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

FORM 10-K

(Mark One)

x **ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the fiscal year ended December 31, 2021

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)	**(I.R.S. Employer Identification No.)**
3100 Zinfandel Drive, Suite 100	
Rancho Cordova, California	**95670**
(Address of principal executive offices)	**(Zip Code)**

(916) 626-5000
(Registrant's telephone number, including area code)
Securities registered pursuant to Section 12(b) of the Act:

Title of Class	Trading Symbol(s)	Name of each exchange on which registered
Common Stock, no par value per share	**FSBC**	**The Nasdaq Stock Market LLC**

Securities registered pursuant to Section 12(g) of the Act: None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. YES o No x

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or 15(d) of the Act. YES o No x

Indicate by check mark whether the registrant (l) 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 (Section 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 has filed a report on and attestation to its management's assessment of the effectiveness of its internal control over financial reporting under Section 404(b) of the Sarbanes-Oxley Act (15 U.S.C. 7262(b)) by the registered public accounting firm that prepared or issued its audit report. 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

The aggregate market value of the voting and non-voting common equity of the registrant held by non-affiliates as of June 30, 2021 was $300.6 million. As of February 22, 2022, the number of shares outstanding of the registrant's common stock was 17,246,549.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the Registrant's Definitive Proxy Statement to be filed with the Securities and Exchange Commission pursuant to Regulation 14A for its 2022 Annual Meeting of Shareholders are incorporated by reference into Part III of this Form 10-K.

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CAUTIONARY NOTE REGARDING FORWARD-LOOKING STATEMENTS

This Annual Report on Form 10-K 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. 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:

- uncertain market conditions and economic trends nationally, regionally, and particularly in Northern California and California, including as a result of the coronavirus, and variants thereof, including the Delta and Omicron variants ("COVID-19"), pandemic;
- 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;
- the occurrence or impact of climate change, natural or man-made disasters or calamities, such as wildfires, droughts, and earthquakes;
- risks related to the impact of the COVID-19 pandemic on our business and operations;
- changes in market interest rates that affect the pricing of our loans and deposits and our net interest income;
- 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 ability to attract and retain executive officers and key employees and their customer and community relationships;
- the risks associated with our loan portfolios, and specifically with our commercial real estate loans;
- 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 maintain adequate liquidity and to maintain capital necessary to fund our growth strategy and operations and to satisfy minimum regulatory capital levels;
- the effects of increased competition from a wide variety of local, regional, national, and other providers of financial and investment services;
- risks associated with unauthorized access, cyber-crime, and other threats to data security;
- our ability to comply with various governmental and regulatory requirements applicable to financial institutions, including supervisory actions by federal and state banking agencies;
- 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;
- governmental monetary and fiscal policies, including the policies of the Board of Governors of the Federal Reserve System (the "Federal Reserve");

- changes in the U.S. economy, including an economic slowdown, inflation, deflation, housing prices, employment levels, rate of growth, and general business conditions;

- our ability to implement, maintain, and improve effective internal controls; and

- other factors that are discussed in the sections entitled "Management's Discussion and Analysis of Financial Condition and Results of Operations" and "Risk Factors."

The foregoing factors should not be considered exhaustive and should be read together with other cautionary statements that are included in this Annual Report on Form 10-K, including those discussed in the section entitled "Risk Factors." Additional factors that could cause results or performance to materially differ from those expressed in our forward-looking statements are detailed in 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 Annual Report on Form 10-K. 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.

PART I

Item 1. Business

Our Company

Headquartered in the greater Sacramento metropolitan area of California, Five Star Bancorp ("Bancorp" or the "Company") is a bank holding company that operates through its wholly owned subsidiary, Five Star Bank ("Five Star" or the "Bank"), a California state-chartered non-member bank. The Bank began operations on December 20, 1999. Bancorp was incorporated on September 16, 2002 and became the sole shareholder of the Bank on June 2, 2003. Our executive offices are located at 3100 Zinfandel Drive, Suite 100, Rancho Cordova, California 95670 and our telephone number is (916) 626-5000. Our website address is www.fivestarbank.com. Information on our website should not be considered a part of this Annual Report on Form 10-K.

The Company provides 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, two loan production offices, the Internet, and its mobile banking application. The Bank's deposits are insured in whole or in part by the Federal Deposit Insurance Corporation (the "FDIC"). The Bank's loans and deposits are primarily within Northern California, and the Bank's primary funding source is deposits from customers. 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 expectations of our shareholders, customers, employees, business partners, and community. We refer to our mission as "purpose-driven and integrity-centered banking." As of December 31, 2021, we had total assets of $2.6 billion, total loans, net of allowance for loan losses, of $1.9 billion, and total deposits of $2.3 billion.

In May 2021, the Company completed its initial public offering ("IPO"), in which the Company issued 6,054,750 shares of common stock, no par value, including 789,750 shares sold pursuant to the underwriters' exercise of their option to purchase additional shares. The securities were sold to the public at a price of $20.00 per share and began trading on the Nasdaq Global Select Market on May 5, 2021 resulting in total net proceeds less other related expenses, including audit fees, legal fees, listing fees, and other expenses, of $109.1 million.

In connection with the IPO, the Company also terminated its status as a Subchapter S corporation as of May 5, 2021 and became a taxable C Corporation.

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" or "Five Star" refer to Five Star Bank, our wholly owned subsidiary.

Our Market

The Company, through the Bank, provides financial services to customers who are predominately small and middle-market businesses, professionals, and individuals primarily in the Northern California region. Our primary loan products are commercial real estate loans, commercial loans, commercial land and construction loans, and farmland loans. Our primary deposit products are money market accounts, non-interest-bearing accounts, and interest checking accounts.

Our principal geographic market is the Roseville/Sacramento/Rancho Cordova/Elk Grove area (the "Greater Sacramento Area"). The Greater Sacramento Area has a profitable and productive economy driven by the governmental, education, technology, health care, agricultural, and manufacturing sectors. Since 2016, our market share of the total deposits in the Sacramento Area has increased significantly, according to the FDIC Deposit Market Share Reports. We believe that our market growth confirms the quality of the purpose-driven and integrity-centered banking that we strive to deliver to our customers.

Our Products and Services

Lending Activities

We focus primarily on commercial lending, with an emphasis on commercial real estate. We offer a variety of loans to small and medium-sized businesses, professionals, and individuals, including commercial real estate, commercial, commercial land and construction, and farmland loans. Although a substantial portion of our loan portfolio consists of commercial real estate loans within our market, our portfolio is diverse and includes a significant amount of Small Business Administration ("SBA") loans to customers nationwide. To a lesser extent, we also offer residential real estate and construction loans and consumer loans.

Commercial real estate loans: As of December 31, 2021, we had $1.6 billion in total commercial real estate loans, representing 81.48% of total loans. These loans are viewed primarily as cash flow loans and secondarily as loans secured by real estate. These loans are generally collateralized by first liens on real estate and amortized over a period of years. We monitor and evaluate commercial real estate loans based on collateral, geography, and risk grade criteria. Our commercial real estate lending typically involves higher loan principal amounts, and the repayment of these loans is generally largely dependent on the successful operation of the property securing the loan or the business conducted on the property securing the loan. Commercial real estate loans may be more adversely affected by conditions in the real estate markets or in the general economy. The properties securing our commercial real estate portfolio are diverse in terms of type and industry. This diversity helps reduce our exposure to adverse economic events that affect any single market or industry.

Commercial loans: As of December 31, 2021, we had $180.3 million in commercial loans, representing 9.26% of total loans. Commercial loans are underwritten after evaluating the borrower's ability to operate profitably and prudently expand its business. Underwriting standards are designed to promote relationship banking rather than transactional banking. 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.

SBA loans: As of December 31, 2021, our total commercial SBA portfolio held for investment, excluding Paycheck Protection Program ("PPP") loans, was $48.0 million, representing 2.48% of total loans held for investment. In 2021, we sold 169 SBA loans, excluding PPP loans, with government guaranteed portions totaling $41.4 million. We participate in the SBA 7(a) program in order to meet the needs of our small business community as well as customers nationwide. As an approved participant in the SBA Preferred Lender Program, we enable our clients to obtain SBA loans without being subject to the potentially lengthy SBA approval process necessary for lenders that are not SBA Preferred Lenders. Pursuant to the Consolidated Appropriations Act, 2021 (the "Consolidated Appropriations Act"), the SBA guaranteed 90% of the principal amount of each qualifying SBA loan originated under the SBA's 7(a) loan program (excluding PPP loans) through October 1, 2021. The SBA presently guarantees 75% to 90% of the principal amount of qualifying loans originated under the 7(a) loan program (excluding PPP loans). The guarantee is conditional and covers a portion of the risk of payment default by the borrower, but not the risk of improper closing and servicing by the lender. As such, prudent underwriting and closing processes are essential to effective utilization of the 7(a) program. We typically sell in the secondary market the SBA-guaranteed portion of the SBA loans we originate.

PPP loans: Pursuant to the Coronavirus Aid, Relief, and Economic Security Act (the "CARES Act") passed in March 2020, we funded over 1,500 loans to eligible small businesses and non-profit organizations nationwide who participated in the PPP administered by the SBA as of December 31, 2021. The balance of PPP loans at December 31, 2021 was $22.1 million, or 1.14% of total loans. PPP loans have terms of two to five years and earn interest at 1.00%. In addition, we received a fee of 1.00% to 5.00% from the SBA depending on the loan amount. PPP loans are fully guaranteed by the SBA and are expected to be forgiven by the SBA if borrowers meet the requirements of the program. The PPP Flexibility Act, signed into law on June 5, 2020, modified, among other things, rules governing the PPP payment deferral period. We ended our origination of new PPP loans under the first round of the PPP on June 30, 2020. In October 2020, due to updated guidance from the SBA that PPP loan payments were to be deferred until the SBA had remitted forgiveness funds to the lender if the borrower had applied during the ten months after the end of its covered period, we modified the first payment due dates for PPP loans that originated prior to June 5, 2020 and extended the payment deferral period from six months to a minimum of 16 months. The Consolidated Appropriations Act provided additional funding for the PPP and allowed eligible borrowers, including certain borrowers that had already received a PPP loan, to apply for PPP loans through March 31, 2021. In January 2021, we restarted our PPP loan origination efforts. The American Rescue Plan Act of 2021 (the "American Rescue Plan Act"), which was enacted on March 11, 2021, expanded the eligibility criteria for PPP loans and revised the exclusions from payroll costs for purposes of loan forgiveness. The PPP Extension Act of 2021 (the "PPP Extension Act"), which became law on March 30, 2021, extended the deadline to apply for a PPP loan through May 31, 2021.

Commercial land and construction loans: As of December 31, 2021, we had $61.6 million in commercial land and construction loans, representing 3.16% of total loans. We make loans to established builders to construct residential properties, loans to developers of commercial real estate investment properties and residential developments, and, to a lesser extent, loans to individual clients for construction of single-family homes in our market. On rare occasions, we also make loans for the acquisition of undeveloped land subject to heightened underwriting requirements. Construction loans are typically disbursed as construction progresses and carry either fixed or variable interest rates generally based on the borrowers' ability to repay the loans from the cash flow of their business(es). The terms of our commercial land and construction loans vary depending on factors such as the type and size of the development and the financial strength of the borrower/guarantor. Loans are typically structured with an interest-only construction period and mature at the completion of construction.

Farmland loans: As of December 31, 2021, we had $54.8 million in farmland loans, representing 2.82% of total loans. We are a strong agricultural lender, with both lines of credit and term 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.

Residential real estate and construction loans: As of December 31, 2021, we had $36.0 million in residential real estate and construction loans, representing 1.85% of total loans. Residential real estate loans are underwritten based upon income, credit history, and collateral. To monitor and manage residential loan risk, policies and procedures are developed and modified, as needed. We believe that 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.

Consumer and other loans: As of December 31, 2021, we had $17.2 million in consumer and other loans, representing 0.88% of total loans. We make a variety of loans in relatively small amounts to individuals for personal purposes, primarily for home repairs and improvements. Consumer loans are underwritten based on the individual borrower's income, current debt level, past credit history, and the value of any available collateral. The terms of consumer loans vary considerably based upon the loan type, nature of collateral, and size of the loan. The performance of consumer loans is affected by the local and regional economy as well as the rates of personal bankruptcies, job loss, divorce, and other individual-specific characteristics. We do not expect these consumer and other loans to make up a significant portion of our lending activity.

Lending Philosophy

In keeping with our mission of purpose-driven and integrity-centered banking, we seek credit arrangements that serve our local community and provide attractive risk-adjusted returns to us. We pursue our objectives and are mindful of liquidity, flexibility, and risk considerations by exercising controls on non-interest expenses and close management of our assets and liabilities. We periodically set guidelines aimed to maintain stability of our loan-to-deposit ratio, minimize past-due and non-accrual loans, and achieve an optimal loan mix and concentration. We seek well-margined and collateralized loan opportunities to borrowers with extensive professional asset operating experience.

Lending Policy and Procedures

We have established common documentation, policies, and standards for lending based on the type of loan. A thorough credit analysis precedes commercial and real estate loan decisions, and we follow well-established and proven procedures when approving consumer loans.

We have established a Management Loan Committee and a Director Loan Committee. Our Management Loan Committee is comprised of our Chief Executive Officer, our Chief Credit Officer, certain other members of management, and select senior loan officers and is primarily responsible for day-to-day implementation and oversight of our loan approval procedures. Our board of directors approves, from time to time, a delegated lending authority to members of the Management Loan Committee. The amount of authority delegated to each member of the committee varies based on years of direct lending experience, responsibility, and performance, and the authority limits also vary by collateral type.

Concentrations of Credit Risk

Although we have a diversified loan portfolio, a substantial portion is secured by commercial and residential real estate located in Northern California. As of December 31, 2021, approximately 69.13% of our real estate loans measured by dollar amount were secured by collateral located in California, a majority of which is in Northern California. Additionally, we have a high concentration of real estate related loans, which represented approximately 89.31% of our loan portfolio at December 31, 2021. 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 our primary market 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 Products

Representing 98.46% of our total liabilities as of December 31, 2021, deposits are our primary source of funding for our business operations. As of December 31, 2021, we held $2.3 billion of total deposits, including $902.1 million in non-interest-bearing deposits.

We offer a complete array of deposit products for small and medium-sized businesses, professionals, and individuals, including a variety of checking and savings accounts, time deposits, and money market accounts. We also provide a wide range of deposit services, including debit cards, remote deposit capture, online banking, mobile banking, and direct deposit services.

We obtain most of our deposits from individuals, small and medium-sized businesses, and municipalities in our market. We solicit deposits through our relationship-driven team of dedicated and accessible bankers and through community-focused marketing. We emphasize obtaining deposit relationships at loan origination. We provide a high level of customer service to our depositors. We have invested in personnel, business and compliance processes, and technology that enable us to acquire, and efficiently and effectively serve, a wide array of business deposit accounts, while continuing to provide the level of customer service for which we are known.

As of December 31, 2021, our 26 largest deposit relationships, each accounting for more than $10 million, totaled $912.7 million, or 39.93% of our total deposits. This includes $424.5 million of our total deposits held by municipalities, of which we conduct a monthly review. Our management maintains our liquidity position and lines of credit with correspondent banks to mitigate the risk of large withdrawals by this group of large depositors.

Investment Securities

As of December 31, 2021, the carrying value of our investment portfolio, which represented 6.01% of total assets, totaled $153.8 million and had an average effective yield of 1.71% and an estimated modified duration of approximately 5.4 years. The primary objectives of the investment portfolio are to provide a source of liquidity and provide collateral that can be readily sold or pledged for public deposits or other business purposes. At December 31, 2021, 53.02% and 32.57% of our investment portfolio consisted of mortgage-backed securities and obligations of states and political subdivisions, respectively. The remainder of our securities portfolio is invested in U.S. government agencies, collateralized mortgage obligations, and corporate bonds. We regularly evaluate the composition of our investment portfolio as the interest rate yield curve changes and may sell or pledge investment securities from time to time to adjust our exposure to interest rates or to provide liquidity to meet loan demand. Due to the low interest rate environment, we are primarily holding the majority of our on-balance sheet liquidity in interest-bearing bank deposits to limit our exposure to interest rate and price risk and to provide readily available funds for loan growth.

Competition

The banking business is highly competitive, and we face strong competition from many other financial institutions and financial services providers. Our principal competitors are commercial and community banks, credit unions, savings and loan associations, mortgage banking firms and online mortgage lenders, and commercial and consumer finance companies, including large national financial institutions that operate in our market. Our profitability depends in large part upon our continued ability to successfully compete with these institutions for lending opportunities, deposit funds, financial products, bankers, and potential acquisition targets.

We conduct business through nine banking centers in our key market of Northern California. Many other commercial and community banks, savings institutions, credit unions, and other financial institutions maintain a physical presence in our primary market area, and some maintain only a virtual presence. Many of these competitors are larger than we are, have significantly more resources, greater brand recognition, and more extensive and established branch networks or geographic footprints than we do, and may be able to attract customers more effectively than we can. Because of their scale, many of these competitors can be more aggressive on loan and deposit pricing than we can and may better afford and make broader use of media advertising, support services, and electronic technology than we do. Also, many of our non-bank competitors have fewer regulatory constraints and may have lower cost structures. To offset these competitive disadvantages, we concentrate marketing efforts in the local markets we service with local advertisements and personal contacts. We depend on our reputation of having greater personal service than our competitors, as well as consistency, flexibility, the ability to make credit and other business decisions quickly, and our deep knowledge of competitor strengths and weaknesses.

Based on the FDIC Summary of Deposits as of June 30, 2021, Five Star ranks eighth in the Sacramento metropolitan statistical area (“MSA”) by deposit market share with deposits of $1.8 billion and four branches. As of June 30, 2021, total market deposits in the Sacramento MSA is $73.2 billion of which $58.8 billion, or approximately 80.23%, is held by seven money center banks across 220 branches. We are the 57th largest insured depository institution in California by deposits as of June 30, 2021.

Information Technology Systems

We have made, and continue to make, significant investments in our information technology systems and staff for our banking and lending operations and treasury management activities. We believe this investment will support our continued growth and enable us to enhance our capabilities to offer new products, improve overall customer experience, improve profitability through efficiencies, and provide scalability for future growth. We utilize nationally recognized software vendors and their cloud/hosted models, which allow us to outsource the processing of our data. Our internal network and e-mail systems are administered by a managed service provider specializing in financial institutions, and we maintain our production infrastructure in a data center facility near Reno, Nevada. This site provides for power and connectivity redundancy, and we maintain a disaster recovery program, including a cloud-based recovery environment.

The majority of our other systems, including our electronic funds transfer, transaction processing, and our online banking services are hosted by third-party service providers. The scalability of this infrastructure will support our growth strategy. In addition, the tested capability of these vendors to automatically switch over to standby systems should allow us to recover our systems and provide business continuity quickly in case of a disaster.

Emerging Growth Company Status

We qualify as an “emerging growth company” under the Jumpstart Our Business Startups Act of 2012 (the “JOBS Act”). An emerging growth company may take advantage of reduced reporting requirements and is relieved of certain other significant requirements that are otherwise generally applicable to public companies. Among other factors, as an emerging growth company:

- we may present only two years of audited financial statements and discuss only our results of operations for two years in “Management’s Discussion and Analysis of Financial Condition and Results of Operations”;

- we are exempt from the requirement to provide an opinion from our auditors on the design and operating effectiveness of our internal control over financial reporting pursuant to the Sarbanes-Oxley Act of 2002, as amended (the “Sarbanes-Oxley Act”);

- we may choose not to comply with any new requirements adopted by the Public Company Accounting Oversight Board (“PCAOB”) requiring mandatory audit firm rotation or a supplement to the auditor’s report providing additional information about the audit and our audited financial statements;

- we are permitted to provide less extensive disclosure regarding our executive compensation arrangements pursuant to the rules applicable to smaller reporting companies, which means we are not required to include a compensation discussion and analysis and other disclosure regarding our executive compensation in this Annual Report on Form 10-K; and

- we are not required to hold nonbinding advisory votes on executive compensation or golden parachute arrangements.

We may take advantage of these provisions for up to five years unless we earlier cease to qualify as an emerging growth company. We would cease to be an emerging growth company upon the earliest of: (i) the first fiscal year following the fifth anniversary of our IPO; (ii) the first fiscal year after our annual gross revenues are $1.07 billion or more; (iii) the date on which we have during the previous three-year period, issued more than $1.0 billion in non-convertible debt securities; or (iv) the date on which we are deemed to be a large accelerated filer under the rules of the U.S. Securities and Exchange Commission (“SEC”). We have elected to adopt the reduced disclosure requirements described above regarding the number of periods for which we are providing audited financial statements and selected financial data, and our executive compensation arrangements. In addition, we take advantage of the reduced reporting and other requirements under the JOBS Act with respect to the periodic reports we file with the SEC and proxy statements that we use to solicit proxies from our shareholders. Accordingly, the information contained herein may be different than the information you receive from other public companies in which you invest.

The JOBS Act exempts emerging growth companies from compliance with new or revised financial accounting standards until private companies (that is, those that have not had a registration statement declared effective under the Securities Act of 1933, as amended (the "Securities Act"), or do not have a class of securities registered under the Securities Exchange Act of 1934, as amended (the "Exchange Act")) are required to comply with the new or revised financial accounting standards. The JOBS Act provides that a company can elect to opt out of this extended transition period and comply with the requirements that apply to non-emerging growth companies, but any such election to opt out is irrevocable. We have elected not to opt out of such extended transition period, which means that when a standard is issued or revised and it has different application dates for public or private companies, we, as an emerging growth company, can adopt the new or revised standard at the time private companies adopt the new or revised standard. As such, our consolidated financial statements may not be comparable with those of a public company that is not an emerging growth company, or those of a public company that is an emerging growth company that has opted out of using the extended transition period, because of the potential differences in accounting standards used.

Risk Management

We believe that effective risk management and control processes are critical to our safety and soundness, our ability to predict and manage the challenges that we face, and, ultimately, our long-term corporate success. Risk management refers to the activities by which we identify, measure, monitor, evaluate, and manage the risks we face in the course of our banking activities. These include liquidity, interest rate, credit, operational, compliance, regulatory, strategic, financial, and reputational risk exposures. Our board of directors, both directly and through its committees, is responsible for overseeing our risk management processes, including quarterly enterprise risk management assessments and annual assessments in the following areas: (i) cyber; (ii) Bank Secrecy Act of 1970 ("Bank Secrecy Act")/anti-money laundering; and (iii) third-party risk, with each of the committees of our board of directors assuming a different and important role in overseeing the management of the risks we face.

The Audit Committee of our board of directors is responsible for overseeing risks associated with financial matters (particularly financial reporting, accounting practices and policies, disclosure controls and procedures, and internal control over financial reporting). The Compensation Committee of our board of directors has primary responsibility for risks and exposures associated with our compensation policies, plans, and practices regarding both executive compensation, board compensation, and our compensation structure generally. Our Compensation Committee, in conjunction with our President and Chief Executive Officer and other members of our management, as appropriate, reviews our incentive compensation arrangements to ensure these programs are consistent with applicable laws and regulations, including safety and soundness requirements, and do not encourage imprudent or excessive risk-taking by our employees. The Governance and Nominating Committee of our board of directors oversees risks associated with the independence of our board of directors and potential conflicts of interest.

Our senior management is responsible for implementing our risk management processes by assessing and managing the risks we face, including strategic, operational, regulatory, investment, and execution risks, on a day-to-day basis, and reporting to our board of directors regarding our risk management processes. Our senior management is also responsible for creating and recommending to our board of directors for approval of appropriate risk appetite metrics reflecting the aggregate levels and types of risk we are willing to accept in connection with the operation of our business and pursuit of our business objectives.

The role of our board of directors in our risk oversight is consistent with our leadership structure, with our President and Chief Executive Officer and the other members of senior management having responsibility for assessing and managing our risk exposure, and our board of directors and its committees providing oversight in connection with those efforts. We believe this division of risk management responsibilities presents a consistent, systemic, and effective approach for identifying, managing, and mitigating risks throughout our operations.

Human Capital

To facilitate talent attraction and retention, we strive to create an inclusive, safe, and healthy workplace with opportunities for our employees to grow and develop in their careers, supported by strong compensation, benefits, and health and welfare programs.

Employee Profile

As of December 31, 2021, we had 163 full-time employees and five part-time employees. None of our employees is covered by a collective bargaining agreement. We consider our relationship with our employees to be good and have not experienced interruptions of operations due to labor disagreements.

Compensation and Benefits

We provide a competitive compensation and benefits program to help meet the needs of our employees. In addition to salaries, this program includes annual bonus opportunities, a 401(k) plan with an employer matching contribution, healthcare and insurance benefits, flexible spending accounts, paid time off and family leave, and an employee assistance program.

Learning and Development

We invest in the growth and development of our employees by providing a multi-dimensional approach to learning that empowers, intellectually grows, and professionally develops our colleagues under the leadership of a Training and Development Manager. We facilitate the educational and professional development of our employees through support to attend conferences and obtain degrees, licenses, and certifications while employed by us.

Commitment to Environmental, Social, and Governance

We are executing, and plan to scale-up, an Environmental, Social, and Governance strategy to drive positive change that focuses on environmental impacts of our business, social factors in the communities we serve, and the governance of our board of directors.

<u>Environmental</u>: Climate change impacts our customers, communities, employees, and shareholders. We are committed to developing policies and procedures that can contribute to reducing the effects of climate change, including funding customer business ventures that create positive environmental impact through agriculture or technology. Beginning in June 2021, we onboarded over 2,000 loans in a micro-loan program funding residential energy efficiency equipment. Additionally, we equip customers with technology tools designed to reduce their carbon footprint by reducing in-branch customer visits.

We have taken steps designed to help reduce our own carbon footprint by utilizing e-signatures to conduct business to reduce paper consumption and encouraging our employees to work remotely, where possible. We recognize that reducing the effects of climate change and helping to drive the transformation of a lower carbon environment are ongoing, and plan to continually seek out opportunities that can positively impact the effect that climate change has on the environment.

<u>Social</u>: We work to create positive social impacts in the communities in which our business operates, including by addressing food deserts, supporting affordable housing projects, and encouraging nonprofit donations. As the effects of the COVID-19 pandemic continue, including the emergence of new variants, we remain committed to employee and customer safety through robust alternative working arrangements and extensive safety measures.

<u>Governance</u>: The Governance and Nominating Committee of our board of directors is committed to diversity on our board of directors and compliance with applicable rules, regulations, and guidance regarding the composition of our leadership. During the course of 2021, we added members to our board of directors that represented diverse backgrounds, including those attributed to race, ethnicity, gender, and other demographics. We are committed to ethical business practices and accounting transparency, as evidenced through our involvement in the community and results of examinations by regulators.

Dedication to Diversity, Equity, and Inclusion

Diversity, Equity, and Inclusion (“DE&I”) is essential in our workplace. We have a fully engaged Senior Vice President, Chief Operations Officer and Chief DE&I Officer who leads our DE&I efforts. Our Human Resources department is demonstrating a commitment to DE&I through hiring practices and employee training. We are committed to ensuring that all employees feel a sense of belonging in the workplace and that processes and programs are impartial, fair, and provide equal opportunity for every individual. We also have a history of serving customers in the nonprofit community who assist our region’s most vulnerable, underserved, and underrepresented populations.

Available Information

The Company’s annual reports on Form 10-K, quarterly reports on Form 10-Q, proxy statements, current reports on Form 8-K, amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Exchange Act, and other filings with the SEC are available free of charge at http://investors.fivestarbank.com under the heading “Financials & Filings,” as soon as reasonably practicable after the Company electronically files such material with, or furnishes it to, the SEC. These reports are also available for free on the SEC’s website at https://www.sec.gov. The information contained on the Company’s website as referenced in this Annual Report on Form 10-K should not be considered a part of this report.

Supervision and Regulation

General

Federal and state banking laws impose a comprehensive system of supervision, examination, regulation, and enforcement on the operations of insured banks and their holding companies. As a result, our growth, earnings performance, and operations may be affected by the requirements of federal and state statutes and by the regulations and policies of various bank regulatory agencies, including the California Department of Financial Protection and Innovation (the “DFPI”), the FDIC, the Federal Reserve, and the Consumer Financial Protection Bureau (the “CFPB”). Furthermore, tax laws administered by the Internal Revenue Service (the “IRS”), and state taxing authorities, accounting rules developed by the Financial Accounting Standards Board (the “FASB”), securities laws administered by the SEC and state securities authorities, anti-money laundering laws enforced by the U.S. Department of the Treasury (the “Treasury Department”), and SBA regulations with respect to small business loans, have an impact on our business. These statutes, regulations, and policies are continually under the review of the United States Congress and state legislatures, as well as federal and state regulatory agencies, and the nature and extent of future legislative, regulatory, or other developments affecting financial institutions are impossible to predict with any certainty. Supervision and regulation of banks, their holding companies, and affiliates is intended primarily for the protection of depositors and customers, the Deposit Insurance Fund (the “DIF”) of the FDIC, and the U.S. banking and financial system, rather than holders of our capital stock.

The following is a summary of material elements of the regulatory and supervisory framework applicable to us and the Bank. It does not describe all of the statutes, regulations, and regulatory policies that apply, nor does it provide complete summaries of the statutes, regulations, and policies referenced therein.

Supervision and Regulation of the Company

We are a bank holding company registered under the Bank Holding Company Act of 1956, as amended (the “BHC Act”). As a result, we are primarily subject to the supervision, examination, and reporting requirements of the BHC Act, Federal Deposit Insurance Act (the “FDI Act”), the regulations of the Federal Reserve and FDIC, and certain of the requirements imposed by the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (the “Dodd-Frank Act”).

Federal law subjects bank holding companies, such as the Company, to restrictions on the types of activities in which they may engage, and to a range of supervisory requirements and activities, including regulatory enforcement actions for violations of laws and regulations. Violations of laws and regulations, or other unsafe and unsound practices, may result in regulatory agencies imposing fines, penalties, or cease and desist orders, or taking other enforcement actions. Under certain circumstances, these agencies may enforce these remedies directly against officers, directors, employees, and other parties participating in the affairs of a bank or bank holding company.

Federal Oversight Over Mergers and Acquisitions, Investments, and Activities

The BHC Act requires a bank holding company to obtain the prior approval of the Federal Reserve before: (i) it may acquire direct or indirect ownership or control of any voting shares of any bank if, after such acquisition, the bank holding company will directly or indirectly own or control 5.00% or more of the voting shares of the bank; (ii) it or any of its subsidiaries, other than a bank, may acquire all or substantially all of the assets of any bank; or (iii) it may merge or consolidate with any other bank holding company.

Before approving any such transaction, the Federal Reserve is required by the BHC Act to consider a number of factors, including the transaction’s competitive impact, the financial and managerial resources and future prospects of the bank holding companies and banks concerned, the convenience and needs of the community to be served, and the effectiveness of the parties in combatting money laundering activities. Provisions of the FDI Act known as the Bank Merger Act impose similar approval standards for an insured depository institution to merge with another insured depository institution or a non-insured institution.

The BHC Act, as amended by the interstate banking provisions of the Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994 (the “Riegle-Neal Act”), permits us to acquire a bank located in any other state, regardless of state law to the contrary, subject to certain deposit percentage, aging requirements, and other restrictions. The Riegle-Neal Act also generally permits national- and state-chartered banks to branch interstate through acquisitions of banks in other states. Bank holding companies must be “well-capitalized” and “well-managed” to obtain federal bank regulatory approval of an interstate acquisition without regard to state law prohibiting the transaction.

The BHC Act also generally requires Federal Reserve approval for a bank holding company's acquisition of a company that is not an insured depository institution. Bank holding companies generally may engage, directly or indirectly, only in managing or controlling banks, and such other activities as are determined by the Federal Reserve to be closely related to banking, and certain other permissible nonbanking activities. Bank holding companies generally must notify the Federal Reserve before acquiring a company that is not an insured depository institution or engaging in a permissible nonbanking activity, and the Federal Reserve considers several factors in reviewing such a notice. The Federal Reserve may order a bank holding company or its subsidiaries to terminate any of these activities or to terminate its ownership or control of any subsidiary when it has reasonable cause to believe that the bank holding company's continued ownership, activity, or control constitutes a serious risk to the financial safety, soundness, or stability of it or any of its bank subsidiaries.

The Gramm-Leach-Bliley Act (the "GLB Act") allows a bank holding company that satisfies certain criteria to elect to become a financial holding company, which would allow such company to engage in activities that are financial in nature, incidental to such activities, or complementary to such activities. We have not elected financial holding company status.

The FDIC has the authority to approve applications by state non-member banks to establish *de novo* branches, including, under the Riegle-Neal Act, in states other than the bank's home state if the law of the state in which the branch is located, or is to be located, would permit establishment of the branch if the bank were a state bank chartered by that state.

Certain acquisitions of our voting stock may be subject to regulatory approval or notice under federal law. Investors are responsible for ensuring that they do not, directly or indirectly, acquire shares of our stock in excess of the amount that can be acquired without regulatory approval under the Change in Bank Control Act and the BHC Act, which prohibit any person or company from acquiring control of the Company without, in most cases, the prior written approval of the Federal Reserve.

Source of Strength

The FDI Act and Federal Reserve regulations require a bank holding company to serve as a source of financial and managerial strength to its bank subsidiaries. As a result, a bank holding company may be expected to commit resources to support its bank subsidiary, including at times when the holding company may not be inclined or in a financial position to provide it.

Capital Adequacy

Bank holding companies and banks are subject to various regulatory capital requirements administered by federal and state bank regulatory agencies. Capital adequacy regulations and prompt corrective action regulations involve quantitative measures of assets, liabilities, and certain off-balance sheet items calculated under regulatory accounting practices, as well as qualitative judgments by the regulators about components of capital, risk-weightings, and other factors. United States capital regulations were substantially revised in 2013 as a result of changes in the Dodd-Frank Act and Basel III capital rules. The Federal Reserve and the FDIC, the primary federal regulators of the Company and Bank, respectively, have substantially similar generally applicable risk-based capital ratio and leverage ratio requirements.

We operate under the Federal Reserve's Small Bank Holding Company Policy Statement, which exempts bank holding companies with assets of less than $3.0 billion that are not engaged in significant nonbanking activities, do not conduct significant off-balance sheet activities, and do not have a material amount of debt or equity securities registered with the SEC from the Federal Reserve's generally applicable risk-based capital ratio and leverage ratio requirements. Historically, the Federal Reserve has not usually deemed a bank holding company ineligible for application of this policy statement solely because its common stock is registered under the Exchange Act. However, there can be no assurance that the Federal Reserve will continue this practice, and changes to this practice may result in the loss of our status as a small bank holding company for these purposes.

If the Company no longer were subject to the Small Bank Holding Company Policy Statement, the following generally applicable capital requirements that apply to the Bank also would apply to the Company. The Bank is required to meet a common equity Tier 1 capital to risk-weighted assets ratio of at least 7.00% (a minimum of 4.50% plus a capital conservation buffer of 2.50%), a Tier 1 capital to risk-weighted assets ratio of at least 8.50% (a minimum of 6.00% plus a capital conservation buffer of 2.50%), a total capital to risk-weighted assets ratio of at least 10.50% (a minimum of 8.00% plus a capital conservation buffer of 2.50%), and a Tier 1 leverage ratio of at least 4.00%. In addition, insured depository institutions such as the Bank, unlike bank holding companies, are subject to further capital requirements to be deemed "well-capitalized" under the prompt corrective action provisions of the FDI Act and implementing regulations of the federal banking agencies, as described in the section entitled "—Supervision and Regulation of the Bank—Prompt Corrective Action" below.

For purposes of calculating the denominator of the risk-based capital ratios, a banking institution's assets and some of its specified off-balance sheet commitments and obligations are assigned to various risk categories. For purposes of calculating the numerator of the capital ratios, capital, at both the holding company and bank levels, is classified in one of three tiers depending on the "quality" and loss-absorbing features of the capital instrument. Common equity Tier 1 capital is predominantly comprised of common stock instruments (including related surplus) and retained earnings, net of treasury stock, and after making necessary capital deductions and adjustments. Tier 1 capital is comprised of common equity Tier 1 capital and additional Tier 1 capital, which includes non-cumulative perpetual preferred stock and similar instruments meeting specified eligibility criteria (including related surplus). Total capital is comprised of Tier 1 capital and Tier 2 capital, which includes certain subordinated debt with a minimum original maturity of five years (including related surplus) and a limited amount of allowance for loan losses. Newly issued trust preferred securities and cumulative perpetual preferred stock may not be included in Tier 1 capital, but generally may be included in Tier 2 capital, provided they do not include features that are disallowed by the capital rules, such as the acceleration of principal other than in the event of a bankruptcy, insolvency, or receivership of the issuer.

Failure to meet minimum capital requirements could subject a banking organization to a variety of enforcement remedies. A banking organization's failure to exceed the capital conservation buffer with common equity Tier 1 capital would result in limitations on the banking organization's ability to make capital distributions and discretionary bonus payments.

At December 31, 2021, common equity Tier 1 capital, Tier 1 capital, and total capital of the Company on a consolidated basis equaled 11.44%, 11.44%, and 13.98% of its total risk-weighted assets, respectively, and its Tier 1 leverage ratio on a consolidated basis was 9.47%. At December 31, 2021, the Bank exceeded its minimum capital requirements with common equity Tier 1 capital, Tier 1 capital, and total capital equal to 12.55%, 12.55%, and 13.69% of its total risk-weighted assets, respectively, and a Tier 1 leverage ratio of 10.38%. As a result, the Bank was "well-capitalized" for prompt corrective action purposes based on the ratios and guidelines described below.

Payment of Dividends and Stock Repurchases

The Company is limited in its ability to pay dividends or repurchase its stock by the Federal Reserve, including if doing so would be an unsafe or unsound banking practice. When a bank holding company intends to declare or pay a dividend that could raise safety and soundness concerns, it generally will be required to inform and consult with the Federal Reserve in advance. It is the policy of the Federal Reserve that a bank holding company should generally pay dividends on common stock only out of earnings, and only if prospective earnings retention is consistent with the company's capital needs and overall current and prospective financial condition. Additionally, bank holding companies should inform and consult with the Federal Reserve in advance of declaring and paying a dividend that exceeds earnings for the period for which the dividend is being paid. We consulted the Federal Reserve in advance of our distribution of $27.0 million to our S Corporation shareholders, which exceeded earnings for the period for which the dividend was paid, from our federal accumulated adjustments account in 2021.

Because the Company operates under the Small Bank Holding Company Policy Statement, the Federal Reserve will generally expect the Company not to pay dividends unless its debt to equity ratio is 1:1 or lower, the Company meets certain other criteria under the Federal Reserve's Regulation Y, and the dividends are reasonable in amount, do not adversely affect the ability of the Company to service its debt in an orderly manner, and do not adversely affect the ability of the Bank to be well-capitalized. Although the Company currently meets these requirements, the Company cannot be sure that it will continue to meet those requirements or that even if it does, it will be able to pay dividends.

If a bank holding company does not operate under the Small Bank Holding Company Policy Statement, according to guidance from the Federal Reserve, the bank holding company's dividend policies will be assessed against, among other things, its ability to achieve applicable capital ratio requirements. If a bank holding company does not achieve applicable capital ratio requirements, it may not be able to pay dividends. The Company cannot be sure that it would meet those requirements or that even if it does, it would be able to pay dividends.

A bank holding company is required to give the Federal Reserve prior written notice before purchasing or redeeming its equity securities if the gross consideration for the purchase or redemption, when aggregated with the net consideration paid by the Company for all such purchases or redemptions during the preceding 12 months, is equal to 10.00% or more of the Company's consolidated net worth. The Federal Reserve may disapprove such a purchase or redemption if it determines that the proposal would constitute an unsafe or unsound practice or would violate any law, regulation, Federal Reserve order, or any condition imposed by or written agreement with the Federal Reserve. This prior notice requirement does not apply to any bank holding company that meets certain "well-capitalized" and "well-managed" standards and is not the subject of any unresolved supervisory issues.

In addition, a bank holding company is required to consult with the Federal Reserve before redeeming any equity or other capital instrument included in Tier 1 or Tier 2 capital prior to stated maturity if such redemption could have a material effect on the level or composition of the organization’s capital base. For bank holding companies subject to the Small Bank Holding Company Policy Statement, such consultation is only required for the redemption of instruments included in equity as defined under accounting principles generally accepted in the United States of America (“GAAP”), such as common and perpetual preferred stock, and not for certain other instruments included as regulatory capital.

Examinations

Bank holding companies and banks are subject to regular examination by their respective regulatory agencies, which results in examination reports and ratings that, while not publicly available, can impact the conduct and growth of their businesses. These examinations may consider not only compliance with applicable laws and regulations, but also capital levels, asset quality and risk, management ability and performance, earnings, liquidity, sensitivity to market risk, and various other factors. The regulatory agencies generally have broad authority to impose restrictions and limitations on the operations of a regulated entity when an agency determines, among other things, that such operations are unsafe or unsound, fail to comply with applicable law, or are otherwise inconsistent with laws and regulations or with the supervisory policies of these agencies.

Anti-Money Laundering Initiatives and Sanctions Compliance

The Company and Bank are subject to extensive regulations aimed at combatting money laundering and terrorist financing. The Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act of 2001 (the “Patriot Act”) substantially broadened the scope of U.S. anti-money laundering laws and regulations by imposing significant compliance and due diligence obligations, creating new crimes and penalties, and expanding the extra-territorial jurisdiction of the United States. Treasury Department regulations implementing the Patriot Act impose obligations on financial institutions to maintain appropriate policies, procedures, and controls to detect, prevent, and report money laundering and terrorist financing and to verify the identity of their customers. In addition, the Anti-Money Laundering Act of 2020 (the “AML Act”), enacted in January 2021, includes the most substantial changes to U.S. anti-money laundering law since the Patriot Act. Among other things, the AML Act creates new beneficial ownership reporting requirements for certain entities doing business in the United States, requires the Treasury Department’s Financial Crimes Enforcement Network to establish national anti-money laundering priorities and combating the financing of terrorism priorities, increases anti-money laundering whistleblower awards and expands whistleblower protections, and enhances penalties for Bank Secrecy Act and anti-money laundering violations. Failure of a financial institution to maintain and implement adequate programs to combat money laundering and terrorist financing, or to comply with all of the relevant laws or regulations, could have serious legal and financial consequences for the institution.

The Treasury Department’s Office of Foreign Assets Control (“OFAC”) is responsible for helping to ensure that U.S. entities do not engage in transactions with certain prohibited parties, as defined by various Executive Orders and Acts of Congress. OFAC publishes lists of persons, organizations, and countries suspected of aiding, harboring, or engaging in terrorist acts, known as Specially Designated Nationals and Blocked Persons. OFAC administers and enforces applicable economic and trade sanctions programs. These sanctions are usually targeted against foreign countries, terrorists, international narcotics traffickers, and those believed to be involved in the proliferation of weapons of mass destruction. These regulations generally require either the blocking of accounts or other property of specified entities or individuals, but they may also require the rejection of certain transactions involving specified entities or individuals. The Company maintains policies, procedures, and other internal controls designed to comply with anti-money laundering requirements and sanctions programs.

Sarbanes-Oxley Act

The Sarbanes-Oxley Act represents a comprehensive revision of laws affecting corporate governance, accounting obligations, and corporate reporting. The Sarbanes-Oxley Act is applicable to all companies with equity securities registered, or that file reports, under the Exchange Act. In particular, the act established: (i) requirements for audit committees, including independence, expertise, and responsibilities; (ii) responsibilities regarding financial statements for the chief executive officer and chief financial officer of the reporting company and new requirements for them to certify the accuracy of periodic reports; (iii) standards for auditors and regulation of audits; (iv) disclosure and reporting obligations for the reporting company and its directors and executive officers; and (v) civil and criminal penalties for violations of the federal securities laws. The legislation also established a new accounting oversight board to enforce auditing standards and restrict the scope of services that accounting firms may provide to their publicly traded company audit clients.

Supervision and Regulation of the Bank

The Bank is a commercial bank chartered under the laws of the state of California and is primarily subject to the supervision, examination, and reporting requirements of the FDIC and the DFPI. Almost every area of the operations and financial condition of the Bank is subject to extensive regulation and supervision and to various requirements and restrictions under federal and state law, including loans, reserves, investments, issuance of securities, establishment of branches, capital adequacy, liquidity, earnings, dividends, management practices, and the provision of services. The FDIC and the DFPI regularly examine the Bank's operations and have the authority to approve or disapprove mergers, the establishment of branches, and similar corporate actions. Both regulatory agencies have the power to take enforcement action to prevent the development or continuance of unsafe or unsound banking practices or other violations of law. The Bank is subject to supervision, examination, enforcement, and reporting requirements under the FDI Act, the California Financial Code, regulations of the FDIC and DFPI, and certain of the requirements imposed by the Dodd-Frank Act. The Company and the Bank are also subject to a wide range of consumer protection laws and regulations.

<u>California Law</u>

California law governs the chartering and regulation of California commercial banks like ours, including organizational and capital requirements, fiduciary powers, investment authority, banking offices and electronic terminals, declaration of dividends, changes of control and mergers, out of state activities, interstate branching and banking, debt offerings, borrowing limits, and limits on loans to one borrower. The DFPI is charged with the Bank's supervision and regulation. The DFPI may take possession of a bank if certain conditions exist, such as insufficient shareholders' equity, unsafe or unauthorized operations, or violations of law.

Under California law, we may engage in the general business of banking, including, but not limited to, accepting deposits, making secured and unsecured loans, purchasing and holding real property for our own use, and issuing, advising, and confirming letters of credit. The amount a bank generally may borrow may not exceed the amount of its shareholders' equity without the consent of the DFPI.

<u>Restrictions on Lending, Insider Transactions, and Affiliate Transactions</u>

California law limits California banks in the amount they may lend to one borrower and the amount they may lend to insiders. Under California law, with limited exceptions, unsecured loans to one person may not exceed 15.00% of the sum of a bank's shareholders' equity, allowance for loan losses, capital notes, and debentures. Additionally, both secured and unsecured loans to one person (excluding certain secured lending and letters of credit) at any given time generally may not exceed 25.00% of the sum of a bank's shareholders' equity, allowance for loan losses, capital notes, and debentures.

Section 22(g) of the Federal Reserve Act, as implemented by the Federal Reserve's Regulation O, governs and restricts extensions of credit by a member bank to an executive officer, director, or principal shareholder of the bank and its affiliates. By making these provisions applicable to state non-member banks, the FDI Act and FDIC regulations impose these restrictions on the Bank's purchases or sales of assets from insiders of the Bank and the Company. Additionally, California law imposes insider lending limits that are similar to the restrictions of the Federal Reserve's Regulation O.

Sections 23A and 23B of the Federal Reserve Act, which the FDI Act makes applicable to a state non-member bank like ours in the same manner and to the same extent as if it were a member bank, establish parameters for an insured bank to conduct "covered transactions" with its affiliates, generally: (i) limiting the extent to which the bank or its subsidiaries may engage in "covered transactions" with any one affiliate to an amount not greater than 10.00% of the bank's capital stock and surplus, and limiting the aggregate of all such transactions with all affiliates to an amount not greater than 20.00% of the bank's capital stock and surplus; and (ii) requiring that all such transactions be on terms substantially the same, or at least as favorable, to the bank or subsidiary as those that would be provided to a non-affiliate. In addition, an insured bank's loans to affiliates generally must be fully collateralized. The term "covered transaction" includes the making of loans to the affiliate, purchase of assets from the affiliate, issuance of a guarantee on behalf of the affiliate, and several other types of transactions.

<u>Concentrations in Lending</u>

In 2006, the federal bank regulatory agencies released guidance advising financial institutions of the risks posed by commercial real estate lending concentrations and reinforcing that financial institutions should implement sound risk management processes to identify, monitor, and control risks associated with commercial real estate concentrations. Higher allowances for loan losses and capital levels may also be required. The commercial real estate guidance provides that further supervisory analysis of an institution's commercial real estate loan concentrations is warranted when its concentrations exceed either: (i) total reported loans for construction, land development, and other land of 100.00% or more of a bank's total risk-based capital; or (ii) total reported loans secured by multifamily and non-farm non-residential properties and loans for construction, land development, and other land of 300.00% or more of a bank's total risk-based capital, where the outstanding balance of the institution's commercial real estate portfolio has also increased by 50.00% or more during the prior 36 months. We have exposures to loans secured by commercial real estate due to the nature of our market and the loan needs of both our retail and commercial customers. We believe that our long-term experience in commercial real estate lending, underwriting policies, internal controls, and other policies currently in place, as well as our loan and credit monitoring and administration procedures, are generally appropriate to managing our concentrations as required under the commercial real estate guidance.

Prompt Corrective Action

The FDI Act identifies five capital categories for insured depository institutions: well-capitalized, adequately capitalized, undercapitalized, significantly undercapitalized, and critically undercapitalized. Under the banking agencies' prompt corrective action framework, an insured depository institution is subject to differential regulation corresponding to the capital category within which the institution falls. For an insured depository institution to be "well-capitalized" under this framework, it must have a common equity Tier 1 capital ratio of at least 6.50%, a Tier 1 capital ratio of at least 8.00%, a total capital ratio of at least 10.00%, and a leverage ratio of at least 5.00%, and must not be subject to any written agreement, order or capital directive, or prompt corrective action directive issued by its primary federal or state banking regulator to meet and maintain a specific capital level for any capital measure. These limitations apply to the Bank, and not to the Company on a standalone basis.

The FDI Act requires the federal banking agencies to take prompt corrective action whenever an insured depository institution does not meet minimum capital requirements. Failure to meet the capital guidelines could also subject an insured depository institution to capital raising requirements. In addition, an insured depository institution is generally prohibited from making capital distributions, including paying dividends or paying management fees to a holding company, if the institution would thereafter be undercapitalized. Finally, failure to meet statutorily mandated capital guidelines or more restrictive ratios separately established for an insured depository institution could subject the institution to a variety of enforcement remedies available to federal regulatory authorities, including issuance of a capital directive, the termination of deposit insurance by the FDIC, a prohibition on accepting or renewing brokered deposits, limitations on the rates of interest that the institution may pay on its deposits, and other restrictions on its business.

The FDI Act also requires the federal banking agencies to prescribe certain noncapital standards for safety and soundness relating generally to operations and management, asset quality, and executive compensation, and permits regulatory action against an insured depository institution that does not meet such standards.

Payment of Dividends

The principal source of the Company's cash flow is dividends from the Bank. There are 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, the Bank may not make any distribution to shareholders that exceeds the lesser of its retained earnings or its net income for the last three fiscal years, less the amount of any distributions made by the Bank to shareholders of the Bank during such period. However, with prior approval of the DFPI, the Bank may make a distribution to shareholders that exceeds such amounts, subject to limits set forth in the California Financial Code. Moreover, an institution's failure to exceed the capital conservation buffer set forth in the federal banking agencies' capital rules with common equity Tier 1 capital would result in limitations on an institution's ability to make capital distributions and discretionary bonus payments. In addition, an insured depository institution is generally prohibited from making capital distributions, including paying dividends or paying management fees to a holding company, if the institution would thereafter be undercapitalized. Finally, the FDI Act prohibits an insured depository institution from paying dividends on its capital stock if it is in default of its payment of deposit insurance assessments to the FDIC.

Reserve Requirements

Federal Reserve rules require depository institutions, such as the Bank, to maintain reserves against their transaction accounts. In response to the COVID-19 pandemic, the Federal Reserve reduced reserve requirement ratios to 0.00% effective March 26, 2020. Increases to the reserve requirement would decrease the amount of the Bank's assets that it may make available for lending and investment activities. Currently, the Federal Reserve has no plans to re-impose reserve requirements. However, the Federal Reserve may adjust reserve requirement ratios in the future if conditions warrant. Balances maintained by or on behalf of depository institutions in accounts at Reserve Banks continue to receive interest when reserve requirement ratios are set to zero percent. All balances earned the interest on excess reserves rate through July 28, 2021. Thereafter, all balances earn the Interest on Reserve Balances (the "IORB") rate. The IORB rate is the rate of interest paid by the Federal Reserve Bank on balances maintained by or on behalf of an eligible institution in an account at a Federal Reserve Bank. The Board of Governors votes on the level of the IORB rate at each Federal Open Market Committee meeting that is consistent with the announced monetary policy stance. The amount of interest on reserve balances is calculated by multiplying the IORB rate on a day by the end of day balance maintained in an account on that day.

Consumer Protection Laws

While consumer lending is not currently a significant focus of our business, we are subject to numerous laws and regulations intended to protect consumers, in addition to those discussed above, when lending or offering deposit products to consumers. These laws include, among others: the Truth in Lending Act, the Truth in Savings Act, the Electronic Fund Transfer Act, the Expedited Funds Availability Act, the Equal Credit Opportunity Act, the Fair and Accurate Credit Transactions Act, the Fair Housing Act, the Fair Credit Reporting Act, the Fair Debt Collection Act, the GLB Act, the Home Mortgage Disclosure Act, the Right to Financial Privacy Act, the Real Estate Settlement Procedures Act, laws regarding unfair and deceptive acts, and practices and usury laws. Additionally, the Dodd-Frank Act created the CFPB, which has authority to issue regulations prohibiting unfair, deceptive, or abusive acts or practices.

Many states and local jurisdictions have consumer protection laws analogous, and in addition to, those listed above. These include, for instance, the California Unfair Competition Law, which broadly prohibits any unlawful, unfair, or fraudulent business act or practice, and false, deceptive, or misleading advertising. Violations of applicable consumer protection laws can result in significant potential liability, including actual damages, restitution, and injunctive relief, from litigation brought by customers, state attorneys general, and other plaintiffs, as well as enforcement actions by banking regulators.

Financial Privacy Laws

The GLB Act and California Consumer Privacy Act impose requirements related to the privacy of customer financial information. Among other things, these laws require disclosure of privacy policies to consumers and, in some circumstances, allow consumers to prevent disclosure of certain personal information to a nonaffiliated third party. The California Consumer Privacy Act grants California residents the rights to know about personal information collected about them, to delete certain of this personal information, to opt out of the sale of personal information, and to non-discrimination for exercising these rights. The privacy provisions of these laws may affect how consumer information is transmitted through diversified financial companies and conveyed to outside vendors.

Branching

Under California law, the Bank may open branch offices throughout California with the prior approval of the DFPI. In addition, with prior DFPI approval, the Bank may acquire branches of existing banks located in California. Under federal law, the Bank may establish branch offices with the prior approval of the FDIC. Federal law allows a bank to branch into a new state through the establishment of a new branch if, among other factors, the bank is “well-managed” and “well-capitalized” and, under the laws of the state in which the branch is to be located, a state bank chartered by that state would be permitted to establish the branch.

FDIC Deposit Insurance Assessments

The deposits of the Bank are insured by the DIF as administered by the FDIC and, accordingly, are subject to deposit insurance assessments to maintain the DIF at minimum levels required by statute. The Dodd-Frank Act increased the minimum reserve ratio requirement for the DIF to 1.35% of total estimated insured deposits or the comparable percentage of the deposit assessment base. Since the outbreak of the COVID-19 pandemic, the amount of total estimated insured deposits has grown very rapidly while the funds in the DIF grew at a normal rate. As a result, the DIF reserve ratio fell to below the statutory minimum of 1.35%. The FDIC adopted a restoration plan on September 15, 2020, to restore the DIF reserve ratio to at least 1.35% by September 30, 2028. Under the restoration plan, the FDIC will continue to closely monitor the factors that affect the DIF reserve ratio and maintain its current schedule of assessment rates. The FDIC expects the surge of insured deposits resulting from the COVID-19 pandemic to eventually recede and insured deposit growth rates to normalize in the medium- to long-term.

The FDIC uses a risk-based assessment system that imposes insurance premiums as determined by multiplying an insured bank’s assessment base by its assessment rate. A bank’s deposit insurance assessment base is generally equal to its total assets minus its average tangible equity during the assessment period. For a depository institution that has been insured for more than five years and that has total consolidated assets of less than $10.0 billion, such as the Bank, the FDIC determines the assessment rate within a range of base assessment rates based on the bank’s CAMELS composite rating, considering other factors and adjustments. The CAMELS rating system is a supervisory rating system developed to classify a bank’s overall condition by considering capital adequacy, assets, management capability, earnings, liquidity, and sensitivity to market and interest rate risk.

