Report of Independent Auditors
and Consolidated Financial Statements

Liberty Northwest Bancorp, Inc.

December 31, 2022 and 2021

MOSSADAMS

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Report of Independent Auditors

The Board of Directors and Shareholders of
Liberty Northwest Bancorp, Inc. and Subsidiary

Report on the Audit of the Financial Statements

Opinion

We have audited the consolidated financial statements of Liberty Northwest Bancorp, Inc., and Subsidiary, which comprise the consolidated balance sheets as of December 31, 2022 and 2021, and the related consolidated 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.

In our opinion, the accompanying consolidated financial statements present fairly, in all material respects, the financial position of Liberty Northwest Bancorp, Inc., and Subsidiary as of December 31, 2022 and 2021, and the results of their operations and their cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Basis for Opinion

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

Responsibilities of Management for the Financial Statements

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

In preparing the financial statements, management is required to evaluate whether there are conditions or events, considered in the aggregate, that raise substantial doubt about Liberty Northwest Bancorp, Inc., and Subsidiary's ability to continue as a going concern within one year after the date that the financial statements are issued.

Auditor's Responsibilities for the Audit of the Financial Statements

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

In performing an audit in accordance with GAAS, we:

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

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

Moss Adams LLP

Everett, Washington
March 20, 2023

Consolidated Financial Statements

Liberty Northwest Bancorp, Inc.
Consolidated Balance Sheets
(dollars in thousands, except share data)
December 31, 2022 and 2021

	2022	2021
ASSETS		
CASH AND CASH EQUIVALENTS		
Cash and due from banks	$ 2,844	$ 2,969
Overnight funds	11,040	21,645
Total cash and cash equivalents	13,884	24,614
INTEREST-BEARING DEPOSITS WITH OTHER FINANCIAL INSTITUTIONS	440	999
INVESTMENT SECURITIES AVAILABLE-FOR-SALE, at fair value	8,932	8,976
INVESTMENT SECURITIES HELD-TO-MATURITY, at amortized cost	14,750	16,832
FEDERAL HOME LOAN BANK STOCK, at cost	1,540	364
LOANS	146,185	120,647
Less allowance for credit losses	1,235	1,525
Total loans, net	144,950	119,122
PREMISES AND EQUIPMENT, net	6,531	2,825
ACCRUED INTEREST RECEIVABLE	699	507
OTHER ASSETS	1,290	871
Total assets	$ 193,016	$ 175,110
LIABILITIES AND STOCKHOLDERS' EQUITY		
DEPOSITS		
Noninterest-bearing	$ 46,152	$ 51,481
Interest-bearing	95,616	99,759
Total deposits	141,768	151,240
BORROWED FUNDS	38,149	10,955
ACCRUED INTEREST PAYABLE	165	73
OTHER LIABILITIES	595	410
Total liabilities	180,677	162,678
STOCKHOLDERS' EQUITY		
Common stock, $1 par value, 50,000,000 shares authorized, 1,669,009 shares issued and outstanding at December 31, 2022, and 1,637,724 issued and outstanding at December 31, 2021	1,633	1,626
Additional paid-in capital	13,019	12,984
Accumulated deficit	(1,528)	(2,067)
Accumulated other comprehensive income (loss)	(785)	(111)
Total stockholders' equity	12,339	12,432
Total liabilities and shareholders' equity	$ 193,016	$ 175,110

See accompanying notes.

Liberty Northwest Bancorp, Inc.
Consolidated Statements of Income
(dollars in thousands, except share data)
Years Ended December 31, 2022 and 2021

	2022	2021
INTEREST AND FEE INCOME		
Loans, including fees	$ 6,128	$ 6,421
Investment securities	386	229
Interest-bearing deposits with other financial institutions and overnight funds	68	27
Total interest and fee income	6,582	6,677
INTEREST EXPENSE		
Deposits	477	201
Borrowed funds	547	386
Total interest expense	1,024	587
NET INTEREST INCOME	5,558	6,090
PROVISION FOR CREDIT LOSSES	190	400
NET INTEREST INCOME AFTER PROVISION FOR CREDIT LOSSES	5,368	5,690
NONINTEREST INCOME		
Service charges on deposits	65	52
Debit and credit card interchange income, net	61	58
Other income	67	205
Total noninterest income	193	315
NONINTEREST EXPENSE		
Salaries and employee benefits	2,773	3,693
Occupancy and equipment	582	598
Data processing	507	488
Advertising and business development	54	50
Professional and regulatory	354	342
Other expenses	609	555
Total noninterest expense	4,879	5,726
NET INCOME BEFORE PROVISION FOR INCOME TAXES	682	279
PROVISION FOR INCOME TAXES	143	60
NET INCOME	$ 539	$ 219

See accompanying notes.

