REPORT OF INDEPENDENT AUDITORS
AND CONSOLIDATED FINANCIAL STATEMENTS

LIBERTY NORTHWEST BANCORP, INC.

December 31, 2020 and 2019

MOSSADAMS

Table of Contents

Report of Independent Auditors

To the Board of Directors and Shareholders
Liberty Northwest Bancorp, Inc.

Report on the Financial Statements

We have audited the accompanying consolidated financial statements of Liberty Northwest Bancorp, Inc. and Subsidiary, which comprise the balance sheets as of December 31, 2020 and 2019, and the related statements of income, comprehensive income, changes in shareholders' equity, and cash flows for the years then ended, and the related notes to the consolidated financial statements.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Liberty Northwest Bancorp, Inc. as of December 31, 2020 and 2019, and the results of its operations and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Moss Adams LLP

Everett, Washington
March 31, 2021

Consolidated Balance Sheets (dollars in thousands)

ASSETS

	December 31, 2020	December 31, 2019
CASH AND CASH EQUIVALENTS		
Cash and due from banks	$ 3,594	$ 3,218
Overnight funds	30,205	27,485
Total cash and cash equivalents	33,799	30,703
INTEREST-BEARING DEPOSITS WITH OTHER FINANCIAL INSTITUTIONS	19	495
INVESTMENT SECURITIES AVAILABLE-FOR-SALE, at fair value	6,338	9,385
INVESTMENT SECURITIES HELD-TO-MATURITY, at amortized cost	3,132	3,077
FEDERAL HOME LOAN BANK STOCK, at cost	394	619
LOANS	124,868	81,766
Less allowance for credit losses	1,125	788
Total loans, net	123,743	80,978
PREMISES AND EQUIPMENT, net	1,205	1,510
ACCRUED INTEREST RECEIVABLE	648	341
OTHER ASSETS	911	1,119
Total assets	$ 170,189	$ 128,227

LIABILITIES AND SHAREHOLDERS' EQUITY

	December 31, 2020	December 31, 2019
DEPOSITS		
Noninterest-bearing	$ 51,537	$ 27,059
Interest-bearing	74,149	77,258
Total deposits	125,686	104,317
Borrowed funds	31,149	12,000
ACCRUED INTEREST PAYABLE	62	13
OTHER LIABILITIES	1,056	344
Total liabilities	157,953	116,674
SHAREHOLDERS' EQUITY		
Common stock, $1 par value, 10,000,000 shares authorized, 1,616,419 and 1,601,419 shares issued and outstanding at December 31, 2020 and 1,624,419 and 1,602,419 issued and outstanding at December 31, 2019	1,601	1,602
Additional paid-in capital	12,853	12,851
Accumulated deficit	(2,286)	(2,799)
Accumulated other comprehensive income (loss)	68	(101)
Total shareholders' equity	12,236	11,553
Total liabilities and shareholders' equity	$ 170,189	$ 128,227

Liberty Northwest Bancorp, Inc.
Consolidated Statements of Income (dollars in thousands)

	Years Ended December 31, 2020	Years Ended December 31, 2019
INTEREST AND FEE INCOME		
Loans, including fees	$ 6,209	$ 4,583
Investments	145	307
Interest-bearing deposits with other financial institutions and overnight funds	66	228
Total interest and fee income	6,420	5,118
INTEREST EXPENSE		
Deposits	443	922
Borrowed funds	189	137
Total interest expense	632	1,059
NET INTEREST INCOME	5,788	4,059
PROVISION FOR CREDIT LOSSES	329	15
NET INTEREST INCOME AFTER PROVISION FOR CREDIT LOSSES	5,459	4,044
NONINTEREST INCOME		
Service charges on deposits	39	58
Debit and credit card interchange income, net	44	40
Gain (loss) on sale of securities available-for-sale	29	(43)
Other income	236	146
Total noninterest income	348	201
NONINTEREST EXPENSE		
Salaries and employee benefits	3,038	2,367
Occupancy and equipment	683	544
Data processing	539	415
Advertising and business development	72	70
Professional and regulatory	301	207
Other expenses	524	453
Total noninterest expense	5,157	4,056
NET INCOME BEFORE PROVISION FOR INCOME TAXES	650	189
PROVISION FOR INCOME TAXES	137	41
NET INCOME	$ 513	$ 148

 See accompanying notes.

Liberty Northwest Bancorp, Inc.
Consolidated Statements of Comprehensive Income (dollars in thousands)

	Years Ended December 31, 2020	Years Ended December 31, 2019
NET INCOME	$ 513	$ 148
Other comprehensive income		
Unrealized gain (loss) on securities available-for-sale		
Unrealized holding gain (loss)	243	540
Tax benefit (expense) on unrealized holding gain (loss)	(51)	(113)
Reclassification adjustments for realized (gain) loss on sales of securities available-for-sale	(29)	43
Tax expense (benefit) for realized gain and (losses) on sales	6	(9)
Other comprehensive income	169	461
COMPREHENSIVE INCOME	$ 682	$ 609

Liberty Northwest Bancorp, Inc.
Consolidated Statements of Changes in Shareholders' Equity
(dollars in thousands)

	Common Stock		Additional Paid-in	Accumulated	Accumulated Other Comprehensive	Total Shareholders'
	Shares	Amount	Capital	Deficit	Income (Loss)	Equity
BALANCE, December 31, 2018	1,435,582	$ 1,436	$ 11,847	$ (2,947)	$ (562)	$ 9,774
Net income	-	-	-	148	-	148
Proceeds from stock issuance, net	160,666	160	960	-	-	1,120
Exercise of options (cashless)	171	-	-	-	-	-
Issuance of restricted stock	30,000	-	-	-	-	-
Vesting of restricted stock	-	6	(6)	-	-	-
Other comprehensive income, net	-	-	-	-	461	461
Stock-based compensation	-	-	50	-	-	50
BALANCE, December 31, 2019	1,626,419	1,602	12,851	(2,799)	(101)	11,553
Net income	-	-	-	513	-	513
Repurchase of shares	(7,000)	(7)	(42)	-	-	(49)
Vesting of restricted stock	-	6	(6)	-	-	-
Other comprehensive income, net	-	-	-	-	169	169
Stock-based compensation	-	-	50	-	-	50
BALANCE, December 31, 2020	1,619,419	$ 1,601	$ 12,853	$ (2,286)	$ 68	$ 12,236

 See accompanying notes.

