UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended September 30, 2023

OR

o 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 001-40379

FIVE STAR BANCORP

(Exact name of Registrant as specified in its charter)

California	**75-3100966**
(State or other jurisdiction of incorporation or organization)	(IRS Employer Identification No.)

3100 Zinfandel Drive, Suite 100 Rancho Cordova, CA 95670

(Address of principal executive office) (Zip Code)

Registrant's telephone number, including area code: **(916) 626-5000**

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

Title of each class	Trading symbol	Name of each exchange on which registered
Common stock, no par value per share	FSBC	The Nasdaq Stock Market LLC

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 x No o

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 x No o

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a 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	o	Accelerated filer	o
Non-accelerated Filer	x	Smaller reporting company	x
Emerging growth company	x		

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. o

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).
Yes o No x

As of November 3, 2023, there were 17,257,023 shares of the registrant's common stock, no par value, outstanding.

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Quarterly Report on Form 10-Q
September 30, 2023

PART I FINANCIAL INFORMATION

ITEM 1. Financial Statements

FIVE STAR BANCORP AND SUBSIDIARY
CONSOLIDATED BALANCE SHEETS
(Unaudited)

(in thousands, except share amounts)	**September 30, 2023**	**December 31, 2022**
ASSETS		
Cash and due from financial institutions	$ 26,744	$ 32,561
Interest-bearing deposits in banks	296,804	227,430
Cash and cash equivalents	323,548	259,991
Time deposits in banks	6,971	9,849
Securities available-for-sale, at fair value, net of allowance for credit losses of $0 at September 30, 2023 and December 31, 2022 (amortized cost of $126,703 and $135,087 at September 30, 2023 and December 31, 2022, respectively)	104,086	115,988
Securities held-to-maturity, at amortized cost, net of allowance for credit losses of $20 at September 30, 2023 and $0 at December 31, 2022 (fair value of $2,811 and $3,432 at September 30, 2023 and December 31, 2022, respectively)	3,104	3,756
Loans held for sale	9,326	9,416
Loans held for investment	3,009,930	2,791,326
Allowance for credit losses - loans	(34,028)	(28,389)
Loans held for investment, net of allowance for credit losses	2,975,902	2,762,937
FHLB stock	15,000	10,890
Operating leases, right-of-use asset, net	4,799	3,981
Premises and equipment, net	1,564	1,605
Bank-owned life insurance	17,023	14,669
Interest receivable and other assets	43,717	34,077
Total assets	**$ 3,505,040**	**$ 3,227,159**
LIABILITIES AND SHAREHOLDERS' EQUITY		
Deposits:		
Non-interest-bearing	$ 833,434	$ 968,749
Interest-bearing	2,198,776	1,813,255
Total deposits	3,032,210	2,782,004
Borrowings:		
FHLB advances	90,000	100,000
Subordinated debt, net	73,713	73,606
Operating lease liability	5,043	4,243
Interest payable and other liabilities	30,050	14,481
Total liabilities	3,231,016	2,974,334
Commitments and contingencies (Note 8)		
Shareholders' equity		
Preferred stock, no par value; 10,000,000 shares authorized; zero issued and outstanding at September 30, 2023 and December 31, 2022	—	—
Common stock, no par value; 100,000,000 shares authorized; 17,257,357 shares issued and outstanding at September 30, 2023; 17,241,926 shares issued and outstanding at December 31, 2022	220,266	219,543
Retained earnings	69,689	46,736
Accumulated other comprehensive loss, net	(15,931)	(13,454)
Total shareholders' equity	274,024	252,825
Total liabilities and shareholders' equity	**$ 3,505,040**	**$ 3,227,159**

See accompanying notes to the unaudited consolidated financial statements.

FIVE STAR BANCORP AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF INCOME
(Unaudited)

(in thousands, except per share amounts)	Three Months Ended September 30, 2023	Three Months Ended September 30, 2022	Nine Months Ended September 30, 2023	Nine Months Ended September 30, 2022
Interest and fee income:				
Loans, including fees	$ 41,861	$ 29,886	$ 119,284	$ 76,877
Taxable securities	472	439	1,401	1,252
Nontaxable securities	181	176	548	532
Interest-bearing deposits in other banks	2,584	1,145	6,969	1,855
Total interest and fee income	45,098	31,646	128,202	80,516
Interest expense:				
Deposits	16,386	2,817	39,733	4,383
FHLB advances	75	47	783	52
Subordinated debt	1,161	1,259	3,484	2,146
Total interest expense	17,622	4,123	44,000	6,581
Net interest income	27,476	27,523	84,202	73,935
Provision for credit losses	1,050	2,250	3,200	5,450
Net interest income after provision for credit losses	26,426	25,273	81,002	68,485
Non-interest income:				
Service charges on deposit accounts	158	132	410	370
Net gain on sale of securities available-for-sale	—	—	—	5
Gain on sale of loans	396	548	1,635	2,297
Loan-related fees	355	447	1,052	1,800
FHLB stock dividends	274	152	656	353
Earnings on BOLI	127	102	355	293
Other	74	52	1,467	438
Total non-interest income	1,384	1,433	5,575	5,556
Non-interest expense:				
Salaries and employee benefits	6,876	5,645	19,915	16,873
Occupancy and equipment	561	515	1,635	1,548
Data processing and software	1,020	797	2,905	2,252
FDIC insurance	375	195	1,187	605
Professional services	700	792	1,917	1,914
Advertising and promotional	535	512	1,686	1,340
Loan-related expenses	345	262	924	929
Other operating expenses	1,603	1,454	4,943	4,491
Total non-interest expense	12,015	10,172	35,112	29,952
Income before provision for income taxes	15,795	16,534	51,465	44,089
Provision for income taxes	4,750	4,830	14,530	12,570
Net income	**$ 11,045**	**$ 11,704**	**$ 36,935**	**$ 31,519**
Basic earnings per common share	$ 0.64	$ 0.68	$ 2.15	$ 1.84
Diluted earnings per common share	$ 0.64	$ 0.68	$ 2.15	$ 1.84

See accompanying notes to unaudited consolidated financial statements.

FIVE STAR BANCORP AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(Unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
(in thousands)	**2023**	**2022**	**2023**	**2022**
Net income	$ 11,045	$ 11,704	$ 36,935	$ 31,519
Unrealized (losses) on securities:				
Net unrealized holding (losses) on securities available-for-sale during the period	(4,195)	(4,718)	(3,516)	(22,005)
Reclassification adjustment for net realized (losses) included in net income	—	—	—	(5)
Income tax (benefit) related to items of other comprehensive income	(1,240)	(1,395)	(1,039)	(6,506)
Other comprehensive (loss)	(2,955)	(3,323)	(2,477)	(15,504)
Total comprehensive income	**$ 8,090**	**$ 8,381**	**$ 34,458**	**$ 16,015**

See accompanying notes to the unaudited consolidated financial statements.

FIVE STAR BANCORP AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY
For the Three Months Ended September 30, 2023 and 2022
(Unaudited)

(in thousands, except per share amounts)	Common Stock Shares	Common Stock Amount	Retained Earnings	Accumulated Other Comprehensive Loss	Total Shareholders' Equity
Balance at June 30, 2022	17,245,983	$ 219,023	$ 26,924	$ (12,747)	$ 233,200
Net income	—	—	11,704	—	11,704
Other comprehensive loss	—	—	—	(3,323)	(3,323)
Stock compensation expense	—	263	—	—	263
Cash dividends paid ($0.15 per share)	—	—	(2,586)	—	(2,586)
Balance at September 30, 2022	**17,245,983**	**$ 219,286**	**$ 36,042**	**$ (16,070)**	**$ 239,258**
Balance at June 30, 2023	17,257,357	$ 220,021	$ 62,095	$ (12,976)	$ 269,140
Net income	—	—	11,045	—	11,045
Other comprehensive loss	—	—	—	(2,955)	(2,955)
Stock compensation expense	—	245	—	—	245
Cash dividends paid ($0.20 per share)	—	—	(3,451)	—	(3,451)
Balance at September 30, 2023	**17,257,357**	**$ 220,266**	**$ 69,689**	**$ (15,931)**	**$ 274,024**

See accompanying notes to the unaudited consolidated financial statements.

FIVE STAR BANCORP AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY
For the Nine Months Ended September 30, 2023 and 2022
(Unaudited)

	Common Stock		Retained Earnings	Accumulated Other Comprehensive Loss	Total Shareholders' Equity
(in thousands, except per share amounts)	Shares	Amount			
Balance at December 31, 2021	17,224,848	$ 218,444	$ 17,168	$ (566)	$ 235,046
Cumulative effect of adoption of ASC 842 on retained earnings	—	—	68	—	68
Net income	—	—	31,519	—	31,519
Other comprehensive loss	—	—	—	(15,504)	(15,504)
Stock issued under stock award plans	23,639	—	—	—	—
Stock compensation expense	—	842	—	—	842
Stock forfeitures	(2,504)	—	—	—	—
Cash dividends paid ($0.90 per share)	—	—	(12,713)	—	(12,713)
Balance at September 30, 2022	**17,245,983**	**$ 219,286**	**$ 36,042**	**$ (16,070)**	**$ 239,258**
Balance at December 31, 2022	17,241,926	$ 219,543	$ 46,736	$ (13,454)	$ 252,825
Cumulative effect of adoption of ASC 326 on retained earnings	—	—	(4,491)	—	(4,491)
Net income	—	—	36,935	—	36,935
Other comprehensive loss	—	—	—	(2,477)	(2,477)
Stock issued under stock award plans	16,978	—	—	—	—
Stock compensation expense	—	723	—	—	723
Stock forfeitures	(1,547)	—	—	—	—
Cash dividends paid ($0.55 per share)	—	—	(9,491)	—	(9,491)
Balance at September 30, 2023	**17,257,357**	**$ 220,266**	**$ 69,689**	**$ (15,931)**	**$ 274,024**

See accompanying notes to unaudited consolidated financial statements.

FIVE STAR BANCORP AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)

(in thousands)	Nine Months Ended September 30, 2023	Nine Months Ended September 30, 2022
Cash flows from operating activities:		
Net income	$ 36,935	$ 31,519
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for credit losses	3,200	5,450
Depreciation and amortization	1,227	1,226
Amortization of deferred loan fees and costs	125	338
Amortization of premiums and discounts on securities	886	962
Amortization of subordinated debt issuance costs	107	96
Stock compensation expense	723	842
Earnings on BOLI	(355)	(293)
Deferred tax provision	79	13
Loans originated for sale	(39,915)	(44,993)
Gain on sale of loans	(1,635)	(2,297)
Proceeds from sale of loans	32,224	36,275
Net gain on sale of securities available-for-sale	—	(5)
Decrease in operating lease liability	(714)	(729)
Cost method of investment-related gain	(1,274)	—
Net changes in:		
Interest receivable and other assets	(5,523)	(3,240)
Interest payable and other liabilities	14,457	2,342
Net cash provided by operating activities	**40,547**	**27,506**
Cash flows from investing activities:		
Proceeds from sale of securities available-for-sale	—	1,623
Maturities, prepayments, and calls of securities available-for-sale	8,134	13,052
Purchases of securities available-for-sale	—	(1,641)
Net change in time deposits in banks	2,878	4,248
Loan originations, net of repayments	(212,137)	(639,040)
Purchase of premises and equipment	(470)	(406)
Purchase of FHLB stock	(4,110)	(4,223)
Purchase of BOLI	(2,000)	(3,054)
Net cash used in investing activities	**(207,705)**	**(629,441)**
Cash flows from financing activities:		
Net change in deposits	250,206	328,442
FHLB advances (payments)	(10,000)	105,000
Cash dividends paid	(9,491)	(12,713)
Proceeds from subordinated note issuance	—	75,000
Subordinated note issuance costs	—	(1,454)
Net cash provided by financing activities	**230,715**	**494,275**
Net change in cash and cash equivalents	63,557	(107,660)
Cash and cash equivalents at beginning of period	259,991	425,329
Cash and cash equivalents at end of period	**$ 323,548**	**$ 317,669**

Supplemental disclosure of cash flow information:		
Interest paid	$ 43,817	$ 3,057
Income taxes paid	1,480	5,200

Supplemental disclosure of noncash items:

Transfer from loans held for sale to loans held for investment	$ 9,416	$ 10,671
Unrealized loss on securities	(3,516)	(22,005)
Operating lease liabilities recorded in conjunction with adoption of ASC 842	—	5,221
ROUA recorded in conjunction with adoption of ASC 842	—	4,974
Operating lease liabilities exchanged for ROUA	1,513	—
ROUA acquired	(1,534)	—
Cumulative effect of adoption of ASC 842 on retained earnings, net of tax	—	68
Cumulative effect of adoption of ASC 326 on retained earnings, net of tax	(4,491)	—

See accompanying notes to the unaudited consolidated financial statements.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)

Note 1: Basis of Presentation and Summary of Significant Accounting Policies

(a) Organization

Five Star Bank (the “Bank”) was chartered on October 26, 1999 and began operations on December 20, 1999. Five Star Bancorp (“Bancorp” or the “Company”) was incorporated on September 16, 2002 and subsequently obtained approval from the Federal Reserve to be a bank holding company in connection with its acquisition of the Bank. The Company became the sole shareholder of the Bank on June 2, 2003 in a statutory merger, pursuant to which each outstanding share of the Bank’s common stock was exchanged for one share of common stock of the Company.

The Company, through the Bank, provides financial services to customers who are predominately small and middle-market businesses, professionals, and individuals residing in the Northern California region. The Company’s primary loan products are commercial real estate loans, land development loans, construction loans, and operating lines of credit, and its primary deposit products are checking accounts, savings accounts, money market accounts, and term certificate accounts. The Bank currently has seven branch offices in Roseville, Natomas, Rancho Cordova, Redding, Elk Grove, Chico, and Yuba City, and one loan production office in Sacramento.

(b) Basis of Financial Statement Presentation and Consolidation

The accompanying unaudited consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America (“GAAP”) as contained within the Financial Accounting Standards Board’s (“FASB”) ASC and the rules and regulations of the SEC, including the instructions to Regulation S-X. These interim unaudited consolidated financial statements reflect all adjustments (consisting solely of normal recurring adjustments and accruals) which, in the opinion of management, are necessary for a fair presentation of financial position, results of operations and comprehensive income, changes in shareholders’ equity, and cash flows for the interim periods presented. These unaudited consolidated financial statements have been prepared on a basis consistent with, and should be read in conjunction with, the audited consolidated financial statements as of and for the year ended December 31, 2022, and the notes thereto, included in the Company’s Annual Report on Form 10-K for the year ended December 31, 2022 (the “2022 Annual Report on Form 10-K”), which was filed with the SEC on February 24, 2023.

The unaudited consolidated financial statements include Bancorp and its wholly owned subsidiary, the Bank. All significant intercompany transactions and balances are eliminated in consolidation.

The results of operations for the three and nine months ended September 30, 2023 are not necessarily indicative of the results of operations that may be expected for any other interim period or for the year ending December 31, 2023.

The Company’s accounting and reporting policies conform to GAAP and to general practices within the banking industry.

Certain amounts reported in previous consolidated financial statements have been reclassified to conform to current period presentation. These reclassifications did not affect previously reported amounts of net income, total assets, or total shareholders’ equity.

(c) Segments

While the Company’s chief decision-makers monitor the revenue streams of the various products and services, operations are managed, and financial performance is evaluated, on a Company-wide basis. Discrete financial information is not available other than on a Company-wide basis. Accordingly, all of the financial service operations are considered by management to be aggregated in one reportable operating segment.

(d) Emerging Growth Company

The Company qualifies as an emerging growth company as defined in the Jumpstart Our Business Startups Act of 2012, and, as such, may take advantage of specified reduced reporting requirements and deferred accounting standards adoption dates, and is relieved of other significant requirements that are otherwise generally applicable to other public companies. The Company will remain an Emerging Growth Company for five years after its IPO date of May 5, 2021, unless one of the following occurs: (i) total annual gross revenues are $1.235 billion or more; (ii) the Company issues more than

$1 billion in non-convertible debt; or (iii) the Company becomes a large accelerated filer with a public float of more than $0.7 billion.

(e) Significant Accounting Policies

The Company's significant accounting policies are included in Note 1, Basis of Presentation on the 2022 Annual Report on Form 10-K. There have been no changes to these significant accounting policies during the first nine months of 2023 other than adoption of ASU No. 2016-13, *Financial Instruments – Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments* and all subsequent amendments that modified ASU 2016-13 (collectively, "ASC 326") as discussed below in this Note, which impacted the following policies:

Allowance for Credit Losses ("ACL")

The ACL is a valuation account that offsets the amortized cost basis of loans receivable and certain other financial assets, including unfunded loan commitments and held-to-maturity debt securities. Under ASC 326, amortized cost basis is the basis on which the ACL is determined. Amortized cost basis on loans receivable is principal outstanding, net of any purchase premiums and discounts, and net of any deferred loan fees and costs.

Credit losses are charged off when management believes that the collectability of at least some portion of outstanding principal is unlikely. These charge-offs are recorded as a reversal to, thereby reducing, the allowance for credit losses. Subsequent recoveries of previously charged-off amounts, if any, are recorded as a provision to, thereby increasing, the allowance for credit losses. The allowance for credit losses is maintained at a level to absorb expected credit losses over the contractual life, including consideration of prepayments. Determining the adequacy of the allowance is complex and requires judgments that are inherently subjective, as it requires estimates that are susceptible to revision as additional information becomes available. While the Company has determined an allowance for credit losses it considers appropriate, there can be no assurance that the allowance will be sufficient to absorb future losses.

The Company's process for determining expected lifetime credit losses entails a loan-level, model-based approach and considers a broad range of information, including historical loss experience, current conditions, and reasonable and supportable forecasts. Credit loss is estimated for all loans. Accordingly, the Company has stratified the full loan population into segments sharing similar characteristics to perform the evaluation of the credit loss collectively. The Company can also further stratify loans of similar types, risk attributes, and methods for credit risk monitoring.

The Company has determined pools based primarily on regulatory reporting codes as the loans within each pool share similar risk characteristics and there is sufficient historical peer loss data from the Federal Financial Institutions Examination Council to provide statistically meaningful support in the models developed. The Company further stratified the C&I portfolio into traditional C&I loans and SBA loans, as the loans in these pools have different repayment structures and credit risk characteristics. The Company also stratified C&I loans and consumer loans that do not require reserves, as the Company has third party agreements in place to cover loan losses. The Company has identified the following pools subject to an estimate of credit loss: (1) 1-4 Family Construction; (2) Other Construction; (3) Farmland; (4) Revolving Secured by 1-4 Family; (5) Residential Secured by First Liens; (6) Residential Secured by Junior Liens; (7) Multifamily; (8) CRE Owner Occupied; (9) CRE Non-Owner Occupied; (10) Agriculture; (11) C&I; (12) C&I SBA; (13) Consumer; and (14) Municipal.

The Company has determined, given its limited loss experience, that peer data and other external data to support loss history provides the best basis for its assessment of expected credit losses. The Company believes that the use of peer loss data from 2008 to 2019 presents loss histories that appropriately reflect a full economic cycle, reflects asset-specific risk characteristics at each pool level identified, and includes a historical look-back period that is objective and reflective of future expected credit losses. Loss data from 2020 to 2021 was excluded from the data set to exclude pandemic-related data in the models.

The method for determining the estimate of lifetime credit losses includes, among other things, the following main components: (i) the use of Probability of Default ("PD") and Loss Given Default ("LGD") assumptions under a Discounted Cash Flow model; (ii) a multi-scenario macroeconomic forecast; (iii) an initial and reasonable and supportable forecast period of one year for all loan segments; and (iv) a reversion period of one year using a linear transition method to historical loss rates.

Given the inherent limitations of a quantitative-only model, qualitative adjustments are included to factor in data points not captured from a quantitative analysis alone.

Qualitative criteria that can be considered includes, among other things, the following:

- Concentrations – the existence and effect of any concentrations of credit, and changes in the level of such concentrations;
- Volume – changes in the nature and volume of the portfolio and in the terms of the loans;
- Economic – changes in international, national, regional, and local economic and business conditions and developments that affect the collectability of the portfolio, including the condition of various market segments;
- Policy – changes in lending policies and procedures, including changes in underwriting standards and collection, charge-off, and recovery practices not considered elsewhere in estimating credit losses;
- Quality – changes in the volume and severity of past due loans, the volume of non-accrual loans, and the volume and severity of adversely classified or graded loans; and
- External – the effect of other external factors, such as competition and legal and regulatory requirements on the level of estimated credit losses in the Company's loan portfolio.

Management reviews current information on a quarterly basis to assess the forecasted future economic impact for purposes of evaluating the adequacy of the ACL. The forecasted direction and magnitude of change with respect to future economic conditions is then assessed against the estimate in the model. Any changes resulting from the quarterly assessment are recorded in "Provision for credit losses" in the unaudited consolidated statements of income.

Accrued Interest

Accrued interest receivable is excluded from amortized cost of all financial instrument types and included in "Interest receivable and other assets" in the unaudited consolidated balance sheets. Accrued interest receivable is not subject to an estimate for credit loss, as the Company has a policy to charge off accrued interest deemed uncollectible in a timely manner. When a loan is placed on non-accrual status, which occurs within 90 days of a borrower becoming delinquent, interest previously accrued but not collected is reversed against current period income.

Individually Assessed Loans

If an individual loan's characteristics have deteriorated to below a range of the overall pool, the loan would be individually assessed. Individually assessed loans are measured for credit loss based on one of the following methods: (i) present value of future expected cash flows, discounted at the loan's effective interest rate; (ii) amount by which carrying value of the loan exceeds the loan's observable market price; or (iii) the fair value of the collateral, less estimated selling costs, if the loan is collateral dependent. The Company applies the practical expedient and defines collateral dependent loans as those where the borrower is experiencing financial difficulty and on which payment is expected to be provided substantially through the operation or sale of the collateral.

