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

Form 10-Q

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

For the quarterly period ended June 30, 2021

OR

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

Commission file number 001-34142

OAK VALLEY BANCORP
(Exact name of registrant as specified in its charter)

California	**26-2326676**
State or other jurisdiction of incorporation or organization	I.R.S. Employer Identification No.

125 N. Third Ave., Oakdale, CA 95361
(Address of principal executive offices)

(209) 848-2265
Issuer's telephone number

Not applicable
(Former name, former address and former fiscal year, if changed since last report)

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

Title of each class	Trading Symbol(s)	Name of each exchange on which registered
Common Stock	OVLY	The Nasdaq Stock Market, LLC

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

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

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

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

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

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

APPLICABLE ONLY TO CORPORATE ISSUERS

State the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date: 8,231,983 shares of common stock outstanding as of August 6, 2021.

Oak Valley Bancorp
June 30, 2021

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PART I – FINANCIAL STATEMENTS

Item 1. Financial Statements

OAK VALLEY BANCORP
CONDENSED CONSOLIDATED BALANCE SHEETS (UNAUDITED)

(in thousands)	June 30, 2021	December 31, 2020
ASSETS		
Cash and due from banks	$ 478,712	$ 193,571
Federal funds sold	47,090	33,085
Cash and cash equivalents	525,802	226,656
Securities - available for sale	236,775	217,164
Securities - equity investments	3,413	3,425
Loans, net of allowance for loan losses of $11,327 and $11,297 at June 30, 2021 and December 31, 2020, respectively	927,543	997,246
Cash surrender value of life insurance	28,673	25,325
Bank premises and equipment, net	15,642	15,770
Goodwill and other intangible assets, net	3,694	3,740
Interest receivable and other assets	22,922	22,152
	$ 1,764,464	$ 1,511,478
LIABILITIES AND SHAREHOLDERS' EQUITY		
Deposits	$ 1,614,480	$ 1,367,809
Interest payable and other liabilities	13,364	13,975
Total liabilities	1,627,844	1,381,784
Shareholders' equity		
Common stock, no par value; 50,000,000 shares authorized, 8,231,983 and 8,218,873 shares issued and outstanding at at June 30, 2021 and December 31, 2020, respectively	25,435	25,435
Additional paid-in capital	4,430	4,216
Retained earnings	99,474	92,349
Accumulated other comprehensive income, net of tax	7,281	7,694
Total shareholders' equity	136,620	129,694
	$ 1,764,464	$ 1,511,478

The accompanying notes are an integral part of these condensed consolidated financial statements.

OAK VALLEY BANCORP
CONDENSED CONSOLIDATED STATEMENTS OF INCOME (UNAUDITED)

(in thousands, except per share amounts)	THREE MONTHS ENDED JUNE 30, 2021	THREE MONTHS ENDED JUNE 30, 2020	SIX MONTHS ENDED JUNE 30, 2021	SIX MONTHS ENDED JUNE 30, 2020
INTEREST INCOME				
Interest and fees on loans	$ 10,865	$ 9,820	$ 22,048	$ 18,610
Interest on securities	1,299	1,599	2,537	2,958
Interest on federal funds sold	7	4	14	47
Interest on deposits with banks	76	29	125	396
Total interest income	12,247	11,452	24,724	22,011
INTEREST EXPENSE				
Deposits	259	274	494	605
FHLB advances	0	32	0	32
Total interest expense	259	306	494	637
Net interest income	11,988	11,146	24,230	21,374
Provision for loan losses	0	1,860	0	2,310
Net interest income after provision for loan losses	11,988	9,286	24,230	19,064
NON-INTEREST INCOME				
Service charges on deposits	323	269	618	656
Debit card transaction fee income	427	312	808	607
Earnings on cash surrender value of life insurance	184	176	348	350
Mortgage commissions	52	6	84	51
Gains on calls of available-for-sale securities	1	1	1	1
Other	418	259	721	642
Total non-interest income	1,405	1,023	2,580	2,307
NON-INTEREST EXPENSE				
Salaries and employee benefits	5,052	3,947	9,795	8,548
Occupancy expenses	985	886	1,951	1,754
Data processing fees	531	505	1,025	999
Regulatory assessments (FDIC & DFPI)	132	72	249	102
Other operating expenses	1,515	1,464	2,915	2,920
Total non-interest expense	8,215	6,874	15,935	14,323
Net income before provision for income taxes	5,178	3,435	10,875	7,048
Total provision for income taxes	1,218	854	2,559	1,758
Net Income	$ 3,960	$ 2,581	$ 8,316	$ 5,290
Net income per share	$ 0.49	$ 0.32	$ 1.02	$ 0.65
Net income per diluted share	$ 0.48	$ 0.32	$ 1.02	$ 0.65

The accompanying notes are an integral part of these condensed consolidated financial statements.