Liberty Northwest Bancorp, Inc.
Consolidated Statements of Cash Flows (dollars in thousands)

	Years Ended December 31, 2020	2019
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income	$ 513	$ 148
Adjustments to reconcile net income to net cash from operating activities		
Provision for credit losses	329	15
Depreciation and amortization	178	184
Deferred expense for income taxes	137	41
Net amortization of investment security premium/discount	65	74
Stock-based compensation	50	50
(Gain) loss on sale of investment securities	(29)	43
Gain on sale of building	(64)	-
Changes in operating assets and liabilities		
Accrued interest receivable	(307)	9
Other assets	25	(24)
Accrued interest payable	49	2
Other liabilities	712	51
Net cash provided by operating activities	1,658	593
CASH FLOWS FROM INVESTING ACTIVITIES		
Net change in interest-bearing deposits with other financial institutions	476	(131)
Activity in securities available-for-sale		
Maturities, prepayments, and calls	2,125	2,854
Sales	3,327	4,485
Purchases	(2,212)	(552)
Activity in securities held-to-maturity		
Maturities, prepayments, and calls	687	480
Purchases	(757)	-
Redemption of Federal Home Loan Bank stock	225	25
Loan originations, net	(43,094)	(2,786)
Sale of premises and equipment	1,201	-
Purchase of premises and equipment	(1,010)	(72)
Net cash used in investing activities	(39,032)	4,303
CASH FLOWS FROM FINANCING ACTIVITIES		
Net increase in deposits	21,370	11,917
Proceeds from Paycheck Protection Program Liquidity Facility, net	25,149	-
Proceeds from advances from the Federal Home Loan Bank	1,500	1,500
Repayments of advances from the Federal Home Loan Bank	(2,500)	(2,500)
Repayment of overnight advances, net	(5,000)	-
Repurchase of stock	(49)	-
Proceeds from stock issuance	-	1,120
Net cash received from financing activities	40,470	12,037
NET CHANGE IN CASH AND CASH EQUIVALENTS	3,096	16,933
CASH AND CASH EQUIVALENTS, beginning of year	30,703	13,770
CASH AND CASH EQUIVALENTS, end of year	$ 33,799	$ 30,703
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION		
Cash paid during the year for interest	$ 1,010	$ 1,058
NONCASH INVESTING AND FINANCING ACTIVITIES		
Unrealized gain on securities available-for-sale	$ 214	$ 583

Note 1 – Organization and Summary of Significant Accounting Policies

Nature of operations – Liberty Northwest Bancorp, Inc. (the Company) is a bank holding company whose wholly owned subsidiary is Liberty Bank (the Bank). The Bank provides a full range of banking services to individual and corporate customers through its main office in Poulsbo, Washington, a leased space in Bellevue, Washington. Its primary deposit products are checking, savings, and term certificate accounts, and its primary lending products are commercial real estate loans, residential real estate loans, and commercial loans. The Bank is subject to significant competition from other financial institutions. The Bank is also subject to the regulations of certain federal and state of Washington agencies and undergoes periodic examinations by those regulatory authorities.

Financial statement presentation and use of estimates – The consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America and reporting practices applicable to the banking industry. In preparing the consolidated financial statements, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities, as of the date of the balance sheet, and revenues and expenses for the year. Actual results could differ from estimated amounts. Material estimates that are particularly susceptible to significant change relate to the determination of the allowance for credit losses, fair value of financial instruments, and deferred tax assets. All dollar amounts are stated in thousands.

Principles of consolidation – The consolidated financial statements include the accounts of the Company and the Bank. All significant intercompany accounts have been eliminated in consolidation.

Subsequent events – Subsequent events are events or transactions that occur after the date of the balance sheet but before consolidated financial statements are issued. Recognized subsequent events are events or transactions that provide additional evidence about conditions that existed at the date of the balance sheet, including the estimates inherent in the process of preparing consolidated financial statements. Nonrecognized subsequent events are events that provide evidence about conditions that did not exist at the date of the balance sheet but arose after that date. Management has reviewed events occurring through March 31, 2021, the date the consolidated financial statements were available to be issued.

On March 23, 2021 (the closing date), Liberty Northwest Bancorp, Inc. issued four unsecured subordinated term notes (the subordinated notes) with an aggregate principal amount of $5 million, maturing April 1, 2031, pursuant to subordinated loan agreements with various investors. The subordinated notes bear interest at an annual interest rate of 5.50% for a fixed rate period from the closing date to March 31, 2026, payable by the Company semi-annually in arrears. From April 1, 2026, through the maturity date, there is a floating rate period where the notes bear interest at an annual interest rate of the greater of 5.50%, payable semi-annually, in arrears, or a floating interest rate based on the 90-day average Secured Overnight Financing Rate plus 500 basis points, payable quarterly, in arrears. Debt issuance costs were not significant.

Note 1 – Organization and Summary of Significant Accounting Policies (continued)

Cash and cash equivalents – For purposes of reporting cash flows, cash and cash equivalents include cash on hand, amounts due from banks, overnight funds, and federal funds sold, all with original maturities of three months or less. Generally, federal funds are purchased and sold for one-day periods. The amounts on deposit fluctuate and, at times, exceed the insured limit by the Federal Deposit Insurance Corporation (FDIC), which potentially subjects the Bank to credit risk. Overnight funds include federal funds purchased and are made with major banks as approved by the Board of Directors.

Interest-bearing deposits with other financial institutions – Interest-bearing deposits with other financial institutions include interest-bearing deposits and certificates of deposit in federally insured financial institutions located throughout the United States. The amounts on deposit fluctuate and, at times, exceed the insured limit by the FDIC, which potentially subjects the Bank to credit risk.

Restricted assets – Federal Reserve Board regulations generally require maintenance of certain minimum reserve balances on deposit with the Federal Reserve Bank or another institution in a pass-through relationship. The amounts of such balances are generally based on size and other factors. There were no such requirements at December 31, 2020 or 2019.

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

Interest income includes amortization of any purchase premium or discount. Premiums and discounts on securities are amortized on the level-yield method without anticipating prepayments, except for mortgage-backed securities where prepayments are anticipated. Gains and losses on sales are recorded on the trade date and determined using the specific identification method.

Investment debt securities are reviewed on an ongoing basis for the presence of other-than-temporary impairment (OTTI) or permanent impairment, taking into consideration current market conditions; fair value in relationship to cost; extent and nature of the change in fair value; issuer rating changes and trends; whether management intends to sell a security or if it is likely that the Bank will be required to sell the security before recovery of the amortized cost basis of the investment, which may be maturity; and other factors. For debt securities, if management intends to sell the security or it is likely that the Bank will be required to sell the security before recovering its cost basis, the entire impairment loss would be recognized in earnings as an OTTI. If management does not intend to sell the security and it is not likely that the Bank will be required to sell the security, but management does not expect to recover the entire amortized cost basis of the security, only the portion of the impairment loss representing credit losses would be recognized in earnings. The credit loss on a security is measured as the difference between the amortized cost basis and the present value of the cash flows expected to be collected. Projected cash flows are discounted by the original or current effective interest rate depending on the nature of the security being measured for potential OTTI. The remaining impairment related to all other factors, i.e., the difference between the present value of the cash flows expected to be collected and fair value, is recognized as a charge to other comprehensive income (loss). Impairment losses related to all other factors are presented as separate categories within other comprehensive income (loss).

Note 1 – Organization and Summary of Significant Accounting Policies (continued)

Federal Home Loan Bank stock – The Bank is a member of the Federal Home Loan Bank (FHLB) of Des Moines. As a member of the FHLB system, the Bank is required to maintain a minimum level of investment in FHLB stock, based on specified percentages of its outstanding FHLB advances. The Bank's investment in FHLB stock is carried at cost, classified as a restricted security, and periodically evaluated for impairment based on ultimate recovery of par value ($100 per share).

The Bank evaluates FHLB stock for impairment. The determination of whether this investment is impaired is based on the Bank's assessment of the ultimate recoverability of cost rather than by recognizing temporary declines in value. The Bank has determined that there is not an other-than-temporary impairment on the FHLB stock investment as of December 31, 2020 or 2019.