Insurance of deposits may be terminated by the FDIC upon a finding that a bank has engaged in unsafe and unsound practices, is in an unsafe or unsound condition to continue operations, or has violated any applicable law, regulation, rule, order, or condition imposed by the bank's federal regulatory agency. In addition, the FDI Act provides that, in the event of the liquidation or other resolution of an insured depository institution, the claims of depositors of the institution, including the claims of the FDIC as subrogee of insured depositors, and certain claims for administrative expenses of the FDIC as a receiver, will have priority over other general unsecured claims against the institution, including those of its parent bank holding company.

Community Reinvestment Act ("CRA")

The CRA requires that, in connection with examinations of insured depository institutions within their respective jurisdictions, the federal banking agencies must evaluate the record of each financial institution in meeting the credit needs of its local community, including low- and moderate-income neighborhoods. A bank's CRA performance is also considered in evaluating applications seeking approval for mergers, acquisitions, and new offices or facilities, and a CRA rating of less than "Satisfactory" may adversely affect the ability of a bank or its parent company to engage in such transactions. The FDIC's evaluation of the Bank's record of performance under the CRA is publicly available. The FDIC's CRA regulations provide that a bank may elect to have its CRA performance evaluated under a strategic plan. This option enables a bank to structure its CRA goals and objectives to address the needs of its community consistent with its business strategy, operational focus, capacity, and constraints. The Bank is operating under a CRA Strategic Plan approved by the FDIC for the years 2019-2021 and has received a rating of "Satisfactory" at its most recent CRA evaluation, dated as of May 3, 2021.

Federal Home Loan Bank of San Francisco ("FHLB") Membership

The Bank is a member of the FHLB, which is one of 12 regional Federal Home Loan Banks that administer the home financing credit function of banking institutions. Each Federal Home Loan Bank is funded primarily from proceeds derived from the sale of consolidated obligations of the Federal Home Loan Bank system and makes advances to members in accordance with policies and procedures established by the Board of Directors of the Federal Home Loan Bank and subject to the oversight of the Federal Housing Finance Agency. All advances from a Federal Home Loan Bank are required to be fully secured by sufficient collateral as determined by the Federal Home Loan Bank. In addition, all long-term advances are required to provide funds for residential home financing.

Cybersecurity

Federal banking agencies pay close attention to the cybersecurity practices of banks and their holding companies and affiliates. The interagency council of the agencies, the Federal Financial Institutions Examination Council (the "FFIEC"), has issued several policy statements and other guidance for banks as new cybersecurity threats arise. The FFIEC has recently focused on such matters as compromised customer credentials and business continuity planning. Examinations by the banking agencies now include review of an institution's information technology and its ability to thwart cyberattacks.

A final rule that the federal banking agencies issued in November 2021 requires banking organizations to notify their primary federal regulator of significant computer security incidents within 36 hours of determining that such an incident has occurred. The compliance date of this rule is May 1, 2022.

Limitations on Incentive Compensation

In April 2016, the Federal Reserve and other federal financial agencies re-proposed restrictions on incentive-based compensation pursuant to Section 956 of the Dodd-Frank Act for financial institutions with $1.0 billion or more in total consolidated assets. For institutions with at least $1.0 billion but less than $50.0 billion in total consolidated assets, the proposal would impose principles-based restrictions that are broadly consistent with existing interagency guidance on incentive-based compensation. Such institutions would be prohibited from entering into incentive compensation arrangements that encourage inappropriate risks by the institution: (i) by providing an executive officer, employee, director, or principal shareholder with excessive compensation, fees, or benefits; or (ii) that could lead to material financial loss to the institution. The proposal would also impose certain governance and recordkeeping requirements on institutions covered by the rule. Whether or when the agencies will finalize the proposal is uncertain.

Coronavirus Aid, Relief, and Economic Security Act

On March 27, 2020, the CARES Act was enacted, providing wide-ranging economic relief for individuals and businesses impacted by COVID-19. Among other things, the statute created the PPP and funded it with $349.0 billion. On April 16, 2020, the SBA announced that it had exhausted the $349.0 billion appropriated to it in the CARES Act. On April 24, 2020, the PPP and Health Care Enhancement Act was signed into law, which supplemented certain programs established by the CARES Act and provided additional funding for the PPP. The PPP expired on August 8, 2020. The Consolidated Appropriations Act, which was signed into law on December 27, 2020, provided additional funding for the PPP of approximately $284.0 billion. The act also permitted eligible borrowers, including certain borrowers who had already received a PPP loan, to apply for PPP loans through March 31, 2021. The American Rescue Plan Act, which was enacted on March 11, 2021, expanded the eligibility criteria for PPP loans and revised the exclusions from payroll costs for purposes of loan forgiveness. The PPP Extension Act, which became law on March 30, 2021, extended the deadline to apply for a PPP loan through May 31, 2021.

The CARES Act, as amended by the Consolidated Appropriations Act, specified that COVID-19-related loan modifications executed between March 1, 2020 and the earlier of: (i) 60 days after the date of termination of the national emergency declared by the President; and (ii) January 1, 2022, on loans that were current as of December 31, 2019 are not troubled debt restructurings ("TDRs"). Additionally, under guidance from the federal banking agencies, other short-term modifications made on a good faith basis in response to COVID-19 to borrowers that were current prior to any relief are not TDRs under Accounting Standards Codification ("ASC") Subtopic 310-40, "Troubled Debt Restructuring by Creditors." These modifications include short-term (e.g., up to six months) modifications such as payment deferrals, fee waivers, extensions of repayment terms, or delays in payment that are insignificant.

The PPP was a stimulus response to the economic impacts of COVID-19, and its purpose was to provide forgivable loans to smaller businesses, non-profit organizations, and other eligible borrowers that use the proceeds of the loans for payroll and certain other qualifying expenses. The SBA manages the PPP and guarantees PPP loans. If a loan is fully forgiven, the SBA will repay the lending bank in full. If a loan is partially forgiven or not forgiven at all, a bank must look to the borrower for repayment of unforgiven principal and interest. If the borrower defaults, the loan is guaranteed by the SBA.

As of December 31, 2021, we had provided approximately $377.4 million in PPP loans for more than 1,500 new and existing customers and we were processing loan forgiveness applications.

Item 1A. Risk Factors

Certain factors may have an adverse effect on our business, financial condition, and results of operations. You should carefully consider the following risks, together with all of the other information contained in this Annual Report on Form 10-K, including the sections entitled "Cautionary Note Regarding Forward-Looking Statements" and "Management's Discussion and Analysis of Financial Condition and Results of Operations" and our financial statements and the related notes thereto. Any of the following risks could have an adverse effect on our business, financial condition, and results of operations and could cause the trading price of our common stock to decline, which would cause you to lose all or part of your investment. Our business, financial condition, and results of operations could also be harmed by risks and uncertainties not currently known to us or that we currently do not believe are material.

Risk Factor Summary

The most significant risks that may have an adverse effect on our business, financial condition, and results of operations are summarized below.

- Our business and operations are concentrated in Northern California, and we are sensitive to adverse changes in the local economy.
- We operate in a highly competitive market and face increasing competition from traditional and new financial services providers.
- We are subject to the various risks associated with our banking business and operations, including, among others, credit, market, liquidity, interest rate, and compliance risks, which may have an adverse effect on our business, financial condition, and results of operations if we are unable to manage such risks.
- We may be unable to effectively manage our growth, which could have an adverse effect on our business, financial condition, and results of operations.

- We operate in a highly regulated industry, and the current regulatory framework and any future legislative and regulatory changes may have an adverse effect on our business, financial condition, and results of operations.

- We are subject to regulatory requirements, including stringent capital requirements, consumer protection laws, and anti-money laundering laws, and failure to comply with these requirements could have an adverse effect on our business, financial condition, and results of operations.

- We are subject to laws regarding privacy, information security, and protection of personal information, and any violation of these laws or incidents involving personal, confidential, or proprietary information of individuals, including, among others, system failures or cybersecurity breaches of our network security, could damage our reputation and otherwise adversely affect our business, financial condition, and results of operations.

- We recently terminated our status as an S Corporation for federal income tax purposes in connection with our IPO and may be subject to claims from taxing authorities related to our prior S Corporation status.

- Our charter documents contain certain provisions, including anti-takeover and exclusive forum provisions, that limit the ability of our shareholders to take certain actions and could delay or discourage takeover attempts that shareholders may consider favorable.

- We are subject to risks associated with the COVID-19 pandemic, which could have an adverse effect on our business, financial condition, and results of operations.

Risks Related to Our Business

Our business and operations are concentrated in California, specifically Northern California, and we are more sensitive than our more geographically diversified competitors to adverse changes in the local economy.

Unlike many of our larger competitors that maintain significant operations located outside our market, substantially all of our customers are individuals and businesses located and doing business in the state of California. As of December 31, 2021, approximately 69.13% of our real estate loans measured by dollar amount were secured by collateral located in California, substantially all of which is in Northern California. Therefore, our success will depend upon the general economic conditions and real estate activity in these areas, which we cannot predict with certainty. As a result, our operations and profitability may be more adversely affected by a local economic downturn than those of large, more geographically diverse competitors. A downturn in the local economy could make it more difficult for our borrowers to repay their loans, may lead to loan losses that are not offset by operations in other markets, and may also reduce the ability of depositors to make or maintain deposits with us. In addition, businesses operating in Northern California, and Sacramento in particular, depend on California state government employees for business, and reduced spending activity by such employees in the event of furloughing or termination of such employees could have an adverse impact on the success or failure of these businesses, some of which are current or could become future customers of the Bank. For these reasons, any regional or local economic downturn could have an adverse effect on our business, financial condition, and results of operations.

The small to medium-sized businesses to which we lend may have fewer resources to weather adverse business developments, which may impair a borrower’s ability to repay a loan.

We target our business development and marketing strategy primarily to serve the banking and financial services needs of small to medium-sized businesses. These businesses generally have fewer financial resources in terms of capital or borrowing capacity than larger entities, frequently have smaller market shares than their competition, may be more vulnerable to economic downturns, often need substantial additional capital to expand or compete, and may experience substantial volatility in operating results, any of which may impair their ability as a borrower to repay a loan. These factors may be especially true given the effects of the COVID-19 pandemic. In addition, the success of small and medium-sized businesses often depends on the management skills, talents, and efforts of one or two people or a small group of people, and the death, disability, or resignation of one or more of these people could have an adverse impact on the business and its ability to repay its loan. If general economic conditions negatively impact the markets in which we operate or any of our borrowers are otherwise affected by adverse business developments, our small to medium-sized borrowers may be disproportionately affected and their ability to repay outstanding loans may be negatively affected, resulting in an adverse effect on our business, financial condition, and results of operations.

Our business is significantly dependent on the real estate markets in which we operate, as a significant percentage of our loan portfolio is secured by real estate.

As of December 31, 2021, approximately 89.31% of our loan portfolio was comprised of loans with real estate as a primary or secondary component of collateral, with a majority of these real estate loans concentrated in Northern California. Real property values in our market may be different from, and in some instances worse than, real property values in other markets or in the United States as a whole and may be affected by a variety of factors outside of our control and the control of our borrowers, including national and local economic conditions, generally. Declines in real estate values, including prices for homes and commercial properties, could result in a deterioration of the credit quality of our borrowers, an increase in the number of loan delinquencies, defaults, and charge-offs, and reduced demand for our products and services, generally. Our commercial real estate loans may have a greater risk of loss than residential mortgage loans, in part because these loans are generally larger or more complex to underwrite. In particular, real estate construction and acquisition and development loans have risks not present in other types of loans, including risks associated with construction cost overruns, project completion risk, general contractor credit risk, and risks associated with the ultimate sale or use of the completed construction. In addition, declines in real property values in California could reduce the value of any collateral we realize following a default on these loans and could adversely affect our ability to continue to grow our loan portfolio consistent with our underwriting standards. We may have to foreclose on real estate assets if borrowers default on their loans, in which case we are required to record the related asset to the then-fair market value of the collateral, which may ultimately result in a loss. An increase in the level of nonperforming assets increases our risk profile and may affect the capital levels regulators believe are appropriate in light of the ensuing risk profile. Our failure to effectively mitigate these risks could have an adverse effect on our business, financial condition, and results of operations.

We are subject to interest rate risk, which could adversely affect our profitability.

Our profitability, like that of most financial institutions of our type, depends to a large extent on our net interest income, which is the difference between our interest income on interest-earning assets, such as loans and investment securities, and our interest expense on interest-bearing liabilities, such as deposits and borrowings. Changes in interest rates can increase or decrease our net interest income because different types of assets and liabilities may react differently, and at different times, to market interest rate changes.

Interest rates are highly sensitive to many factors that are beyond our control, including general economic conditions and policies of various governmental and regulatory agencies and, in particular, the Federal Reserve, which has suggested that it may take steps to raise interest rates in 2022. Changes in monetary policy, including changes in interest rates, could influence not only the interest we receive on loans and securities and the interest we pay on deposits and borrowings, but such changes could also affect our ability to originate loans and obtain deposits, the fair value of our financial assets and liabilities, and the average duration of our assets and liabilities. If the interest rates paid on deposits and other borrowings increase at a faster rate than the interest rates received on loans and other investments, our net interest income, and therefore earnings, could be adversely affected. Earnings could also be adversely affected if the interest rates received on loans and other investments fall more quickly than the interest rates paid on deposits and other borrowings. Any substantial, unexpected, or prolonged change in market interest rates could have an adverse effect on our business, financial condition, and results of operations. As of December 31, 2021, 73.13% of our interest-earning assets and 92.62% of our interest-bearing liabilities were variable rate, where our variable rate liabilities reprice at a slower rate than our variable rate assets.

In addition, an increase in interest rates could also have a negative impact on our results of operations by reducing the demand for loans, decreasing the ability of borrowers to repay their current loan obligations, and increasing early withdrawals on term deposits. These circumstances could not only result in increased loan defaults, foreclosures, and charge-offs, but also reduce collateral values and necessitate further increases to the allowance for loan losses, which could have an adverse effect on our business, financial condition, and results of operations. The Federal Reserve has indicated that it expects it will soon be appropriate to raise the target range for the federal funds rate. In contrast, a decrease in the general level of interest rates, such as the Federal Reserve’s sharp reduction in interest rates in response to the economic and financial effects of the COVID-19 pandemic, may affect us through, among other things, increased prepayments on our loan portfolio, and our cost of funds may not fall as quickly as yields on interest-earning assets. Our asset-liability management strategy may not be effective in mitigating exposure to the risks related to changes in market interest rates.

We operate in a highly competitive market and face increasing competition from a variety of traditional and new financial services providers.

We have many competitors. Our principal competitors are commercial and community banks, credit unions, savings and loan associations, mortgage banking firms and online mortgage lenders, and commercial and consumer finance companies, including large national financial institutions that operate in our market. Many of these competitors are larger than we are, have significantly more resources, greater brand recognition, and more extensive and established branch networks or geographic footprints than we do, and may be able to attract customers more effectively than we can. Because of their scale, many of these competitors can be more aggressive on loan and deposit pricing than we can and may better afford and make broader use of media advertising, support services, and electronic technology than we do. Also, many of our non-bank competitors have fewer regulatory constraints and may have lower cost structures. We compete with these other financial institutions both in attracting deposits and making loans. We expect competition to continue to increase as a result of legislative, regulatory, and technological changes, the continuing trend of consolidation in the financial services industry, and the emergence of alternative banking sources. Our profitability in large part depends upon our continued ability to compete successfully with traditional and new financial services providers, some of which maintain a physical presence in our market and others of which maintain only a virtual presence. Increased competition could require us to increase the rates we pay on deposits or lower the rates that we offer on loans, which could reduce our profitability.

Additionally, like many of our competitors, we rely on customer deposits as our primary source of funding for our lending activities, and we continue to seek and compete for customer deposits to maintain this funding base. Our future growth will largely depend on our ability to retain and grow our deposit base. As of December 31, 2021, we had $2.3 billion in deposits and a loan to deposit ratio of 85.09%. As of the same date, using deposit account related information such as tax identification numbers, account vesting, and account size, we estimated that $1.3 billion of our deposits exceeded the FDIC deposit insurance limits. Additionally, we have $366.9 million of governmental deposits secured by collateral. Although we have historically maintained a high deposit customer retention rate, these deposits are subject to potentially dramatic fluctuations in availability or price due to certain factors outside of our control, such as increasing competitive pressures for deposits, changes in interest rates and returns on other investment classes, customer perceptions of our financial health and general reputation, and a loss of confidence by customers in us or the banking sector generally, which could result in significant outflows of deposits within short periods of time or significant changes in pricing necessary to maintain current customer deposits or attract additional deposits. Additionally, any such loss of funds could result in lower loan originations, which could have an adverse effect on our business, financial condition, and results of operations. Our failure to compete effectively in our market could restrain our growth or cause us to lose market share, which could have an adverse effect on our business, financial condition, and results of operations.

Failure to keep up with the rapid technological changes in the financial services industry could have an adverse effect on our competitive position and profitability.

The financial services industry is undergoing rapid technological changes, with frequent introductions of new technology-driven products and services. The effective use of technology increases efficiency and enables financial institutions to better serve customers and reduce costs. Our future success will depend, in part, upon our ability to address the needs of our customers by using technology to provide products and services that will satisfy customer demands for convenience, as well as to create additional efficiencies in our operations. Many of our competitors have substantially greater resources to invest in technological improvements than we do. We may not be able to implement new technology-driven products and services effectively or be successful in marketing these products and services to our customers. Failure to keep pace successfully with technological change affecting the financial services industry could harm our ability to compete effectively and could have an adverse effect on our business, financial condition, and results of operations. As these technologies improve in the future, we may be required to make significant capital expenditures in order to remain competitive, which may increase our overall expenses and have an adverse effect on our business, financial condition, and results of operations.

We are dependent on the use of data and modeling in both our management's decision-making generally and in meeting regulatory expectations in particular.

The use of statistical and quantitative models and other quantitatively based analyses is endemic to bank decision making and regulatory compliance processes, and the employment of such analyses is becoming increasingly widespread in our operations. Liquidity stress testing, interest rate sensitivity analysis, allowance for loan loss measurement, portfolio stress testing, and the identification of possible violations of anti-money laundering regulations are examples of areas in which we are dependent on models and the data that underlie them. We anticipate that model-derived insights will be used more widely in our decision making in the future. While these quantitative techniques and approaches improve our decision making, they also create the possibility that faulty data or flawed quantitative approaches could yield adverse outcomes or regulatory scrutiny. Secondarily, because of the complexity inherent in these approaches, misunderstanding or misuse of their outputs could similarly result in suboptimal decision making, which could have an adverse effect on our business, financial condition, and results of operations.

We may not be able to measure and limit our credit risk adequately, which could adversely affect our profitability.

Our business depends on our ability to successfully measure and manage credit risk. As a lender, we are exposed to the risk that the principal of, or interest on, a loan will not be paid timely or at all or that the value of any collateral supporting a loan will be insufficient to cover our outstanding exposure. In addition, we are exposed to risks with respect to the period of time over which the loan may be repaid, risks relating to proper loan underwriting, risks resulting from changes in economic and industry conditions, and risks inherent in dealing with individual loans and borrowers. The creditworthiness of a borrower is affected by many factors, including local market conditions and general economic conditions. Many of our loans are made to small to medium-sized businesses that are less able to withstand competitive, economic, and financial pressures than larger borrowers. If the overall economic climate in the United States, generally, or in our market specifically, experiences material disruption, particularly due to the continuing effects of the COVID-19 pandemic, our borrowers may experience difficulties in repaying their loans, the collateral we hold may decrease in value or become illiquid, and the level of nonperforming loans, charge-offs, and delinquencies could rise and require significant additional provisions for loan losses. Additional factors related to the credit quality of multifamily residential, real estate construction, and other commercial real estate loans include the quality of management of the business and tenant vacancy rates.

Our risk management practices, such as monitoring the concentration of our loans within specific markets and our credit approval, review, and administrative practices, may not adequately reduce credit risk, and our credit administration personnel, policies, and procedures may not adequately adapt to changes in economic or any other conditions affecting customers and the quality of the loan portfolio. A failure to effectively measure and limit the credit risk associated with our loan portfolio may result in loan defaults, foreclosures, and additional charge-offs, and may necessitate that we significantly increase our allowance for loan losses, each of which could adversely affect our net income. As a result, our inability to successfully manage credit risk could have an adverse effect on our business, financial condition, and results of operations.

We are exposed to higher credit risk by our commercial real estate, commercial land and construction, commercial construction, and farmland loans.

Commercial real estate, commercial land and construction, commercial construction, and farmland-based lending usually involve higher credit risks than other types of mortgage loans. As of December 31, 2021, the following loan types accounted for the stated percentages of our loan portfolio: commercial real estate (both owner-occupied and non-owner-occupied)—81.48%; and commercial land and construction—3.16%. These types of loans also involve larger loan balances to a single borrower or groups of related borrowers. These higher credit risks are further heightened when the loans are concentrated in a small number of larger borrowers leading to relationship exposure.

Non-owner-occupied commercial real estate loans may be affected to a greater extent than residential loans by adverse conditions in real estate markets or the economy because commercial real estate borrowers' ability to repay their loans depends on successful development of their properties, in addition to the factors affecting residential real estate borrowers. These loans also involve greater risk because they generally are not fully amortizing over the loan period but have a balloon payment due at maturity. A borrower's ability to make a balloon payment typically will depend on being able to either refinance the loan or sell the underlying property in a timely manner.

Banking regulators closely supervise banks' commercial real estate lending activities and may require banks with higher levels of commercial real estate loans to implement improved underwriting, internal controls, risk management policies, and portfolio stress testing, as well as possibly higher levels of allowances for losses and capital levels as a result of commercial real estate lending growth and exposures.

Commercial land development loans and owner-occupied commercial real estate loans are typically based on the borrowers' ability to repay the loans from the cash flow of their businesses. These loans may involve greater risk because the availability of funds to repay each loan depends substantially on the success of the business itself. In addition, the assets securing the loans have the following characteristics: (i) they depreciate over time; (ii) they are difficult to appraise and liquidate; and (iii) they fluctuate in value based on the success of the business.

Commercial real estate loans, commercial and industrial loans, and construction loans are more susceptible to a risk of loss during a downturn in the business cycle. In particular, the COVID-19 pandemic could have adverse effects on our loans for office and hospitality space, which are dependent for repayment on the successful operation and management of the associated commercial real estate. Our underwriting, review, and monitoring cannot eliminate all the risks related to these loans.

We also make both secured and unsecured loans to our commercial clients. Secured commercial loans are generally collateralized by real estate, accounts receivable, inventory, equipment, or other assets owned by the borrower, or may include a personal guaranty of the business owner. Unsecured loans generally involve a higher degree of risk of loss than do secure loans because, without collateral, repayment is wholly dependent upon the success of the borrowers' businesses. Because of this lack of collateral, we are limited in our ability to collect on defaulted unsecured loans. Furthermore, the collateral that secures our secured commercial and industrial loans typically includes inventory, accounts receivable, and equipment, which, if the business is unsuccessful, usually has a value that is insufficient to satisfy the loan without a loss.

Real estate construction loans are based upon estimates of costs and values associated with the complete project. These estimates may be inaccurate, and we may be exposed to significant losses on loans for these projects.

As of December 31, 2021, real estate construction loans comprised 3.16% of our total loan portfolio and such lending involves additional risks because funds are advanced based on the security of the project, which is of uncertain value prior to its completion, and costs may exceed realizable values in declining real estate markets. Because of the uncertainties inherent in estimating construction costs and the realizable market value of the completed project and the effects of governmental regulation of real property, it is relatively difficult to evaluate accurately the total funds required to complete a project and the related loan-to-value ratio. As a result, construction loans often involve the disbursement of substantial funds with repayment dependent, in part, on the success of the ultimate project and the ability of the borrower to sell or lease the property, rather than the ability of the borrower or guarantor to repay principal and interest. If our appraisal of the value of the completed project proves to be overstated or market values or rental rates decline, we may have inadequate security for the repayment of the loan upon completion of construction of the project. If we are forced to foreclose on a project prior to or at completion due to a default, we may not be able to recover all the unpaid balance of, and accrued interest on, the loan, as well as related foreclosure and holding costs. In addition, we may be required to fund additional amounts to complete the project and may have to hold the property for an unspecified period of time while we attempt to dispose of it.

The non-guaranteed portion of SBA loans that we retain on our balance sheet as well as the guaranteed portion of SBA loans that we sell could expose us to various credit and default risks.

At December 31, 2021, our total commercial SBA loan portfolio held for investment, excluding PPP loans, was $48.0 million, representing 2.48% of total loans held for investment. During the year ended December 31, 2021, we sold 169 SBA loans with government-guaranteed portions totaling $41.4 million. The non-guaranteed portion of SBA loans have a higher degree of risk of loss as compared to the guaranteed portion of such loans, and these non-guaranteed loan portions make up a substantial majority of our remaining SBA loans.

When we sell the guaranteed portion of an SBA loan in the ordinary course of business, we are required to make certain representations and warranties to the purchaser about the SBA loan and the manner in which it was originated. Under these agreements, we may be required to repurchase the guaranteed portion of the SBA loan if we have breached any of these representations or warranties, in which case we may record a loss. In addition, if repurchase and indemnity demands increase on loans that we sell from our portfolios, our liquidity, results of operations, and financial condition could be adversely affected. Further, we generally retain the non-guaranteed portions of the SBA loans that we originate and sell, and to the extent the borrowers of such loans experience financial difficulties, our financial condition and results of operations could be adversely impacted.

Curtailment of government-guaranteed loan programs could affect a segment of our business.

One component of our business consists of originating and periodically selling U.S. government-guaranteed loans, in particular those guaranteed by the SBA. Pursuant to the Consolidated Appropriations Act, the SBA guaranteed 90% of the principal amount of each qualifying SBA loan originated under the SBA's 7(a) loan program (excluding PPP loans) through October 1, 2021. The SBA presently guarantees 75% to 90% of the principal amount of qualifying loans originated under the 7(a) loan program (excluding PPP loans). The U.S. government may not maintain the SBA 7(a) loan program, and even if it does, the guaranteed portion may not remain at its current or anticipated level. In addition, from time to time, the government agencies that guarantee these loans reach their internal limits and cease to guarantee future loans. In addition, these agencies may change their rules for qualifying loans or Congress may adopt legislation that would have the effect of discontinuing or changing the loan guarantee programs. Non-governmental programs could replace government programs for some borrowers, but the terms might not be equally acceptable. Therefore, if these changes occur, the volume of loans to small business and industrial borrowers of the types that now qualify for government-guaranteed loans could decline. Also, the profitability of the sale of the guaranteed portion of these loans could decline as a result of market displacements due to increases in interest rates, and premiums realized on the sale of the guaranteed portions could decline from current levels. As the funding and sale of the guaranteed portion of SBA 7(a) loans is a major portion of our business and a significant portion of our non-interest income, any significant changes to the SBA 7(a) loan program, such as its funding or eligibility requirements, may have an unfavorable impact on our prospects, future performance, and results of operations. The aggregate principal balance of SBA 7(a) guaranteed portions sold during the year ended December 31, 2021 was $41.4 million, as compared to $71.3 million for the year ended December 31, 2020.

As a participating lender in the SBA's PPP, we are subject to added risks, including credit, fraud, and litigation risks.

In April 2020, we began processing loan applications under the PPP as an eligible lender with the benefit of a government guarantee of loans to small business clients, many of whom have faced, or continue to face, difficulties even after being granted such a loan. PPP loans have contributed to our loan growth since March 31, 2020. The PPP Extension Act, which became law on March 31, 2021, extended the deadline to apply for a PPP loan through May 31, 2021.

As a participant in the PPP, we face increased risks, particularly in terms of credit, fraud, and litigation. The PPP opened to borrower applications shortly after the enactment of its authorizing legislation, and, as a result, there is some ambiguity in the laws, rules, and guidance regarding the program's operation. Subsequent rounds of legislation and associated agency guidance have not provided needed clarity in all instances and in certain other instances have potentially created additional inconsistencies and ambiguities. Accordingly, we are exposed to risks relating to compliance with PPP requirements, including the risk of becoming the subject of governmental investigations, enforcement actions, private litigation, and negative publicity.

We have additional credit risk with respect to PPP loans if a determination is made by the SBA that there is a deficiency in the manner in which the loan was originated, funded, or serviced, such as an issue with the eligibility of a borrower to receive a PPP loan, which may or may not be related to the ambiguity in the laws, rules, and guidance regarding the operation of the PPP. In the event of a loss resulting from a default on a PPP loan and a determination by the SBA that there was a deficiency in the manner in which the PPP loan was originated, funded, or serviced by us, the SBA may deny its liability under the guarantee, reduce the amount of the guarantee, or, if it has already paid under the guarantee, seek recovery of any loss related to the deficiency from the Bank.

Also, PPP loans are fixed, low interest rate loans that are guaranteed by the SBA and subject to numerous other regulatory requirements, and a borrower may apply to have all or a portion of the loan forgiven. If PPP borrowers fail to qualify for loan forgiveness, we face a heightened risk of holding these loans at unfavorable interest rates for an extended period of time.

Furthermore, since the launch of the PPP, several larger banks have been subject to litigation regarding the process and procedures that such banks used in processing applications for the PPP, and we may be exposed to the risk of litigation, from both customers and non-customers that approached us regarding PPP loans, relating to these or other matters. Also, many financial institutions throughout the country have been named in putative class actions regarding the alleged nonpayment of fees that may be due to certain agents who facilitated PPP loan applications. Although many of these actions have been resolved in favor of banks participating in the PPP, the costs and effects of litigation related to PPP participation could have an adverse effect on our business, financial condition, and results of operations.

Farmland real estate loans and volatility in commodity prices may adversely affect our financial condition and results of operations.

At December 31, 2021, farmland loans totaled $54.8 million, or 2.82% of our total loan portfolio. Farmland lending involves a greater degree of risk and typically involves higher principal amounts than many other types of loans. Repayment is dependent upon the successful operation of the business, which is greatly dependent on many things outside the control of either us or the borrowers. These factors include adverse weather conditions that prevent the planting of crops or limit crop yields (such as hail, drought, fires, and floods), loss of livestock due to disease or other factors, declines in market prices for agricultural products (both domestically and internationally), and the impact of government regulations (including changes in price supports, subsidies, and environmental regulations). Volatility in commodity prices could adversely impact the ability of borrowers in these industries to perform under the terms of their borrowing arrangements with us, and, as a result, a severe and prolonged decline in commodity prices may have an adverse effect on our business, financial condition, and results of operations. It is also difficult to project future commodity prices, as they are dependent upon many different factors beyond our control. In addition, many farms are dependent on a limited number of key individuals whose injury or death may significantly affect the successful operation of the farm. Consequently, farmland real estate loans may involve a greater degree of risk than other types of loans.

Liquidity risk could impair our ability to fund operations and meet our obligations as they become due.

Liquidity is essential to our business, and we monitor our liquidity and manage our liquidity risk at the holding company and bank levels. We require sufficient liquidity to fund asset growth, meet customer loan requests, facilitate customer deposit maturities and withdrawals, make payments on our debt obligations as they come due, and fulfill other cash commitments under both normal operating conditions and other unpredictable circumstances, including events causing industry or general financial market stress. Liquidity risk can increase due to a number of factors, which include, but are not limited to, an over-reliance on a particular source of funding, changes in the liquidity needs of our depositors, adverse regulatory actions against us, or a downturn in the markets in which our loans are concentrated.

Market conditions or other events could also negatively affect the level or cost of funding, affecting our ongoing ability to accommodate liability maturities and deposit withdrawals, meet contractual obligations, and fund asset growth and new business transactions at a reasonable cost, in a timely manner, and without adverse consequences. Our inability to raise funds through deposits, borrowings, the sale of loans, and other sources could have an adverse effect on our business, financial condition, and results of operations, and could result in the closure of the Bank.

Other primary sources of funds consist of cash flows from operations, maturities and sales of investment securities, and proceeds from issuance and sale of our equity and debt securities. Additional liquidity is provided by the ability to borrow from the FHLB and the Federal Reserve Bank of San Francisco to fund our operations. We may also borrow funds from third-party lenders, such as other financial institutions. Our access to funding sources in amounts adequate to finance our activities or on acceptable terms could be impaired by factors that affect our organization specifically or the financial services industry or economy in general. Our access to funding sources could also be affected by a decrease in the level of our business activity as a result of a downturn in our primary market or by one or more adverse regulatory actions against us.

Any substantial, unexpected, and/or prolonged change in the level or cost of liquidity could impair our ability to fund operations and meet our obligations as they become due and could have an adverse effect on our business, financial condition, and results of operations. Although we have historically been able to replace maturing deposits and advances if desired, we may not be able to replace such funds in the future if our financial condition, the financial condition of the FHLB, or market conditions change. FHLB borrowings and other current sources of liquidity may not be available or, if available, may not be sufficient to provide adequate funding for operations and to support our continued growth. The unavailability of sufficient funding could have an adverse effect on our business, financial condition, and results of operations.

We may be adversely affected by the soundness of other financial institutions.

Our ability to engage in routine funding transactions could be adversely affected by the actions and commercial soundness of other financial institutions. Financial services companies may be interrelated as a result of trading, clearing, counterparty, and other relationships. We have exposure to different industries and counterparties through transactions with counterparties in the financial services industry, including broker-dealers, commercial banks, investment banks, and other financial intermediaries. As a result, defaults by, declines in the financial condition of, or even rumors or questions about one or more financial services companies, or the financial services industry generally, could lead to market-wide liquidity problems and losses or defaults by us or other institutions. These losses could have an adverse effect on our business, financial condition, and results of operations.

Our risk management framework may not be effective in mitigating risks and/or losses to us.

Our risk management framework is comprised of various processes, systems, and strategies, and is designed to manage the types of risk to which we are subject, including, among others, credit, market, liquidity, interest rate, and compliance. Our framework also includes financial or other modeling methodologies that involve management assumptions and judgment. Our risk management framework may not be effective under all circumstances. Our risk management framework may not adequately mitigate any risk or loss to us. If our risk management framework is not effective, we could suffer unexpected losses and our business, financial condition, and results of operations could be adversely affected. We may also be subject to potentially adverse regulatory consequences.

We engage in lending secured by real estate and may be forced to foreclose on the collateral and own the underlying real estate, subjecting us to the costs and potential risks associated with the ownership of real property, or consumer protection initiatives or changes in state or federal law may substantially raise the cost of foreclosure or prevent us from foreclosing at all.

Since we originate loans secured by real estate, we may have to foreclose on the collateral property to protect our investment and may thereafter own and operate such property, in which case we would be exposed to the risks inherent in the ownership of real estate. The amount that we, as a mortgagee, may realize after a foreclosure depends on factors outside of our control, including, but not limited to, general or local economic conditions, environmental cleanup liabilities, assessments, interest rates, real estate tax rates, operating expenses of the mortgaged properties, our ability to obtain and maintain adequate occupancy of the properties, zoning laws, governmental and regulatory rules, and natural disasters. Our inability to manage the amount of costs or size of the risks associated with the ownership of real estate, or write-downs in the value of other real estate owned (“OREO”) could have an adverse effect on our business, financial condition, and results of operations.

Additionally, consumer protection initiatives or changes in state or federal law may substantially increase the time and expenses associated with the foreclosure process or prevent us from foreclosing at all. A number of states in recent years have either considered or adopted foreclosure reform laws that make it substantially more difficult and expensive for lenders to foreclose on properties in default. Additionally, federal and state regulators and state attorneys general have prosecuted or pursued enforcement action against a number of mortgage servicing companies for alleged consumer protection law violations. If new federal or state laws or regulations are ultimately enacted that significantly raise the cost of foreclosure or raise outright barriers to foreclosure, they could have an adverse effect on our business, financial condition, and results of operations.

Regulatory requirements affecting our loans secured by commercial real estate could limit our ability to leverage our capital and adversely affect our growth and profitability.

The federal banking agencies have issued guidance regarding concentrations in commercial real estate lending for institutions that are deemed to have particularly high concentrations of commercial real estate loans within their lending portfolios. Under this guidance, an institution that has: (i) total reported loans for construction, land development, and other land which represent 100% or more of the institution’s total risk-based capital; or (ii) total commercial real estate loans representing 300% or more of the institution’s total risk-based capital, where the outstanding balance of the institution’s commercial real estate loan portfolio has increased 50% or more during the prior 36 months, is identified as having potential commercial real estate concentration risk. An institution that is deemed to have concentrations in commercial real estate lending is expected to employ heightened levels of risk management with respect to its commercial real estate portfolios and may be required to maintain higher levels of capital. We have a concentration in commercial real estate loans, and we have experienced significant growth in our commercial real estate portfolio in recent years. From December 31, 2020 through December 31, 2021, our commercial real estate loan balances have increased by $543.0 million. As of December 31, 2021, commercial real estate loans represent 577.92% of our total risk-based capital. We cannot guarantee that any risk management practices we implement will be effective to prevent losses relating to our commercial real estate portfolio. Management has extensive experience in commercial real estate lending and has implemented and continues to maintain heightened portfolio monitoring and reporting, and strong underwriting criteria with respect to our commercial real estate portfolio. Nevertheless, we could be required to maintain higher levels of capital as a result of our commercial real estate concentration, which could limit our growth, require us to obtain additional capital, and have an adverse effect on our business, financial condition, and results of operations.

We could be subject to environmental risks and associated costs on our foreclosed real estate assets.

Our loan portfolio is secured by real property. During the ordinary course of business, we may foreclose on and take title to properties securing loans. There is a risk that hazardous or toxic substances could be found on these properties and that we could be liable for remediation costs, as well as personal injury and property damage. Environmental laws may require us to incur substantial expenses and may materially reduce the affected property’s value or limit our ability to sell the affected property. The remediation costs and any other financial liabilities associated with an environmental hazard could have an adverse effect on our business, financial condition, and results of operations.

Our recovery on commercial real estate loans could be further reduced by a lack of a liquid secondary market for such mortgage loans and mortgage-backed securities.

Our current business strategy includes an emphasis on commercial real estate lending. Although we sold $41.4 million of loans in the year ended December 31, 2021, one of which was a commercial real estate loan, we may decide to sell more loans in the future. A secondary market for most types of commercial real estate loans is not readily liquid, so we have less opportunity to mitigate credit risk by selling part or all of our interest in these loans. As a result of these characteristics, if we foreclose on a commercial real estate loan, our holding period for the collateral typically is longer than for residential mortgage loans because there are fewer potential purchasers of the collateral. Accordingly, charge-offs on commercial real estate loans may be larger as a percentage of the total principal outstanding than those incurred with our residential or consumer loan portfolios.

The appraisals and other valuation techniques we use in evaluating and monitoring loans secured by real property and OREO may not accurately reflect the net value of the asset.

In considering whether to make a loan secured by real property, we generally require an appraisal of the property. However, an appraisal is only an estimate of the value of the property at the time the appraisal is made, and as real estate values may change significantly in value in relatively short periods of time (especially in periods of heightened economic uncertainty), this estimate may not accurately reflect the net value of the collateral after the loan is made. As a result, we may not be able to realize the full amount of any remaining indebtedness when we foreclose on and sell the relevant property. In addition, we rely on appraisals and other valuation techniques to establish the value of OREO that we acquire through foreclosure proceedings and to determine loan impairments. If any of these valuations are inaccurate, our consolidated financial statements may not reflect the correct value of our OREO, if any, and our allowance for loan losses may not reflect accurate loan impairments. Inaccurate valuation of OREO or inaccurate provisioning for loan losses could have an adverse effect on our business, financial condition, and results of operations.

Federal, state, and local consumer lending laws may restrict our or our partners' ability to originate certain loans or increase our risk of liability with respect to such loans.

Federal, state, and local laws have been adopted that are intended to prevent certain lending practices considered "predatory." These laws prohibit practices such as steering borrowers away from more affordable products, selling unnecessary insurance to borrowers, repeatedly refinancing loans, and making loans without a reasonable expectation that the borrowers will be able to repay the loans irrespective of the value of the underlying property. It is our policy to determine borrowers' ability to repay and not to make predatory loans. Nonetheless, the law and related rules create the potential for increased liability with respect to our lending and loan investment activities. Compliance with these laws increases our cost of doing business.

Additionally, consumer protection initiatives or changes in state or federal law, including the CARES Act and its automatic loan forbearance provisions, may substantially increase the time and expenses associated with the foreclosure process or prevent us from foreclosing at all. A number of states in recent years have either considered or adopted foreclosure reform laws that make it substantially more difficult and expensive for lenders to foreclose on properties in default, and we cannot be certain that the state in which we operate will not adopt similar legislation in the future. Additionally, federal regulators have prosecuted or pursued enforcement actions against a number of mortgage servicing companies for alleged consumer protection law violations. If new state or federal laws or regulations are ultimately enacted that significantly raise the cost of foreclosure or raise outright barriers to foreclosure, such laws or regulations could have an adverse effect on our business, financial condition, and results of operations.

Our largest loan relationships make up a material percentage of our total loan portfolio, and credit risks relating to these would have a disproportionate impact.

As of December 31, 2021, our 30 largest borrowing relationships ranged from approximately $14.7 million to $58.9 million (including unfunded commitments) and totaled approximately $784.6 million in total commitments (representing, in the aggregate, 40.53% of our total loans held for investment as of December 31, 2021). Each of the loans associated with these relationships has been underwritten in accordance with our underwriting policies and limits. Along with other risks inherent in these loans, such as the deterioration of the underlying businesses or property securing these loans, this concentration of borrowers presents a risk that, if one or more of these relationships were to become delinquent or suffer default, we could be exposed to material losses. The allowance for loan losses may not be adequate to cover losses associated with any of these relationships, and any loss or increase in the allowance would negatively affect our earnings and capital. Even if these loans are adequately collateralized, an increase in classified assets could harm our reputation with our regulators and inhibit our ability to execute our business plan.

Our largest deposit relationships currently make up a material percentage of our deposits and the withdrawal of deposits by our largest depositors could force us to fund our business through more expensive and less stable sources.

At December 31, 2021, our 26 largest deposit relationships, each accounting for more than $10.0 million, amounted to $912.7 million, or 39.93%, of our total deposits. This includes $424.5 million in deposits from municipalities, of which we conduct a monthly review. Withdrawals of deposits by any one of our largest depositors or by one of our related customer groups could force us to rely more heavily on borrowings and other sources of funding for our business and withdrawal demands, adversely affecting our net interest margin and results of operations. If a significant amount of these deposits were withdrawn within a short period of time, it could have a negative impact on our short-term liquidity and have an adverse impact on our earnings. We may also be forced, as a result of withdrawals of deposits, to rely more heavily on other, potentially more expensive and less stable, funding sources. Additionally, such circumstances could require us to raise deposit rates in an attempt to attract new deposits, which would adversely affect our results of operations, and/or to raise funding through brokered deposits. Under applicable regulations, if the Bank were no longer "well-capitalized," the Bank would not be able to accept brokered deposits without the approval of the FDIC.

Our allowance for loan losses may be inadequate to absorb losses inherent in the loan portfolio.

Experience in the banking industry indicates that a portion of our loans will become delinquent, and that some may only be partially repaid or may never be repaid at all. We may experience losses for reasons beyond our control, such as the impact of general economic conditions on customers and their businesses. Accordingly, we maintain an allowance for loan losses that represents management's judgment of probable losses and risks inherent in our loan portfolio. In determining the size of our allowance for loan losses, we rely on an analysis of our loan portfolio that considers historical loss experience, volume and types of loans, trends in classification, volume and trends in delinquencies and non-accruals, economic conditions, and other pertinent information. The determination of the appropriate level of the allowance for loan losses is inherently highly subjective and requires us to make significant estimates of and assumptions regarding current credit risk and future trends, all of which may change materially. Although we endeavor to maintain our allowance for loan losses at a level adequate to absorb any inherent losses in the loan portfolio, these estimates of loan losses are necessarily subjective, and their accuracy depends on the outcome of future events. At December 31, 2021, the allowance for loan losses was $23.2 million.

Deterioration of economic conditions affecting borrowers, new information regarding existing loans, inaccurate management assumptions, identification of additional problem loans, temporary modifications, loan forgiveness, automatic forbearance, and other factors, both within and outside of our control, may result in our experiencing higher levels of nonperforming assets and charge-offs, and incurring loan losses in excess of our current allowance for loan losses, requiring us to make material additions to our allowance for loan losses, which could have an adverse effect on our business, financial condition, and results of operations.

Additionally, federal and state banking regulators, as an integral part of their supervisory function, periodically review the allowance for loan losses. These regulatory agencies may require us to increase our allowance for loan losses or to recognize further loan charge-offs based upon their judgments, which may be different from ours. If we need to make significant and unanticipated increases in the loss allowance in the future, or to take additional charge-offs for which we have not established adequate reserves, our business, financial condition, and results of operations could be adversely affected at that time.

Finally, the FASB has issued a new accounting standard for establishing allowances for loan and lease losses that will replace the current approach under GAAP, which generally considers only past events and current conditions, with a forward-looking methodology that reflects the expected credit losses over the lives of financial assets, starting when such assets are first originated or acquired. As an emerging growth company relying on the extended transition period for new accounting standards, this standard, referred to as Current Expected Credit Loss ("CECL"), will be effective for us on January 1, 2023. The CECL standard will require us to record, at the time of origination, credit losses expected throughout the life of the asset portfolio on loans and held-to-maturity securities, as opposed to the current practice of recording losses when it is probable that a loss event has occurred. We are currently evaluating the impact the CECL standard will have on our accounting and regulatory capital position. The adoption of the CECL standard will materially affect how we determine allowance for loan losses and could require us to significantly increase the allowance. Moreover, the CECL standard may create more volatility in the level of allowance for loan losses. If we are required to materially increase the level of our allowance for loan losses for any reason, such increase could have an adverse effect on our business, financial condition, and results of operations.

We could recognize losses on investment securities held in our securities portfolio, particularly if interest rates increase or economic and market conditions deteriorate.

As of December 31, 2021, the carrying value of our investment securities portfolio was approximately $153.8 million. As of the same date, 12.80% of our investments were U.S. government agency securities. Factors beyond our control can significantly influence the fair value of securities in our portfolio and can cause potential adverse changes to the fair value of these securities. These factors include, but are not limited to, rating agency actions in respect to the securities, defaults by the issuer or with respect to the underlying securities, and changes in market interest rates and instability in the capital markets. Any of these factors, among others, could cause other-than-temporary impairments ("OTTIs"), realized and/or unrealized losses in future periods, and declines in other comprehensive income, which could have an adverse effect on our business, financial condition, and results of operations. The process for determining whether impairment of a security is OTTI usually requires complex, subjective judgments about the future financial performance and liquidity of the issuer, any collateral underlying the security, and our intent and ability to hold the security for a sufficient period of time to allow for any anticipated recovery in fair value, in order to assess the probability of receiving all contractual principal and interest payments on the security. Our failure to correctly and timely assess any impairments or losses with respect to our securities could have an adverse effect on our business, financial condition, and results of operations.

We depend on the accuracy and completeness of information provided by customers and counterparties.

In deciding whether to extend credit or enter into other transactions with customers and counterparties, we may rely on information furnished by or on behalf of customers and counterparties, including financial information. We may also rely on representations of customers and counterparties as to the accuracy and completeness of that information. In deciding whether to extend credit, we may rely upon customers' representations that their financial statements conform to GAAP and present fairly the financial condition, results of operations, and cash flows of the customer. We also may rely on customer representations and certifications, or other audit or accountants' reports, with respect to the business and financial condition of our customers. Our business, financial condition, and results of operations could be adversely affected if we rely on misleading, false, inaccurate, or fraudulent information.

Risks Related to Our Industry and Regulation

Our industry is highly regulated, and the regulatory framework, together with any future legislative or regulatory changes, may have a materially adverse effect on our operations.

The banking industry is highly regulated and supervised under both federal and state laws and regulations that are intended primarily for the protection of depositors, customers, the public, the banking system as a whole, or the FDIC DIF, not for the protection of our shareholders and creditors. We are subject to regulation and supervision by the Federal Reserve, and our Bank is subject to regulation and supervision by the FDIC and the DFPI. Compliance with these laws and regulations can be difficult and costly, and changes to laws and regulations can impose additional compliance costs. The Dodd-Frank Act, which imposed significant regulatory and compliance changes on financial institutions, is an example of this type of federal law. The laws and regulations applicable to us govern a variety of matters, including permissible types, amounts, and terms of loans and investments we may make, the maximum interest rate that may be charged, the amount of reserves we must hold against deposits we take, the types of deposits we may accept and the rates we may pay on such deposits, maintenance of adequate capital and liquidity, changes in control of us and our Bank, transactions between us and our Bank, handling of nonpublic information, restrictions on dividends, and establishment of new offices. We must obtain approval from our regulators before engaging in certain activities, and there is risk that such approvals may not be granted, either in a timely manner or at all. These requirements may constrain our operations, and the adoption of new laws and changes to or repeal of existing laws may have an adverse effect on our business, financial condition, and results of operations. Also, the burden imposed by those federal and state regulations may place banks in general, including our Bank in particular, at a competitive disadvantage compared to their non-bank competitors. Compliance with current and potential regulation, as well as supervisory scrutiny by our regulators, may significantly increase our costs, impede the efficiency of our internal business processes, require us to increase our regulatory capital, and limit our ability to pursue business opportunities in an efficient manner by requiring us to expend significant time, effort, and resources to ensure compliance and respond to any regulatory inquiries or investigations. Our failure to comply with any applicable laws or regulations, interpretations of such laws and regulations, or regulatory policies could result in sanctions by regulatory agencies, civil money penalties, and/or damage to our reputation, all of which could have an adverse effect on our business, financial condition, and results of operations.

Applicable laws, regulations, interpretations, enforcement policies, and accounting principles have been subject to significant changes in recent years and may be subject to significant future changes. Additionally, federal and state regulatory agencies may change the manner in which existing regulations are applied. We cannot predict the substance or effect of pending or future legislation or regulation or changes to the application of laws and regulations to us. Future changes may have an adverse effect on our business, financial condition, and results of operations.

In addition, given the current economic and financial environment, regulators may elect to alter standards or the interpretation of the standards used to measure regulatory compliance or to determine the adequacy of liquidity, risk management, or other operational practices for financial service companies. This could impact our ability to implement our strategy, could affect us in substantial and unpredictable ways, and could have an adverse effect on our business, financial condition, and results of operations. Furthermore, the regulatory agencies have broad discretion in their interpretation of laws and regulations and their assessment of the quality of our loan portfolio, securities portfolio, and other assets. Based on our regulators' assessment of the quality of our assets, operations, lending practices, investment practices, capital structure, or other aspects of our business, we may be required to take additional charges or undertake, or refrain from taking, actions that could have an adverse effect on our business, financial condition, and results of operations.

Monetary policies and regulations of the Federal Reserve could have an adverse effect on our business, financial condition, and results of operations.

Our earnings and growth are affected by the policies of the Federal Reserve. An important function of the Federal Reserve is to regulate the money supply and credit conditions. Among the instruments used by the Federal Reserve to implement these objectives are open market purchases and sales of U.S. government securities, adjustments of the discount rate, and changes in banks' reserve requirements against bank deposits. These instruments are used in varying combinations to influence overall economic growth and the distribution of credit, bank loans, investments, and deposits. Their use also affects interest rates charged on loans or paid on deposits.

The monetary policies and regulations of the Federal Reserve have had a significant effect on the operating results of commercial banks in the past and are expected to continue to do so in the future. The effects of such policies upon our business, financial condition, and results of operations cannot be predicted.

Federal and state regulators periodically examine our business and may require us to remediate adverse examination findings or may take enforcement action against us.

The Federal Reserve, the FDIC, and the DFPI periodically examine our business, including our compliance with laws and regulations. If, as a result of an examination, the Federal Reserve, the FDIC, or the DFPI were to determine that our financial condition, capital resources, asset quality, earnings prospects, management, liquidity, or other aspects of any of our operations had become unsatisfactory, or that we were in violation of any law or regulation, they may take a number of different remedial actions as they deem appropriate. These actions may include requiring us to remediate any such adverse examination findings.

In addition, these agencies have the power to take enforcement action against us to enjoin "unsafe or unsound" practices, to require affirmative action to correct any conditions resulting from any violation of law or regulation or unsafe or unsound practice, to issue an administrative order that can be judicially enforced, to direct an increase in our capital, to direct the sale of subsidiaries or other assets, to limit dividends and distributions, to restrict our growth, to assess civil money penalties against us or our officers or directors, to remove officers and directors, and, if it is concluded that such conditions cannot be corrected or there is imminent risk of loss to depositors, to terminate our deposit insurance and place our Bank into receivership or conservatorship. Any regulatory enforcement action against us could have an adverse effect on our business, financial condition, and results of operations.

We are subject to stringent capital requirements, which could have an adverse effect on our operations.

Federal regulations establish minimum capital requirements for insured depository institutions, including minimum risk-based capital and leverage ratios, and define different forms of capital for calculating these ratios. The capital rules generally require bank holding companies and banks to maintain a common equity Tier 1 capital to risk-weighted assets ratio of at least 7.00% (a minimum of 4.50% plus a capital conservation buffer of 2.50%), a Tier 1 capital to risk-weighted assets ratio of at least 8.50% (a minimum of 6.00% plus a capital conservation buffer of 2.50%), a total capital to risk-weighted assets ratio of at least 10.50% (a minimum of 8.00% plus a capital conservation buffer of 2.50%), and a Tier 1 leverage ratio of at least 4.00%. An institution's failure to exceed the capital conservation buffer with common equity Tier 1 capital would result in limitations on an institution's ability to make capital distributions and discretionary bonus payments. In addition, for an insured depository institution to be "well-capitalized" under the banking agencies' prompt corrective action framework, it must have a common equity Tier 1 capital ratio of at least 6.50%, a Tier 1 capital ratio of at least 8.00%, a total capital ratio of at least 10.00%, and a Tier 1 leverage ratio of at least 5.00%, and must not be subject to any written agreement, order or capital directive, or prompt corrective action directive issued by its primary federal or state banking regulator to meet and maintain a specific capital level for any capital measure.

We operate under the Federal Reserve's Small Bank Holding Company Policy Statement, which exempts from the Federal Reserve's risk-based capital and leverage rules bank holding companies with total consolidated assets of less than $3.0 billion that are not engaged in significant nonbanking activities, do not conduct significant off-balance sheet activities, and do not have a material amount of debt or equity securities registered with the SEC. Historically, the Federal Reserve has not usually deemed a bank holding company ineligible for application of this policy statement solely because its common stock is registered under the Exchange Act. However, there can be no assurance that the Federal Reserve will continue this practice, and changes to this practice may result in the loss of our status as a small bank holding company for these purposes. Additionally, we will be ineligible to operate under the Small Bank Holding Company Policy Statement if we grow to $3.0 billion or more in total consolidated assets.

Any new or revised standards adopted in the future may require us to maintain materially more capital, with common equity as a more predominant component, or manage the configuration of our assets and liabilities to comply with formulaic capital requirements. We may not be able to raise additional capital at all, or on terms acceptable to us. Failure to maintain capital to meet current or future regulatory requirements could have an adverse effect on our business, financial condition, and results of operations.

We are subject to numerous “fair and responsible banking” laws and other laws and regulations designed to protect consumers, and failure to comply with these laws could lead to a wide variety of sanctions.

The Equal Credit Opportunity Act, the Fair Housing Act, and other fair lending laws and regulations, including state laws and regulations, prohibit discriminatory lending practices by financial institutions. The Federal Trade Commission Act prohibits unfair or deceptive acts or practices, and the Dodd-Frank Act prohibits unfair, deceptive, or abusive acts or practices by financial institutions. The U.S. Department of Justice, federal and state banking agencies, and other federal and state agencies, including the CFPB, are responsible for enforcing these fair and responsible banking laws and regulations. Banks with no more than $10.0 billion in total consolidated assets, including the Bank, are subject to rules promulgated by the CFPB but are examined and supervised by federal banking agencies for compliance with federal consumer protection laws and regulations. Accordingly, CFPB rulemaking has the potential to have a significant impact on the operations of the Bank.

A challenge to an institution’s compliance with fair and responsible banking laws and regulations could result in a wide variety of sanctions, including damages and civil money penalties, injunctive relief, restrictions on mergers and acquisitions activity, restrictions on expansion, and restrictions on entering new business lines. Private parties may also have the ability to challenge an institution’s performance under fair lending laws in private litigation, including through class action litigation. Such actions could have an adverse effect on our business, financial condition, and results of operations.