OAK VALLEY BANCORP
CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (UNAUDITED)

(dollars in thousands)	THREE MONTHS ENDED JUNE 30, 2021	THREE MONTHS ENDED JUNE 30, 2020	SIX MONTHS ENDED JUNE 30, 2021	SIX MONTHS ENDED JUNE 30, 2020
Net income	$ 3,960	$ 2,581	$ 8,316	$ 5,290
Other comprehensive income:				
Unrealized gains on securities:				
Unrealized holding gains/(losses) arising during the period	806	4,004	(586)	4,282
Less: reclassification for net gains included in net income	(1)	(1)	(1)	(1)
Other comprehensive income/(loss), before tax	805	4,003	(587)	4,281
Tax (expense)/ benefit related to items of other comprehensive income	(238)	(1,184)	174	(1,265)
Total other comprehensive income/(loss)	567	2,819	(413)	3,016
Comprehensive income	$ 4,527	$ 5,400	$ 7,903	$ 8,306

The accompanying notes are an integral part of these condensed consolidated financial statements.

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OAK VALLEY BANCORP
CONDENSED CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY (UNAUDITED)

THREE MONTHS ENDED JUNE 30, 2021 AND 2020

(dollars in thousands)	Common Stock Shares	Common Stock Amount	Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total Shareholders' Equity
Balances, April 1, 2020	8,216,714	$ 25,435	$ 3,837	$ 82,521	$ 2,594	$ 114,387
Restricted stock forfeited	(900)					0
Restricted stock surrendered for tax withholding	(407)		(6)			(6)
Stock based compensation			126			126
Other comprehensive income					2,819	2,819
Net income				2,581		2,581
Balances, June 30, 2020	8,215,407	$ 25,435	$ 3,957	$ 85,102	$ 5,413	$ 119,907
Balances, April 1, 2021	8,235,939	$ 25,435	$ 4,279	$ 95,514	$ 6,714	131,942
Restricted stock forfeited	(3,300)					0
Restricted stock surrendered for tax withholding	(656)					-
Stock based compensation			151			151
Other comprehensive income					567	567
Net income				3,960		3,960
Balances, June 30, 2021	8,231,983	$ 25,435	$ 4,430	$ 99,474	$ 7,281	$ 136,620

SIX MONTHS ENDED JUNE 30, 2021 AND 2020

(dollars in thousands)	Common Stock Shares	Common Stock Amount	Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total Shareholders' Equity
Balances, January 1, 2020	8,210,147	$ 25,435	$ 3,777	$ 80,961	$ 2,397	$ 112,570
Restricted stock issued	14,006					0
Restricted stock forfeited	(2,400)					0
Restricted stock surrendered for tax withholding	(6,346)		(106)			(106)
Cash dividends declared $0.135 per share of common stock				(1,149)		(1,149)
Stock based compensation			286			286
Other comprehensive income					3,016	3,016
Net income				5,290		5,290
Balances, June 30, 2020	8,215,407	$ 25,435	$ 3,957	$ 85,102	$ 5,413	$ 119,907
Balances, January 1, 2021	8,218,873	$ 25,435	$ 4,216	$ 92,349	$ 7,694	$ 129,694
Restricted stock issued	22,207					0
Restricted stock forfeited	(3,300)					0
Restricted stock surrendered for tax withholding	(5,797)		(84)			(84)
Cash dividends declared $0.145 per share of common stock				(1,191)		(1,191)
Stock based compensation			298			298
Other comprehensive loss					(413)	(413)
Net income				8,316		8,316
Balances, June 30, 2021	8,231,983	$ 25,435	$ 4,430	$ 99,474	$ 7,281	$ 136,620

The accompanying notes are an integral part of these condensed consolidated financial statements.

OAK VALLEY BANCORP
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)

(dollars in thousands)	SIX MONTHS ENDED JUNE 30, 2021	SIX MONTHS ENDED JUNE 30, 2020
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	$ 8,316	$ 5,290
Adjustments to reconcile net income to net cash from operating activities:		
Provision for loan losses	0	2,310
Increase in deferred fees/costs, net	452	6,133
Depreciation	668	574
Amortization of investment securities, net	211	305
Stock based compensation	298	286
Gain on calls of available for sale securities	(1)	(1)
Earnings on cash surrender value of life insurance	(348)	(350)
(Decrease) increase in interest payable and other liabilities	(346)	413
Decrease (increase) in interest receivable	1,121	(1,322)
Increase in other assets	(936)	(24)
Net cash from operating activities	9,435	13,614
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchases of available for sale securities	(33,731)	(67,627)
Purchases of equity securities	(33)	(42)
Proceeds from maturities, calls, and principal paydowns of securities available for sale	13,368	20,084
Investment in LIHTC	(265)	(590)
Net decrease (increase) in loans	69,251	(252,200)
Purchase of FHLB Stock	(735)	0
Purchase of BOLI policies	(3,000)	0
Purchases of premises and equipment	(540)	(636)
Net cash from (used) in investing activities	44,315	(301,011)
CASH FLOWS FROM FINANCING ACTIVITIES:		
FHLB advanced funds	0	50,000
FHLB payments	0	(20,000)
Shareholder cash dividends paid	(1,191)	(1,149)
Net increase in demand deposits and savings accounts	245,503	281,307
Net increase (decrease) in time deposits	1,168	(1,372)
Tax withholding payments on vested restricted shares surrendered	(84)	(106)
Net cash from financing activities	245,396	308,680
NET INCREASE IN CASH AND CASH EQUIVALENTS	299,146	21,283
CASH AND CASH EQUIVALENTS, beginning of period	226,656	147,594
CASH AND CASH EQUIVALENTS, end of period	$ 525,802	$ 168,877
SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION:		
Cash paid during the period for:		
Interest	$ 497	$ 576
Income taxes	$ 3,515	$ 2,374
NON-CASH INVESTING ACTIVITIES:		
Change in unrealized gain on securities	$ (587)	$ 4,281
Lease right-of-use assets	$ (886)	$ (55)
NON-CASH FINANCING ACTIVITIES:		
Present value of lease obligations	$ 861	$ 15