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

Loans – Loans that management has the intent and ability to hold for the foreseeable future or until maturity or pay-off generally are reported at their outstanding principal adjusted for any charge-offs, the allowance for loan losses, and any deferred fees or costs on originated loans. Interest income is accrued on the unpaid principal balance. Loan origination fees, net of certain origination costs, are deferred and recognized as an adjustment of the related loan yield using the interest method.

The accrual of interest on loans is discontinued at the time the loan is 90 days delinquent unless the credit is well secured and in process of collection. Past due status is based on contractual terms of the loan. In all cases, loans are placed on nonaccrual or charged off at an earlier date if collection of principal or interest is considered doubtful.

All interest accrued but not collected for loans that are placed on nonaccrual or charged off is reversed against interest income. The interest on these loans is accounted for on the cash basis or cost-recovery method, until qualifying for return to accrual. Loans are returned to accrual status when all the principal and interest amounts contractually due are brought current and future payments are reasonably ensured.

In conjunction with the passage of the Coronavirus Aid, Relief, and Economic Security Act (CARES Act) in March 2020, financial institutions have been provided the option, for loans meeting specific criteria, to temporarily suspend certain requirements under GAAP related to Troubled Debt Restructurings (TDRs) for a limited time to assist borrowers experiencing financial hardship due to the COVID-19 Pandemic (the Pandemic). As a result, the Bank has not recognized eligible CARES Act loan modifications as TDRs. Additionally, loans qualifying for these modifications are not required to be reported as delinquent, nonaccrual, impaired or criticized solely as a result of loan modification resulting from the economic effects of the Pandemic. Modifications include deferral of payments and interest only periods. The Bank 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. Accrued interest balances are assessed for collectability on a periodic basis. As of December 31, 2020, there were no loans in deferral under a CARES Act modification agreement, as all loans had resumed scheduled payments.

Note 1 – Organization and Summary of Significant Accounting Policies (continued)

Significant group concentrations of credit risk – Most of the Bank's business activity is with customers located within Kitsap County, Washington. The Bank originates commercial, real estate, construction, and consumer loans. Generally, loans are secured by accounts receivable, inventory, deposit accounts, personal property, or real estate. Rights to collateral vary and are legally documented to the extent practicable. Although the Bank has a diversified loan portfolio, local economic conditions may affect borrowers' ability to meet the stated repayment terms.

The distribution of commitments to extend credit approximates the distribution of loans outstanding. Commercial credit was granted primarily to commercial borrowers. The Bank, as a matter of policy, does not extend credit in excess of 20% of unimpaired capital and surplus to any single borrower or group of related borrowers.

Allowance for credit losses – The allowance for credit losses is established as losses are estimated to have occurred through a provision for credit losses charged to earnings. Loan and lease losses are charged against the allowance when management believes the uncollectibility of a loan or lease balance is confirmed. Subsequent recoveries, if any, are credited to the allowance.

The allowance for loan and lease losses is maintained at a level sufficient to provide for probable loan losses based on evaluating known and inherent risks in the loan and lease portfolio. The allowance is provided based upon management's continuing analysis of the pertinent factors underlying the quality of the loan and lease portfolio. These factors include changes in the size and composition of the loan and lease portfolio, delinquency levels, actual loan and lease loss experience, current economic conditions, and detailed analysis of individual loans for which full collectibility may not be ensured. The detailed analysis includes techniques to estimate the fair value of loan and lease collateral and the existence of potential alternative sources of repayment. The allowance consists of specific, general, and unallocated components. The specific component relates to loans and leases that are classified as impaired.

For such loans or leases classified as impaired, an allowance is established when the discounted cash flows (or collateral value or observable market price) of the impaired loan or lease is lower than the carrying value of that loan or lease. The general component covers nonimpaired loans and is based on historical loss experience adjusted for qualitative factors. An unallocated component is maintained to cover uncertainties that could affect management's estimate of probable losses. The unallocated component of the allowance reflects the margin of imprecision inherent in the underlying assumptions used in the methodologies for estimating specific and general losses in the portfolio. The appropriateness of the allowance for credit losses is estimated based upon these factors and trends identified by management at the time the financial statement is prepared.

Note 1 – Organization and Summary of Significant Accounting Policies (continued)

A loan or lease is considered impaired when, based on current information and events, it is probable that the Bank will be unable to collect the scheduled payments of principal or interest when due according to the contractual terms of the loan or lease agreement. Factors considered by management in determining impairment include payment status, collateral value, and the probability of collecting scheduled principal and interest payments when due. 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 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. Impairment is measured by either the present value of expected future cash flows discounted at the credit's effective interest rate, the credit's obtainable market price, or the fair value of the collateral if the credit is collateral-dependent. Impairment is measured on a loan-by-loan basis for all loans in the portfolio except for the smaller groups of homogeneous consumer loans in the portfolio. Additionally, state and federal regulations, upon examination, may require the Bank to make additional provisions or adjustments to its allowance.

Transfers of financial assets – Transfers of an entire financial asset, a group of entire financial assets, or participating interest in an entire financial asset are accounted for as sales when control over the assets has been surrendered. Control over transferred assets is deemed to be surrendered when (1) the assets have been isolated from the Bank, (2) the transferee obtains the right (free of conditions that constrain it from taking advantage of that right) to pledge or exchange the transferred assets, and (3) the Bank does not maintain effective control over the transferred assets through an agreement to repurchase them before their maturity.

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

Foreclosed assets – Foreclosed assets include real estate and personal property acquired through foreclosure and in-substance foreclosed properties. In-substance foreclosed properties are those properties for which the institution has taken physical possession, regardless of whether formal foreclosure proceedings have taken place.

At the time of foreclosure, foreclosed property is recorded at the fair value less cost to sell, which becomes the property's new basis. Any write-downs based on the asset's fair value at the date of acquisition are charged to the allowance for credit losses. After foreclosure, valuations are periodically performed by management and foreclosed property is carried at the lower of the new cost basis or fair value less costs to sell. Costs incurred in maintaining foreclosed property and subsequent adjustments to the carrying amount of the property are included in noninterest expense.

Note 1 – Organization and Summary of Significant Accounting Policies (continued)

Income taxes – Income taxes are accounted for using an asset and liability approach that requires the recognition of deferred tax assets and liabilities for the expected future tax consequences of temporary differences between the financial statement and tax basis of assets and liabilities at the applicable enacted tax rates. A valuation allowance is provided when it is more likely than not that some portion or all of the deferred tax assets will not be realized. The Bank evaluates the realizability of its deferred tax assets by assessing its valuation allowance and by adjusting the amount of such allowance, if necessary.

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

Advertising costs – The Bank expenses advertising costs as they are incurred. Total advertising expenses were $6 and $18 in 2020 and 2019, respectively.

Comprehensive income – Accounting principles generally require that recognized revenue, expenses, gains, and losses be included in net income. Certain changes in assets and liabilities, such as unrealized gains and losses on available-for-sale investments, are reported as a separate component of the equity section of the balance sheets. Reclassification adjustments during December 31, 2020 and 2019, are included within the statements of comprehensive income.

Stock-based compensation – The Bank has a stock-based compensation plan for employees that includes stock options and restricted stock, which are recognized as stock-based compensation expense in the statements of income based on the grant-date fair value of the award with a corresponding increase in common stock. The fair value is amortized over the requisite service period, which is generally the vesting period. The fair value at the grant date is determined using the Black-Scholes pricing model that takes into account the stock price at the grant date, the exercise price, the expected life of the option, the volatility of the underlying stock, the expected dividend yield, and the risk-free interest rate over the expected life of the option. The Black-Scholes option valuation model requires the input of subjective assumptions, including the expected life of the share-based award and stock price volatility. The assumptions used represent management's best estimates, but these estimates involve inherent uncertainties and the application of management's judgment.