Liberty Northwest Bancorp, Inc.
Consolidated Statements of Comprehensive (Loss) Income
(dollars in thousands, except share data)
Years Ended December 31, 2022 and 2021

	2022	2021
NET INCOME	$ 539	$ 219
Other comprehensive loss		
Unrealized loss on securities available-for-sale		
Unrealized holding gain (loss) on securities available-for-sale	(884)	(64)
Income tax benefit on unrealized holding changes	186	13
Unrealized holding loss on securities available-for-sale transferred to held-to-maturity	-	(128)
Amortization of net unrealized holding gain from securities transferred to held-to-maturity	24	-
Other comprehensive loss, net	(674)	(179)
COMPREHENSIVE (LOSS) INCOME	$ (135)	$ 40

See accompanying notes.

Liberty Northwest Bancorp, Inc.
Consolidated Statements of Changes in Stockholders' Equity
(dollars in thousands, except share data)
Years Ended December 31, 2022 and 2021

	Common Stock		Additional Paid-in	Accumulated	Accumulated Other Comprehensive	Total Shareholders'
	Shares	Amount	Capital	Deficit	Income (Loss)	Equity
BALANCE, December 31, 2020	1,619,419	$ 1,601	$ 12,853	$ (2,286)	$ 68	$ 12,236
Net income	-	-	-	219	-	219
Shares issued	18,305	19	101	-	-	120
Vesting of restricted stock	-	6	(6)	-	-	-
Other comprehensive loss, net	-	-	-	-	(179)	(179)
Stock-based compensation	-	-	36	-	-	36
BALANCE, December 31, 2021	1,637,724	1,626	12,984	(2,067)	(111)	12,432
Net income	-	-	-	539	-	539
Cashless exercise of options	1,285	1	(1)	-	-	-
Vesting of restricted stock	-	6	(6)	-	-	-
Issuance of restricted stock	30,000	-	-	-	-	-
Other comprehensive loss, net	-	-	-	-	(674)	(674)
Stock-based compensation	-	-	42	-	-	42
BALANCE, December 31, 2022	1,669,009	$ 1,633	$ 13,019	$ (1,528)	$ (785)	$ 12,339

See accompanying notes.

Liberty Northwest Bancorp, Inc.
Consolidated Statements of Cash Flows
(dollars in thousands, except share data)
Years Ended December 31, 2022 and 2021

	2022	2021
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income	$ 539	$ 219
Adjustments to reconcile net income to net cash from operating activities		
Provision for credit losses	190	400
Depreciation and amortization	198	119
Deferred expense for income taxes	112	60
Net amortization of investment security premium and discount	77	104
Amortization of subdebt issuance costs	31	-
Stock-based compensation	42	36
Changes in operating assets and liabilities		
Accrued interest receivable	(192)	141
Other assets	65	(7)
Accrued interest payable	92	11
Other liabilities	(225)	(646)
Net cash provided by operating activities	929	437
CASH FLOWS FROM INVESTING ACTIVITIES		
Net change in interest-bearing deposits with other financial institutions	559	(980)
Activity in securities available-for-sale		
Maturities, repayments, and calls	1,206	3,015
Purchases	(2,069)	(12,504)
Activity in securities held-to-maturity		
Maturities, repayments, and calls	2,052	983
Purchases	-	(8,128)
(Purchase) Redemption of Federal Home Loan Bank stock	(1,176)	30
Loan originations and payments, net	(26,018)	4,221
Purchase of premises and equipment	(3,904)	(1,739)
Net cash used in investing activities	(29,350)	(15,102)
CASH FLOWS FROM FINANCING ACTIVITIES		
Net increase in deposits	(9,472)	25,554
Repayment of Paycheck Protection Program Liquidity Facility	(2,087)	(23,062)
Proceeds from advances from the Federal Home Loan Bank	29,250	-
Repayments of advances from the Federal Home Loan Bank	-	(2,000)
Proceeds from stock issuance	-	120
Issuance of subordinated notes	-	4,868
Net cash provided by financing activities	17,691	5,480
NET CHANGE IN CASH AND CASH EQUIVALENTS	(10,730)	(9,185)
CASH AND CASH EQUIVALENTS, beginning of year	24,614	33,799
CASH AND CASH EQUIVALENTS, end of year	$ 13,884	$ 24,614
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION		
Cash paid during the year for income taxes	$ 136	$ -
Cash paid during the year for interest	$ 907	$ 999
SUPPLEMENTAL DISCLOSURE OF NONCASH ITEMS		
Initial recognition of right-of-use asset	$ 410	$ -
Initial recognition of lease liability	$ 410	$ -
Unrealized loss on securities available-for-sale	$ (884)	$ (64)
Transfer of securities available-for-sale to held-to-maturity	$ -	$ 6,581

