis			
	Total Fair Value	Quoted Prices in Active Markets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
June 30, 2023				
Collateral-dependent loans:				
SBA—real estate	\$ 768	\$ —	\$ —	\$ 768
Home mortgage	2,305	—	—	2,305
Total	<u>\$ 3,073</u>	<u>\$ —</u>	<u>\$ —</u>	<u>\$ 3,073</u>
December 31, 2022				
Impaired loans:				
SBA—real estate	\$ 423	\$ —	\$ —	\$ 423
Total	<u>\$ 423</u>	<u>\$ —</u>	<u>\$ —</u>	<u>\$ 423</u>
Total				

The following table presents the increase (decrease) in value of certain assets held at the end of the respective reporting periods presented for which a nonrecurring fair value adjustment was recognized during the period presented:

(\$ in thousands)	Three Months Ended June 30,		Six Months Ended June 30,	
	2023	2022	2023	2022
Collateral-dependent loans:				
SBA—real estate	\$ (1)	\$ 8	\$ 1	\$ 15
Total	<u>\$ (1)</u>	<u>\$ 8</u>	<u>\$ 1</u>	<u>\$ 15</u>

The following table presents information about significant unobservable inputs utilized in the Company's nonrecurring Level 3 fair value measurements as of June 30, 2023 and December 31, 2022:

(\$ in thousands)	Fair Value Measurements (Level 3)	Valuation Techniques	Unobservable Inputs	Range of Inputs	Weighted-Average of Inputs ⁽¹⁾
June 30, 2023					
Collateral-dependent loans:					
SBA—real estate	\$ 768	Income approach - income capitalization	Capitalization rate	8.0% to 11.5%	9.9%
Home mortgage	2,305	Sales comparison approach	Market data comparison	0.5% to 15.1%	6.5%
December 31, 2022					
Impaired loans:					
SBA—real estate	\$ 423	Income approach - income capitalization	Capitalization rate	11.5%	11.5%

⁽¹⁾ Weighted-average of inputs is based on the relative fair value of the respective assets as of June 30, 2023 and December 31, 2022.

Financial Instruments: The carrying amounts and estimated fair values of financial instruments that are not carried at fair value on a recurring basis as of June 30, 2023 and December 31, 2022 are as follows. These financial assets and liabilities are measured at amortized cost basis on the Company's Consolidated Balance Sheets:

(\$ in thousands)	June 30, 2023				
	Carrying Amount	Level 1	Level 2	Level 3	Fair Value
Financial assets:					
Cash and cash equivalents	\$ 143,761	\$ 143,761	\$ —	\$ —	\$ 143,761
Loans held for sale	—	—	—	—	—
Loans receivable, net	1,695,395	—	—	1,681,164	1,681,164
Accrued interest receivable, net	7,703	60	828	6,815	7,703
Other investments:					
FHLB and PCBB stock	12,717	N/A	N/A	N/A	N/A
Time deposits placed	96	—	96	—	96
Servicing assets	12,654	—	—	18,177	18,177
Financial liabilities:					
Deposits	1,859,639	—	1,856,997	—	1,856,997
Accrued interest payable	9,354	—	9,354	—	9,354

(\$ in thousands)	December 31, 2022				
	Carrying Amount	Level 1	Level 2	Level 3	Fair Value
Financial assets:					
Cash and cash equivalents	\$ 82,972	\$ 82,972	\$ —	\$ —	\$ 82,972
Loans held for sale	44,335	—	47,217	—	47,217
Loans receivable, net	1,659,051	—	—	1,626,036	1,626,036
Accrued interest receivable, net	7,180	51	716	6,413	7,180
Other investments:					
FHLB and PCBB stock	8,673	N/A	N/A	N/A	N/A
Time deposits placed	95	—	95	—	95
Servicing assets	12,759	—	—	16,845	16,845
Financial liabilities:					
Deposits	1,885,771	—	1,880,508	—	1,880,508
Accrued interest payable	2,771	—	2,771	—	2,771

Note 12. Regulatory Capital Matters

The Bank is subject to certain risk-based capital and leverage ratio requirements under the U.S. Basel III capital rules administered by the federal and state banking agencies. Failure to be well-capitalized or to meet minimum capital requirements could result in certain mandatory and possible additional discretionary actions by regulators that, if undertaken, could have an adverse material effect on the Company's operations or financial condition. The Basel III capital rules also require the Bank to maintain a capital conservation buffer of 2.5% above the minimum risk-based capital ratios in order to absorb losses during periods of economic stress, effective January 1, 2019. Banking institutions with a ratio of common equity tier 1 capital to risk-weighted assets above the minimum but below the capital conservation buffer will face constraints on dividends, equity repurchases and compensation based on the amount of the shortfall. Management believes that as of June 30, 2023 and December 31, 2022, the Bank met all capital adequacy requirements to which they are subject to. Based on recent changes to the Federal Reserve's definition of a "Small Bank Holding Company" that increased the threshold to \$3 billion in assets, the Company is not currently subject to separate minimum capital measurements. At such time as the Company reaches the \$3 billion asset level, it will again be subject to capital measurements independent of the Bank.

The following table presents the regulatory capital amounts and ratios for the Company and the Bank as of dates indicated:

(\$ in thousands)	June 30, 2023					
	Actual ⁽¹⁾		Required for Capital Adequacy Purposes		Minimum To be Considered "Well Capitalized"	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
Total capital (to risk-weighted assets)						
Consolidated	\$ 222,643	13.10 %	N/A	N/A	N/A	N/A
Bank	220,584	12.98	\$ 136,000	8.00 %	\$ 170,000	10.00 %
Tier 1 capital (to risk-weighted assets)						
Consolidated	202,589	11.92	N/A	N/A	N/A	N/A
Bank	200,530	11.80	102,000	6.00	136,000	8.00
Common equity Tier 1 capital (to risk-weighted assets)						
Consolidated	202,589	11.92	N/A	N/A	N/A	N/A
Bank	200,530	11.80	76,500	4.50	110,500	6.50
Tier 1 capital (to average assets)						
Consolidated	202,589	9.50	N/A	N/A	N/A	N/A
Bank	200,530	9.41	85,257	4.00	106,571	5.00

⁽¹⁾ The capital requirements are only applicable to the Bank, and the Company's ratios are included for comparison purpose.

(\$ in thousands)	December 31, 2022					
	Actual ⁽¹⁾		Required for Capital Adequacy Purposes		Minimum To be Considered "Well Capitalized"	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
Total capital (to risk-weighted assets)						
Consolidated	\$ 213,862	13.06 %	N/A	N/A	N/A	N/A
Bank	211,981	12.94	\$ 131,020	8.00 %	\$ 163,775	10.00 %
Tier 1 capital (to risk-weighted assets)						
Consolidated	194,358	11.87	N/A	N/A	N/A	N/A
Bank	192,477	11.75	98,265	6.00	131,020	8.00
Common equity Tier 1 capital (to risk-weighted assets)						
Consolidated	194,358	11.87	N/A	N/A	N/A	N/A
Bank	192,477	11.75	73,699	4.50	106,454	6.50
Tier 1 capital (to average assets)						
Consolidated	194,358	9.38	N/A	N/A	N/A	N/A
Bank	192,477	9.29	82,836	4.00	103,545	5.00

⁽¹⁾ The capital requirements are only applicable to the Bank, and the Company's ratios are included for comparison purpose.

Note 13. Earnings Per Share

Basic EPS is calculated using the two-class method. Under the two-class method, all earnings (distributed and undistributed) are allocated to common stock and participating securities. The Company grants restricted stock awards, which entitle recipients to receive nonforfeitable dividends during the vesting period on a basis equivalent to dividends paid to holders of the Company's common stock. These restricted stock awards meet the definition of participating

securities based on their respective rights to receive nonforfeitable dividends, and they are treated as a separate class of securities in computing basic EPS. Participating securities are not included as incremental shares in computing diluted EPS.

Diluted EPS incorporates the potential impact of contingently issuable shares. Diluted EPS is calculated under both the two-class and treasury stock methods, and the more dilutive amount is reported. For each of the periods presented in the table below, diluted EPS calculated under two-class method was more dilutive.

The following table presents the calculation of net income applicable to common stockholders and basic and diluted EPS for the three and six months ended June 30, 2023 and 2022:

(\$ in thousands, except share and per share data)	Three Months Ended June 30,		Six Months Ended June 30,	
	2023	2022	2023	2022
Basic				
Net income	\$ 6,091	\$ 8,480	\$ 13,625	\$ 16,632
Distributed and undistributed earnings allocated to participating securities	(127)	(205)	(286)	(346)
Net income allocated to common shares	\$ 5,964	\$ 8,275	\$ 13,339	\$ 16,286
Weighted average common shares outstanding	15,158,365	15,141,975	15,221,010	15,139,903
Basic earnings per common share	\$ 0.39	\$ 0.55	\$ 0.88	\$ 1.08
Diluted				
Net income allocated to common shares	\$ 5,964	\$ 8,275	\$ 13,339	\$ 16,286
Weighted average common shares outstanding for basic earnings per common share	15,158,365	15,141,975	15,221,010	15,139,903
Add: Dilutive effects of assumed exercises of stock options	11,429	92,602	20,893	98,210
Average shares and dilutive potential common shares	15,169,794	15,234,577	15,241,903	15,238,113
Diluted earnings per common share	\$ 0.39	\$ 0.54	\$ 0.88	\$ 1.07

No share of common stock was antidilutive for the three and six months ended June 30, 2023 and 2022.

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

The following discussion and analysis of our financial condition and results of operations should be read in conjunction with our historical financial statements and the related notes thereto contained in this Report. Some of the information contained in this discussion and analysis or set forth elsewhere in this Report, including information with respect to our plans and strategy for our business, includes forward-looking statements that involve risks and uncertainties. You should review the sections titled "Cautionary Note Regarding Forward-Looking Statements" and "Risk Factors" for a discussion of forward-looking statements and important factors that could cause actual results to differ materially from the results described in or implied by the forward-looking statements contained in the following discussion and analysis.

OVERVIEW

We are a bank holding company headquartered in Los Angeles, California. Our commercial community banking activities are operated through Open Bank, our banking subsidiary. We offer commercial banking services to small and medium-sized businesses, their owners and retail customers primarily in the Korean-American community.

Our results of operations depend primarily on our net interest income. We drive our income from interest received on our loan portfolio and the fee income we receive in connection with our deposits, and the sale and service of SBA loans. Our major operating expenses are the interest we pay on deposits, the salaries and related benefits we pay our management and staff, and the rent we pay on our leased properties. We rely primarily on locally-generated deposits, mostly from the Korean-American market within California, to fund our loan activities. We currently operate eight branches in Los Angeles County and Orange County, California, one branch in Santa Clara County, California, and one branch in Carrollton, Texas. We have four loan production offices in Pleasanton, California, Atlanta, Georgia, Aurora, Colorado, and Lynnwood, Washington.