Note 1 – Organization and Summary of Significant Accounting Policies (continued)

Revenue recognition – On January 1, 2019, the Bank adopted Accounting Standards Update (ASU) 2014-09, *Revenue from Contracts with Customers*, and all subsequent amendments to the ASU (collectively, ASC 606), which (i) creates a single framework for recognizing revenue from contracts with customers that fall within its scope and (ii) revises when it is appropriate to recognize a gain (loss) from the transfer of nonfinancial assets, such as OREO. To determine revenue recognition for arrangements that an entity determines are within the scope of Topic 606, the Bank performs the following five steps: (i) identify the contract(s) with a customer; (ii) identify the performance obligations in the contract; (iii) determine the transaction price; (iv) allocate the transaction price to the performance obligations in the contract; and (v) recognize revenue when (or as) the Bank satisfies a performance obligation. The majority of the Bank's revenues come from interest income, including loans and securities that are outside the scope of ASC 606. The Company's services that fall within the scope of ASC 606 are presented within noninterest income and are recognized as revenue as the Company satisfies its obligation to the customer. Services within the scope of ASC 606 include deposit service charges and interchange fee income and expenses.

The Bank adopted ASC 606 using the modified retrospective method applied to all contracts not completed as of January 1, 2019. Results for reporting periods beginning on or after January 1, 2019, are presented under ASC 606, while prior period amounts continue to be reported in accordance with legacy GAAP.

Service charges on deposit accounts – The Bank earns fees from its deposit customers for account maintenance, transaction-based activity, and overdraft services. Account maintenance fees consist primarily of account fees and analyzed account fees charged on deposit accounts on a monthly basis. The performance obligation is satisfied and the fees are recognized on a monthly basis as the service period is completed. Transaction-based fees on deposit accounts are charged to deposit customers for specific services provided to the customer, such as non-sufficient funds fees, overdraft fees, and wire fees. The performance obligation is completed as the transaction occurs and the fees are recognized at the time each specific service is provided to the customer.

Debit and ATM interchange fee income and expenses – Debit and ATM interchange income represent fees earned when a debit card issued by the Company is used. The Company earns interchange fees from debit cardholder transactions through the Visa payment network. Interchange fees from cardholder transactions represent a percentage of the underlying transaction value and are recognized daily, concurrently with the transaction processing services provided to the cardholder. The performance obligation is satisfied and the fees are earned when the cost of the transaction is charged to the cardholders' debit card. Certain expenses directly associated with the debit card are recorded on a net basis with the interchange income.

Fair value measurements – Fair value measurements are estimated using relevant market information and other assumptions. Fair value estimates involve uncertainties and matters of significant judgment regarding interest rates, credit risks, prepayments, and other factors, especially in the absence of broad markets for particular items. Changes in assumptions or in market conditions could significantly affect the estimates.

Notes to Consolidated Financial Statements (dollars in thousands)

Note 2 – Investments

The amortized cost of securities and their approximate fair value are as follows:

December 31, 2020	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Available-for-sale				
Collateralized mortgage obligation securities	$ 1,956	$ 1	$ (3)	$ 1,954
Mortgage-backed securities	$ 4,296	$ 88	$ -	$ 4,384
Total	$ 6,252	$ 89	$ (3)	$ 6,338
Held-to-maturity				
Mortgage-backed securities	$ 2,758	$ 78	$ -	$ 2,836
SBA security	374	29	-	403
Total	$ 3,132	$ 107	$ -	$ 3,239
December 31, 2019				
Available-for-sale				
Mortgage-backed securities	$ 9,513	$ 2	$ (130)	$ 9,385
Held-to-maturity				
Mortgage-backed securities	$ 2,658	$ 2	$ (26)	$ 2,634
SBA security	419	8	-	427
Total	$ 3,077	$ 10	$ (26)	$ 3,061

The amortized cost and estimated fair value of investment securities at December 31, 2020, by contractual or expected maturity, are shown below. Expected maturities will differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

	Available-for-Sale		Held-to-Maturity	
	Amortized Cost	Estimated Fair Value	Amortized Cost	Estimated Fair Value
Due in 1 to 5 years	$ 607	$ 618	$ -	$ -
Due after 5 to 10 years	187	196	-	-
Due after 10 years	5,458	5,524	3,132	3,239
	$ 6,252	$ 6,338	$ 3,132	$ 3,239

As of December 31, 2020, securities with a carrying value of $5,852 were pledged to secure borrowings at the FHLB and securities with a carrying value of $1,385 were pledged to secure public deposits. As of December 31, 2019, securities with a carrying value of $9,086 were pledged to secure borrowings at the FHLB and securities with a carrying value of $3,376 were pledged to secure public deposits.

Notes to Consolidated Financial Statements (dollars in thousands)

Note 2 – Investments (continued)

During the year ended December 31, 2020, the Bank sold eleven investment securities totaling $3,327, with gross gains of $29 recognized on the sales. During the year ended December 31, 2019, the Bank sold nine investment securities totaling $4,485, with gross losses of $43 recognized on the sales.

At December 31, 2020 and 2019, 1 and 29 securities were in an unrealized loss position, with 0 and 26 in a loss position of more than 12 months, respectively. The Bank has evaluated these securities and has determined that the decline in value is temporary and is related to the change in market interest rates since purchase. The decline in value is not related to any bank- or industry-specific event. The Bank anticipates full recovery of amortized cost with respect to these securities at maturity or sooner in the event of a more favorable market interest rate environment. Because management does not intend to sell and does not anticipate being required to sell these securities in the near term, no declines are deemed to be other than temporary.

Information pertaining to investment securities with gross unrealized losses aggregated by investment category and length of time that individual securities have been in a continuous loss position is as follows at December 31:

	Less Than 12 Months		Over 12 Months		
December 31, 2020	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Total Unrealized Losses
Securities available-for-sale					
Collateralized mortgage obligation securities	$ 3	$ 936	$ -	$ -	$ 3
December 31, 2019					
Securities available-for-sale					
Mortgage-backed securities	$ 4	$ 784	$ 126	$ 7,710	$ 130
Held-to-maturity					
Mortgage-backed securities	$ -	$ -	$ 26	$ 1,408	$ 26

Notes to Consolidated Financial Statements (dollars in thousands)

Note 3 – Loans and Allowance for Credit Losses

The major classifications of loans at December 31 are as follows:

	2020	2019
Commercial real estate	$ 38,104	$ 38,989
Commercial	45,109	16,074
Construction and land	4,168	7,127
Consumer	4,589	206
Residential real estate	33,433	19,630
Gross loans	125,403	82,026
Deferred fees and costs, net	(535)	(260)
Allowance for credit losses	(1,125)	(788)
Total loans, net	$ 123,743	$ 80,978

On March 27, 2020, the Coronavirus Aid, Relief, and Economic Security Act (CARES Act) was signed by the President of the United States. During the year ended December 31, 2020, the Bank participated in the Paycheck Protection Program (PPP), under the CARES Act, whereby loans to small businesses are made and those loans are subject to the regulatory requirements that would require forbearance of loan payments for a specified time or that would limit the ability to pursue all available remedies in the event of a loan default. The above table includes $34,456 of PPP loans administered by the U.S. Small Business Administration (SBA) within the Commercial loan segment as of December 31, 2020.