We are subject to laws regarding the privacy, information security, and protection of personal information, and any violation of these laws or other incidents involving personal, confidential, or proprietary information of individuals could damage our reputation and otherwise adversely affect our business.

Our business requires the collection and retention of large volumes of customer data, including personally identifiable information (“PII”), in various information systems that we maintain and in those maintained by third-party service providers. We also maintain important internal company data such as PII about our employees and information relating to our operations. We are subject to complex and evolving laws and regulations governing the privacy and protection of PII of individuals (including customers, employees, and other third parties). For example, our business is subject to the GLB Act, which, among other things: (i) imposes certain limitations on our ability to share nonpublic PII about our customers with nonaffiliated third parties; (ii) requires that we provide certain disclosures to customers about our information collection, sharing, and security practices and afford customers the right to “opt out” of any information sharing by us with nonaffiliated third parties (with certain exceptions); and (iii) requires that we develop, implement, and maintain a written comprehensive information security program containing appropriate safeguards based on our size and complexity, the nature and scope of our activities, and the sensitivity of customer information we process, as well as plans for responding to data security breaches. Various federal and state banking regulators and states have also enacted data breach notification requirements with varying levels of individual, consumer, regulatory, or law enforcement notification in the event of a security breach. The California Consumer Privacy Act grants California residents the rights to know about personal information collected about them, to delete certain of this personal information, to opt out of the sale of personal information, and to non-discrimination for exercising these rights.

Ensuring that our collection, use, transfer, and storage of PII complies with all applicable laws and regulations can increase our costs. Furthermore, we may not be able to ensure that customers and other third parties have appropriate controls in place to protect the confidentiality of the information that they exchange with us, particularly where such information is transmitted by electronic means. If personal, confidential, or proprietary information of customers or others were to be mishandled or misused (in situations where, for example, such information was erroneously provided to parties who are not permitted to have the information, or where such information was intercepted or otherwise compromised by third parties), we could be exposed to litigation or regulatory sanctions under privacy and data protection laws and regulations. Concerns regarding the effectiveness of our measures to safeguard PII, or even the perception that such measures are inadequate, could cause us to lose customers or potential customers and thereby reduce our revenues. Accordingly, any failure or perceived failure to comply with applicable privacy or data protection laws and regulations may subject us to inquiries, examinations, and investigations that could result in requirements to modify or cease certain operations or practices or in significant liabilities, fines, or penalties, and could damage our reputation and otherwise adversely affect our business, financial condition, and results of operations.

We are a bank holding company and are dependent upon the Bank for cash flow, and the Bank’s ability to make cash distributions is restricted.

We are a bank holding company with no material activities other than activities incidental to holding the common stock of the Bank. Our principal source of funds to pay distributions on our common stock and service any of our obligations, other than further issuances of securities, is dividends received from the Bank. Furthermore, the Bank is not obligated to pay dividends to us, and any dividends paid to us would depend on the earnings or financial condition of the Bank, various business considerations, and applicable law and regulation. As is generally the case for banking institutions, the profitability of the Bank is subject to the fluctuating cost and availability of money, changes in interest rates, and economic conditions in general. In addition, various federal and state statutes and regulations limit the amount of dividends that the Bank may pay to the Company without regulatory approval.

The Federal Reserve may require us to commit capital resources to support the Bank.

The Federal Reserve requires a bank holding company to act as a source of financial and managerial strength to its subsidiary banks and to commit resources to support its subsidiary banks. Under the "source of strength" doctrine that was codified by the Dodd-Frank Act, the Federal Reserve may require a bank holding company to make capital injections into a subsidiary bank, including at times when the bank holding company may not be inclined to do so, and may charge the bank holding company with engaging in unsafe and unsound practices for failure to commit resources to such a subsidiary bank. Accordingly, we could be required to provide financial assistance to the Bank if it experiences financial distress.

A capital injection may be required at a time when our resources are limited, and we may be required to borrow the funds or raise capital to make the required capital injection. Any loan by a bank holding company to its subsidiary bank is subordinate in right of payment to deposits and certain other indebtedness of such subsidiary bank. In the event of a bank holding company's bankruptcy, the bankruptcy trustee will assume any commitment by the holding company to a federal bank regulatory agency to maintain the capital of a subsidiary bank. Moreover, bankruptcy law provides that claims based on any such commitment will be entitled to a priority of payment over the claims of the holding company's general unsecured creditors, including the holders of any note obligations. Thus, any borrowing by a bank holding company for the purpose of making a capital injection to a subsidiary bank may become more difficult and expensive relative to other corporate borrowings.

We face a risk of noncompliance and enforcement action with the Bank Secrecy Act and other anti-money laundering statutes and regulations.

The Bank Secrecy Act, the Patriot Act, and other laws and regulations require financial institutions, among other duties, to institute and maintain an effective anti-money laundering program and to file reports such as suspicious activity reports and currency transaction reports. We are required to comply with these and other anti-money laundering requirements. Our federal and state banking regulators, the Treasury Department's Financial Crimes Enforcement Network, and other government agencies are authorized to impose significant civil money penalties for violations of anti-money laundering requirements. We are also subject to increased scrutiny of compliance with the regulations issued and enforced by the Treasury Department's OFAC, which is responsible for helping to ensure that U.S. entities do not engage in transactions with certain prohibited parties, as defined by various Executive Orders and Acts of Congress. If our program is deemed deficient, we could be subject to liability, including fines, civil money penalties, and other regulatory actions, which may include restrictions on our business operations and our ability to pay dividends, restrictions on mergers and acquisitions activity, restrictions on expansion, and restrictions on entering new business lines. Failure to maintain and implement adequate programs to combat money laundering and terrorist financing could also have significant reputational consequences for us. Any of these circumstances could have an adverse effect on our business, financial condition, and results of operations.

Our Bank's FDIC deposit insurance premiums and assessments may increase.

Our Bank's deposits are insured by the FDIC up to legal limits and, accordingly, our Bank is subject to insurance assessments based on our Bank's average consolidated total assets less its average tangible equity. Our Bank's regular assessments are determined by its CAMELS composite rating (a supervisory rating system developed to classify a bank's overall condition by taking into account capital adequacy, assets, management capability, earnings, liquidity, and sensitivity to market and interest rate risk), taking into account other factors and adjustments. In order to maintain a strong funding position and the reserve ratios of the DIF required by statute and FDIC estimates of projected requirements, the FDIC has the power to increase deposit insurance assessment rates and impose special assessments on all FDIC-insured financial institutions. Any future increases or special assessments, including as part of the FDIC's plan to restore the DIF reserve ratio to at least 1.35% by September 30, 2028, could reduce our profitability and could have an adverse effect on our business, financial condition, and results of operations.

The planned discontinuation of the London Inter-Bank Offered Rate ("LIBOR") as a benchmark interest rate and a transition to an alternative reference interest rate could present operational problems and result in market disruption.

The administrator of LIBOR will publish most tenors of LIBOR for U.S. dollars ("USD") through June 30, 2023 and permanently cease publication of the 1-week and 2-month USD LIBOR settings following December 31, 2021. The Federal Reserve and other federal banking agencies have encouraged banks to transition away from LIBOR in new contracts by no later than December 31, 2021, to ensure existing contracts have robust fallback language that includes a clearly defined alternative reference rate, and have emphasized the expectation that supervised institutions with LIBOR exposure continue to progress toward an orderly transition away from LIBOR. Although we expect that the capital and debt markets will cease to use LIBOR as a benchmark in the near future, we cannot predict what impact such a transition may have on our business, financial condition, and results of operations.

The Federal Reserve, based on the recommendations of the Federal Reserve Bank of New York's Alternative Reference Rate Committee, has begun publishing the Secured Overnight Financing Rate ("SOFR"), which is intended to replace LIBOR. Additionally, on April 6, 2021, New York Governor Cuomo signed into law legislation that provides for the substitution of SOFR in any LIBOR-based contract governed by New York state law that does not include clear fallback language, once LIBOR is discontinued. Although SOFR appears to be the preferred replacement rate for LIBOR, it is unclear if other benchmarks may emerge or if other rates will be adopted outside of the United States. The replacement of LIBOR also may result in economic mismatches between different categories of instruments that now consistently rely on the LIBOR benchmark. Markets are slowly developing in response to these new rates, and questions around liquidity in these rates and how to appropriately adjust these rates to eliminate any economic value transfer at the time of transition remain a significant concern. We cannot predict whether the SOFR or another alternative rate will become the market benchmark in place of LIBOR.

Certain of our financial products are tied to LIBOR. We are currently monitoring the actions of LIBOR's regulator and the implementation of alternative reference rates in advance of the expected discontinuation of LIBOR to determine any potential impact on our financial products and our subordinated notes. Inconsistent approaches to a transition from LIBOR to an alternative rate among different market participants and for different financial products may cause market disruption and operational problems, which could adversely affect us, including by exposing us to increased basis risk and resulting costs in connection, and by creating the possibility of disagreements with counterparties.

Risks Related to Ownership of Our Common Stock

Our stock price may be volatile, and we may not be able to meet investor or analyst expectations. You may not be able to resell your shares at or above the price you paid and may lose part or all of your investment as a result.

Stock price volatility may negatively impact the price at which our common stock may be sold and may also negatively impact the timing of any sale. We cannot assure you that the market price of our shares on the Nasdaq Stock Market LLC ("Nasdaq") will equal or exceed prices in privately negotiated transactions of our shares that have occurred from time to time before our IPO. Our stock price may fluctuate widely in response to a variety of factors including the risk factors described herein and, among other things:

- actual or anticipated variations in quarterly or annual operating results, financial conditions, or credit quality;
- changes in business or economic conditions;
- changes in accounting standards, policies, guidance, interpretations, or principles;
- changes in recommendations or research reports about us or the financial services industry in general published by securities analysts;
- the failure of securities analysts to cover, or to continue to cover, us;
- changes in financial estimates or publication of research reports and recommendations by financial analysts or actions taken by rating agencies with respect to us or other financial institutions;
- news reports relating to trends, concerns, and other issues in the financial services industry;
- reports related to the impact of natural or man-made disasters in our market;
- perceptions in the marketplace regarding us and or our competitors;
- sudden increases in the demand for our common stock, including as a result of any "short squeezes";
- significant acquisitions or business combinations, strategic partnerships, joint ventures, or capital commitments by or involving us or our competitors;

- additional investments from third parties;
- additions or departures of key personnel;
- future sales or issuance of additional shares of common stock;
- fluctuations in the stock price and operating results of our competitors;
- changes or proposed changes in laws or regulations, or differing interpretations thereof, affecting our business, or enforcement of these laws or regulations;
- new technology used, or services offered, by competitors;
- additional investments from third parties; or
- geopolitical conditions such as acts or threats of terrorism, pandemics, or military conflicts.

In particular, the realization of any of the risks described in this section could have an adverse effect on the market price of our common stock and cause the value of your investment to decline. In addition, the stock market in general has experienced extreme volatility that has often been unrelated to the operating performance of particular companies. These broad market fluctuations may adversely affect the trading price of our common stock over the short, medium, or long term, regardless of our actual performance.

We are an "emerging growth company," as defined in the JOBS Act, and a "smaller reporting company," as defined in Rule 12b-2 in the Exchange Act, and are able to avail ourselves of reduced disclosure requirements applicable to emerging growth companies and smaller reporting companies, which could make our common stock less attractive to investors and adversely affect the market price of our common stock.

We are an "emerging growth company," as defined in the JOBS Act. For as long as we continue to be an emerging growth company, we may take advantage of certain exemptions from various requirements generally applicable to public companies. These exemptions allow us, among other things, to present only two years of audited financial statements and discuss our results of operations for only two years in related Management's Discussions and Analyses; not to provide an auditor attestation of our internal control over financial reporting; to take advantage of an extended transition period to comply with the new or revised accounting standards applicable to public companies; to provide reduced disclosure regarding our executive compensation arrangements pursuant to the rules applicable to smaller reporting companies, which means we do not have to include a compensation discussion and analysis and certain other disclosure regarding our executive compensation; and not to seek a non-binding advisory vote on executive compensation or golden parachute arrangements.

We may take advantage of these exemptions until we are no longer an emerging growth company. We would cease to be an emerging growth company upon the earliest of: (i) the first fiscal year following the fifth anniversary of our IPO; (ii) the first fiscal year after our annual gross revenues are $1.07 billion or more; (iii) the date on which we have, during the previous three-year period, issued more than $1.0 billion in non-convertible debt securities; or (iv) the date on which we are deemed to be a large accelerated filer under the rules of the SEC.

Even after we no longer qualify as an emerging growth company, we may still qualify as a "smaller reporting company," as defined in Rule 12b-2 in the Exchange Act, which would allow us to take advantage of many of the same exemptions from disclosure requirements, including not being required to provide an auditor attestation of our internal control over financial reporting and reduced disclosure regarding our executive compensation arrangements in our periodic reports and proxy statements.

We cannot predict whether investors will find our common stock less attractive because we may rely on these exemptions. If some investors find our common stock less attractive as a result, there may be a less active trading market for our common stock, and our stock price may be more volatile or decline.

Our significant shareholders have the ability to control significant corporate activities, and our significant shareholders' interests may not coincide with yours.

Upon the closing of our IPO, our directors, executive officers, and principal shareholders beneficially owned an aggregate of 5,881,682 shares, or approximately 34.47% of our issued and outstanding shares of common stock. Consequently, our directors, executive officers, and principal shareholders are able to significantly affect our affairs and policies, including the outcome of the election of directors and the potential outcome of other matters submitted to a vote of our shareholders, such as mergers, the sale of substantially all of our assets, and other extraordinary corporate matters. This influence may also have the effect of delaying or preventing changes of control or changes in management or limiting the ability of our other shareholders to approve transactions that they may deem to be in the best interests of our Company. The interests of these insiders could conflict with the interests of our other shareholders, including you.

Our management had broad discretion in allocating the net proceeds of our IPO. Our failure to effectively utilize such net proceeds may have an adverse effect on our financial performance and the value of our common stock.

Following the distributions to certain of our shareholders in May 2021, we used the net proceeds of our IPO to increase the capital of the Bank in order to support our organic growth strategies, including expanding our overall market share, to strengthen our regulatory capital, and for working capital and other general corporate purposes. However, we were not required to apply any portion of the net proceeds of our IPO for any particular purpose, and our management could have used them for purposes other than those contemplated at the time of the IPO. Accordingly, our management had broad discretion in the application of the net proceeds from the IPO, and you will be relying on the judgment of our management regarding the application of these proceeds. You did not have the opportunity to assess whether we used the proceeds appropriately. Our management might not have applied our net proceeds in ways that would have ultimately increased the value of your investment. If we did not invest or apply the net proceeds from our IPO in ways that enhance shareholder value, we may fail to achieve expected financial results, which could cause our stock price to decline.

If securities or industry analysts do not publish research or publish inaccurate or unfavorable research about our business, our stock price and trading volume could decline.

The trading market for our common stock depends in part on the research and reports that securities or industry analysts publish about us or our business. We may be unable to attract or sustain research coverage by securities and industry analysts. If no securities or industry analysts cover our company, the trading price for our stock would likely be negatively impacted. If we obtain securities or industry analyst coverage and if one or more of the analysts who covers us downgrades our stock or publishes inaccurate or unfavorable research about our business, our stock price would likely decline. If we fail to meet the expectations of analysts for our operating results, our stock price would likely decline. If one or more of these analysts ceases coverage of us or fails to publish reports on us regularly, demand for our stock could decrease, which could cause our stock price and trading volume to decline.

We may not pay dividends on our common stock in the future, and our ability to pay dividends is subject to certain restrictions.

Holders of our common stock are entitled to receive only such dividends as our board of directors may declare out of funds legally available for such payments. Our board of directors may, in its sole discretion, change the amount or frequency of dividends or discontinue the payment of dividends entirely. In addition, we are a bank holding company, and our ability to declare and pay dividends is dependent on federal regulatory considerations, including the guidelines of the Federal Reserve regarding capital adequacy and dividends. It is the policy of the Federal Reserve that bank holding companies should generally pay dividends on common stock only out of earnings, and only if prospective earnings retention is consistent with the organization's expected future needs, asset quality, and financial condition, and that bank holding companies should inform and consult with the Federal Reserve in advance of declaring and paying a dividend that exceeds earnings for the period for which the dividend is being paid.

The holders of our debt obligations and preferred stock, if any, have priority over the holders of our common stock with respect to payment in the event of liquidation, dissolution, or winding up and with respect to the payment of interest and dividends.

In any liquidation, dissolution, or winding up of the Company, our common stock would rank below all claims of debt holders against us as well as any preferred stock that has been issued. As of December 31, 2021, we had an aggregate of $28.4 million of subordinated notes, net of debt issuance costs, outstanding, and we did not have any outstanding preferred stock or trust preferred securities. We could incur such debt obligations or issue preferred stock in the future to raise additional capital. In such event, holders of our common stock will not be entitled to receive any payment or other distribution of assets upon the liquidation, dissolution, or winding up of the Company until after all of our obligations to the debt holders are satisfied and holders of subordinated debt and senior equity securities, including preferred shares, if any, have received any payment or distribution due to them. In addition, we will be required to pay interest on the subordinated notes and dividends on the trust preferred securities and preferred stock before we will be able to pay any dividends on our common stock.

California law and the provisions of our amended and restated articles of incorporation and amended and restated bylaws may have an anti-takeover effect, and there are substantial regulatory limitations on changes of control of bank holding companies.

California corporate law and provisions of our amended and restated articles of incorporation ("articles of incorporation") and our amended and restated bylaws ("bylaws") could make it more difficult for a third party to acquire us, even if doing so would be perceived to be beneficial by our shareholders. Furthermore, with certain limited exceptions, federal regulations prohibit a person or company or a group of persons deemed to be "acting in concert" from, directly or indirectly, acquiring 10% or more (5% or more if the acquirer is a bank holding company) of any class of our voting stock or obtaining the ability to control in any manner the election of a majority of our directors or otherwise direct the management or policies of our Company without prior notice or application to and the approval of the Federal Reserve. Accordingly, prospective investors must comply with these requirements, if applicable, in connection with any purchase of shares of our common stock. Collectively, provisions of our articles of incorporation and bylaws and other statutory and regulatory provisions may delay, prevent, or deter a merger, acquisition, tender offer, proxy contest, or other transaction that might otherwise result in our shareholders receiving a premium over the market price for their common stock. Moreover, the combination of these provisions effectively inhibits certain business combinations, which, in turn, could adversely affect the market price of our common stock.

Our bylaws have an exclusive forum provision, which could limit a shareholder's ability to obtain a favorable judicial forum for disputes with us or our directors, officers, or other employees.

Our bylaws have an exclusive forum provision providing that, unless we consent in writing to the selection of an alternative forum, the United States District Court for the Northern District of California (or, in the event that the United States District Court for the Northern District of California does not have jurisdiction, any federal or state court of California) shall be the sole and exclusive forum for: (i) any derivative action or proceeding brought on our behalf; (ii) any action asserting a claim of breach of any duty owed by any director, officer, or other employee to us or to our shareholders; (iii) any action asserting a claim against us or any of our directors, officers or other employees arising pursuant to any provision of the General Corporation Law of California or the articles of incorporation or the bylaws; or (iv) any action asserting a claim against us or any of our directors, officers, or other employees that is governed by the internal affairs doctrine. Our bylaws will further provide that, unless we consent in writing to the selection of an alternative forum, the federal district courts of the United States of America will, to the fullest extent permitted by applicable law, be the exclusive forum for the resolution of any complaint asserting a cause of action arising under the federal securities laws, including the applicable rules and regulations promulgated thereunder. Any person purchasing or otherwise acquiring any interest in any shares of our capital stock will be deemed to have notice of and to have consented to this provision of our bylaws. The exclusive forum provision may limit a shareholder's ability to bring a claim in a judicial forum that it finds favorable for disputes with us or our directors, officers, or other employees, which may discourage such lawsuits. Alternatively, if a court were to find the exclusive forum provision to be inapplicable or unenforceable in an action, we may incur additional costs associated with resolving such action in other jurisdictions, which could have an adverse effect on our business, financial condition, results of operations, and growth prospects.

Prior to our IPO, we were treated as an S Corporation, and claims of taxing authorities related to our prior status as an S Corporation could adversely affect us.

Immediately prior to the consummation of our IPO, our status as an S Corporation terminated and we commenced treatment as a C Corporation under the provisions of Sections 301 through 385 of the Internal Revenue Code, which treat the corporation as an entity that is subject to U.S. federal income tax. If the unaudited, open tax years in which we were an S Corporation are audited by the IRS, and we are determined not to have qualified for, or to have violated any requirement for maintaining, our S Corporation status, we will be obligated to pay back taxes, interest, and penalties. The amounts that we would be obligated to pay could include taxes on all our taxable income while we were an S Corporation. Any such claims could result in additional costs to us and could have an adverse effect on our business, financial condition, and results of operations.

We have entered into a Tax Sharing Agreement with most of our shareholders who owned our common stock prior to our IPO and could become obligated to make payments to such shareholders for any additional federal, state, or local income taxes assessed against them for tax periods prior to the completion of our IPO.

We historically were treated as an S Corporation for U.S. federal income tax purposes, and our shareholders prior to our IPO were taxed on our net income. Therefore, such shareholders received distributions, referred to as tax distributions, from us that were generally intended to equal the amount of tax the existing shareholders were required to pay with respect to our income. In connection with our IPO, our S Corporation status terminated, and we are now subject to federal and increased California state income taxes. In the event of an adjustment to our reported taxable income for periods prior to termination of our S Corporation status, it is possible that our shareholders who owned our common stock prior to our IPO would be liable for additional income taxes for those prior periods. Pursuant to the Tax Sharing Agreement, upon our filing any tax return (amended or otherwise), in the event of any restatement of our taxable income or pursuant to a determination by, or a settlement with, a taxing authority, for any period during which we were an S Corporation, depending on the nature of the adjustment, we may be required to make a payment to our shareholders who owned our common stock prior to our IPO, who accepted distribution of the estimated balance of our federal accumulated adjustments account under the Tax Sharing Agreement, in an amount equal to such shareholders' incremental tax liability (including interest and penalties), which amount may be material. In addition, the Tax Sharing Agreement provides that we will indemnify such shareholders with respect to unpaid income tax liabilities (including interest and penalties) to the extent that such unpaid income tax liabilities are attributable to an adjustment to our taxable income for any period after our S Corporation status terminated. In both cases the amount of the payment will be based on the assumption that our shareholders are taxed at the highest federal and state income tax rates applicable to married individuals filing jointly and residing in California for the relevant periods. Our shareholders who owned our common stock prior to our IPO and accepted distribution of the estimated balance of our federal accumulated adjustments account under the Tax Sharing Agreement will, severally and not jointly, indemnify us with respect to our unpaid income tax liabilities (including interest and penalties) to the extent that such unpaid income tax liabilities are attributable to a decrease in any such shareholder's taxable income for any tax period and a corresponding increase in our taxable income for any period (but only to the extent of the amount by which the shareholder's tax liability is reduced).

An investment in our common stock is not an insured deposit.

An investment in our common stock is not a bank deposit and, therefore, is not insured against loss by the FDIC, any other deposit insurance fund, or by any other public or private entity. Investment in our common stock is inherently risky for the reasons described herein and is subject to the same market forces that affect the price of common stock in any company. As a result, if you acquire our common stock, you could lose some or all of your investment.

The requirements of being a public company may strain our resources and divert management's attention.

As a public company, we incur significant legal, accounting, insurance, and other expenses. We are subject to the reporting requirements of the Exchange Act, the Sarbanes-Oxley Act, and applicable securities rules and regulations. These laws and regulations increase the scope, complexity, and cost of corporate governance, reporting, and disclosure practices over those of non-public or non-reporting companies. Despite our conducting business in a highly regulated environment, these laws and regulations have different requirements for compliance than we experienced prior to becoming a public company. Among other things, the Exchange Act requires that we file annual, quarterly, and current reports with respect to our business and operating results and maintain effective disclosure controls and procedures and internal control over financial reporting. As a Nasdaq-listed company, we are required to prepare and file proxy materials which meet the requirements of the Exchange Act and the SEC's proxy rules. Compliance with these rules and regulations has increased, and will continue to increase, our legal and financial compliance costs, will make some activities more difficult, time-consuming, or costly, and will increase demand on our systems and resources, particularly after we are no longer an "emerging growth company" as defined in the JOBS Act. In order to maintain, appropriately document and, if required, improve our disclosure controls and procedures and internal control over financial reporting to meet the standards required by the Sarbanes-Oxley Act, significant resources and management oversight may be required. As a result, management's attention may be diverted from other business concerns, which could harm our business and operating results. Additionally, any failure by us to file our periodic reports with the SEC in a timely manner could harm our reputation and cause our investors and potential investors to lose confidence in us, and restrict trading in, and reduce the market price of, our common stock, and potentially impact our ability to access the capital markets.

If we fail to design, implement, and maintain effective internal control over financial reporting or remediate any future material weakness in our internal control over financial reporting, we may be unable to accurately report our financial results or prevent fraud.

Our internal control over financial reporting is designed to provide reasonable assurance regarding the reliability of the financial reporting and the preparation of financial statements for external purposes in accordance with GAAP. Effective internal control over financial reporting is necessary for us to provide reliable reports and prevent fraud. We may not be able to identify all significant deficiencies and/or material weaknesses in our internal control over financial reporting in the future, and our failure to maintain effective internal control over financial reporting in accordance with Section 404 of the Sarbanes-Oxley Act could have an adverse effect on our business, financial condition, and results of operations.

In the normal course of our operations, we may identify deficiencies that would have to be remediated to satisfy the SEC rules for certification of our internal control over financial reporting. A material weakness is defined by the standards issued by the PCAOB as a deficiency, or combination of deficiencies, in internal control over financial reporting that results in a reasonable possibility that a material misstatement of our annual or interim financial statements will not be prevented or detected on a timely basis. As a consequence, we would have to disclose in periodic reports we file with the SEC any material weakness in our internal control over financial reporting. The existence of a material weakness would preclude management from concluding that our internal control over financial reporting is effective and, when we cease to be an emerging growth company under the JOBS Act, preclude our independent registered public accounting firm from rendering their report addressing an assessment of the effectiveness of our internal control over financial reporting. In addition, disclosures of deficiencies of this type in our SEC reports could cause investors to lose confidence in our financial reporting, may negatively affect the market price of our common stock, and could result in the delisting of our securities from the securities exchanges on which they trade. Moreover, effective internal controls are necessary to produce reliable financial reports and to prevent fraud. If we have deficiencies in our disclosure controls and procedures or internal control over financial reporting, such deficiencies may adversely affect us.

General Risk Factors

The COVID-19 pandemic and the impact of actions to mitigate the spread of the virus could adversely affect our business, financial condition, and results of operations.

Federal, state, and local governments enacted various restrictions and policies in an attempt to limit the spread of COVID-19. Such measures disrupted economic activity and contributed to job losses and reductions in consumer and business spending. In response to the economic and financial effects of COVID-19, the Federal Reserve sharply reduced interest rates and instituted quantitative easing measures as well as domestic and global capital market support programs. In addition, the current and prior presidential administrations, Congress, various federal agencies, and state and local governments took measures to address the economic and social consequences of the pandemic, including the passage of the CARES Act, which was enacted on March 27, 2020, the Consolidated Appropriations Act, which was enacted on December 27, 2020, and the American Rescue Plan Act, which was enacted on March 11, 2021. The CARES Act provided wide-ranging economic relief for individuals and businesses impacted by COVID-19, and the Consolidated Appropriations Act and American Rescue Plan Act extended some of these relief provisions in certain respects as well as provided other forms of relief.

The CARES Act established and provided $349.0 billion in funding for the PPP, a loan program administered by the SBA. Under the PPP, small businesses, sole proprietorships, independent contractors, and self-employed individuals were able to apply for forgivable loans from existing SBA lenders and other approved regulated lenders that enrolled in the program, subject to numerous limitations and eligibility criteria. Congress appropriated additional funding to the PPP on April 24, 2020 and amended the PPP on June 5, 2020 to make the terms of the PPP loans and loan forgiveness more flexible. The Consolidated Appropriations Act provided additional funding for the PPP and allowed eligible borrowers, including certain borrowers who had already received a PPP loan, to apply for PPP loans through March 31, 2021. The American Rescue Plan Act expanded the eligibility criteria for both first and second draw PPP loans and revised the exclusions from payroll costs for purposes of loan forgiveness. The PPP Extension Act, which became law on March 30, 2021, extended the deadline to apply for a PPP loan through May 31, 2021. In April 2020, we began processing loan applications under the PPP.

In addition, the CARES Act and related guidance from the federal banking agencies provided financial institutions the option to temporarily suspend requirements under GAAP related to classification of certain loan modifications as TDRs to account for the effects of COVID-19. The CARES Act, as amended by the Consolidated Appropriations Act, specified that COVID-19 related loan modifications executed between March 1, 2020 and the earlier of: (i) 60 days after the date of termination of the national emergency declared by the President; and (ii) January 1, 2022, on loans that were current as of December 31, 2019 are not TDRs. Additionally, under guidance from the federal banking agencies, other short-term modifications made on a good faith basis in response to COVID-19 to borrowers that were current prior to any relief are not TDRs under ASC Subtopic 310-40, "Troubled Debt Restructuring by Creditors." These modifications include short-term (e.g., up to six months) modifications such as payment deferrals, fee waivers, extensions of repayment terms, or delays in payment that are insignificant. We made a high level of loan modifications under our deferred payment program. Further, our loan portfolio includes loans that are in forbearance, but which are not classified as TDRs because they were current at the time forbearance began. When the forbearance periods end, we may be required to classify a substantial portion of these COVID-19 deferments as TDRs.

The CARES Act and the Consolidated Appropriations Act also included a range of other provisions designed to support the U.S. economy and mitigate the impact of COVID-19 on financial institutions and their customers, including through the authorization of various programs and measures that the Treasury Department, the Federal Reserve, and other federal agencies may be or are required to implement. Among other provisions, sections 4022 and 4023 of the CARES Act provide mortgage loan forbearance relief to certain borrowers experiencing financial hardship during the COVID-19 emergency. The full impact on our lending and other business activities as a result of new government and regulatory policies, programs, and guidelines, as well as regulators' reaction to such activities, remains uncertain.

While the impact of the COVID-19 pandemic has begun to decrease in significance, its economic effects on financial markets and key market indices continue to impact overall economic activity. The uncertainty regarding the duration of the pandemic and the resulting economic disruption caused increased market volatility and led to an economic recession and a significant decrease in consumer confidence and business generally, the long-term effects of which remain uncertain. The continuation of these conditions (including whether due to a resurgence or additional waves or variants of COVID-19 infections, particularly as the geographic areas in which we operate determine whether and when to re-open, and how quickly and to what extent normal economic and operating conditions can resume, especially as a vaccine is now widely available), as well as the impacts of the CARES Act and other federal and state measures, specifically with respect to loan forbearances, has adversely affected our business, financial condition, and results of operations, and has and can be expected to further adversely impact our business, financial condition, and results of operations and the operations of our borrowers, customers, and business partners. In particular, these events have had, and/or can be expected to continue to have, the following effects, among others:

- impair the ability of borrowers to repay outstanding loans or other obligations, resulting in increases in delinquencies and modifications to loans;
- impair the value of collateral securing loans (particularly with respect to real estate);
- impair the value of our assets, including our securities portfolio, goodwill, and intangible assets;
- require an increase in our allowance for credit losses;
- adversely affect the stability of our deposit base or otherwise impair our liquidity;
- reduce our revenues from fee-based services;
- negatively impact our self-insurance healthcare costs;
- result in increased compliance risk as we become subject to new regulatory and other requirements, including new and changing guidance, associated with the PPP and other new programs in which we have participated;
- impair the ability of loan guarantors to honor commitments;
- negatively impact our regulatory capital ratios;
- negatively impact the productivity and availability of key personnel necessary to conduct our business and third-party service providers who perform critical services for us, or otherwise cause operational failures due to changes in our normal business practices necessitated by the pandemic and related governmental actions;
- changes in local, regional, and global business, including employment levels and supply chain shortages; and
- increase cyber and payment fraud risk and other operational risks, given increased online and remote activity.

Prolonged measures by health or other governmental authorities encouraging or requiring significant restrictions on travel, assembly, or other core business practices could further harm our business and those of our customers, in particular our small to medium-sized business customers. Although we have business continuity plans and other safeguards in place, there is no assurance that they will be effective.

While the ultimate impact of these factors over the longer term is uncertain and we do not yet know the full extent of the impacts on our business, our operations, or the global economy as a whole, nor the pace of continued economic recovery when the COVID-19 pandemic subsides, the decline in economic conditions generally, and a prolonged negative impact on small to medium-sized businesses in particular, due to COVID-19 is likely to result in an adverse effect on our business, financial condition, and results of operations in future periods, and may heighten many of our known risks.

We are dependent on our management team and key employees.

Our success depends, in large part, on the retention of our management team and key employees. Our management team and other key employees, including those who conduct our loan origination and other business development activities, have significant industry experience. We cannot ensure that we will be able to retain the services of any members of our management team or other key employees. Though we have employment agreements in place with certain members of our management team, they may still elect to leave at any time. The loss of any of our management team or our key employees could adversely affect our ability to execute our business strategy, and we may not be able to find adequate replacements on a timely basis, or at all.

Our future success also depends on our continuing ability to attract, develop, motivate, and retain key employees. Qualified individuals are in high demand, and we may incur significant costs to attract and retain them. Because the market for qualified individuals is highly competitive, we may not be able to attract and retain qualified officers or candidates. Failure to attract and retain a qualified management team and qualified key employees could have an adverse effect on our business, financial condition, and results of operations.

Our success is largely dependent upon our ability to successfully execute our business strategy.

There can be no assurance that we will be able to continue to grow and to remain profitable in future periods, or, if profitable, that our overall earnings will remain consistent with our prior results of operations or increase in the future. A downturn in economic conditions in our market, particularly in the real estate market, heightened competition from other financial services providers, an inability to retain or grow our core deposit base, regulatory and legislative considerations, and failure to attract and retain high-performing talent, among other factors, could limit our ability to grow assets, or increase profitability, as rapidly as we have in the past. Sustainable growth requires that we manage our risks by following prudent loan underwriting standards, balancing loan and deposit growth without materially increasing interest rate risk or compressing our net interest margin, maintaining more than adequate capital at all times, managing a growing number of customer relationships, scaling technology platforms, hiring and retaining qualified employees, and successfully implementing our strategic initiatives. We must also successfully implement improvements to, or integrate, our management information and control systems, procedures, and processes in an efficient and timely manner and identify deficiencies in existing systems and controls. In particular, our controls and procedures must be able to accommodate an increase in loan volume in various markets and the infrastructure that comes with expanding operations, including new branches. Our growth strategy may require us to incur additional expenditures to expand our administrative and operational infrastructure. If we are unable to effectively manage and grow our banking franchise, we may experience compliance and operational problems, have to slow the pace of growth, or have to incur additional expenditures beyond current projections to support such growth. We may not have, or may not be able to develop, the knowledge or relationships necessary to be successful in new markets. Our failure to sustain our historical rate of growth, adequately manage the factors that have contributed to our growth, or successfully enter new markets could have an adverse effect on our earnings and profitability and, therefore, on our business, financial condition, and results of operations.

We may pursue strategic acquisitions in the future, and we may not be able to overcome risks associated with such transactions.

Although we plan to continue to grow our business organically, we may explore opportunities to invest in, or to acquire, other financial institutions and businesses that we believe would complement our existing business.

Our investment or acquisition activities could be material to our business and involve a number of risks including the following:

- investing time and incurring expense associated with identifying and evaluating potential investments or acquisitions and negotiating potential transactions, resulting in our attention being diverted from the operation of our existing business;
- the lack of history among our management team in working together on acquisitions and related integration activities;
- the time, expense, and difficulty of integrating the operations and personnel of the combined businesses;
- unexpected asset quality problems with acquired companies;
- inaccurate estimates and judgments used to evaluate credit, operations, management, and market risks with respect to the target institution or assets;
- risks of impairment to goodwill or OTTI of investment securities;

- potential exposure to unknown or contingent liabilities of banks and businesses we acquire;
- an inability to realize expected synergies or returns on investment;
- potential disruption of our ongoing banking business; and
- loss of key employees or key customers following our investment or acquisition.

We may not be successful in overcoming these risks or other problems encountered in connection with potential investments or acquisitions. Our inability to overcome these risks could have an adverse effect on our ability to implement our business strategy and enhance shareholder value, which, in turn, could have an adverse effect on our business, financial condition, and results of operations. Additionally, if we record goodwill in connection with any acquisition, our business, financial condition, and results of operations may be adversely affected if that goodwill is determined to be impaired, which would require us to take an impairment charge.

New lines of business, products, product enhancements, or services may subject us to additional risk.

From time to time, we may implement new lines of business or offer new products and product enhancements as well as new services within our existing lines of business. There are substantial risks and uncertainties associated with these efforts. In developing, implementing, or marketing new lines of business, products, product enhancements, or services, we may invest significant time and resources. We may underestimate the appropriate level of resources or expertise necessary to make new lines of business or products successful or to realize their expected benefits. We may not achieve the milestones set in initial timetables for the development and introduction of new lines of business, products, product enhancements, or services, and price and profitability targets may not prove feasible. External factors, such as new or changing regulations, competitive alternatives, and shifting market preferences, may also impact the ultimate implementation of a new line of business or offerings of new products, product enhancements, or services. Any new line of business, product, product enhancement, or service could have a significant impact on the effectiveness of our system of internal controls. We may also decide to discontinue businesses or products due to lack of customer acceptance or unprofitability. Failure to successfully manage these risks in the development and implementation of new lines of business or offerings of new products, product enhancements, or services could have an adverse effect on our business, financial condition, and results of operations.

Our reputation is critical to our business, and damage to it could have an adverse effect on us.

A key differentiating factor for our business is the strong reputation we are building in our market. Maintaining a positive reputation is critical to attracting and retaining customers and employees. Adverse perceptions of us could make it more difficult for us to execute on our strategy. Harm to our reputation can arise from many sources, including actual or perceived employee misconduct, errors or misconduct by our third-party vendors or other counterparties, litigation or regulatory actions, our failure to meet our high customer service and quality standards, and compliance failures.

In particular, it is not always possible to prevent employee error or misconduct, and the precautions we take to prevent and detect this activity may not be effective in all cases. Because the nature of the financial services business involves a high volume of transactions, certain errors may be repeated or compounded before they are discovered and successfully rectified. Our necessary dependence upon processing systems to record and process transactions and our large transaction volume may further increase the risk that employee errors, tampering, or manipulation of those systems will result in losses that are difficult to detect. Employee error or misconduct could also subject us to financial claims. If our internal control systems fail to prevent or detect an occurrence, or if any resulting loss is not insured, exceeds applicable insurance limits, or if insurance coverage is denied or not available, it could have an adverse effect on our business, financial condition, and results of operations.

Additionally, as a financial institution, we are inherently exposed to operational risk in the form of theft and other fraudulent activity by employees, customers, and other third parties targeting us and our customers or data. Such activity may take many forms, including check fraud, electronic fraud, wire fraud, phishing, social engineering, and other dishonest acts. Although we devote substantial resources to maintaining effective policies and internal controls to identify and prevent such incidents, given the increasing sophistication of possible perpetrators, we may experience financial losses or reputational harm as a result of fraud.

Negative publicity about us, whether accurate or not, may also damage our reputation, which could have an adverse effect on our business, financial condition, and results of operations.

Our operations could be interrupted if our third-party service providers experience difficulty, terminate their services, or fail to comply with banking regulations.

We outsource some of our operational activities and, accordingly, depend on relationships with third-party providers for services such as core systems support, informational website hosting, internet services, online account opening, and other processing services. Our business depends on the successful and uninterrupted functioning of our information technology and telecommunications systems, many of which also depend on third-party providers. The failure of these systems, a cybersecurity breach involving any of our third-party service providers, or the termination or change in terms of a third-party software license or service agreement on which any of these systems is based could interrupt our operations. Because our information technology and telecommunications systems interface with and depend on third-party systems, we could experience service denials if demand for such services exceeds capacity, or such third-party systems fail or experience interruptions. Replacing vendors or addressing other issues with our third-party service providers could entail significant delay, expense, and disruption of service.

As a result, if these third-party service providers experience difficulties, are subject to cybersecurity breaches, or terminate their services, and we are unable to replace them with other service providers, particularly on a timely basis, our operations could be interrupted. If an interruption were to continue for a significant period of time, our business, financial condition, and results of operations could be adversely affected. Even if we are able to replace third-party service providers, it may be at a higher cost to us, which could adversely affect our business, financial condition, and results of operations.

Furthermore, third-party service providers, and banking organizations' relationships with those providers, are subject to demanding regulatory requirements and attention by bank regulators. These regulatory expectations may change, and potentially become more rigorous in certain ways, due to an interagency effort to replace existing guidance on the risk management of third-party relationships with new guidance. Our regulators may hold us responsible for any deficiencies in our oversight or control of our third-party service providers and in the performance of the parties with which we have these relationships. As a result, if our regulators assess that we have not exercised adequate oversight and control over our third-party service providers or that such providers have not performed adequately, we could be subject to administrative penalties, fines, or other forms of regulatory enforcement action as well as requirements for consumer remediation, any of which could have an adverse effect on our business, financial condition, and results of operations.

System failure or cybersecurity breaches of our network security could subject us to increased operating costs as well as litigation, damage to our reputation, and other potential losses.

Failures in, or breaches of, our computer systems and network infrastructure, or those of our third-party vendors or other service providers, including as a result of cyber-attacks, could disrupt our business, result in the disclosure or misuse of confidential or proprietary information, damage our reputation, increase our costs, and cause losses. Our operations are dependent upon our ability to protect our computer equipment against damage from fire, power loss, telecommunications failure, or a similar catastrophic event. Any damage or failure that causes an interruption in our operations could have an adverse effect on our business, financial condition, and results of operations. In addition, our operations are dependent upon our ability to protect our computer systems and network infrastructure, including our internet banking activities, against damage from physical break-ins, cybersecurity breaches, and other disruptive problems caused by the internet or other users. Cybersecurity breaches and other disruptions would jeopardize the security of information stored in and transmitted through our computer systems and network infrastructure, which may result in significant liability to us and damage to our reputation and may discourage current and potential customers from using our internet banking services. Our security measures, including firewalls and penetration testing, may not prevent or detect future potential losses from system failures or cybersecurity breaches.

In the normal course of business, we collect, process, and retain sensitive and confidential information regarding our customers. Although we devote significant resources and management focus to ensuring the integrity of our systems through information security and business continuity programs, our facilities and systems, and those of our third-party service providers, are vulnerable to external or internal security breaches, acts of vandalism, computer viruses, misplaced or lost data, programming or human errors, or other similar events. We and our third-party service providers have experienced these types of events in the past and expect to continue to experience them in the future. These events could interrupt our business or operations or result in significant legal and financial exposure, supervisory criticism, regulatory enforcement action, damage to our reputation, loss of customers and business, or a loss of confidence in the security of our systems, products, and services. Although the impact to date from these events has not had an adverse effect on us, we cannot be sure this will be the case in the future. Any of these occurrences could have an adverse effect on our business, financial condition, and results of operations.

Information security risks for financial institutions like us have increased recently in part because of new technologies, the use of the internet and telecommunications technologies (including mobile devices) to conduct financial and other business transactions, and the increased sophistication and activities of organized crime, perpetrators of fraud, hackers, terrorists, and others. In addition to cyber-attacks or other security breaches involving the theft of sensitive and confidential information, hackers recently have engaged in attacks against large financial institutions that are designed to disrupt key business services, such as consumer-facing web sites. We are not able to anticipate or implement effective preventive measures against all security breaches of these types, especially because the techniques used change frequently and because attacks can originate from a wide variety of sources. Our early detection and response mechanisms may be thwarted by sophisticated attacks and malware designed to avoid detection.

The federal banking agencies issued a final rule in November 2021 that requires banking organizations to notify their primary federal regulator of significant computer security incidents within 36 hours of determining that such an incident has occurred. The compliance date of this rule is May 1, 2022. Failure to comply with this rule in the event of such an incident could result in sanctions by regulatory agencies, civil money penalties, and/or damage to our reputation, all of which could have an adverse effect on our business, financial condition, and results of operations.

Our ability to conduct our business could be disrupted by natural or man-made disasters or the effects of climate change.

All of our offices, a significant portion of the real estate securing loans we make, and many of our borrowers' business operations in general, are located in California. California has had and will continue to have major earthquakes in areas where a significant portion of the collateral and assets of our borrowers are concentrated. California is also prone to fires, mudslides, floods, and other natural disasters, such as the recent fires that impacted several counties in California, including Orange and Napa. Additionally, acts of terrorism, war, civil unrest, violence, other man-made disasters, or the effects of climate change could also cause disruptions to our business or to the economy as a whole. The occurrence of natural or man-made disasters or the effects of climate change could destroy, or cause a decline in the value of, mortgaged properties or other assets that serve as our collateral and increase the risk of delinquencies, defaults, foreclosures and losses on our loans, damage our banking facilities and offices, negatively impact regional economic conditions, result in a decline in loan demand and loan originations, result in drawdowns of deposits by customers impacted by disasters and negatively impact the implementation of our growth strategy. Natural or man-made disasters or the effects of climate change could also disrupt our business operations more generally. We have implemented a business continuity program that allows us to move critical functions to a backup data center in the event of a catastrophe. Although this program has been tested, we cannot guarantee its effectiveness in any disaster scenarios. Regardless of the effectiveness of our disaster recovery and business continuity plan, the occurrence of any natural or man-made disaster or the effects of climate change could have an adverse effect on our business, financial condition, and results of operations. Climate change also could present financial risks to us as a result of transition risks, such as societal and/or technological responses to climate change, which could include changes in climate policy or in the regulation of financial institutions with respect to risks posed by climate change.

Litigation and regulatory actions, including possible enforcement actions, could subject us to significant fines, penalties, judgments, or other requirements resulting in increased expenses or restrictions on our business activities.

From time to time, in the normal course of business, we have in the past been and may in the future be named as a defendant in various legal actions, arising in connection with our current and/or prior business activities. Legal actions could include claims for substantial compensatory or punitive damages or claims for indeterminate amounts of damages. Further, in the future our regulators may impose consent orders, civil money penalties, matters requiring attention, or similar types of supervisory criticism. We may also, from time to time, be the subject of subpoenas, requests for information, reviews, investigations, and proceedings (both formal and informal) by governmental agencies regarding our current and/or prior business activities. Any such legal or regulatory actions may subject us to substantial compensatory or punitive damages, significant fines, penalties, obligations to change our business practices, or other requirements resulting in increased expenses, diminished income, and damage to our reputation. Our involvement in any such matters, whether tangential or otherwise and even if the matters are ultimately determined in our favor, could also cause significant harm to our reputation and divert management attention from the operation of our business. Further, any settlement, consent order, or adverse judgment in connection with any formal or informal proceeding or investigation by government agencies may result in litigation, investigations, or proceedings as other litigants and government agencies begin independent reviews of the same activities. As a result, the outcome of legal and regulatory actions could have an adverse effect on our business, financial condition, and results of operations.

We are subject to an extensive body of accounting rules and best practices. Periodic changes to such rules may change the treatment and recognition of critical financial line items.

The nature of our business makes us sensitive to the large body of accounting rules in the United States. From time to time, the governing bodies that oversee changes to accounting rules and reporting requirements may release new guidance for the preparation of our consolidated financial statements. These changes can materially impact how we record and report our financial condition and results of operations. In some instances, we could be required to apply a new or revised standard retroactively, resulting in the restatement of prior period financial statements. Changes which have been approved for future implementation, or which are currently proposed or expected to be proposed or adopted include requirements that we: (i) calculate the allowance for loan losses on the basis of the current expected loan losses over the lifetime of our loans, which is expected to be applicable to us beginning in 2023, and may result in increases in our allowance for loan losses and future provisions for loan losses; and (ii) record the value of and liabilities relating to operating leases on our balance sheet, which became applicable to us beginning in 2022. These changes could adversely affect our capital, regulatory capital ratios, ability to make larger loans, earnings, and performance metrics. Any such changes could have an adverse effect on our business, financial condition, and results of operations.

The accuracy of our consolidated financial statements and related disclosures could be affected if the judgments, assumptions, or estimates used in our critical accounting policies are inaccurate.

The preparation of financial statements and related disclosures in conformity with GAAP requires us to make judgments, assumptions, and estimates that affect the amounts reported in our consolidated financial statements and accompanying notes. Our critical accounting policies, which are included in the section entitled “Management’s Discussion and Analysis of Financial Condition and Results of Operations” in this Annual Report on Form 10-K, describe those significant accounting policies and methods used in the preparation of our consolidated financial statements that we consider “critical” because they require judgments, assumptions, and estimates that materially affect our consolidated financial statements and related disclosures. As a result, if future events or regulatory views concerning such analysis differ significantly from the judgments, assumptions, and estimates in our critical accounting policies, those events or assumptions could have a material impact on our consolidated financial statements and related disclosures, in each case resulting in our possible need to revise or, if in error, restate prior period financial statements, cause damage to our reputation and the price of our common stock and adversely affect our business, financial condition, and results of operations.

Item 1B. Unresolved Staff Comments

None.

Item 2. Properties

Our corporate headquarters is located at 3100 Zinfandel Drive, Suite 100, Rancho Cordova, CA 95670. As of December 31, 2021, in addition to our corporate headquarters, which includes our Rancho Cordova branch, we operated six other branch offices in Roseville, Natomas, Redding, Elk Grove, Chico, and Yuba City and two commercial loan production offices in Santa Rosa and Sacramento. We lease our corporate headquarters and all of our other offices. The lease on our corporate headquarters expires in 2026, and the leases on our branch offices and commercial loan production offices expire in 2022 through 2032. We believe that these facilities and additional or alternative space available to us are adequate to meet our needs for the foreseeable future.

Item 3. 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 4. Mine Safety Disclosures

Not applicable.

PART II

Item 5. Market for Registrant’s Common Equity, Related Shareholder Matters and Issuer Purchases of Equity Securities

Market Information, Holders of Common Stock, and Dividends

The Company’s common stock, no par value per share, is traded on the Nasdaq Global Select Market under the symbol “FSBC.” On December 31, 2021, there were 240 holders of record of the Company’s common stock.

The Company has paid cash dividends on its common stock in every quarter since January 2002, with the exception of the third and fourth quarters of 2009 and all quarters of 2010. Historically, we had been treated as an S Corporation for U.S. federal income tax purposes, and as such, we had paid distributions to our existing shareholders to assist them in paying the U.S. federal income taxes on our taxable income that was “passed through” to them, as well as additional amounts for returns on capital. Following the completion of our IPO, our dividend policy and practice has changed, as we are now taxed as a C Corporation and, therefore, no longer pay distributions to provide our shareholders with funds to pay U.S. federal income tax on their pro rata portion of our taxable income.

It is currently the intention of the board of directors of the Company to continue payment of cash dividends on a quarterly basis. There is no assurance, however, that any dividends will be paid since they are dependent on a number of factors, including general and economic conditions, industry standards, our financial condition and operating results, our available cash and current and anticipated cash needs, capital requirements, our ability to service debt obligations senior to our common stock, banking regulations, contractual, legal, tax, and regulatory restrictions, and limitations on the payment of dividends by us to our shareholders or by the Bank to us, and such other factors as our board of directors may deem relevant. As of December 31, 2021, there was $15.5 million available for payment of dividends by the Bank to the Company, under applicable laws and regulations. For a discussion of dividend restrictions on our common stock, or of restrictions on dividends from the Company’s subsidiaries to the Company, see the sections entitled “Part I, Item 1. Business—Supervision and Regulation—Supervision and Regulation of the Company—Payment of Dividends and Stock Repurchases” and “Part I, Item 1. Business—Supervision and Regulation—Supervision and Regulation of the Bank—Payment of Dividends.”

Securities Authorized for Issuance Under Equity Compensation Plans

See “Part III, Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Shareholder Matters.”

Unregistered Sales of Equity Securities and Use of Proceeds

Unregistered Sales of Equity Securities

Not applicable.

Use of Proceeds

On May 7, 2021, we completed our IPO of 6,054,750 shares of our common stock at an IPO price of $20.00 per share, including 789,750 shares pursuant to the exercise of the underwriters’ option to purchase additional shares of our common stock. We raised approximately $111.2 million in net proceeds after deducting underwriting discounts and commissions of approximately $8.5 million and certain estimated offering expenses payable by us of approximately of $1.3 million. The net proceeds less $2.1 million in other related expenses, including audit fees, legal fees, listing fees, and other expenses, totaled $109.1 million. Keefe, Bruyette & Woods, Inc. acted as bookrunner for the IPO, and Stephens Inc. and D.A. Davidson acted as co-managers. None of the expenses associated with the IPO were paid to directors, officers, affiliates, persons owning 10% or more of any class of equity securities, or their associates.

All of the shares issued and sold in our IPO were registered under the Securities Act pursuant to a Registration Statement on Form S-1 (File No. 333-255143) (the “Registration Statement”), which was declared effective by the SEC on May 4, 2021. We have used the proceeds from our IPO as disclosed in our final prospectus dated as of May 4, 2021 and filed with the SEC pursuant to Rule 424(b)(4) on May 6, 2021, including a cash distribution in the amount of $27.0 million to our shareholders of record as of May 3, 2021, paid on May 21, 2021, and there has been no material change in the planned use of proceeds. No proceeds currently remain from the IPO.

Issuer Purchases of Equity Securities

None.

Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations

The following discussion and analysis presents management's perspective on our financial condition and results of operations on a consolidated basis. However, because we conduct all of our material business operations through the Bank, the discussion and analysis relate to activities primarily conducted by the Bank. This discussion and analysis should be read in conjunction with the audited consolidated financial statements and the accompanying notes presented elsewhere in this Annual Report on Form 10-K. Average balances, including balances used in calculating certain financial ratios, are generally comprised of average daily balances.

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. In addition to containing historical information, this discussion contains forward-looking statements that involve risks, uncertainties, and assumptions that could cause results to differ materially from management's expectations. Factors that could cause such differences are discussed in the sections entitled "Cautionary Note Regarding Forward-Looking Statements" and "Part I, Item 1A. Risk Factors." We assume no obligation to update any of these forward-looking statements, except to the extent 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 two loan production offices. 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 December 31, 2021, we had total assets of $2.6 billion, total loans, net of allowance for loan losses, of $1.9 billion, and total deposits of $2.3 billion.

Key Factors Affecting our Business

COVID-19

The COVID-19 pandemic and the impact of actions to mitigate the spread of the virus affected our business, financial condition, and results of operations in the year ended December 31, 2021. During the year, we maintained our focus on relationship-based banking and made the health and safety of our customers and employees our priority. To help protect our customers and their finances during the pandemic, while all of our branches were open, we took into account guidelines from public health officials, and encouraged our customers to conduct business with us via phone, online banking, and mobile apps.

Our financial results for the year ended December 31, 2021 were also impacted by the COVID-19 pandemic. On March 27, 2020, the CARES Act was enacted, providing wide ranging economic relief for individuals and businesses impacted by COVID-19, including the Paycheck Protection Program ("PPP"), a loan program administered by the SBA. The Consolidated Appropriations Act, 2021 (the "Consolidated Appropriations Act") enacted on December 27, 2020, extended some of these relief provisions in certain respects, and the PPP Extension Act of 2021, enacted on March 30, 2021, extended the deadline to apply for a PPP loan through May 31, 2021. Under the PPP if a loan is fully forgiven, the SBA will repay the lending bank in full. If a loan is partially forgiven or not forgiven at all, a lender must look to the borrower for repayment of unforgiven principal and interest. If the borrower defaults, in part or in full, the loan is guaranteed by the SBA.

Our responsiveness and certainty of execution resulted in our ability to quickly provide 1,602 PPP loans to 1,239 customers nationwide, approximately 39% of which were new customers as of December 31, 2021. Because of our relationship-based banking approach, the influx of new customers contributed to a corresponding increase in deposits in the year ended December 31, 2020, which continued into the year ended December 31, 2021. Our balance of PPP loans at December 31, 2021 was $22.1 million, or 1.14% of total loans.