See accompanying notes.

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, and 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. Unrecognized 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 20, 2023, the date the consolidated financial statements were available to be issued.

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, 2022 or 2021.

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 (loss) 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 (loss) income. Impairment losses related to all other factors are presented as separate categories within other comprehensive (loss) income.

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, 2022 or 2021.

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.

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.

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.

Leases – On January 1, 2020, the Bank adopted FASB ASU No. 2016-02, *Leases* (Topic 842), as amended. Topic 842 requires lessees to recognize on the balance sheet the assets and liabilities arising from operating leases. A lessee should recognize a liability to make lease payments and a right-of-use (ROU) asset representing its right to use the underlying asset for the lease term. A lessee should include payments to be made in an optional period only if the lessee is reasonably certain to exercise an option to extend the lease or not to exercise an option to terminate the lease. For operating leases, the lease cost should be allocated over the lease term on a generally straight-line basis.

The Bank adopted the standard using the modified retrospective transition approach with no effect on consolidated retained earnings. The new standard provides for a number of practical expedients in transition. The Bank elected the package of practical expedients, which permits the Bank to not reassess under the new standard prior conclusions about lease identification, lease classification, and initial direct costs. The Bank also elected the use-of-hindsight and elected the practical expedient to not separate lease and nonlease components on real estate leases where the Bank is the lessee. The Bank did not elect the practical expedient pertaining to land easement as it is not applicable. The Bank has elected the short-term lease recognition exemption for certain leases which are less than 12 months in duration or month-to month. This means, for those leases that qualify, ROU assets or lease liabilities will not be recognized. The adoption of Topic 842 on January 1, 2022, created ROU assets of $410 and operating lease liabilities of $410. Refer to Note 5 – Leases for further discussion.

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.

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.

The Company recognizes the tax benefit from an uncertain tax position only if it is more likely than not that the tax position will be sustained on examination by the tax authorities, based on the technical merits of the position. The tax benefit is measured based on the largest benefit that has a greater than 50% likelihood of being realized upon ultimate settlement. The Company does not have any uncertain tax positions as of December 31, 2022 and 2021. The Company's policy is to recognize tax related interest and penalties in income tax expense.

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 $8 and $9 in 2022 and 2021, respectively.

Comprehensive (loss) 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, 2022 and 2021, are included within the statements of consolidated comprehensive (loss) 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.

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.

(dollars in thousands, except share data)

Note 2 – Investments

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

December 31, 2022	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Available-for-sale				
U.S. treasuries	$ 2,988	$ -	$ (293)	$ 2,695
Mortgage-backed securities	6,806	9	(578)	6,237
Total	$ 9,794	$ 9	$ (871)	$ 8,932
Held-to-maturity				
Mortgage-backed securities	$ 5,128	$ -	$ (783)	$ 4,345
Collateralized mortgage obligation securities	8,365	-	(1,227)	7,138
Municipal bonds	1,257	-	(367)	890
Total	$ 14,750	$ -	$ (2,377)	$ 12,373
December 31, 2021				
Available-for-sale				
U.S. treasuries	$ 2,485	$ -	$ (22)	$ 2,463
Mortgage-backed securities	6,469	61	(17)	6,513
Total	$ 8,954	$ 61	$ (39)	$ 8,976
Held-to-maturity				
Mortgage-backed securities	$ 5,816	$ 22	$ (9)	$ 5,829
Collateralized mortgage obligation securities	9,757	14	(55)	9,716
Municipal bonds	1,259	-	(69)	1,190
Total	$ 16,832	$ 36	$ (133)	$ 16,735

The amortized cost and estimated fair value of investment securities at December 31, 2022, 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	$ 2,610	$ 2,377	$ -	$ -
Due after 5 to 10 years	3,364	2,984	627	501
Due after 10 years	3,820	3,571	14,123	11,872
	$ 9,794	$ 8,932	$ 14,750	$ 12,373

(dollars in thousands, except share data)

As of December 31, 2022, securities with a carrying value of $20,925 were pledged to secure borrowings at the FHLB and securities with a carrying value of $3,844 were pledged to secure public deposits. As of December 31, 2021, securities with a carrying value of $4,104 were pledged to secure borrowings at the FHLB and securities with a carrying value of $907 were pledged to secure public deposits.