The Bank pledged certain commercial loans as collateral for purposes of borrowings with the FHLB. Loans totaling $41,624 and $34,065 were pledged to the FHLB at December 31, 2020 and 2019, respectively (Note 6).

Notes to Consolidated Financial Statements (dollars in thousands)

Note 3 – Loans and Allowance for Credit Losses (continued)

The following table presents the activity in the allowance for credit losses by segment for the years ended December 31:

2020	Beginning Balance	Provision (Recovery) for Credit Losses	Charge-offs	Recoveries	Ending Balance
Commercial real estate	$ 411	96	$ -	$ -	$ 507
Commercial	116	(3)	-	(8)	105
Construction and land	60	(48)	-	-	12
Consumer	1	73	-	-	74
Residential real estate	134	261	-	-	395
Unallocated	66	(34)	-	-	32
	$ 788	$ 345	$ -	$ (8)	$ 1,125
2019					
Commercial real estate	$ 418	$ (7)	$ -	$ -	$ 411
Commercial	76	40	-	-	116
Construction and land	130	(70)	-	-	60
Consumer	1	-	-	-	1
Residential real estate	74	60	-	-	134
Unallocated	74	(8)	-	-	66
	$ 773	$ 15	$ -	$ -	$ 788

The following table presents loans individually evaluated for impairment by class of loans as of December 31:

2020	Recorded Investments (Loan Balance Less Charge-off)	Unpaid Principal Balance	Related Allowance	Average Investment in Impaired Loans	Interest Income Recognized
With no allowance recorded					
Commercial real estate	$ -	$ -	$ -	$ 932	$ -
Commercial	-	-	-	302	-
	$ -	$ -	$ -	$ 1,234	$ -
2019					
With no allowance recorded					
Commercial real estate	$ 1,865	$ 1,865	$ -	$ 933	$ 107
Commercial	603	603	-	-	-
	$ 2,468	$ 2,468	$ -	$ 933	$ 107

Notes to Consolidated Financial Statements (dollars in thousands)

Note 3 – Loans and Allowance for Credit Losses (continued)

The following table presents the balance in the allowance for credit losses and the recorded investment in loans by portfolio segment and based on impairment method as of December 31:

	Allowance for Credit Losses			Loans and Leases		
2020	Ending Balance	Ending Balance Individually Evaluated for Impairment	Ending Balance Collectively Evaluated for Impairment	Ending Balance	Ending Balance Individually Evaluated for Impairment	Ending Balance Collectively Evaluated for Impairment
Commercial real estate	$ 507	$ -	$ 507	$ 38,104	$ -	$ 38,104
Commercial	105	-	105	45,109	-	45,109
Construction and land	12	-	12	4,168	-	4,168
Consumer	74	-	74	4,589	-	4,589
Residential real estate	395	-	395	33,433	-	33,433
Unallocated	32	-	32	-	-	-
	$ 1,125	$ -	$ 1,125	$ 125,403	$ -	$ 125,403
2019						
Commercial real estate	$ 411	$ -	$ 411	$ 38,989	$ 1,865	$ 37,124
Commercial	116	-	116	16,074	603	15,471
Construction and land	60	-	60	7,127	-	7,127
Consumer	1	-	1	206	-	206
Residential real estate	134	-	134	19,630	-	19,630
Unallocated	66	-	66	-	-	-
	$ 788	$ -	$ 788	$ 82,026	$ 2,468	$ 79,558

Notes to Consolidated Financial Statements (dollars in thousands)

Note 3 – Loans and Allowance for Credit Losses (continued)

The following table presents current and past due loans, net of partial loan charge-offs, by type and delinquency status, as of December 31:

2020	30 - 59 Days Past Due	60 - 89 Days Past Due	90 Days or More Past Due	Total Past Due	Current	Total Loans
Commercial real estate	$ -	$ -	$ -	$ -	$ 38,104	$ 38,104
Commercial	-	-	-	-	45,109	45,109
Construction and land	-	-	-	-	4,168	4,168
Consumer	-	-	-	-	4,589	4,589
Residential real estate	-	-	-	-	33,433	33,433
	$ -	$ -	$ -	$ -	$ 125,403	$ 125,403
2019						
Commercial real estate	$ -	$ 597	$ 578	$ 1,175	$ 37,814	$ 38,989
Commercial	-	-	75	75	15,999	16,074
Construction and land	-	-	-	-	7,127	7,127
Consumer	-	-	-	-	206	206
Residential real estate	-	-	-	-	19,630	19,630
	$ -	$ 597	$ 653	$ 1,250	$ 80,776	$ 82,026

Additionally, the Bank categorizes loans as performing or nonperforming based on payment activity. Loans that are more than 90 days past due and nonaccrual loans are considered nonperforming.

The following table presents the recorded investment in nonaccrual loans at December 31:

	2020	2019
Commercial real estate	$ -	$ 578
Commercial	-	75
	$ -	$ 653

There were no loans 90 days or more past due and still accruing interest at December 31, 2020 or 2019.

Credit quality indicator – Federal regulations provide for the classification of lower quality loans and other assets, such as debt and equity securities, as substandard, doubtful, or loss. An asset is considered substandard if it is inadequately protected by the current net worth and pay capacity of the borrower or of any collateral pledged. Substandard assets include those characterized by the distinct possibility that the Bank will sustain some loss if the deficiencies are not corrected. Assets classified as doubtful have all the weaknesses inherent in those classified substandard, with the added characteristic that the weaknesses present make collection or liquidation in full highly questionable and improbable on the basis of currently existing facts, conditions, and values. Assets classified as loss are those considered uncollectible and of such little value that their continuance as assets without the establishment of a specific loss reserve is not warranted.

Notes to Consolidated Financial Statements (dollars in thousands)

Note 3 – Loans and Allowance for Credit Losses (continued)

When the Bank classifies problem assets as either substandard or doubtful, it may establish a specific allowance to address the risk specifically or the Bank may allow the loss to be addressed in the general allowance. General allowances represent loss allowances that have been established to recognize the inherent risk associated with lending activities, but, unlike specific allowances, have not been specifically allocated to particular problem assets. When an insured institution classifies problem assets as a loss, it is required to charge off such assets in the period in which they are deemed uncollectible. Assets that do not currently expose the Bank to sufficient risk to warrant classification as substandard or doubtful but possess identified weaknesses are designated as either watch or special mention assets. At December 31, 2020, the Bank had no loans classified as doubtful or loss.

The following tables represent the credit risk profile by internally assigned grade and performing status as of December 31, 2020 and 2019, by class of loans:

Credit Risk Profile by Internally Assigned Grade

2020	Commercial Real Estate	Commercial	Construction and Land	Consumer	Residential Real Estate	Total
Grade						
Pass	$ 34,304	$ 43,359	$ 4,168	$ 4,560	$ 32,926	$ 119,317
Watch	3,800	1,750		29	97	5,676
Special mention	-	-	-	-	410	410
Substandard	-	-	-	-	-	-
Doubtful	-	-	-	-	-	-
	$ 38,104	$ 45,109	$ 4,168	$ 4,589	$ 33,433	$ 125,403
2019						
Grade						
Pass	$ 34,170	$ 15,786	$ 6,599	$ 172	$ 19,630	$ 76,357
Watch	3,054	213		34	-	3,301
Special mention	-	-	-	-	-	-
Substandard	1,765	75	528	-	-	2,368
Doubtful	-	-	-	-	-	-
	$ 38,989	$ 16,074	$ 7,127	$ 206	$ 19,630	$ 82,026

There were no loans modified by the Bank as troubled debt restructurings at December 31, 2020 and 2019, or modified during the years then ended.