The accompanying notes are an integral part of these condensed consolidated financial statements.

OAK VALLEY BANCORP
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1 – BASIS OF PRESENTATION

On July 3, 2008 (the "Effective Date"), a bank holding company reorganization was completed whereby Oak Valley Bancorp ("the Company", "us", "our") became the parent holding company for Oak Valley Community Bank (the "Bank"). On the Effective Date, a tax-free exchange was completed whereby each outstanding share of the Bank was converted into one share of the Company and the Bank became the sole wholly-owned subsidiary of the holding company.

The consolidated financial statements include the accounts of the parent company and its wholly-owned bank subsidiary. Unless otherwise stated, the "Company" refers to the consolidated entity, Oak Valley Bancorp, while the "Bank" refers to Oak Valley Community Bank. All material intercompany transactions have been eliminated. The interim consolidated financial statements included in this report are unaudited but reflect all adjustments which, in the opinion of management, are necessary for a fair presentation of the financial position and results of operations for the interim periods presented. All such adjustments are of a normal recurring nature. The results of operations for the three and six-month periods ended June 30, 2021 are not necessarily indicative of the results of a full year's operations. Certain prior year amounts have been reclassified to conform to the current year presentation. There was no effect on net income or shareholders' equity as previously reported as a result of reclassifications. For further information, refer to the audited consolidated financial statements and footnotes included in the Company's Form 10-K for the year ended December 31, 2020.

Oak Valley Community Bank is a California state-chartered bank. The Company was incorporated under the laws of the State of California on May 31, 1990 and began operations in Oakdale on May 28, 1991. The Company operates branches in Oakdale, Sonora, Bridgeport, Bishop, Mammoth Lakes, Modesto, Manteca, Patterson, Turlock, Ripon, Stockton, Escalon, and Sacramento, California. The Bridgeport, Mammoth Lakes, and Bishop branches operate as a separate division, Eastern Sierra Community Bank. The Company's primary source of revenue is providing loans to customers who are predominantly middle-market businesses. The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America ("GAAP") requires management to make estimates and assumptions. These estimates and assumptions affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Significant accounting estimates reflected in the Company's consolidated financial statements include the allowance for loan losses and fair value measurements. The estimates and assumptions may change as new events occur, as more experience is acquired, as additional information is obtained and as the Company's operating environment changes. Actual results may differ from these estimates due to the uncertainty around the magnitude and duration of the COVID-19 pandemic, as well as other factors.

NOTE 2 – RECENT ACCOUNTING PRONOUNCEMENTS

In June 2016, the FASB issued ASU No. 2016-13, *Financial Instruments – Credit Losses (Topic 326)*. This update revises the methodology used by financial institutions under GAAP to recognize credit losses in the financial statements. Currently, GAAP requires the use of the incurred loss model, whereby financial institutions recognize in current period earnings, incurred credit losses and those inherent in the financial statements, as of the date of the balance sheet. This guidance results in a new model for estimating the allowance for loan and lease losses, commonly referred to as the Current Expected Credit Loss ("CECL") model. Under the CECL model, financial institutions are required to estimate future credit losses and recognize those losses in current period earnings. The amendments within the update are effective for fiscal years and all interim periods beginning after December 15, 2019, with early adoption permitted. In October 2019, FASB approved an amendment that will delay the adoption of this ASU for three years for certain entities including the Company since we are classified as a Small Reporting Company. Accordingly, this ASU will become effective for the Company on January 1, 2023. Upon adoption of the amendments within this update, the Company will be required to make a cumulative-effect adjustment to the opening balance of retained earnings in the year of adoption. The Company is currently in the process of evaluating the impact the adoption of this update will have on its financial statements. While the Company has not quantified the impact of this ASU, it does expect changing from the current incurred loss model to an expected loss model will result in an earlier recognition of losses.