During the years ended December 31, 2022 and 2021, the Bank did not sell any investment securities.

At December 31, 2022 and 2021, respectively, the total portfolio had 50 and 24 securities were in an unrealized loss position, with 32 and zero in a loss position of more than 12 months. 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, 2022	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Total Unrealized Losses
Securities available-for-sale					
U.S. treasuries	$ 9	$ 491	$ 284	$ 2,204	$ 293
Mortgage-backed securities	164	2,854	414	2,783	578
	$ 173	$ 3,345	$ 698	$ 4,987	$ 871
Held-to-maturity					
Mortgage-backed securities	$ -	$ -	$ 783	$ 4,345	$ 783
Collateralized mortgage obligation securities	-	-	1,227	7,138	1,227
Municipal bonds	-	-	367	890	367
	$ -	$ -	$ 2,377	$ 12,373	$ 2,377
December 31, 2021					
Securities available-for-sale					
U.S. treasuries	$ 22	$ 2,463	$ -	$ -	$ 22
Mortgage-backed securities	17	3,605	-	-	17
	$ 39	$ 6,068	$ -	$ -	$ 39
Held-to-maturity					
Mortgage-backed securities	$ 9	$ 1,888	$ -	$ -	$ 9
Collateralized mortgage obligation securities	55	2,803	-	-	55
Municipal bonds	69	1,190	-	-	69
	$ 133	$ 5,881	$ -	$ -	$ 133

(dollars in thousands, except share data)

During the fourth quarter of 2021, the Company transferred approximately $6,581 in securities from available-for-sale to held-to-maturity category. Transfers of debt securities into the held-to-maturity category from the available-for-sale category are made at fair value at the date of transfer. The unrealized holding gain or loss at the date of transfer is retained in other comprehensive (loss) income and in the carrying value of the held-to-maturity securities. At the time of the transfer, the transferred securities had an aggregate unrealized loss of approximately $128 which is to be amortized from accumulated other comprehensive income (loss) over the remaining life of the underlying securities as an adjustment to yield.

Note 3 – Loans and Allowance for Credit Losses

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

	2022	2021
Commercial real estate	$ 41,854	$ 43,429
Commercial	22,347	19,489
Construction and land	5,274	6,157
Consumer	9,002	6,617
Residential real estate	67,533	44,434
Gross loans	146,010	120,126
Deferred fees, net	(311)	(409)
Premiums on purchased loans, net	486	930
Allowance for credit losses	(1,235)	(1,525)
Total loans, net	$ 144,950	$ 119,122

The Bank pledged certain commercial and residential loans as collateral for purposes of borrowings with the FHLB. Loans totaling $62,886 and $44,409 were pledged to the FHLB at December 31, 2022 and 2021, respectively (Note 7).

(dollars in thousands, except share data)

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

2022	Beginning Balance	Provision (Recovery) for Credit Losses	Charge-offs	Recoveries	Ending Balance
Commercial real estate	$ 494	$ (29)	$ -	$ -	$ 465
Commercial	396	200	(480)	-	116
Construction and land	37	18	-	-	55
Consumer	124	(25)	-	-	99
Residential real estate	403	68	-	-	471
Unallocated	71	(42)	-	-	29
	$ 1,525	$ 190	$ (480)	$ -	$ 1,235
2021					
Commercial real estate	$ 507	$ (13)	$ -	$ -	$ 494
Commercial	105	291	-	-	396
Construction and land	12	25	-	-	37
Consumer	74	50	-	-	124
Residential real estate	395	8	-	-	403
Unallocated	32	39	-	-	71
	$ 1,125	$ 400	$ -	$ -	$ 1,525