We adopted Accounting Standards Update ("ASU") 2016-13, which replaced the current incurred loss accounting model with the Current Expected Credit Losses approach. The adoption of this ASU increased the allowance for credit losses by \$1.9 million and allowance for off-balance sheet commitments by \$184 thousand and recorded an deferred tax assets of \$624 thousand and decrease to opening retained earnings of \$1.5 million on January 1, 2023.

The following significant items are of note as of or for the periods presented:

As of June 30, 2023 compared to as of December 31, 2022

- Total assets were \$2.15 billion, an increase of \$57.2 million, or 2.7%, from \$2.09 billion.
- Gross loans were \$1.72 billion, an increase of \$37.9 million, or 2.3%, from \$1.68 billion.
- Total deposits were \$1.86 billion, a decrease of \$26.1 million, or 1.4%, from \$1.89 billion.
- Shareholders' equity was \$183.8 million, an increase of \$6.9 million, or 3.9%, from \$176.9 million.

For the three months ended June 30, 2023 compared to the three months ended June 30, 2022

- Net interest income decreased to \$17.3 million, a decrease of \$1.8 million, or 9.6%, from \$19.1 million.
- Net income was \$6.1 million or \$0.39 per diluted common share, a decrease of \$2 million, or 28.2%, from \$8.5 million or \$0.54 per diluted common share.

For the six months ended June 30, 2023 compared to the six months ended June 30, 2022

- Net interest income decreased to \$35.1 million, a decrease of \$1.2 million, or 3.4%, from \$36.4 million.
- Net income was \$13.6 million or \$0.88 per diluted common share, a decrease of \$3.0 million, or 18.1%, from \$16.6 million or \$1.07 per diluted common share.

SELECTED FINANCIAL DATA

(\$ in thousands, except share and per share data)	Three Months Ended June 30,		Six Months Ended June 30,	
	2023	2022	2023	2022
Income Statement Data:				
Interest income	\$ 30,102	\$ 20,148	\$ 58,696	\$ 38,092
Interest expense	12,850	1,069	23,552	1,723
Net interest income	17,252	19,079	35,144	36,369
Provision for (reversal of) credit losses	—	996	(338)	1,337
Noninterest income	3,605	5,359	7,900	9,575
Noninterest expense	12,300	11,503	24,208	21,165
Income before income taxes	8,557	11,939	19,174	23,442
Income tax expense	2,466	3,459	5,549	6,810
Net income	6,091	8,480	13,625	16,632
Per Share Data:				
Basic income per share	\$ 0.39	\$ 0.55	\$ 0.88	\$ 1.08
Diluted income per share	0.39	0.54	0.88	1.07
Book value per share	12.16	11.16	12.16	11.16
Shares of common stock outstanding	15,118,268	15,137,808	15,118,268	15,137,808
Performance Ratios:				
Return on average assets ⁽¹⁾	1.15 %	1.79 %	1.29 %	1.82 %
Return on average equity ⁽¹⁾	13.27	20.29	15.02	19.92
Yield on total loans ⁽¹⁾	6.34	4.91	6.22	4.88
Yield on average earning assets ⁽¹⁾	5.94	4.44	5.83	4.36
Cost of average interest bearing liabilities ⁽¹⁾	4.01	0.50	3.79	0.42
Cost of deposits ⁽¹⁾	2.63	0.25	2.44	0.21
Net interest margin ⁽¹⁾	3.40	4.21	3.48	4.16
Efficiency ratio ⁽²⁾	58.97	47.07	56.24	46.07

⁽¹⁾ Annualized

⁽²⁾ Represent noninterest expense divided by the sum of net interest income and noninterest income.

(\$ in thousands)	As of	
	June 30, 2023	December 31, 2022
Balance Sheet Data:		
Gross loans receivable	\$ 1,716,197	\$ 1,678,292
Loans held for sale	—	44,335
Allowance for credit losses	(20,802)	(19,241)
Total assets	2,151,701	2,094,497
Deposits	1,859,639	1,885,771
Shareholders' equity	183,770	176,916
Asset Quality Data:		
Nonperforming loans to gross loans receivable	0.51 %	0.18 %
Allowance for credit losses to nonperforming loans	236	625
Allowance for credit losses to gross loans receivable	1.21	1.15
Balance Sheet and Capital Ratios:		
Gross loans receivable to deposits	92.29 %	89.00 %
Noninterest-bearing deposits to deposits	34.13	37.20
Average equity to average total assets	8.68	8.88
Leverage ratio	9.50	9.38
Common equity tier 1 ratio	11.92	11.87
Tier 1 risk-based capital ratio	11.92	11.87
Total risk-based capital ratio	13.10	13.06

RESULTS OF OPERATIONS

Net Income

We reported net income for the three months ended June 30, 2023 of \$6.1 million, compared to net income of \$8.5 million for the same period of 2022. The decrease was primarily due to a \$1.8 million decrease in net interest income and a \$1.8 million decrease in noninterest income, offset by a \$996 thousand decrease in provision for credit losses and a \$993 thousand decrease in income tax expense.

(\$ in thousands)	Three Months Ended June 30,		
	2023	2022	Change
Interest income	\$ 30,102	\$ 20,148	\$ 9,954
Interest expense	12,850	1,069	11,781
Net interest income	17,252	19,079	(1,827)
Provision for credit losses	—	996	(996)
Noninterest income	3,605	5,359	(1,754)
Noninterest expense	12,300	11,503	797
Income before income tax expense	8,557	11,939	(3,382)
Income tax expense	2,466	3,459	(993)
Net income	\$ 6,091	\$ 8,480	\$ (2,389)

We reported net income for the six months ended June 30, 2023 of \$13.6 million, compared to net income of \$16.6 million for the same period of 2022. The decrease was primarily due to a \$3.0 million increase in noninterest expense, a \$1.7 million decrease in noninterest income and a \$1.2 million decrease in net interest income, offset by a \$1.7 million decrease in provision for credit losses and a \$1.3 million decrease income tax expense.

(\$ in thousands)	Six Months Ended June 30,		
	2023	2022	Change
Interest income	\$ 58,696	\$ 38,092	\$ 20,604
Interest expense	23,552	1,723	21,829
Net interest income	35,144	36,369	(1,225)
(Reversal of) provision for credit losses	(338)	1,337	(1,675)
Noninterest income	7,900	9,575	(1,675)
Noninterest expense	24,208	21,165	3,043
Income before income tax expense	19,174	23,442	(4,268)
Income tax expense	5,549	6,810	(1,261)
Net income	\$ 13,625	\$ 16,632	\$ (3,007)

Net Interest Income

The management of interest income and expense is fundamental to our financial performance. Net interest income, the difference between interest income and interest expense, is the largest component of our total revenue. Management closely monitors both total net interest income and the net interest margin (net interest income divided by average earning assets). We seek to maximize net interest income without exposing us to an excessive level of interest rate risk through our asset and liability policies. Interest rate risk is managed by monitoring the pricing, maturity and repricing options of all classes of interest-bearing assets and liabilities. Our net interest margin is also adversely impacted by the reversal of interest on nonaccrual loans and the reinvestment of loan payoffs into lower yielding investment securities and other short-term investments.

The following table presents, for the periods indicated, information about: (i) weighted average balances, the total dollar amount of interest income from interest-earning assets and the resultant average yields, (ii) average balances, the total dollar amount of interest expense on interest-bearing liabilities and the resultant average rates, (iii) net interest income, (iv) the interest rate spread, and (v) the net interest margin.

(\$ in thousands)	Three Months Ended June 30,					
	2023			2022		
	Average Balance	Interest and Fees	Yield / Rate ⁽¹⁾	Average Balance	Interest and Fees	Yield / Rate ⁽¹⁾
Interest-earning assets:						
Interest-bearing deposits in other banks	\$ 79,200	\$ 1,003	5.01 %	\$ 79,628	\$ 197	0.98 %
Federal funds sold and other investments ⁽²⁾	15,374	249	6.46	11,966	140	4.70
Available-for-sale debt securities	209,801	1,562	2.98	165,499	703	1.70
Total investments	304,375	2,814	3.68	257,093	1,040	1.62
Commercial real estate loans	838,526	11,823	5.66	751,610	8,743	4.67
SBA loans	262,825	7,174	10.95	353,138	5,707	6.48
Commercial and industrial loans	114,103	2,232	7.85	160,291	1,811	4.53
Home mortgage loans	508,976	6,043	4.75	294,341	2,837	3.86
Consumer & other loans	1,334	16	4.77	684	10	5.49
Loans ⁽³⁾	1,725,764	27,288	6.34	1,560,064	19,108	4.91
Total interest-earning assets	2,030,139	30,102	5.94	1,817,157	20,148	4.44
Noninterest-earning assets	84,991			73,594		
Total assets	\$ 2,115,130			\$ 1,890,751		
Interest-bearing liabilities:						
Money market deposits and others	\$ 357,517	\$ 3,201	3.59 %	\$ 470,013	\$ 503	0.43 %
Time deposits	843,836	8,719	4.14	389,059	566	0.58
Total interest-bearing deposits	1,201,353	11,920	3.98	859,072	1,069	0.50
Borrowings	82,586	930	4.52	—	—	—
Total interest-bearing liabilities	1,283,939	12,850	4.01	859,072	1,069	0.50
Noninterest-bearing liabilities:						
Noninterest-bearing deposits	615,748			843,788		
Other noninterest-bearing liabilities	31,810			20,720		
Total noninterest-bearing liabilities	647,558			864,508		
Shareholders' equity	183,633			167,171		
Total liabilities and shareholders' equity	\$ 2,115,130			\$ 1,890,751		
Net interest income / interest rate spreads		\$ 17,252	1.93 %		\$ 19,079	3.94 %
Net interest margin			3.40 %			4.21 %
Cost of deposits			2.63 %			0.25 %
Cost of funds			2.71 %			0.25 %

⁽¹⁾ Annualized

⁽²⁾ Includes income and average balances for Federal Home Loan Bank ("FHLB") and Pacific Coast Bankers Bank stock, CRA qualified mutual fund, term federal funds, interest-earning time deposits and other miscellaneous interest-earning assets.

⁽³⁾ Average loan balances include non-accrual loans and loans held for sale.