Available-for-sale ("AFS") Debt Securities

Unrealized credit losses are recognized through an allowance for credit losses instead of an adjustment to amortized cost basis, eliminating the other-than-temporary impairment concept. For AFS debt securities in an unrealized loss position, the Company first assesses whether it intends to sell, or it is more likely than not that it will be required to sell, the security before recovery of amortized cost basis. If either criteria regarding intent or requirement to sell is met, the security's amortized cost basis is written down to fair value through earnings. For AFS debt securities that do not meet the above conditions, the Company evaluates at the individual security level whether the decrease in fair value has resulted from credit factors or non-credit factors. If assessment determines that a credit loss exists, the present value of cash flows expected to be collected from the security is compared to the amortized cost basis of the security. If the present value of cash flows expected to be collected is less than the amortized cost basis of the security, then a credit loss would be recognized, limited to the amount by which the fair value is less than the amortized cost basis. All other changes in fair value of an AFS debt security are recognized in other comprehensive income, net of applicable taxes. Changes in the allowance for credit losses, if any, are recognized as a provision for (or reversal of) credit losses. As of September 30, 2023, the Company's portfolio of AFS debt securities is comprised primarily of debt, mortgage-backed securities, and collateralized mortgage obligations issued by the U.S. government, its agencies, or government-sponsored enterprises, which are either explicitly or implicitly guaranteed by the U.S. government. The remainder of the portfolio is primarily comprised of obligations of state and political subdivisions, which are generally rated as high grade. The history of minimal credit losses from these issuers indicates that expectation of non-payment of the amortized cost basis is zero. As such, the Company determined that the unrealized loss positions in AFS securities were not due to credit losses, but instead related to changes in interest rates and general market conditions and therefore, no credit loss expense was recognized.

Loan Commitments

Loan commitments not unconditionally cancellable are subject to an estimate of credit loss under the CECL model. The Company's process for determining the estimate of credit loss on loan commitments is the same as it is on loans. Unfunded loan commitment reserves are included in "Interest payable and other liabilities" in the unaudited consolidated balance sheets.

Held-to-Maturity Debt Securities

The Company's process for determining the estimate of credit loss on held-to-maturity debt securities is substantially similar to what it is on loans, with segmenting not being applicable. As the amount of held-to-maturity debt securities that the Company carries is limited and given the determination that expected credit loss was immaterial, an immaterial amount was recognized in the ACL upon adoption and no credit loss expense was recorded for the three and nine months ended September 30, 2023.

TDRs and Other Loan Modifications

In accordance with the adoption of ASC 326, which includes ASU No. 2022-02, *Financial Instruments-Credit Losses (Topic 326): Troubled Debt Restructurings and Vintage Disclosures*, accounting guidance for TDRs for creditors has been eliminated. New guidance with respect to recognition, measurement, and disclosures of loans for borrowers experiencing financial difficulties supersedes guidance on TDRs. As of September 30, 2023, the amount of loans modified for borrowers due to experiencing financial difficulties under criteria of principal forgiveness, interest rate reduction, other-than-insignificant payment delay, or term extension was immaterial.

(f) Recently Issued Accounting Standards

The following information reflects recent accounting standards that have been adopted or are pending adoption by the Company. The Company qualifies as an emerging growth company and, as such, has elected to use the extended transition period for complying with new or revised accounting standards and is not subject to the new or revised accounting standards applicable to public companies during the extended transition period. The accounting standards discussed below indicate effective dates for the Company as an emerging growth company using the extended transition period.

Accounting Standards Adopted

On January 1, 2023, the Company adopted ASC 326, which replaces the current "incurred loss" model for recognizing credit losses with an "expected loss" model referred to as the Current Expected Credit Loss ("CECL") model. The CECL model applies to estimated credit losses on loans receivable, held-to-maturity debt securities, unfunded loan commitments, and certain other financial assets measured at amortized cost. Under ASC 326, available-for-sale debt securities are evaluated for impairment if fair value is less than amortized cost, with any estimated credit losses recorded through a credit loss expense and an allowance, rather than a write-down of the investment. Changes in fair value that are not credit-related will continue to be recorded in other comprehensive income. The Company adopted this standard using a modified retrospective approach through a cumulative-effect adjustment to retained earnings as of the beginning of the first reporting period in which the guidance was effective for financial assets measured at amortized cost. For certain new disclosures required under ASC 326, such as credit quality indicators by year of origination, we have not restated comparative financial information before January 1, 2023 to conform under ASC 326. This adoption method is considered a change in accounting principle requiring additional disclosure of the nature and reason for the change, which is solely due to adoption of ASC 326. On January 1, 2023, the Company also adopted ASU No. 2022-02, *Financial Instruments-Credit Losses (Topic 326): Troubled Debt Restructurings and Vintage Disclosures,* which had no material impact.

The following table reflects the cumulative-effect adjustments the Company recorded on January 1, 2023 for the adoption of ASC 326.

	January 1, 2023		
(in thousands)	Pre-ASC 326 Adoption	Impact of ASC 326 Adoption	Post-ASC 326 Adoption
Assets:			
Allowance for Credit Losses	$ (28,389)	$ (5,282)	$ (33,671)
Deferred Tax Asset (Interest receivable and other assets)	12,273	1,883	14,156
Liabilities:			
Reserve for Unfunded Commitments (Interest payable and other liabilities)	(125)	(1,092)	(1,217)
Shareholders' Equity:			
Retained Earnings	(46,736)	4,491	(42,245)

Accounting Standards Issued But Not Yet Adopted

For the fiscal year beginning January 1, 2023, there have been no new accounting standards issued but not yet adopted that are expected to be material to the Company. There are also no accounting standards issued before January 1, 2023 yet to be adopted.

Note 2: Fair Value of Assets and Liabilities

Fair Value Hierarchy and Fair Value Measurement

Accounting standards require the Company to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. The standard describes three levels of inputs that may be used to measure fair value:

Level 1: Quoted prices (unadjusted) for identical assets or liabilities in active markets that the Company 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 the Company's own assumptions about the assumptions that market participants would use in pricing an asset or liability.

The fair values of securities are determined by obtaining quoted prices on nationally recognized securities exchanges (Level 1 inputs) or matrix pricing, which is a mathematical technique widely used in the industry 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 inputs).

The following table summarizes the Company’s assets and liabilities that were required to be recorded at fair value on a recurring basis.

(in thousands)	Carrying Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Measurement Categories: Changes in Fair Value Recorded In
September 30, 2023					
Assets:					
Securities available-for-sale:					
U.S. government agencies, mortgage-backed securities, obligations of states and political subdivisions, collateralized mortgage obligations, and corporate bonds	$ 104,086	$ —	$ 104,086	$ —	OCI
Derivatives – interest rate swap	5	—	5	—	NI
Liabilities:					
Derivatives – interest rate swap	5	—	5	—	NI
December 31, 2022					
Assets:					
Securities available-for-sale:					
U.S. government agencies, mortgage-backed securities, obligations of states and political subdivisions, collateralized mortgage obligations, and corporate bonds	$ 115,988	$ —	$ 115,988	$ —	OCI
Derivatives – interest rate swap	16	—	16	—	NI
Liabilities:					
Derivatives – interest rate swap	16	—	16	—	NI

Available-for-sale securities are recorded at fair value on a recurring basis. When available, quoted market prices (Level 1 inputs) are used to determine the fair value of available-for-sale securities. If quoted market prices are not available, management obtains pricing information from a reputable third-party service provider, who may utilize valuation techniques that use current market-based or independently sourced parameters, such as bid/ask prices, dealer-quoted prices, interest rates, benchmark yield curves, prepayment speeds, probability of default, loss severity, and credit spreads (Level 2 inputs). Level 2 securities include U.S. agencies’ or government-sponsored agencies’ debt securities, mortgage-backed securities, government agency-issued bonds, privately issued collateralized mortgage obligations, and corporate bonds. Level 3 securities are based on unobservable inputs that are supported by little or no market activity. In addition, values use discounted cash flow models and may include significant management judgment and estimation. As of September 30, 2023 and December 31, 2022, there were no Level 1 available-for-sale securities and no transfers between Level 1 and Level 2 classifications for assets or liabilities measured at fair value on a recurring basis.

On a recurring basis, derivative financial instruments are recorded at fair value, which is based on the income approach using observable Level 2 market inputs, reflecting market expectations of future interest rates as of the measurement date. Standard valuation techniques are used to calculate the present value of the future expected cash flows assuming an orderly transaction. Valuation adjustments may be made to reflect both the Company’s credit risk and the counterparties’ credit risk in determining the fair value of the derivatives. A similar credit risk adjustment, correlated to the credit standing of the counterparty, is made when collateral posted by the counterparty does not fully cover their liability to the Company.

Certain financial assets may be measured at fair value on a non-recurring basis. These assets are subject to fair value adjustments that result from the application of the lower of cost or fair value accounting or write-downs of individual assets, such as collateral dependent loans and other real estate owned. As of September 30, 2023 and December 31, 2022, the carrying amount of assets measured at fair value on a non-recurring basis was immaterial to the Company.

Disclosures about Fair Value of Financial Instruments

The table below is a summary of fair value estimates for financial instruments as of September 30, 2023 and December 31, 2022. The carrying amounts in the following table are recorded in the consolidated balance sheets under the indicated captions. Further, management has not disclosed the fair value of financial instruments specifically excluded from disclosure requirements, such as BOLI.

	September 30, 2023			December 31, 2022		
(in thousands)	Carrying Amounts	Fair Value	Fair Value Hierarchy	Carrying Amounts	Fair Value	Fair Value Hierarchy
Financial assets:						
Cash and cash equivalents	$ 323,548	$ 323,548	Level 1	$ 259,991	$ 259,991	Level 1
Time deposits in banks	6,971	6,971	Level 1	9,849	9,849	Level 1
Securities available-for-sale	104,086	104,086	Level 2	115,988	115,988	Level 2
Securities held-to-maturity	3,104	2,811	Level 3	3,756	3,432	Level 3
Loans held for sale	9,326	10,286	Level 2	9,416	9,785	Level 2
Loans held for investment, net of allowance for credit losses	2,975,902	2,773,007	Level 3	2,762,937	2,570,176	Level 3
FHLB stock and other investments	21,693	N/A	N/A	16,570	N/A	N/A
Interest rate swap	5	5	Level 2	16	16	Level 2
Financial liabilities:						
Interest rate swap	$ 5	$ 5	Level 2	$ 16	$ 16	Level 2
FHLB advances	90,000	90,000	Level 2	100,000	100,000	Level 2
Subordinated notes	73,713	72,632	Level 3	73,606	72,273	Level 3

The following methods and assumptions were used by the Company to estimate the fair value of its financial instruments at September 30, 2023 and December 31, 2022:

Cash and cash equivalents and time deposits in banks: The carrying amount is estimated to be fair value due to the liquid nature of the assets and their short-term maturities.

Investment securities: See discussion above for the methods and assumptions used by the Company to estimate the fair value of investment securities. Fair value of held-to-maturity securities is estimated by calculating the net present value of future cash flows based on observable market data, such as interest rates and yield curves (observable at commonly quoted intervals) as provided by an independent third party.

Loans held for sale: For loans held for sale, the fair value is based on what secondary markets are currently offering for portfolios with similar characteristics.

Loans held for investment, net of allowance for credit losses: For variable rate loans that reprice frequently with no significant change in credit risk, fair values are based on carrying values. Fair values for other loans are estimated using discounted cash flow analyses, which use interest rates being offered at each reporting date for loans with similar terms to borrowers of comparable creditworthiness without considering widening credit spreads due to market illiquidity, which approximates the exit price notion. The allowance for credit losses is considered to be a reasonable estimate of loan discount for credit quality concerns.

FHLB stock and other investments: Carrying amounts of these investments are reasonable estimates of fair value because the securities are restricted to member banks and do not have a readily determinable market value.

Derivatives - interest rate swap: See above for a discussion of the methods and assumptions used by the Company to estimate the fair value of derivatives.

FHLB advances: For FHLB advances, the carrying amount is estimated to be fair value.

Subordinated notes: The fair value is estimated by discounting the future cash flow using the current three-month CME Term SOFR. The Company's subordinated notes are not registered securities and were issued through private placements, resulting in a Level 3 classification. The notes are recorded at carrying value.

Note 3: Investment Securities

The Company's investment securities portfolio includes obligations of states and political subdivisions, securities issued by U.S. federal government agencies, such as the SBA, and securities issued by U.S. GSEs, such as the FNMA, the FHLMC, and the FHLB. The Company also invests in residential and commercial mortgage-backed securities, collateralized mortgage obligations issued or guaranteed by government sponsored entities, and corporate bonds, as reflected in the following tables.

A summary of the amortized cost and fair value related to securities held-to-maturity as of September 30, 2023 and December 31, 2022 is presented below.

		Gross Unrealized		
(in thousands)	Amortized Cost	Gains	(Losses)	Fair Value
September 30, 2023				
Obligations of states and political subdivisions	$ 3,104	$ —	$ (293)	$ 2,811
Total held-to-maturity	$ 3,104	$ —	$ (293)	$ 2,811
December 31, 2022				
Obligations of states and political subdivisions	$ 3,756	$ —	$ (324)	$ 3,432
Total held-to-maturity	$ 3,756	$ —	$ (324)	$ 3,432

For securities issued by states and political subdivisions, for purposes of evaluating whether to recognize credit loss expense, management considers: (i) issuer and/or guarantor credit ratings; (ii) historical probability of default and loss given default rates for given bond ratings and remaining maturity; (iii) whether issuers continue to make timely principal and interest payments under the contractual terms of the securities; (iv) internal credit review of the financial information; and (v) whether or not such securities have credit enhancements such as guarantees, contain a defeasance clause, or are pre-refunded by the issuers.

The Company adopted ASC 326 on January 1, 2023, which affects accounting of credit loss expense on held-to-maturity and available-for-sale securities. Refer to Note 1, Basis of Presentation and Summary of Significant Accounting Policies, for further detail.

A summary of the amortized cost and fair value related to securities available-for-sale as of September 30, 2023 and December 31, 2022 is presented below.

		Gross Unrealized		
(in thousands)	Amortized Cost	Gains	(Losses)	Fair Value
September 30, 2023				
U.S. government agencies	$ 11,281	$ 110	$ (182)	$ 11,209
Mortgage-backed securities	68,715	—	(14,252)	54,463
Obligations of states and political subdivisions	44,325	—	(7,974)	36,351
Collateralized mortgage obligations	382	—	(45)	337
Corporate bonds	2,000	—	(274)	1,726
Total available-for-sale	$ 126,703	$ 110	$ (22,727)	$ 104,086
December 31, 2022				
U.S. government agencies	$ 14,317	$ 81	$ (225)	$ 14,173
Mortgage-backed securities	73,111	1	(11,841)	61,271
Obligations of states and political subdivisions	45,223	21	(6,818)	38,426
Collateralized mortgage obligations	436	—	(41)	395
Corporate bonds	2,000	—	(277)	1,723
Total available-for-sale	$ 135,087	$ 103	$ (19,202)	$ 115,988

The amortized cost and fair value of investment securities by contractual maturity at September 30, 2023 and December 31, 2022 are shown below. Expected maturities may differ from contractual maturities if the issuers of the securities have the right to call or prepay obligations with or without call or prepayment penalties.

	September 30, 2023				December 31, 2022			
	Held-to-Maturity		Available-for-Sale		Held-to-Maturity		Available-for-Sale	
(in thousands)	Amortized Cost	Fair Value	Amortized Cost	Fair Value	Amortized Cost	Fair Value	Amortized Cost	Fair Value
Within one year	$ 304	$ 275	$ —	$ —	$ 417	$ 381	$ 501	$ 501
After one but within five years	935	847	397	355	1,015	927	—	—
After five years through ten years	1,365	1,236	6,424	5,510	1,470	1,343	5,320	4,761
After ten years	500	453	37,504	30,486	854	781	39,402	33,164
Investment securities not due at a single maturity date:								
U.S. government agencies	—	—	11,281	11,209	—	—	14,317	14,173
Mortgage-backed securities	—	—	68,715	54,463	—	—	73,111	61,271
Collateralized mortgage obligations	—	—	382	337	—	—	436	395
Corporate bonds	—	—	2,000	1,726	—	—	2,000	1,723
Total	$ 3,104	$ 2,811	$ 126,703	$ 104,086	$ 3,756	$ 3,432	$ 135,087	$ 115,988

Sales of investment securities and gross gains and losses are shown in the following table:

	For the three months ended		For the nine months ended	
(in thousands)	September 30, 2023	September 30, 2022	September 30, 2023	September 30, 2022
Available-for-sale:				
Sales proceeds	$ —	$ —	$ —	$ 1,623
Gross realized gains	—	—	—	5

Pledged investment securities are shown in the following table:

(in thousands)	September 30, 2023	December 31, 2022
Pledged to:		
The State of California, securing deposits of public funds and borrowings	$ 54,076	$ 40,465
The Federal Reserve Discount Window, increasing borrowing capacity	49,128	—
Total pledged investment securities	$ 103,204	$ 40,465

The following table details the gross unrealized losses and fair values aggregated by investment category and length of time that individual available-for-sale securities have been in a continuous unrealized loss position at September 30, 2023 and December 31, 2022:

	Less than 12 months		12 months or more		Total securities in a loss position	
(in thousands)	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
September 30, 2023						
U.S. government agencies	$ 839	$ (19)	$ 7,455	$ (163)	$ 8,294	$ (182)
Mortgage-backed securities	214	(2)	54,249	(14,250)	54,463	(14,252)
Obligations of states and political subdivisions	1,486	(34)	34,864	(7,940)	36,350	(7,974)
Collateralized mortgage obligations	—	—	337	(45)	337	(45)
Corporate bonds	—	—	1,726	(274)	1,726	(274)
	$ 2,539	$ (55)	$ 98,631	$ (22,672)	$ 101,170	$ (22,727)
December 31, 2022						
U.S. government agencies	$ 3,090	$ (125)	$ 8,392	$ (100)	$ 11,482	$ (225)
Mortgage-backed securities	4,360	(470)	56,908	(11,371)	61,268	(11,841)
Obligations of states and political subdivisions	24,707	(4,097)	11,670	(2,721)	36,377	(6,818)
Collateralized mortgage obligations	395	(41)	—	—	395	(41)
Corporate bonds	—	—	1,723	(277)	1,723	(277)
	$ 32,552	$ (4,733)	$ 78,693	$ (14,469)	$ 111,245	$ (19,202)

There were 154 and 152 available-for-sale securities in unrealized loss positions at September 30, 2023 and December 31, 2022, respectively. As of September 30, 2023, the investment portfolio included 148 investment securities that had been in a continuous loss position for twelve months or more and six investment securities that had been in a loss position for less than twelve months.

There was one held-to-maturity security in a continuous unrealized loss position at September 30, 2023, which had been in a continuous loss position for more than twelve months.

Obligations issued or guaranteed by government agencies such as the GNMA and the SBA or GSEs under conservatorship such as the FNMA and the FHLMC, are guaranteed or sponsored by agencies of the U.S. government and have strong credit profiles. The Company therefore expects to receive all contractual interest payments on time and believes the risk of credit losses on these securities is remote.

The Company’s investment in obligations of states and political subdivisions are deemed credit worthy after management’s comprehensive analysis of the issuers’ latest financial information, credit ratings by major credit agencies, and/or credit enhancements.

Non-Marketable Securities Included in Other Assets

FHLB capital stock: As a member of the FHLB, the Company is required to maintain a minimum investment in FHLB capital stock determined by the board of directors of the FHLB. The minimum investment requirements can increase in the event the Company increases its total asset size or borrowings with the FHLB. Shares cannot be purchased or sold except between the FHLB and its members at the $100 per share par value. The Company held $15.0 million and $10.9 million of FHLB stock at September 30, 2023 and December 31, 2022, respectively. The carrying amounts of these investments are reasonable estimates of fair value because the securities are restricted to member banks and do not have a readily determinable market value. Based on management’s analysis of the FHLB’s financial condition and certain qualitative factors, management determined that the FHLB stock was not impaired at September 30, 2023 and December 31, 2022. On July 27, 2023, the FHLB announced a cash dividend for the second quarter of 2023 at an annualized dividend rate of 7.75%, which was paid on August 10, 2023. Cash dividends received on FHLB capital stock amounted to $0.3 million and $0.2 million for the three months ended September 30, 2023 and 2022, respectively, and $0.7 million and $0.4 million for the nine months ended September 30, 2023 and 2022, respectively, and were recorded as non-interest income on the unaudited consolidated statements of income.

Note 4: Loans and Allowance for Credit Losses

The Company's loan portfolio is its largest class of earning assets and typically provides higher yields than other types of earning assets. Associated with the higher yields is an inherent amount of credit risk which the Company attempts to mitigate through strong underwriting practices. The following table presents the balance of each major product type within the Company's portfolio as of the dates indicated.