Additionally, the uncertainty and economic downturn caused by the COVID-19 pandemic affected our overall existing loan portfolio. In 2020, our methodology for evaluating the allowance for loan losses was affected by the COVID-19 pandemic, resulting in higher reserve levels primarily related to our commercial secured portfolio. In 2021, we continued to monitor higher risk concentrations identified in the loan portfolio for ongoing effects from COVID-19 and the impact on the economy. During 2021, reserve amounts were positively impacted by improved economic conditions and reductions to reserves required for classified and watch loans, which was offset by additional provisions required for loan growth during the year. We also recognized COVID-19 deferments and related modifications on our loan portfolio more generally. The CARES Act, as amended by the Consolidated Appropriations Act, specified that COVID-19 related loan modifications executed between March 1, 2020 and the earlier of: (i) 60 days after the date of termination of the national emergency declared by the President; and (ii) January 1, 2022, on loans that were current as of December 31, 2019 are not TDRs. Additionally, under guidance from the federal banking agencies, other short-term modifications made on a good faith basis in response to COVID-19 to borrowers that were current prior to any relief are not troubled debt restructurings ("TDRs") under ASC Subtopic 310-40, "Troubled Debt Restructuring by Creditors." These modifications include short-term (e.g., up to six months) modifications such as payment deferrals, fee waivers, extensions of repayment terms, or delays in payment that are insignificant. We elected to apply these temporary accounting provisions to loans under payment relief beginning in March 2020. As of December 31, 2021, six loans totaling $12.2 million, or 0.63% of the loan portfolio, were in a COVID-19 deferment period and three loans totaling $0.1 million had been in a COVID-19 deferment in the third quarter of 2021 but were not in such deferment as of December 31, 2021. None of the loans that received COVID-19 deferments in the fourth quarter of 2021 had the principal portion deferred to the respective maturity of the loan. We accrue and recognize interest income on loans under payment relief based on the original contractual interest rates. When payments resume at the end of the relief period, the payments will generally be applied to accrued interest due until accrued interest is fully paid.

Interest Rates

Net interest income is the most significant contributor to our net income and is the difference between the interest and fees earned on interest-earning assets and the interest expense incurred in connection with interest-bearing liabilities. Net interest income is primarily a function of the average balances and yields of these interest-earning assets and interest-bearing liabilities. These factors are influenced by internal considerations such as product mix and risk appetite as well as external influences such as economic conditions, competition for loans and deposits and market interest rates.

The cost of our deposits and short-term borrowings is primarily based on short-term interest rates, which are largely driven by the Federal Reserve's actions and market competition. The yields generated by our loans and securities are typically affected by short-term and long-term interest rates, which are driven by market competition and market rates often impacted by the Federal Reserve's actions. The level of net interest income is influenced by movements in such interest rates and the pace at which such movements occur.

We anticipate that interest rates may rise over the next few years. Based on our asset sensitivity, a steepened yield curve could have a beneficial impact on our net interest income. Additionally, a continued flat yield curve would be expected to maintain our net interest income.

Factors Affecting Comparability of Financial Results

S Corporation Status

Beginning at our inception, we elected to be taxed for U.S. federal income tax purposes as an S Corporation. In conjunction with our IPO, we filed consents from the requisite amount of our shareholders to revoke our S Corporation election with the Internal Revenue Service (the "IRS"), resulting in the commencement of our taxation as a C Corporation for U.S. federal and California state income tax purposes in the second quarter of fiscal year 2021. Prior to such revocation, our earnings were not subject to, and we did not pay, U.S. federal income tax, and we were not required to make any provision or recognize any liability for U.S. federal income tax in our consolidated financial statements. While we were not subject to, and did not pay, U.S. federal income tax, we were subject to, and paid, California S Corporation income tax at a current rate of 3.50%. Upon the termination of our status as an S Corporation, we commenced paying U.S. federal income tax and a higher California state income tax on our taxable earnings for each year (including the short year beginning on the date our status as an S Corporation terminated), and our consolidated financial statements reflect a provision for U.S. federal income tax and a higher California state income tax from that date forward. As a result of this change, the net income and earnings per share ("EPS") data presented in our historical 2020 financial statements and the other related financial information set forth in this Annual Report on Form 10-K, which (unless otherwise specified) do not include any provision for U.S. federal income tax or the higher California state income tax rate, will not be comparable with our net income and EPS in periods after we commenced being taxed as a C Corporation. As a C Corporation, our net income is calculated by including a provision for U.S. federal income tax and a higher California state income tax rate at a combined statutory rate of 29.56%.

The termination of our status as an S Corporation may also affect our financial condition and cash flows. Historically, we made quarterly cash distributions to our shareholders in amounts estimated by us to be sufficient for them to pay estimated individual U.S. federal and California state income tax liabilities resulting from our taxable income that was "passed through" to them. However, these distributions were not consistent, as sometimes the distributions were less than or in excess of the shareholders' estimated U.S. federal and California state income tax liabilities resulting from their ownership of our stock. In addition, these estimates were based on individual income tax rates, which may differ from the rates imposed on the income of C Corporations. As a C Corporation, no income is "passed through" to any shareholders, but, as noted above, we commenced paying U.S. federal income tax and a higher California state income tax. However, in the event of an adjustment to our reported taxable income for periods prior to the termination of our S Corporation status, it is possible that our pre-IPO shareholders would be liable for additional income taxes for those prior periods. Pursuant to the Tax Sharing Agreement we entered into with such shareholders, upon our filing any tax return (amended or otherwise), in the event of any restatement of our taxable income or pursuant to a determination by, or a settlement with, a taxing authority, for any period during which we were an S Corporation, depending on the nature of the adjustment, we may be required to make a payment to such shareholders, who accepted distribution of the estimated balance of our federal accumulated adjustments account of $27.0 million under the Tax Sharing Agreement, in an amount equal to such shareholders' incremental tax liability (including interest and penalties). In addition, the Tax Sharing Agreement provides that we will indemnify such shareholders with respect to unpaid income tax liabilities (including interest and penalties) to the extent that such unpaid income tax liabilities are attributable to an adjustment to our taxable income for any period after our S Corporation status terminated. The amounts that we have historically distributed to our shareholders may not be indicative of the amount of U.S. federal and California state income tax that we will be required to pay going forward. Depending on our effective tax rate and our future dividend rate, our future cash flows and financial condition could be positively or adversely affected compared to our historical cash flows and financial condition.

Furthermore, deferred tax assets and liabilities were recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of our existing assets and liabilities and their respective tax bases. Deferred tax assets and liabilities are measured using tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of the change in tax rates resulting from becoming a C Corporation was recognized in net income in the year ended December 31, 2021.

Refer to the highlights of the financial results table within the section entitled "—Executive Summary" below for the impact of being taxed as a C Corporation on our net income, EPS, and various other financial measures for the years ended December 31, 2021 and 2020.

Public Company Costs

Following the completion of our IPO, we began to, and will continue to, incur additional costs associated with operating as a public company. These costs include additional personnel, legal, consulting, regulatory, insurance, accounting, investor relations, and other expenses that we did not incur as a private company.

The Sarbanes-Oxley Act, as well as rules adopted by the SEC, the FDIC, and national securities exchanges, require public companies to implement specified corporate governance practices that were inapplicable to us as a private company. These additional rules and regulations have increased, and are expected to continue to increase, our legal, regulatory, and financial compliance costs and will make some activities more time-consuming and costly.

Critical Accounting Estimates

Our consolidated financial statements are prepared in accordance with accounting principles that are generally accepted in the United States. The preparation of these consolidated financial statements requires management to make estimates and assumptions that affect the reported amounts of our assets, liabilities, revenue, and expenses. We have identified certain policies and estimates as critical to our business operations and the understanding of our past or present consolidated financial condition and results of operations. These policies and estimates are considered critical because they have a material impact, or they have the potential to have a material impact, on our consolidated financial statements and because they require us to make significant judgments, assumptions, or estimates. 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.

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.

Provision and Allowance for Loan Losses

The allowance for loan losses represents the estimated probable incurred loan losses in our loan portfolio. The allowance for loan losses is established through a provision for loan losses charged to operations. Loans are charged against the allowance for loan losses 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 loan losses.

The allowance for loan losses is evaluated on a regular basis by management in consideration of optimistic, moderate, and pessimistic current conditions, 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, prevailing economic conditions specifically impacting each loan type by purpose and by geography, and concentrations within the loan portfolio. This evaluation is inherently subjective, as it requires estimates that are susceptible to significant revision as more information becomes available.

A significant amount of the allowance for loan losses is measured on a collective (pool) basis by loan type when similar risk characteristics exist. For loans evaluated collectively, the allowance for loan losses is determined using historical losses adjusted for qualitative and environmental factors to reflect current conditions. The most significant components of qualitative and environmental factors used to estimate the allowance for loan losses are adjustments relating to prevailing economic conditions and volume of the loan portfolio. The prevailing economic conditions factor is estimated based on a range of potential economic conditions and is applied at both the portfolio and individual concentration level based on various factors. This estimate is subject to significant judgment and could potentially add $7.5 million based on existing loan balances, if not more, to the allowance for loan losses in pessimistic economic conditions. The volume of the loan portfolio is estimated based on growth rates in the prior year combined with an assessment of underwriting and credit standards. This estimate is subject to significant judgment and could potentially add $2.9 million based on existing loan balances, if not more, to the allowance for loan losses based on growth due to significant changes to underwriting standards. The concentrations estimate of qualitative and environmental factors is determined by the overall market outlook and is focused on significant concentrations within the loan portfolio. This estimate is subject to significant judgment and could potentially add $5.3 million based on existing loan balances, if not more, to the allowance for loan losses based on a pessimistic market outlook for the specifically identified concentration.

Income Taxes

Income tax expense is the total of the current year income tax due or refundable and the change in deferred tax assets and liabilities. Deferred tax assets and liabilities are the expected future tax amounts for the temporary differences between carrying amounts and tax bases of assets and liabilities, computed using tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. A valuation allowance, if needed, reduces deferred tax assets to the amount expected to be realized. These estimates are determined using information available in the current year and are subject to change. As of December 31, 2021, the estimated net deferred tax asset was approximately $4.9 million and was estimated using an estimated blended statutory tax rate of 29.56%. Actual enacted tax rates upon recognition of the tax asset could vary significantly from our initial estimate.

Uncertain tax positions are recognized as a benefit only if it is “more likely than not” that the tax position would be sustained in a tax examination, with a tax examination being presumed to occur. The amount recognized is the largest amount of tax benefit that has a likelihood greater than 50% of being realized on examination. For tax positions not meeting the “more likely than not” test, no tax benefit is recorded. As of December 31, 2021, the Company did not recognize any uncertain tax positions.

Executive Summary

Our strategic focus is to continue to grow organically by leveraging our existing core competencies and positioning our business for success in the evolving banking landscape. In leveraging our core competencies, we intend to:

- continue our organic lending growth in our market through our "purpose-driven and integrity-centered" approach to banking;
- continue to focus and grow each of the diverse industry clusters throughout our market areas;
- build upon the strength of our brand to deepen and broaden client relationships and grow our deposit base;
- attract additional banking professionals with track records of driving revenue growth;
- maintain our disciplined credit underwriting and robust risk management;
- enhance our disciplined cost management culture;
- leverage our technology platforms to improve our efficiency; and
- further engage in the economic development of our communities and market areas.

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

(dollars in thousands)	December 31, 2021	December 31, 2020
Selected financial condition data:		
Total assets	$ 2,556,761	$ 1,953,765
Total loans, net	1,921,888	1,485,790
Total deposits	2,285,890	1,784,001
Total subordinated notes, net	28,386	28,320
Total shareholders' equity	235,046	133,775
Asset quality ratios:		
Allowance for loan losses to total loans	1.20%	1.47%
Allowance for loan losses to total loans, excluding PPP loans[1]	1.21%	1.63%
Allowance for loan losses to period end nonperforming loans	39.54x	49.09x
Non-accrual loans to period end loans	0.03%	0.03%
Capital ratios:		
Total capital (to risk-weighted assets)	13.98%	12.18%
Tier 1 capital (to risk-weighted assets)	11.44%	8.98%
Common equity Tier 1 capital (to risk-weighted assets)	11.44%	8.98%
Tier 1 leverage ratio	9.47%	6.58%
Total shareholders' equity to total assets ratio	9.19%	6.85%
Tangible shareholders' equity to tangible assets[2]	9.19%	6.85%

(dollars in thousands, except share and per share data)	For the year ended December 31, 2021	For the year ended December 31, 2020
Selected operating data:		
Net interest income	$ 77,611	$ 65,210
Provision for loan losses	1,700	9,000
Non-interest income	7,280	9,302
Non-interest expense	36,043	28,257
Net income	42,441	35,928
Earnings per common share:		
Basic	$ 2.83	$ 3.57
Diluted	$ 2.83	$ 3.57
Book value per share	$ 13.65	$ 12.16
Tangible book value per share[3]	$ 13.65	$ 12.16
Weighted average basic common shares outstanding	14,972,637	10,063,183
Weighted average diluted common shares outstanding	14,995,213	10,063,183
Shares outstanding at end of period	17,224,848	11,000,273
Selected pro forma operating data:		
Pro forma net income[4]	37,813	26,242
Pro forma provision for income taxes[4]	9,335	11,013
Pro forma earnings per common share[4]:		
Basic	$ 2.53	$ 2.61
Diluted	$ 2.52	$ 2.61
Performance and other financial ratios:		
Return on average assets ("ROAA")	1.86%	1.95%
Return on average equity ("ROAE")	22.49%	31.16%
Net interest margin	3.64%	3.68%
Cost of funds	0.19%	0.54%
Efficiency ratio	42.46%	37.92%
Average equity to average assets	8.28%	6.25%
Cash dividend payout ratio on common stock[5]	160.52%	73.66%
Selected pro forma ratios:		
Pro forma ROAA[4, 6]	1.66%	1.42%
Pro forma ROAE[4, 6]	20.03%	22.75%

1 The allowance for loan losses to total loans, excluding PPP loans, is considered a non-GAAP financial measure. See the section entitled "Non-GAAP Financial Measures" for a reconciliation of our non-GAAP measures to the most directly comparable GAAP financial measure. Allowance for loan losses to total loans, excluding PPP loans, is defined as allowance for loan losses, divided by total loans less PPP loans. The most directly comparable GAAP financial measure is allowance for loan losses to total loans.

2 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 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.

3 Tangible book value per share is considered a non-GAAP financial measure. See the section entitled "Non-GAAP Financial Measures" for a reconciliation of our non-GAAP 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 of the dates 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.

4 For the year ended December 31, 2020, we calculate our pro forma net income, provision for income taxes, net income per common share, ROAA, and ROAE by adding back our S Corporation tax to net income and applying a combined C Corporation effective tax rate for U.S. federal and California state income taxes of 29.56%. This calculation reflects only the change in our status as an S Corporation and does not give effect to any other transaction. For the year ended December 31, 2021, we calculate our pro forma net income, provision for income taxes, net income per common share, ROAA, and ROAE using an effective tax rate of 19.80%, which is the actual effective tax rate, excluding the effects of the discrete deferred tax adjustment of $4.6 million, discussed in the section entitled "Provision for Income Taxes" below.

5 Cash dividend payout ratio on common stock is calculated as dividends on common shares divided by basic net income per common share.

6 Pro forma ROAA and ROAE are calculated using pro forma net income balances, with no adjustments to average assets and average equity balances.

RESULTS OF OPERATIONS

The following discussion of our results of operations compares the year ended December 31, 2021 to the year ended December 31, 2020.

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 interest-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.

Our net interest margin of 3.64% for the year ended December 31, 2021 decreased from 3.68% for the year ended December 31, 2020. This decrease was primarily due to a 37 basis point decrease in yields on interest-earning assets, which decreased from 4.20% for the year ended December 31, 2020 to 3.83% for the year ended December 31, 2021, partially offset by a 46 basis point decrease in yields on interest-bearing liabilities, which decreased from 0.78% for the year ended December 31, 2020 to 0.32% for the year ended December 31, 2021.

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 rates paid for each period reported. The average balances are daily averages and include both performing and nonperforming loans.

(dollars in thousands)	For the year ended December 31, 2021 Average Balance	Interest Income/ Expense	Average Yield/ Rate	For the year ended December 31, 2020 Average Balance	Interest Income/ Expense	Average Yield/ Rate
Assets						
Interest-earning deposits with banks[1]	$ 346,522	$ 547	0.16%	$ 237,815	$ 1,198	0.50%
Investment securities[2]	147,519	2,142	1.45%	95,158	1,787	1.88%
Loans[1, 3]	1,637,280	78,894	4.82%	1,439,380	71,405	4.96%
Total interest-earning assets[1]	2,131,321	81,583	3.83%	1,772,353	74,390	4.20%
Interest receivable and other assets, net	148,830			72,628		
Total assets	$ 2,280,151			$ 1,844,981		
Liabilities and shareholders' equity						
Interest-bearing transaction accounts	$ 155,163	$ 155	0.10%	$ 141,293	$ 374	0.26%
Savings accounts	74,402	74	0.10%	39,182	94	0.24%
Money market accounts	935,445	1,798	0.19%	867,417	5,750	0.66%
Time accounts	53,222	172	0.32%	102,890	1,189	1.16%
Subordinated debt[1]	28,350	1,773	6.25%	28,364	1,773	6.25%
Total interest-bearing liabilities	1,246,582	3,972	0.32%	1,179,146	9,180	0.78%
Demand accounts	835,834			546,048		
Interest payable and other liabilities	8,984			4,496		
Shareholders' equity	188,751			115,291		
Total liabilities & shareholders' equity	$ 2,280,151			$ 1,844,981		
Net interest spread[4]			3.51%			3.42%
Net interest income/margin[5]		$ 77,611	3.64%		$ 65,210	3.68%

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 amortized cost balances rather than fair value, as changes in fair value are reflected as a component of shareholders' equity. Investment security interest is earned on 30/360 day basis monthly. Yields are not calculated on a tax-equivalent basis.

3 Average loan balance includes both loans held for investment and loans held for sale. 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.

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

5 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 interest 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 rate. The effect of rate changes is calculated by multiplying the change in average rate by the previous period's volume. Changes not solely attributable to volume or rates have been allocated in proportion to the respective volume and rate components.

(dollars in thousands)	For the year ended December 31, 2021 compared to the year ended December 31, 2020		
	Variance due to		
	Volume	Yield/Rate	Total
Interest-earning deposits with banks	$ 171	$ (822)	$ (651)
Investment securities	760	(405)	355
Loans	9,536	(2,047)	7,489
Total interest-earning assets	10,467	(3,274)	7,193
Interest-bearing transaction accounts	(14)	233	219
Savings accounts	(35)	55	20
Money market accounts	(131)	4,083	3,952
Time accounts	161	856	1,017
Subordinated debt	1	(1)	—
Total interest-bearing liabilities	(18)	5,226	5,208
Changes in net interest income/margin	$ 10,449	$ 1,952	$ 12,401

Net interest income increased while net interest margin decreased for the year ended December 31, 2021 as compared to the year ended December 31, 2020. The increase in net interest income was driven primarily by a $7.5 million increase in interest income from loans to $78.9 million for the year ended December 31, 2021, as the average daily balance of loans increased by $197.9 million, or 13.75%, as compared to the year ended December 31, 2020. The four basis point decrease in net interest margin to 3.64% for the year ended December 31, 2021, as compared to the year ended December 31, 2020, was primarily attributable to a 14 basis point decrease in average loan yields to 4.82% for the year ended December 31, 2021, as compared to 4.96% for the year ended December 31, 2020 and a 39 basis point decrease in average loan yields, excluding PPP loans, to 4.70% for the year ended December 31, 2021, as compared to 5.09% for the year ended December 31, 2020. Average total loans and average loan yield, excluding PPP loans, respectively, are considered non-GAAP financial measures. See the section entitled “Non-GAAP Financial Measures” for a reconciliation of our non-GAAP measures to the most directly comparable GAAP financial measure. Decreases in market interest rates and increases in market competition caused a majority of the Company’s current fixed rate loans funded in 2021 to recognize yields lower than those recognized in the year ended December 31, 2020, contributing to the aforementioned decrease in average loan yields. Additionally, the rates associated with the index utilized for a significant portion of the Company’s variable rate loans, the United States 5 Year Treasury index, were higher during the year ended December 31, 2021 than during the prior year, but a majority of these loans were not scheduled to reprice during the year ended December 31, 2021, contributing to the downward trend in average loan yields. Partially offsetting the declining average loan yields was $6.2 million of fee income resulting from PPP loans being forgiven and repaid by the SBA that was recognized in the year ended December 31, 2021, as compared to $4.9 million during the year ended December 31, 2020. As a result, yields on PPP loans increased from 3.95% for the year ended December 31, 2020 to 6.36% for the year ended December 31, 2021.

Interest expense decreased for the year ended December 31, 2021, when compared to the year ended December 31, 2020. The decline in interest expense was primarily attributed to reductions in the rates offered on deposit products. In addition, the growth of non-interest-bearing deposits continues to benefit the cost of funds as compared to historical periods. Specifically, the ratio of average total non-interest-bearing deposits to average total deposits was 40.69% in the year ended December 31, 2021, as compared to 32.18% in the year ended December 31, 2020. As a result, the cost of interest-bearing liabilities decreased by 46 basis points at December 31, 2021 to 0.32%, from 0.78% at December 31, 2020, and the cost of funds decreased to 0.19% at December 31, 2021, as compared to 0.54% at December 31, 2020.

Provision for Loan Losses

The provision for loan losses is based on management’s assessment of the adequacy of our allowance for loan 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 loan losses is charged against earnings in order to maintain our allowance for loan losses, which reflects management’s best estimate of probable losses inherent in our loan portfolio at the balance sheet date.

We recorded a $1.7 million provision for loan losses in the year ended December 31, 2021, compared to a $9.0 million provision for loan losses for the year ended December 31, 2020. The decline of $7.3 million for the provision year-over-year was primarily due to improvements in general economic conditions, albeit at a pace slower than expected due to unforeseen disruptions in the supply chain and increasing energy prices. The level of government assistance provided through the PPP and other programs during 2021, as well as the less significant impact of the COVID-19 pandemic, as compared to 2020, within California and other states where our collateral is located, resulted in favorable economic conditions for our borrowers.

Non-interest Income

Non-interest income is a secondary contributor to our net income. Non-interest income consists primarily of gain on sale of loans, net gain on sale of securities, FHLB dividends, and other fee income, including loan-related fees and fees related to customer deposits.

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

	For the year ended		$	%
(dollars in thousands)	**December 31, 2021**	**December 31, 2020**	**Increase (Decrease)**	**Increase (Decrease)**
Service charges on deposit accounts	$ 424	$ 367	$ 57	15.53%
Net gain on sale of securities	724	1,438	(714)	(49.65)%
Gain on sale of loans	4,082	4,145	(63)	(1.52)%
Loan-related fees	639	2,309	(1,670)	(72.33)%
FHLB stock dividends	372	321	51	15.89%
Earnings on bank-owned life insurance	237	220	17	7.73%
Other income	802	502	300	59.76%
Total non-interest income	$ 7,280	$ 9,302	$ (2,022)	(21.74)%

Net gain on sale of securities. The decrease in net gain on sale of securities was primarily due to a decrease in the gain recognized on the sale of approximately $47.1 million of municipal securities, U.S. government agencies, and U.S. government treasuries during the year ended December 31, 2021, as compared to the gain recognized on the sale of approximately $46.4 million of municipal securities, mortgage-backed securities, and corporate bonds during the year ended December 31, 2020. Of the securities sold during the year ended December 31, 2020, approximately $18.7 million were sold prior to the shutdowns enacted in response to the COVID-19 pandemic, representing approximately $0.5 million of the gain, and the remaining balance of the securities were sold throughout the remainder of the year in response to market fluctuations.

Loan-related fees. The decrease in loan-related fees resulted primarily from a $1.4 million decrease in swap referral fees recognized in the year ended December 31, 2021, as compared to the year ended December 31, 2020, combined with $0.4 million of loan-related fees earned during the year ended December 31, 2020 for processing micro-loans on behalf of a local government agency to businesses in the local area in response to the COVID-19 pandemic, which did not recur in the year ended December 31, 2021.

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 our efficiency ratio. The efficiency ratio 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, which has enabled us to reduce our non-interest expense in both absolute terms and 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 and infrastructure. Additionally, to support corporate organizational matters leading up to the IPO, we experienced increased audit, consulting, and legal costs, particularly during the year ended December 31, 2021. As a result, non-interest expense is increasing in the periods presented below; however, we do not anticipate incurring significant costs of this type in future periods, and we expect our efficiency ratio will improve going forward due, in part, to our past investment in infrastructure.

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

(dollars in thousands)	For the year ended December 31, 2021	December 31, 2020	$ Increase (Decrease)	% Increase (Decrease)
Salaries and employee benefits	$ 19,825	$ 16,084	$ 3,741	23.26%
Occupancy and equipment	1,938	1,715	223	13.00%
Data processing and software	2,494	1,982	512	25.83%
FDIC insurance	700	1,137	(437)	(38.43)%
Professional services	3,792	1,960	1,832	93.47%
Advertising and promotional	1,300	1,102	198	17.97%
Loan-related expenses	1,045	732	313	42.76%
Other operating expenses	4,949	3,545	1,404	39.61%
Total non-interest expense	$ 36,043	$ 28,257	$ 7,786	27.55%

Salaries and employee benefits. The increase in salaries and employee benefits year-over-year was primarily related to an increase of employees and increased commissions related to our loan and deposit growth for the year ended December 31, 2021, as compared to the year ended December 31, 2020, as well as an increase in restricted stock compensation expense recognized for employee restricted share grants of $0.3 million during the year ended December 31, 2021, compared to the year ended December 31, 2020. These increases were partially offset by a $1.7 million increase in deferred loan origination costs for the year ended December 31, 2021, as compared to the year ended December 31, 2020, from increased loan originations.

Data processing and software. Data processing and software increased, primarily as a result of: (i) increased usage of our digital banking platform; (ii) higher transaction volumes related to the increased number of loan and deposit accounts; (iii) increased number of licenses for new users on our loan origination and documentation system; and (iv) increased costs related to improved collateral tracking, electronic statements, and mobile payment solutions.

Professional services. Professional services increased, primarily as a result of increased audit, consulting, and legal costs incurred to support corporate organizational matters leading up to the IPO during the year ended December 31, 2021, as compared to the year ended December 31, 2020.

Other operating expenses. Other operating expenses are comprised of travel, insurance, postage and supplies, director fees, other employee expenses, armored car expenses, courier services, and other miscellaneous administrative expenses. The increase in other operating expenses year-over-year was primarily related to stock compensation expense recognized for director restricted share grants of $0.8 million, which were related to the IPO, during the year ended December 31, 2021. These expenses did not occur in the year ended December 31, 2020. Additionally, other operating expenses increased as a result of increased director fees and expenses combined with increases in expenses related to travel, insurance, dues and subscriptions, data, and telephone, which increased as a result of an increase in volume of customers and employees period-over-period.

Provision for Income Taxes

The Company terminated its status as a Subchapter S corporation as of May 5, 2021, in connection with its IPO, and became a C Corporation. Prior to that date, as an S Corporation, the Company had no U.S. federal income tax expense. The provision recorded for the year ended December 31, 2021 yielded an effective tax rate of 9.98%. Refer to the section entitled “Pro Forma C Corporation Income Tax Expense” below for a discussion on what the Company’s income tax expense and net income potentially could have been had the Company been taxed as a C Corporation for the year ended December 31, 2021 and for the year ended December 31, 2020.

In conjunction with the termination of the Subchapter S corporation status as of May 5, 2021, the C Corporation deferred tax assets and liabilities were estimated for future tax consequences attributable to differences between the financial statement carrying amounts of the Company’s existing assets and liabilities and their respective tax bases. The deferred tax assets and liabilities were measured using tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of the change in tax rates resulting from becoming a C Corporation was recognized by increasing the net deferred tax asset to $5.4 million through a reduction to the provision for income taxes of $4.6 million during the year ended December 31, 2021. Provision for income taxes increased by $3.4 million, or 254.71%, to $4.7 million for the year ended December 31, 2021, as compared to $1.3 million for the year ended December 31, 2020. This increase is due to the change in the tax rate as a result of the Company’s conversion from an S Corporation to a C Corporation, which was partially offset by the $4.6 million reduction to the provision for income taxes for the adjustment of the net deferred tax assets due to the termination of the Company’s S Corporation status, recorded during the year ended December 31, 2021.

Pro Forma C Corporation Income Tax Expense

Because of the Company's status as a Subchapter S Corporation prior to May 5, 2021, no U.S. federal income tax expense was recorded for a portion of the year ended December 31, 2021 and the entirety of the year ended December 31, 2020. Had the Company been taxed as a C Corporation and paid U.S. federal income tax for such periods, the combined statutory income tax rate would have been 29.56% in each period. These pro forma statutory rates reflect a U.S. federal income tax rate of 21.00% and a California income tax rate of 8.56%, after adjustment for the federal tax benefit, on corporate taxable income. Had the Company been subject to U.S. federal income tax for each of these periods, on a statutory income tax rate pro forma basis, the provision for combined federal and state income tax would have been $11.0 million for the year ended December 31, 2020. As a result of the foregoing factors, the Company's pro forma net income (after U.S. federal and California state income tax) would have been $26.2 million for the year ended December 31, 2020. The pro forma statutory rates for the year ended December 31, 2021 are calculated using an effective tax rate of 19.80%, which is the actual effective tax rate, excluding the effects of the discrete deferred tax adjustment of $4.6 million, discussed above. As a result, the Company's pro forma provision for income taxes and pro forma net income for the year ended December 31, 2021 are $9.3 million and $37.8 million, respectively.

FINANCIAL CONDITION SUMMARY

The following discussion compares our financial condition as of December 31, 2021 to our financial condition as of December 31, 2020. The following table summarizes selected components of our consolidated balance sheet as of December 31, 2021 and December 31, 2020.

(dollars in thousands)	**December 31, 2021**	**December 31, 2020**
Total assets	$ 2,556,761	$ 1,953,765
Cash and cash equivalents	$ 425,329	$ 290,493
Total investments	$ 153,753	$ 122,928
Total loans held for investment, net of deferred loan fees	$ 1,934,460	$ 1,503,159
Total deposits	$ 2,285,890	$ 1,784,001
Subordinated notes, net	$ 28,386	$ 28,320
Total shareholders' equity	$ 235,046	$ 133,775

Total Assets

At December 31, 2021, total assets were $2.6 billion, an increase of $603.0 million from $2.0 billion at December 31, 2020, primarily due to increases in cash and cash equivalents, total investments, and total loans held for investment, net of deferred loan fees, as discussed below.

Cash and Cash Equivalents

Total cash and cash equivalents were $425.3 million at December 31, 2021, an increase of $134.8 million, as compared to $290.5 million at December 31, 2020. The increase in cash and cash equivalents since December 31, 2020 was primarily a result of net income recognized of $42.4 million, proceeds from the sale of securities of $47.1 million, cash inflows of $18.7 million related to maturities, prepayments, and calls of available-for-sale securities, an increase in deposits of $501.9 million, and net proceeds of $111.2 million from the issuance of 6,054,750 shares of common stock in our IPO. These increases were partially offset by a decrease of $99.7 million related to purchases of securities, an increase in total loans held for investment, net of deferred loan fees, of $431.3 million, and cash dividends paid of $51.9 million during the same period.

Investment Portfolio

Our investment portfolio is primarily comprised of U.S. government agencies, 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 held for investment and available-for-sale amounted to $153.8 million at December 31, 2021 and $122.9 million at December 31, 2020, an increase of $30.8 million year-over-year. The increase was primarily due to purchases of $99.7 million of mortgage-backed securities, obligations of states and political subdivisions, and U.S. government treasuries to deploy excess cash into interest-earning assets in a more favorable interest rate environment and was partially offset by the sale of $47.1 million of low-yielding securities, and paydowns, calls, and maturities of $18.7 million.

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

	December 31, 2021		December 31, 2020	
(dollars in thousands)	**Carrying Value**	**% of Total**	**Carrying Value**	**% of Total**
Available-for-sale (at fair value):				
U.S. government agencies	$ 19,682	12.80%	$ 31,828	25.89%
Mortgage-backed securities	81,513	53.02%	23,932	19.47%
Obligations of states and political subdivisions	45,137	29.36%	58,420	47.52%
Collateralized mortgage obligations	540	0.35%	769	0.63%
Corporate bonds	1,935	1.26%	—	—
Total available-for-sale	148,807	96.79%	114,949	93.51%
Held-to-maturity (at amortized cost):				
Obligations of states and political subdivisions	4,946	3.21%	7,979	6.49%
	$ 153,753	100.00%	$ 122,928	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, at December 31, 2021:

	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 Avg Yield**	**Carrying Value**	**Weighted Avg Yield**	**Carrying Value**	**Weighted Avg Yield**	**Carrying Value**	**Weighted Avg Yield**	**Carrying Value**	**Weighted Avg Yield**
Available-for-sale:										
U.S. government agencies	$ —	—	$ 1,591	1.97%	$ 3,814	0.69%	$ 14,277	0.19%	$ 19,682	0.43%
Mortgage-backed securities	—	—	—	—	3	6.90%	81,510	1.51%	81,513	1.51%
Obligations of states and political subdivisions	—	—	522	2.80%	3,748	1.56%	40,867	1.69%	45,137	1.69%
Collateralized mortgage obligations	—	—	—	—	—	—	540	1.73%	540	1.73%
Corporate bonds	—	—	1,935	1.25%	—	—	—	—	1,935	1.25%
Total available-for-sale	—	—	4,048	1.73%	7,565	1.12%	137,194	1.43%	148,807	1.42%
Held-to-maturity:										
Obligations of states and political subdivisions	491	6.00%	951	6.00%	3,504	6.00%	—	—	4,946	6.00%
	$ 491	6.00%	$ 4,999	2.54%	$ 11,069	2.67%	$ 137,194	1.43%	$ 153,753	1.57%

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, at December 31, 2020:

(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 Avg Yield	Carrying Value	Weighted Avg Yield	Carrying Value	Weighted Avg Yield	Carrying Value	Weighted Avg Yield	Carrying Value	Weighted Avg Yield
Available-for-sale:										
U.S. government agencies	$ —	—	$ —	—	$ 7,708	1.22%	$ 24,120	0.97%	$ 31,828	1.03%
Mortgage-backed securities	—	—	—	—	—	—	23,932	1.12%	23,932	1.12%
Obligations of states and political subdivisions	—	—	1,206	2.52%	8,599	1.57%	48,615	1.65%	58,420	1.66%
Collateralized mortgage obligations	—	—	—	—	—	—	769	1.70%	769	1.70%
Total available-for-sale	—	—	1,206	2.52%	16,307	1.40%	97,436	1.35%	114,949	1.37%
Held-to-maturity:										
Obligations of states and political subdivisions	494	6.00%	2,143	6.00%	2,755	6.00%	2,587	6.00%	7,979	6.00%
	$ 494	6.00%	$ 3,349	4.75%	$ 19,062	2.07%	$ 100,023	1.47%	$ 122,928	1.67%

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

A summary of the book value and fair value related to securities at December 31, 2021 and December 31, 2020 is presented below.

(dollars in thousands)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized (Losses)	Fair Value
December 31, 2021				
Available-for-sale:				
U.S. government agencies	$ 19,824	$ 60	$ (202)	$ 19,682
Mortgage-backed securities	82,517	94	(1,098)	81,513
Obligations of states and political subdivisions	44,732	525	(120)	45,137
Collateralized mortgage obligations	537	3	—	540
Corporate bonds	2,000	—	(65)	1,935
Total available-for-sale	$ 149,610	$ 682	$ (1,485)	$ 148,807
Held-to-maturity:				
Obligations of states and political subdivisions	$ 4,946	$ 251	$ —	$ 5,197
December 31, 2020				
Available-for-sale:				
U.S. government agencies	$ 32,069	$ 111	$ (352)	$ 31,828
Mortgage-backed securities	23,601	338	(7)	23,932
Obligations of states and political subdivisions	57,137	1,291	(8)	58,420
Collateralized mortgage obligations	748	21	—	769
Total available-for-sale	$ 113,555	$ 1,761	$ (367)	$ 114,949
Held-to-maturity:				
Obligations of states and political subdivisions	$ 7,979	$ 776	$ —	$ 8,755

The unrealized losses on securities are attributed to interest rate changes rather than the marketability of the securities or the issuer's ability to honor redemption of the obligations, as the securities with losses are all obligations of or guaranteed by agencies sponsored by the U.S. government. We have adequate liquidity and the ability and intent to hold these securities to maturity, resulting in full recovery of the indicated impairment. Accordingly, none of the unrealized losses on these securities have been determined to be other than temporary.

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 December 31, 2021 and December 31, 2020, our total loans amounted to $1.9 billion and $1.5 billion, respectively. The following table presents the balance and associated percentage of each major product type within our portfolio as of the dates indicated.

	December 31, 2021		December 31, 2020	
(dollars in thousands)	**Amount**	**% of Loans**	**Amount**	**% of Loans**
Loans held for investment:				
Real estate:				
Commercial	$ 1,586,232	81.48%	$ 1,002,497	66.33%
Commercial land and development	7,376	0.38%	10,600	0.70%
Commercial construction	54,214	2.78%	91,760	6.07%
Residential construction	7,388	0.38%	11,914	0.79%
Residential	28,562	1.47%	30,431	2.01%
Farmland	54,805	2.82%	50,164	3.32%
Commercial:				
Secured	137,062	7.03%	138,676	9.18%
Unsecured	21,136	1.09%	17,526	1.16%
PPP	22,124	1.14%	147,965	9.79%
Consumer and other	17,167	0.88%	4,921	0.33%
Total loans held for investment	1,936,066	99.45%	1,506,454	99.68%
Loans held for sale:				
Commercial	10,671	0.55%	4,820	0.32%
Total loans before deferred fees	1,946,737	100.00%	1,511,274	100.00%
Net deferred loan fees	(1,606)		(3,295)	
Total loans	$ 1,945,131		$ 1,507,979	

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. 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 owners.

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 by collateral type, estimated collateral values, and related loan-to-value ("LTV") ranges 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 $1.0 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
December 31, 2021					
Manufactured home community	$ 518,910	32.71%	$ 849,269	14.22%	78.00%
Office	166,960	10.53%	307,376	5.10%	75.00%
Multifamily	152,412	9.61%	350,953	5.13%	75.00%
Retail	135,401	8.54%	318,875	1.43%	74.51%
Faith-based	134,728	8.49%	294,367	1.67%	75.00%
Industrial	108,718	6.85%	272,383	4.59%	80.14%
Mixed use	85,712	5.40%	159,810	20.76%	69.05%
Mini storage	83,270	5.25%	155,961	1.04%	71.98%
All other types[1]	200,121	12.62%	473,952	8.00%	94.97%
Total	$ 1,586,232	100.00%	$ 3,182,946	1.04%	94.97%

(dollars in thousands)	Loan Balance	% of Commercial Real Estate	Collateral Value	Minimum LTV	Maximum LTV
December 31, 2020					
Manufactured home community	$ 244,156	24.35%	$ 421,048	12.12%	73.64%
Office	115,913	11.56%	237,837	4.05%	75.00%
Retail	104,878	10.46%	208,632	4.52%	76.14%
Faith-based	92,885	9.27%	242,148	3.23%	73.18%
Mini storage	69,973	6.98%	120,010	21.19%	70.00%
Industrial	69,153	6.90%	174,140	1.93%	75.55%
Multifamily	66,113	6.59%	171,411	0.33%	75.00%
Mixed use	62,531	6.24%	119,333	2.87%	75.00%
All other types[1]	176,895	17.65%	413,381	6.89%	84.89%
Total	$ 1,002,497	100.00%	$ 2,107,940	0.33%	84.89%

1 Types of collateral in the “all other types” category are those that individually make up less than 5.00% commercial real estate concentration and include hospitality, auto dealerships, car washes, assisted living communities, country clubs, gas stations/convenience stores, medical offices, special purpose property, mortuaries, restaurants, and schools.

Over the past few years, we have experienced significant growth in our loan portfolio, although the relative composition of the portfolio has not changed significantly (when PPP loans are excluded). Our primary focus remains commercial real estate lending (including commercial, commercial land and development, and commercial construction), which constitutes 84.64% of our portfolio at December 31, 2021. Commercial secured lending (consisting primarily of SBA 7(a) loans under $350,000) represents 7.03% of our portfolio at December 31, 2021. We sell the guaranteed portion of all SBA 7(a) loans, excluding PPP 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 577.92% and 624.70% as of December 31, 2021 and December 31, 2020, respectively. We have established internal concentration limits in the loan portfolio for commercial real estate loans by sector (i.e., manufactured home communities, self-storage, hospitality, etc.). All loan sectors were within our established limits as of December 31, 2021. 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 at December 31, 2021:

(dollars 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	$ 32,107	$ 170,222	$ 1,343,367	$ 40,536	$ 1,586,232
Commercial land and development	1,209	6,167	—	—	7,376
Commercial construction	3,418	17,575	32,131	1,090	54,214
Residential construction	5,609	1,779	—	—	7,388
Residential	1,183	8,246	17,871	1,262	28,562
Farmland	3,876	8,116	42,813	—	54,805
Commercial:					
Secured	31,436	29,880	82,526	3,891	147,733
Unsecured	1,182	3,976	15,978	—	21,136
PPP	598	21,526	—	—	22,124
Consumer and other	35	3,619	13,513	—	17,167
Total loans	$ 80,653	$ 271,106	$ 1,548,199	$ 46,779	$ 1,946,737

The following table sets forth the contractual maturities of our loan portfolio at December 31, 2020:

(dollars 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	$ 46,579	$ 100,882	$ 821,130	$ 33,906	$ 1,002,497
Commercial land and development	7,248	2,672	680	—	10,600
Commercial construction	12,358	15,883	63,519	—	91,760
Residential construction	5,754	6,160	—	—	11,914
Residential	1,462	4,905	22,205	1,859	30,431
Farmland	410	13,060	36,694	—	50,164
Commercial:					
Secured	44,230	36,055	63,211	—	143,496
Unsecured	1,580	1,692	14,254	—	17,526
PPP	—	147,965	—	—	147,965
Consumer and other	51	3,835	1,035	—	4,921
Total loans	$ 119,672	$ 333,109	$ 1,022,728	$ 35,765	$ 1,511,274

The following table sets forth the sensitivity to interest rate changes of our loan portfolio at December 31, 2021:

(dollars in thousands)	Fixed Interest Rates	Floating or Adjustable Rates	Total
Real estate:			
Commercial	$ 394,648	$ 1,191,584	$ 1,586,232
Commercial land and development	722	6,654	7,376
Commercial construction	—	54,214	54,214
Residential construction	—	7,388	7,388
Residential	2,222	26,340	28,562
Farmland	4,183	50,622	54,805
Commercial:			
Secured	34,771	112,962	147,733
Unsecured	19,841	1,295	21,136
PPP	22,124	—	22,124
Consumer and other	17,167	—	17,167
Total loans	$ 495,678	$ 1,451,059	$ 1,946,737

The following table sets forth the sensitivity to interest rate changes of our loan portfolio at December 31, 2020:

(dollars in thousands)	Fixed Interest Rates	Floating or Adjustable Rates	Total
Real estate:			
Commercial	$ 134,029	$ 868,468	$ 1,002,497
Commercial land and development	743	9,857	10,600
Commercial construction	15,527	76,233	91,760
Residential construction	—	11,914	11,914
Residential	2,737	27,694	30,431
Farmland	4,464	45,700	50,164
Commercial:			
Secured	28,241	115,255	143,496
Unsecured	14,882	2,644	17,526
PPP	147,965	—	147,965
Consumer and other	4,921	—	4,921
Total loans	$ 353,509	$ 1,157,765	$ 1,511,274

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 loan 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 assessing the adequacy of our allowance for loan 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.

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.

Troubled Debt Restructurings

We consider a loan to be a TDR when we have granted a concession and the borrower is experiencing financial difficulty. In order to determine whether a borrower is experiencing financial difficulty, an evaluation is performed of the probability that the borrower will be in payment default on any of its debt in the foreseeable future without the modification. This evaluation is performed under our internal underwriting policy. A TDR loan generally is kept on non-accrual status until, among other criteria, the borrower has paid for six consecutive months with no payment defaults, at which time the TDR may be placed back on accrual status.

COVID-19 Deferments

The CARES Act, as amended by the Consolidated Appropriations Act, specified that COVID-19 related loan modifications executed between March 1, 2020 and the earlier of: (i) 60 days after the date of termination of the national emergency declared by the President; and (ii) January 1, 2022, on loans that were current as of December 31, 2019 are not TDRs. Additionally, under guidance from the federal banking agencies, other short-term modifications made on a good faith basis in response to COVID-19 to borrowers that were current prior to any relief are not TDRs under ASC Subtopic 310-40, “Troubled Debt Restructuring by Creditors.” These modifications include short-term modifications (e.g., up to six months) such as payment deferrals, fee waivers, extensions of repayment terms, or delays in payment that are insignificant. We elected to apply these temporary accounting provisions to loans under payment relief beginning in March 2020. As of December 31, 2021, six borrowing relationships with six loans totaling $12.2 million, or 0.63% of the loan portfolio, were in a COVID-19 deferment period and three loans totaling $0.1 million had been in a COVID-19 deferment period in the third quarter of 2021 but were not in a deferment period as of December 31, 2021. None of the loans that received COVID-19 deferments in the fourth quarter of 2021 had the principal portion deferred to the respective maturity of the loan. We accrue and recognize interest income on loans under payment relief based on the original contractual interest rates. When payments resume at the end of the relief period, the payments will generally be applied to accrued interest due until accrued interest is fully paid.

PPP Loan Forgiveness

At December 31, 2021, there were 60 PPP loans outstanding totaling $22.1 million, which included 59 loans totaling $21.5 million funded during 2021 under the second round of the PPP stimulus plan. Approximately 11 of these PPP loans, or 18.33% of total PPP loans at December 31, 2021, totaling $0.6 million, were less than or equal to $0.15 million and had access to streamlined forgiveness processing. At December 31, 2021, 1,370 PPP loan forgiveness applications had been submitted to the SBA and forgiveness payments had been received on 1,367 of these PPP loans, totaling $332.4 million in principal and interest. The Company has submitted all forgiveness applications on the first round of PPP loans and received payment on all but one pending application. We expect full forgiveness of the second round of PPP loans to be completed in the near term.

SBA 7(a) Payments Made Under the CARES Act

Section 1112 of the CARES Act required the SBA to make payments on new and existing 7(a) loans for up to six months. The Consolidated Appropriations Act amended this section of the CARES Act to extend the payment on 7(a) loans in existence on March 27, 2020, beginning on February 1, 2021, for up to eight or eleven months, depending on the borrower’s industry code, and to require the SBA to make up to three months of payments on new 7(a) loans approved between February 1, 2021 and September 30, 2021. These payments are not deferments but rather full payments of principal and interest that the borrower will not be responsible for in the future. In the year ended December 31, 2021, the SBA made payments under this program on 1,099 of our SBA 7(a) loans, totaling $7.6 million in principal and interest. As of December 31, 2021, 25 loans totaling $2.9 million were still eligible to receive these payments under the CARES Act.

SBA Loans

During 2021, the Company sold 169 SBA 7(a) loans with government guaranteed portions totaling $41.4 million. Of the loans sold in 2021, the Company received gross proceeds of $45.3 million resulting in a net gain on sale of $3.9 million. The Company did not sell any PPP loans in 2021.

During 2020, the Company sold 373 SBA 7(a) loans with government guaranteed portions totaling $71.3 million. Of the loans sold in 2020, the Company received gross proceeds of $79.7 million resulting in a net gain on sale of $4.0 million. Additionally, the company sold 157 PPP loans with balances of $10.6 million resulting in a gain of $0.2 million.

Non-accrual Loans

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

(dollars in thousands)	**December 31, 2021**	**December 31, 2020**
Non-accrual loans		
Real estate:		
Commercial	$ 122	$ 137
Commercial land and development	—	—
Commercial construction	—	—
Residential construction	—	—
Residential	178	183
Farmland	—	—
Commercial:		
Secured	288	132
Unsecured	—	—
PPP	—	—
Consumer and other	—	—
Total non-accrual loans	588	452
Loans past due 90 days or more and still accruing		
Real estate:		
Commercial	—	—
Commercial land and development	—	—
Commercial construction	—	—
Residential construction	—	—
Residential	—	—
Farmland	—	—
Commercial:		
Secured	—	—
Unsecured	—	—
PPP	—	—
Consumer and other	—	—
Total loans past due and still accruing	—	—
Total nonperforming loans	588	452
Real estate owned	—	—
Total nonperforming assets	$ 588	$ 452
COVID-19 deferments	$ 12,156	$ 41,439
Performing TDRs (not included above)	$ —	$ —
Allowance for loan losses to period end non-accrual loans	3,954.30%	4,909.07%
Non-accrual loans to period end loans	0.03%	0.03%
Nonperforming assets to total assets	0.02%	0.02%
Nonperforming loans plus performing TDRs to period end loans	0.03%	0.03%
COVID-19 deferments to period end loans	0.63%	2.75%

The ratio of non-accrual loans to period end loans was unchanged at 0.03% as of December 31, 2020 and December 31, 2021, partially due to the stability of our non-accrual loans.

The ratio of the allowance for loan losses to period end non-accrual loans decreased from 4,909.07% as of December 31, 2020 to 3,954.30% as of December 31, 2021. The decrease was primarily due to an increase in the allowance for loan losses of 4.75% from December 31, 2020 to December 31, 2021, coupled with a 30.04% increase in period end non-accrual loans from December 31, 2020 to December 31, 2021, which was primarily due to an increase of $0.2 million in commercial secured non-accrual loans from December 31, 2020 to December 31, 2021. The rate at which the allowance for loan losses increased was significantly less than the rate at which non-accrual loans increased year-over-year, thus causing a decrease in the ratio of allowance for loan losses to period end non-accrual loans year-over-year.

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 loan losses. All loans are grouped into a risk category at the time of origination. Commercial real estate loans over $1.0 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. Loans by credit quality risk rating were as follows as of the periods indicated:

(dollars in thousands)	Pass	Watch	Substandard	Doubtful	Total
December 31, 2021					
Real estate:					
Commercial	$ 1,575,006	$ 1,970	$ 9,256	$ —	$ 1,586,232
Commercial land and development	7,376	—	—	—	7,376
Commercial construction	48,288	5,926	—	—	54,214
Residential construction	7,388	—	—	—	7,388
Residential	28,384	—	178	—	28,562
Farmland	54,805	—	—	—	54,805
Commercial:					
Secured	135,131	751	1,180	—	137,062
Unsecured	21,136	—	—	—	21,136
PPP	22,124	—	—	—	22,124
Consumer	17,167	—	—	—	17,167
Total loans	$ 1,916,805	$ 8,647	$ 10,614	$ —	$ 1,936,066

	Pass	Watch	Substandard	Doubtful	Total
December 31, 2020					
Real estate:					
Commercial	$ 950,118	$ 16,836	$ 35,543	$ —	$ 1,002,497
Commercial land and development	10,600	—	—	—	10,600
Commercial construction	85,860	5,900	—	—	91,760
Residential construction	11,914	—	—	—	11,914
Residential	30,248	—	183	—	30,431
Farmland	50,164	—	—	—	50,164
Commercial:					
Secured	136,992	1,552	132	—	138,676
Unsecured	17,526	—	—	—	17,526
PPP	147,965	—	—	—	147,965
Consumer	4,921	—	—	—	4,921
Total loans	$ 1,446,308	$ 24,288	$ 35,858	$ —	$ 1,506,454

Loans designated as watch and substandard, which are not considered adversely classified, decreased to $19.3 million at December 31, 2021 from $60.1 million at December 31, 2020, reducing reserves related to classified and watch loans by $0.5 million, which was offset by additional provision for loan growth. There were no loans with doubtful risk grades at December 31, 2021 or December 31, 2020.

Allowance for Loan Losses

The allowance for loan losses is established through a provision for loan losses charged to operations. Loans are charged against the allowance for loan losses 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 loan losses.

The allowance for loan losses 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.

In the year ended December 31, 2021, our methodology for evaluating allowance for loan losses continued to be affected by the COVID-19 pandemic, resulting in sustained higher reserve levels, primarily related to our commercial real estate portfolio. Reserves on the commercial real estate portfolio increased period-over-period due to higher uncertainty related to the COVID-19 pandemic and related economic effects.

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

The allowance for loan losses was $23.2 million at December 31, 2021, as compared to $22.2 million at December 31, 2020. The $1.1 million increase is due to a $1.7 million provision for loan losses recorded during the year ended December 31, 2021, offset by net charge-offs of $0.6 million during the year ended December 31, 2021.

The following table is a summary of the allowance for loan losses by loan class as of the periods indicated:

	December 31, 2021		December 31, 2020	
(dollars in thousands)	**Dollars**	**% of Total**	**Dollars**	**% of Total**
Collectively evaluated for impairment:				
Real estate:				
Commercial	$ 12,869	55.37%	$ 9,358	42.17%
Commercial land and development	50	0.22%	77	0.35%
Commercial construction	371	1.60%	821	3.70%
Residential construction	50	0.22%	87	0.39%
Residential	192	0.83%	220	0.99%
Farmland	645	2.78%	615	2.77%
Commercial:				
Secured	6,687	28.77%	9,476	42.71%
Unsecured	207	0.89%	179	0.81%
PPP	—	0.00%	—	0.00%
Consumer and other	889	3.82%	632	2.85%
Unallocated	1,111	4.78%	724	3.26%
	23,071	99.28%	22,189	100.00%
Individually evaluated for impairment	172	0.72%	—	0.00%
	172	0.72%	—	0.00%
Total allowance for loan losses	$ 23,243	100.00%	$ 22,189	100.00%

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

	As of and for the year ended			
	December 31, 2021		December 31, 2020	
(dollars in thousands)	**Activity**	**% of Period End Loans**	**Activity**	**% of Period End Loans**
Loans held for investment	$ 1,936,066		$ 1,506,454	
Allowance for loan losses (beginning of period)	$ 22,189		$ 14,915	
Net (charge-offs) recoveries:				
Real estate:				
Commercial	—	0.00%	—	0.00%
Commercial land and development	—	0.00%	—	0.00%
Commercial construction	—	0.00%	—	0.00%
Residential construction	—	0.00%	—	0.00%
Residential	—	0.00%	90	0.30%
Farmland	—	0.00%	—	0.00%
Commercial:				
Secured	(559)	(0.41)%	(1,428)	(1.03)%
Unsecured	—	0.00%	—	0.00%
PPP	—	0.00%	—	0.00%
Consumer and other	(87)	(0.51)%	(388)	(7.88)%
Net charge-offs	(646)	(0.03)%	(1,726)	(0.11)%
Provision for loan losses	1,700		9,000	
Allowance for loan losses (end of period)	$ 23,243		$ 22,189	
Allowance for loan losses to total loans	1.20%		1.47%	

The ratio of allowance for loan losses to total loans was 1.20% at December 31, 2021, compared to 1.47% at December 31, 2020. The decrease was primarily due to an improvement in economic conditions for commercial secured loans during fiscal year 2021 and increased loan growth year-over-year. Excluding PPP loans, the ratio of the allowance for loan losses to total loans was 1.21% and 1.63% at December 31, 2021 and 2020, respectively. See the section entitled "Non-GAAP Financial Measures" for a reconciliation of our non-GAAP measures to the most directly comparable GAAP financial measure. Non-accrual loans totaled $0.6 million, or 0.03% of total loans, at December 31, 2021, remaining largely unchanged from $0.5 million, or 0.03% of total loans, at December 31, 2020.

Net charge-offs as a percent of period end loans decreased slightly from 0.11% for the year ended December 31, 2020 to 0.03% for the year ended December 31, 2021. The net recovery rate related to the residential real estate portfolio was 0.30% for the year ended December 31, 2020 and 0.00% for the year ended December 31, 2021. The net charge-off rate related to the commercial secured portfolio improved from 1.03% in the year ended December 31, 2020 to 0.41% in the year ended December 31, 2021. The net charge-off rate related to the consumer portfolio improved from 7.88% in the year ended December 31, 2020 to 0.51% in the year ended December 31, 2021.