(\$ in thousands)	Six Months Ended June 30,					
	2023			2022		
	Average Balance	Interest and Fees	Yield / Rate ⁽¹⁾	Average Balance	Interest and Fees	Yield / Rate ⁽¹⁾
Interest-earning assets:						
Interest-bearing deposits in other banks	\$ 76,695	\$ 1,849	4.79 %	\$ 83,231	\$ 238	0.57 %
Federal funds sold and other investments ⁽¹⁾	13,761	420	6.10	11,465	256	4.45
Available-for-sale debt securities	210,130	3,128	2.98	161,230	1,233	1.53
Total investments	300,586	5,397	3.58 %	255,926	1,727	1.35 %
Commercial real estate loans	839,459	23,002	5.53	731,413	16,545	4.56
SBA loans	268,823	14,156	10.62	355,916	11,542	6.54
Commercial and industrial loans	117,988	4,432	7.58	158,334	3,348	4.26
Home mortgage loans	497,949	11,676	4.69	255,936	4,911	3.84
Consumer & other loans	1,360	33	4.92	780	19	5.15
Loans ⁽²⁾	1,725,579	53,299	6.22	1,502,379	36,365	4.88
Total interest-earning assets	2,026,165	58,696	5.83	1,758,305	38,092	4.36
Noninterest-earning assets	83,771			68,334		
Total assets	\$ 2,109,936			\$ 1,826,639		
Interest-bearing liabilities:						
Money market deposits and others	\$ 383,521	\$ 6,351	3.34 %	\$ 441,314	\$ 754	0.34 %
Time deposits	815,267	15,952	3.95	381,879	969	0.51
Total interest-bearing deposits	1,198,788	22,303	3.75	823,193	1,723	0.42
Borrowings	54,533	1,249	4.62	—	—	—
Total interest-bearing liabilities	1,253,321	23,552	3.79	823,193	1,723	0.42
Noninterest-bearing liabilities:						
Noninterest-bearing deposits	643,465			813,791		
Other noninterest-bearing liabilities	31,729			22,649		
Total noninterest-bearing liabilities	675,194			836,440		
Shareholders' equity	181,421			167,006		
Total liabilities and shareholders' equity	\$ 2,109,936			\$ 1,826,639		
Net interest income / interest rate spreads		\$ 35,144	2.04 %		\$ 36,369	3.94 %
Net interest margin			3.48 %			4.16 %
Cost of deposits			2.44 %			0.21 %
Cost of funds			2.50 %			0.21 %

⁽¹⁾ Annualized

⁽²⁾ Includes income and average balances for Federal Home Loan Bank ("FHLB") and Pacific Coast Bankers Bank stock, CRA qualified mutual fund, term federal funds, interest-earning time deposits and other miscellaneous interest-earning assets.

⁽³⁾ Average loan balances include non-accrual loans and loans held for sale.

Increases and decreases in interest income and interest expense result from changes in average balances (volume) of interest-earning assets and interest-bearing liabilities, as well as changes in average interest rates. The following tables set forth the effects of changing rates and volumes on our net interest income during the period shown. Information is provided with respect to (i) effects on interest income attributable to changes in volume (change in volume multiplied by prior rate) and (ii) effects on interest income attributable to changes in rate (changes in rate multiplied by prior volume). Change applicable to both volume and rate have been allocated to volume and rate ratably.

(\$ in thousands)	Three Months Ended June 30,		
	2023 vs 2022		
	Increases (Decreases) Due to Change in		
	Volume	Rate	Total
Interest-earning assets:			
Interest-bearing deposits in other banks	\$ (3)	\$ 809	\$ 806
Federal funds sold and other investments	59	50	109
Available-for-sale debt securities	262	597	859
Total investments	318	1,456	1,774
Commercial real estate loans	1,118	1,962	3,080
SBA loans	(1,838)	3,305	1,467
Commercial and industrial loans	(774)	1,195	421
Home mortgage loans	2,364	842	3,206
Consumer & other loans	8	(2)	6
Total loans	878	7,302	8,180
Total interest-earning assets	1,196	8,758	9,954
Interest-bearing liabilities:			
Money market deposits and others	(194)	2,892	2,698
Time deposits	2,759	5,394	8,153
Total interest-bearing deposits	2,565	8,286	10,851
Borrowings	465	465	930
Total interest-bearing liabilities	3,030	8,751	11,781
Net interest income	\$ (1,834)	\$ 7	\$ (1,827)

(\$ in thousands)	Six Months Ended June 30,		
	2023 vs 2022		
	Increases (Decreases) Due to Change in		
	Volume	Rate	Total
Interest-earning assets:			
Interest-bearing deposits in other banks	\$ (87)	\$ 1,698	\$ 1,611
Federal funds sold and other investments	80	84	164
Available-for-sale debt securities	556	1,339	1,895
Total investments	549	3,121	3,670
Commercial real estate loans	2,702	3,755	6,457
SBA loans	(3,479)	6,093	2,614
Commercial and industrial loans	(1,321)	2,405	1,084
Home mortgage loans	5,167	1,598	6,765
Consumer & other loans	15	(1)	14
Total loans	3,084	13,850	16,934
Total interest-earning assets	3,633	16,971	20,604
Interest-bearing liabilities:			
Money market deposits and others	227	5,370	5,597
Time deposits	4,917	10,066	14,983
Total interest-bearing deposits	5,144	15,436	20,580
Borrowings	625	624	1,249
Total interest-bearing liabilities	5,769	16,060	21,829
Net interest income	\$ (2,136)	\$ 911	\$ (1,225)

Comparison for the Three Months Ended June 30, 2023 and 2022

Net interest income decreased \$1.8 million, or 9.6%, primarily due to higher interest expense on deposits, partially offset by higher interest income on loans. Net interest margin was 3.40%, a decrease of 81 basis points from 4.21%.

An \$8.2 million increase in interest income on loans was primarily due to a \$165.7 million increase in average balance and a 143 basis point increase in loan yield as a result of the Federal Reserve's rate increases.

A \$10.9 million increase in interest expense on deposits was primarily due to a \$342.3 million increase in average balance and a 348 basis point increase in average cost driven by the Federal Reserve's rate increases.

Comparison for the Six Months Ended June 30, 2023 and 2022

Net interest income decreased \$1.2 million, or 3.4%, primarily due to higher interest expense on deposits, partially offset by higher interest income on loans. Net interest margin was 3.48%, a decrease of 68 basis points from 4.16%.

An \$16.9 million increase in interest income on loans was primarily due to a \$223.2 million increase in average balance and a 134 basis point increase in loan yield as a result of the Federal Reserve's rate increases.

A \$21 million increase in interest expense on deposits was primarily due to a \$375.6 million increase in average balance and a 333 basis point increase in average cost driven by the Federal Reserve's rate increases.

Provision for Credit Losses

Credit risk is inherent in the business of making loans. We establish an allowance for credit losses both on loans and off-balance sheet commitments through charges to earnings, which are shown in the statements of operations as the provision for credit losses. Specifically identifiable and quantifiable known losses are promptly charged off against the

allowance. The provision for credit losses is determined by conducting a quarterly evaluation of the adequacy of our allowance for credit losses and charging the shortfall or excess, if any, to the current quarter's expense. This has the effect of creating variability in the amount and frequency of charges to earnings. The provision for credit losses and level of allowance for each period are dependent upon many factors, including loan growth, net charge-offs, changes in the composition of the loan portfolio, delinquencies, management's assessment of the quality of the loan portfolio, the valuation of problem loans and the general economic conditions in our market area.

The provision for credit losses was zero for the three months ended June 30, 2023, compared to provision for credit losses of \$996 thousand for the same period of 2022. A \$163 thousand increase from qualitative factor adjustments in the second quarter of 2023 was primarily offset by decreases in specific reserve requirements on individually analyzed loans. The change in quantitative general reserve during the quarter was insignificant as an increase from a 1.4% growth in gross loans was mostly offset by a decrease in forecasts of Probability of Default ("PD") and Loss Given Default ("LGD") rates.

The reversal of credit losses was \$338 thousand for the six months ended June 30, 2023, compared to provision for credit losses of \$1.3 million for the same period of 2022. The reversal was primarily due to a \$345 thousand decrease in quantitative general reserve driven by a decrease in forecasts of PD and LGD rates and a \$201 thousand decrease in specific reserve requirements on individually analyzed loans, partially offset by a \$116 thousand increase in qualitative factor adjustments.

Noninterest Income

While interest income remains the largest single component of total revenues, noninterest income is also an important component. A portion of our noninterest income is associated with SBA lending activity, consisting of gains on the sale of loans sold in the secondary market and servicing income from loans sold with servicing retained. Other sources of noninterest income include service charges on deposit.

Comparison for the Three Months Ended June 30, 2023 and 2022

The following table sets forth the various components of our noninterest income for the three months ended June 30, 2023 and 2022:

(\$ in thousands)	Three Months Ended June 30,			
	2023	2022	\$ Change	% Change
Noninterest income:				
Service charges on deposits	\$ 573	\$ 427	\$ 146	34.2 %
Loan servicing fees, net of amortization	595	654	(59)	(9.0)
Gain on sale of loans	2,098	3,873	(1,775)	(45.8)
Other income	339	405	(66)	(16.3)
Total noninterest income	<u>\$ 3,605</u>	<u>\$ 5,359</u>	<u>\$ (1,754)</u>	<u>(32.7)%</u>

Noninterest income for the three months ended June 30, 2023 was \$3.6 million, a decrease of \$1.8 million, or 32.7%, compared to \$5.4 million for the same period of 2022, primarily due to a decrease of 1.8 million in gain on sale of loans.

Gain on sale of loans was \$2.1 million for the three months ended June 30, 2023, compared to \$3.9 million for the same period of 2022, a decrease of \$1.8 million or 45.8%. The decrease was primarily due to a lower SBA loans sold amount partially offset by a lower average sales premium. We sold \$36.8 million of SBA loans with an average premium of 6.64% for the three months ended June 30, 2023, compared to a sale of \$58.6 million of SBA loans with an average premium of 7.02% in the same period of 2022.

Comparison for the Six Months Ended 2023 and 2022

The following table sets forth the various components of our noninterest income for the Six Months Ended June 30, 2023 and 2022:

(\$ in thousands)	Six Months Ended June 30,			
	2023	2022	\$ Change	% Change
Noninterest income:				
Service charges on deposit	\$ 991	\$ 815	\$ 176	21.6 %
Loan servicing fees, net of amortization	1,441	1,101	340	30.9
Gain on sale of loans	4,668	7,111	(2,443)	(34.4)
Other income	800	548	252	46.0
Total noninterest income	<u>\$ 7,900</u>	<u>\$ 9,575</u>	<u>\$ (1,675)</u>	<u>(17.5)%</u>

Noninterest income for the six months ended June 30, 2023 was \$7.9 million, a decrease of \$1.7 million, or 17.5%, compared to \$9.6 million for the same period of 2022, primarily due to a decrease of \$2.4 million in gain on sale of loans, partially offset by increases of \$340 thousand and \$252 thousand in net loan servicing fees and other income, respectively.