(in thousands)	September 30, 2023	December 31, 2022
Real estate:		
Commercial	$ 2,599,616	$ 2,394,674
Commercial land and development	15,482	7,477
Commercial construction	95,352	88,669
Residential construction	13,922	6,693
Residential	25,028	24,230
Farmland	51,921	52,478
Commercial:		
Secured	157,273	165,186
Unsecured	23,997	25,431
Consumer and other	29,604	28,628
Subtotal	3,012,195	2,793,466
Net deferred loan fees	(2,265)	(2,140)
Allowance for credit losses	(34,028)	(28,389)
Loans held for investment, net of allowance for credit losses	$ 2,975,902	$ 2,762,937

Underwriting

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

Real estate loans: Real estate loans are subject to underwriting standards and processes similar to commercial loans. These loans are viewed primarily as cash flow loans and secondarily as loans secured by real estate. Commercial real estate lending typically involves higher loan principal amounts, and the repayment of these loans is generally largely dependent on the successful operation of the property securing the loan or the business conducted on the property securing the loan. Commercial real estate loans may be more adversely affected than other loans by conditions in the real estate market or in the general economy. The properties securing the Company's commercial real estate portfolio are diverse in terms of type. This diversity helps reduce the Company's exposure to adverse economic events that affect any single market or industry. Management monitors and evaluates commercial real estate loans based on collateral, geography, and risk grade criteria.

Construction loans: With respect to construction loans that the Company may originate from time to time, the Company generally requires the borrower to have had an existing relationship with the Company and have a proven record of success. Construction loans are underwritten utilizing feasibility studies, independent appraisal reviews, sensitivity analysis of absorption and lease rates, and financial analysis of the developers and property owners. Construction loans are generally based upon estimates of costs and value associated with the completed project. These estimates may be inaccurate. Construction loans often involve the disbursement of substantial funds with repayment substantially dependent on the ultimate success of the project. Sources of repayment for these types of loans may be pre-committed permanent loans from approved long-term lenders, sales of developed property, or an interim loan commitment from the Company until permanent financing is obtained. These loans are closely monitored using on-site inspections and are generally considered to have higher risks than other real estate loans due to their ultimate repayment being sensitive to interest rate changes, governmental regulation of real property, general economic conditions, and the availability of long-term financing.

Residential real estate loans: Residential real estate loans are underwritten based upon the borrower's income, credit history, and collateral. To monitor and manage residential loan risk, policies and procedures are developed and modified, as needed. This activity, coupled with relatively small loan amounts that are spread across many individual borrowers, minimizes risk. Underwriting standards for home loans are heavily influenced by statutory requirements, which include, but are not limited to, a maximum loan-to-value percentage, collection remedies, the number of such loans a borrower can have at one time, and documentation requirements.

Farmland loans: Farmland loans are generally made to producers and processors of crops and livestock. Repayment is primarily from the sale of an agricultural product or service. Farmland loans are secured by real property and are susceptible to changes in market demand for specific commodities. This may be exacerbated by, among other things, industry changes, changes in the individual financial capacity of the business owner, general economic conditions, and changes in business cycles, as well as adverse weather conditions.

Consumer loans: The Company purchased consumer loans underwritten utilizing credit scoring analysis to supplement the underwriting process. To monitor and manage consumer loan risk, policies and procedures are developed and modified, as needed. This activity, coupled with relatively small loan amounts that are spread across many individual borrowers, minimizes risk. Underwriting standards for home equity loans are heavily influenced by statutory requirements, which include, but are not limited to, a maximum loan-to-value percentage, collection remedies, the number of such loans a borrower can have at one time, and documentation requirements.

Credit Quality Indicators

The Company has established a loan risk rating system to measure and monitor the quality of the loan portfolio. All loans are assigned a risk rating from the inception of the loan until the loan is paid off. The primary loan grades are as follows:

Loans rated pass: These are loans to borrowers with satisfactory financial support, repayment capacity, and credit strength. Borrowers in this category demonstrate fundamentally sound financial positions, repayment capacity, credit history, and management expertise. Loans in this category must have an identifiable and stable source of repayment and meet the Company's policy regarding debt service coverage ratios. These borrowers are capable of sustaining normal economic, market, or operational setbacks without significant financial impacts and their financial ratios and trends are acceptable. Negative external industry factors are generally not present. The loan may be secured, unsecured, or supported by non-real estate collateral for which the value is more difficult to determine and/or marketability is more uncertain.

Loans rated watch: These are loans which have deficient loan quality and potentially significant issues, but losses do not appear to be imminent, and the issues are expected to be temporary in nature. The significant issues are typically: (i) a history of losses or events that threaten the borrower's viability; (ii) a property with significant depreciation and/or marketability concerns; or (iii) poor or deteriorating credit, occasional late payments, and/or limited reserves but the loan is generally kept current. If left uncorrected, these potential weaknesses may result in deterioration of the repayment prospects for the asset or in the Company's credit position at some future date.

Loans rated substandard: These are loans which are inadequately protected by the current net worth and paying capacity of the obligor or of the collateral pledged (if any). Loans so classified exhibit a well-defined weakness or weaknesses that jeopardize the liquidation of the debt. Loans are characterized by the distinct possibility that the Company may sustain some loss if the deficiencies are not corrected.

Loans rated doubtful: These are loans for which the collection or liquidation of the entire debt is highly questionable or improbable. Typically, the possibility of loss is extremely high. The losses on these loans are deferred until all pending factors have been addressed.

The amortized cost basis of the Company's loans by origination year, where origination is defined as the later of origination or renewal date, and credit quality indicator as of September 30, 2023 was as follows (disclosure not comparative due to adoption of ASC 326 on January 1, 2023 – refer to Note 1, Basis of Presentation and Summary of Significant Accounting Policies, for further details):

	Amortized Cost Basis by Origination Year								
(in thousands)	2023	2022	2021	2020	2019	Prior	Revolving Loans	Revolving Converted to Term	Total
Real estate:									
Commercial									
Pass	$ 251,745	$ 987,248	$ 712,268	$ 239,894	$ 124,560	$ 248,634	$ 4,144	$ —	$ 2,568,493
Watch	—	2,722	5,691	7,132	5,364	5,614	—	—	26,523
Substandard	—	—	—	—	—	1,920	—	—	1,920
Doubtful	—	—	—	—	—	—	—	—	—
Total	251,745	989,970	717,959	247,026	129,924	256,168	4,144	—	2,596,936
Commercial land and development									
Pass	10,376	4,141	—	186	—	752	—	—	15,455
Watch	—	—	—	—	—	—	—	—	—
Substandard	—	—	—	—	—	—	—	—	—
Doubtful	—	—	—	—	—	—	—	—	—
Total	10,376	4,141	—	186	—	752	—	—	15,455
Commercial construction									
Pass	2,692	33,946	41,889	10,530	—	—	—	—	89,057
Watch	—	—	—	—	—	5,897	—	—	5,897
Substandard	—	—	—	—	—	—	—	—	—
Doubtful	—	—	—	—	—	—	—	—	—
Total	2,692	33,946	41,889	10,530	—	5,897	—	—	94,954
Residential construction									
Pass	—	8,162	5,750	—	—	—	—	—	13,912
Watch	—	—	—	—	—	—	—	—	—
Substandard	—	—	—	—	—	—	—	—	—
Doubtful	—	—	—	—	—	—	—	—	—
Total	—	8,162	5,750	—	—	—	—	—	13,912
Residential									
Pass	3,606	3,998	6,292	2,298	1,187	6,085	1,591	—	25,057
Watch	—	—	—	—	—	—	—	—	—
Substandard	—	—	—	—	—	—	—	—	—
Doubtful	—	—	—	—	—	—	—	—	—
Total	3,606	3,998	6,292	2,298	1,187	6,085	1,591	—	25,057
Farmland									
Pass	1,887	8,044	12,767	8,015	12,581	8,600	4	—	51,898
Watch	—	—	—	—	—	—	—	—	—
Substandard	—	—	—	—	—	—	—	—	—
Doubtful	—	—	—	—	—	—	—	—	—
Total	1,887	8,044	12,767	8,015	12,581	8,600	4	—	51,898
Commercial:									
Secured									
Pass	20,091	44,970	18,656	13,206	10,668	11,384	37,613	—	156,588
Watch	—	—	37	31	157	896	—	—	1,121
Substandard	—	—	—	—	49	30	—	—	79
Doubtful	—	—	—	—	—	—	—	—	—
Total	20,091	44,970	18,693	13,237	10,874	12,310	37,613	—	157,788

(in thousands)	Amortized Cost Basis by Origination Year 2023	2022	2021	2020	2019	Prior	Revolving Loans	Revolving Converted to Term	Total
Commercial:									
Unsecured									
Pass	3,081	3,869	5,068	6,157	2,339	20	3,475	—	24,009
Watch	—	—	—	—	—	—	—	—	—
Substandard	—	—	—	—	—	—	—	—	—
Doubtful	—	—	—	—	—	—	—	—	—
Total	3,081	3,869	5,068	6,157	2,339	20	3,475	—	24,009
Consumer and other									
Pass	7,977	12,585	8,997	5	—	320	—	—	29,884
Watch	—	16	—	—	—	—	—	—	16
Substandard	—	21	—	—	—	—	—	—	21
Doubtful	—	—	—	—	—	—	—	—	—
Total	7,977	12,622	8,997	5	—	320	—	—	29,921
Total									
Pass	301,455	1,106,963	811,687	280,291	151,335	275,795	46,827	—	2,974,353
Watch	—	2,738	5,728	7,163	5,521	12,407	—	—	33,557
Substandard	—	21	—	—	49	1,950	—	—	2,020
Doubtful	—	—	—	—	—	—	—	—	—
Total	$ 301,455	$ 1,109,722	$ 817,415	$ 287,454	$ 156,905	$ 290,152	$ 46,827	$ —	$ 3,009,930

Management regularly reviews the Company’s loans for accuracy of risk grades whenever new information is received. Borrowers are generally required to submit financial information at regular intervals. Typically, commercial borrowers with lines of credit are required to submit financial information with reporting intervals ranging from monthly to annually depending on credit size, risk, and complexity. In addition, investor commercial real estate borrowers with loans exceeding a certain dollar threshold are usually required to submit rent rolls or property income statements annually. Management monitors construction loans monthly and reviews consumer loans based on delinquency. Management also reviews loans graded “watch” or worse, regardless of loan type, no less than quarterly.

The age analysis of past due loans by class as of September 30, 2023 consisted of the following:

(in thousands)	Past Due 30-59 Days	60-89 Days	Greater Than 90 Days	Total Past Due	Current	Total Loans Receivable
Real estate:						
Commercial	$ —	$ —	$ —	$ —	$ 2,596,936	$ 2,596,936
Commercial land and development	—	—	—	—	15,455	15,455
Commercial construction	—	—	—	—	94,954	94,954
Residential construction	—	—	—	—	13,912	13,912
Residential	—	—	—	—	25,057	25,057
Farmland	—	—	—	—	51,898	51,898
Commercial:						
Secured	—	—	—	—	157,788	157,788
Unsecured	—	—	—	—	24,009	24,009
Consumer and other	156	—	—	156	29,765	29,921
Total	$ 156	$ —	$ —	$ 156	$ 3,009,774	$ 3,009,930

There were no loans greater than 90 days past due and still accruing interest income as of September 30, 2023.

The age analysis of past due loans by class as of December 31, 2022 consisted of the following:

(in thousands)	Past Due					
	30-59 Days	60-89 Days	Greater Than 90 Days	Total Past Due	Current	Total Loans Receivable
Real estate:						
Commercial	$ —	$ —	$ —	$ —	$ 2,392,053	$ 2,392,053
Commercial land and development	—	—	—	—	7,447	7,447
Commercial construction	—	—	—	—	88,314	88,314
Residential construction	—	—	—	—	6,693	6,693
Residential	—	175	—	175	24,088	24,263
Farmland	—	—	—	—	52,446	52,446
Commercial:						
Secured	—	—	—	—	165,609	165,609
Unsecured	—	—	—	—	25,488	25,488
Consumer and other	194	—	—	194	28,819	29,013
Total	$ 194	$ 175	$ —	$ 369	$ 2,790,957	$ 2,791,326

There were no loans greater than 90 days past due and still accruing interest income as of December 31, 2022.

No collateral dependent loans were in process of foreclosure at September 30, 2023.

Non-accrual loans, segregated by class, were as follows as of September 30, 2023 and December 31, 2022:

(in thousands)	September 30, 2023	December 31, 2022
Real estate:		
Commercial	$ 1,923	$ 106
Residential	—	175
Commercial:		
Secured	79	123
Total non-accrual loans	$ 2,002	$ 404

No interest income was recognized on non-accrual loans in the three and nine months ended September 30, 2023 or September 30, 2022. Non-accrual real estate loans did not have an allowance for credit losses as of September 30, 2023. Interest income can be recognized on non-accrual loans in cases where resolution occurs through a sale or full payment is received on the non-accrual loan.

The amount of foregone interest income related to non-accrual loans was $27.1 thousand and $62.3 thousand for the three and nine months ended September 30, 2023, respectively, compared to $6.9 thousand and $32.0 thousand for the three and nine months ended September 30, 2022, respectively.

Allowance for Credit Losses

The following table discloses activity in the allowance for credit losses for the three months ended September 30, 2023.

(in thousands)	Beginning Balance	Charge-offs	Recoveries	Provision (Benefit)	Ending Balance
Real estate:					
Commercial	$ 27,553	$ —	$ —	$ 348	$ 27,901
Commercial land and development	184	—	—	14	198
Commercial construction	1,212	—	—	8	1,220
Residential construction	217	—	—	(102)	115
Residential	152	—	—	(1)	151
Farmland	236	—	—	157	393
Commercial:					
Secured	3,751	(1,245)	219	736	3,461
Unsecured	209	—	—	4	213
Consumer and other	470	(187)	207	(114)	376
Total	$ 33,984	$ (1,432)	$ 426	$ 1,050	$ 34,028

The following table discloses activity in the allowance for credit losses for the three months ended September 30, 2022.

(in thousands)	Beginning Balance	Charge-offs	Recoveries	Provision (Benefit)	Ending Balance
Real estate:					
Commercial	$ 16,621	$ —	$ —	$ 1,688	$ 18,309
Commercial land and development	68	—	—	30	98
Commercial construction	508	—	—	38	546
Residential construction	51	—	—	(10)	41
Residential	188	—	—	(13)	175
Farmland	616	—	—	48	664
Commercial:					
Secured	6,284	(346)	68	356	6,362
Unsecured	265	(2)	—	15	278
PPP	—	—	21	(21)	—
Consumer and other	537	(182)	243	(62)	536
Unallocated	648	—	—	181	829
Total	$ 25,786	$ (530)	$ 332	$ 2,250	$ 27,838

The following table discloses activity in the allowance for credit losses for the nine months ended September 30, 2023.

(in thousands)	Beginning Balance	Effect of Adoption of ASC 326	Charge-offs	Recoveries	Provision (Benefit)	Ending Balance
Real estate:						
Commercial	$ 19,216	$ 7,606	$ —	$ —	$ 1,079	$ 27,901
Commercial land and development	54	74	—	—	70	198
Commercial construction	645	882	—	—	(307)	1,220
Residential construction	49	81	—	—	(15)	115
Residential	175	3	—	—	(27)	151
Farmland	644	(396)	—	—	145	393
Commercial:						
Secured	7,098	(3,060)	(2,856)	358	1,921	3,461
Unsecured	116	37	—	—	60	213
Consumer and other	347	80	(709)	714	(56)	376
Unallocated	45	(45)	—	—	—	—
Total	$ 28,389	$ 5,262	$ (3,565)	$ 1,072	$ 2,870	$ 34,028

The following table discloses activity in the allowance for credit losses for the nine months ended September 30, 2022.

(in thousands)	Beginning Balance	Charge-offs	Recoveries	Provision (Benefit)	Ending Balance
Real estate:					
Commercial	$ 12,869	$ —	$ —	$ 5,440	$ 18,309
Commercial land and development	50	—	—	48	98
Commercial construction	371	—	—	175	546
Residential construction	50	—	—	(9)	41
Residential	192	—	—	(17)	175
Farmland	645	—	—	19	664
Commercial:					
Secured	6,859	(928)	152	279	6,362
Unsecured	207	(2)	—	73	278
PPP	—	(21)	21	—	—
Consumer and other	889	(508)	431	(276)	536
Unallocated	1,111	—	—	(282)	829
Total	$ 23,243	$ (1,459)	$ 604	$ 5,450	$ 27,838

Unfunded Loan Commitment Reserves

Unfunded loan commitment reserves are included in “Interest payable and other liabilities” in the unaudited consolidated balance sheets. Provisions for unfunded loan commitments are included in “Provision for credit losses” in the unaudited consolidated statements of income. Prior to adoption of ASC 326, provisions for unfunded loan commitments were included in “Other operating expenses” in the unaudited consolidated statements of income.

	Three months ended		Nine months ended	
(in thousands)	September 30, 2023	September 30, 2022	September 30, 2023	September 30, 2022
Balance at beginning of period	$ 1,547	$ 125	$ 125	$ 102
Effect of adoption of ASC 326	—	—	1,092	—
Provision	—	—	330	23
Balance at end of period	$ 1,547	$ 125	$ 1,547	$ 125

Pledged Loans

The Company’s FHLB line of credit is secured under terms of a collateral agreement by a pledge of certain qualifying loans with unpaid principal balances of $1.7 billion and $1.6 billion at September 30, 2023 and December 31, 2022, respectively. In addition, the Company pledges eligible tenants in common loans, which totaled $39.3 million and $41.9 million at September 30, 2023 and December 31, 2022, respectively, to secure its borrowing capacity with the Federal Reserve Bank of San Francisco. See Note 6, Long Term Debt and Other Borrowings, for further discussion of these borrowings.

Note 5: Interest-Bearing Deposits

Interest-bearing deposits consisted of the following as of September 30, 2023 and December 31, 2022:

(in thousands)	September 30, 2023	December 31, 2022
Interest-bearing transaction accounts	$ 297,678	$ 242,632
Savings accounts	138,029	154,581
Money market accounts	1,335,545	1,073,528
Time accounts, more than $250	330,913	198,159
Other time accounts	96,611	144,355
Total time deposits	427,524	342,514
Total interest-bearing deposits	$ 2,198,776	$ 1,813,255

Time deposits totaled $427.5 million and $342.5 million as of September 30, 2023 and December 31, 2022, respectively. As of September 30, 2023, scheduled maturities of time deposits for the next five years were as follows:

(in thousands)	
2023	$ 218,703
2024	186,345
2025	21,135
2026	1,341
2027	—
Total time deposits	$ 427,524

Total deposits include deposits offered through the IntraFi Network (formerly Promontory Interfinancial Network) that are comprised of Certificate of Deposit Account Registry Service® ("CDARS") balances included in time deposits and Insured Cash Sweep® ("ICS") balances included in money market and interest checking deposits. Through this network, the Company offers customers access to FDIC-insured deposit products in aggregate amounts exceeding current insurance limits. When funds are deposited through CDARS and ICS on behalf of a customer, the Company has the option of receiving matching deposits through the network's reciprocal deposit program or placing deposits "one-way," for which the Company receives no matching deposits. The Company considers the reciprocal deposits to be in-market deposits, as distinguished from traditional out-of-market brokered deposits. There were no one-way deposits at September 30, 2023 and December 31, 2022. The composition of network deposits as of September 30, 2023 and December 31, 2022 was as follows:

(in thousands)	September 30, 2023	December 31, 2022
CDARS	$ 15,542	$ 13,248
ICS	689,983	272,719
Total network deposits	$ 705,525	$ 285,967

Interest expense recognized on interest-bearing deposits for periods ended September 30, 2023 and 2022 consisted of the following:

	Three months ended		Nine months ended	
(in thousands)	September 30, 2023	September 30, 2022	September 30, 2023	September 30, 2022
Interest-bearing transaction accounts	$ 972	$ 115	$ 2,230	$ 251
Savings accounts	880	65	2,182	128
Money market accounts	9,536	1,779	23,108	2,825
Time accounts, $250 or more	3,865	789	8,462	1,074
Other time accounts	1,133	69	3,751	105
Total interest expense on interest-bearing deposits	$ 16,386	$ 2,817	$ 39,733	$ 4,383

Note 6: Long Term Debt and Other Borrowings

Subordinated notes: On August 17, 2022, the Company completed a private placement of $75.0 million of fixed-to-floating rate subordinated notes to certain qualified investors, of which $19.3 million was purchased by existing or former members of the board of directors and their affiliates. The notes will be used for capital management and general corporate purposes, including, without limitation, the redemption of existing subordinated notes. The subordinated notes have a maturity date of September 1, 2032 and bear interest, payable semi-annually, at the rate of 6.00% per annum until September 1, 2027. On that date, the interest rate will be adjusted to float at a rate equal to the three-month Term SOFR plus 329.0 basis points (8.70% as of September 30, 2023) until maturity. The notes include a right of prepayment, on or after August 17, 2027 or, in certain limited circumstances, before that date. The indebtedness evidenced by the subordinated notes, including principal and interest, is unsecured and subordinate and junior in right to payment to general and secured creditors and depositors of the Company.

The subordinated notes have been structured to qualify as Tier 2 capital for the Company for regulatory capital purposes. Eligible amounts will be phased out by 20% per year beginning five years before the maturity date of the notes. Debt issuance costs incurred in conjunction with the notes were $1.5 million, of which $0.2 million has been amortized as of September 30, 2023. The Company reflects debt issuance costs as a direct deduction from the face of the note. The debt issuance costs are amortized into interest expense through the maturity period. At September 30, 2023 and December 31, 2022, the Company's subordinated debt outstanding was $73.7 million and $73.6 million, respectively.

Other borrowings: The Company entered into an agreement with the FHLB which granted the FHLB a blanket lien on all loans receivable (except for construction and agricultural loans) as collateral for a borrowing line. Based on the dollar volume of qualifying loan collateral, the Company had a total financing availability of $1.1 billion at September 30, 2023 and $1.0 billion at December 31, 2022. At September 30, 2023 and December 31, 2022, the Company had $90.0 million and $100.0 million of outstanding borrowings, respectively. As of September 30, 2023 and December 31, 2022, the

Company had letters of credit ("LCs") issued on its behalf totaling $671.5 million and $686.5 million, respectively, as discussed below.