Liabilities

During 2021, total liabilities increased by $501.7 million from $1.8 billion at December 31, 2020 to $2.3 billion at December 31, 2021. This increase was primarily due to an increase in total deposits of $501.9 million, comprised of increases of $201.0 million in non-interest-bearing deposits and $300.9 million in interest-bearing deposits.

Deposits

Representing 98.46% of our total liabilities as of December 31, 2021, deposits are our primary source of funding for our business operations.

Total deposits increased by $501.9 million, or 28.13%, to $2.3 billion at December 31, 2021 from $1.8 billion as of December 31, 2020. Deposit increases were attributed to an increase in the number of new relationships, as well as fluctuations in our existing accounts. Non-interest-bearing deposits increased by $201.0 million in 2021 to $902.1 million, and represented 39.46% of total deposits at December 31, 2021, compared to 39.30% of total deposits at December 31, 2020. Our loan to deposit ratio was 85.09% at December 31, 2021 compared to 84.50% at December 31, 2020. We intend to continue to operate our business with a loan to deposit ratio similar to these levels.

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

	For the year ended					
	December 31, 2021			December 31, 2020		
(dollars in thousands)	Average Amount	Average Rate Paid	% of Total Deposits	Average Amount	Average Rate Paid	% of Total Deposits
Transaction accounts	$ 155,163	0.10%	12.74%	$ 141,293	0.26%	12.28%
Money market and savings	1,009,847	0.19%	82.89%	906,599	0.64%	78.78%
Time	53,222	0.32%	4.37%	102,890	1.16%	8.94%
Total deposits	$ 1,218,232	0.18%	100.00%	$ 1,150,782	0.64%	100.00%

Uninsured deposits, excluding time deposits, totaled $1.3 billion and $1.1 billion at December 31, 2021 and 2020, respectively.

As of December 31, 2021, our 26 largest deposit relationships, each accounting for more than $10.0 million, totaled $912.7 million, or 39.93% of our total deposits. As of December 31, 2020, our 18 largest deposit relationships, each accounting for more than $10.0 million, totaled $641.2 million, or 35.90% 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:

(dollars in thousands)	December 31, 2021	December 31, 2020
Municipalities	$ 424,483	$ 318,357
Non-Profit	181,080	165,046
Business	307,132	157,757
Total	$ 912,695	$ 641,160

Our largest single deposit relationship relates to a non-profit association that supports hospitals and health systems. The balances for this customer were $155.0 million, or 6.78% of total deposits, at December 31, 2021 and $133.3 million, or 7.50%, of total deposits at December 31, 2020.

The following table sets forth the maturity of time deposits as of December 31, 2021:

(dollars in thousands)	$250,000 or Greater	Less than $250,000	Total	Uninsured Portion
Remaining maturity:				
Three months or less	$ 77,563	$ 25,771	$ 103,334	$ 75,063
Over three through six months	305	606	911	109
Over six through twelve months	—	26	26	—
Over twelve months	—	1	1	—
Total	$ 77,868	$ 26,404	$ 104,272	$ 75,172

FHLB Advances and Other Borrowings

From time to time, we utilize short-term collateralized FHLB borrowings to maintain adequate liquidity. There were no borrowings outstanding as of December 31, 2021 and December 31, 2020.

In 2017 and 2019, we issued subordinated notes of $25.0 million and $3.75 million, respectively. This debt was issued to investors in private placement transactions. See Note 9, Long Term Debt and Other Borrowings, in the notes to our consolidated financial statements included in this Annual Report on Form 10-K for additional information regarding these subordinated notes. The proceeds of the notes constitute Tier 2 capital under the regulatory capital rules of the federal banking agencies. The following table is a summary of our outstanding subordinated notes as of December 31, 2021:

(dollars in thousands)	Issuance Date	Amount of Notes	Prepayment Right	Maturity Date
Subordinated notes	September 2017	$ 25,000	September 28, 2022	September 15, 2027
Fixed at 6.00% through September 15, 2022, then three-month London Inter-bank Offered Rate (“LIBOR”) plus 404.4 basis points (4.25% as of December 31, 2021) through maturity				
Subordinated notes	November 2019	$ 3,750	September 30, 2022	September 15, 2027
Fixed at 5.50% through September 15, 2022, then three-month LIBOR plus 354.4 basis points (3.75% as of December 31, 2021) through maturity				

Shareholders’ Equity

Shareholders’ equity totaled $235.0 million at December 31, 2021 and $133.8 million at December 31, 2020. The increase in shareholders’ equity was primarily attributable to net proceeds of $111.2 million from the issuance of 6,054,750 shares of common stock in our IPO and net income recognized of $42.4 million, partially offset by $51.9 million in cash dividends paid during the year ended December 31, 2021.

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 the liquidity of the Bank 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 credit, market, 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 Bancorp 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 Bank of San Francisco discount window, draws on established federal funds lines from unaffiliated commercial banks, and the issuance of debt or equity securities. We believe that we have ample liquidity resources to fund future growth and meet other cash needs as necessary.

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 gathering of deposits, and our principal uses of cash include funding of loans, operating expenses, income taxes, and dividend payments, as described below. In 2021, we also had significant cash inflows as a result of our IPO.

Based on our current capital allocation objectives, during 2022, we project expending approximately $0.5 million to $1.5 million of cash related to continued buildout of our IT systems and processes and $10.3 million of cash for dividends on our common stock (based on the assumptions described below). We project an additional distribution to shareholders of record as of May 3, 2021 of approximately $4.9 million for the final distribution of the Accumulated Adjustments Account ("AAA") payout under the Company's Tax Sharing Agreement, which represents previously taxed but undistributed earnings. The final AAA distribution amount is subject to adjustment upon completion of the 2021 tax return, which could be material.

For the 12-month period ending December 31, 2022, we project that our fixed commitments could potentially include: (i) approximately $249.0 million to fund off balance sheet commitments outstanding at December 31, 2021; (ii) $5.0 million for IT services, IT support and compliance expenditures; and (iii) $1.0 million for operating leases. In future years, we expect that our main sources and uses of cash will relate primarily to regular operating activities.

As of December 31, 2021, management believes the above-mentioned sources will provide adequate liquidity during the next twelve months for the Bank to meet its operating needs.

IPO

On May 7, 2021, we completed our IPO at a price of $20.00 per share. We raised approximately $111.2 million in net proceeds after deducting underwriting discounts and commissions of approximately $8.5 million and certain estimated offering expenses payable by us of approximately of $1.3 million. The net proceeds less $2.1 million in other related expenses, including audit fees, legal fees, listing fees, and other expenses totaled $109.1 million.

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 year ended December 31, 2021, we had cash outflows of $426.9 million in loan originations and advances, net of principal collected, and $48.2 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 December 31, 2021, total off-balance sheet commitments totaled $248.9 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 made up of primarily non-interest checking and money market 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 year ended December 31, 2021, we had significant cash inflows related to an increase in deposits of $501.9 million, primarily as a result of an increase in the number of new relationships and fluctuations in existing accounts.

Over the next twelve months, $103.3 million of time deposits are expected to mature. Additionally, we expect to obtain a new time deposit in the amount of $75.0 million with a state organization. We expect $0.9 million of time deposits to mature through 2026. As these time deposits mature, some of these deposits may not renew due to market 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, combined with our liquid investment portfolio, as discussed below, provides a stable funding base.

Investment Securities

Our investment securities, excluding held-to-maturity securities, totaled $148.8 million at December 31, 2021. At December 31, 2021, 53.02% and 32.57% of our investment portfolio consisted of mortgage-backed securities and obligations of states and political subdivisions, 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 $14.4 million from our securities over the next 12 months. 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 year ended December 31, 2021, we had cash proceeds from sales, maturities, and/or prepayments of securities of $65.8 million, offset by cash outflows of $99.7 million related to investment securities purchased. Additionally, at December 31, 2021, securities available-for-sale totaled $148.8 million, of which $63.4 million has been pledged as collateral for borrowings and other commitments.

Future Contractual Obligations

Our estimated future obligations as of December 31, 2021 include both current and long-term obligations. Under our operating leases as discussed in Note 15, Commitments and Contingencies, we have a current obligation of $1.0 million and a long-term obligation of $4.4 million. We also have a current obligation of $103.3 million and a long-term obligation of $0.9 million related to time deposits, as discussed in Note 8, Interest-Bearing Deposits. We have subordinated notes of $28.4 million, all of which are long-term obligations. Finally, we have one significant, long-term contract for core processing services. While the actual obligation is unknown and dependent on certain factors, including volume and activities, we estimate that our current obligation under this contract is $1.2 million and our long-term obligation is $0.5 million, which is estimated using 2021 average monthly expense extrapolated over the remaining life of the contract.

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 December 31, 2021, the Bank had a total financing availability of $275.8 million, net of letters of credit issued of $420.5 million.

Impact of Inflation

Our 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 most 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.

Dividends

A use of liquidity for the Company is shareholder dividends. Bancorp paid dividends to its shareholders totaling $51.9 million during the year ended December 31, 2021, including a cash distribution in the amount of $27.0 million paid on May 21, 2021 to shareholders of record as of May 3, 2021, for the AAA payout, which is described in further detail in the Company's Registration Statement on Form S-1.

We expect to continue our current practice of paying quarterly cash dividends in 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 2022 at a rate of $0.15 per share, which is the rate of each of our three last quarterly dividend payments, our average total dividend paid each quarter would be approximately $2.6 million based on the number of current outstanding shares, which assumes no increases or decreases in the number of shares, and considering that unvested RSAs share equally in dividends with outstanding common stock.

Historical Information

The following table summarizes our consolidated cash flow activities:

	For the year ended		Amount
(dollars in thousands)	**December 31, 2021**	**December 31, 2020**	**Increase (Decrease)**
Net cash provided by operating activities	$ 28,657	$ 51,475	$ (22,818)
Net cash used in investing activities	(455,011)	(372,630)	(82,381)
Net cash provided by financing activities	561,190	434,282	126,908

Operating Activities

Net cash provided by operating activities decreased by $22.8 million for the year ended December 31, 2021 as compared to the year ended December 31, 2020, primarily due to a decrease in loans originated for sale, offset by a decrease in proceeds from sale of loans. Various other, less material items made up the remainder of the change. 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.

For additional information about our operating results, see "Results of Operations" above.

Investing Activities

Net cash used in investing activities increased by $82.4 million for the year ended December 31, 2021 as compared to the year ended December 31, 2020, primarily due to an increase in loan originations, net of repayments, an increase in purchases of available-for-sale securities, and an increase in purchases of bank-owned life insurance, partially offset by decreases in time deposits in banks.

Financing Activities

Net cash provided by financing activities increased by $126.9 million for the year ended December 31, 2021 as compared to the year ended December 31, 2020, primarily due to proceeds received in connection with the IPO during the year and growth in deposit account balances, partially offset by an increase in cash dividends paid, including a cash dividend payout from the Company's AAA.

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 loan 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 consolidated financial statements. We operate under the Small Bank Holding Company Policy Statement, and, accordingly, are exempt from the Federal Reserve's generally applicable risk-based capital ratio and leverage ratio requirements. The Bank is subject to minimum risk-based and leverage capital requirements under federal regulations implementing the Basel III framework, and 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, as well as 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 December 31, 2021, 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 December 31, 2021 and December 31, 2020 for Bancorp and the Bank are presented in the following tables. As of December 31, 2021 and December 31, 2020, Bancorp's Tier 2 capital included subordinated debt, which was not included at the Bank level.

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**
December 31, 2021						
Total capital (to risk-weighted assets)	$ 285,128	13.98%	$ 163,177	≥ 8.00%	N/A	N/A
Tier 1 capital (to risk-weighted assets)	$ 233,397	11.44%	$ 122,382	≥ 6.00%	N/A	N/A
Common equity tier 1 capital (to risk-weighted assets)	$ 233,397	11.44%	$ 91,787	≥ 4.50%	N/A	N/A
Tier 1 leverage	$ 233,397	9.47%	$ 98,600	≥ 4.00%	N/A	N/A
December 31, 2020						
Total capital (to risk-weighted assets)	$ 176,861	12.18%	$ 116,138	≥ 8.00%	N/A	N/A
Tier 1 capital (to risk-weighted assets)	$ 130,347	8.98%	$ 87,103	≥ 6.00%	N/A	N/A
Common equity tier 1 capital (to risk-weighted assets)	$ 130,347	8.98%	$ 65,327	≥ 4.50%	N/A	N/A
Tier 1 leverage	$ 130,347	6.58%	$ 79,204	≥ 4.00%	N/A	N/A

Capital Ratios for the Bank (dollars in thousands)	Actual Ratio Amount	Actual Ratio Ratio	Required for Capital Adequacy Purposes Amount	Required for Capital Adequacy Purposes Ratio	Ratio to be Well-Capitalized under Prompt Corrective Action Provisions Amount	Ratio to be Well-Capitalized under Prompt Corrective Action Provisions Ratio
December 31, 2021						
Total capital (to risk-weighted assets)	$ 279,152	13.69%	$ 163,078	≥ 8.00%	$ 203,848	≥ 10.00%
Tier 1 capital (to risk-weighted assets)	$ 255,807	12.55%	$ 122,309	≥ 6.00%	$ 163,078	≥ 8.00%
Common equity tier 1 capital (to risk-weighted assets)	$ 255,807	12.55%	$ 91,731	≥ 4.50%	$ 132,501	≥ 6.50%
Tier 1 leverage	$ 255,807	10.38%	$ 98,555	≥ 4.00%	$ 123,193	≥ 5.00%
December 31, 2020						
Total capital (to risk-weighted assets)	$ 174,002	11.99%	$ 116,114	≥ 8.00%	$ 145,143	≥ 10.00%
Tier 1 capital (to risk-weighted assets)	$ 155,808	10.73%	$ 87,086	≥ 6.00%	$ 116,114	≥ 8.00%
Common equity tier 1 capital (to risk-weighted assets)	$ 155,808	10.73%	$ 65,314	≥ 4.50%	$ 94,343	≥ 6.50%
Tier 1 leverage	$ 155,808	7.87%	$ 79,199	≥ 4.00%	$ 98,998	≥ 5.00%

1 Presented as if Bancorp were subject to Basel III capital requirements. The Company operates under the Small Bank Holding Company Policy Statement and therefore is not currently subject to generally applicable capital adequacy requirements.

Recent Accounting Pronouncements

For a discussion of the expected impact of accounting pronouncements recently adopted and accounting pronouncements recently issued but not yet adopted by us as of December 31, 2021, see Note 2, Recently Issued Accounting Standards, of our audited consolidated financial statements included elsewhere in this Annual Report on Form 10-K.

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.

Allowance for loan losses to total loans, excluding PPP loans, average loans, excluding PPP loans, average loan yield, excluding PPP loans, tangible shareholders’ equity to tangible assets, and tangible book value per share are non-GAAP financial measures.

Allowance for loan losses to total loans, excluding PPP loans, is defined as allowance for loan losses, divided by total loans less PPP loans. The most directly comparable GAAP financial measure is allowance for loan losses to total loans.

Average loans, excluding PPP loans, is defined as the daily average loan balance, less the daily average loan balance of PPP loans, and includes both performing and nonperforming loans. The most directly comparable GAAP financial measure is average loans.

Average loan yield, excluding PPP loans, is defined as the interest income on loans, excluding interest income on PPP loans, divided by the average total loans, excluding average PPP loans. The most directly comparable GAAP financial measure is average loan yield.

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 their non-GAAP financial measures when making comparisons.

The following reconciliation table provides a more detailed analysis of these non-GAAP financial measures along with their most directly comparable financial measures calculated in accordance with GAAP.

Allowance for loan losses to total loans, excluding PPP loans (dollars in thousands)	**December 31, 2021**	**December 31, 2020**
Allowance for loan losses (numerator)	$ 23,243	$ 22,189
Total loans	1,945,131	1,507,979
Less: PPP loans	22,124	147,965
Total loans, excluding PPP loans (denominator)	$ 1,923,007	$ 1,360,014
Allowance for loan losses to total loans, excluding PPP loans	1.21%	1.63%

Average loans, excluding PPP loans (dollars in thousands)	**For the year ended December 31, 2021**	**December 31, 2020**
Average total loans	$ 1,637,280	$ 1,439,380
Less: Average PPP Loans	116,652	165,414
Average total loans, excluding PPP loans	1,520,628	1,273,966

Average loan yield, excluding PPP loans (dollars in thousands)	**For the year ended December 31, 2021**	**December 31, 2020**
Interest income on loans	$ 78,894	$ 71,405
Less: interest income on PPP loans	7,417	6,535
Interest income on loans, excluding PPP loans (numerator)	71,477	64,870
Average total loans	1,637,280	1,439,380
Less: average PPP loans	116,652	165,414
Average total loans, excluding PPP loans (denominator)	$ 1,520,628	$ 1,273,966
Average loan yield, excluding PPP loans	4.70%	5.09%

Item 7A. Quantitative and Qualitative Disclosure About Market Risk

Not applicable for a smaller reporting company.

Item 8. Financial Statements and Supplementary Data

MOSSADAMS

Report of Independent Registered Public Accounting Firm

The Shareholders and the Board of Directors of
Five Star Bancorp and Subsidiary

Opinion on the Consolidated Financial Statements

We have audited the accompanying consolidated balance sheets of Five Star Bancorp and Subsidiary (the "Company"), as of December 31, 2021 and 2020, the related consolidated statements of income, comprehensive income, changes in shareholders' equity, and cash flows for the years then ended, and the related notes (collectively referred to as the "consolidated financial statements"). In our opinion, the consolidated financial statements present fairly, in all material respects, the consolidated financial position of the Company as of December 31, 2021 and 2020, and the consolidated results of its operations and its cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

Basis for Opinion

These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on the Company's consolidated financial statements based on our audits. We are a public accounting firm registered with the Public Company Accounting Oversight Board (United States) ("PCAOB") and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audits in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement, whether due to error or fraud. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting in accordance with the standards of the PCAOB. As part of our audits, we are required to obtain an understanding of internal control over financial reporting, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting in accordance with the standards of the PCAOB. Accordingly, we express no such opinion.

Our audits included performing procedures to assess the risks of material misstatement of the consolidated financial statements, whether due to error or fraud, and performing procedures to respond to those risks. Such procedures included examining, on a test basis, evidence regarding the amounts and disclosures in the consolidated financial statements. Our audits also included evaluating the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements. We believe that our audits provide a reasonable basis for our opinion.

/s/ Moss Adams LLP
San Francisco, California
Firm ID is 659
February 25, 2022

We have served as the Company's auditor since 2010.

FIVE STAR BANCORP AND SUBSIDIARY
CONSOLIDATED BALANCE SHEETS
December 31, 2021 and 2020
(In thousands, except share data)

	2021	2020
ASSETS		
Cash and due from financial institutions	$ 136,074	$ 46,028
Interest-bearing deposits in banks	289,255	244,465
Cash and cash equivalents	425,329	290,493
Time deposits in banks	14,464	23,705
Securities available-for-sale, at fair value	148,807	114,949
Securities held-to-maturity, at amortized cost (fair value of $5,197 and $8,755 at December 31, 2021 and 2020, respectively)	4,946	7,979
Loans held for sale	10,671	4,820
Loans held for investment, net of allowance for loan losses of $23,243 and $22,189 at December 31, 2021 and 2020, respectively	1,911,217	1,480,970
Federal Home Loan Bank of San Francisco (“FHLB”) stock	6,723	6,232
Premises and equipment, net	1,773	1,663
Bank-owned life insurance (“BOLI”)	11,203	8,662
Interest receivable and other assets	21,628	14,292
	$ 2,556,761	$ 1,953,765
LIABILITIES AND SHAREHOLDERS’ EQUITY		
Deposits		
Non-interest-bearing	$ 902,118	$ 701,079
Interest-bearing	1,383,772	1,082,922
Total deposits	2,285,890	1,784,001
Subordinated notes, net	28,386	28,320
Interest payable and other liabilities	7,439	7,669
Total liabilities	2,321,715	1,819,990
Commitments and contingencies (Note 15)		
Shareholders’ equity		
Preferred stock, no par value; 10,000,000 shares authorized; zero issued and outstanding at December 31, 2021 and 2020, respectively	—	—
Common stock, no par value; 100,000,000 shares authorized; 17,224,848 shares issued and outstanding at December 31, 2021; 11,000,273 shares issued and outstanding at December 31, 2020	218,444	110,082
Retained earnings	17,168	22,348
Accumulated other comprehensive (loss) income, net	(566)	1,345
Total shareholders’ equity	235,046	133,775
	$ 2,556,761	$ 1,953,765

See accompanying notes to consolidated financial statements.

FIVE STAR BANCORP AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF INCOME
Years ended December 31, 2021 and 2020
(In thousands, except per share data)

	2021	2020
Interest and dividend income		
Loans, including fees	$ 78,894	$ 71,405
Taxable securities	1,321	1,287
Nontaxable securities	821	500
Interest-bearing deposits in other banks	547	1,198
	81,583	74,390
Interest expense		
Deposits	2,199	7,407
Subordinated notes	1,773	1,773
	3,972	9,180
Net interest income	77,611	65,210
Provision for loan losses	1,700	9,000
Net interest income after provision for loan losses	75,911	56,210
Non-interest income		
Service charges on deposit accounts	424	367
Net gain on sale of securities	724	1,438
Gain on sale of loans	4,082	4,145
Loan-related fees	639	2,309
FHLB stock dividends	372	321
Earnings on BOLI	237	220
Other	802	502
	7,280	9,302
Non-interest expense		
Salaries and employee benefits	19,825	16,084
Occupancy and equipment	1,938	1,715
Data processing and software	2,494	1,982
Federal Deposit Insurance Corporation (“FDIC”) insurance	700	1,137
Professional services	3,792	1,960
Advertising and promotional	1,300	1,102
Loan-related expenses	1,045	732
Other operating expenses	4,949	3,545
	36,043	28,257
Income before provision for income taxes	47,148	37,255
Provision for income taxes	4,707	1,327
Net income	$ 42,441	$ 35,928
Basic earnings per share	$ 2.83	$ 3.57
Diluted earnings per share	$ 2.83	$ 3.57

See accompanying notes to consolidated financial statements.

FIVE STAR BANCORP AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
Years ended December 31, 2021 and 2020
(In thousands)

	2021	2020
Net income	$ 42,441	$ 35,928
Net unrealized holding (loss) gain on securities available-for-sale during the period	(1,475)	2,860
Reclassification adjustment for net realized gains included in net income	(724)	(1,438)
Income tax (benefit) expense related to other comprehensive (loss) income	(288)	51
Other comprehensive (loss) income	(1,911)	1,371
Total comprehensive income	$ 40,530	$ 37,299

See accompanying notes to consolidated financial statements.

FIVE STAR BANCORP AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY
Years ended December 31, 2021 and 2020
(In thousands, except share and per share data)

	Common Stock		Retained	Accumulated Other Comprehensive Income (Loss),	
	Shares	Amount	Earnings	Net of Taxes	Total
Balance at December 31, 2019	9,674,875	$ 96,114	$ 12,789	$ (26)	$ 108,877
Net income	—	—	35,928	—	35,928
Other comprehensive income	—	—	—	1,371	1,371
Stock offering	1,250,000	12,500	—	—	12,500
Stock issued under stock award plans	9,398	—	—	—	—
Stock compensation expense	—	316	—	—	316
Director stock compensation expense	16,000	252	—	—	252
Common stock issued	50,000	900	—	—	900
Cash dividends paid ($2.63 per share)	—	—	(26,369)	—	(26,369)
Balance at December 31, 2020	11,000,273	$ 110,082	$ 22,348	$ 1,345	$ 133,775
Net income	—	—	42,441	—	42,441
Other comprehensive loss	—	—	—	(1,911)	(1,911)
Stock offering	6,054,750	111,243	—	—	111,243
Stock issued under stock award plans	132,707	—	—	—	—
Stock compensation expense	—	594	—	—	594
Director stock compensation expense	41,640	846	—	—	846
Restricted stock forfeitures	(4,522)	—	—	—	—
Reclassification of retained deficit	—	(4,321)	4,321	—	—
Cash dividends paid ($4.55 per share)	—	—	(51,942)	—	(51,942)
Balance at December 31, 2021	17,224,848	$ 218,444	$ 17,168	$ (566)	$ 235,046

See accompanying notes to consolidated financial statements.

FIVE STAR BANCORP AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF CASH FLOWS
Years ended December 31, 2021 and 2020
(In thousands)

	2021	2020
Cash flows from operating activities:		
Net income	$ 42,441	$ 35,928
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for loan losses	1,700	9,000
Loans originated for sale	(48,169)	(98,399)
Gain on sale of loans	(4,082)	(4,145)
Proceeds from sale of loans	43,024	108,149
Net gain on sale of securities	(724)	(1,438)
Earnings on BOLI	(237)	(220)
Stock compensation expense	594	316
Director stock compensation expense	846	252
Change in deferred loan fees	(1,689)	2,367
Amortization and accretion of security premiums and discounts	1,561	1,138
Amortization of subordinated notes issuance costs	66	67
Depreciation and amortization	607	461
Deferred taxes	(4,001)	(143)
Net changes in:		
Interest receivable and other assets	(3,050)	(3,548)
Interest payable and other liabilities	(230)	1,690
Net cash provided by operating activities	28,657	51,475
Cash flows from investing activities:		
Proceeds from sale of securities available-for-sale	47,096	46,406
Maturities, prepayments, and calls of securities available-for-sale	18,732	16,118
Purchases of securities available-for-sale	(99,686)	(97,571)
Increase (decrease) in time deposits in banks	9,241	(3,761)
Loan originations, net of repayments	(426,882)	(330,837)
Purchase of premises and equipment	(717)	(833)
Purchase of FHLB stock	(491)	(1,152)
Purchase of BOLI	(2,304)	(1,000)
Net cash used in investing activities	(455,011)	(372,630)
Cash flows from financing activities:		
Net change in deposits	501,889	472,251
Proceeds from issuance of common stock	111,243	13,400
FHLB repayment	—	(25,000)
Cash dividends paid	(51,942)	(26,369)
Net cash provided by financing activities	561,190	434,282
Net change in cash and cash equivalents	134,836	113,127
Cash and cash equivalents at beginning of period	290,493	177,366
Cash and cash equivalents at end of period	$ 425,329	$ 290,493
Supplemental disclosure of cash flow information:		
Interest paid	$ 4,505	$ 9,713
Income taxes paid	$ 10,450	$ 1,655
Supplemental disclosure of noncash investing and financing activities:		
Transfer from loans held for investment to loans held for sale	$ 4,820	$ 6,527
Unrealized (loss) gain on securities	$ (2,199)	$ 1,422
Disposal of premises and equipment	$ 515	$ —
Reclassification of retained deficit	$ 4,321	$ —

See accompanying notes to consolidated financial statements.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 1: Basis of Presentation

Nature of Operations and Principles of Consolidation

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 Board of Governors of the Federal Reserve System (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 a broad range of banking products and services to customers who are predominately small and medium-sized businesses, professionals, and individuals primarily in the Northern California region. Its primary loan products are commercial real estate loans, land development loans, construction loans, and operating lines of credit. 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 two loan production offices in Santa Rosa and Sacramento.

The Company terminated its status as a Subchapter S corporation as of May 5, 2021, in connection with the Company’s Initial Public Offering (“IPO”) and became a taxable C Corporation. Prior to that date, as an S Corporation, the Company had no U.S. federal income tax expense.

The Company publicly filed a Registration Statement on Form S-1 with the U.S. Securities and Exchange Commission (“SEC”) in connection with its IPO (the “Registration Statement”), which was declared effective by the SEC on May 4, 2021. In connection with the IPO, the Company issued 6,054,750 shares of common stock, no par value, which included 789,750 shares sold pursuant to the underwriters’ exercise of their option to purchase additional shares. The securities were sold to the public at a price of $20.00 per share and began trading on the Nasdaq Global Select Market on May 5, 2021. On May 7, 2021, the closing date of the IPO, the Company received total net proceeds of $111,243,000. The net proceeds less other related expenses, including audit fees, legal fees, listing fees, and other expenses, totaled $109,082,000.

Basis of Financial Statement Presentation and Consolidation

The accompanying 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”) Accounting Standards Codification (“ASC”) and the rules and regulations of the SEC, including the instructions to Regulation S-X.

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

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.

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

The Company qualifies as an emerging growth company as defined in the Jumpstart Our Business Startups Act of 2012, and a smaller reporting company, and, as such, may take advantage of specified reduced reporting requirements and is relieved of other significant requirements that are otherwise generally applicable to other public companies.

Use of Estimates

Management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. These estimates and assumptions affect the amounts reported in the consolidated financial statements and the disclosures provided, and actual results could differ. The allowance for loan losses is the most significant accounting estimate reflected in the Company’s consolidated financial statements. Other estimates include fair value measurements, valuation of servicing assets, and deferred tax asset valuation.

Cash and Cash Equivalents

The Company defines cash and cash equivalents as cash, due from financial institutions, interest-bearing deposits in banks with short term original maturities, and federal funds sold. Generally, federal funds are sold for one-day periods, if at all. At times throughout the year, balances can exceed FDIC insurance limits. The Company has not experienced any historical losses associated with balances maintained with financial institutions in excess of FDIC insurance limits, and management continues to monitor the financial condition of the major financial institutions where these funds are held.

Securities Available-for-Sale

Available-for-sale securities consist of bonds, notes, and debentures not classified as trading securities or held-to-maturity securities. Securities are classified as available-for-sale if the Company intends and has the ability to hold those securities for a period of time, but not necessarily to maturity. Any decision to sell a security classified as available-for-sale would be based on various factors, including significant movements in interest rates, changes in the maturity mix of assets and liabilities, liquidity needs, regulatory capital considerations, and other similar factors. Securities available-for-sale are carried at fair value. Unrealized holding gains or losses are included in other comprehensive income as a separate component of shareholders' equity, net of tax. Realized gains or losses, determined based on the cost of specific securities sold, are included in earnings. Premiums are amortized over the life of the security, or if a callable bond, over the earliest call date, and discounts are accreted over the life of the related investment security as an adjustment to interest income using the effective interest method. Interest income is recognized when earned.

Investments with fair values that are less than amortized cost are considered impaired. Impairment may result from either a decline in the financial condition of the issuing entity or, in the case of fixed interest rate investments, from rising interest rates, or both. At each consolidated financial statement date, management assesses each investment to determine if impaired investments are temporarily impaired or if the impairment is other-than-temporary. Various factors are considered in the assessment, including the nature of the investment, the cause of the impairment, the severity and duration of the impairment, credit ratings, and other credit-related factors such as third-party guarantees and volatility of the security's fair value. This assessment also includes a determination as to whether the Company intends to sell the security, or if it is more likely than not that the Company will be required to sell the security before recovery of its amortized cost basis less any current-period credit losses. If the Company intends to sell a security or if it is more likely than not that the Company will be required to sell the security before recovery, an other-than-temporary impairment ("OTTI") write-down is recognized in earnings equal to the entire difference between the security's amortized cost basis and its fair value. For debt securities that are considered to be OTTI and that the Company does not intend to sell and will not be required to sell prior to recovery of the amortized cost basis, the amount of impairment is separated into the amount that is credit-related (credit loss component) and the amount due to all other factors. The credit loss component is recognized in earnings and is calculated as the difference between the security's amortized cost basis and the present value of its expected future cash flows. The remaining difference between the security's fair value and the present value of the future expected cash flows is deemed to be due to factors that are not credit-related and is recognized in other comprehensive income.

Securities Held-to-Maturity

Securities are classified as held-to-maturity if the Company has both the intent and ability to hold those securities to maturity regardless of changes in market conditions, liquidity needs, or changes in general economic conditions. These securities are carried at cost adjusted for amortization of premium to the earliest callable call date and accretion of discount, computed by the effective interest method over the life of the related investment.

Loans and Allowance for Loan Losses

Loans are reported at the principal amount outstanding, net of deferred loan fees and costs and the allowance for loan losses. Interest on loans is accrued daily based on the principal outstanding.

Loan fees, net of certain direct costs of origination, are deferred and recognized in interest income using the level-yield method without anticipating prepayments. During the years ended December 31, 2021 and 2020, salaries and employee benefits totaling $5,198,000 and $3,194,000, respectively, were deferred as loan origination costs.

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.

The allowance for loan losses represents the estimated probable incurred loan losses in the Company's loan portfolio. The allowance for loan losses is established through a provision for loan losses charged to operations. Loans are charged against the allowance for loan losses 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 loan losses.

The allowance for loan losses 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. The Audit Committee of the board of directors reviews the adequacy of the allowance at least quarterly.

The allowance consists of: (i) specific allowances for individually identified impaired loans (ASC 310-10, *Receivables*); (ii) general allowances for pools of loans (ASC 450-20, *Contingencies – Loss Contingencies*), which incorporate quantitative (e.g., historical loan loss rates) and qualitative risk factors (e.g., portfolio growth and trends, credit concentrations, economic and regulatory factors, etc.); and (iii) unallocated allowances, if any.

The first component, specific allowances, results from the analysis of identified problem credits and the evaluation of sources of repayment, including collateral, as applicable. Through management's ongoing credit monitoring process, individual loans are identified that have conditions indicating the borrower may be unable to pay all amounts due in accordance with contractual terms. These loans are evaluated for impairment individually by management. Management considers an originated loan to be impaired when it is probable that collection of all amounts due according to the contractual terms of the loan agreement is unlikely. Loans that experience insignificant payment delays and payment shortfalls generally are not classified as impaired. Management determines the significance of payment delays and payment shortfalls on a case-by-case basis, taking into consideration all of the facts and circumstances surrounding the loan and the borrower, including the length of the delay, the reasons for the delay, the borrower's prior payment record, and the amount of the shortfall in relation to the principal and interest owed. Interest income is recognized on impaired loans in the same manner as non-accrual loans.

When the fair value of the impaired loan is less than the recorded investment in the loan, the difference is recorded as an impairment through the establishment of a specific allowance. For loans determined to be impaired, the extent of the impairment is measured based on the present value of expected future cash flows discounted at the loan's effective interest rate at origination, based on the loan's observable market price, or based on the fair value of the collateral if the loan is collateral dependent or if foreclosure is imminent. Generally, with problem credits that are collateral dependent, management obtains appraisals of the collateral at least annually. Appraisals may be obtained more frequently if management believes the collateral value is subject to market volatility, if a specific event has occurred to the collateral, or if the Company believes foreclosure is imminent.

The second component, general allowances, is an estimate of the probable inherent losses in each loan pool with similar risk characteristics. This analysis encompasses the entire loan portfolio, excluding individually identified impaired loans. The model determines general allowances by loan segment based on quantitative (loss history) and qualitative risk factors.

The third component, unallocated allowances, is maintained to cover other uncertainties that could affect management's estimate of probable losses. The unallocated allowances reflect the margin of imprecision inherent in the underlying assumptions used in the methodologies for estimating specific and general losses in the portfolio. While management believes the best information available is used to determine the allowance for loan losses, the results of operations could be significantly affected if circumstances differ substantially from the assumptions used in determining the allowance. A decline in local and national economic conditions, or significant changes in other assumptions, could result in a material increase in the allowance for loan losses and may adversely affect the Company's financial condition and results of operations. While the Company believes the estimates and assumptions used in the determination of the adequacy of the allowance for loan losses are reasonable, there can be no assurance that such estimates and assumptions will not be proved incorrect in the future, that the actual amounts of future provisions will not exceed the amounts of past provisions, or that any increased provisions that may be required will not adversely impact the financial condition and results of operations of the Company.

The Company considers a loan to be a troubled debt restructure (“TDR”) when the Company has granted a concession and the borrower is experiencing financial difficulty. In order to determine whether a borrower is experiencing financial difficulty, an evaluation is performed of the probability that the borrower will be in payment default on any of its debt in the foreseeable future without the modification. This evaluation is performed under the Company’s internal underwriting policy. A TDR loan generally is kept on non-accrual status until, among other criteria, the borrower has paid for six consecutive months with no payment defaults, at which time the TDR may be placed back on accrual status.

In conjunction with the passage of the Coronavirus Aid, Relief, and Economic Security Act (“CARES Act”), as well as the revised interagency guidance issued in April 2020, the “Interagency Statement on Loan Modifications and Reporting for Financial Institutions Working With Customers Affected by the Coronavirus (Revised),” banks have been provided the option, for loans meeting specific criteria, to temporarily suspend certain requirements under GAAP related to TDRs for a limited time to account for the effects of COVID-19. As a result, the Company has not recognized eligible COVID-19 loan modifications as TDRs. The CARES Act, as amended by the Consolidated Appropriations Act, specified that COVID-19 related loan modifications executed between March 1, 2020 and the earlier of: (i) 60 days after the date of termination of the national emergency declared by the President; and (ii) January 1, 2022, on loans that were current as of December 31, 2019 are not TDRs. Additionally, loans qualifying for these modifications are not required to be reported as delinquent, non-accrual, impaired, or criticized solely as a result of a COVID-19 loan modification.

Federal Home Loan Bank Stock

Federal Home Loan Bank stock represents the Company’s investment in the stock of the Federal Home Loan Bank of San Francisco (“FHLB”) and is carried at par value. While technically these are considered equity securities, there is no market for the FHLB stock. Therefore, the shares are considered as other investment securities.

Management periodically evaluates FHLB stock for OTTI. Management’s determination of whether these investments are impaired is based on its assessment of the ultimate recoverability of cost rather than by recognizing temporary declines in value. The determination of whether a decline affects the ultimate recoverability of cost is influenced by criteria such as: (i) the significance of any decline in net assets of the FHLB as compared to the capital stock amount for the FHLB and the length of time this situation has persisted; (ii) commitments by the FHLB to make payments required by law or regulation and the level of such payments in relation to the operating performance of the FHLB; (iii) the impact of legislative and regulatory changes on institutions and, accordingly, the customer base of the FHLB; and (iv) the liquidity position of the FHLB. Both cash and stock dividends are reported as non-interest income.

Premises and Equipment

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

Equipment	3-12 years
Furniture and Fixtures	5-10 years
Leasehold Improvements	5-15 years
Automobiles	3-5 years

Leasehold improvements are amortized over the lesser of the useful life of the asset or the remaining term of the lease. The straight-line method of depreciation is followed for all assets for financial reporting purposes, but accelerated methods are used for tax purposes.

When assets are sold or otherwise disposed of, the cost and related accumulated depreciation or amortization are removed from the accounts, and any resulting gain or loss is recognized in income for the period. The cost of maintenance and repairs is charged to expense as incurred.

Other Real Estate

Real estate properties acquired through, or in lieu of, loan foreclosure, are classified as other real estate owned ("OREO"), are to be sold and are initially recorded at fair value of the property at the date of foreclosure less estimated selling costs. Any write-downs in value are recorded against the allowance for loan losses. Subsequent to foreclosure, valuations are periodically performed, and any revisions in the estimate of fair value are reported as adjustments to the carrying value of the real estate, provided the adjusted carrying amount does not exceed the original amount at foreclosure. Subsequent valuation adjustments are recognized as OREO write-downs. Revenues and expenses incurred from OREO property management are recorded in non-interest income and non-interest expense, respectively. During 2021 and 2020, the Bank did not foreclose on any loans.

BOLI

BOLI is recorded at the amount that can be realized under the insurance contract at the consolidated balance sheet date, which is the cash surrender value adjusted for other charges or other amounts due that are probable at settlement. Increases in contract value are recorded as non-interest income, and insurance proceeds received are recorded as a reduction of the contract value.

Long-Term Assets

Premises, equipment, and other long-term assets are reviewed for impairment when events indicate that their carrying amount may not be recoverable from future undiscounted cash flows. If impaired, the assets are adjusted to reflect their fair value.

Equity Investments

Equity investments with readily determinable fair values are carried at fair value, with changes in fair value reported in net income. Equity investments without readily determinable fair values are carried at cost, less impairment, if any, and adjusted for changes resulting from observable price changes in orderly transactions for the identical or similar investment.

Loss Contingencies

Loss contingencies, including claims and legal actions arising in the ordinary course of business, are recorded as liabilities when the likelihood of loss is probable, and an amount or range of loss can be reasonably estimated.

Transfers of Financial Assets

Transfers of an entire financial asset, a group of financial assets, or a participating interest in an entire financial asset, are accounted for as sales when control has been relinquished. Control is deemed to be surrendered when the assets have been isolated from the Company, the transferee obtains the right (free of more than trivial conditions that constrain it from taking advantage of that right) to pledge or exchange the transferred assets, and the Company does not maintain effective control over the transferred assets through an agreement to repurchase them before their maturity.

Included in the loan portfolio are loans guaranteed by the Small Business Administration ("SBA"), the Farm Service Agency ("FSA"), the Federal Agriculture Mortgage Corporation ("Farmer Mac") and the United States Department of Agriculture ("USDA"), of which the guaranteed portion is expected to be sold in the secondary market in exchange for a one-time premium. At the time the guaranteed portion of the loan is sold, the unguaranteed portion and related right to service the entire loan is retained with the Company, to earn future servicing income. The loans held for sale are accounted for at the lower of cost or fair value, using the aggregate method. Government guaranteed loans held for sale totaled $10,671,000 and $4,820,000 at December 31, 2021 and 2020, respectively.

Servicing rights acquired through the origination of loans, which are subsequently sold with servicing rights retained, are recognized as separate assets or liabilities. Servicing assets and liabilities are initially recorded at fair value and are subsequently amortized in proportion to, and over the period of, the related net servicing income or expense. The amortized assets are assessed for impairment or increased obligations at the loan level, based on the fair value on a periodic basis.

Loan Commitments and Related Financial Instruments

Financial instruments include off-balance-sheet credit instruments, such as commitments to make loans, and financial standby letters of credit issued to meet customer financing needs. The face amount for these items represents the exposure to loss, before considering customer collateral or ability to repay. Such financial instruments are recorded when they are funded.

The Company records an allowance for loan 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. Reserves for unfunded commitments are included as a component of Interest payable and other liabilities on the consolidated balance sheets.

Stock-Based Compensation

Compensation cost is recognized for stock options and restricted stock awards (“RSAs”) issued to executives, directors, and employees, based on the fair value of these awards at the date of grant. A Black-Scholes model is utilized to estimate the grant date fair value of stock options, while the fair value of the Company’s common stock at the date of grant is used for RSAs. Compensation cost is recognized over the required service period, generally defined as the vesting period. For awards with graded vesting, compensation cost is recognized on a straight-line basis over the requisite service period for the entire award.

Supplemental Executive Retirement Plan

The Bank has entered into a non-qualified retirement plan for the Chief Executive Officer based on a continuation of employment. The present value of annual post-retirement payments is allocated to expense over the years of required service.

Income Taxes

The Company has historically elected to be taxed for U. S. federal income tax purposes as an S Corporation. In conjunction with the IPO, the Company filed consents from the requisite amount of shareholders to revoke its S Corporation election with the Internal Revenue Service (the “IRS”), resulting in the commencement of taxation as a C Corporation for U.S. federal and California state income tax purposes in the second quarter of fiscal year 2021. Upon termination of the Company’s S Corporation status, the Company commenced paying U.S. federal income tax and a higher California state income tax on taxable earnings for each year (including the short year beginning on the date the Company’s status as an S Corporation terminated).

As a result of the termination of S Corporation status, deferred tax assets and liabilities were recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax basis. Deferred tax assets and liabilities are measured using tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of the change in tax rates resulting from becoming a C Corporation was recognized in net income in the year ended December 31, 2021.

The Company files its income taxes on a consolidated basis with its subsidiary. The allocation of income tax expense represents each entity’s proportionate share of the consolidated provision for income taxes.

Income tax expense is the total of the current year income tax due or refundable and the change in deferred tax assets and liabilities. Deferred tax assets and liabilities are the expected future tax amounts for the temporary differences between carrying amounts and tax bases of assets and liabilities computed using enacted tax rates. A valuation allowance, if needed, reduces deferred tax assets to the amount expected to be realized.

The Company accounts for uncertain tax positions in accordance with FASB ASC Topic No. 740, Accounting for Uncertainty in Income Taxes. A tax position is recognized as a benefit only if it is “more likely than not” that the tax position would be sustained in a tax examination, with a tax examination being presumed to occur. The amount recognized is the largest amount of tax benefit that has a likelihood greater than 50% of being realized on examination. For tax positions not meeting the “more likely than not” test, no tax benefit is recorded.

Derivatives

All derivative instruments are recorded at fair value. If derivative instruments are designated as hedges of fair values, both the change in the fair value of the hedge and the hedged item are included in current earnings. Fair value adjustments related to cash flow hedges, if any, are recorded in other comprehensive income or loss and reclassified to earnings when the hedged transaction is reflected in earnings.

Comprehensive Income or Loss

Comprehensive income or loss consists of net income and other comprehensive income or loss. Other comprehensive income or loss includes unrealized gains and losses on securities available-for-sale, net of tax, which are also recognized as separate components of shareholders' equity.

Earnings Per Share ("EPS")

Basic EPS is net income divided by the weighted average number of common shares outstanding during the period less average unvested RSAs. Diluted EPS includes the dilutive effect of additional potential common shares related to unvested RSAs using the treasury stock method. During the years ended December 31, 2021 and 2020, there were no outstanding stock options. The Company has two forms of outstanding common stock: common stock and unvested RSAs. Following the Company's IPO, holders of unvested RSAs receive non-forfeitable dividends at the same rate as common shareholders and they both share equally in undistributed earnings; 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 and per share data)	2021	2020
Net income	$ 42,441	$ 35,928
Weighted average basic common shares outstanding	14,972,637	10,063,183
Add: Dilutive effects of assumed vesting of restricted stock	22,576	—
Weighted average diluted common shares outstanding	14,995,213	10,063,183
Income per common share:		
Basic EPS	$ 2.83	$ 3.57
Diluted EPS	$ 2.83	$ 3.57

Anti-dilutive shares, which are excluded from the dilutive EPS calculation, were deemed to be immaterial.

For the year ended December 31, 2020, pro forma EPS is calculated by applying a C Corporation effective tax rate of 29.56% to net income before provision for income taxes and using the determined pro forma net income balance to calculate EPS. For the year ended December 31, 2021, pro forma EPS is calculated by applying an effective tax rate of 19.80%, which is the actual effective tax rate, excluding the effects of the discrete deferred tax adjustment of $4,638,000, as discussed in Note 11, Income Taxes. The following reconciliation table provides a detailed calculation of pro forma EPS:

(in thousands, except share and per share data)	2021	2020
Net income before provision for income taxes - GAAP	$ 47,148	$ 37,255
Actual/pro forma provision for income taxes	(9,335)	(11,013)
Actual/pro forma net income	37,813	26,242
Weighted average basic common shares outstanding	14,972,637	10,063,183
Add: Dilutive effects of assumed vesting of restricted stock	22,576	—
Weighted average diluted common shares outstanding	14,995,213	10,063,183
Income per common share:		
Basic EPS	$ 2.53	$ 2.61
Diluted EPS	$ 2.52	$ 2.61

Subordinated Notes

The subordinated notes are recorded at par with related debt issuance costs reported as a direct reduction from the carrying amount. Issuance costs are amortized over the remaining maturity of the notes and reflected in interest expense.

Fair Value of Financial Instruments

The consolidated financial statements include various estimated fair value information as of December 31, 2021 and 2020. Such information, which pertains to the Company's financial instruments, does not purport to represent the aggregate net fair value of the Company. Further, the fair value estimates are based on various assumptions, methodologies, and subjective considerations, which vary widely among different financial institutions, and are subject to change.

Fair Value Measurements

The Company uses fair value measurements to record fair value adjustments to certain assets and liabilities and to determine fair value disclosures. The Company bases the fair values on the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Securities available-for-sale, and derivatives, if any, are recorded at fair value on a recurring basis.

Additionally, from time to time, the Company may be required to record certain assets at fair value on a non-recurring basis, such as loans held for sale, certain collateral dependent impaired loans held for investment and held-to-maturity securities that are other-than-temporarily impaired. These non-recurring fair value adjustments typically involve write-downs of individual assets due to application of lower of cost or fair value accounting.

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).

As a result, if other assumptions had been used, the Company’s recorded earnings or disclosures could have been materially different from those reflected in these consolidated financial statements.

Subsequent Events

The Company has evaluated events and transactions subsequent to December 31, 2021 for recognition or disclosure.

Reclassifications

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

Note 2: Recently Issued Accounting Standards

The following reflect recent accounting standards that are pending adoption by the Company. As discussed in Note 1, Basis of Presentation, 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 reflect effective dates for the Company as an emerging growth company with the extended transition period.

Accounting Standards Not Yet Adopted

In February 2016, the FASB issued ASU No. 2016-02, *Leases (Topic 842)*. The amendments in this ASU intend to increase transparency and comparability among organizations by recognizing an asset, which represents the right to use the asset for the lease term, and a lease liability, which is a lessee’s obligation to make lease payments measured on a discounted basis. This ASU generally applies to leasing arrangements exceeding a twelve-month term. As amended by ASU 2020-05, *Revenue from Contracts with Customers (Topic 606) and Leases (Topic 842): Effective Dates for Certain Entities*, ASU 2016-02 is effective for annual periods, including interim periods within those annual periods beginning after December 15, 2021 and requires a modified retrospective method of adoption. In July 2018, the FASB issued two amendments to ASU 2016-02: ASU No. 2018-10, *Codification Improvements to Topic 842, Leases*, which provides various corrections and clarifications to ASU 2016-02; and ASU No. 2018-11, *Leases (Topic 842): Targeted Improvements*, which provides a new optional transition method and provides a lessor with practical expedients for separating lease and non-lease components of a lease. In July 2021, the FASB issued ASU No. 2021-05, *Leases (Topic 842): Lessors- Certain Leases with Variable Lease Payments*, which amends ASU 2016-02 and requires a lessor to classify a lease with variable lease payments that do not depend on an index or rate as an operating lease on the commencement date of the lease if specified criteria are met. Entities will apply a modified retrospective approach at either the beginning of the earliest period presented or at the beginning of the period of adoption through a cumulative-effect adjustment to retained earnings. The Company estimates that the adoption of this standard will result in an increase in assets of approximately $5,200,000, with a corresponding increase in liabilities, to recognize the present value of its lease obligations in accordance with the standard. The Company does not expect this to have a material impact on the Company’s results of operations or cash flows.

In June 2016, the FASB issued ASU No. 2016-13, *Financial Instruments – Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments*. The standard will replace the "incurred loss" model with a "current expected credit loss" ("CECL") model. The CECL model will apply to estimated credit losses on loans receivable, held-to-maturity debt securities, unfunded loan commitments, and certain other financial assets measured at amortized cost. The CECL model is based on lifetime expected losses, rather than incurred losses, and requires the recognition of credit loss expense in the consolidated statement of income and a related allowance for credit losses on the consolidated statement of condition at the time of origination or purchase of a loan receivable or held-to-maturity debt security. Likewise, subsequent changes in this estimate are recorded through credit loss expense and related allowance. The CECL model requires the use of not only relevant historical experience and current conditions, but reasonable and supportable forecasts of future events and circumstances, incorporating a broad range of information in developing credit loss estimates, which could result in significant changes to both the timing and amount of credit loss expense and allowance. Under ASU 2016-13, 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 ASU also expands the disclosure requirements regarding assumptions, models, and methods for estimating the allowance for loan losses. In addition, entities will need to disclose the amortized cost balance for each class of financial asset by credit quality indicator, disaggregated by the year of origination. ASU 2016-13 is effective for the Company for fiscal years beginning after December 15, 2022, including interim periods within those fiscal years. Entities will apply 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 is effective. While the Company believes the change from an incurred loss model to a CECL model has the potential to increase the allowance for loan losses at the adoption date, the Company cannot reasonably quantify the impact of the adoption of the amendments to its financial condition or results of operations at this time due to the complexity and extensive changes resulting from these amendments. The Company is working with its third-party vendor to identify data gaps and determine the appropriate methodologies and resources to utilize in preparation for its transition to the new accounting standard, including but not limited to the use of certain tools to forecast future economic conditions that affect the cash flows of loans over their lifetime.

In August 2017, the FASB issued ASU No. 2017-12, *Derivatives and Hedging (Topic 815): Targeted Improvements to Accounting for Hedging Activities.* The primary objective of the amendments in this update is to simplify the application of hedge accounting. More specifically, the amendments in this update better align an entity's risk management activities and financial reporting for hedging relationships through changes to both the designation and measurement guidance for qualifying hedging relationships and the presentation of hedge results. Furthermore, the amendments expand and refine hedge accounting for both nonfinancial and financial risk components and align the recognition and presentation of the effects of the hedging instrument and the hedged item in the financial statements. Additionally, amendments in this update require an entity to present the earnings effect of the hedging instrument in the same income statement line item in which the earnings effect of the hedged item is reported. Hedge ineffectiveness is no longer separately measured and reported. The amendments in this update will be effective for fiscal years beginning after December 15, 2020 and interim periods within fiscal years beginning after December 15, 2021. Early adoption is permitted in any interim period. The impact of adopting this ASU is expected to be immaterial to the Company's consolidated financial statements.

In March 2020, the FASB issued ASU No. 2020-04, *Reference Rate Reform (Topic 848)*. The amendments in this ASU are elective and provide optional guidance for a limited period of time to ease the potential burden in accounting for (or recognizing the effects of) reference rate reform. The amendments in this ASU provide optional expedients and exceptions for applying GAAP to contracts, hedging relationships, and other transactions that reference the London Inter-Bank Offered Rate ("LIBOR") or another reference rate expected to be discontinued because of reference rate reform. Additionally, in January 2021, the FASB issued ASU No. 2021-01, *Reference Rate Reform (Topic 848)*, which refines the scope of ASC 848 and clarifies its guidance, permitting entities to elect certain optional expedients and exceptions when accounting for derivative contracts and certain hedging relationships affected by changes in the interest rates used for discounting cash flows, computing variation margin settlements, and calculating price alignment interest in connection with reference rate reform activities under way in global financial markets. The amendments in these ASUs may be elected as of March 12, 2020 through December 31, 2022. LIBOR administrators have indicated that certain LIBOR settings will continue to be published through June 30, 2023. An entity may choose to elect the amendments in these updates at an interim period subsequent to March 12, 2020, with adoption methods varying based on transaction type. The Company has not elected to apply these amendments; however, the Company is assessing the applicability of the ASUs and continues to monitor guidance for reference rate reform from FASB and its impact on the Company's consolidated financial statements.

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 Government National Mortgage Association (the "GNMA") and the SBA, and securities issued by U.S. government-sponsored enterprises ("GSEs"), such as the Federal National Mortgage Association (the "FNMA"), the Federal Home Loan Mortgage Corporation (the "FHLMC"), and the FHLB. The Company also invests in residential and commercial mortgage-backed securities, collateralized mortgage obligations issued or guaranteed by the GSEs, 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 December 31, 2021 and 2020 is presented below.

		Gross Unrealized		
(in thousands)	Amortized Cost	Gains	(Losses)	Fair Value
2021				
Obligations of states and political subdivisions	4,946	251	—	5,197
Total held-to-maturity	$ 4,946	$ 251	$ —	$ 5,197
2020				
Obligations of states and political subdivisions	7,979	776	—	8,755
Total held-to-maturity	$ 7,979	$ 776	$ —	$ 8,755

For securities issued by states and political subdivisions, for OTTI purposes, 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.

A summary of the amortized cost and fair value related to securities available-for-sale as of December 31, 2021 and 2020 is presented below.

		Gross Unrealized		
(in thousands)	Amortized Cost	Gains	(Losses)	Fair Value
2021				
U.S. government agencies	$ 19,824	$ 60	$ (202)	$ 19,682
Mortgage-backed securities	82,517	94	(1,098)	81,513
Obligations of states and political subdivisions	44,732	525	(120)	45,137
Collateralized mortgage obligations	537	3	—	540
Corporate bonds	2,000	—	(65)	1,935
Total available-for-sale	$ 149,610	$ 682	$ (1,485)	$ 148,807
2020				
U.S. government agencies	$ 32,069	$ 111	$ (352)	$ 31,828
Mortgage-backed securities	23,601	338	(7)	23,932
Obligations of states and political subdivisions	57,137	1,291	(8)	58,420
Collateralized mortgage obligations	748	21	—	769
Total available-for-sale	$ 113,555	$ 1,761	$ (367)	$ 114,949

The amortized cost and fair value of investment debt securities by contractual maturity at December 31, 2021 and 2020 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.