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

2022	Recorded Investments (Loan Balance Less Charge-off)	Unpaid Principal Balance	Related Allowance	Average Investment in Impaired Loans	Interest Income Recognized
With an allowance recorded					
Commercial	$ -	$ -	$ -	$ 243	$ -
With no allowance recorded					
Residential real estate	661	661	-	682	-
	$ 661	$ 661	$ -	$ 925	$ -
2021					
With no allowance recorded					
Commercial	$ 485	$ 485	$ 300	$ -	$ -
With no allowance recorded					
Residential real estate	702	702	-	-	-
	$ 1,187	$ 1,187	$ 300	$ -	$ -

(dollars in thousands, except share data)

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		
2022	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	$ 465	$ -	$ 465	$ 41,854	$ -	$ 41,854
Commercial	116	-	116	22,347	-	22,347
Construction and land	55	-	55	5,274	-	5,274
Consumer	99	-	99	9,002	-	9,002
Residential real estate	471	-	471	67,533	661	66,872
Unallocated	29	-	29	-	-	-
	$ 1,235	$ -	$ 1,235	$ 146,010	$ 661	$ 145,349
2021						
Commercial real estate	$ 494	$ -	$ 494	$ 43,429	$ -	$ 43,429
Commercial	396	300	96	19,489	485	19,004
Construction and land	37	-	37	6,157	-	6,157
Consumer	124	-	124	6,617	-	6,617
Residential real estate	403	-	403	44,434	702	43,732
Unallocated	71	-	71	-	-	-
	$ 1,525	$ 300	$ 1,225	$ 120,126	$ 1,187	$ 118,939

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

2022	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	$ -	$ -	$ -	$ -	$ 41,854	$ 41,854
Commercial	-	-	-	-	22,347	22,347
Construction and land	-	-	-	-	5,274	5,274
Consumer	-	-	-	-	9,002	9,002
Residential real estate	383	-	-	383	67,150	67,533
	$ 383	$ -	$ -	$ 383	$ 145,627	$ 146,010
2021						
Commercial real estate	$ -	$ -	$ -	$ -	$ 43,429	$ 43,429
Commercial	-	-	-	-	19,489	19,489
Construction and land	-	-	-	-	6,157	6,157
Consumer	-	-	-	-	6,617	6,617
Residential real estate	-	-	-	-	44,434	44,434
	$ -	$ -	$ -	$ -	$ 120,126	$ 120,126

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.

(dollars in thousands, except share data)

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

	2022	2021
Commercial	$ -	$ 485
Residential real estate	661	702
	$ 661	$ 1,187

There were no loans 90 days or more past due and still accruing interest at December 31, 2022 or 2021.

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.

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, 2022 or 2021, the Bank had no loans classified as doubtful or loss.

(dollars in thousands, except share data)

The following tables represent the credit risk profile by internally assigned grade and performing status as of December 31, 2022 and 2021, by class of loans:

Credit Risk Profile by Internally Assigned Grade

2022	Commercial Real Estate	Commercial	Construction and Land	Consumer	Residential Real Estate	Total
Grade						
Pass	$ 39,847	$ 22,347	$ 5,274	$ 8,616	$ 66,156	$ 142,240
Watch	2,007	-	-	386	-	2,393
Special mention	-	-	-	-	-	-
Substandard	-	-	-	-	1,377	1,377
Doubtful	-	-	-	-	-	-
	$ 41,854	$ 22,347	$ 5,274	$ 9,002	$ 67,533	$ 146,010
2021						
Grade						
Pass	$ 41,352	$ 19,004	$ 6,157	$ 6,617	$ 41,427	$ 114,557
Watch	-	-	-	-	-	-
Special mention	2,077	-	-	-	2,305	4,382
Substandard	-	485	-	-	702	1,187
Doubtful	-	-	-	-	-	-
	$ 43,429	$ 19,489	$ 6,157	$ 6,617	$ 44,434	$ 120,126

There were no loans modified by the Bank as troubled debt restructurings at December 31, 2022 and 2021, or modified during the years then ended.

Note 4 – Premises and Equipment

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

	2022	2021
Land	$ 673	$ 673
Building	5,465	-
Leasehold improvements	56	769
Furniture, fixtures, and office equipment	769	584
Vehicles	32	23
Construction in progress	-	1,980
	6,995	4,029
Less accumulated depreciation and amortization	(464)	(1,204)
	$ 6,531	$ 2,825

(dollars in thousands, except share data)

Note 5 – Leases

The Bank leased its main office in Poulsbo, Washington, at standard market rates through July 2022, at which time it put in service a newly constructed building in Poulsbo to serve as its main office. The Bank executed a sublease agreement for a branch in Bellevue, Washington, effective November 2019 with terms extending through January 2022. During 2021, the Bank signed a long-term lease for the Bellevue branch, effective February 2022 through March 2024.