At September 30, 2023 and December 31, 2022, LCs totaling $261.5 million and $206.5 million, respectively, were pledged to secure State of California deposits, and LCs totaling $410.0 million and $480.0 million, respectively, were pledged to secure local agency deposits. The LCs issued reduced the Company's available borrowing capacity to $292.1 million and $216.3 million as of September 30, 2023 and December 31, 2022, respectively.

At September 30, 2023, the Company had five unsecured federal funds lines of credit with its correspondent banks totaling $175.0 million. At December 31, 2022, the Company had seven unsecured federal funds lines of credit with its correspondent banks totaling $190.0 million. There were no amounts outstanding at September 30, 2023 and December 31, 2022.

At September 30, 2023 and December 31, 2022, the Company had the ability to borrow from the Federal Reserve Discount Window. At September 30, 2023 and December 31, 2022, the borrowing capacity under this arrangement was $69.0 million and $21.9 million, respectively. There were no amounts outstanding at September 30, 2023 and December 31, 2022. The borrowing line is secured by liens on the Company's construction and agricultural loan portfolios and certain available-for-sale securities.

Note 7: Shareholders' Equity

(a) EPS

Basic EPS is net income divided by the weighted average number of common shares outstanding during the period less average unvested restricted stock awards ("RSAs"). Diluted EPS includes the dilutive effect of additional potential common shares related to unvested RSAs using the treasury stock method. The Company has two forms of outstanding common stock: common stock and unvested RSAs. Holders of unvested RSAs receive non-forfeitable dividends at the same rate as common shareholders and they both share equally in undistributed earnings, and therefore the RSAs are considered participating securities. However, under the two-class method, the difference in EPS is not significant for these participating securities.

(in thousands, except share count and earnings per common share)	Three months ended		Nine months ended	
	September 30, 2023	September 30, 2022	September 30, 2023	September 30, 2022
Net income	$ 11,045	$ 11,704	$ 36,935	$ 31,519
Basic weighted average common shares outstanding	17,175,034	17,140,435	17,163,609	17,123,016
Add: Dilutive effects of assumed vesting of restricted stock	19,791	28,012	22,626	37,794
Total dilutive weighted average common shares outstanding	17,194,825	17,168,447	17,186,235	17,160,810
Earnings per common share:				
Basic EPS	$ 0.64	$ 0.68	$ 2.15	$ 1.84
Diluted EPS	0.64	0.68	2.15	1.84

The Company did not have any anti-dilutive shares at September 30, 2023 or September 30, 2022.

(b) Dividends

On July 20, 2023, the board of directors declared a $0.20 per common share dividend, totaling $3.5 million.

(c) Stock-Based Incentive Arrangement

The Company's stock-based compensation consists of RSAs granted under its historical stock-based incentive arrangement (the "Historical Incentive Plan") and RSAs issued under the Five Star Bancorp 2021 Equity Incentive Plan (the "Equity Incentive Plan"). The Historical Incentive Plan consisted of RSAs for certain executive officers of the Company. The arrangement provided that these executive officers would receive shares of restricted common stock of the Company that vested over three years, with the number of shares granted based upon achieving certain performance objectives. These objectives included, but were not limited to, net income adjusted for the provision for credit losses, deposit growth, efficiency ratio, net interest margin, and asset quality. Compensation expense for RSAs granted under the Historical Incentive Plan is recognized over the service period, which is equal to the vesting period of the shares based on the fair value of the shares at issue date.

In connection with its IPO in May 2021, the Company granted RSAs under the Equity Incentive Plan to certain employees, officers, executives, and non-employee directors. Shares granted to non-employee directors vested immediately upon grant, while shares granted to certain employees, officers, and executives vest ratably over three, five, or seven years (as defined in the respective agreements). Since the completion of the IPO, the Company has granted RSAs under the Equity Incentive Plan to executives and directors, which vest annually over three years and over one year, respectively. All RSAs were granted at the fair value of common stock at the time of the award. The RSAs are considered fixed awards, as the number of shares and fair value are known at the date of grant and the fair value at the grant date is amortized over the service period.

Non-cash stock compensation expense recognized for the three months ended September 30, 2023 and 2022 was $0.2 million and $0.3 million, respectively. Non-cash stock compensation expense recognized for the nine months ended September 30, 2023 and 2022 was $0.7 million and $0.8 million, respectively.

At September 30, 2023 and 2022, there were 82,324 and 104,348 unvested restricted shares, respectively. As of September 30, 2023, there was approximately $1.4 million of unrecognized compensation expense related to the 82,324 unvested restricted shares. The holders of unvested RSAs are entitled to dividends at the same per-share ratio as holders of common stock. Tax benefits for dividends paid on unvested RSAs are recorded as tax benefits in the consolidated statements of income with a corresponding decrease to current taxes payable. Such tax benefits are expected to be recognized over the weighted average term remaining on the unvested restricted shares of 2.67 years as of September 30, 2023. The impact of tax benefits for dividends paid on unvested restricted stock on the Company's unaudited consolidated statements of income for the three and nine months ended September 30, 2023 and 2022 was immaterial.

The following table summarizes activity related to restricted shares for the periods indicated:

	For the three months ended September 30,				For the nine months ended September 30,			
	2023		2022		2023		2022	
	Shares	Weighted Average Grant Date Fair Value	Shares	Weighted Average Grant Date Fair Value	Shares	Weighted Average Grant Date Fair Value	Shares	Weighted Average Grant Date Fair Value
Beginning of the period balance	82,324	$ 21.75	107,824	$ 20.88	96,826	$ 20.34	127,751	$ 19.95
Shares granted	—	—	—	—	16,978	28.52	23,639	28.29
Shares vested	—	—	(3,476)	28.50	(29,933)	20.78	(44,538)	22.65
Shares forfeited	—	—	—	—	(1,547)	26.95	(2,504)	22.50
End of the period balance	82,324	$ 21.75	104,348	$ 20.62	82,324	$ 21.75	104,348	$ 20.62

Note 8: Commitments and Contingencies

Financial Instruments with Off-Balance Sheet Risk

Some financial instruments, such as loan commitments, credit lines, letters of credit, and overdraft protection, are issued to meet customer financing needs. These are agreements to provide credit or to support the credit of others, as long as conditions established in the contract are met, and usually have expiration dates. Commitments may expire without being used. Substantially all of these commitments are at variable interest rates, based on an index, and have fixed expiration dates.

Off-balance sheet risk to loan loss exists up to the face amount of these instruments, although material losses are not anticipated. The Company uses the same credit policies in making commitments to originate loans and lines of credit as it does for on-balance sheet instruments, including obtaining collateral at exercise of the commitment. The contractual amounts of unfunded loan commitments and standby letters of credit not reflected in the unaudited consolidated balance sheets were as follows:

(in thousands)	September 30, 2023	December 31, 2022
Commercial lines of credit	$ 173,603	$ 147,021
Undisbursed construction loans	98,901	80,726
Undisbursed commercial real estate loans	94,537	79,121
Agricultural lines of credit	24,839	10,399
Undisbursed residential real estate loans	6,377	8,945
Undisbursed agricultural real estate loans	1,200	1,068
Other	2,477	1,868
Total commitments and standby letters of credit	$ 401,934	$ 329,148

The Company records an allowance for credit losses on unfunded loan commitments at the consolidated balance sheet date based on estimates of the probability that these commitments will be drawn upon according to historical utilization experience of the different types of commitments and historical loss rates determined for pooled funded loans. The allowance for credit losses on unfunded commitments totaled $1.5 million as of September 30, 2023 and $0.1 million as of December 31, 2022, which is recorded in “Interest payable and other liabilities” in the unaudited consolidated balance sheets.

Concentrations of credit risk: The Company grants real estate mortgage, real estate construction, commercial, and consumer loans to customers primarily in Northern California. Although the Company has a diversified loan portfolio, a substantial portion is secured by commercial and residential real estate.

In management’s judgment, a concentration of loans exists in real estate related loans, which represented approximately 92.71% of the Company’s loan portfolio at September 30, 2023 and 91.84% of the Company’s loan portfolio at December 31, 2022. Although management believes such concentrations have no more than the normal risk of collectability, a substantial decline in the economy in general, or a decline in real estate values in the Company’s primary market areas in particular, could have an adverse impact on the collectability of these loans. Personal and business incomes represent the primary source of repayment for the majority of these loans.

Deposit concentrations: At September 30, 2023, the Company had 86 deposit relationships that exceeded $5.0 million each, totaling $1.9 billion, or approximately 61.64% of total deposits. The Company’s largest single deposit relationship at September 30, 2023 totaled $250.0 million, or approximately 8.24% of total deposits. Management maintains the Company’s liquidity position and lines of credit with correspondent banks to mitigate the risk of large withdrawals by this group of large depositors.

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

Correspondent banking agreements: The Company maintains funds on deposit with other FDIC-insured financial institutions under correspondent banking agreements. Uninsured deposits through these agreements totaled $22.1 million and $16.2 million at September 30, 2023 and December 31, 2022, respectively.

Litigation Matters

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

Note 9: Subsequent Events

On October 19, 2023, the Board of Directors of the Company authorized a cash dividend of $0.20 per common share, payable on November 13, 2023 to shareholders of record as of November 6, 2023.

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

The following discussion presents management's perspective on our results of operations and financial condition on a consolidated basis. However, because we conduct all of our material business operations through our bank subsidiary, Five Star Bank (the "Bank"), the discussion and analysis relates to activities primarily conducted by the Bank.

Management's discussion of the financial condition and results of operations, which is unaudited, should be read in conjunction with the related unaudited consolidated financial statements and accompanying notes in this Quarterly Report on Form 10-Q and the audited consolidated financial statements and accompanying notes included in the 2022 Annual Report on Form 10-K, which was filed with the SEC on February 24, 2023. Average balances, including balances used in calculating certain financial ratios, are generally comprised of average daily balances.

Unless otherwise indicated, references in this report to "we," "our," "us," "the Company," or "Bancorp" refer to Five Star Bancorp and our consolidated subsidiary. All references to "the Bank" refer to Five Star Bank, our wholly owned subsidiary.

Cautionary Note Regarding Forward-Looking Statements

This report contains forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. These forward-looking statements represent plans, estimates, objectives, goals, guidelines, expectations, intentions, projections, and statements of our beliefs concerning future events, business plans, objectives, expected operating results, and the assumptions upon which those statements are based. Forward-looking statements include, without limitation, any statement that may predict, forecast, indicate, or imply future results, performance, or achievements, and are typically identified with words such as "may," "could," "should," "will," "would," "believe," "anticipate," "estimate," "expect," "aim," "intend," "plan," or words or phases of similar meaning. To the extent that this discussion describes prior performance, the descriptions relate only to the periods listed, which may not be indicative of our future financial outcomes. We caution that the forward-looking statements are based largely on our expectations and are subject to a number of known and unknown risks and uncertainties that are subject to change based on factors which are, in many instances, beyond our control. Such forward-looking statements are based on various assumptions (some of which may be beyond our control) and are subject to risks and uncertainties, which change over time, and other factors which could cause actual results to differ materially from those currently anticipated. Such risks and uncertainties include, but are not limited to:

- risks related to the concentration of our business in California, and specifically within Northern California, including risks associated with any downturn in the real estate sector;
- changes in market interest rates that affect the pricing of our loans and deposits, our net interest income, and our borrowers' ability to repay loans;
- changes in the U.S. economy, including an economic slowdown, inflation, deflation, housing prices, employment levels, rate of growth, and general business conditions;
- uncertain market conditions and economic trends nationally, regionally, and particularly in Northern California and California;
- the impacts related to or resulting from recent bank failures and other economic and industry volatility, including increased regulatory requirements and costs and potential impacts to macroeconomic conditions;
- the impact of recent and future legislative and regulatory changes, including changes in banking, securities, and tax laws and regulations and their application by our regulators, and economic stimulus programs;
- the effects of increased competition from a wide variety of local, regional, national, and other providers of financial and investment services;
- the risks associated with our loan portfolios, and specifically with our commercial real estate loans;
- our ability to maintain adequate liquidity and to maintain capital necessary to fund our growth strategy and operations and to satisfy minimum regulatory capital levels;
- risks related to our strategic focus on lending to small to medium-sized businesses;
- the sufficiency of the assumptions and estimates we make in establishing reserves for potential loan losses and the value of loan collateral and securities;
- our level of nonperforming assets and the costs associated with resolving problem loans, if any, and complying with government-imposed foreclosure moratoriums;

- our ability to comply with various governmental and regulatory requirements applicable to financial institutions, including supervisory actions by federal and state banking agencies;
- governmental monetary and fiscal policies, including the policies of the Federal Reserve;
- risks associated with unauthorized access, cyber-crime, and other threats to data security;
- our ability to implement, maintain, and improve effective internal controls;
- our ability to attract and retain executive officers and key employees and their customer and community relationships;
- the occurrence or impact of climate change or natural or man-made disasters or calamities, such as wildfires, droughts, and earthquakes; and
- other factors that are discussed in the section entitled “Management’s Discussion and Analysis of Financial Condition and Results of Operations.”

The foregoing factors could cause results or performance to materially differ from those expressed in our forward-looking statements, should not be considered exhaustive, and should be read together with other cautionary statements that are included in this report and those discussed in the section entitled “Risk Factors” of our 2022 Annual Report on Form 10-K and our Quarterly Reports on Form 10-Q for the three months ended March 31, 2023 and June 30, 2023, and other filings we may make with the SEC, copies of which are available from us at no charge. New risks and uncertainties may emerge from time to time, and it is not possible for us to predict their occurrence or how they will affect us. If one or more of the factors affecting our forward-looking information and statements proves incorrect, then our actual results, performance, or achievements could differ materially from those expressed in, or implied by, forward-looking information and statements contained in this Quarterly Report on Form 10-Q. Therefore, we caution you not to place undue reliance on our forward-looking information and statements. We disclaim any duty to revise or update the forward-looking statements, whether written or oral, to reflect actual results or changes in the factors affecting the forward-looking statements, except as specifically required by law.

Company Overview

Headquartered in the greater Sacramento metropolitan area of California, Five Star Bancorp is a bank holding company that operates through its wholly owned subsidiary, Five Star Bank, a California state-chartered non-member bank. We provide a broad range of banking products and services to small and medium-sized businesses, professionals, and individuals primarily in Northern California through seven branch offices and one loan production office. Our mission is to strive to become the top business bank in all markets we serve through exceptional service, deep connectivity, and customer empathy. We are dedicated to serving real estate, agricultural, faith-based, and small to medium-sized enterprises. We aim to consistently deliver value that meets or exceeds the expectations of our shareholders, customers, employees, business partners, and community. We refer to our mission as “purpose-driven and integrity-centered banking.” At September 30, 2023, we had total assets of $3.5 billion, total loans held for investment, net of allowance for credit losses, of $3.0 billion, and total deposits of $3.0 billion.

Critical Accounting Estimates

The accompanying unaudited consolidated financial statements have been prepared in accordance with the instructions to Quarterly Reports on Form 10-Q and, therefore, do not include all footnotes as would be necessary for a fair presentation of financial position, results of operations and comprehensive income, changes in shareholders’ equity, and cash flows in conformity with GAAP as contained within the FASB’s ASC and the rules and regulations of the SEC, including the instructions to Regulation S-X. However, these interim unaudited consolidated financial statements reflect all adjustments (consisting solely of normal recurring adjustments and accruals) which, in the opinion of management, are necessary for a fair presentation of financial position, results of operations and comprehensive income, changes in shareholders’ equity, and cash flows for the interim periods presented. These unaudited consolidated financial statements have been prepared on a basis consistent with, and should be read in conjunction with, the audited consolidated financial statements as filed in our 2022 Annual Report on Form 10-K and the notes thereto.

Our most significant accounting policies and our critical accounting estimates are described in greater detail in Note 1, Basis of Presentation, in our audited consolidated financial statements and Item 7. Management’s Discussion and Analysis of Financial Condition and Results of Operations - Critical Accounting Estimates included in our 2022 Annual Report on Form 10-K. We have identified accounting policies and estimates that, due to the difficult, subjective, or complex judgments and assumptions inherent in those policies and estimates and the potential sensitivity of our unaudited consolidated financial statements to those judgments and assumptions, are critical to an understanding of our consolidated financial condition and results of operations. We believe that the judgments, estimates, and assumptions used in the preparation of our financial statements are reasonable and appropriate, based on the information available at the time they were made. However, actual results may differ from those estimates, and these differences may be material. There have been no significant changes concerning our critical accounting estimates as described in our 2022 Annual Report on Form 10-K.

Pursuant to the Jumpstart Our Business Startups Act of 2012 (the “JOBS Act”), as an emerging growth company, we can elect to opt out of the extended transition period for adopting any new or revised accounting standards. We have elected not to opt out of the extended transition period, which means that when a standard is issued or revised and it has different application dates for public and private companies, we may adopt the standard on the application date for private companies.

We have elected to take advantage of the scaled disclosures and other relief under the JOBS Act, and we may take advantage of some or all of the reduced regulatory and reporting requirements that will be available to us under the JOBS Act, so long as we qualify as an emerging growth company.

Executive Summary

Net income for the three and nine months ended September 30, 2023 totaled $11.0 million and $36.9 million, respectively, compared to net income of $11.7 million and $31.5 million for the three and nine months ended September 30, 2022, respectively.

The following are highlights of our operating and financial performance, and financial condition for the dates and periods presented:

- ***Deposits.*** Total deposits increased by $250.2 million from $2.8 billion at December 31, 2022 to $3.0 billion at September 30, 2023. Non-brokered deposits increased by $300.2 million in the first nine months of 2023 to $3.0 billion. Non-interest-bearing deposits decreased by $135.3 million in the first nine months of 2023 to $833.4 million, and represented 27.49% of total deposits at September 30, 2023, as compared to 34.82% of total deposits at December 31, 2022. Total deposit increases were primarily attributable to an increase in the number of new deposit relationships, as well as normal fluctuations in some of our large existing accounts. Our loan to deposit ratio was 99.57% at September 30, 2023, as compared to 100.67% at December 31, 2022.

- ***Assets.*** Total assets were $3.5 billion at September 30, 2023, representing a $277.9 million, or 8.61%, increase compared to $3.2 billion at December 31, 2022.

- ***Loans.*** Total loans held for investment were $3.0 billion at September 30, 2023, compared to $2.8 billion at December 31, 2022, an increase of $218.6 million, or 7.83%. The increase was primarily attributable to increases of $204.9 million in commercial real estate loans, $8.0 million in commercial land and development loans, $7.2 million in residential construction loans, and $6.7 million in commercial construction loans.

- ***Credit Quality.*** Credit quality remains strong, with non-accrual loans representing $2.0 million, or 0.07% of total loans held for investment, at September 30, 2023, as compared to $0.4 million, or 0.01% of total loans held for investment, at December 31, 2022. The ratio of allowance for credit losses to total loans held for investment, or total loans at period end, was 1.13% at September 30, 2023 and 1.02% at December 31, 2022.

- ***Net Interest Margin.*** Net interest margin was 3.31% and 3.50% for the three and nine months ended September 30, 2023, respectively, and 3.86% and 3.73% for the three and nine months ended September 30, 2022, respectively. The decrease in net interest margin for the both the three and nine months ended September 30, 2023 compared to the three and nine months ended September 30, 2022 was primarily due to an increase in deposit costs more than offsetting increases in yields on earning assets, as the effective Federal Funds rate increased from 3.08% at September 30, 2022 to 5.33% at September 30, 2023.

- ***Efficiency Ratio.*** Efficiency ratio was 41.63% for the three months ended September 30, 2023, up from 35.13% for the corresponding period of 2022. Additionally, efficiency ratio was 39.11% for the nine months ended September 30, 2023, up from 37.68% for the corresponding period of 2022.

- ***Capital Ratios***. All capital ratios were above well-capitalized regulatory thresholds as of September 30, 2023. The total risk-based capital ratio for the Company was 12.37% at September 30, 2023, compared to 12.46% at December 31, 2022. The Tier 1 leverage ratio was 8.58% at September 30, 2023, as compared to 8.60% at December 31, 2022. For additional information about the regulatory capital requirements applicable to the Company and the Bank, see the section entitled "—Financial Condition Summary—Capital Adequacy" below.

- ***Dividends.*** The board of directors declared a cash dividend of $0.20 per share on July 20, 2023.