	2021				2020			
	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	$ 491	$ 516	$ —	$ —	$ 494	$ 543	$ —	$ —
After one but within five years	951	999	507	522	2,143	2,351	1,141	1,206
After five years through ten years	3,504	3,682	3,697	3,748	2,755	3,023	8,340	8,599
After ten years	—	—	40,528	40,867	2,587	2,838	47,656	48,615
Investment securities not due at a single maturity date:								
U.S. government agencies	—	—	19,824	19,682	—	—	32,069	31,828
Mortgage-backed securities	—	—	82,517	81,513	—	—	23,601	23,932
Collateralized mortgage obligations	—	—	537	540	—	—	748	769
Corporate bonds	—	—	2,000	1,935	—	—	—	—
Total	$ 4,946	$ 5,197	$ 149,610	$ 148,807	$ 7,979	$ 8,755	$ 113,555	$ 114,949

Sales proceeds of investment securities and gross realized gains and/or losses are shown in the following table:

(in thousands)	2021	2020
Available-for-sale:		
Sales proceeds	$ 47,096	$ 46,406
Gross realized gains	724	1,438

Pledged investment securities are shown in the following table:

(in thousands)	2021	2020
Pledged to the State of California:		
Secure deposits of public funds and borrowings	$ 63,363	$ 52,897
Total pledged investment securities	$ 63,363	$ 52,897

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 December 31, 2021 and 2020:

(in thousands)	< 12 continuous months		≥ 12 continuous months		Total securities in a loss position	
	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
2021						
U.S. government agencies	$ —	$ —	$ 13,399	$ (202)	$ 13,399	$ (202)
Mortgage-backed securities	73,972	(1,046)	1,400	(52)	75,372	(1,098)
Obligations of states and political subdivisions	14,014	(112)	407	(8)	14,421	(120)
Corporate bonds	1,935	(65)	—	—	1,935	(65)
Total temporarily impaired securities	$ 89,921	$ (1,223)	$ 15,206	$ (262)	$ 105,127	$ (1,485)
2020						
U.S. government agencies	$ 10,800	$ (56)	$ 15,195	$ (296)	$ 25,995	$ (352)
Mortgage-backed securities	1,786	(7)	—	—	1,786	(7)
Obligations of states and political subdivisions	3,922	(8)	—	—	3,922	(8)
Total temporarily impaired securities	$ 16,508	$ (71)	$ 15,195	$ (296)	$ 31,703	$ (367)

There were 91 and 31 securities in unrealized loss positions at December 31, 2021 and 2020, respectively, which were all classified as available-for-sale. As of December 31, 2021, the investment portfolio included 16 investment securities that had been in a continuous loss position for twelve months or more and 75 investment securities that had been in a loss position for less than twelve months.

The Company periodically evaluates each available-for-sale investment security in an unrealized loss position to determine if the impairment is temporary or other than temporary and has determined that no investment security is OTTI. The unrealized losses are due primarily to interest rate changes. The Company does not intend, and it is more likely than not that the Company will not be required, to sell the securities before the earlier of the forecasted recovery or the maturity of the underlying debt security.

There were no held-to-maturity securities in a continuous loss position at December 31, 2021 or 2020.

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 $6,723,000 and $6,232,000 of FHLB stock at December 31, 2021 and 2020, 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 December 31, 2021 and 2020. For the years ended December 31, 2021 and 2020, cash dividends received on FHLB capital stock in the amount of $372,000 and $321,000, respectively, were recorded as non-interest income on the consolidated statements of income.

Note 4: Loans and Allowance for Loan Losses

The following table presents the balance of each major product type within the Company's portfolio as of the dates indicated.

(in thousands)	2021	2020
Real estate:		
Commercial	$ 1,586,232	$ 1,002,497
Commercial land and development	7,376	10,600
Commercial construction	54,214	91,760
Residential construction	7,388	11,914
Residential	28,562	30,431
Farmland	54,805	50,164
Commercial:		
Secured	137,062	138,676
Unsecured	21,136	17,526
Paycheck Protection Program ("PPP")	22,124	147,965
Consumer and other	17,167	4,921
Subtotal	1,936,066	1,506,454
Less: Net deferred loan fees	1,606	3,295
Less: Allowance for loan losses	23,243	22,189
Total loans, net	$ 1,911,217	$ 1,480,970

Allowance for Loan Losses

Management has an established methodology to determine the adequacy of the allowance for loan losses that assesses the risks and losses inherent in the loan portfolio. For purposes of determining the allowance for loan losses, the Bank has segmented certain loans in the portfolio by product type. Loans are segmented into the following pools: commercial, real estate, and consumer. The Company further sub-divides these segments into classes based on the associated risks within those segments. Commercial loans are divided into the following two classes: unsecured and secured loans. Real estate loans are divided into the following six classes: commercial real estate, commercial land and development, commercial construction, residential construction, residential real estate, and farmland. For each class of loans, management exercises significant judgment to determine the estimation method that fits the credit risk characteristics of its portfolio segment.

The Company uses an internally developed model in this process. Management must use judgment in establishing additional input metrics for the modeling processes. The models and assumptions used to determine the allowance are independently validated and reviewed, at least annually, to ensure that their theoretical foundation, assumptions, data integrity, computational processes, reporting practices, and end-user controls are appropriate and properly documented.

CARES Act and PPP Loans

Pursuant to the CARES Act, which was passed in March 2020, the Company funded over 1,500 loans to eligible small businesses and non-profit organizations who participated in the PPP administered by the SBA. PPP loans have terms of two or five years and earn interest at 1.00%. In addition, the Bank received a fee of 1.00% to 5.00% from the SBA depending on the loan amount, which was netted with loan origination costs and amortized into interest income under the effective yield method over the contractual life of the loan. The recognition of fees and costs is accelerated when the loan is forgiven by the SBA and/or paid off prior to maturity. PPP loans are fully guaranteed by the SBA and are expected to be forgiven by the SBA if they meet the requirements of the program. The balance of PPP loans at December 31, 2021 and 2020 was $22,124,000 and $147,965,000, respectively.

The CARES Act also required the SBA to make payments on new and existing 7(a) loans for a period of six months. These were not deferments but rather full payments of principal and interest for which the borrower will not be responsible for in the future. As of December 31, 2021 and 2020, the principal outstanding on loans receiving one or more of these payments under the CARES Act was $46,601,000 and $51,237,000, respectively.

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 complete 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 by 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.

Concentrations

The Company's customers are primarily located in the Greater Sacramento and North Valley regions of California. As of December 31, 2021, approximately 90% of the Company's loans were real estate related, 9% were commercial, and less than 1% were consumer.

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. 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 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. The substandard loan category includes loans that management has determined not to be impaired, as well as loans that are impaired.

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 following table summarizes the credit quality indicators related to the Company's loans by class as of December 31, 2021:

(in thousands)	Pass	Watch	Substandard	Doubtful	Total
Real estate:					
Commercial	$ 1,575,006	$ 1,970	$ 9,256	$ —	$ 1,586,232
Commercial land and development	7,376	—	—	—	7,376
Commercial construction	48,288	5,926	—	—	54,214
Residential construction	7,388	—	—	—	7,388
Residential	28,384	—	178	—	28,562
Farmland	54,805	—	—	—	54,805
Commercial:					
Secured	135,131	751	1,180	—	137,062
Unsecured	21,136	—	—	—	21,136
PPP	22,124	—	—	—	22,124
Consumer	17,167	—	—	—	17,167
Total	$ 1,916,805	$ 8,647	$ 10,614	$ —	$ 1,936,066

The following table summarizes the credit quality indicators related to the Company's loans by class as of December 31, 2020:

(in thousands)	Pass	Watch	Substandard	Doubtful	Total
Real estate:					
Commercial	$ 950,118	$ 16,836	$ 35,543	$ —	$ 1,002,497
Commercial land and development	10,600	—	—	—	10,600
Commercial construction	85,860	5,900	—	—	91,760
Residential construction	11,914	—	—	—	11,914
Residential	30,248	—	183	—	30,431
Farmland	50,164	—	—	—	50,164
Commercial:					
Secured	136,992	1,552	132	—	138,676
Unsecured	17,526	—	—	—	17,526
PPP	147,965	—	—	—	147,965
Consumer	4,921	—	—	—	4,921
Total	$ 1,446,308	$ 24,288	$ 35,858	$ —	$ 1,506,454

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 other 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 December 31, 2021 consisted of the following:

	Past Due				
(in thousands)	30-89 Days	Greater Than 90 Days	Total Past Due	Current	Total Loans Receivable
Real estate:					
Commercial	$ —	$ —	$ —	$ 1,586,232	$ 1,586,232
Commercial land and development	—	—	—	7,376	7,376
Commercial construction	—	—	—	54,214	54,214
Residential construction	—	—	—	7,388	7,388
Residential	—	—	—	28,562	28,562
Farmland	—	—	—	54,805	54,805
Commercial:					
Secured	—	—	—	137,062	137,062
Unsecured	—	—	—	21,136	21,136
PPP	—	—	—	22,124	22,124
Consumer and other	334	—	334	16,833	17,167
Total loans	$ 334	$ —	$ 334	$ 1,935,732	$ 1,936,066

There were no loans between 60-89 days past due, nor any loans greater than 90 days past due and still accruing as of December 31, 2021.

The age analysis of past due loans by class as of December 31, 2020 consisted of the following:

	Past Due				
(in thousands)	30-89 Days	Greater Than 90 Days	Total Past Due	Current	Total Loans Receivable
Real estate:					
Commercial	$ —	$ —	$ —	$ 1,002,497	$ 1,002,497
Commercial land and development	—	—	—	10,600	10,600
Commercial construction	—	—	—	91,760	91,760
Residential construction	—	—	—	11,914	11,914
Residential	—	—	—	30,431	30,431
Farmland	—	—	—	50,164	50,164
Commercial:					
Secured	—	—	—	138,676	138,676
Unsecured	—	—	—	17,526	17,526
PPP	—	—	—	147,965	147,965
Consumer and other	137	—	137	4,784	4,921
Total loans	$ 137	$ —	$ 137	$ 1,506,317	$ 1,506,454

There were no loans between 60-89 days past due nor any loans greater than 90 days past due and still accruing as of December 31, 2020.

Impaired Loans

Information related to impaired loans as of December 31, 2021 and 2020 consisted of the following:

(in thousands)	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized
2021					
Real estate:					
Commercial	$ 122	$ 122	$ —	$ 130	$ —
Residential	178	178	—	181	—
Commercial:					
Secured	288	288	172	306	—
Total impaired loans	$ 588	$ 588	$ 172	$ 617	$ —
2020					
Real estate:					
Commercial	$ 137	$ 137	$ —	$ 69	$ —
Residential	183	183	—	92	—
Commercial:					
Secured	132	132	—	65	—
Total impaired loans	$ 452	$ 452	$ —	$ 226	$ —

No collateral dependent loans were in process of foreclosure at December 31, 2021 or 2020. In addition, the weighted average loan-to-value of impaired, collateral dependent loans was approximately 70.67% and 50.51% at December 31, 2021 and 2020, respectively.

Non-accrual loans, segregated by class, are as follows as of December 31, 2021 and 2020:

(in thousands)	2021	2020
Real estate:		
Commercial	$ 122	$ 137
Residential	178	183
Commercial:		
Secured	288	132
Total non-accrual loans	$ 588	$ 452

The amount of foregone interest income related to non-accrual loans was $33,000 and $35,000 for the years ended December 31, 2021 and 2020, respectively.

Troubled Debt Restructuring

The Company's loan portfolio may include certain loans that have been modified in a TDR, which are loans for which concessions in terms have been granted because of the borrowers' financial difficulties. These concessions typically result from the Company's loss mitigation activities and could include reductions in the interest rate, payment extensions, forgiveness of principal, forbearance, or other actions. Certain TDRs are placed on non-accrual status at the time of restructure and may only be returned to accruing status after considering the borrower's sustained repayment performance for a reasonable period, generally six months.

When a loan is modified, it is measured based upon the present value of future cash flows discounted at the effective interest rate of the original loan agreement or the fair value of collateral less selling costs if the loan is collateral dependent. If the value of the modified loan is less than the recorded investment in the loan, impairment is recognized through a specific allowance or a charge-off of the loan.

There were no loans outstanding with a TDR designation at December 31, 2021 or 2020.

The CARES Act, as amended, specified that to be eligible not to be considered a TDR, a loan modification must be (i) related to the COVID-19 pandemic; (ii) executed on a loan that was not more than 30 days past due as of December 31, 2019; and (iii) executed between March 1, 2020, and the earlier of: (i) 60 days after the date of termination of the federal national emergency; or (ii) January 1, 2022. The Company elected to apply the temporary accounting relief provisions for loan modifications that met certain criteria, which would otherwise be designated TDRs under existing GAAP. As of December 31, 2021, six borrowing relationships with six loans totaling $12,156,000 were continuing to benefit from payment relief. The Company accrues and recognizes interest income on loans under payment relief based on the original contractual interest rates. When payments resume at the end of the relief period, the payments will generally be applied to accrued interest due until accrued interest is fully paid.

The following table discloses activity in the allowance for loan losses for the periods presented.

	Real Estate						Commercial					
(in thousands)	Comml	Comml Land and Devel	Comml Const	Resid Const	Resid	Farm-land	Secured	Unsec	PPP	Consu	Unal	Total
2021												
Beginning balance	$ 9,358	$ 77	$ 821	$ 87	$ 220	$ 615	$ 9,476	$ 179	$ —	$ 632	$ 724	$ 22,189
Charge-offs	—	—	—	—	—	—	(822)	—	—	(321)	—	(1,143)
Recoveries	—	—	—	—	—	—	263	—	—	234	—	497
Provision (recapture)	3,511	(27)	(450)	(37)	(28)	30	(2,058)	28	—	344	387	1,700
Ending balance	$ 12,869	$ 50	$ 371	$ 50	$ 192	$ 645	$ 6,859	$ 207	$ —	$ 889	$ 1,111	$ 23,243
2020												
Beginning balance	$ 6,331	$ 109	$ 661	$ 116	$ 224	$ 1,382	$ 4,976	$ 88	$ —	$ 601	$ 427	$ 14,915
Charge-offs	—	—	—	—	—	—	(1,604)	—	—	(559)	—	(2,163)
Recoveries	—	—	—	—	90	—	176	—	—	171	—	437
Provision (recapture)	3,027	(32)	160	(29)	(94)	(767)	5,928	91	—	419	297	9,000
Ending balance	$ 9,358	$ 77	$ 821	$ 87	$ 220	$ 615	$ 9,476	$ 179	$ —	$ 632	$ 724	$ 22,189

The following table summarizes the allocation of the allowance for loan losses by impairment methodology for the periods presented.

	Real Estate						Commercial					
(in thousands)	Comml	Comml Land and Devel	Comml Const	Resid Const	Resid	Farm-land	Secured	Unsec	PPP	Consu	Unal	Total
2021												
Ending allowance balance allocated to:												
Loans individually evaluated for impairment	$ —	$ —	$ —	$ —	$ —	$ —	$ 172	$ —	$ —	$ —	$ —	$ 172
Loans collectively evaluated for impairment	12,869	50	371	50	192	645	6,687	207	—	889	1,111	23,071
Ending balance	$ 12,869	$ 50	$ 371	$ 50	$ 192	$ 645	$ 6,859	$ 207	$ —	$ 889	$ 1,111	$ 23,243
Loans:												
Ending balance individually evaluated for impairment	$ 122	$ —	$ —	$ —	$ 178	$ —	$ 288	$ —	$ —	$ —	$ —	$ 588
Ending balance collectively evaluated for impairment	1,586,110	7,376	54,214	7,388	28,384	54,805	136,774	21,136	22,124	17,167	—	1,935,478
Ending balance	$ 1,586,232	$ 7,376	$ 54,214	$ 7,388	$ 28,562	$ 54,805	$ 137,062	$ 21,136	$ 22,124	$ 17,167	$ —	$ 1,936,066
2020												
Ending allowance balance allocated to:												
Loans individually evaluated for impairment	$ —	$ —	$ —	$ —	$ —	$ —	$ —	$ —	$ —	$ —	$ —	$ —
Loans collectively evaluated for impairment	9,358	77	821	87	220	615	9,476	179	—	632	724	22,189
Ending balance	$ 9,358	$ 77	$ 821	$ 87	$ 220	$ 615	$ 9,476	$ 179	$ —	$ 632	$ 724	$ 22,189
Loans:												
Ending balance individually evaluated for impairment	$ 137	$ —	$ —	$ —	$ 183	$ —	$ 132	$ —	$ —	$ —	$ —	$ 452
Ending balance collectively evaluated for impairment	1,002,360	10,600	91,760	11,914	30,248	50,164	138,544	17,526	147,965	4,921	—	1,506,002
Ending balance	$ 1,002,497	$ 10,600	$ 91,760	$ 11,914	$ 30,431	$ 50,164	$ 138,676	$ 17,526	$ 147,965	$ 4,921	$ —	$ 1,506,454

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 $941,160,000 and $1,093,513,000 at December 31, 2021 and 2020, respectively. In addition, the Company pledges eligible Tenants in Common loans, which totaled $33,391,000 and $61,635,000 at December 31, 2021 and 2020, respectively, to secure its borrowing capacity with the Federal Reserve Bank of San Francisco. See Note 9, Long Term Debt and Other Borrowings, for further discussion of these borrowings.

Note 5: Premises and Equipment, Net

Premises and equipment, net, were as follows as of December 31, 2021 and 2020:

(in thousands)	2021	2020
Furniture, fixtures, and equipment	$ 3,314	$ 3,057
Tenant improvements	1,973	2,027
	5,287	5,084
Less: Accumulated depreciation and amortization	3,514	3,421
Premises and equipment, net	$ 1,773	$ 1,663

Depreciation expense for occupancy, furniture, fixtures, and equipment was $607,000 and $461,000 for the years ended December 31, 2021 and 2020, respectively.

Note 6: Bank-owned Life Insurance

The Company owns life insurance policies on the lives of certain current and former officers designated by the board of directors to fund our employee benefit programs. Death benefits provided under the specific terms of these insurance policies are estimated to be $26,956,000 at December 31, 2021. The benefits to employees' beneficiaries are limited to each employee's active service period. The investment in BOLI policies is reported at their cash surrender value, net of surrender charges, of $11,203,000 and $8,662,000 at December 31, 2021 and 2020, respectively. The cash surrender value includes both the original premiums paid for the life insurance policies and the accumulated accretion of policy income since inception of the policies, net of mortality costs and other fees. Income of $237,000 and $220,000 was recognized on these life insurance policies for the years ended December 31, 2021 and 2020, respectively.

Note 7: Interest Receivable and Other Assets

Interest receivable and other assets consisted of the following as of December 31, 2021 and 2020:

(in thousands)	2021	2020
Interest receivable	$ 5,332	$ 5,422
Equity investments	5,741	3,757
Servicing assets	2,215	2,083
Other assets	8,340	3,030
	$ 21,628	$ 14,292

Servicing assets represent the assets related to servicing loans for others, including collecting payments, maintaining escrow accounts, disbursing payments to investors, and conducting foreclosure proceedings. Loan servicing income is recorded on the accrual basis and includes servicing fees from investors and certain charges collected from borrowers. The Company serviced loans with unpaid principal balances of $194,649,000 and $187,834,000 as of December 31, 2021 and 2020, respectively, on behalf of others.

Note 8: Interest-Bearing Deposits

Interest-bearing deposits consisted of the following as of December 31, 2021 and 2020:

(in thousands)	2021	2020
Savings	$ 88,536	$ 49,714
Money market	912,558	839,053
Interest checking accounts	278,406	146,553
Time, $250 or more	77,868	7,568
Other time	26,404	40,034
Total interest-bearing deposits	$ 1,383,772	$ 1,082,922

Time deposits totaled $104,272,000 and $47,602,000 as of December 31, 2021 and 2020, respectively. As of December 31, 2021, scheduled maturities of time deposits for the next five years were as follows:

(in thousands)	
2022	$ 103,334
2023	911
2024	26
2025	—
2026	1
Total time deposits	$ 104,272

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 deposits. Through this network the Company offers customers access to Federal Deposit Insurance Corporation ("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 December 31, 2021 and 2020. The composition of network deposits as of December 31, 2021 and 2020 was as follows:

(in thousands)	2021	2020
CDARS	$ 22,411	$ 35,534
ICS	307,636	261,127
Total network deposits	$ 330,047	$ 296,661

Interest expense recognized on interest-bearing deposits for the years ended December 31, 2021 and 2020 consisted of the following:

(in thousands)	2021	2020
Savings	$ 74	$ 94
Money market	1,797	5,750
Interest checking accounts	155	374
Time, $250 or more	42	797
Other time	131	392
Total interest expense on interest-bearing deposits	$ 2,199	$ 7,407

Note 9: Long Term Debt and Other Borrowings

Subordinated notes: On November 8, 2019, the Company completed a private placement of $3,750,000 of fixed-to-floating rate subordinated notes to certain qualified investors. All of the debt was purchased by four existing members of the board of directors or their affiliates. The notes were used for general corporate purposes, for capital management, and to support future growth. The subordinated notes have a maturity date of September 15, 2027 and bear interest, payable semi-annually, at the rate of 5.50% per annum until September 15, 2022. On that date, the interest rate will be adjusted to float at a rate equal to the three-month LIBOR rate plus 354.4 basis points (3.75% as of December 31, 2021) until maturity. The notes include a right of prepayment, on or after September 30, 2022 and, 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 Company has $25,000,000 in principal of fixed-to-floating rate subordinated notes to certain qualified investors, of which $8,000,000 is owned by an entity that is controlled by a member of the board of directors and three principal shareholders. The notes were used for general corporate purposes, for capital management, and to support future growth. The subordinated notes have a maturity date of September 15, 2027 and bear interest, payable semi-annually, at the rate of 6.00% per annum until September 15, 2022. On that date, the interest rate will be adjusted to float at a rate equal to the three-month LIBOR rate plus 404.4 basis points (4.25% as of December 31, 2021) until maturity. The notes include a right of prepayment, on or after September 28, 2022 and, 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 regulatory capital purposes. Debt issuance costs incurred in conjunction with the notes were $642,000, of which $280,000 has been amortized through December 31, 2021. 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 December 31, 2021 and 2020, the Company's subordinated debt carrying value was $28,386,000 and $28,320,000, respectively.

Other borrowings: The Company has an agreement with the FHLB that 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 $696,285,000 at December 31, 2021 and $519,274,000 at December 31, 2020. At December 31, 2021 and 2020, the Company had no outstanding borrowings. As of December 31, 2021 and 2020, the Company had letters of credit issued on its behalf totaling $420,500,000 and $293,500,000, respectively, as discussed below.

As of December 31, 2021, letters of credit totaling $80,500,000 were pledged to secure State of California deposits and $340,000,000 were pledged to secure local agency deposits. As of December 31, 2020, letters of credit totaling $13,500,000 were pledged to secure State of California deposits and $280,000,000 were pledged to secure local agency deposits. The letters of credit issued reduced the Company's available borrowing capacity to $275,785,000 and $284,810,000 as of December 31, 2021 and 2020, respectively.

At December 31, 2021, the Company had five unsecured federal funds lines of credit totaling $150,000,000 with five of its correspondent banks, respectively. At December 31, 2020, the Company had three unsecured federal funds lines of credit totaling $75,000,000 with three of its correspondent banks, respectively. There were no amounts outstanding at December 31, 2021 and 2020.

At December 31, 2021 and 2020, the Company had the ability to borrow from the Federal Reserve Discount Window. At December 31, 2021 and 2020, the borrowing capacity under this arrangement was $16,999,000 and $25,881,000, respectively. There were no amounts outstanding at December 31, 2021 and 2020. The borrowing line is secured by liens on the Company's construction and agricultural loan portfolios.

Note 10: 401(k) Benefit Plan

A 401(k) benefit plan covers substantially all employees and allows voluntary employee contributions up to the lesser of 80% of compensation or the annually adjusted IRS dollar limit. These voluntary contributions are matched equal to 100% of the first 3% of the employee's compensation contributed and 50% of contributions exceeding 3% of eligible compensation, not to exceed 5% of the total eligible compensation. The employees' voluntary contributions and the Company's matching contributions are 100% vested immediately. The expense related to matching employees' contributions for 2021 and 2020 was $593,000 and $465,000, respectively.

Note 11: Income Taxes

The Company terminated its status as a Subchapter S corporation as of May 5, 2021, in connection with its IPO and became a taxable C Corporation. Prior to that date, as an S Corporation, the Company had no U.S. federal income tax expense. As such, any periods prior to May 5, 2021 will only reflect an effective state income tax rate and corresponding tax expense.

In conjunction with the termination of the Subchapter S corporation status, the C Corporation deferred tax assets and liabilities were estimated for future tax consequences attributable to differences between the financial statement carrying amounts of the Company's existing assets and liabilities and their respective tax bases. The deferred tax assets and liabilities were measured using tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of the change in tax rates resulting from becoming a C Corporation was recognized as a $4,638,000 increase to the net deferred tax asset to $5,370,000 and a reduction to the provision for income taxes of $4,638,000 during the year ended December 31, 2021.

The provision for income tax for the years ended December 31, 2021 and 2020 differs from the statutory federal rate of 21.00% due to the following items, which relate primarily to the Company's conversion from an S Corporation to a C Corporation:

(in thousands)	2021	2020
Statutory U.S. federal income tax	$ 9,901	$ 7,824
Increase (decrease) resulting from:		
Benefit of S Corporation status	(4,884)	(7,824)
State taxes	4,045	1,327
Deferred tax asset adjustment	(4,638)	—
Other	283	—
Provision for income taxes	$ 4,707	$ 1,327

For the year ended December 31, 2021, the Company's effective tax rate differed from the statutory California tax rate of 3.50% used prior to May 5, 2021 and the statutory federal and state tax rate, net of federal benefit, of 29.56% used May 5, 2021 and after, as the effective tax rate primarily represents the weighted average rate between the S Corporation tax rate of 3.50% and the C Corporation tax rate of 29.56% based on the number of days the Company was each type of corporation during 2021.

The components of the consolidated provision for income taxes are as follows:

(in thousands)	2021	2020
Current tax expense		
Federal	$ 6,178	$ —
State	2,530	1,468
	$ 8,708	$ 1,468
Deferred tax benefit		
Federal	$ (3,561)	$ —
State	(440)	(141)
	$ (4,001)	(141)
Provision for income taxes	$ 4,707	$ 1,327

Deferred tax assets and liabilities were due to the following as of December 31, 2021 and 2020:

(in thousands)	2021	2020
Deferred tax assets:		
Allowance for credit losses	$ 7,398	$ 777
Supplemental employee retirement plan	521	52
Gain on available-for-sale assets	151	5
Net unrealized loss on securities available-for-sale	237	—
Accrual to cash adjustment	—	13
Depreciation	—	43
Other	562	—
	8,869	890
Deferred tax liabilities:		
Deferred loan fees	(2,927)	(177)
Net unrealized gain on securities available-for-sale	—	(49)
State tax	(379)	—
Depreciation	(419)	—
Other	(228)	(31)
	(3,953)	(257)
Net deferred tax asset	$ 4,916	$ 633

No deferred tax asset valuation allowance was established during 2021 or 2020, as management believes it is more likely than not the Company will realize the benefits of these deductible differences as of December 31, 2021 and 2020.

No unrecognized tax benefits were outstanding as of December 31, 2021 or 2020. The Company files tax returns in the U.S. federal and California state jurisdictions. The Company is no longer subject to examinations for years before 2017.

There were no interest or penalties in 2021 and 2020. It is the Company's policy to record such accruals in its income taxes accounts.

During 2021, the Company paid approximately $27,000,000 to shareholders of record as of May 3, 2021, for the Accumulated Adjustments Account ("AAA") payout under the Company's Tax Sharing Agreement. The AAA represents previously taxed, but undistributed, earnings. As of December 31, 2021, the balance of the Company's AAA was estimated to be approximately $4,877,000 and is subject to adjustment upon completion of the 2021 tax return, which could be material. The balance in the AAA account represents the remaining amount of previously taxed but undistributed earnings of the Company.

Note 12: Related Party Transactions

During the normal course of business, the Company may enter into transactions with related parties, including directors, executive officers, principal shareholders, and their businesses or affiliates. In accordance with applicable regulations and Bank policies, these loans are granted on substantially the same terms, including interest rates and collateral on loans, as those prevailing at the same time for comparable transactions with persons not related to the Company. Likewise, these transactions do not involve more than the normal risk of collectability or present other unfavorable features. The following is a summary of loans to related parties in 2021 and 2020:

(in thousands)	2021	2020
Beginning balance	$ 2,048	$ 1,348
New loans or advance	7,828	280
Loans issued in prior years to new related parties	—	695
Repayments	(458)	(275)
Ending balance	$ 9,418	$ 2,048

At December 31, 2021 and 2020, deposits from related parties (directors, executive officers, and principal shareholders) totaled $32,410,000 and $42,466,000, respectively. Property management fees totaling $12,000 and $27,000 in 2021 and 2020, respectively, were paid to an entity owned by some of the Company's directors.

During 2021, nine of the Company's directors were each granted 4,500 fully vested shares of the Company's stock for the payment of director fees in addition to their standard cash compensation, totaling 40,500 shares with a combined fair value of $810,000, and one director was granted 1,140 fully vested shares of the Company's stock, with a fair value of $36,000, upon retirement. Additionally, during 2021, ten directors purchased a total of 190,071 shares for $3,985,000. During 2020, eight of the Company's directors were each granted 2,000 fully vested shares of the Company's stock for the payment of director fees in addition to their standard cash compensation, totaling 16,000 shares with a combined fair value of $252,000. Additionally, during 2020, two new directors purchased 50,000 shares for $900,000.

Additional transactions with related parties are described in Note 15, Commitments and Contingencies.

Note 13: Equity Incentive Plan

In April 2021, the Company's board of directors and shareholders approved the Five Star Bancorp 2021 Equity Incentive Plan (the "Equity Incentive Plan"). The Equity Incentive Plan provides for the grant of stock options, stock appreciation rights, performance awards, restricted stock, restricted stock units, and other stock-based awards that the Compensation Committee determines are consistent with the purpose of the Equity Incentive Plan and the interests of the Company. Awards may be granted to the Company's executives and other key employees, directors, and other service providers, and are designed to align the interests of the Equity Incentive Plan's participants with the interests of our shareholders. The stock options granted under the Equity Incentive Plan may be either non-statutory stock options or incentive stock options. There were no stock options outstanding at December 31, 2021 or 2020, respectively.

The total number of shares of our common stock reserved and available for grant and issuance pursuant to the Equity Incentive Plan will not exceed 1,700,000 shares. Each of these shares may be issued as an incentive stock option. The Equity Incentive Plan does not contain an "evergreen" provision pursuant to which shares authorized for issuance may be automatically replenished.

Stock-Based Compensation

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 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 loan 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 employees, officers, executives, and non-employee directors. Shares granted to non-employee directors vested immediately upon grant, while shares granted to employees, officers, and executives vest ratably over three, five, or seven years (as defined in the respective agreements). 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.

The Company granted 174,347 and 11,398 restricted shares during the years ended December 31, 2021 and 2020, respectively. In addition, 4,522 and no restricted shares were forfeited during the years ended December 31, 2021 and 2020, respectively. Non-cash stock compensation expense recognized for the years ended December 31, 2021 and 2020 was $1,440,000 and $568,000, respectively.

In 2021, the Company granted a total of 41,640 fully vested shares to members of the board of directors as compensation for their service. In 2020, the Company granted 2,000 fully vested shares to the Chief Executive Officer for service as a member of the board of directors and 1,250 fully vested shares to another officer as a discretionary grant.

At December 31, 2021 and 2020, respectively, there were 127,751 and 11,568 unvested restricted shares. As of December 31, 2021, there was approximately $2,204,000 of unrecognized compensation expense related to the 127,751 unvested restricted shares. The holders of unvested RSAs are entitled to dividends on 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. The impact of tax benefits for dividends paid on unvested restricted stock on the Company's consolidated statements of income for the years ended December 31, 2021 and 2020 was immaterial.

The following table summarizes information about unvested restricted shares:

	2021		2020	
	Shares	Weighted Average Grant Date Fair Value	Shares	Weighted Average Grant Date Fair Value
Beginning of the period balance	11,568	$ 21.25	15,794	$ 21.03
Shares granted	174,347	19.97	11,398	20.14
Shares vested	(53,642)	20.35	(15,624)	20.23
Shares forfeited	(4,522)	19.33	—	—
End of the period balance	127,751	$ 19.95	11,568	$ 21.25

Note 14: Shareholders' Equity

Dividends

During the year ended December 31, 2021, the Company declared cash dividends on its common shares totaling $24,975,000. On May 20, 2021, as a result of the Company's conversion to a C Corporation, the board of directors declared an aggregate distribution of $26,967,000 for the AAA payout, which is described in further detail in Note 11, Income Taxes, and the Company reclassified the resulting retained deficit related to S Corporation activities to common stock.

Note 15: 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 amount of unfunded loan commitments and standby letters of credit not reflected in the consolidated balance sheets are as follows:

(in thousands)	2021	2020
Commercial lines of credit	$ 137,354	$ 107,231
Undisbursed construction loans	46,584	50,442
Undisbursed commercial real estate loans	47,793	39,946
Agricultural lines of credit	9,955	11,553
Undisbursed agricultural real estate loans	3,427	5,945
Other	3,764	920
Total commitments and standby letters of credit	$ 248,877	$ 216,037

The Company records an allowance for loan 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 loan losses on unfunded commitments totaled $100,000 as of December 31, 2021 and 2020, which is recorded in interest payable and other liabilities in the consolidated balance sheets.

<u>Concentrations of credit risk</u>: 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 89.31% of the Company's loan portfolio at December 31, 2021 and 79.23% of the Company's loan portfolio at December 31, 2020. 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.

<u>Deposit concentrations</u>: At December 31, 2021, the Company had 64 deposit relationships that exceeded $5,000,000 each, totaling $1,166,728,000, or approximately 51.04% of total deposits. The Company's largest single deposit relationship at December 31, 2021 totaled $154,988,000, or approximately 6.78% 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 the Company's large depositors.

<u>Correspondent banking agreements</u>: The Company maintains funds on deposit with other FDIC-insured financial institutions under correspondent banking agreements. Uninsured deposits through these agreements totaled $147,219,000 and $118,003,000 at December 31, 2021 and 2020, respectively.

Leases

The Company leases office space for its banking operations under non-cancelable operating leases of various terms. The leases expire at various dates through 2032 and provide for renewal options from zero to five years. In the normal course of business, it is expected that these leases will be renewed or replaced by leases on other properties. One of the leases provides for increases in future minimum annual rental payments based on defined increases in the Consumer Price Index, while the remaining leases include pre-defined rental increases over the term of the lease.

The Company has a sublease agreement for space adjacent to the Redding location. The sublease has renewal terms extended to December 31, 2022.

The Company leases its Sacramento loan production office from a partnership comprised of some of the Company's shareholders and certain members of the board of directors. The Sacramento loan production office lease extends through April 2023. Additionally, the Company leased its Natomas branch from the same partnership of related parties until July 13, 2021, at which time ownership of the property was transferred to an unrelated third-party landlord. Rent expense paid to the partnership was $140,000 and $225,000 for the years ended December 31, 2021 and 2020, respectively, under these leases.

The following table shows the future minimum lease payments and weighted average remaining lease terms under the Company's operating lease arrangements as of December 31, 2021.

(in thousands)		
2022	$	1,025
2023		978
2024		951
2025		733
2026		604
Thereafter		1,094
Total	$	5,385
Weighted average remaining term (in years)		4.64

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 16: Capital Requirements and Restrictions on Retained Earnings

The Company and the Bank are subject to various regulatory capital requirements administered by federal and state banking agencies. Failure to meet minimum capital requirements can initiate certain mandatory and possibly additional discretionary actions by regulators that, if undertaken, could have a direct material effect on the Company's consolidated financial statements.

Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Company and the Bank must meet specific capital guidelines that involve quantitative measures of their assets, liabilities, and certain off-balance sheet items as calculated under regulatory accounting practices.

The capital amounts and the Bank's prompt corrective action classifications are also subject to qualitative judgments by the regulators about components, risk weightings, and other factors. Prompt corrective action provisions are generally not applicable to bank holding companies. Quantitative measures established by regulation to ensure capital adequacy require the Company and the Bank to maintain minimum amounts and ratios (set forth in the below table) of total capital, Tier 1 capital, and common equity Tier 1 capital (as defined in the regulations) to risk-weighted assets and of Tier 1 capital to average assets. The Company operates under the Small Bank Holding Company Policy Statement, and, accordingly, is exempt from the Federal Reserve's generally applicable risk-based capital ratio and leverage ratio requirements. The Bank is required to meet a common equity Tier 1 capital to risk-weighted assets ratio of at least 7.00% (a minimum of 4.50% plus a capital conservation buffer of 2.50%), a Tier 1 capital to risk-weighted assets ratio of at least 8.50% (a minimum of 6.00% plus a capital conservation buffer of 2.50%), a total capital to risk-weighted assets ratio of at least 10.50% (a minimum of 8.00% plus a capital conservation buffer of 2.50%), and a Tier 1 leverage ratio of at least 4.00%. Management believes that, as of December 31, 2021, the Company and the Bank met all capital adequacy requirements to which they are subject.

As of December 31, 2021, the Bank was categorized as "well-capitalized" under the regulatory framework for prompt corrective action. To be categorized as well-capitalized, an institution must maintain minimum total risk-based, Tier 1 risk-based, and Tier 1 leverage ratios as set forth in the below table. There are no conditions or events since that notification that management believes have changed the Bank's category.

The principal source of cash for the Company is dividends from the Bank. Dividends from the Bank to the Company are restricted under California law to the lesser of: (a) the Bank's retained earnings; or (b) the Bank's net income for the latest three fiscal years, less dividends previously declared during that period. As of December 31, 2021 and 2020, the maximum amount available for dividend distribution under this restriction was approximately $15,464,000 and $15,624,000, respectively. If a proposed dividend exceeds the limit, the Bank may still pay a dividend to the Holding Company if it obtains approval from the California Department of Financial Protection and Innovation and the dividend does not exceed the greater of: (i) the retained earnings of the Bank; (ii) the net income of the Bank for its last fiscal year; or (iii) the net income of the Bank for its current fiscal year.

The Company's and the Bank's actual capital amounts and ratios as of December 31, 2021 and 2020 are presented in the following table:

Capital Ratios for Bancorp (dollars in thousands)	Actual Ratio		Required for Capital Adequacy Purposes[1]		Ratio to be Well-Capitalized under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
2021						
Total capital (to risk-weighted assets)	$ 285,128	13.98%	$ 163,177	≥ 8.00%	N/A	N/A
Tier 1 capital (to risk-weighted assets)	$ 233,397	11.44%	$ 122,382	≥ 6.00%	N/A	N/A
Common equity tier 1 capital (to risk-weighted assets)	$ 233,397	11.44%	$ 91,787	≥ 4.50%	N/A	N/A
Tier 1 leverage	$ 233,397	9.47%	$ 98,600	≥ 4.00%	N/A	N/A
2020						
Total capital (to risk-weighted assets)	$ 176,861	12.18%	$ 116,138	≥ 8.00%	N/A	N/A
Tier 1 capital (to risk-weighted assets)	$ 130,347	8.98%	$ 87,103	≥ 6.00%	N/A	N/A
Common equity tier 1 capital (to risk-weighted assets)	$ 130,347	8.98%	$ 65,327	≥ 4.50%	N/A	N/A
Tier 1 leverage	$ 130,347	6.58%	$ 79,204	≥ 4.00%	N/A	N/A

Capital Ratios for the Bank (dollars in thousands)	Actual Ratio		Required for Capital Adequacy Purposes		Ratio to be Well-Capitalized under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
2021						
Total capital (to risk-weighted assets)	$ 279,152	13.69%	$ 163,078	≥ 8.00%	$ 203,848	≥ 10.00%
Tier 1 capital (to risk-weighted assets)	$ 255,807	12.55%	$ 122,309	≥ 6.00%	$ 163,078	≥ 8.00%
Common equity tier 1 capital (to risk-weighted assets)	$ 255,807	12.55%	$ 91,731	≥ 4.50%	$ 132,501	≥ 6.50%
Tier 1 leverage	$ 255,807	10.38%	$ 98,555	≥ 4.00%	$ 123,193	≥ 5.00%
2020						
Total capital (to risk-weighted assets)	$ 174,002	11.99%	$ 116,114	≥ 8.00%	$ 145,143	≥ 10.00%
Tier 1 capital (to risk-weighted assets)	$ 155,808	10.73%	$ 87,086	≥ 6.00%	$ 116,114	≥ 8.00%
Common equity tier 1 capital (to risk-weighted assets)	$ 155,808	10.73%	$ 65,314	≥ 4.50%	$ 94,343	≥ 6.50%
Tier 1 leverage	$ 155,808	7.87%	$ 79,199	≥ 4.00%	$ 98,998	≥ 5.00%

1 Presented as if Bancorp were subject to Basel III capital requirements. The Company operates under the Small Bank Holding Company Policy Statement and therefore is not currently subject to generally applicable capital adequacy requirements.

Note 17: Fair Value of Assets and Liabilities

The following table summarizes the Company's assets and liabilities that were carried 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[1]
2021					
Assets:					
Securities available-for-sale:					
U.S. government agencies, mortgage-backed securities, obligations of states and political subdivisions, collateralized mortgage obligations, and corporate bonds	$ 148,807	$ —	$ 148,807	$ —	OCI
Derivatives – interest rate swap	92	—	92	—	NI
Liabilities:					
Derivatives – interest rate swap	92	—	92	—	NI
2020					
Assets:					
Securities available-for-sale:					
U.S. government agencies, mortgage-backed securities, obligations of states and political subdivisions, and collateralized mortgage obligations	$ 114,949	$ —	$ 114,949	$ —	OCI
Derivatives – interest rate swap	149	—	149	—	NI
Liabilities:					
Derivatives – interest rate swap	149	—	149	$ —	NI

1 Other comprehensive income ("OCI") or net income ("NI").

Available-for-sale securities are recorded at fair value on a recurring basis. When available, quoted market prices (Level 1) 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). 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. As of December 31, 2021 and 2020, there were no Level 1 or Level 3 securities and no transfers between Level 1 and Level 2 classifications for assets or liabilities measured at fair value on a recurring basis.

The Company's investment portfolio service bureau has developed a model for pricing available-for-sale debt securities. Information such as historical and current performance of the underlying collateral, deferral/default rates, collateral coverage ratios, break-even yield calculations, cash flow projections, liquidity, and credit premiums required by a market participant, as well as financial trend analysis with respect to the individual issuing financial institutions and insurance companies, are utilized in determining individual security valuations. Due to current market conditions, as well as the limited trading activity of the securities, the market value of the securities is highly sensitive to assumption changes and market volatility.

The Company's derivative is comprised of an interest rate swap for a structured lending arrangement and is reported at fair value utilizing Level 2 inputs. The Company obtains fair values from financial institutions that utilize internal models with observable market data inputs to estimate the values of these instruments (Level 2 inputs).

The fair value of collateral dependent impaired loans and other real estate is generally based on recent real estate appraisals. These appraisals may utilize a single valuation approach or a combination of approaches including comparable sales and the income approach. Adjustments are routinely made in the appraisal process by the appraisers to adjust for differences between the comparable sales and income data available. Management also incorporates assumptions regarding market trends or other relevant factors and selling and commission costs ranging from 5.00% to 7.00%. Such adjustments and assumptions are typically significant and result in a Level 3 classification of the inputs for determining fair value.

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 impaired loans that are collateral dependent and OREO. As of December 31, 2021 and 2020, the Company did not carry any assets measured at fair value on a non-recurring basis.

Disclosures about Fair Value of Financial Instruments

The table below is a summary of fair value estimates for financial instruments as of December 31, 2021 and 2020. These estimates are made at a specific point in time based on relevant market data and information about the financial instruments. These estimates do not reflect any premium or discount that could result from offering the Company's entire holdings of a particular financial instrument for sale at one time, nor do they attempt to estimate the value of anticipated future business related to the instruments. In addition, the tax ramifications related to the realization of unrealized gains and losses can have a significant effect on fair value estimates and have not been considered in any of these estimates.

Because no market exists for a significant portion of the Company's financial instruments, fair value estimates are based on judgments regarding current economic conditions, risk characteristics of various financial instruments, and other factors. These estimates are subjective in nature and involve uncertainties and matters of significant judgment and therefore cannot be determined with precision. Changes in assumptions could significantly affect the fair values presented. 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.

	December 31, 2021			December 31, 2020		
(in thousands)	Carrying Amounts	Fair Value	Fair Value Hierarchy	Carrying Amounts	Fair Value	Fair Value Hierarchy
Financial assets:						
Cash and cash equivalents	$ 425,329	$ 425,329	Level 1	$ 290,493	$ 290,493	Level 1
Time deposits in banks	14,464	14,464	Level 1	23,705	23,705	Level 1
Securities available-for-sale	148,807	148,807	Level 2	114,949	114,949	Level 2
Securities held-to-maturity	4,946	5,197	Level 3	7,979	8,755	Level 3
Loans held for sale	10,671	11,217	Level 2	4,820	5,012	Level 2
Loans held for investment	1,911,217	1,893,431	Level 3	1,480,970	1,464,794	Level 3
FHLB stock and other investments	12,464	N/A	N/A	9,989	N/A	N/A
Interest receivable	5,332	5,332	Level 2	5,422	5,422	Level 2
Interest rate swap	92	92	Level 2	149	149	Level 2
Financial liabilities:						
Deposits	2,285,890	2,210,555	Level 2	1,784,001	1,785,944	Level 2
Interest payable	23	23	Level 2	75	75	Level 2
Interest rate swap	92	92	Level 2	149	149	Level 2
Subordinated notes	28,386	28,386	Level 3	28,320	28,320	Level 3

The following methods and assumptions were used by the Company to estimate the fair value of its financial instruments at December 31, 2021 and 2020:

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

<u>Investment securities</u>: See discussion above for the methods and assumptions used by the Company to estimate the fair value of investment securities.

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

<u>Loans held for investment</u>: 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 loan losses is considered to be a reasonable estimate of loan discount for credit quality concerns.

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

Deposits: The fair values for demand deposits are, by definition, equal to the amount payable on demand at the reporting date represented by their carrying amount. Fair values for fixed rate certificates of deposit are estimated using a discounted cash flow analysis that uses interest rates being offered at each reporting date by the Company for certificates with similar remaining maturities. For variable rate time deposits, cost approximates fair value.

Commitments to extend credit: Commitments to extend credit are primarily for adjustable rate loans. For these commitments, there are no differences between the committed amounts and their fair values. Commitments to fund fixed rate loans are at rates which approximate fair value at each reporting date.

Subordinated notes: The fair value is estimated by discounting the future cash flow using the current 3-month LIBOR rate. 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 18: Parent Company Only Condensed Financial Information

CONDENSED BALANCE SHEETS
December 31, 2021 and 2020
(In thousands)

	2021	2020
ASSETS		
Cash and cash equivalents	$ 5,636	$ 3,555
Investment in banking subsidiary	257,456	159,236
Other assets	922	291
Total assets	$ 264,014	$ 163,082
LIABILITIES AND SHAREHOLDERS' EQUITY		
Subordinated notes and other liabilities	$ 28,968	$ 29,307
Shareholders' equity	235,046	133,775
Total liabilities and shareholders' equity	$ 264,014	$ 163,082

CONDENSED STATEMENTS OF INCOME
Years ended December 31, 2021 and 2020
(In thousands)

	2021	2020
Dividends from banking subsidiary	$ 27,630	$ 28,077
Interest expense	1,773	1,773
Other expense	3,559	1,023
Income before income tax and undistributed banking subsidiary income	22,298	25,281
Income tax benefit	812	10
Equity in undistributed banking subsidiary income	19,331	10,637
Net income	$ 42,441	$ 35,928

CONDENSED STATEMENTS OF CASH FLOWS
Years ended December 31, 2021 and 2020
(In thousands)

	2021	2020
Cash flows from operating activities:		
Net income	$ 42,441	$ 35,928
Adjustments to reconcile net income to net cash provided by operating activities:		
Stock compensation expense	594	316
Stock issued to directors	846	252
Equity in undistributed banking subsidiary income	(19,331)	(10,637)
Amortization of subordinated notes issuance costs	66	67
Change in other assets	(631)	(203)
Change in accrued expenses and other liabilities	(405)	514
Net cash provided by operating activities	23,580	26,237
Cash flows from investing activities:		
Investment in subsidiary	(80,800)	(13,500)
Net cash used in investing activities	(80,800)	(13,500)
Cash flows from financing activities:		
Proceeds from sale of stock	111,243	13,400
Cash dividends paid	(51,942)	(26,369)
Net cash provided by financing activities	59,301	(12,969)
Net change in cash and cash equivalents	2,081	(232)
Cash and cash equivalents at beginning of period	3,555	3,787
Cash and cash equivalents at end of period	$ 5,636	$ 3,555

Note 19: Subsequent Events

On January 20, 2022, the board of directors declared a $0.15 per common share dividend for shareholders of record as of February 7, 2022, which was paid on February 14, 2022 in the amount of $2,587,000.

Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure

None.

Item 9A. 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 of the design and operation of our disclosure controls and procedures, as defined in Rule 13a-15(e) under the Securities Exchange Act of 1934 (the "Exchange Act"), as of December 31, 2021. 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 and implementing 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 period covered by this Annual Report on Form 10-K.

Management's Report on Internal Control Over Financial Reporting

This annual report does not include a management's report regarding internal control over financial reporting due to a transition period established by rules of the SEC for newly public companies.

Changes in Internal Control over Financial Reporting

There was no change in our internal control over financial reporting (as such term is defined in Rule 13a-15(f) under the Exchange Act) that occurred during the three months ended December 31, 2021 that has materially affected, or is reasonably likely to materially affect, such controls.

Attestation Report of the Independent Registered Public Accounting Firm

Not applicable for an emerging growth company.

Item 9B. Other Information

On February 23, 2022, the Company's board of directors amended and restated the Company's bylaws, clarifying the Company's voting standards for the election of directors, which is determined by a plurality vote. The bylaws, as amended and restated, are effective as of February 23, 2022 and are attached hereto as Exhibit 3.2. The provisions of the Company's bylaws described herein otherwise remain unchanged.

PART III

Item 10. Directors, Executive Officers and Corporate Governance

Board of Directors

For information relating to the Company's board of directors, the section entitled *"Items to be Voted on by Shareholders —Item 1 —Election of Directors"* in the Company's Proxy Statement for the 2022 Annual Meeting of Shareholders is incorporated herein by reference.

Executive Officers

For information relating to officers of the Company, the section entitled *"Information About Our Executive Officers"* in the Company's Proxy Statement for the 2022 Annual Meeting of Shareholders is incorporated herein by reference.

Delinquent Section 16(a) Reports

For information regarding compliance with Delinquent Section 16(a) Reports, the section entitled *"Stock Information —Delinquent Section 16(a) Reports"* in the Company's Proxy Statement for the 2022 Annual Meeting of Shareholders is incorporated herein by reference.

Disclosure of Code of Conduct

For information concerning the Company's Code of Conduct, the information contained under the section entitled *"Corporate Governance —Code of Conduct"* in the Company's Proxy Statement for the 2022 Annual Meeting of Shareholders is incorporated by reference. A copy of the Code of Conduct is available to shareholders on the Company's investor relations website at https://investors.fivestarbank.com/corporate-governance/governance-overview.

Nominating and Audit Committees

For information regarding the Company's Nominating and Audit Committees, their composition, and the audit committee financial experts, the section entitled *"Corporate Governance —Board Committees"* in the Company's Proxy Statement for the 2022 Annual Meeting of Shareholders is incorporated herein by reference.

Item 11. Executive Compensation

For information regarding executive compensation, the sections entitled *"Executive Compensation"* and *"Director Compensation"* in the Company's Proxy Statement for the 2022 Annual Meeting of Shareholders are incorporated herein by reference.

Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Shareholder Matters

Security Ownership of Certain Beneficial Owners

Information required by this item is incorporated herein by reference to the section entitled *"Stock Information —Security Ownership of Certain Beneficial Owners and Management"* in the Company's Proxy Statement for the 2022 Annual Meeting of Shareholders.

Security Ownership of Management

Information required by this item is incorporated herein by reference to the section entitled *"Stock Information —Security Ownership of Certain Beneficial Owners and Management"* in in the Company's Proxy Statement for the 2022 Annual Meeting of Shareholders.

Securities Authorized for Issuance Under Equity Compensation Plans

The following table sets forth information about the Company common stock that may be issued upon the exercise of stock options, warrants, and rights under all the Company's equity compensation plans as of December 31, 2021.

	(a) Number of securities to be issued upon exercise of outstanding options, warrants, and rights	(b) Weighted-average exercise price of outstanding options	(c) Number of securities remaining available for issuance under equity compensation plans (excluding securities reflected in column (a))
Equity compensation plan approved by shareholders[1]	—	$ —	1,536,904
Equity compensation not approved by shareholders	—	—	—
Total	—	$ —	1,536,904

1 Plans approved by shareholders include the Five Star Bancorp 2021 Equity Incentive Plan.

Item 13. Certain Relationships and Related Transactions, and Director Independence

Certain Relationships and Related Transactions

For information regarding certain relationships and related transactions, the section entitled "*Other Information —Transactions with Related Parties*" in the Company's Proxy Statement for the 2022 Annual Meeting of Shareholders is incorporated herein by reference.

Director Independence

For information regarding director independence, the section entitled "*Corporate Governance —Director Independence*" in the Company's Proxy Statement for the 2022 Annual Meeting of Shareholders is incorporated herein by reference.

Item 14. Principal Accountant Fees and Services

For information regarding the principal accountant fees and expenses, the section entitled "*Item 2 —Ratification of Selection of Independent Registered Public Accounting Firm*" in the Company's Proxy Statement for the 2022 Annual Meeting of Shareholders is incorporated herein by reference.

PART IV

Item 15. Exhibits and Financial Statement Schedules

(1) The financial statements required in response to this item are incorporated herein by reference from Part II, Item 8 of this Annual Report on Form 10-K.

(2) All financial statement schedules are omitted because they are not required or applicable, or the required information is shown in the consolidated financial statements or the notes thereto.

(3) Exhibits

		Incorporated by Reference				
Exhibit Number	Exhibit Description	Form	File No.	Exhibit	Filing Date	Herewith
3.1	Amended and Restated Articles of Incorporation of Five Star Bancorp	10-Q	001-40379	3.1	June 17, 2021	
3.2	Amended and Restated Bylaws of Five Star Bancorp					Filed
4.1	Form of Common Stock Certificate of Five Star Bancorp	S-1	333-255143	4.1	April 26, 2021	
4.2	Form of 6.0% Fixed-to-Floating Rate Subordinated Note Due 2027	S-1	333-255143	Exhibit A of Exhibit 10.9	April 9, 2021	
4.3	Form of 5.5% Fixed-to-Floating Rate Subordinated Note Due 2027	S-1	333-255143	Exhibit A of Exhibit 10.10	April 9, 2021	
4.4	Description of Securities					Filed
10.1†	Form of S Corporation Termination and Tax Sharing Agreement	S-1	333-255143	10.1	April 9, 2021	
10.2*	Five Star Bancorp 2021 Equity Incentive Plan	S-1	333-255143	10.4	April 26, 2021	
10.3*	Form of Restricted Stock Vesting Agreement pursuant to Historical Incentive Plan	S-1	333-255143	10.5	April 9, 2021	
10.4	Form of Restricted Stock Vesting Agreement for Executives pursuant to the Five Star Bancorp 2021 Equity Incentive Plan					Filed
10.5	Form of Restricted Stock Vesting Agreement for Directors pursuant to the Five Star Bancorp 2021 Equity Incentive Plan					Filed
10.6†	Form of Subordinated Note Purchase Agreement for 6.0% Fixed-to-Floating Rate Subordinated Note Due 2027	S-1	333-255143	10.9	April 9, 2021	
10.7	Form of Subordinated Note Purchase Agreement for 5.5 % Fixed-to-Floating Rate Subordinated Note Due 2027	S-1	333-255143	10.10	April 9, 2021	
10.8*	Executive Employment Agreement, dated January 3, 2019, between Five Star Bank and James Beckwith	S-1	333-255143	10.11	April 9, 2021	
10.9*	Five Star Bank Salary Continuation Agreement, dated September 1, 2007, as amended, between Five Star Bank and James Beckwith	S-1	333-255143	Exhibit A of Exhibit 10.11	April 9, 2021	
21.1	Subsidiaries of the Registrant					Filed
23.1	Consent of Moss Adams LLP					Filed
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

† Certain of the exhibits and schedules to this Exhibit have been omitted in accordance with Regulation S-K Item 601(a)(5). The Registrant agrees to furnish a copy of all omitted exhibits and schedules to the SEC upon its request.