Gain on sale of loans was \$4.7 million for the six months ended June 30, 2023, compared to \$7.1 million for the same period of 2022, a decrease of \$2.4 million or 34.4%. The decrease was primarily due to a lower average sales premium and a lower SBA loans sold amount. We sold \$81.5 million of SBA loans with an average premium of 7.02% for the six months ended June 30, 2023, compared to a sale of \$90.4 million of SBA loans with an average premium of 8.43% in the same period of 2022.

Loan servicing fees, net of amortization, were \$1.4 million for the six month ended June 30, 2023, compared to \$1.1 million for the same period of 2022. The increase was primarily due to an increase in servicing portfolio and a decrease in servicing asset amortization driven by slower loan prepayments in 2023. Our total SBA loan servicing portfolio was \$726.3 million as of June 30, 2023, compared to \$686.4 million as of the same period of 2022.

Other income was \$800 thousand, an increase of \$252 thousand from \$548 thousand, primarily due to an increase of \$226 thousand in fair value of equity investment.

Noninterest Expense

Comparison for the Three Months Ended June 30, 2023 and 2022

The following table sets forth the major components of our noninterest expense for the three months ended June 30, 2023 and 2022:

(\$ in thousands)	Three Months Ended June 30,			
	2023	2022	\$ Change	% Change
Noninterest expense:				
Salaries and employee benefits	\$ 7,681	\$ 7,109	\$ 572	8.0 %
Occupancy and equipment	1,598	1,489	109	7.3
Data processing and communication	546	492	54	11.0
Professional fees	381	364	17	4.7
FDIC insurance and regulatory assessments	420	192	228	118.8
Promotion and advertising	159	165	(6)	(3.6)
Directors' fees	210	190	20	10.5
Foundation donation and other contributions	594	852	(258)	(30.3)
Other expenses	711	650	61	9.4
Total noninterest expense	\$ 12,300	\$ 11,503	\$ 797	6.9 %

Noninterest expense for the three months ended June 30, 2023 was \$12.3 million, compared with \$11.5 million for the same period of 2022, an increase of \$797 thousand, or 6.9%.

Salaries and employee benefits expense for the three months ended June 30, 2023 was \$7.7 million, compared to \$7.1 million for the same period of 2022, an increase of \$572 thousand, or 8.0%. The increase was primarily due to 22 additional full-time employees to support our continued growth.

FDIC insurance and regulatory assessments for the three months ended June 30, 2023 was \$420 thousand, compared to \$192 thousand, an increase of \$228 thousand, or 118.8%. The increase was primarily due to our deposit growth from the same period of 2022 and increases in FDIC assessment fees in 2023.

Foundation donations and other contributions for the three months ended June 30, 2023 was \$594 thousand, compared to \$852 thousand, a decrease of \$258 thousand, of 30.3%. The decrease was primarily due to lower donation accruals for Open Stewardship as a result of lower net income.

Comparison for the Six Months Ended 2023 and 2022

(\$ in thousands)	Six Months Ended June 30,			
	2023	2022	\$ Change	% Change
Noninterest expense:				
Salaries and employee benefits	\$ 14,933	\$ 12,766	\$ 2,167	17.0 %
Occupancy and equipment	3,168	2,867	301	10.5
Data processing and communication	1,096	985	111	11.3
Professional fees	740	688	52	7.6
FDIC insurance and regulatory assessments	887	399	488	122.3
Promotion and advertising	321	354	(33)	(9.3)
Directors' fees	371	367	4	1.1
Foundation donation and other contributions	1,347	1,667	(320)	(19.2)
Other expenses	1,345	1,072	273	25.5
Total noninterest expense	\$ 24,208	\$ 21,165	\$ 3,043	14.4 %

Noninterest expense for the six months ended June 30, 2023 was \$24.2 million, compared with \$21.2 million for the same period of 2022, an increase of \$3.0 million, or 14.4%.

Salaries and employee benefits expense for the six months ended June 30, 2023 was \$14.9 million, compared to \$12.8 million for the same period of 2022, an increase of \$2.2 million, or 17.0%. The increase was primarily due to additional full-time employees to support our continued growth.

FDIC insurance and regulatory assessments for the six months ended June 30, 2023 was \$887 thousand, compared to \$399 thousand, an increase of \$488 thousand, or 122.3%. The increase was primarily due to our deposit growth from the same period of 2022 and increases in FDIC assessment fees in 2023.

Foundation donations and other contributions for the six months ended June 30, 2023 was \$1.3 million, compared to \$1.7 million, a decrease of \$320 thousand, or 19.2%. The decrease was primarily due to lower donation accruals for Open Stewardship as a result of lower net income.

Income Tax Expense

Income tax expense was \$2.5 million and \$3.5 million for the three months ended June 30, 2023 and 2022, respectively. Effective tax rates were 28.8% and 29.0% for the three months ended June 30, 2023 and 2022, respectively. Income tax expense was \$5.5 million and \$6.8 million for the six months ended June 30, 2023 and 2022, respectively. Effective tax rates were 28.9% and 29.1% for the six months ended June 30, 2023 and 2022, respectively.

After consideration of the matters in the preceding paragraph, we have determined that it is more likely than not that net deferred tax assets as of June 30, 2023 will be fully realized in future years.

FINANCIAL CONDITION

Investment Portfolio

The securities portfolio is the second largest component of our interest earning assets, and the structure and composition of this portfolio is important to an analysis of our financial condition. The portfolio serves the following purposes: (i) it provides a source of pledged assets for securing certain deposits and borrowed funds, as may be required by law or by specific agreement with a depositor or lender; (ii) it provides liquidity to even out cash flows from the loan and deposit activities of customers; (iii) it can be used as an interest rate risk management tool, because it provides a large base of assets, the maturity and interest rate characteristics of which can be changed more readily than the loan portfolio to better match changes in the deposit base and our other funding sources; and (iv) it is an alternative interest-earning use of funds when loan demand is weak or when deposits grow more rapidly than loans.

We classify our securities as either available-for-sale or held-to-maturity at the time of purchase. Accounting guidance requires available-for-sale securities to be marked to fair value with an offset to accumulated other comprehensive income (loss), a component of shareholders' equity. Monthly adjustments are made to reflect changes in the fair value of our available-for-sale securities.

All securities in our investment portfolio were classified as available-for-sale as of June 30, 2023. There were no held-to-maturity or trading securities in our investment portfolio as of June 30, 2023. All available-for-sale securities are carried at fair value and consist of U.S. government agencies or sponsored agency securities and tax-exempt municipal securities.

Available-for-sale debt securities decreased \$7.6 million, or 3.6%, to \$202.3 million at June 30, 2023 from \$209.8 million at December 31, 2022, primarily due to principal paydowns of \$12.6 million, mainly offset by purchases of \$5.6 million in tax exempt municipal securities for the six months ended June 30, 2023. No issuer of the available-for-sale securities, other than U.S. Government and its agencies, comprised more than ten percent of our shareholders' equity as of June 30, 2023 and December 31, 2022.

The following table summarizes the fair value of the available-for-sale securities portfolio as of the dates presented:

(\$ in thousands)	June 30, 2023			December 31, 2022		
	Amortized Cost	Fair Value	Unrealized (Loss) Gain	Amortized Cost	Fair Value	Unrealized Loss
U.S. Government agencies or sponsored agency securities:						
Residential mortgage-backed securities	\$ 51,660	\$ 46,332	\$ (5,328)	\$ 55,189	\$ 49,764	\$ (5,425)
Residential collateralized mortgage obligations	170,707	150,131	(20,576)	179,953	160,045	(19,908)
Municipal securities-tax exempt	5,677	5,787	110	—	—	—
Total available-for-sale debt securities	\$ 228,044	\$ 202,250	\$ (25,794)	\$ 235,142	\$ 209,809	\$ (25,333)

Certain securities have fair values less than amortized cost and, therefore, contain unrealized losses. The unrealized losses were primarily attributable to interest rate movement, not credit quality. These securities (Fannie Mae, Ginnie Mae, and Freddie Mac) are guaranteed or sponsored by agencies of the U.S. government, and the issuers of the securities are of high credit quality. We believe that the net unrealized losses presented in the previous tables are temporary and no credit losses are expected. As a result, we expect full collection of the carrying amount of these securities, does not intend to sell the securities in an unrealized loss position, and it was more-likely-than-not we will not have to sell these securities prior to recovery of amortized cost. Accordingly, for available-for-sale debt securities, we did not record allowance for credit losses on January 1, 2013 and does not have allowance for credit losses as of June 30, 2023.

The following table sets forth certain information regarding contractual maturities and the weighted average yields of our investment securities as of the dates presented. Expected maturities may differ from contractual maturities if borrowers have the right to call or prepay obligations with or without call or prepayment penalties.

(\$ in thousands)	June 30, 2023							
	Due in One Year or Less		Due after One Year Through Five Years		Due after Five Years Through Ten Years		Due after Ten Years	
	Amortized Cost	Weighted Average Yield	Amortized Cost	Weighted Average Yield	Amortized Cost	Weighted Average Yield	Amortized Cost	Weighted Average Yield
U.S. Government agencies or sponsored agency securities:								
Residential mortgage-backed securities	\$ —	— %	\$ 1,373	2.12 %	\$ 732	2.28 %	\$ 49,555	2.25 %
Residential collateralized mortgage obligations	—	—	311	1.81	3,037	1.25	167,359	2.81
Municipal securities-tax exempt	—	—	—	—	—	—	5,677	5.11
Total available-for-sale debt securities	\$ —	— %	\$ 1,684	2.07 %	\$ 3,769	1.45 %	\$ 222,591	2.74 %

We have not used interest rate swaps or other derivative instruments to hedge fixed rate loans or securities to otherwise mitigate interest rate risk.

Loans

Our loans represent the largest portion of our earning assets, substantially greater than the securities portfolio or any other asset category, and the quality and diversification of the loan portfolio is an important consideration when reviewing our financial condition.