In January 2017, the FASB issued ASU 2017-04, *Intangibles Goodwill and Other (Subtopic 350)*: *Simplifying the Test for Goodwill Impairment*. The provisions of the update eliminate the existing second step of the goodwill impairment test which provides for the allocation of reporting unit fair value among existing assets and liabilities, with the net leftover amount representing the implied fair value of goodwill. In replacement of the existing goodwill impairment rule, the update will provide that impairment should be recognized as the excess of any of the reporting unit's goodwill over the fair value of the reporting unit. Under the provisions of this update, the amount of the impairment is limited to the carrying value of the reporting unit's goodwill. For public business entities that are Securities and Exchange Commission filers, the amendments of the update became effective in fiscal years beginning after December 15, 2019. The Company adopted the standards update effective January 1, 2020 and evaluates goodwill in accordance with the provisions of the standard. Due to the economic impact that COVID-19 has had on the Company, management concluded that factors such as the decline in macroeconomic conditions have led to the occurrence of a triggering event and therefore an interim impairment test over goodwill was performed as of September 30, 2020. As part of this interim impairment assessment, if the Company concluded that all or a portion of its goodwill is impaired, a non-cash charge for the amount of such impairment would be recorded to earnings. Such a charge would have no impact on tangible capital or regulatory capital. Based upon the results of our interim goodwill assessment, we have concluded that an impairment did not exist as of the time of the assessment.

In August 2018, the FASB issued ASU 2018-13, *Fair Value Measurement (Subtopic 820)*: *Disclosure Framework - Changes to the Disclosure Requirements for Fair Value Measurement.* The primary focus of ASU 2018-13 is to improve the effectiveness of the disclosure requirements for fair value measurements. The changes affect all companies that are required to include fair value measurement disclosures. In general, the amendments in ASU 2018-13 are effective for all entities for fiscal years and interim periods within those fiscal years, beginning after December 15, 2019. An entity is permitted to early adopt the removed or modified disclosures upon the issuance of ASU 2018-13 and may delay adoption of the additional disclosures, which are required for public companies only, until their effective date. The Company first adopted this ASU beginning with the period ended March 31, 2020, and it did not have a significant impact on the Company's consolidated financial statements.

In April 2019, the FASB issued ASU 2019-04, *Codification Improvements to Topic 326, Financial Instruments - Credit Losses, Topic 815, Derivatives and Hedging, and Topic 825, Financial Instruments* that clarifies and improves areas of guidance related to recently issued standards on credit losses, hedging and recognition and measurement. The provisions of this ASU became effective and were adopted by the Company on January 1, 2020. This ASU did not have a material impact on our financial condition or results of operations.

In May 2019, the FASB issued ASU 2019-05, *Financial Instruments - Credit Losses (Topic 326): Targeted Transition Relief.* This ASU allows an option for entities to irrevocably elect the fair value option on an instrument-by-instrument basis for eligible financial assets measured at amortized cost basis upon adoption of the credit loss standards. This amendment provides relief for those entities electing the fair value option on newly originated or purchased financial assets, while maintaining existing similar financial assets at amortized cost, avoiding the requirement to maintain dual measurement methods for similar assets. The fair value option does not apply to held-to-maturity debt securities. The effective date for this ASU is the same as for ASU 2016-13, as discussed above. We will evaluate this ASU in conjunction with ASU 2016-13 to determine its impact on our financial condition and results of operations.

In March 2020, FASB issued ASU 2020-04 - *Reference Rate Reform (Subtopic 848): Facilitation of the Effects of Reference Rate Reform on Financial Reporting.* This ASU provides optional expedients and exceptions for contracts, hedging relationships, and other transactions that reference LIBOR or other reference rates expected to be discontinued because of reference rate reform. The ASU is effective for all entities as of March 12, 2020 through December 31, 2022. The Company is in the process of evaluating the provisions of this ASU and its effects on our consolidated financial statements.

NOTE 3 – SECURITIES

Equity Securities

The Company held equity securities with fair values of $3,413,000 and $3,425,000 as of June 30, 2021 and December 31, 2020, respectively. There were no sales of equity securities during the three and six-month periods ended June 30, 2021 and 2020. Consistent with ASU 2016-01, these securities are carried at fair value with the changes in fair value recognized in the condensed consolidated statements of income. Accordingly, the Company recognized no gains or losses during the three months ended June 30, 2021, and a loss of $45,000 during the six months ended June 30, 2021, as compared to gains of $15,000 and $66,000 during the same periods of 2020.

Debt Securities

Debt securities have been classified in the financial statements as available for sale. The amortized cost and estimated fair values of debt securities as of June 30, 2021 are as follows:

(dollars in thousands)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Available-for-sale securities:				
U.S. agencies	$ 24,585	$ 734	$ (1)	$ 25,318
Collateralized mortgage obligations	1,078	16	(27)	1,067
Municipalities	135,034	8,975	(12)	143,997
SBA pools	4,478	21	(12)	4,487
Corporate debt	14,730	290	(71)	14,949
Asset backed securities	46,533	536	(112)	46,957
	$ 226,438	$ 10,572	$ (235)	$ 236,775

The following tables detail the gross unrealized losses and fair values of debt securities aggregated by investment category and the length of time that individual securities have been in a continuous unrealized loss position as of June 30, 2021.