* Management contract or compensatory plan, contract, or arrangement.

Item 16. Form 10-K Summary

None.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) 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

Dated: February 25, 2022

/s/ James E. Beckwith
James E. Beckwith
President and Chief Executive Officer

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

Name	Title	Date
/s/ James E. Beckwith James E. Beckwith	President and Chief Executive Officer and Director (Principal Executive Officer)	February 25, 2022
/s/ Heather C. Luck Heather C. Luck	Senior Vice President and Chief Financial Officer (Principal Financial and Accounting Officer)	February 25, 2022
/s/ David J. Lucchetti David J. Lucchetti	Chair of the Board and Director	February 25, 2022
/s/ David F. Nickum David F. Nickum	Vice Chair of the Board and Director	February 25, 2022
/s/ Larry E. Allbaugh Larry E. Allbaugh	Director	February 25, 2022
/s/ Michael D. Campbell Michael D. Campbell	Director	February 25, 2022
/s/ Shannon Deary-Bell Shannon Deary-Bell	Director	February 25, 2022
/s/ Warren P. Kashiwagi Warren P. Kashiwagi	Director	February 25, 2022
/s/ Donna L. Lucas Donna L. Lucas	Director	February 25, 2022
/s/ Robert T. Perry-Smith Robert T. Perry-Smith	Director	February 25, 2022
/s/ Kevin F. Ramos Kevin F. Ramos	Director	February 25, 2022
/s/ Randall E. Reynoso Randall E. Reynoso	Director	February 25, 2022
/s/ Judson T. Riggs Judson T. Riggs	Director	February 25, 2022
/s/ Leigh A. White Leigh A. White	Director	February 25, 2022

AMENDED AND RESTATED BYLAWS

OF

FIVE STAR BANCORP

(As adopted on February 23, 2022)

ARTICLE I

Offices

Section 1.1. Principal Office. The principal executive office of the corporation is hereby located at such place as the board of directors (the "Board") shall determine. The Board is hereby granted full power and authority to change said principal executive office from one location to another.

Section 1.2. Other Offices. Other business offices may, at any time, be established by the Board at such other places as it deems appropriate.

ARTICLE II

Meetings of Shareholders

Section 2.1. Place of Meetings. Meetings of shareholders may be held at such place within or outside the state of California, or at no place, as designated by the Board, or by means of remote communication. In the absence of any such designation, shareholders' meetings shall be held at the principal executive office of the corporation.

Section 2.2. Annual Meeting. (a) The annual meeting of shareholders shall be held for the election of directors on a date and at a time designated by the Board. The date so designated shall be within fifteen months after the last annual meeting. At such meeting, directors shall be elected, and any other proper business within the power of the shareholders may be transacted. The Board may postpone, reschedule or cancel any annual meeting.

To the extent permitted by applicable law, nominations of persons for election to the Board and the proposal of business to be considered by the shareholders may be made at a meeting of shareholders: (i) pursuant to the corporation's notice of meeting of shareholders (with respect to business other than nominations); (ii) brought specifically by or at the direction of the Board; or (iii) by any shareholder of the corporation who was a shareholder of record at the time of giving the shareholder's notice provided in the following paragraph, who is entitled to vote at the meeting and who complied with the notice procedures set forth in this Section 2.2. For the avoidance of doubt, clause (iii) above shall be the exclusive means for a shareholder to make nominations and submit other business (other than matters properly included in the corporation's notice of meeting of shareholders and proxy statement under Rule 14a-8 under the Securities Exchange Act of 1934, as amended, and the rules and regulations thereunder (the "1934 Act")) before an annual meeting of shareholders.

(b) At an annual meeting of the shareholders, only such business shall be conducted as is a proper matter for shareholder action under California law and as shall have been properly brought before the meeting in accordance with the procedures below.

(i) For nominations for the election to the Board to be properly brought before an annual meeting by a shareholder pursuant to clause (iii) of Section 2.2(a) of these bylaws, the shareholder must deliver written notice to the secretary at the principal executive offices of the corporation on a timely basis as set forth in Section 2.2(b)(iii) and must update and supplement such written notice on a timely basis as set forth in Section 2.2(c). Such shareholder's notice shall set forth: (A) as to each nominee such shareholder proposes to nominate at the meeting: (1) the name, age, business address and residence address of such nominee, (2) the principal occupation or employment of such nominee, (3) the class and number of shares of each class of capital stock of the corporation which are owned of record and beneficially by such nominee, (4) the date or dates on which such shares were acquired and the investment intent of such acquisition, (5) a statement that such nominee agrees to tender an irrevocable resignation to the secretary, to be effective upon (x) such person's failure to receive the required vote for re-election in any uncontested election at which such person would face re-election and (y) acceptance of such resignation by the Board and (6) such other information concerning such nominee as would be required to be disclosed in a proxy statement soliciting proxies for the election of such nominee as a director in an election contest (even if an election contest is not involved), or that is otherwise required to be disclosed pursuant to Section 14 of the 1934 Act (including such person's written consent to being named as a nominee and to serving as a director if elected); and (B) the information required by Section 2.2(b)(iv). The corporation may require any proposed nominee to furnish such other information as it may reasonably require to determine the eligibility of such proposed nominee to serve as an independent director of the corporation or that could be material to a reasonable shareholder's understanding of the independence, or lack thereof, of such proposed nominee.

(ii) Other than proposals sought to be included in the corporation's proxy materials pursuant to Rule 14a-8 under the 1934 Act, for business other than nominations for the election to the Board of Directors to be properly brought before an annual meeting by a shareholder pursuant to clause (iii) of Section 2.2(a) of these bylaws, the shareholder must deliver written notice to the secretary at the principal executive offices of the corporation on a timely basis as set forth in Section 2.2(b)(iii), and must update and supplement such written notice on a timely basis as set forth in Section 2.2(c). Such shareholder's notice shall set forth: (A) as to each matter such shareholder proposes to bring before the meeting, a brief description of the business desired to be brought before the meeting, the reasons for conducting such business at the meeting, and any material interest in such business of any Proponent (as defined below) (including any anticipated benefit of such business to any Proponent other than solely as a result of its ownership of the corporation's capital stock, that is material to any Proponent individually, or to the Proponents in the aggregate); and (B) the information required by Section 2.2(b)(iv).

(iii) To be timely, the written notice required by Section 2.2(b)(i) or 2.2(b)(ii) must be received by the secretary at the principal executive offices of the corporation not later than the close of business on the 90th day nor earlier than the close of business on the 120th day prior to the first anniversary of the preceding year's annual meeting; provided that, subject to the last sentence of this Section 2.2(b)(iii), in the event that the date of the annual meeting is advanced more than 30 days prior to or delayed by more than 30 days after the anniversary of the preceding year's annual meeting, notice by the shareholder to be timely must be so received (A) not earlier than the close of business on the 120th day prior to such annual meeting and (B) not later than the close of business on the later of the 90th day prior to such annual meeting or the tenth day following the day on which public announcement of the date of such meeting is first made. In no event shall an adjournment or a postponement of an annual meeting for which notice has been given, or the public announcement thereof has been made, commence a new time period for the giving of a shareholder's notice as described above.

(iv) The written notice required by Section 2.2(b)(i) or 2.2(b)(ii) shall also set forth, as of the date of the notice and as to the shareholder giving the notice and the beneficial owner, if any, on whose behalf the nomination or proposal is made (each, a "Proponent" and collectively, the "Proponents"): (A) the name and address of each Proponent, as they appear on the corporation's books; (B) the class, series and number of shares of the corporation that are owned beneficially and of record by each Proponent; (C) a description of any agreement, arrangement or understanding (whether oral or in writing) with respect to such nomination or proposal between or among any Proponent and any of its affiliates or associates, and any others (including their names) acting in concert, or otherwise under the agreement, arrangement or understanding, with any of the foregoing; (D) a representation that the Proponents are holders of record or beneficial owners, as the case may be, of shares of the corporation entitled to vote at the meeting and intend to appear in person or by proxy at the meeting to nominate the person or persons specified in the notice (with respect to a notice under Section 2.2(b)(i)) or to propose the business that is specified in the notice (with respect to a notice under Section 2.2(b)(ii)); (E) a representation as to whether the Proponents intend to deliver a proxy statement and form of proxy to holders of a sufficient number of holders of the corporation's voting shares to elect such nominee or nominees (with respect to a notice under Section 2.2(b)(i)) or to carry such proposal (with respect to a notice under Section 2.2(b)(ii)); (F) to the extent known by any Proponent, the name and address of any other shareholder supporting the proposal on the date of such shareholder's notice; and (G) a description of all Derivative Transactions (as defined below) by each Proponent during the previous twelve month period, including the date of the transactions and the class, series and number of securities involved in, and the material economic terms of, such Derivative Transactions.

(c) A shareholder providing written notice required by Section 2.2(b)(i) or 2.2(b)(ii) shall update and supplement such notice in writing, if necessary, so that the information provided or required to be provided in such notice is true and correct in all material respects as of (i) the record date for the meeting and (ii) the date that is five business days prior to the meeting and, in the event of any adjournment or postponement thereof, five business days prior to such adjourned or postponed meeting. In the case of an update and supplement pursuant to clause (i) of this Section 2.2(c), such update and supplement shall be received by the secretary at the principal executive offices of the corporation not later than five business days after the record date for the meeting. In the case of an update and supplement pursuant to clause (ii) of this Section 2.2(c), such update and supplement shall be received by the secretary at the principal executive offices of the corporation not later than two business days prior to the date for the meeting, and, in the event of any adjournment or postponement thereof, two business days prior to such adjourned or postponed meeting.

(d) Notwithstanding anything in Section 2.2(b)(iii) to the contrary, in the event that the number of directors of the Board of the corporation is increased and there is no public announcement of the appointment of a director, or, if no appointment was made, of the vacancy, made by the corporation at least ten days before the last day a shareholder may deliver a notice of nomination in accordance with Section 2.2(b)(iii), a shareholder's notice required by this Section 2.2 and which complies with the requirements in Section 2.2(b)(i), other than the timing requirements in Section 2.2(b)(iii), shall also be considered timely, but only with respect to nominees for any new positions created by such increase, if it shall be received by the secretary at the principal executive offices of the corporation not later than the close of business on the tenth day following the day on which such public announcement is first made by the corporation.

(e) A person shall not be eligible for election as a director unless the person is nominated either in accordance with clause (ii) of Section 2.2(a), or in accordance with clause (iii) of Section 2.2(a). Except as otherwise required by law, the chairperson of the meeting shall have the power and duty to determine whether a nomination or any business proposed to be brought before the meeting was made, or proposed, as the case may be, in accordance with the procedures set forth in these bylaws and, if any proposed nomination or business is not in compliance with these bylaws, or the Proponent does not act in accordance with the representations in Sections 2.2(b)(iv)(D) and 2.2(b)(iv)(E), to declare that such proposal or nomination shall not be presented for shareholder action at the meeting and shall be disregarded, notwithstanding that proxies in respect of such nominations or such business may have been solicited or received.

(f) Notwithstanding the foregoing provisions of this Section 2.2, in order to include information with respect to a shareholder proposal in the proxy statement and form of proxy for a shareholders' meeting, a shareholder must also comply with all applicable requirements of the 1934 Act. Nothing in these bylaws shall be deemed to affect any rights of shareholders to request inclusion of proposals in the corporation's proxy statement pursuant to Rule 14a-8 under the 1934 Act; provided that any references in these bylaws to the 1934 Act are not intended to and shall not limit the requirements applicable to proposals and/or nominations to be considered pursuant to Section 2.2(a)(iii) of these bylaws.

(g) For purposes of Section 2.2,

(i) "affiliates" and "associates" shall have the meanings set forth in Rule 405 under the Securities Act of 1933, as amended, and Rule 12b-2 under the 1934 Act.

(ii) a "Derivative Transaction" means any agreement, arrangement, interest or understanding entered into by, or on behalf or for the benefit of, any Proponent or any of its affiliates or associates, whether record or beneficial:

(A) the value of which is derived in whole or in part from the value of any class or series of shares or other securities of the corporation,

(B) which otherwise provides any direct or indirect opportunity to gain or share in any gain derived from a change in the value of securities of the corporation,

(C) the effect or intent of which is to mitigate loss, manage risk or benefit of security value or price changes, or

(D) which provides the right to vote or increase or decrease the voting power of, such Proponent, or any of its affiliates or associates, with respect to any securities of the corporation, which agreement, arrangement, interest or understanding may include, without limitation, any option, warrant, debt position, note, bond, convertible security, swap, stock appreciation right, short position, profit interest, hedge, right to dividends, voting agreement, performance-related fee or arrangement to borrow or lend shares (whether or not subject to payment, settlement, exercise or conversion in any such class or series), and any proportionate interest of such Proponent in the securities of the corporation held by any general or limited partnership, or any limited liability company, of which such Proponent is, directly or indirectly, a general partner or managing member; and

(iii) "public announcement" shall mean disclosure in a press release reported by the Dow Jones News Service, Associated Press or comparable national news service or in a document publicly filed by the corporation with the United States Securities and Exchange Commission (the "SEC") pursuant to Section 13, 14 or 15(d) of the 1934 Act.

Section 2.3. Special Meetings. Special meetings of the shareholders may be called at any time by the Board, the chairperson of the Board, the president, or by the holders of shares entitled to cast not less than ten percent of the votes at such meeting. If a special meeting is called by any person or persons other than the Board, the request shall be in writing, specifying the time and place of such meeting and the general nature of the business proposed to be transacted, and shall be delivered personally or by registered mail to the chairperson of the Board, the president, any vice president or the secretary of the corporation. The officer receiving the request shall cause notice to be promptly given to the shareholders entitled to vote that a meeting will be held at a time requested by the person or persons calling the meeting, not less than 35 nor more than 60 days after receipt of the request. If the notice is not given within 20 days after receipt of the request, the person or persons requesting the meeting may give the notice. Nothing in this paragraph shall be construed as limiting, fixing or affecting the time when a meeting of shareholders called by action of the Board may be held.

Section 2.4. Notice of Meetings. Electronic notice, in accordance with Section 2.5, of each annual or special meeting of shareholders shall be given not less than ten nor more than 60 days before the date of the meeting to each shareholder entitled to vote thereat. Such notice shall state the place, date and hour of the meeting and (a) in the case of a special meeting, the general nature of the business to be transacted, and no other business may be transacted, or (b) in the case of the annual meeting, those matters which the Board, at the time of the mailing of the notice, intends to present for action by the shareholders, but, subject to the provisions of applicable law, any proper matter may be presented at the meeting for such action. The notice of any meeting at which directors are to be elected shall include the names of nominees intended at the time of the notice to be presented by the Board for election.

If action is proposed to be taken at any meeting for approval of (a) a contract or transaction in which a director has a direct or indirect financial interest, pursuant to Section 310 of the California Corporations Code, as amended (the "Code"), (b) an amendment of the articles of incorporation, pursuant to Section 902 of the Code, (c) a reorganization of the corporation, pursuant to Section 1201 of the Code, (d) a voluntary dissolution of the corporation, pursuant to Section 1900 of the Code, or (e) a distribution in dissolution other than in accordance with the rights of outstanding preferred shares, pursuant to Section 2007 of the Code, the notice shall also state the general nature of that proposal.

Section 2.5. Manner of Giving Notice. Notice of a shareholders' meeting shall be given either in writing or by electronic transmission. If mailed, notice is given when deposited in the United States mail, postage prepaid, directed to the shareholder at the shareholder's address as it appears on the records of the corporation. If sent via electronic transmission, notice is given as of the sending time recorded at the time of transmission. Notice of the time, place, if any, and purpose of any meeting of shareholders (to the extent required) may be waived in writing, signed by the person entitled to notice thereof, or by electronic transmission by such person, either before or after such meeting, and will be waived by any shareholder by his or her attendance thereat in person, by remote communication, if applicable, or by proxy, except when the shareholder attends a meeting for the express purpose of objecting, at the beginning of the meeting, to the transaction of any business because the meeting is not lawfully called or convened. Any shareholder so waiving notice of such meeting shall be bound by the proceedings of any such meeting in all respects as if due notice thereof had been given.

Section 2.6. Quorum. A majority of the shares entitled to vote represented in person or by proxy, shall constitute a quorum at any meeting of shareholders. The shareholders present at a duly called or held meeting at which a quorum is present may continue to transact business until adjournment notwithstanding the withdrawal of enough shareholders to leave less than a quorum, if any action taken (other than adjournment) is approved by at least a majority of the shares required to constitute a quorum.

Section 2.7. Adjourned Meeting and Notice Thereof. Any shareholders' meeting, whether or not a quorum is present, may be adjourned from time to time, either by the chairperson of the meeting or by the vote of a majority of the shares represented either in person or by proxy at the meeting. At the adjourned meeting, the corporation may transact any business that might have been transacted at the original meeting.

When any meeting of shareholders, either annual or special, is adjourned to another time or place, notice need not be given of the adjourned meeting if the time and place are announced at the meeting at which the adjournment is taken. However, when any shareholders' meeting is adjourned for more than 45 days from the date set for the original meeting, or, if after adjournment a new record date is fixed for the adjourned meeting, notice of the adjourned meeting shall be given to each shareholder of record entitled to vote at the meeting.

Section 2.8. Voting. The shareholders entitled to notice of any meeting or to vote at any such meeting shall be only persons in whose name shares stand on the stock records of the corporation as of the record date determined in accordance with Section 2.9. Every person entitled to vote shall have the right to do so either in person, by remote communication, if applicable, or by an agent or agents authorized by a proxy granted in accordance with Section 2.12. An agent so appointed need not be a shareholder.

Voting of shares of the corporation shall in all cases be subject to the provisions of Sections 700 through 711, inclusive, of the Code.

On any matter any shareholder may vote part of the shares in favor of the proposal and refrain from voting the remaining shares or vote them against the proposal (other than the election of directors), but, if the shareholder fails to specify the number of shares which the shareholder is voting affirmatively, it will be conclusively presumed that the shareholder's approving vote is with respect to all shares that the shareholder is entitled to vote. If a quorum is present, the affirmative vote of the majority of the shares represented at the meeting and entitled to vote on any matter (which shares voting affirmatively shall also constitute at least a majority of the required quorum), other than the election of directors, shall be the act of the shareholders, unless the vote of a greater number or voting by classes is required by the Code or by the articles of incorporation.

Shareholders are prohibited from cumulating their votes in any election of directors of the corporation. In any election of directors, the candidates receiving the highest number of affirmative votes of the shares entitled to be voted for them, up to the number of directors to be elected, shall be elected. Votes against the director and votes withheld shall have no legal effect.

Section 2.9. Record Date.

(a) The Board may fix, in advance, a record date for the determination of the shareholders entitled to notice of any meeting or to vote or entitled to give written consent to corporate action without a meeting. The record date so fixed shall be not more than 60 days nor less than ten days prior to the date of the meeting. When a record date is so fixed, only shareholders of record on that date are entitled to notice of and to vote at the meeting or to give written consent to corporate action without a meeting, as the case may be, notwithstanding any transfer of shares on the books of the corporation after the record date. A record date for a meeting of shareholders shall apply to any adjournment of the meeting unless the Board fixes a new record date for the adjourned meeting. The Board shall fix a new record date if the meeting is adjourned for more than 45 days. If no record date is fixed by the Board, (i) the record date for determining shareholders entitled to notice of or to vote at a meeting of shareholders shall be at the close of business on the business day preceding the day on which notice of the meeting is given or, if notice is waived, the close of business on the business day preceding the day on which the meeting is held, and (ii) the record date for determining shareholders entitled to give consent pursuant to Section 2.11, when no prior action by the Board has been taken, shall be the day on which the first written consent is given.

(b) The Board may fix, in advance, a record date for the determination of the shareholders entitled to receive payment of any dividend or other distribution, or allotment of any rights, or to exercise any rights in respect of any other lawful action. The record date so fixed shall be not more than 60 days prior to any such action. When a record date is so fixed, only shareholders of record on that date are entitled to receive the dividend, distribution, or allotment of rights, or to exercise rights, as the case may be, notwithstanding any transfer of shares on the books of the corporation after the record date. If no record date is fixed by the Board, the record date for determining shareholders for any such purpose shall be at the close of business on the day on which the Board adopts the resolution relating thereto, or the 60th day prior to the date of such other action, whichever is later.

Section 2.10. Consent of Absentees. The transactions of any meeting of shareholders, however called and noticed, and wherever held, are as valid as though had at a meeting duly held after regular call and notice, if a quorum is present either in person or by proxy, and if, either before or after the meeting, each of the persons entitled to vote, who was not present in person or by proxy, signs a written waiver of notice, or a consent to the holding of the meeting or an approval of the minutes thereof. All such waivers, consents or approvals shall be filed with the corporate records or made a part of the minutes of the meeting. Attendance of a person at a meeting shall constitute a waiver of notice of and presence at such meeting, except when the person objects, at the beginning of the meeting, to the transaction of any business because the meeting is not lawfully called or convened and except that attendance at a meeting is not a waiver of any right to object to the consideration of matters required by the Code to be included in the notice but not so included, if such objection is expressly made at the meeting. Neither the business to be transacted at, nor the purpose of, any regular or special meeting of shareholders need be specified in any written waiver of notice, consent to the holding of the meeting or approval of the minutes of the meeting, except that if action is taken or proposed to be taken for approval of any of those matters specified in the second paragraph of Section 2.4, the waiver of notice, consent or approval shall state the general nature of the proposal.

Section 2.11. Action by Written Consent Without a Meeting. Subject to Section 603 of the Code, any action which may be taken at any annual or special meeting of shareholders may be taken without a meeting and without prior notice if a consent in writing, setting forth the action so taken, is signed by the holders of the outstanding shares, or their proxies, having not less than the minimum number of votes that would be necessary to authorize or take such action at a meeting at which all shares entitled to vote thereon were present and voted. All such consents shall be filed with the secretary of the corporation and shall be maintained in the corporate records; provided that (a) unless the consents of all shareholders entitled to vote have been solicited in writing, notice of any shareholder approval without a meeting by less than unanimous consent shall be given, as provided by Section 603(b) of the Code, and (b) in the case of election of directors, such a consent shall be effective only if signed by the holders of all outstanding shares entitled to vote for the election of directors; provided that subject to applicable law, a director may be elected at any time to fill a vacancy on the Board that has not been filled by the directors, by the written consent of the holders of a majority of the outstanding shares entitled to vote for the election of directors. Any written consent may be revoked by a writing received by the secretary of the corporation prior to the time that written consents of the number of shares required to authorize the proposed action have been filed with the secretary.

Section 2.12. Proxies. Every person entitled to vote shares or execute written consents has the right to do so either in person or by one or more persons authorized by a written proxy executed and dated by such shareholder and filed with the secretary of the corporation prior to the convening of any meeting of the shareholders at which any such proxy is to be used or prior to the use of such written consent. A validly executed proxy which does not state that it is irrevocable continues in full force and effect unless: (a) revoked by the person executing it prior to the vote pursuant thereto, by a writing delivered to the corporation stating that the proxy is revoked or by a subsequent proxy executed by the person executing the prior proxy and presented to the meeting, or as to any meeting of shareholders, by attendance at such meeting and voting in person by the person executing the proxy; or (b) written notice of the death or incapacity of the maker of the proxy is received by the corporation before the vote pursuant thereto is counted; provided that no proxy shall be valid after the expiration of 11 months from the date of its execution unless otherwise provided in the proxy.

Section 2.13. Inspectors of Election. In advance of any meeting of shareholders, the Board may appoint any persons other than nominees for office as inspectors of election to act at such meeting and any adjournment thereof. If no inspectors of election are so appointed, or if any persons so appointed fail to appear or refuse to act, the chairperson of any such meeting may, and on the request of any shareholder or shareholder's proxy shall, appoint inspectors of election at the meeting. The number of inspectors shall be either one or three. If inspectors are appointed at a meeting on the request of one or more shareholders or proxies, the holders of a majority of shares or their proxies present shall determine whether one or three inspectors are to be appointed.

The duties of such inspectors shall be as prescribed by Section 707(b) of the Code and shall include: determining the number of shares outstanding and the voting power of each; determining the shares represented at the meeting; determining the existence of a quorum; determining the authenticity, validity and the effect of proxies; receiving votes, ballots or consents; hearing and determining all challenges and questions in any way arising in connection with the right to vote; counting and tabulating all votes or consents; determining when the polls shall close; determining the result; and doing such acts as may be proper to conduct the election or vote with fairness to all shareholders. If there are three inspectors of election, the decision, act or certificate of a majority is effective in all respects as the decision, act or certificate of all. In the event that any person appointed as an inspector fails to appear or fails or refuses to act, the vacancy may, and on the request of any shareholder or a shareholder's proxy shall, be filled by appointment by the Board in advance of the meeting, or at the meeting by the chairperson of the Board.

Section 2.14. Conduct of Meetings. The president shall preside at all meetings of the shareholders and shall conduct each such meeting in a businesslike and fair manner, but shall not be obligated to follow any technical, formal or parliamentary rules or principles of procedure. The presiding officer's rulings on procedural matters shall be conclusive and binding on all shareholders, unless at the time of ruling a request for a vote is made to the shareholders entitled to vote and represented in person or by proxy at the meeting, in which case the decision of a majority of such shares shall be conclusive and binding on all shareholders. Without limiting the generality of the foregoing, the presiding officer shall have all the powers usually vested in the presiding officer of a meeting of shareholders.

ARTICLE III

Directors

Section 3.1. Powers. Subject to the provisions of the Code and any limitations in the articles of incorporation and these bylaws relating to actions required to be approved by the shareholders or by the outstanding shares, the business and affairs of the corporation shall be managed and all corporate powers shall be exercised by or under the direction of the Board. The Board may delegate the management of the day-to-day operations of the business of the corporation to an officer, agent or other person provided that the business and affairs of the corporation shall be managed and all corporate powers shall be exercised under the ultimate direction of the Board. Without prejudice to such general powers, but subject to the same limitations, it is hereby expressly declared that the Board shall have the following powers in addition to the other powers enumerated in these bylaws:

(a) to select and remove all the other officers, agents and employees of the corporation, prescribe any qualifications, powers and duties for them that are consistent with law, the articles of incorporation or these bylaws, fix their compensation, and require from them security for faithful service;

(b) to conduct, manage and control the affairs and business of the corporation and to make such rules and regulations therefor not inconsistent with law, the articles of incorporation or these bylaws, as they may deem best;

(c) to adopt, make and use a corporate seal, to prescribe the forms of certificates of stock, and to alter the form of such seal and of such certificates from time to time as in their judgment they may deem best;

(d) to authorize the issuance of shares of stock of the corporation from time to time, upon such terms and for such consideration as may be lawful;

(e) to borrow money and incur indebtedness for the purposes of the corporation, and to cause to be executed and delivered therefor, in the corporate name, promissory and capital notes, bonds, debentures, deeds of trust, mortgages, pledges, hypothecations or other evidences of debt and securities therefor and any agreements pertaining thereto;

(f) to prescribe the manner in which and the person or persons by whom any or all of the checks, drafts, notes, contracts and other corporate instruments shall be executed;

(g) to appoint and designate, by resolution adopted by a majority of the authorized number of directors, one or more committees, each consisting of two or more directors, including the appointment of alternate members of any committee who may replace any absent member at any meeting of the committee;

(h) to provide for the compensation of directors for their services as such and may provide for the payment or reimbursement of any or all expenses reasonably incurred by them in attending meetings of the Board or of any committee of the Board or in the performance of their other duties as directors;

(i) to change the principal executive and principal office for the transaction of the business of the corporation from one location to another as provided in Section 1.1 hereof; to fix and locate from time to time one or more subsidiary offices of the corporation within or outside of the State of California, as provided in Section 1.2 hereof; to designate any place within or outside of the State of California for the holding of any shareholders' meeting or meetings; and

(j) generally, to do and perform every act or thing whatever that may pertain to or be authorized by the board of directors of a corporation incorporated under the laws of the State of California.

Section 3.2. Number and Qualification of Directors. The authorized number of directors of the corporation shall not be less than five nor more than fifteen until changed by an amendment of the articles of incorporation or by a bylaw amending this Section 3.2 duly adopted by the vote or written consent of holders of a majority of the outstanding shares entitled to vote. The exact number of directors shall be fixed from time to time, within the range specified in the articles of incorporation or in this Section 3.2 initially by a resolution duly adopted by the Board and thereafter by a bylaw or amendment thereof duly adopted by the Board or the vote of a majority of the shares entitled to vote represented at a duly held meeting of shareholders at which a quorum is present, or by the written consent of the holders of a majority of the outstanding shares entitled to vote; or by approval of the shareholders (as defined in Section 153 of the Code).

Section 3.3. Nominations of Directors. Nominations for election of members of the Board may be made by the Board or by any holder of any outstanding class of capital stock of the corporation entitled to vote for the election of directors. Nominations for election of members of the Board may be made at an annual meeting of shareholders in accordance with Section 2.2.

Section 3.4. Election and Term of Office. The directors shall be elected at each annual meeting of shareholders, but if any annual meeting is not held or the directors are not elected thereat, the directors may be elected at any special meeting of shareholders held for that purpose. Each director shall hold office until the next annual meeting and until a successor has been elected and qualified. Notwithstanding the rule stated herein that directors shall be elected annually, each director continuing to serve as such at the time of an annual or special meeting of the shareholders shall nevertheless continue as a director until the expiration of the term to which he or she was previously elected by the shareholders, or until his or her earlier prior death, resignation or removal.

Section 3.5. Vacancies. Vacancies on the Board, except for a vacancy created by the removal of a director, may be filled by a majority of the remaining directors, though less than a quorum, or by a sole remaining director, and each director so elected shall hold office until the next annual meeting and until such director's successor has been elected and qualified. A vacancy on the Board created by the removal of a director may only be filled by the vote of a majority of the shares entitled to vote represented at a duly held meeting at which a quorum is present, or by the written consent of the holders of all of the outstanding shares.

The shareholders may elect a director or directors at any time to fill any vacancy or vacancies not filled by the directors. Any such election by written consent other than to fill a vacancy created by removal requires the consent of a majority of the outstanding shares entitled to vote.

Any director may resign effective upon giving written notice to the chairperson of the Board, the president, secretary, or the Board, unless the notice specifies a later time for the effectiveness of such resignation. If the Board accepts the resignation of a director tendered to take effect at a future time, the Board or the shareholders shall have power to elect a successor to take office when the resignation is to become effective.

A vacancy or vacancies on the Board shall be deemed to exist in case of the death, resignation or removal of any director, or if the authorized number of directors is increased, or if the shareholders fail, at any annual or special meeting of shareholders at which any director or directors are elected, to elect the full authorized number of directors to be voted for at that meeting.

The Board may declare vacant the office of a director who has been declared of unsound mind by an order of court or convicted of a felony.

No reduction of the authorized number of directors shall have the effect of removing any director prior to the expiration of the director’s term of office.

Section 3.6. Place of Meetings. Regular or special meetings of the Board shall be held at any place within or outside the state of California which has been designated in the notice of meeting or if there is no notice, at the principal executive office of the corporation, or at a place or no place, as designated by resolution of the Board or by the written consent of all members of the Board, or may be held by means of remote communication. Any regular or special meeting is valid wherever held (including by means of remote communication) if held upon written consent of all members of the Board given either before or after the meeting and filed with the secretary of the corporation.

Section 3.7. Regular Meetings. Immediately following each annual meeting of shareholders, the Board shall hold a regular meeting for the purpose of organization, any desired election of officers and the transaction of other business. Notice of this meeting shall not be required.

Other regular meetings of the Board shall be held from time to time by resolution of the Board or by written consent of all members of the Board. In the absence of such designation, regular meetings shall be held at the principal executive offices of the corporation. Special meetings of the Board may be held either at a place so designated, within the State of California, or at the principal executive office. There shall be no required notice period for any regular meeting of the Board.

Section 3.8. Special Meetings. Special meetings of the Board for any purpose or purposes may be called at any time by the chairperson of the Board, the Lead Independent Director (as defined below) (if appointed), the president, any vice president, the secretary or by any two directors.

The person or persons calling a special meeting of the Board shall, at least 24 hours before the meeting, give notice thereof by any usual means of communication. Such notice may be communicated, without limitation, in person; by telephone, facsimile, or other electronic transmission; by mail or private carrier; or in the manner and to the extent permitted by applicable law.

Special meetings may be held without notice by the waiver of notice by the directors.

Section 3.9. Quorum. A majority of the authorized number of directors constitutes a quorum of the Board for the transaction of business, except to adjourn as hereinafter provided. Every act or decision done or made by a majority of the directors present at a meeting duly held at which a quorum is present shall be regarded as the act of the Board, unless a greater number be required by the articles of incorporation and subject to the provisions of Section 310 of the Code (as to approval of contracts or transactions in which a director has a direct or indirect material financial interest) and Section 317(e) of the Code (as to indemnification of directors). A meeting at which a quorum is initially present may continue to transact business notwithstanding the withdrawal of directors, if any action taken is approved by at least a majority of the required quorum for such meeting.

Section 3.10. Participation in Meetings by Remote Communication. Members of the Board may participate in a meeting through use of a conference telephone or similar communications equipment or other means of remote communication not prohibited by applicable law, so long as all members participating in such meeting can hear one another. Participation in a meeting pursuant to this Section 3.10 constitutes presence in person at such meeting.

Section 3.11. Waiver of Notice. Notice of a meeting need not be given to any director who signs a waiver of notice or a consent to holding the meeting or an approval of the minutes of the meeting, whether before or after the meeting, or who attends the meeting without protesting, before the meeting or at its commencement, the lack of notice to such director. All such waivers, consents or approvals shall be filed with the corporate records or made a part of the minutes of the meeting.

Section 3.12. Adjournment. A majority of the directors present, whether or not a quorum is present, may adjourn any directors' meeting to another time and/or place. Notice of the time and/or place of holding an adjourned meeting need not be given, unless the meeting is adjourned for more than twenty-four hours, in which case notice of the time and place shall be given before the time of the adjourned meeting to the directors who were not present at the time of the adjournment.

Section 3.13. Action Without Meeting. Any action required or permitted to be taken at any meeting of the Board or a duly authorized committee thereof by the Board or such duly authorized committee thereof may be taken without a meeting if all members of the Board or such committee shall consent in writing to such action. Such written consent or consents shall be filed with the minutes of the proceedings of the Board or committee, as the case may be. Such action by written consent shall have the same effect as a unanimous vote of the board.

Section 3.14. Fees and Compensation. Directors and members of committees shall be entitled to such compensation, if any, for their services, and such reimbursement for expenses, as may be fixed or determined by the Board. This Section 3.14 shall not be construed to preclude any director from serving the corporation in any other capacity as an officer, agent, employee or otherwise, and receiving compensation for those services.

Section 3.15. Rights of Inspection. Every director of the corporation shall have the right at any reasonable time to inspect and copy all books, records and documents of the corporation and to inspect the physical properties of the corporation and also of its subsidiary corporations, domestic or foreign. Such inspection by a director may be made in person or by agent or attorney, and the right of inspection includes the right to copy and make extracts.

Section 3.16. Removal of Director without Cause. Subject to any limitation imposed by applicable law, the Board or any individual director or directors may be removed with or without cause by the affirmative vote of the holders of at least 66 2/3 percent of the then-outstanding shares of capital stock of the corporation entitled to vote generally at an election of directors.

Section 3.17. Chairperson. The chairperson of the Board, if appointed and when present, shall preside at all meetings of the Board and exercise and perform such other powers and duties as may be assigned from time to time by the Board.

Section 3.18. Vice Chairperson. The vice chairperson of the Board, if appointed and when present, shall, in the absence of the chairperson of the Board, preside at all meetings of the Board and shareholders and exercise and perform such other powers and duties as may be assigned from time to time by the Board.

Section 3.19. Lead Independent Director. The chairperson of the Board, or if the chairperson is not an independent director, one of the independent directors, may be designated by the independent members of the Board as lead independent director annually or until replaced by such members of the Board ("Lead Independent Director"), but such election shall not be required. The Lead Independent Director may be removed as Lead Independent Director by vote of a majority of the independent members of the Board. If appointed, the Lead Independent Director will serve as chairperson of Board meetings in the absence of both the chairperson and the vice chairperson of the Board or otherwise at their request, preside over meetings of the independent directors, and perform such other duties as may be established or delegated by the Board from time to time. For purposes of this Section, "independent" has the meaning set forth in the Nasdaq Stock Market listing rules, unless the corporation's common stock ceases to be listed on the Nasdaq Stock Market and is listed on another exchange, in which case such exchange's definition of "independent" shall apply.

ARTICLE IV

Officers

Section 4.1 Officers. The officers of the corporation shall be a president, a secretary and a chief financial officer. The corporation may also have, at the discretion of the Board, a chairperson of the Board, a vice chairperson of the Board, one or more vice presidents, one or more assistant secretaries, one or more assistant financial officers and such other officers as may be elected or appointed in accordance with the provisions of Section 4.3.

Section 4.2. Appointment. The officers of the corporation, except such officers as may be appointed in accordance with the provisions of Section 4.3 or Section 4.5, shall be chosen by, and shall serve at the pleasure of, the Board, and shall hold their respective offices until their resignation, removal or other disqualification from service, or until their respective successors shall be appointed, subject to the rights, if any, of an officer under any contract of employment.

Section 4.3. Subordinate Officers. The Board may appoint, or may empower the president to appoint, such other officers as the business of the corporation may require, each to hold office for such period, have such authority and perform such duties as are provided in these bylaws or as the Board may from time to time determine.

Section 4.4. Removal and Resignation. Subject to the rights, if any, of an officer under any contract of employment, any officer may be removed, either with or without cause, by the Board at any time, or by any officer upon whom such power of removal may be conferred by the Board.

Any officer may resign at any time by giving written notice to the Board or to the president, or to the secretary of the corporation without prejudice to the rights, if any, of the corporation under any contract to which the officer is a party. Any such resignation shall take effect at the date of the receipt of such notice by the Board or by the president, or by the secretary of the corporation, or at any later time specified therein; and, unless otherwise specified therein, the acceptance of such resignation shall not be necessary to make it effective.

Section 4.5. Vacancies. A vacancy in any office because of death, resignation, removal, disqualification or any other cause shall be filled in the manner prescribed in these bylaws for regular appointment to such office.

Section 4.6. President. Subject to such powers, if any, as may be given by the Board to the chairperson of the Board, if there shall be such an officer, the president is the general manager and chief executive officer of the corporation and has, subject to the control of the Board, general supervision, direction and control of the business and affairs of the corporation. The president shall preside at all meetings of the shareholders and in the absence of both the chairperson of the Board and the vice chairperson, or if there be none, at all meetings of the Board. The president has the general powers and duties of management usually vested in the office of president and chief executive officer of a corporation and such other powers and duties as may be prescribed by the Board.

Section 4.7. Vice President. In the absence or disability of the president, the vice presidents in order of their rank as fixed by the Board or, if not ranked, the vice president designated by the Board, shall perform all the duties of the president and, when so acting, shall have all the powers of, and be subject to all the restrictions upon, the president. The vice presidents shall have such other powers and perform such other duties as from time to time may be prescribed for them respectively by these bylaws, the Board, the president or the chairperson of the Board.

Section 4.8. Secretary. The secretary shall keep or cause to be kept, at the principal executive office or such other place as the Board may order, a book of minutes of all meetings of shareholders, the Board and its committees, with the time and place of holding, whether regular or special, and, if special, how authorized, the notice or waivers of notice thereof given, the names of those present at the Board and committee meetings, the number of shares present or represented at shareholders' meetings, and the proceedings thereof.

The secretary shall keep, or cause to be kept, a copy of these bylaws of the corporation at the principal executive office or business office in accordance with Section 213 of the Code. The secretary shall keep, or cause to be kept, at the principal executive office or at the office of the corporation's transfer agent or registrar, if one is appointed, a record of its shareholders, or a duplicate record of its shareholders, giving the names and addresses of all shareholders and the number and class of shares held by each.

The secretary shall give, or cause to be given, notice of all the meetings of the shareholders, of the Board and of any committees thereof required by these bylaws or by law to be given, shall keep the seal of the corporation in safe custody, and shall have such other powers and perform such other duties as may be prescribed by the Board.

Section 4.9. Assistant Secretary. The assistant secretary or the assistant secretaries, in the order of their seniority, shall, in the absence or disability of the secretary, or in the event of such officer's refusal to act, perform the duties and exercise the powers of the secretary and shall have such additional powers and discharge such duties as may be assigned from time to time by the president or by the Board.

Section 4.10. Chief Financial Officer. The chief financial officer shall keep and maintain, or cause to be kept and maintained, adequate and correct books and records of the properties and financial and business transactions of the corporation, including accounts of its assets, liabilities, receipts, disbursements, gains, losses, capital, retained earnings and shares, and shall send or cause to be sent to the shareholders of the corporation such financial statements and reports that by law or these bylaws are required to be sent to them. The books of account shall at all times be open to inspection by any director of the corporation.

The chief financial officer shall deposit all monies and other valuables in the name and to the credit of the corporation with such depositories as may be designated by the Board. The chief financial officer shall disburse the funds of the corporation as may be ordered by the Board, shall render to the president and directors, whenever they request it, an account of all transactions engaged in as chief financial officer and of the financial condition of the corporation, and shall have such other powers and perform such other duties as may be prescribed by the Board.

Section 4.11. Assistant Financial Officer. The assistant financial officer or the assistant financial officers, in the order of their seniority, shall, in the absence or disability of the chief financial officer, or in the event of such officer's refusal to act, perform the duties and exercise the powers of the chief financial officer, and shall have such additional powers and discharge such duties as may be assigned from time to time by the president or by the Board.

Section 4.12. Salaries. The salaries of the officers shall be fixed from time to time by the Board or a duly authorized committee thereof and no officer shall be prevented from receiving such salary by reason of the fact that such officer is also a director of the corporation.

Section 4.13. Officers Holding More Than One Office. Any one person may hold any number of offices of the corporation at one time unless specifically prohibited therefrom by law.

Section 4.14. **Inability to Act.** In the case of absence or inability to act of any officer of the corporation and of any person herein authorized to act in his or her place, the Board may from time to time delegate the powers or duties of such officer to any other officer, or any director or other person whom it may select.

ARTICLE V

Committees

Section 5.1. **Committees of Directors**. The Board may, by resolution adopted by a majority of the authorized number of directors, designate one or more committees, each consisting of two or more directors, to serve at the pleasure of the Board. The Board may designate one or more directors as alternate members of any committees, who may replace any absent member at any meeting of the committee. Any committee, to the extent provided in the resolution of the Board, shall have all the authority of the Board, except with respect to:

(a) the approval of any action which, under the Code, also requires shareholders' approval or approval of the outstanding shares;

(b) the filling of vacancies on the Board or in any committee;

(c) the fixing of compensation of the directors for serving on the Board or on any committee;

(d) the amendment or repeal of bylaws or the adoption of new bylaws;

(e) the amendment or repeal of any resolution of the Board which by its express terms is not so amendable or reparable;

(f) the appointment of committees of the Board or the members thereof;

(g) a distribution to the shareholders of the corporation, except at a rate or in a periodic amount or within a price range determined by the Board; or

(h) the appointment of any other committees of the Board or the members of these committees.

Section 5.2. **Meetings and Action of Committees**. Meetings and action of committees shall be governed by, and held and taken in accordance with, the provisions of Article III of these bylaws, with such changes in the context of those bylaws as are necessary to substitute the committee and its members for the Board and its members, except that the time of regular meetings of committees may be determined either by resolution of the Board or by resolution of the committee; special meetings of committees may also be called by resolution of the Board or by resolution of the committee; and notice of special meetings of committees shall also be given to all alternate members, who shall have the right to attend all meetings of the committee. The Board or a committee may adopt rules for the governance of the committee not inconsistent with the provisions of these bylaws.

ARTICLE VI

<u>Indemnification</u>

Section 6.1. <u>Definitions</u>. For use in this Article VI, certain terms are defined as follows:

(a) "Agent": A director, officer, employee or agent of the corporation or a person who is or was serving at the request of the corporation as a director, officer, employee or agent of another foreign or domestic corporation, partnership, joint venture, trust, or other enterprise (including service with respect to employee benefit plans and service on creditors' committees with respect to any proceeding under the United States Bankruptcy Code of 1978, as amended, assignment for the benefit of creditors or other liquidation of assets of a debtor of the corporation), or a person who was a director, officer, employee or agent of a foreign or domestic corporation which was a predecessor corporation of the corporation or of another enterprise at the request of the predecessor corporation.

(b) "Loss": All expenses, liabilities, and losses including attorneys' fees, judgments, fines, Employee Retirement Income Security Act excise taxes and penalties, amounts paid or to be paid in settlement, any interest, assessments, or other charges imposed thereon, and any federal, state, local, or foreign taxes imposed on any Agent as a result of the actual or deemed receipt of any payments under this Article.

(c) "Proceeding": Any threatened, pending or completed action, suit or proceeding including any and all appeals, whether civil, criminal, administrative or investigative.

Section 6.2. <u>Right to Indemnification</u>. Each person who is or was a director or officer of the corporation (or was serving at the request of the corporation as a director or officer of another foreign or domestic corporation, partnership, joint venture, trust or other enterprise) including any current or former director or officer who was or is a party or is threatened to be made a party to or is involved (as a party, witness or otherwise) in any Proceeding, by reason of the fact that he or she, or a person of whom he or she is the legal representative, is or was an Agent, is entitled to indemnification. In such cases, such person shall be indemnified and held harmless by the corporation to the fullest extent authorized by law. The right to indemnification conferred in this Article VI shall be a contract right. It is the corporation's intention that these bylaws provide indemnification in excess of that expressly permitted by Section 317 of the Code, as authorized by the corporation's articles of incorporation.

Section 6.3. <u>Authority to Advance Expenses</u>. The right to indemnification provided in Section 6.2 of these bylaws shall include the right to be paid, in advance of a Proceeding's final disposition, expenses incurred in defending that Proceeding; provided that if required by the California General Corporation Law, as amended, the payment of expenses in advance of the final disposition of the Proceeding shall be made only upon delivery to the corporation of an undertaking by or on behalf of the person entitled to indemnification hereunder to repay such amount if it shall ultimately be determined that he or she is not entitled to be indemnified by the corporation as authorized under this Article VI or otherwise. The indemnified party's obligation to reimburse the corporation for advances shall be unsecured and no interest shall be charged thereon.

Section 6.4. **Right of Claimant to Bring Suit.** If a claim under Section 6.2 or 6.3 of these bylaws is not paid in full by the corporation within 30 days after a written claim has been received by the corporation, the claimant may at any time thereafter bring suit against the corporation to recover the unpaid amount of the claim and, if successful in whole or in part, the claimant shall be entitled to be paid also the expenses (including attorneys' fees) of prosecuting such claim. It shall be a defense to any such action (other than an action brought to enforce a claim for expenses incurred in defending a Proceeding in advance of its final disposition where the required undertaking has been tendered to the corporation) that the claimant has not met the standards of conduct that make it permissible under the California General Corporation Law for the corporation to indemnify the claimant for the amount claimed. The burden of proving such a defense shall be on the corporation. Neither the failure of the corporation (including its board of directors, independent legal counsel, or its shareholders) to have made a determination prior to the commencement of such action that the indemnification of the claimant is proper under the circumstances because he or she has met the applicable standard of conduct set forth in the California General Corporation Law, nor an actual determination by the corporation (including its board of directors, independent legal counsel, or its shareholders) that the claimant has not met such applicable standard of conduct, shall be a defense to the action or create a presumption that claimant has not already met the applicable standard of conduct.

Section 6.5. **Provisions Nonexclusive.** The rights conferred on any person by this Article V shall not be exclusive of any other rights that such person may have or hereafter acquire under any statute, provision of the articles of incorporation, agreement, vote of shareholders or disinterested directors, or otherwise, both as to action in an official capacity and as to action in another capacity while holding such office. To the extent that any provision of the articles of incorporation, agreement, or vote of the shareholders or disinterested directors is inconsistent with these bylaws, the provision, agreement, or vote shall take precedence.

Section 6.6. **Authority to Insure.** The corporation may purchase and maintain insurance to protect itself and any Agent against any Loss asserted against or incurred by such person, whether or not the corporation would have the power to indemnify such Agent against such Loss under applicable law or the provisions of this Article VI. If the corporation owns all or a portion of the shares of the company issuing the insurance policy, the company and/or the policy must meet one of the two sets of conditions set forth in Section 317 of the Code.

Section 6.7. **Survival of Rights.** The rights provided by this Article VI shall continue as to a person who is entitled to be indemnified hereunder and has ceased to be an Agent and shall inure to the benefit of the heirs, executors, and administrators of such person.

Section 6.8. **Settlement of Claims.** The corporation shall not be liable to indemnify any Agent under this Article VI for (a) any amounts paid in settlement of any action or claim effected without the corporation's written consent, which consent shall not be unreasonably withheld; or (b) any judicial award, if the corporation was not given a reasonable and timely opportunity, at its expense, to participate in the defense of such action.

Section 6.9. **Effect of Amendment.** Any amendment, repeal or modification of this Article VI shall not adversely affect any right or protection of any Agent existing at the time of such amendment, repeal or modification.

Section 6.10. Subrogation. Upon payment under this Article VI, the corporation shall be subrogated to the extent of such payment to all of the rights of recovery of an Agent, who shall execute all papers required and shall do everything that may be necessary to secure such rights, including the execution of such documents necessary to enable the corporation effectively to bring suit to enforce such rights.

Section 6.11. No Duplication of Payments. The corporation shall not be liable under this Article VI to make any payment in connection with any claim made against an Agent to the extent such Agent has otherwise actually received payment (under any insurance policy, agreement, vote or otherwise) of the amounts otherwise indemnifiable hereunder.

ARTICLE VII

Other Provisions

Section 7.1. Inspection of Corporate Records.

(a) A shareholder or shareholders of the corporation holding at least five percent in the aggregate of the outstanding voting shares of the corporation or who hold at least one percent of the outstanding voting shares and have filed a Schedule 14B with the SEC relating to the election of directors of the corporation shall have an absolute right to do either or both of the following:

(i) inspect and copy the record of shareholders' names and addresses and shareholdings during usual business hours upon five business days' prior written demand upon the corporation; or

(ii) obtain from the transfer agent, if any, for the corporation, upon written demand and upon the tender of its usual charges for such a list (the amount of which charges shall be stated to the shareholder by the transfer agent upon request), a list of the shareholders' names and addresses who are entitled to vote for the election of directors and their shareholdings, as of the most recent record date for which it has been compiled, or as of a date specified by the shareholder subsequent to the date of demand. The corporation shall have a responsibility to cause the transfer agent to comply with this Section 7.1.

(b) The record of shareholders shall also be open to inspection and copying by any shareholder or holder of a voting trust certificate at any time during usual business hours upon written demand on the corporation, for a purpose reasonably related to such holder's interest as a shareholder or holder of a voting trust certificate. A written demand for such inspection shall be accompanied by a statement in reasonable detail of the purpose of the inspection.

(c) The accounting books and records and minutes of proceedings of the shareholders and the Board and committees of the Board shall be open to inspection upon written demand on the corporation by any shareholder or holder of a voting trust certificate at any reasonable time during usual business hours, for a purpose reasonably related to such holder's interest as a shareholder or as a holder of such voting trust certificate. The right of inspection created by this Section 7.1(c) shall extend to the records of each subsidiary of the corporation. A written demand for such inspection shall be accompanied by a statement in reasonable detail of the purpose of the inspection.

Section 7.2. Execution of Documents, Contracts. Subject to the provisions of applicable law, any note, mortgage, evidence of indebtedness, contract, share certificate, initial transaction statement or written statement, conveyance or other instrument in writing and any assignment or endorsement thereof executed or entered into between the corporation and any other person, when signed by the chairperson of the Board, the president or any vice president and the secretary, any assistant secretary, the chief financial officer or any assistant financial officer of the corporation, or when stamped with a facsimile signature of such appropriate officers in the case of share certificates, shall be valid and binding upon the corporation in the absence of actual knowledge on the part of the other person that the signing officers did not have authority to execute the same. Any such instruments may be signed by any other person or persons and in such manner as from time to time shall be determined by the Board, and unless so authorized by the Board, no officer, agent or employee shall have any power or authority to bind the corporation by any contract or engagement or to pledge its credit or to render it liable for any purpose or amount.

Section 7.3. Certificates of Stock. Unless otherwise provided in the articles of incorporation or herein, every holder of shares of the corporation shall be entitled to have a certificate signed in the name of the corporation by any officer authorized to sign stock certificates, certifying the number of shares and the class or series of shares owned by the shareholder. The signatures on the certificates may be facsimile signatures. If any officer, transfer agent or registrar who has signed a certificate or whose facsimile signature has been placed upon the certificate shall have ceased to be such officer, transfer agent or registrar before such certificate is issued, it may be issued by the corporation with the same effect as if such person were an officer, transfer agent or registrar at the date of issue.

Except as provided in this Section 7.3, no new certificate for shares shall be issued in lieu of an old certificate unless the latter is surrendered and canceled at the same time. The Board may, however, in case any certificate for shares is alleged to have been lost, stolen or destroyed, authorize the issuance of a new certificate in lieu thereof, and the corporation may require that the corporation be given a bond or other adequate security sufficient to indemnify it against any claim that may be made against it (including any expense or liability) on account of the alleged loss, theft or destruction of such certificate or the issuance of such new certificate.

Prior to the due presentment for registration of transfer in the stock transfer book of the corporation, the registered owner shall be treated as the person exclusively entitled to vote, to receive notifications and otherwise to exercise all the rights and powers of an owner, except as expressly provided otherwise by the laws of the state of California.

Notwithstanding any other provision of these bylaws and this Section 7.3, the corporation shall be entitled to issue in its discretion uncertificated securities in compliance with California Corporations Code Section 416(b), as amended, subject to the right of a holder of shares of the corporation to request issuance of a certificate in compliance with the provisions of this Section 7.3.

Section 7.4. Representation of Shares of Other Corporations. The president or any other officer or officers authorized by the Board or the president are each authorized to vote, represent and exercise on behalf of the corporation all rights incident to any and all shares or other securities of any other corporation or corporations standing in the name of the corporation. The authority herein granted may be exercised either by any such officer in person or by any other person authorized to do so by proxy or power of attorney duly executed by said officer.

Section 7.5 Regulations. The board of directors may make such rules and regulations as it may deem expedient, not inconsistent with these bylaws, concerning the issuance, transfer and registration of certificated or uncertificated shares of stock of the corporation. It may appoint, or authorize any officer or officers to appoint, one or more transfer clerks or one or more transfer agents and one or more registrars, and, in the case of certificated shares of stock, may require all such certificates to bear the signature or signatures of any of them or a facsimile thereof.

Section 7.6. Seal. The corporate seal of the corporation shall consist of two concentric circles, between which shall be the name of the corporation, and in the center shall be inscribed the word “Incorporated” and the date of its incorporation.

Section 7.7. Fiscal Year. The fiscal year of the corporation shall begin on the first day of January and end on the 31st day of December of each year.

Section 7.8. Construction and Definitions. Unless the context otherwise requires, the general provisions, rules of construction and definitions contained in the Code and the California General Corporation Law shall govern the construction of these bylaws. Without limiting the generality of this provision, the singular number includes the plural, the plural number includes the singular, and the term “person” includes both a corporation and a natural person.

Section 7.9. Bylaw Provisions Contrary to or Inconsistent with Provisions of Law. Any article, section, subsection, subdivision, sentence, clause or phrase of these bylaws which, upon being construed in the manner provided in this Section 7.9, shall be contrary to or inconsistent with any applicable provision of the Code or other applicable laws of the state of California or of the United States shall not apply so long as said provisions of law shall remain in effect, but such result shall not affect the validity or applicability of any other portions of these bylaws, it being hereby declared that these bylaws would have been adopted and each article, section, subsection, subdivision, sentence, clause or phrase thereof, irrespective of the fact that any one or more articles, sections, subsections, subdivisions, sentences, clauses or phrases is or are illegal.