The components of lease cost (included in occupancy and equipment expense on the statements of income) are as follows for the year ended December 31:

	2022
Lease cost	
Minimum rent payments	$ 320
Other operating costs	2
	$ 322

The following table provides supplemental information related to operating leases for the purpose of the measurement of lease liabilities at or for the year ended December 31:

	2022
Operating cash flows from operating leases	$ 322
Weighted average remaining lease term (years)	1.25
Weighted average discount rate	1.48%

Lease expense under operating leases was $322 and $440 for the years ended December 31, 2022 and 2021, respectively. Minimum rental commitments under noncancelable leases having an original or remaining term of more than one year for future years ending December 31 are as follows:

2023	$ 194
2024	49
Total lease payments	243
Less imputed interest	(2)
Total	$ 241

The Bank's lease does not contain a discount rate implicit in the lease contract. As an alternative, the Bank uses the incremental borrowing rate commensurate with the lease term.

(dollars in thousands, except share data)

Note 6 – Deposits

Deposits as of December 31 consisted of the following:

	2022	2021
Savings accounts	$ 12,816	$ 13,514
Certificates of deposit	31,286	8,860
Demand accounts		
Noninterest-bearing	46,152	51,481
Interest-bearing	23,891	39,377
Money market accounts	27,623	38,008
	$ 141,768	$ 151,240

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

2023	$ 28,904
2024	2,051
2025	331
Total	$ 31,286

The Bank had $15,706 and $4,818 of certificates of deposit that met or exceeded the $250,000 federally insured limit at December 31, 2022 and 2021, respectively.

Note 7 – Credit Arrangements

Line of Credit

At December 31, 2022, committed line-of-credit agreements totaling approximately $10,000 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 combined compensating balances of at least $485 maintained in a demand deposit account. The compensating balance is included in cash and cash equivalents. There was no balance on line-of-credit agreements at December 31, 2022 and 2021.

Paycheck Protection Program Liquidity Facility

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 had $0 and $2,087 outstanding in PPPLF as of December 31, 2022 and 2021, respectively.

(dollars in thousands, except share data)

FHLB Borrowings

The Bank is a member of the FHLB of Des Moines and has a committed credit line to borrow funds under fixed-rate advance agreements and through overnight borrowings which renew daily until paid. The terms of the credit line call for pledging of certain investments held in safekeeping by the FHLB and a portion of the Bank's mortgage and commercial loan portfolio. The maximum borrowing line with the FHLB is calculated as a percentage of the market value of pledged collateral, depending on the collateral type. The total available credit line was $62,648 and $33,229 at December 31, 2022 and 2021, respectively. The market value of collateral pledged at December 31, 2022 and 2021, was approximately $78,754 and $44,516, respectively. As of December 31, 2022, the Bank had borrowings outstanding with the FHLB of $33,250, comprised of overnight funds of $14,750 at 4.60%, and term advances of $18,500. Term advances included fixed interest rates ranging from 1.77% and 4.48%, and a weighted average interest rate of 3.75%% as of December 31, 2022. At December 31, 2021, the Bank had $4,000 of long-term advances outstanding with the FHLB with fixed interest rates ranging from 1.77% and 3.10%, and a weighted-average rate of 2.47%.

The contractual maturities of long-term FHLB advances at December 31, 2022, are as follows:

2023	$ 15,000
2024	1,000
2025	500
2026	-
2027	2,000
	$ 18,500

Subordinated Notes

In March 2021, the Company issued four unsecured subordinated term notes (the Subordinated Notes) in the aggregate principal amount of $5,000 due April 1, 2031 (maturity date), pursuant to Subordinated Loan Agreements with various investors. The Subordinated Notes bear interest at an annual fixed interest rate of 5.50% until April 1, 2026, and floating from April 2, 2026, until maturity at the 90-day average secured overnight financing rate (SOFR) plus 5.00%, payable by the Company quarterly in arrears beginning January 1, April 1, July 1, and October 1 of each year. The notes are presented net of $101 in debt issuance costs on the consolidated balance sheets.