(dollars in thousands)	Less than 12 months		12 months or more		Total	
Description of Securities	**Fair Value**	**Unrealized Loss**	**Fair Value**	**Unrealized Loss**	**Fair Value**	**Unrealized Loss**
U.S. agencies	$ 5,000	$ (1)	$ 87	$ 0	$ 5,087	$ (1)
Collateralized mortgage obligations	0	0	525	(27)	525	(27)
Municipalities	3,866	(12)	0	0	3,866	(12)
SBA pools	0	0	2,144	(12)	2,144	(12)
Corporate debt	4,963	(37)	2,466	(34)	7,429	(71)
Asset backed securities	5,547	(13)	11,222	(99)	16,769	(112)
Total temporarily impaired securities	$ 19,376	$ (63)	$ 16,444	$ (172)	$ 35,820	$ (235)

As of June 30, 2021, one corporate debt, three U.S. agencies, four Small Business Administration (“SBA”) pools, one collateralized mortgage obligation and seven asset backed securities make up the total debt securities in an unrealized loss position for greater than 12 months. As of June 30, 2021, four asset backed securities, two corporate debts, one U.S. agency and two municipalities make up the total debt securities in a loss position for less than 12 months. Management periodically evaluates each available-for-sale investment security in an unrealized loss position to determine if the impairment is temporary or other than temporary. This evaluation encompasses various factors including, the nature of the investment, the cause of the impairment, the severity and duration of the impairment, credit ratings and other credit related factors such as third party guarantees and the volatility of the security’s fair value. Management has determined that no investment security is other than temporarily impaired. The unrealized losses are due primarily to asset backed securities that are backed by federal government guaranteed student loans that are repaying slower than expected due to legislation that allows borrowers to extend payment schedules based on their income level. The Company does not intend to sell the securities and it is not likely that the Company will be required to sell the securities before the earlier of the forecasted recovery or the maturity of the underlying investment security.

The amortized cost and estimated fair value of debt securities as of June 30, 2021, segregated by contractual maturity or call date, 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.

(dollars in thousands)	**Amortized Cost**	**Fair Value**
Available-for-sale securities:		
Due in one year or less	$ 10,919	$ 11,075
Due after one year through five years	82,660	87,365
Due after five years through ten years	76,337	80,232
Due after ten years	56,522	58,103
	$ 226,438	$ 236,775

The amortized cost and estimated fair values of debt securities as of December 31, 2020 are as follows:

(dollars in thousands)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Available-for-sale securities:				
U.S. agencies	$ 22,802	$ 892	$ (2)	$ 23,692
Collateralized mortgage obligations	1,250	18	(45)	1,223
Municipalities	115,706	9,896	0	125,602
SBA pools	5,027	6	(25)	5,008
Corporate debt	14,229	308	(185)	14,352
Asset backed securities	47,226	392	(331)	47,287
	$ 206,240	$ 11,512	$ (588)	$ 217,164

The following tables detail the gross unrealized losses and fair values aggregated of debt securities by investment category and length of time that individual securities have been in a continuous unrealized loss position at December 31, 2020.

(dollars in thousands)	Less than 12 months		12 months or more		Total	
Description of Securities	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
U.S. agencies	$ 94	$ (1)	$ 251	$ (1)	$ 345	$ (2)
Collateralized mortgage obligations	0	0	565	(45)	565	(45)
Municipalities	0	0	0	0	0	0
SBA pools	0	0	3,847	(25)	3,847	(25)
Corporate debt	0	0	6,315	(185)	6,315	(185)
Asset backed securities	11,268	(58)	25,104	(273)	36,372	(331)
Total temporarily impaired securities	$ 11,362	$ (59)	$ 36,082	$ (529)	$ 47,444	$ (588)

At December 31, 2020, fourteen asset-backed securities, seven Small Business Administration pools, three corporate debts, one U.S. agency, and one collateralized mortgage obligations make up the total debt securities in an unrealized loss position for greater than 12 months. At December 31, 2020, seven asset backed securities and three U.S. agencies make up the total debt securities in a loss position for less than 12 months.

The Company recognized gains of $1,000 on called securities during the three and six-month periods ended June 30, 2021 and 2020. There were no sales of available-for-sale securities during the six-months ended June 30, 2021 and 2020.

Debt securities carried at $174,081,000 and $147,795,000 as of June 30, 2021 and December 31, 2020, respectively, were pledged to secure deposits of public funds.

NOTE 4 – LOANS

The Company's customers are primarily located in Stanislaus, San Joaquin, Tuolumne, Inyo, and Mono Counties. As of June 30, 2021, approximately 70% of the Company's loans are commercial real estate loans which include construction loans. Approximately 25% of the Company's loans are for general commercial uses including professional, retail, and small business. Also included in the commercial and industrial loans in the table below are Paycheck Protection Program loans (as described below) totaling $151,439,000. Additionally, 3% of the Company's loans are for residential real estate and other consumer loans. The remaining 2% are agriculture loans. Loan totals were as follows:

(in thousands)	June 30, 2021	December 31, 2020
Commercial real estate:		
Commercial real estate- construction	$ 18,383	$ 32,459
Commercial real estate- mortgages	556,939	540,556
Land	5,156	5,318
Farmland	81,049	82,998
Commercial and industrial	231,494	292,006
Consumer	536	636
Consumer residential	27,614	30,887
Agriculture	22,723	28,255
Total loans	943,894	1,013,115
Less:		
Deferred loan fees and costs, net	(5,024)	(4,572)
Allowance for loan losses	(11,327)	(11,297)
Net loans	$ 927,543	$ 997,246

Paycheck Protection Program. With the passage of the Paycheck Protection Program ("PPP"), administered by the SBA, the Company assisted its customers with applications for resources through the program. As of April 16, 2020, all $350 billion of the available funds under the First Draw of this program had been allocated. The Treasury Department later announced that an additional $310 billion would be available for second round of the First Draw PPP, which commenced on April 27, 2020 and closed on August 8, 2020. As of December 31, 2020, the PPP remained closed and was not accepting applications, but resumed in January 2021. Also, in January 2021 the SBA began its Second Draw PPP to provide a second PPP loan to small businesses provided they meet specific criteria pertaining to economic hardship. PPP loans have a two-year term if the loan was approved by the SBA prior to June 5, 2020, and loans approved after that date have a five-year term. All PPP loans earn a contractual interest rate of 1%. The Company believes that the vast majority of PPP loans will ultimately be forgiven by the SBA in accordance with the terms of the program, which resulted in loan pay-offs of approximately $33 million during the fourth quarter of 2020, $62 million during the first quarter of 2021 and $99 million during the second quarter of 2021. As of December 31, 2020, the Company had received approvals with the SBA for 1,671 PPP loans representing approximately $244,197,000 in funding under the First Draw PPP, of which $33,375,000 was paid off by the SBA through PPP loan forgiveness, resulting in an outstanding balance of $210,822,000 at December 31, 2020. During the first six months of 2021, the Company received approvals with the SBA for 924 Second Draw PPP loans, representing approximately $100,698,000 in funding, resulting in a total PPP outstanding balance of $151,439,000 at June 30, 2021. As a result of funding the PPP loans, the Company received fee income that is recorded to total interest income net of deferred loan costs, through amortization over the life of the loans. It is the Company's understanding that loans funded through the PPP program are fully guaranteed by the U.S. government, and therefore, no allowance for credit losses has been allocated for PPP loans. Should those circumstances change, the Company could be required to establish additional allowance for credit losses through additional provision for credit loss expense charged to earnings.

COVID-19 Related Loan Payment Deferrals. The COVID-19 Pandemic has negatively impacted the revenue streams of certain borrowers of the Company, and therefore, during the second quarter of 2020 the Company elected to allow these clients to defer payments for a term up to six months. These deferrals were specifically related to the pandemic and the resulting economic hardships. As of December 31, 2020, the Company had no loans for which payments were deferred due to the financial impact of the pandemic, as normal payment schedules had resumed on the deferrals granted during the second quarter of 2020. As of June 30, 2021, one borrowing relationship consisting of 4 loans totaling $8,381,000 has experienced economic hardship related to COVID-19 during 2021 and the bank responded by deferring principal payments, and thus converting the loans to interest-only for the remainder of 2021. After an evaluation of financial stability, no specific loan loss reserve allocation was required on any of these loans at the time of deferral. In accordance with regulatory and accounting guidance, these short-term modifications granted in response to the COVID-19 pandemic are not considered to be troubled debt restructurings.

Loan Origination/Risk Management. The Company has certain lending policies and procedures in place that are designed to maximize loan income within an acceptable level of risk. Management reviews and approves these policies and procedures on a regular basis. A reporting system supplements the review process by providing management with frequent reports related to loan production, loan quality, concentration of credit, loan delinquencies and non-performing and potential problem loans. Diversification in the loan portfolio is a means of managing risk associated with fluctuations in economic conditions.

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

Commercial real estate loans are subject to underwriting standards and processes similar to commercial and industrial loans, in addition to those of real estate loans. These loans are viewed primarily as cash flow loans and secondarily as loans secured by real estate. Commercial real estate lending typically involves higher loan principal amounts and the repayment of these loans is generally largely dependent on the successful operation of the property securing the loan or the business conducted on the property securing the loan. Commercial real estate loans may be more adversely affected by conditions in the real estate markets or in the general economy. The properties securing the Company's commercial real estate portfolio are diverse in terms of type and geographic location. This diversity helps reduce the Company's exposure to adverse economic events that affect any single market or industry. Management monitors and evaluates commercial real estate loans based on collateral, geography and risk grade criteria. As a general rule, the Company avoids financing single-purpose projects unless other underwriting factors are present to help mitigate risk. The Company also utilizes third-party experts to provide insight and guidance about economic conditions and trends affecting market areas it serves. In addition, management tracks the level of owner-occupied commercial real estate loans versus non-owner occupied loans. As of June 30, 2021 and December 31, 2020, approximately 36% of the outstanding principal balance of commercial real estate loans were secured by owner-occupied properties.