The loan distribution table that follows sets forth our gross loans outstanding, and the percentage distribution in each category as of the dates indicated:

(\$ in thousands)	June 30, 2023		December 31, 2022	
	Amount	% of Total	Amount	% of Total
Commercial real estate	\$ 847,863	49.4 %	\$ 842,208	50.1 %
SBA—real estate	224,476	13.1	221,340	13.2
SBA—non-real estate	14,309	0.8	13,377	0.8
Commercial and industrial	112,160	6.5	116,951	7.0
Home mortgage	516,226	30.1	482,949	28.8
Consumer	1,163	0.1	1,467	0.1
Gross loans receivable	1,716,197	100.0 %	1,678,292	100.0 %
Allowance for credit losses	(20,802)		(19,241)	
Loans receivable, net ⁽¹⁾	\$ 1,695,395		\$ 1,659,051	

⁽¹⁾ Includes net deferred loan costs/(fees) and unamortized premiums/(unaccreted discounts) of \$(381) thousand and \$160 thousand as of June 30, 2023 and December 31, 2022, respectively.

Gross loans increased \$37.9 million, or 2.3%, to \$1.72 billion as of June 30, 2023, compared to \$1.68 billion as of December 31, 2022. The increase was primarily attributable to new loan production of \$181.5 million, mainly offset by loan payoffs and paydowns of \$111.9 million and net decrease of \$37.5 million in sale of loans and loans held for sale.

The following tables presents the contractual loan maturities by loan category and the contractual distribution of loans to changes in interest rates as of June 30, 2023 and December 31, 2022:

	June 30, 2023						
	Due in One Year or Less		Due after One Year Through Five Years		Due after Five Years		
(\$ in thousands)	Fixed Rate	Adjustable Rate	Fixed Rate	Adjustable Rate	Fixed Rate	Adjustable Rate	Total
Commercial real estate	\$ 38,093	\$ 59,791	\$ 407,579	\$ 88,490	\$ 228,868	\$ 25,042	\$ 847,863
SBA—real estate	—	—	—	29	—	224,447	224,476
SBA—non- real estate	—	123	247	3,843	—	10,096	14,309
Commercial and industrial	12,498	21,302	7,787	24,133	25,639	20,801	112,160
Home mortgage	—	—	—	—	495,756	20,470	516,226
Consumer	—	1,038	—	125	—	—	1,163
Gross loans	\$ 50,591	\$ 82,254	\$ 415,613	\$ 116,620	\$ 750,263	\$ 300,856	\$ 1,716,197

	December 31, 2022						
	Due in One Year or Less		Due after One Year Through Five Years		Due after Five Years		
(\$ in thousands)	Fixed Rate	Adjustable Rate	Fixed Rate	Adjustable Rate	Fixed Rate	Adjustable Rate	Total
Commercial real estate	\$ 27,735	\$ 33,894	\$ 387,902	\$ 116,088	\$ 248,812	\$ 27,777	\$ 842,208
SBA—real estate	—	—	—	34	—	221,306	221,340
SBA—non- real estate	—	75	442	3,964	—	8,896	13,377
Commercial and industrial	8,905	27,917	1,611	28,082	31,185	19,251	116,951
Home mortgage	—	—	—	—	465,749	17,200	482,949
Consumer	—	1,136	—	331	—	—	1,467
Gross loans	\$ 36,640	\$ 63,022	\$ 389,955	\$ 148,499	\$ 745,746	\$ 294,430	\$ 1,678,292

Our loan portfolio is concentrated in commercial real estate, which includes unguaranteed balances in SBA loans, home mortgage and commercial (primarily manufacturing, wholesale, and services oriented entities). We do not have any

material concentrations by industry or group of industries in the loan portfolio. However, 92.6% of our gross loans were secured by real property as of June 30, 2023, compared to 92.1% as of December 31, 2022.

Loans — Commercial Real Estate: We have established concentration limits in the loan portfolio for commercial real estate loans, commercial and industrial loans, and unsecured lending, among others. All loan types are within established limits. We use underwriting guidelines to assess the borrowers' historical cash flow to determine debt service, and we further stress test the debt service under higher interest rate scenarios. Financial and performance covenants are used in commercial lending agreements to allow us to react to a borrower's deteriorating financial condition, should that occur.

Commercial real estate loans include owner-occupied and non-occupied commercial real estate. We originate both fixed and adjustable rate loans. Adjustable rate loans are based on the *Wall Street Journal* prime rate. Our commercial real estate loan portfolio totaled \$847.9 million at June 30, 2023 compared to \$842.2 million at December 31, 2022. During the six months ended June 30, 2023, we originated \$54.2 million of commercial real estate loans. As of June 30, 2023, approximately 79.6% of the commercial real estate portfolio consisted of fixed-rate loans. Our policy maximum loan-to-value, or LTV, is 70% for commercial real estate loans. As of June 30, 2023, our average loan to value for commercial real estate loans was 51.3%.

Loans — SBA: We are designated as an SBA Preferred Lender under the SBA Preferred Lender Program. We offer mostly SBA 7(a) variable-rate loans. We generally sell the 75% guaranteed portion of the SBA loans that we originate. Our SBA loans are typically made to small-sized manufacturing, wholesale, retail, hotel/motel and service businesses for working capital needs or business expansions. SBA loans have maturities up to 25 years. Typically, non-real estate secured loans mature in less than 10 years. Collateral may also include inventory, accounts receivable and equipment, and may include personal guarantees. Our unguaranteed SBA loans collateralized by real estate are monitored by collateral type and included in our commercial real estate Concentration Guidance.

As of June 30, 2023, our SBA portfolio totaled \$238.8 million, compared to \$234.7 million as of December 31, 2022. We originated \$50.6 million for the six months ended June 30, 2023. We sold SBA loans of \$81.5 million with a 7.02% average premium during the six months ended June 30, 2023.

From our total SBA loan portfolio, \$224.5 million is secured by real estate and \$14.3 million is unsecured or secured by business assets as of June 30, 2023.

Loans — Commercial and Industrial: Commercial and industrial loans totaled \$112.2 million as of June 30, 2023, compared to \$117.0 million as of December 31, 2022. We originated \$33.4 million for the six months ended June 30, 2023.

Loans - Home Mortgage: We originate mainly non-qualified, alternative documentation single-family home mortgage loans ("home mortgage") primarily through our retail branch network and our correspondent lender network. The primary loan product is a five-year or seven-year hybrid adjustable rate mortgage, which reprices after five years to a selected SOFR plus certain spreads. We also purchase residential mortgage loans from third party mortgage originators based on the review of their underwriting and file quality as opportunities arise.

Home mortgage loans totaled \$516.2 million as of June 30, 2023, compared to \$482.9 million as of December 31, 2022. For the six months ended June 30, 2023, we originated \$43.4 million of home mortgage loans and purchased \$18.5 million of home mortgage loans from third party mortgage originators.

Loan Servicing

As of June 30, 2023 and December 31, 2022, we serviced \$726.3 million and \$707.1 million, respectively, of SBA and USDA loans for others. Activity for loan servicing rights was as follows:

(\$ in thousands)	Three Months Ended June 30,		Six Months Ended June 30,	
	2023	2022	2023	2022
Beginning balance	\$ 12,898	\$ 12,341	\$ 12,759	\$ 12,720
Additions from loans sold with servicing retained	869	1,357	1,969	2,149
Amortized to expense	(1,113)	(990)	(2,074)	(2,161)
Ending balance	\$ 12,654	\$ 12,708	\$ 12,654	\$ 12,708

Loan servicing rights are reported on our Consolidated Balance Sheets and reported net of amortization.

Allowance for Credit Losses

We adopted ASU 2016-13 using a modified retrospective approach on January 1, 2023 without electing the fair value option on eligible financial instruments under ASU 2019-05. We replaced the current incurred loss accounting model with the Current Expected Credit Losses ("CECL") approach for financial instruments measured at amortized cost and other commitments to extend credit. CECL requires the immediate recognition of estimated credit losses expected to occur over the estimated remaining life of the asset. The forward-looking concept of CECL requires loss estimates to consider historical experience, current conditions and reasonable and supportable forecasts.

The adoption of this ASU increased the allowance for credit losses by \$1.9 million and allowance for off-balance sheet commitments by \$184 thousand. We also recorded a deferred tax asset of \$624 thousand and decrease to opening retained earnings of \$1.5 million on January 1, 2023. The increase to allowance for credit losses was primarily longer duration of home mortgage loans, offset primarily by shorter duration of commercial and industrial loans. We did not record an allowance for credit losses on our available-for-sale debt securities as a result of this adoption. Disclosures for periods after January 1, 2023 are presented in accordance with ASC 326 while prior period amounts continue to be reported in accordance with previously applicable standards and the accounting policies.

We employ a modeled approach that takes into account current and future economic conditions to estimate lifetime expected losses on a collective basis. With the adoption of CECL, we elected not to consider accrued interest receivable in its estimated credit losses because we write off uncollectible accrued interest receivable in a timely manner. We consider writing off accrued interest amounts once the amounts become 90 days past due to be considered within a timely manner. We have elected to write off accrued interest receivable by reversing interest income. We use transition matrices to develop the Probability of Default ("PD") and Loss Given Default ("LGD") approach, incorporating quantitative factors and qualitative considerations in the calculation of the allowance for credit losses for collectively assessed loans. The model provides forecasts of PD and LGD based on national unemployment rates using regression analysis. We incorporate future economic conditions using a weighted multiple scenario approach: baseline and adverse. We apply a reasonable and supportable period of one year for the baseline scenario and two years for the adverse scenario, after which loss assumptions revert to historical loss information through a one-year reversion period for the baseline scenario and a two-year reversion period for the adverse scenario.

In order to quantify the credit risk impact of other trends and changes within the loan portfolio, we utilize qualitative adjustments to the modeled estimated loss approaches. The parameters for making adjustments are established under a Credit Risk Matrix that provides different possible scenarios for each of the factors listed below. The Credit Risk Matrix and the possible scenarios enable the Bank to qualitatively adjust the loss rates. This matrix considers the following nine factors, which are patterned after the guidelines provided under the Federal Financial Institutions Examination Council Interagency Policy Statement on the Allowance for Credit Losses, updated to reflect the adoption of CECL:

- Changes in lending policies and procedures, including changes in underwriting standards and practices for collection, charge-offs, and recoveries;

- Actual and expected changes in national and local economic and business conditions and developments in which the institution operates that affect the collectivity of loans;
- Changes in the nature and volume of the loan portfolio;
- Changes in the experience, ability, and depth of lending management and staff;
- Changes in the volume and severity of past due loans, the volume of nonaccrual loans, and the volume and severity of adversely classified loans;
- Changes in the quality of the credit review function;
- Changes in the value of the underlying collateral for loans that are not collateral-dependent;
- The existence, growth, and effect of any concentrations of credit, and
- The effect of other external factors, such as the regulatory, legal and technological environments; competition; and events such as natural disasters.