Notes to Consolidated Financial Statements (dollars in thousands)

Note 4 – Premises and Equipment

Bank land, leaseholds, and equipment at December 31 are classified as follows:

	2020	2019
Land	$ 673	$ 132
Building	-	1,292
Leasehold improvements	769	713
Furniture, fixtures, and office equipment	723	620
Vehicles	23	23
Construction in progress	268	8
	2,456	2,788
Less accumulated depreciation and amortization	(1,251)	(1,278)
	$ 1,205	$ 1,510

The Bank leases its main office in Poulsbo, Washington, at standard market rates. The Bank renewed its original lease for its main office location in 2018 for an additional three-year term ending in 2021. There are no more renewal options remaining in the original lease contract. The lease requires the Bank to pay its pro rata share of building operating expenses. During the year, the Bank purchased a piece of land adjacent to the main office for the purpose of building a new headquarters. Additionally, the Bank executed a sublease agreement in Bellevue, Washington, effective November 2019 with terms extending through January 2022. The annual lease payments through both lease agreements outlined above are as follows:

2021	$ 274
2022	13
	$ 287

Rental expense, including operating expenses charged to operations, was $442 and $310 for the years ended December 31, 2020 and 2019, respectively.

During 2020, the Bank continued to lease a portion of the Port Orchard loan production office. The lease included an option by the tenant to purchase the building, which was exercised in June 2020. During the option term, a portion of lease payments per year were deferred from rental income and applied to the purchase price upon exercising the option. Total proceeds for the sale to the Bank was $1,201, and a gain on sale of $64 was recorded within other income on the consolidated statements of income.

Notes to Consolidated Financial Statements (dollars in thousands)

Note 5 – Deposits

Deposits as of December 31 consisted of the following:

	2020	2019
Savings accounts	$ 10,013	$ 8,054
Certificates of deposit	6,782	14,905
Demand accounts		
Noninterest-bearing	51,537	27,059
Interest-bearing	17,237	12,821
Money market accounts	40,117	41,478
	$ 125,686	$ 104,317

At December 31, scheduled maturities of certificates of deposit are as follows:

2021	$ 6,468
2022	311
2023	-
2024	-
2025	3
Total	$ 6,782

The Bank had $2,865 and $5,229 of certificates of deposit that met or exceeded the $250,000 federally insured limit at December 31, 2020 and 2019, respectively.

Note 6 – Credit Arrangements

At December 31, 2020, committed line-of-credit agreements totaling approximately $10.0 million were available to the Bank from unaffiliated banks, subject to interest at then-current rates. Such lines generally provide for interest at the lending bank's prime rate or other money market rates. These arrangements require total compensating balances of at least $485 maintained in a demand deposit account. The compensating balance is included in cash and cash equivalents at December 31, 2020.

The Bank also utilized the Federal Reserve Bank's Paycheck Protection Program Liquidity Facility (the PPPLF) to fund PPP loans during the year ended December 31, 2020. These advances had an interest rate of 0.35%. The Company has not obtained any other new borrowing lines or other new sources of liquidity other than the PPPLF program during the year ended December 31, 2020. The Company had $25,149 outstanding in PPPLF as of December 31, 2020, which mature in April 2022, and has pledged with loans as required by the terms of the PPPLF.

Notes to Consolidated Financial Statements (dollars in thousands)

Note 6 – Credit Arrangements (continued)

The Bank is a member of the FHLB of Des Moines, and as such, is eligible for a credit line up to 45% of total assets, subject to certain collateral requirements. At December 31, 2020, loans and investments pledged as collateral to the FHLB equated to a borrowing capacity of $35,393, when fully collateralized. Borrowings generally provide for interest at the then-current published rates and are subject to certain reserve rates. Borrowings must be secured by eligible investments held at the FHLB.

At December 31, 2020, the Bank had $6,000 of long-term advances outstanding with the FHLB with a weighted-average rate of 2.35%. Current borrowings are collateralized by pledged investment securities (Note 3) and loans (Note 4). The excess balance of all collateral can be used for additional borrowings.

The contractual maturities of long-term FHLB advances at December 31, 2020, are as follows:

2021	$ 2,000
2022	1,500
2023	1,000
2024	1,000
2025	500
	$ 6,000

Note 7 – Income Taxes

Income taxes consist of the following for the years ended December 31:

	2020	2019
Deferred	$ 137	$ 41
Current	-	-
Total tax expense	$ 137	$ 41

The following is a reconciliation between the statutory and the effective federal income tax rate for the years ended December 31:

	2020		2019	
	Amount	Percent of Pre-Tax Income	Amount	Percent of Pre-Tax Income
Income tax at statutory rates	$ 136	21%	$ 40	21%
Increase resulting from				
Permanent differences	1	0%	1	1%
Total income tax expense	$ 137	21%	$ 41	22%

Notes to Consolidated Financial Statements (dollars in thousands)

Note 7 – Income Taxes (continued)

The nature and components of the Bank's net deferred tax asset at December 31 are as follows:

	2020	2019
Deferred tax assets		
Net operating loss carryforward	$ 91	$ 410
Organization expenditures	65	84
Property and equipment depreciation	26	32
Unrealized loss on securities	-	27
Other, net	24	21
Cash basis method of accounting	45	-
Allowance for credit losses	224	155
Subtotal	475	729
Deferred tax liabilities		
Unrealized gain on securities	18	-
Cash basis method of accounting	-	82
Deferred costs	18	26
Subtotal	36	108
Net deferred tax asset	$ 439	$ 621

A valuation allowance is required for deferred tax assets if, based on available evidence, it is more-likely-than-not that all or some portion of the asset will not be realized due to the inability to generate sufficient taxable income to use the benefit of the deferred tax asset. After evaluating the positive and negative evidence associated with the deferred tax asset, including the consideration of the Bank's earnings history over the recent three-year period, and projections, the Bank determined that the deferred tax asset could be supported at December 31, 2020 and 2019.

On March 27, 2020, CARES Act was enacted in response to the COVID-19 pandemic. The CARES Act, among other things, permits NOL carryovers and carrybacks to offset 100% of taxable income for taxable years beginning before 2021. In addition, the CARES Act allows NOLs incurred in 2018, 2019, and 2020 to be carried back to each of the five preceding taxable years to generate a refund of previously paid income taxes. The Company has evaluated the impact of the CARES Act and determined that none of the changes would result in a material income tax benefit to the Company.

On December 27, 2020, the Consolidated Appropriations Act, 2021 was signed into law and extends several provisions of the CARES Act. As of December 31, 2020, the Company has determined that neither this Act nor changes to income tax laws or regulations in other jurisdictions have a significant impact on our effective tax rate.

At December 31, 2020, the Bank has, for tax reporting purposes, a net operating loss carryforward totaling approximately $430, eligible to offset future federal income taxes. The net operating loss carryforward will begin to expire in 2032.