(dollars in thousands, except share data)

Note 8 – Income Taxes

Reconciliation of the provision for income tax expense based on the statutory income tax rate to actual income tax expense for the years ended December 31:

	2022		2021	
	Amount	Percent	Amount	Percent
Federal income tax at statutory rate	$ 143	21%	$ 59	21%
Equity compensation	5	1%	-	0%
Other	(5)	-1%	1	0%
	$ 143	21%	$ 60	21%

Provision for income tax expense consists of the following for the years ended December 31:

	2022	2021
Current	$ 31	$ -
Deferred	112	60
Total tax expense	$ 143	$ 60

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

	2022	2021
Deferred tax assets		
Net operating loss carryforward	$ -	$ 46
Organization expenditures	30	46
Property and equipment depreciation	89	49
Other, net	16	31
Unrealized loss on securities	181	-
Allowance for credit losses	235	308
Lease Liability	51	-
Subtotal	602	480
Deferred tax liabilities		
Unrealized gain on securities	-	5
Cash basis method of accounting	69	65
Deferred costs	18	18
Right-of-Use Asset	50	-
Subtotal	137	88
Net deferred tax asset	$ 465	$ 392

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, 2022 and 2021.

At December 31, 2022, the Bank has no net operating loss carryforward remaining.

At December 31, 2022, the Bank had unamortized preopening expenditures of approximately $21 (for tax reporting purposes) that can be used to offset future federal income taxes. These expenditures are being amortized over 15 years on the straight-line basis.

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 2019.

Note 9 – 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, 2022 and 2021.

Note 10 – 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 authorized the Bank to grant up to an initial 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, when added to awards currently outstanding, do not exceed the lesser of 15% of currently outstanding shares, or 650,000. As of December 31, 2022, the number of authorized shares available to grant was 6,399. 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.

(dollars in thousands, except share data)

The Bank granted options in 2022 and 2021. The fair value of each option award is estimated on the date of grant using the Black-Scholes-Merton valuation model that uses the assumptions noted in the following table. Expected volatilities are based on historical volatility of the Bank's stock and other factors. The expected term of options granted was evaluated by a calculation that factored in the contractual term and vesting period and considered different employee segments. The risk-free interest rate for periods within the contractual life of the option is based on the U.S. Treasury yield curve in effect at the time of grant.

	2022	2021
Assumptions		
Risk-free interest rate	1.96% - 3.56%	1.21%
Dividend yield rate	0.00%	0.00%
Expected volatility	11.28% - 13.31%	15.39%
Expected term (in years)	7.0	7.0

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, 2021	$ 159,752	$ 6.35	3.33
Granted	42,200	8.00	-
Exercised	(6,000)	5.50	-
Cancelled	-	-	-
Forfeited	-	-	-
Outstanding at December 31, 2022	$ 195,952	$ 6.73	3.96
Options exercisable at December 31, 2022	$ 148,152	$ 6.32	2.17

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, 2021	12,000	$ 6.00
Granted	30,000	6.78
Vested	(6,000)	6.00
Forfeited	-	-
Nonvested at December 31, 2022	36,000	$ 6.65

At December 31, 2022, there was approximately $226 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 11 – Regulatory Capital

Regulatory capital – The Company and 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 Company'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, 2022.

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, 2022 and 2021, that the Company and Bank meets all capital adequacy requirements to which it is subject.

As of December 31, 2022, 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 Company's consolidated assets are less than $1 billion at the beginning of the year, therefore consolidated ratios are not required to be disclosed.

(dollars in thousands, except share data)

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, 2022								
Total capital								
(to risk-weighted assets)	$ 18,329	14.63%	$ 10,021	8.00%	$ 13,153	10.50%	$ 12,527	10.00%
Tier 1 capital								
(to risk-weighted assets)	17,084	13.64%	7,516	6.00%	10,648	8.50%	10,021	8.00%
Common equity Tier 1 capital								
(to risk-weighted assets)	17,084	13.64%	5,637	4.50%	8,769	7.00%	8,142	6.50%
Tier 1 capital								
(to average assets)	17,084	9.37%	7,297	4.00%	N/A		9,121	5.00%
As of December 31, 2021								
Total capital								
(to risk-weighted assets)	$ 17,036	15.70%	$ 8,682	8.00%	$ 11,395	10.50%	$ 10,852	10.00%
Tier 1 capital								
(to risk-weighted assets)	15,678	14.45%	6,511	6.00%	9,224	8.50%	8,682	8.00%
Common equity Tier 1 capital								
(to risk-weighted assets)	15,678	14.45%	4,883	4.50%	7,596	7.00%	7,054	6.50%
Tier 1 capital								
(to average assets)	15,678	9.08%	6,908	4.00%	N/A		8,636	5.00%

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, 2022, that the Bank meets all capital adequacy requirements to which it is subject.