For loans that do not share similar risk characteristics such as nonaccrual loans above \$250 thousand, we evaluate these loans on an individual basis in accordance with ASC 326. Such nonaccrual loans are considered to have different risk profiles than performing loans and are therefore evaluated individually. We elected to collectively assess nonaccrual loans with balances below \$250 thousand along with the performing and accrual loans, in order to reduce the operational burden of individually assessing small nonaccrual loans with immaterial balances. For individually assessed loans, the allowance for credit losses is measured using either 1) the present value of future cash flows discounted at the loan's effective interest rate; or 2) the fair value of the collateral, if the loan is collateral-dependent. For the collateral-dependent loans, We obtains a new appraisal to determine the fair value of collateral. The appraisals are based on an "as-is" valuation. To ensure that appraised values remain current, we obtains updated appraisals every twelve months from a qualified independent appraiser. If the fair value of the collateral is less than the amortized balance of the loan, we recognizes an allowance for credit losses with a corresponding charge to the provision for credit losses.

We maintain a separate allowance for credit losses for its off-balance sheet commitments. We use an estimated funding rate to allocate an allowance to undrawn exposures. This funding rate is used as a credit conversion factor to capture how much undrawn lines of credit can potentially become drawn at any point. The funding rate is determined based on a look-back period of 8 quarters. Credit loss is not estimated for off-balance sheet commitments that are unconditionally cancellable by us.

The allowance for credit losses was \$20.8 million at June 30, 2023, compared to \$19.2 million at December 31, 2022. No provision of credit losses was recorded for the three months ended June 30, 2023, compared to provision for credit losses of \$996 thousand for the same period in 2022.

Analysis of the Allowance for Credit Losses

The following table provides an analysis of the allowance for credit losses, provision for credit losses and net charge-offs, by category, for the three months ended June 30, 2023 and 2022:

(\$ in thousands)	As of and for the Three Months Ended June 30,							
	2023				2022			
	Beginning	Provision (Reversal)	Net (Charge-offs) Recoveries	Ending	Beginning	Provision (Reversal)	Net (Charge-offs) Recoveries	Ending
Commercial real estate	\$ 6,784	\$ —	\$ —	\$ 6,784	\$ 6,480	\$ 1,263	\$ —	\$ 7,743
SBA—real estate	1,218	—	—	1,218	1,750	43	7	1,800
SBA—non- real estate	67	—	(12)	55	169	(61)	27	135
Commercial and industrial	1,270	—	—	1,270	3,492	(1,390)	—	2,102
Home mortgage	11,472	—	—	11,472	4,768	1,145	—	5,913
Consumer	3	—	\$ —	3	13	(4)	—	9
Total	<u>\$ 20,814</u>	<u>\$ —</u>	<u>\$ (12)</u>	<u>\$ 20,802</u>	<u>\$ 16,672</u>	<u>\$ 996</u>	<u>\$ 34</u>	<u>\$ 17,702</u>
Gross loans ⁽¹⁾				\$ 1,716,197				\$ 1,484,718
Average loans ⁽¹⁾				\$ 1,725,764				\$ 1,461,081
Net (charge-offs) recoveries to average gross loans				(0.00)%				(0.01)%
Allowance for credit losses to gross loans				1.21 %				1.19 %

⁽¹⁾ Excludes loans held for sale.

The following table provides an analysis of the allowance for credit losses, provision for credit losses and net charge-offs, by category, for the six months ended June 30, 2023 and 2022:

	As of and for the Six Months Ended June 30,								
	2023					2022			
(\$ in thousands)	Beginning	Impact of CECL Adoption	(Reversal) Provision	Net (Charge-offs) Recoveries	Ending	Beginning	(Reversal) Provision	Net (Charge-offs) Recoveries	Ending
Commercial real estate	\$ 6,951	\$ 875	\$ (951)	\$ (91)	\$ 6,784	\$ 8,150	\$ (407)	\$ —	\$ 7,743
SBA—real estate	1,607	(238)	(140)	(11)	1,218	2,022	(215)	(7)	1,800
SBA—non- real estate	207	(142)	(7)	(3)	55	199	(108)	44	135
Commercial and industrial	1,643	(320)	(53)	—	1,270	2,848	(746)	—	2,102
Home mortgage	8,826	1,753	893	—	11,472	2,891	3,022	—	5,913
Consumer	7	(4)	—	\$ —	3	13	(5)	1	9
Total	<u>\$ 19,241</u>	<u>\$ 1,924</u>	<u>\$ (258)</u>	<u>\$ (105)</u>	<u>\$ 20,802</u>	<u>\$ 16,123</u>	<u>\$ 1,541</u>	<u>\$ 38</u>	<u>\$ 17,702</u>
Gross loans ⁽¹⁾					\$ 1,716,197				\$ 1,484,718
Average loans ⁽¹⁾					\$ 1,725,764				\$ 1,406,075
Net (charge-offs) recoveries to average gross loans					(0.02)%				(0.01)%
Allowance for credit losses to gross loans					1.21 %				1.19 %

⁽¹⁾ Excludes loans held for sale.

The following table presents an allocation of the allowance for credit losses by portfolio as of June 30, 2023 and December 31, 2022:

(\$ in thousands)	June 30, 2023		December 31, 2022	
	Amount	% to Total	Amount	% to Total
Commercial real estate	\$ 6,784	32.6 %	\$ 6,951	36.1 %
SBA—real estate	1,218	5.9	1,607	8.4
SBA—non- real estate	55	0.3	207	1.1
Commercial and industrial	1,270	6.1	1,643	8.5
Home mortgage	11,472	55.1	8,826	45.9
Consumer	3	—	7	—
Total	\$ 20,802	100.0 %	\$ 19,241	100.0 %

Nonperforming Assets

Loans are considered delinquent when principal or interest payments are past due 30 days or more. Delinquent loans may remain on accrual status between 30 days and 90 days past due. Loans on which the accrual of interest has been discontinued are designated as non-accrual loans. Typically, the accrual of interest on loans is discontinued when principal or interest payments are 90 days past due or when, in the opinion of management, there is a reasonable doubt as to collectability in the normal course of business. When loans are placed on non-accrual status, all interest previously accrued, but not collected, is reversed against current period interest income. Income on non-accrual loans is subsequently recognized only to the extent that cash is received, and the loan's principal balance is deemed collectible. Loans are restored to accrual status when loans become well-secured and management believes full collectability of principal and interest is probable.

Nonperforming loans include loans that are 90 days past due and still accruing, loans accounted for on a non-accrual basis and accruing restructured loans. Nonperforming assets consist of nonperforming loans plus other real estate owned ("OREO").

Nonperforming loans were \$8.8 million at June 30, 2023, compared to \$3.1 million at December 31, 2022. Nonperforming loans included the guaranteed portion of SBA loans of \$5.4 million and \$1.0 million as of June 30, 2023 and December 31, 2022, respectively.

Real estate we acquire as a result of foreclosure or by deed-in-lieu of foreclosure is classified as OREO until sold, and is initially recorded at fair value less costs to sell when acquired, establishing a new cost basis. We had no OREO as of June 30, 2023 and December 31, 2022.

The following table sets forth the allocation of our nonperforming assets among our different asset categories as of the dates indicated. Nonperforming loans include non-accrual loans, loans past due 90 days or more and still accruing interest, and loans modified under troubled debt restructurings.

(\$ in thousands)	June 30, 2023	December 31, 2022
Nonaccrual loans	\$ 8,566	\$ 2,639
Past due loans 90 days or more and still accruing	246	442
Total nonperforming loans ⁽¹⁾	8,812	3,081
OREO	—	—
Total nonperforming assets	\$ 8,812	\$ 3,081
Nonperforming loans to gross loans	0.51 %	0.18 %
Nonperforming assets to total assets	0.41 %	0.15 %
Allowance for credit losses to nonperforming loans	236 %	625 %

⁽¹⁾ Includes guaranteed portion of SBA loans of \$5.4 million and \$1.0 million as of June 30, 2023 and December 31, 2022, respectively.

Deposits and Other Sources of Funds

We gather deposits primarily through our branch locations. We offer a variety of deposit products including demand deposits accounts, interest-bearing products, savings accounts and certificate of deposits. We dedicate continuing effort into gathering noninterest demand deposits accounts through marketing to our existing and new loan customers, customer referrals, our marketing staff and various involvement with community networks.

The following table show the composition of deposits by type as of the dates presented:

(\$ in thousands)	June 30, 2023		December 31, 2022	
	Amount	Percent	Amount	Percent
Noninterest-bearing demand	\$ 634,745	34.1 %	\$ 701,584	37.2 %
Interest-bearing:				
Money market and others	344,162	18.5	526,321	27.9
Time deposits (more than \$250)	416,208	22.4	356,197	18.9
Time deposits (\$250 or less)	464,524	25.0	301,669	16.0
Total interest-bearing	1,224,894	65.9	1,184,187	62.8
Total deposits	\$ 1,859,639	100.0 %	\$ 1,885,771	100.0 %

The following tables set forth the maturity of time deposits as of June 30, 2023:

(\$ in thousands)	Maturity Within:				
	Three Months	Three to Six Months	Six to 12 Months	After 12 Months	Total
Time deposits (more than \$250)	\$ 30,086	\$ 188,654	\$ 195,818	\$ 1,650	\$ 416,208
Time deposits (\$250 or less)	67,165	174,086	180,766	42,507	464,524
Total time deposits	\$ 97,251	\$ 362,740	\$ 376,584	\$ 44,157	\$ 880,732

Other than deposits, we also utilized FHLB advances as a supplementary funding source to finance our operations. The advances from the FHLB are collateralized by residential and commercial real estate loans. As of June 30, 2023 and December 31, 2022, we had maximum borrowing capacity from the FHLB of \$625.9 million and \$582.8 million, respectively. We had \$75.0 million borrowings from FHLB as of June 30, 2023 and no borrowing from FHLB as of December 31, 2022.

Liquidity and Capital Recourses

Liquidity refers to the measure of our ability to meet the cash flow requirements of depositors and borrowers, while at the same time meeting our operating, capital and strategic cash flow needs, all at a reasonable cost. We continuously monitor our liquidity position to ensure that assets and liabilities are managed in a manner that will meet all short-term and long-term cash requirements. We manage our liquidity position to meet the daily cash flow needs of customers, while maintaining an appropriate balance between assets and liabilities to meet the return on investment objectives of our shareholders. Our short-term and long-term liquidity requirements are primarily met through cash flow from operations, redeployment of prepaying and maturing balances in our loan and investment portfolios, and increases in customer deposits. Other alternative sources of funds will supplement these primary sources to the extent necessary to meet additional liquidity requirements on either a short-term or long-term basis.