Highlights of our financial results are presented in the following tables:

(dollars in thousands)	September 30, 2023	December 31, 2022
Selected financial condition data:		
Total assets	$ 3,505,040	$ 3,227,159
Total loans held for investment	3,009,930	2,791,326
Total deposits	3,032,210	2,782,004
Total subordinated notes, net	73,713	73,606
Total shareholders' equity	274,024	252,825
Asset quality ratios:		
Allowance for credit losses to total loans held for investment	1.13 %	1.02 %
Allowance for credit losses to nonperforming loans	1,699.35 %	7,026.98 %
Nonperforming loans to total loans held for investment	0.07 %	0.01 %
Capital ratios:		
Total capital (to risk-weighted assets)	12.37 %	12.46 %
Tier 1 capital (to risk-weighted assets)	9.07 %	8.99 %
Common equity Tier 1 capital (to risk-weighted assets)	9.07 %	8.99 %
Tier 1 leverage	8.58 %	8.60 %
Total shareholders' equity to total assets	7.82 %	7.83 %
Tangible shareholders' equity to tangible assets[1]	7.82 %	7.83 %

	For the three months ended		For the nine months ended	
(dollars in thousands, except per share data)	September 30, 2023	September 30, 2022	September 30, 2023	September 30, 2022
Selected operating data:				
Net interest income	$ 27,476	$ 27,523	$ 84,202	$ 73,935
Provision for credit losses	1,050	2,250	3,200	5,450
Non-interest income	1,384	1,433	5,575	5,556
Non-interest expense	12,015	10,172	35,112	29,952
Net income	11,045	11,704	36,935	31,519
Per common share data:				
Earnings per common share:				
Basic	$ 0.64	$ 0.68	$ 2.15	$ 1.84
Diluted	0.64	0.68	2.15	1.84
Book value per share	15.88	13.87	15.88	13.87
Tangible book value per share[2]	15.88	13.87	15.88	13.87
Performance and other financial ratios:				
ROAA	1.30 %	1.60 %	1.50 %	1.53 %
ROAE	16.09 %	19.35 %	18.70 %	17.85 %
Net interest margin	3.31 %	3.86 %	3.50 %	3.73 %
Cost of funds	2.28 %	0.62 %	1.96 %	0.35 %
Efficiency ratio	41.63 %	35.13 %	39.11 %	37.68 %
Cash dividend payout ratio on common stock[3]	31.25 %	22.06 %	25.58 %	24.53 %

[1] Tangible shareholders' equity to tangible assets is considered a non-GAAP financial measure. See the section entitled "Non-GAAP Financial Measures" for a reconciliation of our non-GAAP financial measures to the most directly comparable GAAP financial measure. Tangible shareholders' equity to tangible assets is defined as total equity less goodwill and other intangible assets, divided

by total assets less goodwill and other intangible assets. The most directly comparable GAAP financial measure is total shareholders' equity to total assets. We had no goodwill or other intangible assets as of any of the dates indicated. As a result, tangible shareholders' equity to tangible assets is the same as total shareholders' equity to total assets at the end of each of the periods indicated.

[2] Tangible book value is considered a non-GAAP financial measure. See the section entitled "Non-GAAP Financial Measures" for a reconciliation of our non-GAAP financial measures to the most directly comparable GAAP financial measure. Tangible book value per share is defined as total shareholders' equity less goodwill and other intangible assets, divided by the outstanding number of common shares at the end of the period. The most directly comparable GAAP financial measure is book value per share. We had no goodwill or other intangible assets at the end of any period indicated. As a result, tangible book value per share is the same as book value per share at the end of each of the periods indicated.

[3] Cash dividend payout ratio on common stock is calculated as dividends on common shares divided by basic earnings per common share.

RESULTS OF OPERATIONS

The following discussion of our results of operations compares the three and nine months ended September 30, 2023 to the three and nine months ended September 30, 2022. The results of operations for the three and nine months ended September 30, 2023 are not necessarily indicative of the results of operations that may be expected for the year ending December 31, 2023.

Net Interest Income

Net interest income is the most significant contributor to our net income. Net interest income represents interest income from interest-earning assets, such as loans and investments, less interest expense on interest-bearing liabilities, such as deposits, FHLB advances, subordinated notes, and other borrowings, which are used to fund those assets. In evaluating our net interest income, we measure and monitor yields on our interest-earning assets and interest-bearing liabilities as well as trends in our net interest margin. Net interest margin is a ratio calculated as net interest income divided by total interest-earning assets for the same period. We manage our earning assets and funding sources in order to maximize this margin while limiting credit risk and interest rate sensitivity to our established risk appetite levels. Changes in market interest rates and competition in our market typically have the largest impact on periodic changes in our net interest margin.

Three months ended September 30, 2023 compared to three months ended September 30, 2022

Net interest income remained consistent at $27.5 million for the three months ended September 30, 2023 and September 30, 2022 and our net interest margin of 3.31% for the three months ended September 30, 2023 decreased from 3.86% for the three months ended September 30, 2022. The contraction of our net interest margin was primarily due to the increased rates paid on interest-bearing liabilities more than offsetting the increased yields earned on interest-earning assets. These changes related to the change in the effective Federal Funds rate from 3.08% at September 30, 2022 to 5.33% at September 30, 2023. Additional detail relating to net interest margin in each period is provided below.

Average balance sheet, interest, and yield/rate analysis. The following table presents average balance sheet information, interest income, interest expense, and the corresponding average yield earned or rate paid for each period reported. The average balances are daily averages and include both performing and nonperforming loans.

	For the three months ended September 30, 2023			For the three months ended September 30, 2022		
(dollars in thousands)	**Average Balance**	**Interest Income/Expense**	**Average Yield/Rate**	**Average Balance**	**Interest Income/Expense**	**Average Yield/Rate**
Assets						
Interest-earning deposits with banks[1]	$ 198,751	$ 2,584	5.16 %	$ 210,179	$ 1,145	2.16 %
Investment securities[1,2]	112,154	653	2.31 %	126,733	615	1.93 %
Loans held for investment and sale[1,3]	2,982,140	41,861	5.57 %	2,494,468	29,886	4.75 %
Total interest-earning assets[1]	3,293,045	45,098	5.43 %	2,831,380	31,646	4.43 %
Interest receivable and other assets, net[4]	77,757			78,112		
Total assets	$ 3,370,802			$ 2,909,492		
Liabilities and shareholders' equity						
Interest-bearing transaction accounts[1]	$ 296,230	$ 972	1.30 %	$ 213,926	$ 115	0.21 %
Savings accounts[1]	134,920	880	2.59 %	103,142	65	0.25 %
Money market accounts[1]	1,328,290	9,536	2.85 %	1,015,698	1,780	0.69 %
Time accounts[1]	399,514	4,998	4.96 %	208,678	857	1.63 %
Subordinated debt and other borrowings[1]	79,085	1,236	6.20 %	72,195	1,306	7.18 %
Total interest-bearing liabilities	2,238,039	17,622	3.12 %	1,613,639	4,123	1.01 %
Demand accounts	825,254			1,041,222		
Interest payable and other liabilities	35,123			14,687		
Shareholders' equity	272,386			239,944		
Total liabilities and shareholders' equity	$ 3,370,802			$ 2,909,492		
Net interest spread[5]			2.31 %			3.42 %
Net interest income/margin[6]		$ 27,476	3.31 %		$ 27,523	3.86 %

1 Interest income/expense is divided by the actual number of days in the period multiplied by the actual number of days in the year to correspond to stated interest rate terms, where applicable.

2 Yields on available-for-sale securities are calculated based on fair value. Investment security interest is earned on a 30/360 day basis monthly. Yields are not calculated on a tax-equivalent basis.

3 Non-accrual loans are included in total loan balances. No adjustment has been made for these loans in the yield calculations. Interest income on loans includes amortization of deferred loan fees, net of deferred loan costs. Allowance for credit losses is not included in total loan balances.

4 Allowance for credit losses is included in interest receivable and other assets, net.

5 Net interest spread represents the average yield earned on interest-earning assets minus the average rate paid on interest-bearing liabilities.

6 Net interest margin is computed by calculating the difference between interest income and interest expense, divided by the average balance of interest-earning assets, then annualized based on the number of days in the given period.

Analysis of changes in interest income and expenses. 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 yields/rates. The following table shows the effect that these factors had on the interest earned from our interest-earning assets and interest incurred on our interest-bearing liabilities. The effect of changes in volume is determined by multiplying the change in volume by the current period's average yield/rate. The effect of rate changes is calculated by multiplying the change in average yield/rate by the previous period's volume. Changes not solely attributable to volume or yields/rates have been allocated in proportion to the respective volume and yield/rate components.

	For the three months ended September 30, 2023 compared to the three months ended September 30, 2022		
(dollars in thousands)	**Volume**	**Yield/Rate**	**Total Increase (Decrease)**
Interest-earning deposits with banks	$ (149)	$ 1,588	$ 1,439
Investment securities	(85)	123	38
Loans held for investment and sale	6,846	5,129	11,975
Total interest-earning assets	6,612	6,840	13,452
Interest-bearing transaction accounts	270	587	857
Savings accounts	207	608	815
Money market accounts	2,244	5,512	7,756
Time accounts	2,388	1,753	4,141
Subordinated debt and other borrowings	108	(178)	(70)
Total interest-bearing liabilities	5,217	8,282	13,499
Changes in net interest income/margin	$ 1,395	$ (1,442)	$ (47)

Net interest income decreased $47.0 thousand, and net interest margin decreased 55 basis points for the three months ended September 30, 2023 compared to the same quarter of the prior year. The decrease in net interest income is primarily attributable to an additional $13.6 million in deposit interest expense due to increases in interest rates and average balances as compared to the same quarter of the prior year. The cost of interest-bearing deposits increased 228 basis points as compared to the same quarter of the prior year, while average balances increased 40.06%. In addition, the average balance of non-interest-bearing deposits decreased by $216.0 million as compared to the same quarter of the prior year. The increase in deposit interest expense was partially offset by an increase in total interest income of $13.5 million, as compared to the same quarter of the prior year. Average loan yields increased 82 basis points as compared to the same quarter of the prior year, while average balances increased 19.55%.

Nine months ended September 30, 2023 compared to nine months ended September 30, 2022

Net interest income increased by $10.3 million, or 13.89%, for the nine months ended September 30, 2023 as compared to the nine months ended September 30, 2022, while our net interest margin decreased 23 basis points during the same period. The contraction of our net interest margin was primarily due to the increased rates paid on interest-bearing liabilities more than offsetting the increased yields earned on interest-earning assets, relating to changes in the effective Federal Funds rate in each period. Additional detail relating to net interest margin in each period is provided below.

Average balance sheet, interest, and yield/rate analysis. The following table presents average balance sheet information, interest income, interest expense, and the corresponding average yield earned or rate paid for each period reported. The average balances are daily averages and include both performing and nonperforming loans.

	For the nine months ended September 30, 2023			For the nine months ended September 30, 2022		
(In thousands)	Average Balance	Interest Income/Expense	Average Yield/Rate	Average Balance	Interest Income/Expense	Average Yield/Rate
Assets						
Interest-earning deposits with banks[1]	$ 192,976	$ 6,969	4.83 %	$ 280,994	$ 1,855	0.88 %
Investment securities[1,2]	115,884	1,949	2.25 %	136,067	1,784	1.75 %
Loans held for investment and sale[1,3]	2,911,397	119,284	5.48 %	2,234,958	76,877	4.60 %
Total interest-earning assets[1]	3,220,257	128,202	5.32 %	2,652,019	80,516	4.06 %
Interest receivable and other assets, net[4]	74,184			108,803		
Total assets	$ 3,294,441			$ 2,760,822		
Liabilities and shareholders' equity						
Interest-bearing transaction accounts[1]	$ 320,013	$ 2,230	0.93 %	$ 248,540	$ 251	0.14 %
Savings accounts[1]	143,142	2,182	2.04 %	96,986	128	0.18 %
Money market accounts[1]	1,235,375	23,108	2.50 %	972,959	2,825	0.39 %
Time accounts[1]	357,433	12,213	4.57 %	170,912	1,179	0.92 %
Subordinated debt and other borrowings[1]	94,923	4,267	6.01 %	43,562	2,198	6.75 %
Total interest-bearing liabilities	2,150,886	44,000	2.74 %	1,532,959	6,581	0.57 %
Demand accounts	851,608			977,894		
Interest payable and other liabilities	27,883			13,936		
Shareholders' equity	264,064			236,033		
Total liabilities and shareholders' equity	$ 3,294,441			$ 2,760,822		
Net interest spread[5]			2.58 %			3.49 %
Net interest income/margin[6]		$ 84,202	3.50 %		$ 73,935	3.73 %

1 Interest income/expense is divided by the actual number of days in the period multiplied by the actual number of days in the year to correspond to stated interest rate terms, where applicable.

2 Yields on available-for-sale securities are calculated based on fair value. Investment security interest is earned on a 30/360 day basis monthly. Yields are not calculated on a tax-equivalent basis.

3 Non-accrual loans are included in total loan balances. No adjustment has been made for these loans in the yield calculations. Interest income on loans includes amortization of deferred loan fees, net of deferred loan costs. Allowance for credit losses is not included in total loan balances.

4 Allowance for credit losses is included in interest receivable and other assets, net.

5 Net interest spread represents the average yield earned on interest-earning assets minus the average rate paid on interest-bearing liabilities.

6 Net interest margin is computed by calculating the difference between interest income and interest expense, divided by the average balance of interest-earning assets, then annualized based on the number of days in the given period.

Analysis of changes in interest income and expenses. 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 yields/rates. The following table shows the effect that these factors had on the interest earned from our interest-earning assets and interest incurred on our interest-bearing liabilities. The effect of changes in volume is determined by multiplying the change in volume by the current period's average yield/rate. The effect of rate changes is calculated by multiplying the change in average yield/rate by the previous period's volume. Changes not solely attributable to volume or yields/rates have been allocated in proportion to the respective volume and yield/rate components.

	For the nine months ended September 30, 2023 compared to the nine months ended September 30, 2022		
(In thousands)	**Volume**	**Yield/Rate**	**Total Increase (Decrease)**
Interest-earning deposits with banks	$ (3,179)	$ 8,293	$ 5,114
Investment securities	(339)	504	165
Loans held for investment and sale	27,714	14,693	42,407
Total interest-earning assets	24,196	23,490	47,686
Interest-bearing transaction accounts	498	1,481	1,979
Savings accounts	704	1,350	2,054
Money market accounts	4,908	15,375	20,283
Time accounts	6,373	4,661	11,034
Subordinated debt and other borrowings	2,309	(240)	2,069
Total interest-bearing liabilities	14,792	22,627	37,419
Changes in net interest income/margin	$ 9,404	$ 863	$ 10,267

Net interest income increased by 13.89%, while net interest margin decreased 23 basis points for the nine months ended September 30, 2023 as compared to the nine months ended September 30, 2022. The increase in net interest income is primarily attributable to an additional $42.4 million in interest income on loans due to increases in interest rates and average balances as compared to the same period of the prior year. The average yield on loans increased 88 basis points as compared to the same period of the prior year, while average balances increased $676.4 million, or 30.27%. The cost of interest-bearing deposits increased 219 basis points as compared to the same period of the prior year due to increases in interest rates and an increase in average balances of $566.6 million, or 38.04%. In addition, the average balance of non-interest-bearing deposits decreased by $126.3 million, or 12.91%, as compared to the same period of the prior year. While the increase in total interest income more than offset the increase in total interest expense, net interest income relative to interest-earning assets decreased as compared to the same period of the prior year.

Provision for Credit Losses

The provision for credit losses is based on management's assessment of the adequacy of our allowance for credit losses. Factors impacting the provision include inherent risk characteristics in our loan portfolio, the level of nonperforming loans and net charge-offs, both current and historic, local economic and credit conditions, the direction of the change in collateral values, and the funding probability on unfunded lending commitments. The provision for credit losses is charged against earnings in order to maintain our allowance for credit losses, which reflects management's best estimate of forecasted life of loan losses in our loan portfolio at the balance sheet date.

Beginning January 1, 2023, we adopted ASC 326, which replaced the former "incurred loss" model for recognizing credit losses with an "expected loss" model referred to as the CECL model. The CECL allowance model calculates reserves over the life of the loan and is largely driven by portfolio characteristics, economic outlook, and other key methodology assumptions. Under the CECL model, the calculated allowance for credit losses was $5.3 million higher on January 1, 2023 than the allowance under the incurred loss model. Utilizing CECL may have an impact on our allowance for credit losses going forward and may result in a lack of comparability between the 2022 and 2023 periods.

Three months ended September 30, 2023 compared to three months ended September 30, 2022

We recorded a $1.1 million provision for credit losses in the third quarter of 2023, as compared to a $2.3 million provision for credit losses recorded for the same period of 2022. As explained above, utilizing CECL may result in a lack of comparability between the 2022 and 2023 periods. The provision recorded is primarily due to loan growth, loan type mix, and updates in the macroeconomic environment.

Nine months ended September 30, 2023 compared to nine months ended September 30, 2022

We recorded a $3.2 million provision for credit losses in the first nine months of 2023, as compared to a $5.5 million provision for credit losses for the same period of 2022. As explained above, utilizing CECL may result in a lack of comparability between the 2022 and 2023 periods. The provision recorded is primarily due to loan growth, loan type mix, and updates in the macroeconomic environment.

Non-interest Income

Non-interest income is a secondary contributor to our net income. Non-interest income consists of service charges on deposit accounts, net gain on sale of securities, gain on sale of loans, loan-related fees, FHLB stock dividends, earnings on BOLI, and other income.

Three months ended September 30, 2023 compared to three months ended September 30, 2022

The following table details the components of non-interest income for the periods indicated.

	For the three months ended			
(dollars in thousands)	**September 30, 2023**	**September 30, 2022**	**$ Change**	**% Change**
Service charges on deposit accounts	$ 158	$ 132	$ 26	19.70 %
Gain on sale of loans	396	548	(152)	(27.74)%
Loan-related fees	355	447	(92)	(20.58)%
FHLB stock dividends	274	152	122	80.26 %
Earnings on BOLI	127	102	25	24.51 %
Other income	74	52	22	42.31 %
Total non-interest income	$ 1,384	$ 1,433	$ (49)	(3.42)%

Gain on sale of loans. The decrease in gain on sale of loans related primarily to an overall decline in the volume of loans sold during the three months ended September 30, 2023, as compared to the three months ended September 30, 2022. During the three months ended September 30, 2023, approximately $7.0 million of loans were sold with an effective yield of 5.63%, as compared to approximately $10.5 million of loans sold with an effective yield of 5.20% during the three months ended September 30, 2022.

FHLB stock dividends. The increase in FHLB stock dividends was primarily due to increased yields from dividends received of 7.75% for the three months ended September 30, 2023, as compared to 6.00% for the three months ended September 30, 2022.

Nine months ended September 30, 2023 compared to nine months ended September 30, 2022

The following table details the components of non-interest income for the periods indicated.

	For the nine months ended			
(In thousands)	**September 30, 2023**	**September 30, 2022**	**$ Change**	**% Change**
Service charges on deposit accounts	$ 410	$ 370	$ 40	10.81 %
Net gain on sale of securities	—	5	(5)	(100.00)%
Gain on sale of loans	1,635	2,297	(662)	(28.82)%
Loan-related fees	1,052	1,800	(748)	(41.56)%
FHLB stock dividends	656	353	303	85.84 %
Earnings on BOLI	355	293	62	21.16 %
Other income	1,467	438	1,029	234.93 %
Total non-interest income	$ 5,575	$ 5,556	$ 19	0.34 %

Gain on sale of loans. The decrease in gain on sale of loans related primarily to an overall decline in the volume and yields on loans sold during the nine months ended September 30, 2023 compared to the nine months ended September 30, 2022. During the nine months ended September 30, 2023, approximately $30.6 million of loans were sold with an effective yield of 5.34%, as compared to approximately $36.3 million of loans sold with an effective yield of 6.33% during the nine months ended September 30, 2022.

Loan-related fees. The decrease in loan-related fees primarily related to $0.1 million of swap referral fees recognized during the nine months ended September 30, 2023, as compared to $0.8 million recognized in the nine months ended September 30, 2022.

FHLB stock dividends. The increase in FHLB stock dividends was primarily due to increased yields on dividends received combined with an increase in the number of FHLB shares outstanding between September 30, 2022 and September 30, 2023.

Other income. The increase in other income resulted primarily from a $1.3 million gain recorded for distributions received from venture-backed fund investments during the nine months ended September 30, 2023 compared to a $0.3 million gain recorded during the nine months ended September 30, 2022.

Non-interest Expense

Non-interest expense includes salaries and employee benefits, occupancy and equipment, data processing and software, FDIC insurance, professional services, advertising and promotional, loan-related expenses, and other operating expenses. In evaluating our level of non-interest expense, we closely monitor the Company’s efficiency ratio, which is calculated as non-interest expense divided by the sum of net interest income and non-interest income. We constantly seek to identify ways to streamline our business and operate more efficiently in order to reduce our non-interest expense over time as a percentage of our revenue, while continuing to achieve growth in total loans and assets.

Over the past several years, we have invested significant resources in personnel, technology, and infrastructure. As we execute initiatives based on growth, we expect non-interest expense to grow. Non-interest expense has increased throughout the periods presented below; however, we expect our efficiency ratio will improve going forward due, in part, to our past investment in infrastructure.

Three months ended September 30, 2023 compared to three months ended September 30, 2022

The following table details the components of non-interest expense for the periods indicated.

	For the three months ended			
(dollars in thousands)	**September 30, 2023**	**September 30, 2022**	**$ Change**	**% Change**
Salaries and employee benefits	$ 6,876	$ 5,645	$ 1,231	21.81 %
Occupancy and equipment	561	515	46	8.93 %
Data processing and software	1,020	797	223	27.98 %
FDIC insurance	375	195	180	92.31 %
Professional services	700	792	(92)	(11.62)%
Advertising and promotional	535	512	23	4.49 %
Loan-related expenses	345	262	83	31.68 %
Other operating expenses	1,603	1,454	149	10.25 %
Total non-interest expense	$ 12,015	$ 10,172	$ 1,843	18.12 %

Salaries and employee benefits. The increase in salaries and employee benefits was primarily a result of: (i) a $0.8 million increase in salaries, insurance, and benefits as a result of a 8.72% increase in headcount during the three months ended September 30, 2023, as compared to the three months ended September 30, 2022 and (ii) a $0.8 million decrease in loan origination costs due to lower loan production period-over-period. These increases were partially offset by $0.4 million of lower commission expenses due to lower loan production during the three months ended September 30, 2023, as compared to the three months ended September 30, 2022.