Note 7 – Income Taxes (continued)

At December 31, 2020, the Bank had unamortized preopening expenditures of approximately $308 (for tax reporting purposes) that can be used to offset future federal income taxes. These expenditures are amortizing over 15 years on the straight-line basis at a rate of approximately $91 per year.

The Bank files income tax returns in the U.S. federal jurisdiction. In general, the Bank is no longer subject to U.S. federal income tax examinations by tax authorities for the years before 2017.

Note 8 – Employee Benefit Plans

The Bank has a 401(k) defined contribution plan for those employees who meet the eligibility requirements. Individuals who are 21 years of age and have completed three consecutive months of service are considered eligible to participate. Eligible employees can contribute up to an amount or percentage of compensation not to exceed certain limits based on federal tax laws. In addition, the Bank has elected discretionary contributions under the 401(k) plan. Contributions vest at 20% per year after the first year and will be fully vested after six years of service. There were no discretionary contributions for the years ended December 31, 2020 and 2019.

Note 9 – Stock-Based Compensation

The Bank has an equity incentive plan (the Plan). The Plan provides for up to a maximum of 235,000 shares of authorized common stock; of this amount, no more than 100,000 shares may be granted as restricted stock. During the year ended December 31, 2019, the Plan expired. In 2020, shareholders approved the Liberty Bank 2020 Equity Incentive plan (the 2020 Plan), which permits the grant of incentive stock options, nonqualified stock options, and restricted stock awards to certain key employees and directors, at the discretion of the Board Governance Committee of the Bank. The 2020 Plan authorizes the Bank to grant up to 48,610 shares of common stock, subject to change through an annual review by the Board, provided the total number of shares available for issuance under the 2020 Plan do not exceed 650,000. As of December 31, 2020, the number of shares available to grant was 48,610. The 2020 Plan limits the grant of restricted shares to 45% of the authorized shares. The Bank believes that such awards better align the interests of its employees with those of its shareholders. Restricted stock is granted at the fair value on date of grant, and option awards are generally granted with an exercise price equal to or greater than the market price of the Bank’s stock at the date of grant; those option awards generally vest and become exercisable in incremental percentages over five years of continuous service from the grant date and expire after ten years.

There were no equity awards granted in 2020 or 2019.

Notes to Consolidated Financial Statements (dollars in thousands)

Note 9 – Stock-Based Compensation (continued)

A summary of stock option transactions is presented below:

	Granted Options for Common Stock	Weighted-Average Exercise Price of Shares Under Plan	Weighted-Average Remaining Contractual Term
Outstanding at December 31, 2019	$ 167,752	$ 6.24	4.99
Granted	-	-	-
Exercised	-	-	-
Cancelled	-	-	-
Forfeited	(15,000)	5.80	-
Outstanding at December 31, 2020	$ 152,752	$ 6.28	4.04
Options exercisable at December 31, 2020	$ 152,752	$ 6.28	4.04

Restricted stock grants –A summary of nonvested restricted stock grants activity is presented below:

	Shares	Weighted-Average Grant-Date Fair Value
Nonvested at December 31, 2019	24,000	$ 6.00
Granted	-	-
Vested	(6,000)	6.00
Forfeited	-	-
Nonvested at December 31, 2020	18,000	$ 6.28

At December 31, 2020, there was approximately $98 of total unrecognized compensation cost related to share-based compensation arrangements. The cost is expected to be recognized over a period of approximately three years.

Note 10 – Shareholders' Equity

Warrants – The Bank had warrants outstanding to purchase 172,000 shares of the Bank's common stock at $10 per share, which were issued in connection with the Bank's initial offering. The warrants expired June 5, 2019.

Notes to Consolidated Financial Statements (dollars in thousands)

Note 10 – Shareholders' Equity (continued)

Regulatory capital – The Bank is subject to various regulatory capital requirements administered by the federal banking agencies. Failure to meet minimum capital requirements can initiate certain mandatory and possibly additional discretionary actions by regulators that, if undertaken, could have a direct material effect on the Bank's consolidated financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Bank must meet specific capital guidelines that involve quantitative measures of the Bank's assets, liabilities, and certain off-balance-sheet items as calculated under regulatory accounting practices. The Bank's capital amounts and classifications are also subject to qualitative judgments by the regulators about components, risk weightings, and other factors. During 2020, with the passage of the CARES Act, federal banking agencies passed an interim rule to assign a zero percent risk weighting to PPP loans that remained in effect as of December 31, 2020.

Quantitative measures established by regulation to ensure capital adequacy require the Bank to maintain minimum amounts and ratios (set forth in the following table) of total, Common equity Tier 1, and Tier 1 capital (as defined in the regulations) to risk-weighted assets (as defined), and of Tier 1 capital (as defined) to average assets (as defined). Management believes, as of December 31, 2020 and 2019, that the Bank meets all capital adequacy requirements to which it is subject.

As of December 31, 2020, the most recent notification from the FDIC categorized the Bank 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, Common equity Tier 1, and Tier 1 leverage ratios as set forth in the following table. There are no conditions or events since the notification that management believes have changed the Bank's category.

The Bank's actual capital amounts and ratios as of December 31 are also presented in the table:

	Actual		For Capital Adequacy Purposes		For Capital Adequacy with Capital Buffer		To Be Well Capitalized Under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio	Amount	Ratio
As of December 31, 2020								
Total capital								
(to risk-weighted assets)	$ 12,801	15.47%	$ 6,667	8.00%	$ 8,751	10.50%	$ 8,334	10.00%
Tier 1 capital								
(to risk-weighted assets)	11,766	14.22%	5,000	6.00%	7,084	8.50%	6,667	8.00%
Common equity Tier 1 capital								
(to risk-weighted assets)	11,766	14.22%	3,750	4.50%	5,834	7.00%	5,417	6.50%
Tier 1 capital								
(to average assets)	11,766	8.20%	5,738	4.00%	N/A		7,172	5.00%
As of December 31, 2019								
Total capital								
(to risk-weighted assets)	$ 11,866	15.67%	$ 6,058	8.00%	$ 7,951	10.50%	$ 7,572	10.00%
Tier 1 capital								
(to risk-weighted assets)	11,070	14.62%	4,543	6.00%	6,436	8.50%	6,058	8.00%
Common equity Tier 1 capital								
(to risk-weighted assets)	11,070	14.62%	3,407	4.50%	5,300	7.00%	4,922	6.50%
Tier 1 capital								
(to average assets)	11,070	9.36%	4,733	4.00%	N/A		5,916	5.00%

Notes to Consolidated Financial Statements (dollars in thousands)

Note 10 – Shareholders' Equity (continued)

Banking regulations limit the transfer of assets in the form of dividends from the Bank to its shareholders. Dividends may also be subject to approval by regulators depending upon the financial condition of the Bank.

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

Note 11 – Related-Party Transactions

Certain directors, executive officers, and principal shareholders are Bank customers and have had banking transactions with the Bank. All loans and commitments included in such transactions were made in compliance with applicable laws on substantially the same terms (including interest rates and collateral) as those prevailing at the time for comparable transactions with other persons and do not involve more than the normal risk of collectibility or present any other unfavorable features.

The activity of related-party loans through December 31 is as follows:

	2020	2019
Balance, beginning of year	$ 1,515	$ 3,252
New loans	-	-
Repayments	(323)	(1,737)
Balance, end of year	$ 1,192	$ 1,515

There were $3,127 and $2,066 of related party deposits at December 31, 2020 and 2019, respectively.