Deposits are the primarily funding source for the Bank. Deposits provide a stable source of funding and reduce our reliance on the wholesale funding markets. The following table presents the loan and deposit balances, the loans-to-deposit ratios, and deposits as a percentage of total liabilities as of June 30, 2023 and December 31, 2022:

(\$ in thousands)	June 30, 2023		December 31, 2022	
Deposits	\$	1,859,639	\$	1,885,771
Deposits as a % of total liabilities		94.5 %		98.3 %
Loans, net	\$	1,695,395	\$	1,659,051
Loans-to-deposits ratio		91.2 %		88.0 %

In addition to deposits, we have access to various sources of wholesale funding, as well as borrowing capacity at the FHLB, Federal Reserve, and correspondent banks to sustain an adequate liquid asset portfolio, meet daily cash demands and allow management flexibility to execute the business strategy. Economic conditions and the stability of capital markets impact the access to and the cost of wholesale funding. The access to capital markets is also affected by the ratings received from various credit rating agencies.

We had \$100.0 million of unsecured federal funds lines with no amounts advanced as of June 30, 2023 and December 31, 2022. In addition, on such dates we had lines of credit from the Federal Reserve discount window of \$172.3 million and \$175.6 million.. The Federal Reserve discount window lines were collateralized by a pool of commercial real estate loans and commercial and industrial loans totaling \$244.2 million and \$254.7 million as of June 30, 2023 and December 31, 2022, respectively. We did not have any borrowings outstanding with the Federal Reserve as of June 30, 2023 or December 31, 2022, and our borrowing capacity is limited only by eligible collateral.

Based on the values of loans pledged as collateral, we had \$400.5 million of additional borrowing availability with the FHLB as of June 30, 2023. We also maintain relationships in the capital markets with brokers to issue certificates of deposit and money market accounts.

We maintain ample access to liquidity, including highly liquid assets on our balance sheet and available unused borrowings from other financial institutions. The following table presents our liquid assets and available borrowings as of June 30, 2023 and December 31, 2022:

(\$ in thousands)	June 30, 2023		December 31, 2022		% Change
Liquid assets:					
Cash and cash equivalents	\$	143,761	\$	82,972	73.3 %
AFS debt securities		202,250		209,809	(3.6)
Liquid assets	\$	346,011	\$	292,781	18.2 %
Liquid assets to total assets		16.1 %		14.0 %	
Available borrowings:					
FHLB	\$	400,543	\$	440,358	(9.0)%
Federal Reserve Bank		172,316		175,605	(1.9)
Pacific Coast Bankers Bank		50,000		50,000	—
Zions Bank		25,000		25,000	—
First Horizon Bank		25,000		24,950	0.2
Total available borrowings	\$	672,859	\$	715,913	(6.0)%
Total available borrowings to total assets		31.3 %		34.2 %	
Liquid assets and available borrowings to total assets		47.4 %		48.2 %	

The following tables summarizes short- and long-term material cash requirements as of June 30, 2023, which we believe that we will be able to fund these obligations through cash generated from our operations and available alternative sources of funds:

(\$ in thousands)	Material Cash Requirements					Total
	Within One Year	One to Three Years	Three to Five Years	After Five Years	Indeterminable maturity ⁽¹⁾	
Deposits ⁽²⁾	\$ 459,991	\$ 403,084	\$ 17,657	\$ —	\$ 978,907	\$ 1,859,639
Operating lease commitments	2,601	4,040	3,899	2,680	—	13,220
Advances from FHLB ⁽²⁾	—	75,000	—	—	—	75,000
Commitments to fund investment for Low Income Housing Tax Credit	3,828	2,984	122	251	—	7,185
Total contractual obligations	\$ 466,420	\$ 485,108	\$ 21,678	\$ 2,931	\$ 978,907	\$ 1,955,044

⁽¹⁾ Includes deposits with no defined maturity, such as noninterest-bearing demand, savings and money market.

⁽²⁾ Excludes accrued interest.

In addition to contractual obligations, other commitments of us impact liquidity. These include unused commitments to extend credit, standby letters of credit and commercial letters of credit. Since many of these commitments expire without being drawn upon, and each customer must continue to meet the conditions established in the contract, the total amount of these commercial commitments does not necessarily represent the future cash requirements of us. Our liquidity sources have been, and are expected to be, sufficient to meet the cash requirements of its lending activities. Information about our loan commitments, standby letters of credit and commercial letters of credit is provided in Note 9. Commitments and Contingencies to the Consolidated Financial Statements in this Form 10-Q.

Capital Requirements

We are subject to various regulatory capital requirements administered by the federal and state banking regulators. Failure to meet regulatory capital requirements may result in certain mandatory and possible additional discretionary actions by regulators that, if undertaken, could have a direct material effect on our financial statements. Under capital adequacy guidelines and the regulatory framework for “prompt corrective action”, we must meet specific capital guidelines that involve quantitative measures of our assets, liabilities and certain off-balance sheet items as calculated under regulatory accounting policies. The capital amounts and classifications are subject to qualitative judgments by the federal banking regulators regarding components, risk weightings and other factors. Qualitative measures established by regulation to ensure capital adequacy required us to maintain minimum amounts and various ratios of CET1 capital, Tier 1 capital and total capital to risk-weighted assets and of Tier 1 capital to average consolidated assets, referred to as the “leverage ratio.”

The table below also summarizes the capital requirements applicable to us and the Bank in order to be considered “well-capitalized” from a regulatory perspective, as well as our and the Bank’s capital ratios as of June 30, 2023 and December 31, 2022. The Bank exceeded all regulatory capital requirements under the Basel III Capital Rules and were considered to be “well-capitalized” as of the dates reflected in the table below. As of June 30, 2023, the FDIC categorized us as well-capitalized under the prompt corrective action framework. There have been no conditions or events since June 30, 2023 that management believes would change this classification.

As of June 30, 2023 (\$ in thousands)	Actual ⁽¹⁾		Regulatory Capital Ratio Requirements		Minimum to be Considered "Well Capitalized"		Regulatory Capital Ratio Requirements, including fully phased in Capital Conservation Buffer	
	Amount	Ratio	Amount	Ratio	Amount	Ratio	Amount	Ratio
Total capital (to risk-weighted assets)								
Consolidated	\$ 222,643	13.10 %	N/A	N/A	N/A	N/A	N/A	N/A
Bank	220,584	12.98	\$ 136,000	8.00 %	\$ 170,000	10.00 %	\$ 178,500	10.50 %
Tier 1 capital (to risk-weighted assets)								
Consolidated	202,589	11.92	N/A	N/A	N/A	N/A	N/A	N/A
Bank	200,530	11.80	102,000	6.00	136,000	8.00	144,500	8.50
CET1 capital (to risk-weighted assets)								
Consolidated	202,589	11.92	N/A	N/A	N/A	N/A	N/A	N/A
Bank	200,530	11.80	76,500	4.50	110,500	6.50	119,000	7.00
Tier 1 leverage (to average assets)								
Consolidated	202,589	9.50	N/A	N/A	N/A	N/A	N/A	N/A
Bank	200,530	9.41	85,257	4.00	106,571	5.00	85,257	4.00

⁽¹⁾ The capital requirements are only applicable to the Bank, and our ratios are included for comparison purpose.

As of December 31, 2022 (\$ in thousands)	Actual ⁽¹⁾		Regulatory Capital Ratio Requirements		Minimum to be Considered "Well Capitalized"		Regulatory Capital Ratio Requirements, including fully phased in Capital Conservation Buffer	
	Amount	Ratio	Amount	Ratio	Amount	Ratio	Amount	Ratio
Total capital (to risk-weighted assets)								
Consolidated	\$ 213,862	13.06 %	N/A	N/A	N/A	N/A	N/A	N/A
Bank	211,981	12.94	\$ 131,020	8.00 %	\$ 163,775	10.00 %	\$ 171,964	10.50 %
Tier 1 capital (to risk-weighted assets)								
Consolidated	194,358	11.87	N/A	N/A	N/A	N/A	N/A	N/A
Bank	192,477	11.75	98,265	6.00	131,020	8.00	139,209	8.50
CET1 capital (to risk-weighted assets)								
Consolidated	194,358	11.87	N/A	N/A	N/A	N/A	N/A	N/A
Bank	192,477	11.75	73,699	4.50	106,454	6.50	114,642	7.00
Tier 1 leverage (to average assets)								
Consolidated	194,358	9.38	N/A	N/A	N/A	N/A	N/A	N/A
Bank	192,477	9.29	82,836	4.00	103,545	5.00	82,836	4.00

⁽¹⁾ The capital requirements are only applicable to the Bank, and our ratios are included for comparison purpose.

Item 3. Quantitative and Qualitative Disclosures About Market Risk.

Market risk represents the risk of loss due to changes in market values of assets and liabilities. We incur market risk in the normal course of business through exposures to market interest rates, equity prices, and credit spreads. We have identified interest rate risk as our primary source of market risk.

Interest Rate Risk

Interest rate risk is the risk to earnings and value arising from changes in market interest rates. Interest rate risk arises from timing differences in the repricing and maturities of interest-earning assets and interest-bearing liabilities (repricing risk), changes in the expected maturities of assets and liabilities arising from embedded options, such as borrowers' ability to prepay home mortgage loans at any time and depositors' ability to redeem certificates of deposit before maturity (option risk), changes in the shape of the yield curve where interest rates increase or decrease in a nonparallel fashion (yield curve risk), and changes in spread relationships between different yield curves, such as U.S. Treasuries and SOFR (basis risk).

Our board's asset liability committee, or ALM, establishes broad policy limits with respect to interest rate risk. Our management's asset liability committee, or ALCO, establishes specific operating guidelines within the parameters of the policies set by the ALM. In general, we seek to minimize the impact of changing interest rates on net interest income and the economic values of assets and liabilities. Our ALCO monitors the level of interest rate risk sensitivity on a quarterly basis to ensure compliance with the ALM-approved risk limits. The policy requires a periodic review of all key assumptions used, such as identifying appropriate interest rate scenarios, setting loan prepayment rates based on historical analysis, and noninterest-bearing and interest-bearing deposit durations based on historical analysis.

Interest rate risk management is an active process that encompasses monitoring loan and deposit flows complemented by investment and funding activities. Effective management of interest rate risk begins with understanding the dynamic characteristics of assets and liabilities and determining the appropriate interest rate risk posture given business forecasts, management objectives, market expectations, and policy constraints.