Data processing and software. The increase in data processing and software expense was primarily due to: (i) increased usage of our digital banking platform; (ii) higher transaction volumes related to the increased number of loan and deposit accounts; and (iii) an increased number of licenses required for new users on our loan origination and documentation system.

FDIC insurance. The increase related primarily to a final rule adopted by the FDIC to increase initial base deposit insurance assessment rates for insured depository institutions by two basis points, beginning with the first quarterly assessment period of 2023. FDIC insurance also increased for the three months ended September 30, 2023 compared to the three months ended September 30, 2022, due to a $320.8 million increase in the assessment base period-over-period.

Other operating expenses. The increase in other operating expenses was primarily due to a $0.1 million increase in IntraFi Network fees resulting from an overall increase in balances carried in the network. The remainder of the increase related to an overall increase in travel, conference fees, and professional membership fees during the three months ended September 30, 2023, as compared to the three months ended September 30, 2022.

Nine months ended September 30, 2023 compared to nine months ended September 30, 2022

The following table details the components of non-interest expense for the periods indicated.

(In thousands)	For the nine months ended September 30, 2023	For the nine months ended September 30, 2022	$ Change	% Change
Salaries and employee benefits	$ 19,915	$ 16,873	$ 3,042	18.03 %
Occupancy and equipment	1,635	1,548	87	5.62 %
Data processing and software	2,905	2,252	653	29.00 %
FDIC insurance	1,187	605	582	96.20 %
Professional services	1,917	1,914	3	0.16 %
Advertising and promotional	1,686	1,340	346	25.82 %
Loan-related expenses	924	929	(5)	(0.54)%
Other operating expenses	4,943	4,491	452	10.06 %
Total non-interest expense	$ 35,112	$ 29,952	$ 5,160	17.23 %

Salaries and employee benefits. The increase in salaries and employee benefits was primarily a result of: (i) a $2.1 million increase in salaries, insurance, and benefits as a result of a 8.72% increase in headcount; (ii) a $1.9 million decrease in loan origination costs due to lower loan production period-over-period; and (iii) a $0.3 million increase in bonus expense during the nine months ended September 30, 2023, as compared to the nine months ended September 30, 2022. These increases were partially offset by a reduction of $1.4 million of commission expenses for the nine months ended September 30, 2023, as compared to the nine months ended September 30, 2022.

Data processing and software. The increase in data processing and software was primarily due to: (i) increased usage of our digital banking platform; (ii) higher transaction volumes related to the increased number of loan and deposit accounts; and (iii) an increased number of licenses required for new users on our loan origination and documentation system.

FDIC insurance. The increase related primarily to a final rule adopted by the FDIC to increase initial base deposit insurance assessment rates for insured depository institutions by two basis points, beginning with the first quarterly assessment period of 2023. FDIC insurance also increased for the nine months ended September 30, 2023 compared to the nine months ended September 30, 2022, due to a $320.8 million increase in the assessment base period-over-period.

Advertising and promotional. The increase in advertising and promotional costs was primarily due to an increased customer base and a 28.57% increase in the number of Business Development Officers from 21 as of September 30, 2022 to 27 as of September 30, 2023.

Other operating expenses. The increase in other operating expenses was primarily due to a $0.2 million increase in travel and a $0.2 million increase in IntraFi Network fees resulting from an overall increase in balances carried in the network during the nine months ended September 30, 2023, as compared to the nine months ended September 30, 2022.

Provision for Income Taxes

Three months ended September 30, 2023 compared to three months ended September 30, 2022

The provision for income taxes was $4.8 million for the three months ended September 30, 2023, compared to $4.8 million for the three months ended September 30, 2022. There was a decline in the provision due to an overall decrease in pre-tax income period-over-period, which was partially offset by a $0.2 million adjustment to the provision recorded during the three months ended September 30, 2023 to true-up the year-to-date effective tax rate. The effective income tax rates for the three months ended September 30, 2023 and 2022 were 30.07% and 29.21%, respectively.

Nine months ended September 30, 2023 compared to nine months ended September 30, 2022

The provision for income taxes was $14.5 million for the nine months ended September 30, 2023, compared to $12.6 million for the nine months ended September 30, 2022. The increase was primarily due to an overall increase in pre-tax income period-over-period, which was partially offset by a $0.5 million state tax benefit recorded during the nine months ended September 30, 2023 relating to an overall reduction in the state tax blended rate for the Company since its transition to a C Corporation. The effective tax rates for the nine months ended September 30, 2023 and 2022 were 28.23% and 28.51%, respectively.

FINANCIAL CONDITION SUMMARY

The following discussion compares our financial condition as of September 30, 2023 to our financial condition as of December 31, 2022. The following table summarizes selected components of our unaudited consolidated balance sheets as of September 30, 2023 and December 31, 2022.

(in thousands)	September 30, 2023	December 31, 2022
Total assets	$ 3,505,040	$ 3,227,159
Cash and cash equivalents	323,548	259,991
Total investments	107,190	119,744
Loans held for investment	3,009,930	2,791,326
Total deposits	3,032,210	2,782,004
Subordinated notes, net	73,713	73,606
Total shareholders' equity	274,024	252,825

Total Assets

At September 30, 2023, total assets were $3.5 billion, an increase of $277.9 million from $3.2 billion at December 31, 2022, primarily due to increases in cash and cash equivalents of $63.6 million and loans held for investment of $218.6 million.

Cash and Cash Equivalents

Total cash and cash equivalents were $323.5 million at September 30, 2023, an increase of $63.5 million from $260.0 million at December 31, 2022. The increase in cash and cash equivalents was primarily due to increases in deposits of $250.2 million and net income of $36.9 million, partially offset by loan originations, net of repayments, of $212.1 million.

Investment Portfolio

Our investment portfolio is primarily comprised of U.S. government agency securities, mortgage-backed securities, and obligations of states and political subdivisions, which are high-quality liquid investments. We manage our investment portfolio according to written investment policies approved by our board of directors. Our investment strategy aims to maximize earnings while maintaining liquidity in securities with minimal credit risk and interest rate risk that is reflective of the yields obtained on those securities. Most of our securities are classified as available-for-sale, although we have one long-term, fixed rate municipal security classified as held-to-maturity.

Our total securities available-for-sale and held-to-maturity amounted to $107.2 million at September 30, 2023 and $119.7 million at December 31, 2022, representing a decrease of $12.5 million period-over-period. The decrease to available-for-sale securities was primarily due to maturities, prepayments, and calls of $8.1 million and an unrealized loss on securities of $3.5 million, with the remainder of the change due to amortization of premiums. For the three months ended September 30, 2023, other comprehensive loss was $3.0 million, primarily due to rate changes and other market conditions on securities.

The following table presents the carrying value of our investment portfolio as of the dates indicated:

	As of			
	September 30, 2023		December 31, 2022	
(dollars in thousands)	Carrying Value	% of Total	Carrying Value	% of Total
Available-for-sale (at fair value):				
U.S. government agencies	$ 11,209	10.46 %	$ 14,173	11.84 %
Mortgage-backed securities	54,463	50.81 %	61,271	51.17 %
Obligations of states and political subdivisions	36,351	33.91 %	38,426	32.09 %
Collateralized mortgage obligations	337	0.31 %	395	0.33 %
Corporate bonds	1,726	1.61 %	1,723	1.44 %
Total available-for-sale	104,086	97.10 %	115,988	96.87 %
Held-to-maturity (at amortized cost):				
Obligations of states and political subdivisions	3,104	2.90 %	3,756	3.13 %
Total	$ 107,190	100.00 %	$ 119,744	100.00 %

The following table presents the carrying value of our securities by their stated maturities, as well as the weighted average yields for each maturity range, as of September 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		Total	
(dollars in thousands)	**Carrying Value**	**Weighted Average Yield**	**Carrying Value**	**Weighted Average Yield**	**Carrying Value**	**Weighted Average Yield**	**Carrying Value**	**Weighted Average Yield**	**Carrying Value**	**Weighted Average Yield**
Available-for-sale:										
U.S. government agencies	$ —	— %	$ 805	3.45 %	$ 2,181	5.34 %	$ 8,223	5.44 %	$ 11,209	5.28 %
Mortgage-backed securities	—	— %	—	— %	601	2.74 %	53,862	1.69 %	54,463	1.70 %
Obligations of states and political subdivisions	—	— %	355	0.84 %	5,510	1.72 %	30,486	1.76 %	36,351	1.74 %
Collateralized mortgage obligations	—	— %	—	— %	337	1.76 %	—	— %	337	1.76 %
Corporate bonds	—	— %	1,726	1.25 %	—	— %	—	— %	1,726	1.25 %
Total available-for-sale	—	— %	2,886	1.81 %	8,629	2.71 %	92,571	2.04 %	104,086	2.09 %
Held-to-maturity:										
Obligations of states and political subdivisions	304	6.00 %	935	6.00 %	1,365	6.00 %	500	6.00 %	3,104	6.00 %
Total	$ 304	6.00 %	$ 3,821	2.84 %	$ 9,994	3.16 %	$ 93,071	2.06 %	$107,190	2.21 %

The following table presents the carrying value of our securities by their stated maturities, as well as the weighted average yields for each maturity range, as of December 31, 2022:

(dollars in thousands)	Due in one year or less		Due after one year through five years		Due after five years through ten years		Due after ten years		Total	
	Carrying Value	Weighted Average Yield	Carrying Value	Weighted Average Yield	Carrying Value	Weighted Average Yield	Carrying Value	Weighted Average Yield	Carrying Value	Weighted Average Yield
Available-for-sale:										
U.S. government agencies	$ —	— %	$ 849	1.98 %	$ 2,625	3.61 %	$ 10,699	2.90 %	$ 14,173	2.98 %
Mortgage-backed securities	—	— %	—	— %	2	6.94 %	61,269	1.67 %	61,271	1.67 %
Obligations of states and political subdivisions	501	2.80 %	—	— %	4,761	1.63 %	33,164	1.76 %	38,426	1.76 %
Collateralized mortgage obligations	—	— %	—	— %	—	— %	395	1.76 %	395	1.76 %
Corporate bonds	—	— %	1,723	1.25 %	—	— %	—	— %	1,723	1.25 %
Total available-for-sale	501	2.80 %	2,572	1.49 %	7,388	2.33 %	105,527	1.82 %	115,988	1.85 %
Held-to-maturity:										
Obligations of states and political subdivisions	417	6.00 %	1,015	6.00 %	1,470	6.00 %	854	6.00 %	3,756	6.00 %
Total	$ 918	4.25 %	$ 3,587	2.77 %	$ 8,858	2.94 %	$ 106,381	1.86 %	$ 119,744	1.98 %

Weighted average yield for securities available-for-sale is the projected yield to maturity given current cash flow projections for U.S. government agency securities, mortgage-backed securities, and collateralized mortgage obligations. For callable municipal securities and corporate bonds, weighted average yield is a yield to worst. Weighted average yield for securities held-to-maturity is the stated coupon of the bond.

Loan Portfolio

Our loan portfolio is our largest class of interest-earning assets and typically provides higher yields than other types of interest-earning assets. Associated with the higher yields is an inherent amount of credit risk, which we attempt to mitigate with strong underwriting. As of September 30, 2023 and December 31, 2022, our total loans amounted to $3.0 billion and $2.8 billion, respectively. The following table presents the balance and associated percentage of each major product type within our portfolio as of the dates indicated.

	As of			
	September 30, 2023		December 31, 2022	
(dollars in thousands)	Amount	% of Loans	Amount	% of Loans
Loans held for investment:				
Real estate:				
Commercial	$ 2,599,616	86.03 %	$ 2,394,674	85.44 %
Commercial land and development	15,482	0.51 %	7,477	0.27 %
Commercial construction	95,352	3.16 %	88,669	3.16 %
Residential construction	13,922	0.46 %	6,693	0.24 %
Residential	25,028	0.83 %	24,230	0.86 %
Farmland	51,921	1.72 %	52,478	1.87 %
Commercial:				
Secured	157,273	5.21 %	165,186	5.89 %
Unsecured	23,997	0.79 %	25,431	0.91 %
Consumer and other	29,604	0.98 %	28,628	1.02 %
Loans held for investment, gross	3,012,195	99.69 %	2,793,466	99.66 %
Loans held for sale:				
Commercial	9,326	0.31 %	9,416	0.34 %
Total loans, gross	3,021,521	100.00 %	2,802,882	100.00 %
Net deferred loan fees	(2,265)		(2,140)	
Total loans	$ 3,019,256		$ 2,800,742	

Commercial real estate loans consist of term loans secured by a mortgage lien on the real property, such as office and industrial buildings, manufactured home communities, self-storage facilities, hospitality properties, faith-based properties, retail shopping centers, and apartment buildings, as well as commercial real estate construction loans that are offered to builders and developers.

Commercial land and development and commercial construction loans consist of loans made to fund commercial land acquisition and development and commercial construction, respectively. The real estate purchased with these loans is generally located in or near our market.

Commercial loans consist of financing for commercial purposes in various lines of business, including manufacturing, service industry, and professional service areas. Commercial loans can be secured or unsecured but are generally secured with the assets of the company and/or the personal guaranty of the business owner(s).

Residential real estate and construction real estate loans consist of loans secured by single-family and multifamily residential properties, which are both owner-occupied and investor-owned.

The following tables present the commercial real estate loan balance, associated percentage of commercial real estate concentrations, estimated real estate collateral values, and related loan-to-value ("LTV") ranges by collateral type as of the dates indicated. Revolving lines of credit with zero balance and 0.00% LTV are excluded from this table. Collateral values are determined at origination using third-party real estate appraisals or evaluations. Updated appraisals, which are included in the table below, are obtained for loans that are downgraded to watch or substandard. Loans over $2.0 million are reviewed annually, at which time an internal assessment of collateral values is completed.

(dollars in thousands)	Loan Balance	% of Commercial Real Estate	Collateral Value	Minimum LTV	Maximum LTV
September 30, 2023					
Manufactured home community	$ 784,780	30.19 %	$ 1,372,955	16.87 %	82.73 %
RV Park	336,158	12.93 %	579,226	18.38 %	82.94 %
Retail	271,271	10.44 %	521,575	6.99 %	74.38 %
Multifamily	211,302	8.13 %	426,282	13.39 %	75.00 %
Faith-based	178,020	6.85 %	469,562	8.37 %	78.98 %
Industrial	173,036	6.66 %	416,343	8.71 %	83.62 %
Mini storage	157,724	6.07 %	322,569	16.64 %	70.00 %
Office	137,256	5.28 %	301,178	1.24 %	73.63 %
All other types[1]	350,069	13.45 %	714,214	4.00 %	152.48 %
Total[2]	$ 2,599,616	100.00 %	$ 5,123,904		
December 31, 2022					
Manufactured home community	$ 673,891	28.14 %	$ 1,174,642	17.10 %	78.19 %
RV Park	292,886	12.23 %	506,041	18.64 %	77.89 %
Retail	264,599	11.05 %	490,291	16.48 %	73.93 %
Multifamily	202,203	8.44 %	459,695	14.19 %	75.00 %
Industrial	166,403	6.95 %	366,291	10.77 %	75.00 %
Mini storage	158,650	6.63 %	289,820	20.20 %	70.04 %
Faith-based	146,740	6.13 %	383,321	3.19 %	73.55 %
Office	145,899	6.09 %	310,248	6.66 %	74.68 %
All other types[1]	343,403	14.34 %	704,984	— %	152.96 %
Total[2]	$ 2,394,674	100.00 %	$ 4,685,333		

1 Types of collateral in the "all other types" category are those that individually make up less than 5.00% of the commercial real estate concentration.

2 Minimum LTV and Maximum LTV not shown for aggregated totals, as such values are meaningful only when presented by specific category.

Over the past several years, we have experienced significant growth in our loan portfolio, although the relative composition of the portfolio has not changed significantly. Our primary focus remains commercial real estate lending (including commercial, commercial land and development, and commercial construction), which constitutes 90.05% of loans held for investment at September 30, 2023. Commercial secured lending represents 5.23% of loans held for investment at September 30, 2023. We sell the guaranteed portion of all SBA 7(a) loans in the secondary market and will continue to do so as long as market conditions continue to be favorable.

We recognize that our commercial real estate loan concentration is significant within our balance sheet. Commercial real estate loan balances as a percentage of risk-based capital were 682.70% and 680.34% as of September 30, 2023 and December 31, 2022, respectively. We have established internal concentration limits in the loan portfolio for commercial real estate loans by sector (e.g., manufactured home communities, self-storage, hospitality, etc.). All loan sectors were within our established limits as of September 30, 2023. Additionally, our loans are geographically concentrated with borrowers and collateral properties primarily in California.

We believe that our past success is attributable to focusing on products and markets where we have significant expertise. Given our concentrations, we have established strong risk management practices, including risk-based lending standards, self-established product and geographical limits, annual evaluations of income property loans, and semi-annual top-down and bottom-up stress testing. We expect to continue growing our loan portfolio. We do not expect our product or geographic concentrations to materially change.

The following table sets forth the contractual maturities of our loan portfolio as of September 30, 2023:

(in thousands)	**Due in 1 year or less**	**Due after 1 year through 5 years**	**Due after 5 years through 15 years**	**Due after 15 years**	**Total**
Real estate:					
Commercial	$ 47,516	$ 229,286	$ 2,257,419	$ 65,395	$ 2,599,616
Commercial land and development	9,916	4,769	797	—	15,482
Commercial construction	20,222	34,856	40,274	—	95,352
Residential construction	8,310	5,612	—	—	13,922
Residential	502	5,952	17,607	967	25,028
Farmland	1,774	4,697	45,450	—	51,921
Commercial:					
Secured	33,687	42,353	90,146	413	166,599
Unsecured	688	10,890	12,419	—	23,997
Consumer and other	1,086	6,365	22,153	—	29,604
Total	$ 123,701	$ 344,780	$ 2,486,265	$ 66,775	$ 3,021,521

The following table sets forth the contractual maturities of our loan portfolio as of December 31, 2022:

(in thousands)	**Due in 1 year or less**	**Due after 1 year through 5 years**	**Due after 5 years through 15 years**	**Due after 15 years**	**Total**
Real estate:					
Commercial	$ 19,406	$ 227,519	$ 2,083,818	$ 63,931	$ 2,394,674
Commercial land and development	1,611	5,053	813	—	7,477
Commercial construction	1,957	37,510	49,202	—	88,669
Residential construction	594	4,783	1,316	—	6,693
Residential	348	6,635	16,248	999	24,230
Farmland	992	5,685	45,801	—	52,478
Commercial:					
Secured	36,154	46,814	88,418	3,216	174,602
Unsecured	55	10,347	15,029	—	25,431
Consumer and other	1,321	8,234	19,067	6	28,628
Total	$ 62,438	$ 352,580	$ 2,319,712	$ 68,152	$ 2,802,882

The following table sets forth the sensitivity to interest rate changes of our loan portfolio as of September 30, 2023:

(in thousands)	Fixed Interest Rates	Floating or Adjustable Rates	Total
Real estate:			
Commercial	$ 557,677	$ 2,041,939	$ 2,599,616
Commercial land and development	10,094	5,388	15,482
Commercial construction	2,188	93,164	95,352
Residential construction	3,913	10,009	13,922
Residential	1,304	23,724	25,028
Farmland	6,158	45,763	51,921
Commercial:			
Secured	39,054	127,545	166,599
Unsecured	16,102	7,895	23,997
Consumer and other	29,541	63	29,604
Total	$ 666,031	$ 2,355,490	$ 3,021,521

The following table sets forth the sensitivity to interest rate changes of our loan portfolio as of December 31, 2022:

(in thousands)	Fixed Interest Rates	Floating or Adjustable Rates	Total
Real estate:			
Commercial	$ 552,206	$ 1,842,468	$ 2,394,674
Commercial land and development	1,514	5,963	7,477
Commercial construction	1,405	87,264	88,669
Residential construction	3,366	3,327	6,693
Residential	1,531	22,699	24,230
Farmland	6,261	46,217	52,478
Commercial:			
Secured	37,517	137,085	174,602
Unsecured	16,767	8,664	25,431
Consumer and other	28,547	81	28,628
Total	$ 649,114	$ 2,153,768	$ 2,802,882

Asset Quality

We manage the quality of our loans based upon trends at the overall loan portfolio level as well as within each product type. We measure and monitor key factors that include the level and trend of classified, delinquent, non-accrual, and nonperforming assets, collateral coverage, credit scores, and debt service coverage, where applicable. These metrics directly impact our evaluation of the adequacy of our allowance for credit losses.

Our primary objective is to maintain a high level of asset quality in our loan portfolio. We believe our underwriting practices and policies, established by experienced professionals, appropriately govern the risk profile for our loan portfolio. These policies are continually evaluated and updated as necessary. All loans are assessed and assigned a risk classification at origination based on underlying characteristics of the transaction, such as collateral cash flow, collateral coverage, and borrower strength. We believe that we have a comprehensive methodology to proactively monitor our credit quality after the origination process. Particular emphasis is placed on our commercial portfolio, where risk assessments are reevaluated as a result of reviewing commercial property operating statements and borrower financials. On an ongoing basis, we also monitor payment performance, delinquencies, and tax and property insurance compliance. We design our practices to facilitate the early detection and remediation of problems within our loan portfolio. Assigned risk classifications are an integral part of management’s assessment of the adequacy of our allowance for credit losses. We periodically employ the use of an independent consulting firm to evaluate our underwriting and risk assessment process. Like other financial institutions, we are subject to the risk that our loan portfolio will be exposed to increasing pressures from deteriorating borrower credit due to general economic conditions and rising interest rates.