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

Agricultural production, real estate and development lending is susceptible to credit risks including adverse weather conditions, pest and disease, as well as market price fluctuations and foreign competition. Agricultural loan underwriting standards are maintained by following Company policies and procedures in place to minimize risk in this lending segment. These standards consist of limiting credit to experienced farmers who have demonstrated farm management capabilities, requiring cash flow projections displaying margins sufficient for repayment from normal farm operations along with equity injected as required by policy, as well as providing adequate secondary repayment and sponsorship including satisfactory collateral support. Credit enhancement obtained through government guarantee programs may also be used to provide further support as available.

The Company originates consumer loans utilizing common underwriting criteria specified in policy. To monitor and manage consumer loan risk, policies and procedures are developed and modified, as needed, jointly by line and staff personnel. This activity, coupled with relatively small loan amounts that are spread across many individual borrowers, minimizes risk. Additionally, trend and outlook reports are reviewed by management on a regular basis. Underwriting standards for 1-4 family residential loans, home equity lines and loans follow bank policy, which include, but are not limited to, a maximum loan-to-value percentage of 80%, a maximum housing and total debt ratio of 36% and 42%, respectively, and other specified credit and documentation requirements.

The Company maintains an independent loan review program that reviews and validates the credit risk program on a periodic basis. Results of these reviews are presented to management. The loan review process complements and reinforces the risk identification and assessment decisions made by lenders and credit personnel, as well as the Bank's policies and procedures.

Non-Accrual and Past Due Loans. Loans are considered past due if the required principal and interest payments have not been received as of the date such payments were due. Loans are placed on non-accrual status when, in management's opinion, the borrower may be unable to meet payment obligations as they become due, as well as when required by regulatory provisions. Loans may be placed on non-accrual status regardless of whether or not such loans are considered past due. When interest accrual is discontinued, all unpaid accrued interest is reversed. Interest income is subsequently recognized only to the extent cash payments are received in excess of principal due. Loans are returned to accrual status when all the principal and interest amounts contractually due are brought current and future payments are reasonably assured.

Non-accrual loans, segregated by class of loans, were as follows:

(in thousands)	June 30, 2021	December 31, 2020
Commercial real estate:		
Commercial real estate- construction	$ 0	$ 0
Commercial real estate- mortgages	362	0
Land	0	0
Farmland	0	0
Commercial and industrial	0	0
Consumer	0	0
Consumer residential	0	0
Agriculture	0	0
Total non-accrual loans	$ 362	$ 0

Had non-accrual loans performed in accordance with their original contract terms, the Company would have recognized additional interest income of approximately $3,000 and $6,000 in the three and six-month periods ended June 30, 2021, respectively, as compared to $11,000 and $22,000 in the same periods of 2020.

The following table analyzes past due loans including the past due non-accrual loans in the above table, segregated by class of loans, as of June 30, 2021 (in thousands):

June 30, 2021	30-59 Days Past Due	60-89 Days Past Due	Greater Than 90 Days Past Due	Total Past Due	Current	Total	Greater Than 90 Days Past Due and Still Accruing
Commercial real estate:							
Commercial R.E. - construction	$ 0	$ 0	$ 0	$ 0	$ 18,383	$ 18,383	$ 0
Commercial R.E. - mortgages	0	0	362	362	556,577	556,939	0
Land	0	0	0	0	5,156	5,156	0
Farmland	0	0	0	0	81,049	81,049	0
Commercial and industrial	0	0	0	0	231,494	231,494	0
Consumer	0	0	0	0	536	536	0
Consumer residential	0	0	0	0	27,614	27,614	0
Agriculture	0	0	0	0	22,723	22,723	0
Total	$ 0	$ 0	$ 362	$ 362	$ 943,532	$ 943,894	$ 0

The following table analyzes past due loans including the past due non-accrual loans in the above table, segregated by class of loans, as of December 31, 2020 (in thousands):

December 31, 2020	30-59 Days Past Due	60-89 Days Past Due	Greater Than 90 Days Past Due	Total Past Due	Current	Total	Greater Than 90 Days Past Due and Still Accruing
Commercial real estate:							
Commercial R.E. - construction	$ 0	0	0	0	$ 32,459	$ 32,459	$ 0
Commercial R.E. - mortgages	362	0	0	362	540,194	540,556	0
Land	0	0	0	0	5,318	5,318	0
Farmland	0	0	0	0	82,998	82,998	0
Commercial and industrial	0	0	0	0	292,006	292,006	0
Consumer	0	0	0	0	636	636	0
Consumer residential	0	0	0	0	30,887	30,887	0
Agriculture	0	0	0	0	28,255	28,255	0
Total	$ 362	$ 0	$ 0	$ 362	$ 1,012,753	$ 1,013,115	$ 0

Impaired Loans. Loans are considered impaired when, based on current information and events, it is probable the Company will be unable to collect all amounts due in accordance with the original contractual terms of the loan agreement, including scheduled principal and interest payments. Impairment is evaluated in total for smaller-balance loans of a similar nature and on an individual loan basis for other loans. If a loan is impaired, a specific valuation allowance is allocated, if necessary, so that the loan is reported net, at the present value of estimated future cash flows using the loan's existing rate or at the fair value of collateral if repayment is expected solely from the collateral. Interest payments on impaired loans are typically applied to principal unless collectability of the principal amount is reasonably assured, in which case interest is recognized on a cash basis. There was no interest income realized on impaired loans for the three and six-months ended June 30, 2021 and 2020.