ARTICLE VIII

Forum

Section 8.1. **Exclusive Forum for Certain Litigation**. Unless the corporation consents in writing to the selection of an alternative forum, the United States District Court for the Northern District of California (or, in the event that the United States District Court for the Northern District of California does not have jurisdiction, any other federal or state court of California) shall be the sole and exclusive forum for (a) any derivative action or proceeding brought on behalf of the corporation, (b) any action asserting a claim of breach of any duty owed by any director or officer or other employee of the corporation to the corporation or to the shareholders of the corporation, (c) any action asserting a claim against the corporation or any director or officer or other employee of the corporation arising pursuant to any provision of the Code or the Articles of Incorporation or these bylaws, or (d) any action asserting a claim against the corporation or any director or officer or other employee of the corporation that is governed by the internal affairs doctrine. Unless the corporation consents in writing to the selection of an alternative forum, the federal district courts of the United States of America shall, to the fullest extent permitted by applicable law, be the exclusive forum for the resolution of any complaint asserting a cause of action arising under the federal securities laws of the United States of America, including, in each case, the applicable rules and regulations promulgated thereunder. If any provision of this Article VIII shall be held to be invalid, illegal or unenforceable as applied to any person or entity or circumstance for any reason whatsoever, then, to the fullest extent permitted by law, the validity, legality and enforceability of such provision in any other circumstance and of the remaining provisions of this Article VIII (including, without limitation, each portion of any sentence of this Article VIII containing any such provision held to be invalid, illegal or unenforceable that is not itself held to be invalid, illegal or unenforceable) and the application of such provision to other persons or entities and circumstances shall not in any way be affected or impaired thereby. Any person or entity purchasing or otherwise acquiring or holding any interest in share of capital stock of the corporation shall be deemed to have notice of and to have consented to the provisions of this Article VIII.

ARTICLE IX

Amendments

Section 9.1. **Amendment by Shareholders.** New bylaws may be adopted or these bylaws may be amended or repealed by the vote or written consent of holders of a majority of the outstanding shares entitled to vote; provided that if the articles of incorporation of the corporation set forth the number of authorized directors of the corporation, the authorized number of directors may be changed only by an amendment of the articles of incorporation and provided also that a bylaw reducing the fixed number or the minimum number of directors to a number less than five cannot be adopted if the votes cast against adoption at a meeting, or the shares not consenting in the case of action by written consent, are equal to more than 16 2/3 percent of the outstanding shares entitled to vote.

Section 9.2. **Amendment by Directors.** Subject to the rights of the shareholders as provided in Section 9.1, bylaws, other than a bylaw specifying or changing a fixed number of directors or the maximum or minimum number or changing from a fixed to a variable board or vice versa, may be adopted, amended or repealed by the Board.

DESCRIPTION OF REGISTRANT'S SECURITIES

As of December 31, 2021, Five Star Bancorp (the "Company," "we," "our" and "us"), had one class of securities registered under Section 12 of the Securities Exchange Act of 1934, as amended (the "Exchange Act"): common stock, no par value per share ("common stock").

DESCRIPTION OF CAPITAL STOCK

General

The following description of the current terms of our capital stock is a summary and is not meant to be complete. It is qualified in its entirety by reference to the California General Corporation Law (the "CGCL"), federal law, the Company's amended and restated articles of incorporation (the "Articles of Incorporation"), and the Company's amended and restated bylaws (the "Bylaws"). Our Articles of Incorporation and Bylaws are included as exhibits to our Annual Report on Form 10-K of which this Exhibit 4.4 forms a part. We encourage you to carefully read our Articles of Incorporation, Bylaws, and the applicable provisions of federal law and the CGCL for additional information.

Authorized Capital Stock

Our authorized capital stock consists of 100,000,000 shares of common stock and 10,000,000 shares of undesignated preferred stock, no par value per share ("preferred stock"), the terms of which may be established by our Board of Directors (the "Board") by resolution.

Voting Rights and Majority Written Consent

Holders of our common stock are entitled to one vote per share on all matters requiring shareholder action, including the election of directors.

Our Bylaws provide that a majority of the shares entitled to vote at a shareholders' meeting, represented in person or by proxy, constitutes a quorum. When a quorum is present, the affirmative vote of a majority of the shares represented at the meeting and entitled to vote, such affirmatively voting shares constituting at least a majority of the required quorum, are required to take action, unless otherwise specified by law or our Articles of Incorporation, and except for the election of directors, which will be determined by a plurality vote. There are no cumulative voting rights.

Any action that, under any provision of the CGCL, may be taken at a meeting of the shareholders, may be taken without a meeting and without prior notice if a consent in writing, setting forth the action so taken, is signed by the holders of the outstanding shares having not less than the minimum number of votes that would be necessary to authorize or take such action at a meeting at which all shares are entitled to vote thereon were present and voted; provided, that unless the consents of all shareholders entitled to vote have been solicited in writing, notice of any shareholder approval without a meeting by less than unanimous consent must be given as required under the CGCL, to such shareholders who are required to receive such notice under the CGCL. In addition, directors may be elected by written consent only if signed by the holders of all outstanding shares entitled to vote for the election of directors, except that action taken by shareholders to fill one or more vacancies on the Board (other than any vacancy created by removal) that has not been filled by the Board may be taken by written consent of a majority of the outstanding shares entitled to vote.

No Preemptive or Similar Rights

Under our Articles of Incorporation and Bylaws, the holders of our common stock have no preemptive or other subscription rights, and there are no redemption, sinking fund, or conversion privileges applicable to our common stock.

Dividend Rights

The payment of dividends is subject to the restrictions set forth in the CGCL. The CGCL provides that neither a company nor any of its subsidiaries may make any distribution to its shareholders unless: (i) the amount of retained earnings of the company immediately prior to the distribution equals or exceeds the sum of (a) the amount of the proposed distribution plus (b) the preferential dividends arrears amount (as calculated pursuant to Section 500(b) of the CGCL) or (ii) following the distribution, the value of the company's assets would equal or exceed the sum of its total liabilities plus the preferential rights amount (as calculated pursuant to Section 500(b) of the CGCL).

Holders of our common stock may receive dividends when, as, and if declared by our Board out of funds legally available for the payment of dividends, subject to any restrictions imposed by regulatory authorities and the payment of any preferential amounts to which any class of preferred stock may be entitled.

Liquidation Rights

In the event of the liquidation, dissolution or winding up of the Company, subject to the rights of the holders of any then outstanding shares of preferred stock, the holders of our common stock are entitled to receive all of our assets remaining after satisfaction of all our liabilities and the payment of any liquidation preference of any outstanding preferred stock.

Anti-Takeover Provisions

Certain provisions of our Articles of Incorporation and Bylaws, and the CGCL and federal banking regulations applicable to us, may be deemed to have anti-takeover effects and may delay, defer, or prevent a change of control of the Company and/or limit the price that certain investors may be willing to pay in the future for shares of our common stock.

Authorized but Unissued Shares

The corporate laws and regulations applicable to us enable our Board to issue, from time to time and at its discretion, but subject to the rules of any applicable securities exchange, any authorized but unissued shares of our common stock or preferred stock. Any such issuance of shares could be utilized for a variety of corporate purposes, including future offerings to raise additional capital, acquisitions, and employee benefit plans. The ability of our Board to issue authorized but unissued shares of our common stock or preferred stock at its sole discretion may enable our Board to sell shares to individuals or groups whom the Board perceives as friendly with management, which may make more difficult unsolicited attempts to obtain control of our organization. In addition, the ability of our board of directors to issue authorized but unissued shares of our capital stock at its sole discretion could deprive the shareholders of opportunities to sell their shares of common stock or preferred stock for prices higher than prevailing market prices.

Preferred Stock

Our Articles of Incorporation contain provisions that permit our Board to issue, without any further vote or action by the shareholders, up to 10,000,000 shares of preferred stock in one or more series and, with respect to each such series, to fix the number of shares constituting the series and the designation of the series, and to determine or alter the rights, powers, preferences, and restrictions of the shares of such series.

The existence of shares of authorized undesignated preferred stock enables us to meet possible contingencies or opportunities in which the issuance of shares of preferred stock may be advisable, such as in the case of acquisition or financing transactions. Having shares of preferred stock available for issuance gives us flexibility in that it would allow us to avoid the expense and delay of calling a meeting of shareholders at the time the contingency or opportunity arises. Any issuance of preferred stock with voting rights or which is convertible into voting shares could adversely affect the voting power of the holders of common stock. Furthermore, the issuance of preferred stock could adversely affect the likelihood that such holders will receive dividend payments and payments upon liquidation. The shares of preferred stock that may be issued in the future may have other rights, including economic rights senior to our common stock, and, as a result, could have an adverse effect on the market value of our common stock.

Any of these actions could have an anti-takeover effect and discourage a transaction that some or a majority of our shareholders might believe to be in their best interests or in which our shareholders might receive a premium for their shares over our then-market price.

Board Size and Vacancies

Our Bylaws enable our Board to increase the size of the Board between annual meetings and fill the vacancies created by the increase by a majority of the remaining directors.

No Cumulative Voting

Our Bylaws prohibit cumulative voting in the election of directors. In the absence of cumulative voting, the holders of a majority of the shares of our common stock may elect all of the directors standing for election, if they should so choose.

Special Meetings of Shareholders

Special meetings of the shareholders may be called by the Board, the chairperson of the Board, the president, or by the holders of shares entitled to cast at least 10% of the vote at such a meeting.

Advance Notice Procedures for Director Nominations and Shareholder Proposals

Our Bylaws establish an advance notice procedure with regard to business to be brought before an annual or special meeting of shareholders and with regard to the nomination of candidates for election as directors, other than by or at the direction of the Board of directors. Although this procedure does not give our Board any power to approve or disapprove shareholder nominations for the election of directors or proposals for action, it may have the effect of precluding a contest for the election of directors or the consideration of shareholder proposals if the established procedure is not followed, and of discouraging or deterring a third party from conducting a solicitation of proxies to elect its own slate of directors or to approve its proposal without regard to whether consideration of the nominees or proposals might be harmful or beneficial to our shareholders and us.

Amending Certain Provisions of our Articles of Incorporation.

Our Articles of Incorporation require a two-thirds vote of the directors then in office and two-thirds vote of then-outstanding shares of capital stock to modify the sections of our Articles of Incorporation addressing limitation of liability and indemnification of our officers and directors, which provide limitation of liability and indemnification to the maximum extent permitted by law and addressing the amendment of the Articles of Incorporation.

Amending our Amended Bylaws

Our board of directors may amend our Bylaws, other than a bylaw specifying or changing a fixed number of directors or the maximum or minimum number or changing from a fixed to a variable board or vice versa, without shareholder approval.

Approval of Merger

Under the CGCL, most business combinations, including mergers, consolidations, and sales of substantially all of the assets of a California corporation must be approved by the vote of the holders of at least a majority of the outstanding shares of common stock and any other affected class of stock of such corporation. The articles of incorporation of a California corporation may, but are not required to, set a higher standard for approval of such transactions. Our Articles of Incorporation do not set higher limits.

California Law and Federal Banking Laws

We are subject to the provisions of Section 1203 of the CGCL, which contains provisions that may have the effect of deterring hostile takeovers or delaying or preventing changes in control in which our shareholders could receive a premium for their shares or other changes in our management. First, if an "interested party" makes an offer to purchase the shares of some or all of our existing shareholders, we must obtain an affirmative opinion in writing as to the fairness of the offering price prior to completing the transaction. California law considers a person to be an "interested party" if the person directly or indirectly controls our company, if the person is directly or indirectly controlled by one of our officers or directors, or if the person is an entity in which one of our executive officers or directors holds a material financial interest. If, after receiving an offer from such an "interested person," we receive a subsequent offer from a neutral third party at least 10 days prior to the date for acceptance of the tendered shares or the vote or notice of shareholder approval of the offer from such an "interested person," then we must notify our shareholders of such third party offer and afford each of them the opportunity to withdraw their vote, consent, or proxy previously given to the "interested party" offer before such vote, consent, or proxy becomes effective or afford a reasonable time to withdraw any tendered shares before the purchase of the shares pursuant to the "interested party" proposal (with a delay of 10 days from the notice or publication of the later proposal will be deemed to provide a reasonable opportunity or time to effect that withdrawal).

We are also subject to other provisions of the CGCL, which include voting requirements that may also have the effect of deterring hostile takeovers, disposing of our assets or delaying or preventing changes in control of our management. Under Section 1101 of the CGCL, except in (i) a short-form merger or (ii) a merger of a corporation into a subsidiary in which it owns at least 90% of the outstanding shares of each class, if a single entity or constituent corporation owns, directly or indirectly, prior to the merger more than 50% of any class of our capital stock and attempts to merge our Company into itself or other constituent corporation, the Company's non-redeemable securities may only be exchanged for non-redeemable securities of the surviving entity, unless all of the shareholders of the applicable class of non-redeemable securities consent to the transaction or the terms of the transaction are approved and determined to be fair by the California Department of Financial Protection and Innovation ("DFPI"). Section 1001(d) of the CGCL provides that the principle terms of any proposed sale or disposition of all or substantially all of our assets to any other corporation that we are controlled by or under common control with must be consented to by at least 90% of the of the voting power of our capital stock or approved and determined fair by the DFPI, provided, however that this restriction does not apply if the disposition is to a domestic or foreign corporation or other business entity in consideration of the nonredeemable common shares or nonredeemable equity securities of the acquiring party or its parent. Sections 1101 and 1001 of the CGCL could make it significantly more difficult for a third party to acquire control of our Company by preventing a possible acquirer from cashing out minority shareholders or selling substantially all of our assets to a related party, and therefore could discourage a hostile bid or could delay, prevent, or deter entirely a merger, acquisition, or tender offer in which our shareholders could receive a premium for their shares or a proxy contest for control of us or other changes in our management.

Furthermore, the Bank Holding Company Act of 1956, as amended (the "BHC Act"), the Change in Bank Control Act (the "CBCA"), the DFPI, and the California Financial Code impose notice, application, approvals, and ongoing regulatory requirements on any shareholder or other party that seeks to acquire direct or indirect control of bank holding companies or banks, as applicable. These laws could delay or prevent an acquisition. The ability of a third party to acquire our stock is limited under applicable U.S. banking laws, and regulatory approval for the acquisition of our stock may be required under certain circumstances. The BHC Act requires any bank holding company to obtain the approval of the Federal Reserve prior to acquiring more than 5% of our outstanding common stock. Any corporation or other company that becomes a holder of 25% or more of our outstanding common stock, or otherwise is deemed to control us under the BHC Act, would be subject to regulation as a bank holding company under the BHC Act. In addition, any person other than a bank holding company may be required to obtain prior approval of the Federal Reserve to acquire 10% or more of our outstanding common stock under the CBCA. Further, prior approval of the DFPI is required for any person to acquire control of us, and control for these purposes is presumed to exist when a person owns 10% or more of our outstanding common stock.

Exclusive Forum Selection

Our Bylaws provide that, subject to limited exceptions, the United States District Court for the Northern District of California (or, in the event that the United States District Court for the Northern District of California does not have jurisdiction, any other federal or state court of California) will be the sole and exclusive forum for (i) any derivative action or proceeding brought on our behalf; (ii) any action asserting a claim of breach of a fiduciary duty owed by any of our directors, officers, or other employees to us or our shareholders; (iii) any action asserting a claim against us or any of our directors, officers, or other employees arising pursuant to any provision of the CGCL, our Articles of Incorporation, or Bylaws; or (iv) any other action asserting a claim against us or any of our directors, officers, or other employees that is governed by the internal affairs doctrine. Our Bylaws further provide that, unless we consent in writing to the selection of an alternative forum, the federal district courts of the United States of America will, to the fullest extent permitted by applicable law, be the exclusive forum for the resolution of any complaint asserting a cause of action arising under the federal securities laws, including the applicable rules and regulations promulgated thereunder. Any person or entity purchasing or otherwise acquiring or holding any interest in any shares of our capital stock will be deemed to have notice of and to have consented to this provision of our Bylaws. Although we believe this provision benefits us by providing increased consistency in the application of California and federal securities law in the types of lawsuits to which it applies, the provision may have the effect of discouraging lawsuits against our directors and officers.

Section 27 of the Exchange Act vests exclusive federal jurisdiction for all claims brought to enforce any duty or liability created under the Exchange Act or the rules and regulations thereunder. Therefore, claims to enforce any duty or liability created under the Exchange Act or the rules and regulations thereunder must be brought in a federal court as required by Section 27 of the Exchange Act and as provided in the exclusive forum selection provision of our Bylaws.

In addition, Section 22 of the Securities Act of 1933, as amended (the "Securities Act") creates concurrent jurisdiction for federal and state courts over all suits brought to enforce any duty or liability created by the Securities Act or the rules and regulations thereunder. As a result, there is uncertainty as to whether a court would enforce a forum selection clause in connection with claims arising under the Securities Act and the rules and regulations thereunder, and, in any event, shareholders will not be deemed to have waived the Company's compliance with the federal securities laws and the rules and regulations thereunder.

Transfer Agent and Registrar

The transfer agent and registrar for our common stock is Computershare Trust Company, N.A.

Exhibit 10.4

FORM OF RESTRICTED STOCK AWARD AGREEMENT

FIVE STAR BANCORP

[_______], 2022

This Restricted Stock Award Agreement (the "Agreement") is entered into between Five Star Bancorp, a California corporation (the "Company"), and the individual participant specified in the table below (the "Participant").

Participant	[NAME]
Grant Date	
Total Number of Restricted Shares	
Share Price	$[___] per share (determined as of [DATE])
Vesting Terms	*Check one:* o Cliff Vesting with a Vesting Date of [DATE] pursuant to Section 3(a)(i). o Incremental Vesting over a Restriction Period pursuant to Section 3(a)(ii), with substantially equal installments Vesting (as defined below) on each of the following dates (each a "Vesting Date"): [DATE(S)]

WHEREAS, the Company desires to provide the Participant an incentive to participate in the success and growth of the Company through the opportunity to earn a proprietary interest in the Company; and

WHEREAS, to give effect to the foregoing intention, the Company desires to grant to the Participant a Restricted Stock Award, pursuant to the Five Star Bancorp 2021 Equity Incentive Plan (the "Plan");

NOW, THEREFORE, in consideration of the mutual covenants hereinafter set forth and for good and valuable consideration, the parties hereto agree as follows:

1. Award. The Company hereby awards the Participant a Restricted Stock Award for the number of shares of Common Stock reflected in the table above (each a "Restricted Share" and collectively the "Restricted Shares"), subject to the terms and conditions set forth herein and the provisions of the Plan, the terms of which are incorporated herein by reference. Capitalized terms used but not otherwise defined in this Agreement shall have the meanings as set forth in the Plan. The Restricted Shares will be issued to the Participant following the date of this Agreement.

2. Restrictions on Sale or Other Transfer.

(a) Each Restricted Share awarded to the Participant pursuant to this Agreement shall be subject to forfeiture and may not be sold, transferred, assigned or pledged or otherwise be the subject of any disposition during the Restriction Period (as defined below). Notwithstanding anything to the contrary contained in this Section 2(a), the transfer of any or all of the Restricted Shares to the Participant's Immediate Family (as defined below) or to a trust for the direct or indirect benefit of the Participant's Immediate Family shall be exempt from the provisions of this Section 2(a); *provided* that any such transfer shall not involve a disposition for value and *further provided* that such transferee or other recipient acknowledges and agrees in writing that such transferee or other recipient will hold the Restricted Shares subject to the provisions of this Agreement, and there shall be no further transfer of such Restricted Shares except in accordance with the terms of this Section 2(a). "Immediate Family" as used herein shall mean the Participant's child, stepchild, grandchild, parent, stepparent, grandparent, spouse, or sibling, and shall include adoptive relationships.

(b) Each Restricted Share shall be held physically or in book entry form with the Company's transfer agent until the restrictions set forth above with respect to such Restricted Share have lapsed in accordance with the provisions of Section 3 or until such Restricted Share is forfeited pursuant to Section 3. Restricted Shares shall be delivered to the Participant only when and to the extent that the restrictions set forth in Section 3 with respect to such Restricted Shares have lapsed. The Company shall not be required (i) to transfer on its books any Restricted Shares that have been purportedly sold or otherwise transferred in violation of any of the provisions of this Agreement (a "Disallowed Transfer") or (ii) to treat any person to whom Restricted Shares have been purportedly sold or transferred by means of a Disallowed Transfer (a "Disallowed Transferee") as owner of such Restricted Shares, accord a Disallowed Transferee the right to vote, or pay dividends to a Disallowed Transferee.

3. Restriction Period. The Restricted Shares shall become vested, and the restrictions applicable to the Restricted Shares shall lapse (such period, the "Restriction Period") as follows:

(a) The Restricted Shares shall become nonforfeitable ("Vest") as follows:

(i) If designated as Cliff Vesting shares on the table appearing on the first page of this Agreement, the Restricted Shares shall Vest on the Vesting Date specified on such table, *provided* that the Participant remains in Continuous Service through such Vesting Date; or

(ii) If designated as Incremental Vesting shares on the table appearing on the first page of this Agreement, the Restricted Shares shall Vest in substantially equal installments on each of the Vesting Dates on the table appearing on the first page of this Agreement, *provided* that the Participant remains in Continuous Service through each Vesting Date.

Except as provided in Section 3(b) below, any Restricted Shares that have not Vested pursuant to Section 3(a)(i) or (ii) above, will be forfeited if the Participant ceases to remain in Continuous Service prior to the applicable Vesting Date. For purposes of this Agreement, "Continuous Service" means that the Participant's service with the Company or any Affiliate, whether as an employee, Director or Consultant, is not interrupted or terminated during the relevant period (generally from the Grant Date until the applicable Vesting Date). Whether the Participant's service with the Company or any Affiliate has been interrupted or terminated shall be determined according to the records of the Company, subject to applicable law; *provided* that the Participant's service shall not be deemed to have been interrupted, and the Participant shall not be deemed to have ceased Continuous Service, solely by reason of (i) the transfer of the Participant's service among the Company and any of its Affiliates, (ii) an employed Participant's leave of absence pursuant to the Family and Medical Leave Act or similar law, or (iii) the Participant's absence or leave, which has been approved by the Board of Directors of the Company (the "Board") or a duly authorized officer of the Company or any of its Affiliates.

(b) Notwithstanding Section 3(a) above, all of the Restricted Shares shall Vest

(i) if the Participant's Continuous Service is terminated as a result of the Participant's death or Disability prior to any Vesting Date, all of the Restricted Shares shall become fully Vested immediately as of the Participant's last day of employment (or other service relationship); or

(ii) if at any time before a Vesting Date, and a Change in Control occurs while the Participant remains in Continuous Service, then

(1) if the Restricted Shares are not assumed as set forth in Section 13(b) of the Plan, all of the Restricted Shares shall become fully Vested immediately as of the Change in Control; or

(2) if the Restricted Shares are assumed in connection with the Change in Control and the Participant experiences a termination of Continuous Service with the successor of the Company or an Affiliate (the "Successor") by reason of a termination by the Successor without Cause or by the Participant for Good Reason, in each case within a period of twelve (12) months after the Change in Control, any assumed Restricted Shares that have not fully Vested shall become fully Vested immediately as of the date of termination.

(c) For purposes of this Section 3 the following terms shall have the following meanings:

(i) "Cause" shall mean any of the following: (A) the Participant's willful failure to perform the Participant's material duties (other than any such failure resulting from incapacity due to physical or mental illness); (B) the Participant's engagement in dishonesty, illegal conduct or misconduct, which, in each case, is materially injurious to the financial interests or reputation of the Company or its Affiliates or is reasonably determined by the Company or an Affiliate to pose a substantial risk of such material injury; (C) the Participant's embezzlement, misappropriation or fraud, whether or not related to the Participant's employment (or other service relationship) with the Company or any Affiliate; (D) the Participant's commission of, plea of guilty, *nolo contendere*, or plea in abeyance to, or acceptance of a deferred adjudication or probated sentence with respect to, a crime that constitutes a felony (or state law equivalent) or a crime that constitutes a misdemeanor involving moral turpitude; (E) the Participant's willful violation of a material policy or code of conduct of the Company, including without limitation its Insider Trading Policy or Code of Ethics or any policy with respect to discrimination, sexual harassment, or sexual abuse; or (F) the Participant's material breach of any material obligation under any written agreement between the Participant and the Company, including, but not limited to any restrictive covenant agreement.

(ii) "Disability" shall mean (A) the Participant's inability, due to physical or mental incapacity, to substantially perform the Participant's duties and responsibilities with the Company or any Affiliate for one hundred eighty (180) days out of any three hundred sixty-five (365) day period or one hundred twenty (120) consecutive days; or (B) the Participant's eligibility to receive long-term disability benefits under a long-term disability plan sponsored by the Company or any of its Affiliates.

(iii) "Good Reason" shall mean the occurrence of any of the following without the Participant's written consent (A) a material reduction in the Participant's base salary (other than an across-the-board reduction similarly affecting all or substantially all similarly-situated employees, Directors or Consultants (as applicable) of the Company or an Affiliate); (B) with respect to Participants who are employees, a relocation of the Participant's principal place of employment as of the Grant Date by more than fifty (50) miles; or (C) a material diminution in the Participant's title or the nature or scope of the Participant's duties and responsibilities (other than a temporary diminution by reason of the Participant's physical or mental incapacity or an administrative leave for the purpose of investigating whether a Cause event has occurred). The Participant cannot terminate the Participant's employment (or other service relationship) for Good Reason unless the Participant provides written notice to the Company of the event or circumstance constituting Good Reason within sixty (60) days of the initial existence of such event or circumstance, the Company fails to cure such event or circumstance within thirty (30) days after receipt of such written notice, and the Participant terminates the Participant's employment (or other service relationship) within 120 days after the first occurrence of the applicable event or circumstances.

4. Forfeiture. Except to the extent otherwise provided in Section 3, upon termination of the Participant's Continuous Service with the Company and its Affiliates, any Restricted Shares as to which the Restriction Period has not then lapsed shall be automatically and irrevocably forfeited by the Participant, and such Restricted Shares shall thereupon be transferred to the Company at no cost to the Company, and the Participant shall then have no rights or entitlement to any payment or consideration thereto.

5. Rights as Shareholder. Except with respect to the restrictions set forth in Section 2 above, following the date of this Agreement and upon the issuance to the Participant of Restricted Shares hereunder, the Participant shall have all the rights of a shareholder of Common Stock with respect to such Restricted Shares, including the right to vote the shares and receive all dividends and other distributions paid or made with respect thereto.

6. Government Regulations. Notwithstanding anything contained herein to the contrary, the Company's obligation hereunder to issue or deliver shares of Common Stock shall be subject to the terms of the Plan, all applicable federal, state, and local laws, rules and regulations (including state blue sky laws, rules and regulations) and to such approvals by any governmental agencies or national securities exchanges as may be required. The Company shall have the right to impose restrictions on any Restricted Shares as it deems necessary or advisable under such laws, rules and regulations.

7. Participant Representations. The Participant has reviewed with the Participant's own tax advisors the federal, state, local and foreign tax consequences of the transactions contemplated by this Agreement. The Participant is relying solely on such advisors, and not on any statements or representations of the Company or any of its agents, if any, made to the Participant. The Participant understands that the Participant (and not the Company) shall be responsible for the Participant's own liability arising as a result of the transactions contemplated by this Agreement.

8. Tax Matters.

(a) Withholding Taxes. If any withholding is required with respect to the Shares, the Company shall have the right to require the Participant to remit such withholding tax to the Company or an Affiliate, or to withhold from other amounts payable to the Participant (as compensation or otherwise), **the maximum statutory amount required** to satisfy all federal, state and local income tax withholding requirements and the Participant's share of applicable employment withholding taxes (including, without limitation, any such income or employment taxes resulting from the issuance or Vesting of the Restricted Shares).

(b) Section 83(b) Election. The Participant hereby acknowledges that the Participant has been informed that, with respect to the Restricted Shares, the Participant may file an election with the Internal Revenue Service, within 30 days of the date on which the Restricted Shares are granted, electing pursuant to Section 83(b) ("Section 83(b)") of the Internal Revenue Code of 1986, as amended (the "Code") to be taxed currently on the Fair Market Value on the date of issuance. Absent such an election, taxable income will be measured and recognized by the Participant at the time or times at which the forfeiture restrictions on the Restricted Shares lapse. The Participant is strongly encouraged to seek the advice of his or her own tax consultant in connection with the issuance of the Restricted Shares and the Participant's decision whether to file a Section 83(b) election. **THE PARTICIPANT ACKNOWLEDGES THAT IT THE PARTICIPANT'S SOLE RESPONSIBILITY TO TIMELY FILE ANY SECTION 83(b) ELECTION, AND THE COMPANY WILL NOT MAKE SUCH FILING ON THE PARTICIPANT'S BEHALF.** If the Participant files a Section 83(b) election, the Participant shall promptly furnish the Company with a copy of the election. A form of election under Section 83(b) is attached hereto as Exhibit A for reference.

(c) Section 409A. This Agreement is intended to be exempt from, or comply with, Section 409A of the Code ("Section 409A"). If any provision of the Plan or this Agreement fails to satisfy the requirements for compliance with, or exemption from, Section 409A, the Company may, in its sole discretion and without the Participant's consent, modify such provision to the extent necessary to so comply. Nothing in this Section 10(c) or elsewhere in this Agreement transfers to the Company the obligation to pay any tax, interest or penalty incurred by the Participant in connection with the Restricted Shares (including any tax or penalty incurred as a result of a violation of Section 409A) or creates any obligation on the part of the Company to modify the Plan or this Agreement. To the extent necessary to avoid any tax or penalty under Section 409A, a termination of employment shall not be deemed to have occurred for purposes of any provision of this Agreement providing for the payment of any amounts or benefits upon or following a termination of employment unless such termination also constitutes a "Separation from Service" within the meaning of Section 409A and, for purposes of any such provision of this Agreement, references to a "termination," "termination of employment," "separation from service" or like terms shall mean Separation from Service. Any installment payment required under this Agreement (and any dividend paid with respect to the Restricted Shares) shall be considered a separate payment for purposes of Section 409A. If, upon separation from service, the Participant is a "specified employee" within the meaning of Section 409A, any payment under this Agreement that is subject to Section 409A and would otherwise be paid within six months after the Participant's separation from service will instead be paid in the seventh month following the Participant's separation from service (to the extent required by Section 409A(a)(2)(B)(i)). No payment under this Agreement that constitutes deferred compensation subject to Section 409A shall be subject to offset by any other amount unless otherwise permitted by Section 409A.

9. No Guarantee of Continued Service. The Participant acknowledges and agrees that (i) nothing in this Agreement or the Plan confers on the Participant any right to continue in an employment, consulting, directorship or other service relationship with the Company, nor shall it affect in any way the Participant's right or the Company's right to terminate the Participant's employment, consulting, directorship or other service relationship at any time, with or without cause, subject to any employment or service agreement that may have been entered into by the Commpany and the Participant; and (ii) the Company would not have granted this Award to the Participant but for these acknowledgements and agreements.

10. Further Assurances. The Participant agrees upon request to do all such reasonable acts and things and execute any further reasonable documents or instruments reasonably requested by the Company to carry out the purposes or intent of this Agreement and to facilitate the sale or other disposition of the Restricted Shares pursuant to this Agreement and/or to comply with all applicable federal, state, blue sky and local laws, rules and regulations and to obtain any necessary or desirable approvals by any governmental agencies or national securities exchanges.

11. Opportunity for Review. The Participant and the Company agree that this Award is granted under and governed by the terms and conditions of the Plan and this Award Agreement. The Participant has reviewed the Plan and this Award Agreement in their entirety, has had an opportunity to obtain the advice of counsel prior to accepting this Award Agreement and fully understands all provisions of the Plan and this Award Agreement. The Participant hereby agrees to accept as binding, conclusive and final all decisions or interpretations of the Committee upon any questions relating to the Plan and this Award Agreement. The Participant further agrees to notify the Company upon any change in the Participant's residence address.

12. Notices. Notices or communications to be made hereunder shall be in writing and shall be delivered in person, by registered mail, by confirmed facsimile or by a reputable overnight courier service to the Company at its principal office or to the Participant at his or her address contained in the records of the Company. Alternatively, notices and other communications may be provided in the form and manner of such electronic means as the Company may permit.

13. Entire Agreement; Governing Law. The Plan is incorporated herein by reference. The Plan and this Award Agreement constitute the entire agreement of the parties with respect to the subject matter hereof and supersede in their entirety all prior undertakings and agreements of the Company and the Participant with respect to the subject matter hereof, and may not be modified adversely to the Participant's interest except by means of a writing signed by the Company and the Participant. In the event of any conflict between this Agreement and the Plan, the Plan shall be controlling unless explicitly specified otherwise herein. This Agreement shall be construed under the laws of the State of California, without regard to conflict of laws principles.

14. Binding Effect; Equitable Relief. This Agreement shall be binding upon and inure to the benefit of the Company and the Participant and their respective permitted successors, assigns, heirs, beneficiaries and representatives. The parties hereto agree and declare that legal remedies are inadequate to enforce the provisions of this Agreement and that equitable relief, including specific performance and injunctive relief, may be used to enforce the provisions of this Agreement.

15. Electronic Delivery. The Company may, in its sole discretion, deliver any documents related to the Restricted Shares and the Participant's participation in the Plan (including any prospectuses, annual reports and other information required to be delivered by applicable securities laws, rules and regulations), or future awards that may be granted under the Plan, by electronic means or request the Participant's consent to participate in the Plan by electronic means. The Participant hereby consents to receive such documents by electronic delivery and, if requested, agrees to participate in the Plan through an on-line or electronic system established and maintained by the Company or another third party designated by the Company.

16. Construction; Waiver; Severability. The headings in this Agreement are provided for convenience only and are not to serve as a basis for interpretation or construction, and shall not constitute a part of this Agreement. Any right of the Company in this Agreement may be waived in writing by the Board or the Compensation Committee of the Board. No waiver or any right hereunder by any party shall operate as a waiver of any other right, or as a waiver of the same right with respect to any subsequent occasion for its exercise, or as a waiver of any right to damages. If any provision of this Agreement is held to be unenforceable or invalid, the remaining provisions shall be severable and enforceable to the extent permitted by law.

17. Counterparts. This Agreement may be executed in one or more counterparts, each of which shall be deemed to be an original but all of which together will constitute one and the same agreement.

[Signature Page Follows]

IN WITNESS WHEREOF, the parties hereto have executed this Agreement as of the date first set forth above.

FIVE STAR BANCORP

By: ______________________________
Name:
Title:

PARTICIPANT

Name: ______________________________

EXHIBIT A

ELECTION UNDER SECTION 83(b)
OF THE INTERNAL REVENUE CODE OF 1986

The undersigned taxpayer hereby makes an election pursuant to Section 83(b) of the Internal Revenue Code of 1986, as amended, and the Treasury Regulations thereunder (the "Regulations"), to include in gross income for the taxpayer's current taxable year the fair market value of the property described below (less any consideration paid for such property, if applicable) at the time of the transfer. In connection with this election, the undersigned taxpayer hereby supplies the following information:

1. The name, address and taxpayer identification number of the undersigned are:

Name: ______________________________
Address: ______________________________
____

Social Security Number: _______ – _____ – _________

2. The election is being made with respect to ________ shares of common stock (the "Stock") of Five Star Bancorp., a California corporation (the "Company").

3. The date on which the Stock was transferred to the undersigned was ______________, 20____. The taxable year for which this election is being made is calendar year 20____.

4. The property is subject to the following restrictions:

   The above-mentioned shares may not be transferred and are subject to forfeiture under the terms of an agreement between the taxpayer and the Company. These restrictions lapse upon the satisfaction of certain conditions contained in such agreement.

5. The fair market value of the Stock at the time of transfer (determined without regard to any lapse restriction, as defined in §1.83-3(i) of the Regulations) was $ [_____].

6. The undersigned did not pay any amount for the Stock. Therefore, $ [______] (the full fair market value of the Stock stated above) is includible in the undersigned's gross income as compensation for services.

7. A copy of this election has been furnished to the Company as required by §1.83-2(d) of the Regulations.

Dated: ________________________

____
[taxpayer signature]

INSTRUCTIONS FOR FILING SECTION 83(b) ELECTION

Attached is a form of election under Section 83(b) of the Internal Revenue Code. If you wish to make such an election, you should complete, sign and date the election and then proceed as follows:

1. Execute three counterparts of your completed election, retaining at least one copy for your records.

2. Send one counterpart to the Internal Revenue Service Center office where you will file your federal income tax return for the current calendar year, via certified mail with return receipt requested. THE ELECTION SHOULD BE SENT IMMEDIATELY, AS YOU ONLY HAVE 30 DAYS FROM THE DATE ON WHICH THE RESTRICTED SHARES ARE TRANSFERRED WITHIN WHICH TO MAKE THE ELECTION. NO WAIVERS, LATE FILINGS OR EXTENSIONS ARE PERMITTED. THIS ELECTION CANNOT BE REVOKED WITHOUT THE CONSENT OF THE IRS.

3. Deliver one counterpart of the completed election to the Company for its files.

4. Retain one copy for your records.

Exhibit 10.5

FORM OF RESTRICTED STOCK AWARD AGREEMENT

FIVE STAR BANCORP

[_______], 2022

This Restricted Stock Award Agreement (the "Agreement") is entered into between Five Star Bancorp, a California corporation (the "Company"), and the individual participant specified in the table below (the "Participant") in connection with service as a member of the Company's Board of Directors (the "*Board*").

Participant	[NAME]
Grant Date	
Total Number of Restricted Shares	
Share Price	$[___] per share (determined as of [DATE])
Vesting Terms	*Check one:* o Cliff Vesting with a Vesting Date of [DATE] pursuant to Section 3(a)(i). o Incremental Vesting over a Restriction Period pursuant to Section 3(a)(ii).

WHEREAS, the Company desires to provide the Participant an incentive to participate in the success and growth of the Company through the opportunity to earn a proprietary interest in the Company; and

WHEREAS, to give effect to the foregoing intention, the Company desires to grant to the Participant a Restricted Stock Award, pursuant to the Five Star Bancorp 2021 Equity Incentive Plan (the "Plan");

NOW, THEREFORE, in consideration of the mutual covenants hereinafter set forth and for good and valuable consideration, the parties hereto agree as follows:

1. Award. The Company hereby awards the Participant a Restricted Stock Award for the number of shares of Common Stock reflected in the table above (each a "Restricted Share" and collectively the "Restricted Shares"), subject to the terms and conditions set forth herein and the provisions of the Plan, the terms of which are incorporated herein by reference. Capitalized terms used but not otherwise defined in this Agreement shall have the meanings as set forth in the Plan. The Restricted Shares will be issued to the Participant following the date of this Agreement.

2. Restrictions on Sale or Other Transfer.

(a) Each Restricted Share awarded to the Participant pursuant to this Agreement shall be subject to forfeiture and may not be sold, transferred, assigned or pledged or otherwise be the subject of any disposition during the Restriction Period (as defined below). Notwithstanding anything to the contrary contained in this Section 2(a), the transfer of any or all of the Restricted Shares to the Participant's Immediate Family (as defined below) or to a trust for the direct or indirect benefit of the Participant's Immediate Family shall be exempt from the provisions of this Section 2(a); *provided* that any such transfer shall not involve a disposition for value and *further provided* that such transferee or other recipient acknowledges and agrees in writing that such transferee or other recipient will hold the Restricted Shares subject to the provisions of this Agreement, and there shall be no further transfer of such Restricted Shares except in accordance with the terms of this Section 2(a). "Immediate Family" as used herein shall mean the Participant's child, stepchild, grandchild, parent, stepparent, grandparent, spouse, or sibling, and shall include adoptive relationships.

(b) Each Restricted Share shall be held physically or in book entry form with the Company's transfer agent until the restrictions set forth above with respect to such Restricted Share have lapsed in accordance with the provisions of Section 3 or until such Restricted Share is forfeited pursuant to Section 3. Restricted Shares shall be delivered to the Participant only when and to the extent that the restrictions set forth in Section 3 with respect to such Restricted Shares have lapsed. The Company shall not be required (i) to transfer on its books any Restricted Shares that have been purportedly sold or otherwise transferred in violation of any of the provisions of this Agreement (a "Disallowed Transfer") or (ii) to treat any person to whom Restricted Shares have been purportedly sold or transferred by means of a Disallowed Transfer (a "Disallowed Transferee") as owner of such Restricted Shares, accord a Disallowed Transferee the right to vote, or pay dividends to a Disallowed Transferee.

3. Restriction Period. The Restricted Shares shall become vested, and the restrictions applicable to the Restricted Shares shall lapse (such period, the "Restriction Period") as follows:

(a) The Restricted Shares shall become nonforfeitable ("Vest") as follows:

(i) If designated as Cliff Vesting shares on the table appearing on the first page of this Agreement, the Restricted Shares shall Vest on the Vesting Date specified on such table, *provided* that the Participant remains in Continuous Service through such Vesting Date; or

(ii) If designated as Incremental Vesting shares on the table appearing on the first page of this Agreement, the Restricted Shares shall Vest in twelve (12) substantially equal installments, with the first installment Vesting on the Grant Date and the remaining installments vesting monthly on the first day of the month beginning with the month immediately following the Grant Date (each such date, a "Vesting Date"), *provided* that the Participant remains in Continuous Service through each Vesting Date.

Except as provided in Section 3(b) below, any Restricted Shares that have not Vested pursuant to Section 3(a)(i) or (ii) above, will be forfeited if the Participant ceases to remain in Continuous Service prior to the applicable Vesting Date. For purposes of this Agreement, "Continuous Service" means that the Participant's service with the Company or any Affiliate, whether as an employee, Director or Consultant, is not interrupted or terminated during the relevant period (generally from the Grant Date until the applicable Vesting Date).

(b) Notwithstanding Section 3(a) above, all of the Restricted Shares shall Vest

(i) if the Participant's Continuous Service is terminated as a result of the Participant's death or Disability prior to any Vesting Date, all of the Restricted Shares shall become fully Vested immediately as of the Participant's last day of employment (or other service relationship); or

(ii) if at any time before a Vesting Date, and a Change in Control occurs while the Participant remains in Continuous Service, then the Restricted Shares shall become fully Vested immediately as of the Change in Control.

(iii) "Disability" shall mean the Participant's inability, due to physical or mental incapacity, to substantially perform the Participant's duties and responsibilities with the Company or any Affiliate for one hundred eighty (180) days out of any three hundred sixty-five (365) day period or one hundred twenty (120) consecutive days.

4. Forfeiture. Except to the extent otherwise provided in Section 3, upon termination of the Participant's Continuous Service with the Company and its Affiliates, any Restricted Shares as to which the Restriction Period has not then lapsed shall be automatically and irrevocably forfeited by the Participant, and such Restricted Shares shall thereupon be transferred to the Company at no cost to the Company, and the Participant shall then have no rights or entitlement to any payment or consideration thereto.

5. Rights as Shareholder. Except with respect to the restrictions set forth in Section 2 above, following the date of this Agreement and upon the issuance to the Participant of Restricted Shares hereunder, the Participant shall have all the rights of a shareholder of Common Stock with respect to such Restricted Shares, including the right to vote the shares and receive all dividends and other distributions paid or made with respect thereto.

6. Government Regulations. Notwithstanding anything contained herein to the contrary, the Company's obligation hereunder to issue or deliver shares of Common Stock shall be subject to the terms of the Plan, all applicable federal, state, and local laws, rules and regulations (including state blue sky laws, rules and regulations) and to such approvals by any governmental agencies or national securities exchanges as may be required. The Company shall have the right to impose restrictions on any Restricted Shares as it deems necessary or advisable under such laws, rules and regulations.

7. Participant Representations. The Participant has reviewed with the Participant's own tax advisors the federal, state, local and foreign tax consequences of the transactions contemplated by this Agreement. The Participant is relying solely on such advisors, and not on any statements or representations of the Company or any of its agents, if any, made to the Participant. The Participant understands that the Participant (and not the Company) shall be responsible for the Participant's own liability arising as a result of the transactions contemplated by this Agreement.

8. Tax Matters.

(a) Withholding Taxes. If any withholding is required with respect to the Shares, the Company shall have the right to require the Participant to remit such withholding tax to the Company or an Affiliate, or to withhold from other amounts payable to the Participant (as compensation or otherwise), **the maximum statutory amount required** to satisfy all federal, state and local income tax withholding requirements and the Participant's share of applicable employment withholding taxes (including, without limitation, any such income or employment taxes resulting from the issuance or Vesting of the Restricted Shares).

(b) Section 83(b) Election. The Participant hereby acknowledges that the Participant has been informed that, with respect to the Restricted Shares, the Participant may file an election with the Internal Revenue Service, within 30 days of the date on which the Restricted Shares are granted, electing pursuant to Section 83(b) ("Section 83(b)") of the Internal Revenue Code of 1986, as amended (the "Code") to be taxed currently on the Fair Market Value on the date of issuance. Absent such an election, taxable income will be measured and recognized by the Participant at the time or times at which the forfeiture restrictions on the Restricted Shares lapse. The Participant is strongly encouraged to seek the advice of his or her own tax consultant in connection with the issuance of the Restricted Shares and the Participant's decision whether to file a Section 83(b) election. **THE PARTICIPANT ACKNOWLEDGES THAT IT THE PARTICIPANT'S SOLE RESPONSIBILITY TO TIMELY FILE ANY SECTION 83(b) ELECTION, AND THE COMPANY WILL NOT MAKE SUCH FILING ON THE PARTICIPANT'S BEHALF.** If the Participant files a Section 83(b) election, the Participant shall promptly furnish the Company with a copy of the election. A form of election under Section 83(b) is attached hereto as Exhibit A for reference.

(c) Section 409A. This Agreement is intended to be exempt from, or comply with, Section 409A of the Code ("Section 409A"). If any provision of the Plan or this Agreement fails to satisfy the requirements for compliance with, or exemption from, Section 409A, the Company may, in its sole discretion and without the Participant's consent, modify such provision to the extent necessary to so comply. Nothing in this Section 10(c) or elsewhere in this Agreement transfers to the Company the obligation to pay any tax, interest or penalty incurred by the Participant in connection with the Restricted Shares (including any tax or penalty incurred as a result of a violation of Section 409A) or creates any obligation on the part of the Company to modify the Plan or this Agreement. To the extent necessary to avoid any tax or penalty under Section 409A, a termination of employment shall not be deemed to have occurred for purposes of any provision of this Agreement providing for the payment of any amounts or benefits upon or following a termination of employment unless such termination also constitutes a "Separation from Service" within the meaning of Section 409A and, for purposes of any such provision of this Agreement, references to a "termination," "termination of employment," "separation from service" or like terms shall mean Separation from Service. Any installment payment required under this Agreement (and any dividend paid with respect to the Restricted Shares) shall be considered a separate payment for purposes of Section 409A. If, upon separation from service, the Participant is a "specified employee" within the meaning of Section 409A, any payment under this Agreement that is subject to Section 409A and would otherwise be paid within six months after the Participant's separation from service will instead be paid in the seventh month following the Participant's separation from service (to the extent required by Section 409A(a)(2)(B)(i)). No payment under this Agreement that constitutes deferred compensation subject to Section 409A shall be subject to offset by any other amount unless otherwise permitted by Section 409A.

9. No Guarantee of Continued Service. The Participant acknowledges and agrees that (i) nothing in this Agreement or the Plan confers on the Participant any right to continue in an employment, consulting, directorship or other service relationship with the Company, nor shall it affect in any way the Participant's right or the Company's right to terminate the Participant's employment, consulting, directorship or other service relationship at any time, with or without cause, subject to any employment or service agreement that may have been entered into by the Commpany and the Participant; and (ii) the Company would not have granted this Award to the Participant but for these acknowledgements and agreements.

10. Further Assurances. The Participant agrees upon request to do all such reasonable acts and things and execute any further reasonable documents or instruments reasonably requested by the Company to carry out the purposes or intent of this Agreement and to facilitate the sale or other disposition of the Restricted Shares pursuant to this Agreement and/or to comply with all applicable federal, state, blue sky and local laws, rules and regulations and to obtain any necessary or desirable approvals by any governmental agencies or national securities exchanges.

11. Opportunity for Review. The Participant and the Company agree that this Award is granted under and governed by the terms and conditions of the Plan and this Award Agreement. The Participant has reviewed the Plan and this Award Agreement in their entirety, has had an opportunity to obtain the advice of counsel prior to accepting this Award Agreement and fully understands all provisions of the Plan and this Award Agreement. The Participant hereby agrees to accept as binding, conclusive and final all decisions or interpretations of the Committee upon any questions relating to the Plan and this Award Agreement. The Participant further agrees to notify the Company upon any change in the Participant's residence address.

12. Notices. Notices or communications to be made hereunder shall be in writing and shall be delivered in person, by registered mail, by confirmed facsimile or by a reputable overnight courier service to the Company at its principal office or to the Participant at his or her address contained in the records of the Company. Alternatively, notices and other communications may be provided in the form and manner of such electronic means as the Company may permit.

13. Entire Agreement; Governing Law. The Plan is incorporated herein by reference. The Plan and this Award Agreement constitute the entire agreement of the parties with respect to the subject matter hereof and supersede in their entirety all prior undertakings and agreements of the Company and the Participant with respect to the subject matter hereof, and may not be modified adversely to the Participant's interest except by means of a writing signed by the Company and the Participant. In the event of any conflict between this Agreement and the Plan, the Plan shall be controlling unless explicitly specified otherwise herein. This Agreement shall be construed under the laws of the State of California, without regard to conflict of laws principles.

14. Binding Effect; Equitable Relief. This Agreement shall be binding upon and inure to the benefit of the Company and the Participant and their respective permitted successors, assigns, heirs, beneficiaries and representatives. The parties hereto agree and declare that legal remedies are inadequate to enforce the provisions of this Agreement and that equitable relief, including specific performance and injunctive relief, may be used to enforce the provisions of this Agreement.

15. Electronic Delivery. The Company may, in its sole discretion, deliver any documents related to the Restricted Shares and the Participant's participation in the Plan (including any prospectuses, annual reports and other information required to be delivered by applicable securities laws, rules and regulations), or future awards that may be granted under the Plan, by electronic means or request the Participant's consent to participate in the Plan by electronic means. The Participant hereby consents to receive such documents by electronic delivery and, if requested, agrees to participate in the Plan through an on-line or electronic system established and maintained by the Company or another third party designated by the Company.

16. Construction; Waiver; Severability. The headings in this Agreement are provided for convenience only and are not to serve as a basis for interpretation or construction, and shall not constitute a part of this Agreement. Any right of the Company in this Agreement may be waived in writing by the Board or the Compensation Committee of the Board. No waiver or any right hereunder by any party shall operate as a waiver of any other right, or as a waiver of the same right with respect to any subsequent occasion for its exercise, or as a waiver of any right to damages. If any provision of this Agreement is held to be unenforceable or invalid, the remaining provisions shall be severable and enforceable to the extent permitted by law.

17. Counterparts. This Agreement may be executed in one or more counterparts, each of which shall be deemed to be an original but all of which together will constitute one and the same agreement.

[Signature Page Follows]

IN WITNESS WHEREOF, the parties hereto have executed this Agreement as of the date first set forth above.

FIVE STAR BANCORP

By: ______________________________
Name:
Title:

PARTICIPANT

Name: ______________________________

EXHIBIT A

ELECTION UNDER SECTION 83(b)
OF THE INTERNAL REVENUE CODE OF 1986

The undersigned taxpayer hereby makes an election pursuant to Section 83(b) of the Internal Revenue Code of 1986, as amended, and the Treasury Regulations thereunder (the "Regulations"), to include in gross income for the taxpayer's current taxable year the fair market value of the property described below (less any consideration paid for such property, if applicable) at the time of the transfer. In connection with this election, the undersigned taxpayer hereby supplies the following information:

1. The name, address and taxpayer identification number of the undersigned are:

   Name: ______________________________
   Address: ______________________________
   ____

   Social Security Number: _______ – _____ – _________

2. The election is being made with respect to ________ shares of common stock (the "Stock") of Five Star Bancorp., a California corporation (the "Company").

3. The date on which the Stock was transferred to the undersigned was ______________, 20____. The taxable year for which this election is being made is calendar year 20____.

4. The property is subject to the following restrictions:

   The above-mentioned shares may not be transferred and are subject to forfeiture under the terms of an agreement between the taxpayer and the Company. These restrictions lapse upon the satisfaction of certain conditions contained in such agreement.

5. The fair market value of the Stock at the time of transfer (determined without regard to any lapse restriction, as defined in §1.83-3(i) of the Regulations) was $ [_____].

6. The undersigned did not pay any amount for the Stock. Therefore, $ [______] (the full fair market value of the Stock stated above) is includible in the undersigned's gross income as compensation for services.

7. A copy of this election has been furnished to the Company as required by §1.83-2(d) of the Regulations.

   Dated: ________________________

   ____
   [taxpayer signature]

INSTRUCTIONS FOR FILING SECTION 83(b) ELECTION

Attached is a form of election under Section 83(b) of the Internal Revenue Code. If you wish to make such an election, you should complete, sign and date the election and then proceed as follows:

1. Execute three counterparts of your completed election, retaining at least one copy for your records.

2. Send one counterpart to the Internal Revenue Service Center office where you will file your federal income tax return for the current calendar year, via certified mail with return receipt requested. THE ELECTION SHOULD BE SENT IMMEDIATELY, AS YOU ONLY HAVE 30 DAYS FROM THE DATE ON WHICH THE RESTRICTED SHARES ARE TRANSFERRED WITHIN WHICH TO MAKE THE ELECTION. NO WAIVERS, LATE FILINGS OR EXTENSIONS ARE PERMITTED. THIS ELECTION CANNOT BE REVOKED WITHOUT THE CONSENT OF THE IRS.

3. Deliver one counterpart of the completed election to the Company for its files.

4. Retain one copy for your records.

Exhibit 21.1

Subsidiaries of the Registrant

The following is a list of subsidiaries of Five Star Bancorp, the names under which subsidiaries do business, and the jurisdiction in which each was organized, as of the date of this prospectus. All subsidiaries are wholly-owned unless otherwise noted.

Subsidiaries of Five Star Bancorp

Name	Jurisdiction of Organization
Five Star Bank	California

Exhibit 23.1

Consent of Independent Registered Public Accounting Firm

We consent to the incorporation by reference in the Registration Statement (Form S-8, No. 333-256345) of Five Star Bancorp of our report dated February 25, 2022, relating to the consolidated financial statements of Five Star Bancorp which report appears in the Form 10-K of Five Star Bancorp for the year ended December 31, 2021.

/s/ Moss Adams LLP

San Francisco, California
February 25, 2022

EXHIBIT 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

I, James Beckwith, certify that:

1. I have reviewed this Annual Report on Form 10-K 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.

February 25, 2022	*/s/ James E. Beckwith*
Date	James E. Beckwith
	President and Chief Executive Officer

EXHIBIT 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

I, Heather Luck, certify that:

1. I have reviewed this Annual Report on Form 10-K 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.

February 25, 2022	*/s/ Heather C. Luck*
Date	Heather C. Luck Senior Vice President and Chief Financial Officer

EXHIBIT 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

In connection with the Annual Report on Form 10-K of Five Star Bancorp (the “Registrant”) for the year ended December 31, 2021, as filed with the Securities and Exchange Commission on the date hereof (the “Report”), I, James Beckwith, President & Chief Executive Officer of the Registrant, 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.

February 25, 2022	*/s/ James E. Beckwith*
Date	James E. Beckwith President and Chief Executive Officer

EXHIBIT 32.2

CERTIFICATION OF CHIEF 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 Annual Report on Form 10-K of Five Star Bancorp (the “Registrant”) for the year ended December 31, 2021, as filed with the Securities and Exchange Commission on the date hereof (the “Report”), I, Heather Luck, Senior Vice President & Chief Financial Officer of the Registrant, 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.

February 25, 2022	*/s/ Heather C. Luck*
Date	Heather C. Luck Senior Vice President and Chief Financial Officer