Nonperforming Assets

Our nonperforming assets consist of nonperforming loans and foreclosed real estate, if any. Nonperforming loans consist of non-accrual loans and loans contractually past due by 90 days or more and still accruing. Loans on which the accrual of interest has been discontinued are designated as non-accrual loans. Accrual of interest on loans is discontinued either when reasonable doubt exists as to the full and timely collection of interest or principal or when a loan becomes contractually past due by 90 days or more with respect to interest or principal. When a loan is placed on non-accrual status, all interest previously accrued, but not collected, is reversed against current period interest income. Income on such loans is then recognized only to the extent that cash is received and where the future collection of principal is probable. Interest accruals are resumed on such loans only when they are brought fully current with respect to interest and principal and when, in the judgment of management, the loans are estimated to be fully collectible as to both principal and interest.

SBA Loans

During the three and nine months ended September 30, 2023, the Company sold 24 and 125 SBA 7(a) loans, respectively, with government guaranteed portions totaling $7.0 million and $30.6 million, respectively. The Company received gross proceeds of $7.4 million and $32.2 million on the loans sold during the three and nine months ended September 30, 2023, respectively, resulting in the recognition of net gains on sale of $0.4 million and $1.6 million, respectively, during the same periods.

Non-accrual Loans

The following table provides details of our nonperforming and restructured assets and certain other related information as of the dates presented:

	As of	
(dollars in thousands)	**September 30, 2023**	**December 31, 2022**
Non-accrual loans:		
Real estate:		
Commercial	$ 1,923	$ 106
Residential	—	175
Commercial:		
Secured	79	123
Total non-accrual loans	2,002	404
Loans past due 90 days or more and still accruing:		
Total loans past due and still accruing	—	—
Total nonperforming loans	2,002	404
Real estate owned	—	—
Total nonperforming assets	$ 2,002	$ 404
Performing LMs (not included above)	$ —	$ —
Allowance for credit losses to period end nonperforming loans	1,699.35 %	7,026.98 %
Nonperforming loans to loans held for investment	0.07 %	0.01 %
Nonperforming assets to total assets	0.06 %	0.01 %
Nonperforming loans plus performing LMs to loans held for investment	0.07 %	0.01 %

The ratio of nonperforming loans to loans held for investment was 0.07% at September 30, 2023, increasing from 0.01% at December 31, 2022, as a result of financial challenges experienced by a small subset of our borrowers.

Potential Problem Loans

We utilize a risk grading system for our loans to aid us in evaluating the overall credit quality of our real estate loan portfolio and assessing the adequacy of our allowance for credit losses. All loans are grouped into a risk category at the time of origination. Commercial real estate loans over $2.0 million are reevaluated at least annually for proper classification in conjunction with our review of property and borrower financial information. All loans are reevaluated for proper risk grading as new information such as payment patterns, collateral condition, and other relevant information comes to our attention.

The banking industry defines loans graded substandard or doubtful as “classified” loans. The following table shows our levels of classified loans as of the periods indicated:

(in thousands)	Pass	Watch	Substandard	Doubtful	Total
September 30, 2023					
Real estate:					
Commercial	$ 2,571,154	$ 26,539	$ 1,923	$ —	$ 2,599,616
Commercial land and development	15,482	—	—	—	15,482
Commercial construction	89,453	5,899	—	—	95,352
Residential construction	13,922	—	—	—	13,922
Residential	25,028	—	—	—	25,028
Farmland	51,921	—	—	—	51,921
Commercial:					
Secured	156,074	1,120	79	—	157,273
Unsecured	23,997	—	—	—	23,997
Consumer and other	29,568	15	21	—	29,604
Total	$ 2,976,599	$ 33,573	$ 2,023	$ —	$ 3,012,195
December 31, 2022					
Real estate:					
Commercial	$ 2,379,766	$ 14,802	$ 106	$ —	$ 2,394,674
Commercial land and development	7,477	—	—	—	7,477
Commercial construction	82,769	5,900	—	—	88,669
Residential construction	6,693	—	—	—	6,693
Residential	24,055	—	175	—	24,230
Farmland	52,478	—	—	—	52,478
Commercial:					
Secured	163,879	1,184	123	—	165,186
Unsecured	25,431	—	—	—	25,431
Consumer and other	28,602	—	26	—	28,628
Total	$ 2,771,150	$ 21,886	$ 430	$ —	$ 2,793,466

Loans designated as watch and substandard, which are not considered adversely classified, increased to $35.6 million at September 30, 2023 from $22.3 million at December 31, 2022. There were no loans with doubtful risk grades at September 30, 2023 or December 31, 2022.

Allowance for Credit Losses - Loans

The allowance for credit losses - loans is established through a provision for credit losses charged to operations. Provisions are charged against the allowance for credit losses - loans when management believes that the collectability of the principal is unlikely. Subsequent recoveries of previously charged-off amounts, if any, are credited to the allowance for credit losses - loans.

The allowance for credit losses - loans is evaluated on a regular basis by management and is based on management's periodic review of the collectability of the loans in light of historical experience, the nature and volume of the loan portfolio, adverse situations that may affect the borrower's ability to repay, estimated value of any underlying collateral, and prevailing economic conditions. This evaluation is inherently subjective, as it requires estimates that are susceptible to significant revision as more information becomes available.

At September 30, 2023, the Company's allowance for credit losses - loans was $34.0 million, as compared to $28.4 million at December 31, 2022. The $5.6 million increase in the allowance is due to a $5.3 million adjustment recorded in connection with the adoption of ASC 326 and a $2.9 million provision for credit losses recorded during the nine months ended September 30, 2023, partially offset by net charge-offs of $2.5 million during the same period.

While the entire allowance for credit losses - loans is available to absorb losses from any and all loans, the following table represents management's allocation of our allowance for credit losses by loan category, and the percentage of the allowance for credit losses in each category, for the periods indicated.

	September 30, 2023		December 31, 2022	
(in thousands)	**Amount**	**% of Total**	**Amount**	**% of Total**
Real estate:				
Commercial	$ 27,901	82.00 %	$ 19,216	67.69 %
Commercial land and development	198	0.58 %	54	0.19 %
Commercial construction	1,220	3.59 %	645	2.27 %
Residential construction	115	0.34 %	49	0.17 %
Residential	151	0.44 %	175	0.62 %
Farmland	393	1.15 %	644	2.27 %
Commercial:				
Secured	3,461	10.17 %	7,098	25.00 %
Unsecured	213	0.63 %	116	0.41 %
Consumer and other	376	1.10 %	347	1.22 %
Unallocated	—	— %	45	0.16 %
Total allowance for credit losses	$ 34,028	100.00 %	$ 28,389	100.00 %

The ratio of the allowance for credit losses to total loans held for investment was 1.13% at September 30, 2023, as compared to 1.02% at December 31, 2022.

The following table provides information on the activity within the allowance for credit losses - loans as of and for the periods indicated:

	As of and for the three months ended			
	September 30, 2023		September 30, 2022	
(dollars in thousands)	Activity	% of Average Loans Held for Investment	Activity	% of Average Loans Held for Investment
Average loans held for investment	$ 2,973,842		$ 2,483,451	
Allowance for credit losses - loans	$ 33,984		$ 25,786	
Net (charge-offs) recoveries:				
Commercial:				
Secured	(1,026)	(0.03)%	(278)	(0.01)%
Unsecured	—	— %	(2)	— %
PPP	—	— %	21	— %
Consumer and other	20	— %	61	— %
Net charge-offs	(1,006)	(0.03)%	(198)	(0.01)%
Provision for credit losses	1,050		2,250	
Allowance for credit losses - loans	$ 34,028		$ 27,838	
Loans held for investment	$ 3,009,930		$ 2,582,978	
Allowance for credit losses - loans to loans held for investment	1.13 %		1.08 %	

	As of and for the nine months ended			
	September 30, 2023		September 30, 2022	
(In thousands)	Activity	% of Average Loans Held for Investment	Activity	% of Average Loans Held for Investment
Average loans held for investment	$ 2,901,893		$ 2,225,609	
Allowance for credit losses - loans	$ 28,389		$ 23,243	
Effect of adoption of ASC 326	5,262		—	
Net (charge-offs) recoveries:				
Commercial:				
Secured	(2,498)	(0.09)%	(776)	(0.03)%
Unsecured	—	— %	(2)	— %
Consumer and other	5	— %	(77)	— %
Net charge-offs	(2,493)	(0.09)%	(855)	(0.04)%
Provision for credit losses	2,870		5,450	
Allowance for credit losses - loans	$ 34,028		$ 27,838	
Loans held for investment	$ 3,009,930		$ 2,582,978	
Allowance for credit losses - loans to loans held for investment	1.13 %		1.08 %	

The allowance for credit losses - loans to loans held for investment increased from 1.08% as of September 30, 2022 to 1.13% as of September 30, 2023. Net charge-offs as a percent of average loans held for investment increased from 0.01% to 0.03% for the three months ended September 30, 2022 and September 30, 2023, respectively. Net charge-offs as a percent of average loans held for investment increased from 0.04% to 0.09% for the nine months ended September 30, 2022 and September 30, 2023, respectively.

Liabilities

During the first nine months of 2023, total liabilities increased by $256.7 million from $3.0 billion as of December 31, 2022 to $3.2 billion as of September 30, 2023. This increase was primarily due to an increase in total deposits of $250.2 million, comprised of an increase of $385.5 million in interest-bearing deposits, partially offset by a decrease of $135.3 million in non-interest-bearing deposits.

Deposits

Representing 93.85% of our total liabilities as of September 30, 2023, deposits are our primary source of funding for our business operations.

Total deposits increased by $250.2 million, or 8.99%, to $3.0 billion at September 30, 2023 from $2.8 billion at December 31, 2022. Deposit increases were primarily attributable to an increase in the number of new relationships, as well as normal fluctuations in some of our larger accounts. Non-interest-bearing deposits decreased by $135.3 million from December 31, 2022 to $833.4 million at September 30, 2023, representing 27.49% of total deposits at that date, as compared to 34.82% of total deposits at December 31, 2022. Our loan to deposit ratio was 99.57% at September 30, 2023, as compared to 100.67% at December 31, 2022. We intend to continue to operate our business with close monitoring of the loan to deposit ratio.

The following tables summarize our deposit composition by average deposit balances and average rates paid for the periods indicated:

	For the three months ended					
	September 30, 2023			September 30, 2022		
(dollars in thousands)	Average Amount	Average Rate Paid	% of Total Deposits	Average Amount	Average Rate Paid	% of Total Deposits
Interest-bearing transaction accounts	$ 296,230	1.30 %	9.93 %	$ 213,926	0.21 %	8.28 %
Money market and savings accounts	1,463,210	2.83 %	49.03 %	1,118,840	0.65 %	43.32 %
Time accounts	399,514	4.96 %	13.39 %	208,678	1.63 %	8.08 %
Demand accounts	825,254	— %	27.65 %	1,041,222	— %	40.32 %
Total deposits	$ 2,984,208	2.18 %	100.00 %	$ 2,582,666	0.43 %	100.00 %

	For the nine months ended					
	September 30, 2023			September 30, 2022		
(In thousands)	Average Amount	Average Rate Paid	% of Total Deposits	Average Amount	Average Rate Paid	% of Total Deposits
Interest-bearing transaction accounts	$ 320,013	0.93 %	11.01 %	$ 248,540	0.14 %	10.07 %
Money market and savings accounts	1,378,517	2.45 %	47.41 %	1,069,945	0.37 %	43.37 %
Time accounts	357,433	4.57 %	12.29 %	170,912	0.92 %	6.93 %
Demand accounts	851,608	— %	29.29 %	977,894	— %	39.63 %
Total deposits	$ 2,907,571	1.83 %	100.00 %	$ 2,467,291	0.24 %	100.00 %

Uninsured and uncollateralized deposits totaled $1.0 billion and $1.2 billion at September 30, 2023 and December 31, 2022, respectively.

As of September 30, 2023, our 42 largest deposit relationships, each accounting for more than $10.0 million, totaled $1.6 billion, or 51.37% of our total deposits. The average age on deposit relationships of more than $5.0 million was approximately 9 years. As of December 31, 2022, our 40 largest deposit relationships, each accounting for more than $10.0 million, totaled $1.5 billion, or 52.15% of our total deposits. Overall, our large deposit relationships have been relatively consistent over time and have helped to continue to grow our deposit base. Our large deposit relationships are comprised of the following entity types as of the periods indicated:

(in thousands)	September 30, 2023	December 31, 2022
Municipalities	$ 589,305	$ 601,968
Non-profits	220,527	195,996
Businesses	672,848	527,921
Brokered deposits	74,994	124,993
Total	$ 1,557,674	$ 1,450,878

Our largest single deposit relationship at September 30, 2023 related to a government agency. The balances for this customer were $250.0 million, or approximately 8.24% of total deposits as of that date. At December 31, 2022, our largest single deposit relationship related to a government agency and had balances of $180.0 million, or 6.47% of total deposits as of that date.

The following table sets forth the maturity of time deposits as of September 30, 2023:

(in thousands)	$250,000 or Greater	Less than $250,000	Total	Uninsured Portion
Remaining maturity:				
Three months or less	$ 140,711	$ 77,993	$ 218,704	$ 136,960
Over three through six months	132,099	1,256	133,355	128,349
Over six through twelve months	36,354	16,589	52,943	33,604
Over twelve months	21,749	773	22,522	19,999
Total	$ 330,913	$ 96,611	$ 427,524	$ 318,912

FHLB Advances and Other Borrowings

From time to time, we utilize short-term collateralized FHLB borrowings to maintain adequate liquidity. There were borrowings of $90.0 million and $100.0 million outstanding as of September 30, 2023 and December 31, 2022, respectively.

In 2022, we issued subordinated notes of $75.0 million. This debt was issued to investors in private placement transactions. See Note 6, Long Term Debt and Other Borrowings, in the notes to our unaudited consolidated financial statements included in this Quarterly Report on Form 10-Q for additional information regarding these subordinated notes. The proceeds of the notes qualify as Tier 2 capital for the Company under the regulatory capital rules of the federal banking agencies. The following table is a summary of our outstanding subordinated notes as of September 30, 2023:

(in thousands)	Issuance Date	Amount of Notes	Prepayment Right	Maturity Date
Subordinated notes	August 2022	$ 75,000	August 17, 2027	September 1, 2032
Fixed at 6.00% through September 1, 2027, then three-month Term SOFR plus 329.0 basis points (8.70% as of September 30, 2023) through maturity				

Shareholders' Equity

Shareholders' equity totaled $274.0 million at September 30, 2023 and $252.8 million at December 31, 2022. The increase in shareholders' equity was primarily attributable to net income recognized of $36.9 million, partially offset by: (i) a $2.5 million increase in accumulated other comprehensive loss; (ii) a decrease of $4.5 million in retained earnings, net of tax effect, relating to the adoption of ASC 326 on January 1, 2023; and (iii) $9.5 million in cash dividends paid during the nine months ended September 30, 2023.

Liquidity and Capital Resources

Liquidity Management

We manage liquidity based upon factors that include the level of diversification of our funding sources, the composition of our deposit types, the availability of unused funding sources, our off-balance sheet obligations, the amount of cash and liquid securities we hold, and the availability of assets to be readily converted into cash without undue loss. As the primary federal regulator of the Bank, the FDIC evaluates our liquidity on a stand-alone basis pursuant to applicable guidance and policies.

Liquidity refers to our capacity to meet our cash obligations at a reasonable cost. Our cash obligations require us to have cash flow that is adequate to fund loan growth and maintain on-balance sheet liquidity while meeting present and future obligations of deposit withdrawals, borrowing maturities, and other contractual cash obligations. In managing our cash flows, management regularly confronts situations that can give rise to increased liquidity risk. These include funding mismatches, market constraints in accessing sources of funds, and the ability to convert assets into cash. Changes in economic conditions or exposure to borrower credit quality, capital markets, and operational, legal, or reputational risks could also affect the Bank's liquidity risk profile and are considered in the assessment of liquidity management.

The Company is a corporation separate and apart from the Bank and, therefore, must provide for its own liquidity, including liquidity required to meet its debt service requirements on its subordinated debt. The Company's main source of cash flow is dividends declared and paid to it by the Bank. There are statutory and regulatory limitations that affect the ability of the Bank to pay dividends to the Company, including various legal and regulatory provisions that limit the amount of dividends the Bank can pay to the Company without regulatory approval. Under the California Financial Code, payment of a dividend from the Bank to the Company without advance regulatory approval is restricted to the lesser of the Bank's retained earnings or the amount of the Bank's net income from the previous three fiscal years less the amount of dividends paid during that period. We believe that these limitations will not impact our ability to meet our ongoing short-term cash obligations. For contingency purposes, the Company maintains a minimum level of cash to fund one year's projected operating cash flow needs plus two years' subordinated notes debt service. We continually monitor our liquidity position in order to meet all reasonably foreseeable short-term, long-term, and strategic liquidity demands. Management has established a comprehensive process for identifying, measuring, monitoring, and controlling liquidity risk. Because of its critical importance to the viability of the Bank, liquidity risk management is fully integrated into our risk management processes. Critical elements of our liquidity risk management include effective corporate governance, consisting of oversight by the board of directors and active involvement by management; appropriate strategies, policies, procedures, and limits used to manage and mitigate liquidity risk; comprehensive liquidity risk measurement and monitoring systems, including stress tests, that are commensurate with the complexity of our business activities; active management of intraday liquidity and collateral; an appropriately diverse mix of existing and potential future funding sources; adequate levels of highly liquid marketable securities free of legal, regulatory, or operational impediments that can be used to meet liquidity needs in stress situations; comprehensive contingency funding plans that sufficiently address potential adverse liquidity events and emergency cash flow requirements; and internal controls and internal audit processes sufficient to determine the adequacy of the Bank's liquidity risk management process.

Our liquidity position is supported by management of our liquid assets and liabilities and access to alternative sources of funds. Our liquidity requirements are met primarily through our deposits, FHLB advances, and the principal and interest payments we receive on loans and investment securities. Cash on hand, cash at third-party banks, investments available-for-sale, and maturing or prepaying balances in our investment and loan portfolios are our most liquid assets. Other sources of liquidity that are routinely available to us include funds from retail and wholesale deposits, advances from the FHLB, and proceeds from the sale of loans. Less commonly used sources of funding include borrowings from the Federal Reserve Discount Window, draws on established federal funds lines from unaffiliated commercial banks, and the issuance of debt or equity securities. We believe we have ample liquidity resources to fund future growth and meet other cash needs as necessary.

In addition, we have a shelf registration statement on file with the SEC registering $250.0 million for any combination of equity or debt securities, depository shares, warrants, purchase contracts, purchase units, subscription rights, and units in one or more offerings. Specific information on the terms of and the securities being offered will be provided at the time of the offering. Proceeds from any future offerings are expected to be used for corporate purposes or other purposes to be disclosed at the time of the offering.

Sources and Uses of Cash

Our executive officers and board of directors review our sources and potential uses of cash in connection with our annual budgeting process. Generally speaking, our principal funding source is cash from deposits, and our principal uses of cash include funding of loans, operating expenses, income taxes, and dividend payments, as described below. As of September 30, 2023, management believes the above-mentioned sources will provide adequate liquidity during the next twelve months for the Bank to meet its operating needs.

Loans

Loans are a significant use of cash in daily operations, and a source of cash as customers make payments on their loans or as loans are sold to other financial institutions. Cash flows from loans are affected by the timing and amount of customer payments and prepayments, changes in interest rates, the general economic environment, competition, and the political environment.

During the nine months ended September 30, 2023, we had cash outflows of $212.1 million in loan originations and advances, net of principal collected, and $39.9 million in loans originated for sale.

Additionally, we enter into commitments to extend credit in the ordinary course of business, such as commitments to fund new loans and undisbursed construction funds. While these commitments represent contractual cash requirements, a portion of these commitments to extend credit may expire without being drawn upon. Therefore, the total commitment amounts do not necessarily represent future cash requirements. At September 30, 2023, total off-balance sheet commitments totaled $401.9 million. We expect to fund these commitments to the extent utilized primarily through the repayment of existing loans, deposit growth, and liquid assets.

Deposits

Deposits are our primary source of funding for our business operations, and the cost of deposits has a significant impact on our net interest income and net interest margin.

Our deposits are primarily made up of money market, interest checking, time, and non-interest-bearing demand deposits. Aside from commercial and business clients, a significant portion of our deposits are from municipalities and non-profit organizations. Cash flows from deposits are impacted by the timing and amount of customer deposits, changes in market rates, and collateral availability.

During the nine months ended September 30, 2023, we had cash inflows related to an increase in deposits of $250.2 million, primarily as a result of an increase in the number of new relationships and fluctuations in existing accounts.

During the twelve months following September 30, 2023, approximately $405.0 million of time deposits are expected to mature. These deposits may not renew due to general competition. However, based on our historical runoff experience, we expect the outflow will not be significant and can be replenished through our organic growth in deposits. We believe our emphasis on local deposits, our recent San Francisco Bay area expansion, and our liquid investment portfolio provide a stable funding base.

At September 30, 2023, cash and cash equivalents represented 10.67% of total deposits.

Investment Securities

Our investment securities totaled $107.2 million at September 30, 2023. Mortgage-backed securities and obligations of states and political subdivisions comprised 50.81% and 33.91% of our investment portfolio, respectively. Cash proceeds from mortgage-backed securities result from payments of principal and interest by borrowers. Cash proceeds from obligations of states and political subdivisions occur when these securities are called or mature. Assuming the current prepayment speed and interest rate environment, we expect to receive approximately $7.3 million from our securities over the twelve months following September 30, 2023. In future periods, we expect to maintain approximately the same level of cash flows from our securities. Depending on market yield and our liquidity, we may purchase securities as a use of cash in our interest-earning asset portfolio.