Note 12 – Commitments and Contingencies

The Bank is a party to financial instruments with off-balance-sheet risk in the normal course of business to meet the financing needs of its customers and to reduce its own exposure to fluctuations in interest rates. These financial instruments include commitments to extend credit, standby letters of credit, and financial guarantees. These instruments involve, to varying degrees, elements of credit and interest rate risk in excess of the amount recognized in the balance sheets. The contract or notional amounts of these instruments reflect the extent of the Bank's involvement in particular classes of financial instruments.

Notes to Consolidated Financial Statements (dollars in thousands)

Note 12 – Commitments and Contingencies (continued)

The Bank's exposure to credit loss in the event of nonperformance by the other party to the financial instrument for commitments to extend credit, standby letters of credit, and financial guarantees written is represented by the contractual notional amount of these instruments. The Bank uses the same credit policies in making commitments and conditional obligations as it does for on-balance-sheet instruments.

Commitments to extend credit, standby letters of credit, and financial guarantees – Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Because many of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. The Bank evaluates customers' creditworthiness on a case-by-case basis. The amount of collateral obtained, if it is deemed necessary by the Bank upon extension of credit, is based on management's credit evaluation of the counterparty. Collateral held varies but may include accounts receivable, inventory, property, plant, and equipment, income-producing commercial properties, and other real estate.

Standby letters of credit and financial guarantees written are conditional commitments issued by the Bank to guarantee the performance of a customer to a third party. Those guarantees are primarily issued to support public and private borrowing arrangements, including commercial paper, bond financing, and similar transactions. The credit risk involved in issuing letters of credit and financial guarantees is essentially the same as that involved in extending loan facilities to customers. The Bank maintains various levels of collateral supporting those commitments for which collateral is deemed necessary.

The Bank has not been required to perform on any financial guarantees. The Bank has not incurred any losses on its commitments in 2020 or 2019.

A summary of the notional amounts of the Bank's financial instruments with off-balance-sheet risk at December 31 follows:

	2020	2019
Commitments to extend credit		
Real estate secured	$ 7,481	$ 7,630
Commercial real estate, construction, and land development	3,487	2,964
Commercial loans	5,418	4,362
Other	411	351
Total commitments to extend credit	$ 16,797	$ 15,307

Contingencies – At periodic intervals, the state of Washington and the FDIC routinely examine the Bank's consolidated financial statements as part of their legally prescribed oversight of the banking system. Based on these examinations, the regulators can direct that the Bank's consolidated financial statements be adjusted in accordance with their findings.

Note 12 – Commitments and Contingencies (continued)

Various legal claims also arise from time to time in the normal course of business that, in the opinion of management, will have no material effect on the Bank's consolidated financial statements.

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

Note 13 – Fair Value Measurements

Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants on the measurement date. The accounting guidance establishes a consistent framework for measuring fair value and expands disclosure requirements about fair value measurements. In determining fair value, the Bank maximizes the use of observable inputs and minimizes the use of unobservable inputs.

Observable inputs are those assumptions that market participants would use in pricing the particular asset or liability. These inputs are based on market data and are obtained from a source independent of the Bank.

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

There is a three-level valuation hierarchy for determining fair value that is based on the transparency of the inputs used in the valuation process. The inputs used in determining fair value in each of the three levels of the hierarchy are as follows:

Level 1 – Quoted prices (unadjusted) in active markets for identical assets or liabilities.

Level 2 – Either (i) quoted prices for similar assets or liabilities; (ii) observable inputs, such as interest rates or yield curves; or (iii) inputs derived principally from or corroborated by observable market data.

Level 3 – Unobservable inputs.

The hierarchy gives the highest ranking to Level 1 inputs and the lowest ranking to Level 3 inputs. The level in the fair value hierarchy within which the fair value measurement in its entirety falls is determined based on the lowest level input that is significant to the overall fair value measurement.

There were no transfers between levels during the years ended December 31, 2020 and 2019.

Notes to Consolidated Financial Statements (dollars in thousands)

Note 13 – Fair Value Measurements (continued)

Qualitative disclosures of valuation techniques

Securities available-for-sale – Where quoted prices are available in an active market, securities are classified as Level 1. Level 1 instruments include highly liquid government bonds, securities issued by the U.S. Treasury, and exchange-traded equity securities. If quoted prices are not available, management determines fair value using pricing models, quoted prices of similar securities, or discounted cash flows. Such instruments are classified as Level 2. In certain cases, where there is limited activity in the market for particular instruments, assumptions must be made to determine their fair value. Such instruments are classified as Level 3.

Assets and liabilities measured at fair value on a recurring basis – Assets and liabilities are considered to be fair valued on a recurring basis if fair value is measured regularly (i.e., daily, weekly, monthly, or quarterly).

The following table presents the Bank's assets measured at fair value on a recurring basis as of December 31, 2020 and 2019.

	Level 1	Level 2	Level 3	Total
2020				
Mortgage-backed securities	$ -	$ 1,954	$ -	$ 1,954
Collateralized mortgage obligation securities	-	4,384	-	4,384
Total	$ -	$ 6,338	$ -	$ 6,338
2019				
Mortgage-backed securities	$ -	$ 9,385	$ -	$ 9,385
Total	$ -	$ 9,385	$ -	$ 9,385

Assets measured at fair value on a nonrecurring basis – Assets are considered to be fair valued on a nonrecurring basis if the fair value measurement of the instrument does not necessarily result in a change in the amount recorded on the balance sheets. Generally, nonrecurring valuation is the result of the application of other accounting pronouncements that require assets or liabilities to be assessed for impairment or recorded at the lower of cost or fair value.

The following table presents the Bank's assets measured at fair value on a nonrecurring basis as of December 31, 2019. There were no assets measured at fair value on a nonrecurring basis as of December 31, 2020.

December 31, 2019	Level 1	Level 2	Level 3	Total
Impaired loans	$ -	$ -	$ 2,468	$ 2,468

Note 13 – Fair Value Measurements (continued)

Valuations of impaired loans are periodically performed by management, and the fair value of the loans is carried at the fair value of the underlying collateral less cost to foreclose, sell, and carry the collateral. Fair value of the underlying collateral is determined by an appraisal performed by a qualified independent appraiser.

Quantitative information about Level 3 fair value measurements – The range and weighted average of the significant unobservable inputs used to fair value Level 3 nonrecurring assets during the year ending December 31, 2019 is in the below table.

	Fair Value at December 31, 2019	Valuation Technique	Unobservable Input	Range [1]
Impaired loans	$ 2,468	Real estate appraisal	Discount to appraisal	0% - 10%

[1] Discount for selling costs.

Fair value estimates are subjective in nature and involve uncertainties and matters of significant judgment; therefore, they are not necessarily indicative of the amounts the Bank could realize in a current market exchange. The Bank has not included certain material items in its disclosure, such as the value of the long-term relationships with the Bank's lending and deposit clients, because this is an intangible and not a financial instrument. Additionally, the estimates do not include any tax ramifications. There may be inherent weaknesses in any calculation technique and changes in the underlying assumptions used, including discount rates and estimates of future cash flows that could materially affect the results. For all these reasons, the aggregation of the fair value calculations presented herein do not represent, and should not be construed to represent, the underlying value of the Bank.

MOSSADAMS