(dollars in thousands, except share data)

Note 12 – 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 collectability or present any other unfavorable features.

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

	2022	2021
Balance, beginning of year	$ 1,396	$ 1,192
New loans	112	500
Repayments	(915)	(296)
Balance, end of year	$ 593	$ 1,396

There were $2,538 and $4,001 of related-party deposits at December 31, 2022 and 2021, respectively.

Note 13 – 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.

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.

(dollars in thousands, except share data)

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 2022 or 2021.

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

	2022	2021
Commitments to extend credit		
Real estate secured	$ 8,518	$ 7,552
Commercial real estate, construction, and land development	2,688	5,490
Commercial loans	4,967	4,019
Other	294	251
Total commitments to extend credit	$ 16,467	$ 17,312

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.

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.

Note 14 – 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.

(dollars in thousands, except share data)

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, 2022 and 2021.

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, 2022 and 2021.

	Level 1	Level 2	Level 3	Total
2022				
U.S. treasuries	$ -	$ 2,695	$ -	$ 2,695
Mortgage-backed securities	-	6,237	-	6,237
Total	$ -	$ 8,932	$ -	$ 8,932
2021				
U.S. treasuries	$ -	$ 2,463	$ -	$ 2,463
Mortgage-backed securities	-	6,513	-	6,513
Total	$ -	$ 8,976	$ -	$ 8,976

(dollars in thousands, except share data)

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 and liabilities measured at fair value on a nonrecurring basis:

December 31, 2022	Level 1	Level 2	Level 3	Total
Impaired loans	$ -	$ -	$ 661	$ 661
December 31, 2021	Level 1	Level 2	Level 3	Total
Impaired loans	$ -	$ -	$ 1,187	$ 1,187

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 years ending December 31, 2022, is in the below table.

	Fair Value at December 31, 2022	Valuation Technique	Unobservable Input	Range
Impaired loans	$ 661	Appraisal	Discount to appraisal	0%-10% [1]

[1] Discount for selling costs.

	Fair Value at December 31, 2021	Valuation Technique	Unobservable Input	Range [1]
Impaired loans	$ 1,187	Real estate appraisal	Discount to appraisal	0% - 10%
		Accounts receivable cost	Liquidation discount	65%

[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.

(dollars in thousands, except share data)

Carrying amounts and estimated fair values of financial instruments, not previously presented, as of December 31 are as follows:

	Carrying Amount	Estimated Fair Value	Estimated Fair Value Level: Level 1	Level 2	Level 3
December 31, 2022					
Financial assets					
Securities available-for-sale	$ 8,932	$ 8,932	$ -	$ 8,932	$ -
Securities held-to-maturity	14,750	12,373	-	12,373	-
Loans receivable, net	144,950	133,021	-	-	133,021
Federal Home Loan Bank stock	1,540	1,540	1,540	-	-
Financial liabilities					
Time deposits	31,286	31,106	-	31,106	-
Borrowed Funds	38,149	38,827	-	38,827	-
December 31, 2021					
Financial assets					
Securities available-for-sale	$ 8,976	$ 8,976	$ -	$ 8,976	$ -
Securities held-to-maturity	16,832	16,735		16,735	
Loans receivable, net	119,122	116,968	-	-	116,968
Federal Home Loan Bank stock	364	364	364	-	-
Financial liabilities					
Time deposits	8,860	8,856	-	8,856	-
Borrowed Funds	10,955	10,629	-	10,629	-

Note 15 – Earnings Per Common Share

The following table presents a reconciliation of the components used to compute basic and diluted earnings per common share:

	2022	2021
Net income	$ 539	$ 219
Basic weighted-average common shares outstanding	1,629,367	1,622,572
Plus dilutive incremental shares	20,912	15,084
Diluted weighted-average common shares outstanding	1,650,279	1,637,656
Basic earnings per common share	$ 0.33	$ 0.13
Diluted earnings per common share	$ 0.33	$ 0.13

Antidilutive options for 2022 and 2021 were 8,391 and 7,602, respectively.

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