An asset sensitive position refers to a balance sheet position in which an increase in short-term interest rates is expected to generate higher net interest income, as rates earned on our interest-earning assets would reprice upward more quickly than rates paid on our interest-bearing liabilities, thus expanding our net interest margin. Conversely, a liability sensitive position refers to a balance sheet position in which an increase in short-term interest rates is expected to generate lower net interest income, as rates paid on our interest-bearing liabilities would reprice upward more quickly than rates earned on our interest-earning assets, thus compressing our net interest margin.

Interest rate risk measurement is calculated and reported to the ALCO and ALM at least quarterly. The information reported includes period-end results and identifies any policy limits exceeded, along with an assessment of the policy limit breach and the action plan and timeline for resolution, mitigation, or assumption of the risk.

Evaluation of Interest Rate Risk

We use a net interest income simulation model to measure and evaluate potential changes in our net interest income. We run various hypothetical interest rate scenarios at least quarterly and compare these results against a scenario with no changes in interest rates. We use two approaches to model interest rate risk: Earnings at Risk, or EAR, and Economic Value of Equity, or EVE. Under EAR, net interest income is modeled utilizing various assumptions for assets and liabilities. EVE measures the period end market value of assets minus the market value of liabilities and the change in this value as rates change. EVE is a period end measurement.

Our simulation model incorporates various assumptions, which we believe are reasonable but which may have a significant impact on results such as: (i) the timing of changes in interest rates; (ii) shifts or rotations in the yield curve; (iii) re-pricing characteristics for market-rate-sensitive instruments; (iv) varying loan prepayment speeds for different interest rate scenarios; and (v) the overall growth and mix of assets and liabilities. Because of limitations inherent in any approach used to measure interest rate risk, simulation results are not intended as a forecast of the actual effect of a change in market interest rates on our results but rather as a means to better plan and execute appropriate asset-liability management strategies and manage our interest rate risk.

Potential changes to our net interest income in hypothetical rising and declining rate scenarios calculated as of June 30, 2023 and December 31, 2022 are presented in the following table. The projections assume (1) immediate, parallel shifts downward of the yield curve of 100, 200 and 300 basis points and (2) immediate, parallel shifts upward of the yield curve of 100, 200, and 300 basis points over 12 months.

	Net Interest Sensitivity		Economic Value of Equity Sensitivity	
	June 30, 2023	December 31, 2022	June 30, 2023	December 31, 2022
+300 basis points	(0.65)%	0.12 %	(39.84)%	(42.72)%
+200 basis points	0.53	1.13	(19.06)	(23.29)
+100 basis points	0.58	0.97	(7.37)	(9.11)
-100 basis points	(0.37)	(0.94)	1.96	(1.78)
-200 basis points	0.67	(0.70)	(1.47)	(7.31)
-300 basis points	1.19	(3.24)	(11.28)	(18.42)

Item 4. Controls and Procedures.

Evaluation of disclosure controls and procedures

Our management, including our President and Chief Executive Officer and our Chief Financial Officer, have evaluated the effectiveness of our “disclosure controls and procedures” (as defined in Rule 13a-15(e) under the Securities and Exchange Act of 1934, as amended (the “Exchange Act”)), as of the end of the period covered in this report. Based on such evaluation, our President and Chief Executive Officer and our Chief Financial Officer have concluded that, as of the end of such period, our disclosure controls and procedures were effective as of that date to provide reasonable assurance that the information required to be disclosed by us in the reports it files or submits under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the rules and forms of the SEC and that information required to be disclosed by us in the reports it files or submits under the Exchange Act is accumulated and communicated to our management, including its President and Chief Executive Officer and its Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure.

Changes in internal control over financial reporting

We identified, designed, and documented additional internal controls to address new risks posed by the new processes and estimation activities resulting from the CECL adoption. However, there have not been any material changes in our internal control over financial reporting (as such term is defined in Rule 13a-15(f) under the Exchange Act) during the period covered to which this report relates that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II - OTHER INFORMATION

Item 1. Legal Proceedings.

In the normal course of business, we are subject to legal proceedings or claims. Management has reviewed all legal claims against us and possible loss contingencies, and does not expect the amounts to be material to any of the consolidated financial statements.

Item 1A. Risk Factors.

A discussion of the risk factors affecting us is set forth in Part I, Item 1A. Risk Factors in our 2022 Annual Report on Form 10-K. The discussion of risk factors provides a description of some of the important risk factors that could affect our actual results and could cause our results to vary materially from those expressed in public statements or documents. In addition to the disclosures set forth in such report, certain factors that developed or were discovered after the date of our Form 10-K are set forth below, and you should read those discussions carefully. However, other factors besides those included in the discussion of risk factors or discussed elsewhere in other of our reports filed with or furnished to the SEC could affect our business or results. The readers should not consider any description of such factors to be a complete set of all potential risks that we may face.

Recent and continuing uncertainties surrounding the banking sector may disproportionately affect our business.

During the first quarter and early in the second quarter of 2023, a number of regional banks suffered liquidity crises that ultimately resulted in their closure by federal and state banking regulators. During and since those failures, customer confidence in the safety of their deposits has declined, particularly with respect to uninsured deposits. News articles and other media items have created greater skepticism among all banking customers, and both the news media and customers have tended to scrutinize smaller institutions much more closely than larger ones. Although we have been largely successful in maintaining our depositors' confidence, a continuation or exacerbation of these developments may further erode customer confidence generally or with respect to smaller institutions such as the Bank. In part in response to these concerns, we have been forced to maintain, and we expect to continue to maintain, higher liquidity levels, which will limit our ability to invest funds from customer deposits into higher-yielding investments and thus will adversely impact our net income. Further, if we cannot maintain sufficient liquidity to assure an ability to meet customer withdrawal demands, our business could suffer or, in particularly acute circumstances, could fail. Because the Bank is the Company's primary operating subsidiary and is responsible for substantially all of the Company's financial capacity, a failure of the Bank would materially and adversely affect the value of the Company's securities.

Shifting customer expectations may require us to respond in ways that decrease our net interest income.

In recent periods we have seen substantial increases in benchmark interest rates as the Federal Open Markets Committee has increased the Federal Funds rate in response to reports of rising inflation. For quite some time we have been able to maintain unusually low interest costs on deposits as a result of near-zero benchmark rates. However, the shift to higher market interest rates has motivated many customers to seek higher yields on their deposits, and accordingly we have responded by meeting these needs. Further, as noted above, we have found it necessary to maintain additional liquidity to respond to potential increases in customer withdrawal demand, which in turn has limited our ability to invest in higher-yielding loan and investment products. We expect that these conditions will continue for the indefinite future, as a result of which we expect near-term contraction in our net interest margin and net interest income.

We may be subject to greater than ordinary degrees of scrutiny from federal and state banking regulators.

In times of significant uncertainty surrounding the banking industry, federal and state banking regulators have tended to scrutinize regulated institutions much more closely to assure the safety and soundness of deposits, the security of the banking system, and the integrity of the Federal Deposit Insurance Fund. These measures, as well as consumer protection regulations, are intended solely for the protection of depositors and other customers, and banking regulators charged with enforcing those regulations are not focused on the protection of shareholders. Among other things, regulators are vested with broad discretion regarding the adequacy of a bank's liquidity and the quality of its loan and deposit portfolios. We expect the recent failures of two regional banks in California to cause our regulators to scrutinize our assets and our liquidity much more carefully. While we believe we have taken appropriate measures to respond to current market

conditions and trends, our regulators may disagree, and may require us to take further actions such as increasing liquidity, reducing our loan-to-deposit ratio, increasing our reserves for credit losses, or both, or to take other measures to protect customers or the Deposit Insurance Fund. If our regulators impose additional requirements in response to these conditions, we may experience further reductions to our net income or we may be required to take other actions that adversely affect our results of operations.

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

None.

Item 3. Defaults Upon Senior Securities.

None.

Item 4. Mine Safety Disclosures.

Not applicable.

Item 5. Other Information.

None.

Item 6. Exhibits.

Exhibit Number	Description
3.1	<u>Articles of Incorporation of OP Bancorp (incorporated herein by reference to Exhibit 3.1 to the Registrant's Form S-1 Registration Statement (Registration No. 333-223444) filed on March 5, 2018).</u>
3.2	<u>Amended and Restated Bylaws of OP Bancorp (incorporated herein by reference to Exhibit 3.2 to the Registrant's Form S-1 Registration Statement (Registration No. 333-223444) filed on March 5, 2018).</u>
3.3	<u>First Amendment to the Amended and Restated Bylaws of OP Bancorp (incorporated herein by reference to Exhibit 3.3 to the Registrant's Annual Report on Form 10-K (File No. 001-38437) filed on March 15, 2021).</u>
31.1	<u>Certification of Principal Executive Officer Pursuant to Rules 13a-14(a) or 15d-14(a) under the Securities Exchange Act of 1934, as Adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.</u>
31.2	<u>Certification of Principal Financial Officer Pursuant to Rules 13a-14(a) or 15d-14(a) under the Securities Exchange Act of 1934, as Adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.</u>
32.1	<u>Certification of Principal Executive Officer Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.</u>
32.2	<u>Certification of Principal Financial Officer Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.</u>
101.INS	XBRL Instance Document
101.SCH	XBRL Taxonomy Extension Schema Document
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document
101.LAB	XBRL Taxonomy Extension Label Linkbase Document
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this Report to be signed on its behalf by the undersigned, thereunto duly authorized.

OP Bancorp

Date: August 9, 2023

By:

/s/ MIN J. KIM

Min J. Kim
President and Chief Executive Officer

Date: August 9, 2023

By:

/s/ CHRISTINE Y. OH

Christine Y. Oh
Chief Financial Officer

**CERTIFICATION PURSUANT TO
RULES 13a-14(a) OR 15d-14(a) UNDER THE SECURITIES EXCHANGE ACT OF 1934,
AS ADOPTED PURSUANT TO SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002**

I, Min J. Kim, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of OP Bancorp (the “registrant”);
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:
 - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - (b) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - (c) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: August 9, 2023

By: _____ /s/ MIN J. KIM

Min J. Kim
President and Chief Executive Officer

1. I have reviewed this Quarterly Report on Form 10-Q of OP Bancorp (the “registrant”);
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:
 - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - (b) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - (c) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

By: /s/ CHRISTINE Y. OH
Christine Y. Oh
Executive Vice President and Chief Financial Officer

- (1) The Report fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and result of operations of the Company.

Date: August 9, 2023

By: /s/ MIN J. KIM

Min J. Kim
President and Chief Executive Officer

- (1) The Report fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and result of operations of the Company.

By: /s/ CHRISTINE Y. OH
Christine Y. Oh
Executive Vice President and Chief Financial Officer