During the nine months ended September 30, 2023, we had cash proceeds from sales, maturities, calls, and prepayments of securities of $8.1 million. Additionally, at September 30, 2023, securities available-for-sale totaled $104.1 million, of which $103.2 million has been pledged as collateral for borrowings and other commitments.

FHLB Financing

The Bank is a shareholder of the FHLB, which enables the Bank to have access to lower-cost FHLB financing when necessary. At September 30, 2023, the Bank had outstanding borrowings of $90.0 million and a total financing availability of $292.1 million, net of letters of credit issued of $671.5 million.

Federal Reserve Discount Window and Correspondent Bank Lines of Credit

At September 30, 2023, unused and available amounts for borrowing from the Federal Reserve Discount Window and correspondent bank lines of credit were $69.0 million and $175.0 million, respectively.

Total Liquidity

Total liquidity (consisting of cash and cash equivalents and unused and immediately available borrowing capacity as set forth below) was approximately $859.7 million as of September 30, 2023.

	September 30, 2023			
(in thousands)	**Line of Credit**	**Letters of Credit Issued**	**Borrowings**	**Available**
FHLB advances	$ 1,053,625	$ 671,500	$ 90,000	$ 292,125
Federal Reserve Discount Window	69,012	—	—	69,012
Correspondent bank lines of credit	175,000	—	—	175,000
Cash and cash equivalents	—	—	—	323,548
Total	$ 1,297,637	$ 671,500	$ 90,000	$ 859,685

Future Contractual Obligations

Our estimated future contractual obligations as of September 30, 2023 include both current and long-term obligations. Under our operating leases, we have an operating lease liability of $5.0 million. We have a current obligation of $405.0 million and a long-term obligation of $22.5 million related to time deposits, as discussed in Note 5, Interest-Bearing Deposits. We have net subordinated notes of $73.7 million, all of which are long-term obligations. We also have contractual obligations on unfunded loan commitments and standby letters of credit totaling $401.9 million.

Dividends

The Company paid dividends to its shareholders totaling $3.5 million during the three months ended September 30, 2023.

We expect to continue our current practice of paying quarterly cash dividends with respect to our common stock, subject to our board of directors' discretion to modify or terminate this practice at any time and for any reason without prior notice. We believe our quarterly dividend rate per share, as approved by our board of directors, enables us to balance our multiple objectives of managing our business and returning a portion of our earnings to our shareholders. Assuming continued payment during the rest of 2023 at a rate of $0.20 per share, our average total dividend paid each quarter would be approximately $3.5 million based on the number of currently outstanding shares if there are no increases or decreases in the number of shares, and given that unvested RSAs share equally in dividends with outstanding common stock.

Impact of Inflation

Our unaudited consolidated financial statements and related notes have been prepared in accordance with GAAP, which require the measurement of financial position and operating results in terms of historical dollars, without considering the changes in the relative purchasing power of money over time due to inflation. The impact of inflation is reflected in the increased cost of operations. Unlike industrial companies, nearly all of our assets and liabilities are monetary in nature. As a result, interest rates have a greater impact on our performance than do the effects of general levels of inflation. Interest rates do not necessarily move in the same direction or to the same extent as the price of goods or services.

Historical Information

The following table summarizes our consolidated cash flow activities:

	Nine months ended September 30,		
(in thousands)	2023	2022	$ Change
Net cash provided by operating activities	$ 40,547	$ 27,506	$ 13,041
Net cash used in investing activities	(207,705)	(629,441)	421,736
Net cash provided by financing activities	230,715	494,275	(263,560)

Operating Activities

Net cash provided by operating activities increased by $13.0 million for the nine months ended September 30, 2023 as compared to the nine months ended September 30, 2022. Cash provided by operating activities is subject to variability period-over-period as a result of timing differences, including with respect to the collection of receivables and payments of interest expense, accounts payable, and bonuses.

Investing Activities

Net cash used in investing activities decreased by $421.7 million for the nine months ended September 30, 2023 as compared to the nine months ended September 30, 2022, primarily due to decreased loan origination growth.

Financing Activities

Net cash provided by financing activities decreased by $263.6 million for the nine months ended September 30, 2023 as compared to the nine months ended September 30, 2022, primarily due to decreased deposit growth and lower borrowings.

Capital Adequacy

We manage our capital by tracking our level and quality of capital with consideration given to our overall financial condition, our asset quality, our level of allowance for credit losses, our geographic and industry concentrations, and other risk factors on our balance sheet, including interest rate sensitivity.

Bancorp and the Bank are subject to various regulatory capital requirements administered by the federal and state banking agencies. Failure to meet minimum capital requirements as set forth in the following tables can initiate certain mandatory and possibly additional discretionary actions by regulators that, if undertaken, could have a material effect on our unaudited consolidated financial statements.

Historically, as a bank holding company with less than $3.0 billion in total consolidated assets and that met certain other criteria, we had been operating under the Small Bank Holding Company Policy Statement, which provides an exemption from the Federal Reserve’s generally applicable risk-based capital ratio and leverage ratio requirements. Having passed this threshold as of September 30, 2022, we are no longer subject to this policy statement and our capital adequacy is evaluated relative to the Federal Reserve’s generally applicable capital requirements. Additionally, as of June 30, 2023, the Company’s consolidated assets were in excess of $3.0 billion, and as a consequence, beginning in March 2024, the Company will no longer prepare and file financial reports with the Federal Reserve as a small bank holding company and will be subject to capital ratio requirements for bank holding companies.

Under federal regulations implementing the Basel III framework, the Bank is subject to minimum risk-based and leverage capital requirements. The Bank also is subject to regulatory thresholds that must be met for an insured depository institution to be classified as “well-capitalized” under the prompt corrective action framework. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Bank must meet specific capital guidelines that involve quantitative measures of its assets, liabilities, and certain off-balance sheet items, as calculated under regulatory accounting practices. Capital amounts for Bancorp and the Bank, and the Bank’s prompt corrective action classification, are also subject to qualitative judgments by the regulators about components of capital, risk weightings, and other factors. As of September 30, 2023, both Bancorp and the Bank were in compliance with all applicable regulatory capital requirements, and the Bank qualified as “well-capitalized” under the prompt corrective action framework.

Management reviews capital ratios on a regular basis to ensure that capital exceeds the prescribed regulatory minimums and is adequate to meet our anticipated future needs. For all periods presented, the Bank's ratios exceed the regulatory definition of "well-capitalized" under the regulatory framework for prompt corrective action, and Bancorp's ratios exceed the minimum ratios that would be required for it to be considered a well-capitalized bank holding company.

The capital adequacy ratios as of September 30, 2023 and December 31, 2022 for Bancorp and the Bank are presented in the following tables. As of September 30, 2023 and December 31, 2022, Bancorp's Tier 2 capital included subordinated debt, which was not included at the Bank level. Eligible amounts of subordinated debt included in Tier 2 capital will be phased out by 20% per year beginning five years before the maturity date of the notes.

Capital Ratios for Bancorp	**Actual Ratio**		**Required for Capital Adequacy Purposes**[1]		**Ratio to be Well-Capitalized under Prompt Corrective Action Provisions**	
(dollars in thousands)	**Amount**	**Ratio**	**Amount**	**Ratio**	**Amount**	**Ratio**
September 30, 2023						
Total capital (to risk-weighted assets)	$ 397,021	12.37 %	$ 254,093	8.00 %	N/A	N/A
Tier 1 capital (to risk-weighted assets)	$ 291,081	9.07 %	$ 192,556	6.00 %	N/A	N/A
Common equity tier 1 capital (to risk-weighted assets)	$ 291,081	9.07 %	$ 144,417	4.50 %	N/A	N/A
Tier 1 leverage	$ 291,081	8.58 %	$ 135,702	4.00 %	N/A	N/A
December 31, 2022						
Total capital (to risk-weighted assets)	$ 366,113	12.46 %	$ 235,065	8.00 %	N/A	N/A
Tier 1 capital (to risk-weighted assets)	$ 263,993	8.99 %	$ 176,191	6.00 %	N/A	N/A
Common equity tier 1 capital (to risk-weighted assets)	$ 263,993	8.99 %	$ 132,144	4.50 %	N/A	N/A
Tier 1 leverage	$ 263,993	8.60 %	$ 122,788	4.00 %	N/A	N/A

Capital Ratios for the Bank	**Actual Ratio**		**Required for Capital Adequacy Purposes**		**Ratio to be Well-Capitalized under Prompt Corrective Action Provisions**	
(dollars in thousands)	**Amount**	**Ratio**	**Amount**	**Ratio**	**Amount**	**Ratio**
September 30, 2023						
Total capital (to risk-weighted assets)	$ 383,511	11.97 %	$ 256,314	8.00 %	$ 320,393	10.00 %
Tier 1 capital (to risk-weighted assets)	$ 351,283	10.96 %	$ 192,308	6.00 %	$ 256,411	8.00 %
Common equity tier 1 capital (to risk-weighted assets)	$ 351,283	10.96 %	$ 144,231	4.50 %	$ 208,334	6.50 %
Tier 1 leverage	$ 351,283	10.37 %	$ 135,500	4.00 %	$ 169,375	5.00 %
December 31, 2022						
Total capital (to risk-weighted assets)	$ 356,301	12.14 %	$ 234,795	8.00 %	$ 293,494	10.00 %
Tier 1 capital (to risk-weighted assets)	$ 327,788	11.17 %	$ 176,072	6.00 %	$ 234,763	8.00 %
Common equity tier 1 capital (to risk-weighted assets)	$ 327,788	11.17 %	$ 132,054	4.50 %	$ 190,745	6.50 %
Tier 1 leverage	$ 327,788	10.69 %	$ 122,652	4.00 %	$ 153,315	5.00 %

[1] The listed capital adequacy ratios exclude capital conservation buffers.

Non-GAAP Financial Measures

Some of the financial measures discussed herein are non-GAAP financial measures. In accordance with SEC rules, we classify a financial measure as being a non-GAAP financial measure if that financial measure excludes or includes amounts, or is subject to adjustments that have the effect of excluding or including amounts, that are included or excluded, as the case may be, in the most directly comparable measure calculated and presented in accordance with GAAP in our consolidated statements of income, balance sheets, statements of shareholders' equity, or statements of cash flows.

Tangible shareholders' equity to tangible assets is defined as total equity less goodwill and other intangible assets, divided by total assets less goodwill and other intangible assets. The most directly comparable GAAP financial measure is total shareholders' equity to total assets. We had no goodwill or other intangible assets at the end of any period indicated. As a result, tangible shareholders' equity to tangible assets is the same as total shareholders' equity to total assets at the end of each of the periods indicated.

Tangible book value per share is defined as total shareholders' equity less goodwill and other intangible assets, divided by the outstanding number of common shares at the end of the period. The most directly comparable GAAP financial measure is book value per share. We had no goodwill or other intangible assets at the end of any period indicated. As a result, tangible book value per share is the same as book value per share at the end of each of the periods indicated.

We believe that these non-GAAP financial measures provide useful information to management and investors that is supplementary to our financial condition, results of operations, and cash flows computed in accordance with GAAP. However, we acknowledge that our non-GAAP financial measures have a number of limitations. As such, you should not view these disclosures as a substitute for results determined in accordance with GAAP, and they are not necessarily comparable to non-GAAP financial measures that other banking companies use. Other banking companies may use names similar to those we use for the non-GAAP financial measures we disclose, but may calculate them differently. You should understand how we and other companies each calculate our non-GAAP financial measures when making comparisons.

Recent Legislative and Regulatory Developments

Potential Regulatory Reform in Response to Recent Bank Failures

The failures of Silicon Valley Bank (Santa Clara, California), Signature Bank (New York, New York), and First Republic Bank (San Francisco, California) in March and May, 2023, may lead to regulatory changes and initiatives that could impact the Company. For example, President Biden has encouraged the federal banking agencies to adopt various reforms, including the completion of an incentive compensation rule for bank executives pursuant to Section 956 of the Dodd-Frank Act, in response to these bank failures. On April 28, 2023, the Federal Reserve and the FDIC issued reports on the failures of Silicon Valley Bank and Signature Bank, respectively, identifying potential causes that the federal banking agencies may seek to address through changes to their supervisory and regulatory policies. Additionally, agency officials, including the Vice Chair for Supervision of the Board of Governors of the Federal Reserve System, have called for changes to the manner in which banks' capital, interest rate, and liquidity risks are supervised and regulated. The extent of final actions to be taken by the regulatory agencies in response to these bank failures, including the potential changes discussed by the Vice Chair or highlighted in the Federal Reserve and FDIC reports, remains unclear.

Bank Term Funding Program

The Federal Reserve created the Bank Term Funding Program (the "BTFP") in response to recent concerns over liquidity in the banking sector. This program provides funding to eligible depository institutions to help ensure that banks can meet the needs of all depositors. The BTFP offers one-year loans to banks pledging any collateral eligible for purchase by the Federal Reserve Banks in open market operations, such as U.S. Treasury securities, U.S. agency securities, and U.S. agency mortgage-backed securities. At September 30, 2023, the Company had neither used nor established borrowing capacity with the BTFP.

Small Business Lending Data Collection Rule

On March 30, 2023, the Consumer Financial Protection Bureau (the "CFPB") finalized a rule under Section 1071 of the Dodd-Frank Act requiring lenders to collect and report data regarding small business lending activity. The Company is evaluating the impact of the new rule.

The rule took effect on August 29, 2023, and requires compliance by October 1, 2024, April 1, 2025, or January 1, 2026, depending on the number of covered small business loans that a covered lender originates. In October 2023, the U.S.

District Court for the Southern District of Texas issued a nationwide preliminary injunction enjoining the CFPB from enforcing and implementing the rule.

Third Party Risk Management Guidance

On June 6, 2023, the FDIC, the Federal Reserve, and the OCC issued final guidance providing sound principles that support a risk-based approach to third-party risk management. The Company is evaluating the impact of this guidance on its practices.

Community Reinvestment Act Reform

On October 24, 2023, the Agencies released a final rule revising the framework that the Agencies use to evaluate banks' records of community reinvestment under the Community Reinvestment Act (the "CRA"). Under the revised framework, banks with assets of at least $2 billion, such as the Bank, are considered large banks and will have their retail lending, retail services and products, community development financing, and community development services subject to periodic evaluation. Depending on a large bank's geographic distribution of lending, the evaluation of retail lending may include assessment areas in which the bank extends loans but does not operate any deposit-taking facilities, in addition to assessment areas in which the bank has deposit-taking facilities. The rule becomes effective April 1, 2024. Most provisions of the final rule will apply beginning January 1, 2026, and the remaining provisions will apply beginning January 1, 2027. The Company is evaluating the impact of the final rule.

Glossary of Acronyms, Abbreviations, and Terms

The terms identified below are used in various sections of this Form 10-Q, including "Management's Discussion and Analysis of Financial Condition and Results of Operations" in Item 2 and the unaudited Consolidated Financial Statements and Notes to the Financial Statements in Item 1 of this Form 10-Q.

2022 Annual Report on Form 10-K	Company's Annual Report on Form 10-K for the year ended December 31, 2022	FNMA	Federal National Mortgage Association
ACL	Allowance for Credit Losses	Federal Reserve	Board of Governors of the Federal Reserve System
ASC	Accounting Standards Codification	GAAP	Generally Accepted Accounting Principles in the U.S.
ASU	Accounting Standards Update	GNMA	Government National Mortgage Association
AFS	Available-for-Sale	GSE	Government Sponsored Entity
Bancorp	Five Star Bancorp and its subsidiary	ICS	Insured Cash Sweep®
Bank	Five Star Bank	IPO	Initial Public Offering
Basel III	A capital framework and rules for U.S. banking organizations	LM	Loan modification made to borrower experiencing financial difficulty
BOLI	Bank-Owned Life Insurance	NI	Net Income
BTFP	Bank Term Funding Program	NIM	Net Interest Margin
CDARS	Certificate of Deposit Account Registry Service®	OCC	The Office of the Comptroller of the Currency
CECL	Current Expected Credit Loss model for recognition of credit losses under ASC 326	OCI	Other Comprehensive Income
CFPB	Consumer Financial Protection Bureau	PPP	Paycheck Protection Program
CRA	Community Reinvestment Act	RSA	Restricted Stock Award
CME	Chicago Mercantile Exchange	ROAA	Return on Average Assets, annualized
CRE	Commercial Real Estate	ROAE	Return on Average Equity, annualized
C&I	Commercial & Industrial	ROUA	Right-of-Use Asset
EPS	Earnings per Share	SBA	U.S. Small Business Administration
FASB	Financial Accounting Standards Board	SEC	Securities and Exchange Commission
FDIC	Federal Deposit Insurance Corporation	SOFR	Secured Overnight Financing Rate
FHLB	Federal Home Loan Bank of San Francisco	TDR	Troubled Debt Restructuring
FHLMC	Federal Home Loan Mortgage Corporation		

ITEM 3. Quantitative and Qualitative Disclosures About Market Risk

Not applicable for a smaller reporting company.

ITEM 4. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

Our management, with the participation of our Chief Executive Officer and Chief Financial Officer, conducted an evaluation of the effectiveness as of September 30, 2023 of our disclosure controls and procedures, as defined in Rule 13a-15(e) under the Securities Exchange Act of 1934, as amended (the "Exchange Act"). In designing and evaluating the disclosure controls and procedures, management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives, and management was required to apply judgment in evaluating its controls and procedures. Based on this evaluation, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures were effective as of the end of the fiscal quarter covered by this Quarterly Report on Form 10-Q.

On January 1, 2023, the Company adopted ASC 326. As a result, the Company made changes to and incorporated new policies, processes, and controls over the estimation of the allowance for credit losses. There were changes implemented to account for the additional complexity of the credit loss models, review of economic forecasts, and other assumptions used in the estimation process. These changes were not undertaken in response to any identified deficiency in the Company's internal control over financial reporting. There have been no other changes in the Company's internal control.

PART II OTHER INFORMATION

ITEM 1. Legal Proceedings

From time to time, we are a party to various litigation matters incidental to the conduct of our business. We do not believe that any currently pending legal proceedings will have a material adverse effect on our business, financial condition, or results of operations.

ITEM 1A. Risk Factors

There have been no material changes to the risk factors previously disclosed under Item 1A of the Company's 2022 Annual Report on Form 10-K and our Quarterly Reports on Form 10-Q for the three months ended March 31, 2023 and June 30, 2023, previously filed with the SEC.

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

(a) Unregistered Sales of Equity Securities

None.

(b) Use of Proceeds

Not applicable.

(c) Issuer Purchases of Equity Securities

None.

ITEM 3. Defaults Upon Senior Securities

None.

ITEM 4. Mine Safety Disclosures

Not applicable.

ITEM 5. Other Information

None.

ITEM 6. Exhibits

The following exhibits are filed as part of this report or hereby incorporated by references to filings previously made with the SEC.

Exhibit Number	Exhibit Description	Incorporated by Reference Form	File No.	Exhibit	Filing Date	Herewith
31.1	Certification of Chief Executive Officer pursuant to Rule 13a-14(a)/15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002					Filed
31.2	Certification of Chief Financial Officer pursuant to Rule 13a-14(a)/15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002					Filed
32.1	Certification of Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002					Filed
32.2	Certification of Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted by Section 906 of the Sarbanes-Oxley Act of 2002					Filed
101	Inline XBRL Interactive Data					Filed
104	Cover Page Interactive Data File (embedded within the Inline XBRL document in Exhibit 101)					Filed

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.

	Five Star Bancorp (registrant)
November 8, 2023	*/s/ James E. Beckwith*
Date	James E. Beckwith President & Chief Executive Officer (Principal Executive Officer)
November 8, 2023	*/s/ Heather C. Luck*
Date	Heather C. Luck Senior Vice President & Chief Financial Officer (Principal Financial Officer)

EXHIBIT 31.1

CERTIFICATION OF PRINCIPAL EXECUTIVE OFFICER
PURSUANT TO RULE 13a-14(a)/15d-14(a), AS ADOPTED
PURSUANT TO SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002

I, James E. Beckwith, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of Five Star 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 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)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) 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) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

   (c) 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

   (d) 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 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.

November 8, 2023	*/s/ James E. Beckwith*
Date	James E. Beckwith President & Chief Executive Officer

EXHIBIT 31.2

CERTIFICATION OF PRINCIPAL FINANCIAL OFFICER
PURSUANT TO RULE 13a-14(a)/15d-14(a), AS ADOPTED
PURSUANT TO SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002

I, Heather C. Luck, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of Five Star 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 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)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) 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) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

   (c) 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

   (d) 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 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.

November 8, 2023	*/s/ Heather C. Luck*
Date	Heather C. Luck Senior Vice President & Chief Financial Officer

EXHIBIT 32.1

**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**

In connection with the Quarterly Report on Form 10-Q of Five Star Bancorp (the “Company”) for the period ended September 30, 2023, as filed with the Securities and Exchange Commission on the date hereof (the “Report”), I, James E. Beckwith, President & Chief Executive Officer of the Company, hereby certify pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

1) the Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended; and

2) the information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

November 8, 2023	*/s/ James E. Beckwith*
Date	James E. Beckwith President & Chief Executive Officer

EXHIBIT 32.2

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

In connection with the Quarterly Report on Form 10-Q of Five Star Bancorp (the “Company”) for the period ended September 30, 2023, as filed with the Securities and Exchange Commission on the date hereof (the “Report”), I, Heather C. Luck, Senior Vice President & Chief Financial Officer of the Company, hereby certify pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

1) the Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended; and

2) the information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Registrant.

November 8, 2023	*/s/ Heather C. Luck*
Date	Heather C. Luck
	Senior Vice President & Chief Financial Officer