Impaired loans as of June 30, 2021 are set forth in the following table.

(in thousands)	Unpaid Contractual Principal Balance	Recorded Investment With No Allowance	Recorded Investment With Allowance	Total Recorded Investment	Related Allowance
June 30, 2021					
Commercial real estate:					
Commercial R.E. - construction	$ 0	$ 0	$ 0	$ 0	$ 0
Commercial R.E. - mortgages	362	362	0	362	0
Land	0	0	0	0	0
Farmland	0	0	0	0	0
Commercial and Industrial	0	0	0	0	0
Consumer	0	0	0	0	0
Consumer residential	0	0	0	0	0
Agriculture	0	0	0	0	0
Total	$ 362	$ 362	$ 0	$ 362	$ 0

Average recorded investment in impaired loans outstanding as of June 30, 2021 and 2020 is set forth in the following table.

(in thousands)	Average Recorded Investment for the Three Months Ended June 30,		Average Recorded Investment for the Six Months Ended June 30,	
	2021	2020	2021	2020
Commercial real estate:				
Commercial R.E. - construction	$ 0	$ 0	$ 0	$ 0
Commercial R.E. - mortgages	362	0	248	0
Land	0	803	0	819
Farmland	0	0	0	0
Commercial and Industrial	0	0	0	0
Consumer	0	0	0	0
Consumer residential	0	137	0	164
Agriculture	0	0	0	0
Total	$ 362	$ 940	$ 248	$ 983

Impaired loans as of December 31, 2020 are set forth in the following table.

(in thousands)	Unpaid Contractual Principal Balance	Recorded Investment With No Allowance	Recorded Investment With Allowance	Total Recorded Investment	Related Allowance	Average Recorded Investment
December 31, 2020						
Commercial real estate:						
Commercial R.E. - construction	$ 0	$ 0	$ 0	$ 0	$ 0	$ 0
Commercial R.E. - mortgages	0	0	0	0	0	0
Land	0	0	0	0	0	724
Farmland	0	0	0	0	0	0
Commercial and Industrial	0	0	0	0	0	0
Consumer	0	0	0	0	0	0
Consumer residential	0	0	0	0	0	87
Agriculture	0	0	0	0	0	0
Total	$ 0	$ 0	$ 0	$ 0	$ 0	$ 811

Troubled Debt Restructurings – In order to determine whether a borrower is experiencing financial difficulty, an evaluation is performed of the probability that the borrower will be in payment default on any of its debt in the foreseeable future without the modification. This evaluation is performed under the Company's internal underwriting policy. The modification of the terms of such loans typically includes one or a combination of the following: a reduction of the stated interest rate of the loan; an extension of the maturity date; or a temporary payment modification in which the payment amount allocated towards principal was reduced. In some cases, a permanent reduction of the accrued interest on the loan is conceded.

As of June 30, 2021 and December 31, 2020, there were no loans classified as troubled debt restructurings. During the six-months ended June 30, 2021 and 2020, there were no loans that were modified as troubled debt restructurings. There were no loans modified as troubled debt restructurings within the previous twelve months and for which there was a payment default during the six-month periods ended June 30, 2021 and 2020. A loan is considered to be in payment default once it is ninety days contractually past due under the modified terms.

Loan Risk Grades– Quality ratings (Risk Grades) are assigned to all commitments and stand-alone notes. Risk grades define the basic characteristics of commitments or stand-alone note in relation to their risk. All loans are graded using a system that maximizes the loan quality information contained in loan review grades, while ensuring that the system is compatible with the grades used by bank examiners.

The Company grades loans using the following letter system:

1 Exceptional Loan
2 Quality Loan
3A Better Than Acceptable Loan
3B Acceptable Loan
3C Marginally Acceptable Loan
4 (W) Watch Acceptable Loan
5 Special Mention Loan
6 Substandard Loan
7 Doubtful Loan
8 Loss

1. Exceptional Loan - Loans with A+ credits that contain very little, if any, risk. Grade 1 loans are considered Pass. To qualify for this rating, the following characteristics must be present:

- A high level of liquidity and whose debt-servicing capacity exceeds expected obligations by a substantial margin.
- Where leverage is below average for the industry and earnings are consistent or growing without severe vulnerability to economic cycles.
- Also included in this rating (but not mandatory unless one or more of the preceding characteristics are missing) are loans that are fully secured and properly margined by our own time instruments or U.S. blue chip securities. To be properly margined, cash collateral must be equal to, or greater than, 110% of the loan amount.

2. Quality Loan - Loans with excellent sources of repayment that conform in all respects to bank policy and regulatory requirements. These are also loans for which little repayment risk has been identified. No credit or collateral exceptions. Grade 2 loans are considered Pass. Other factors include:

- Unquestionable debt-servicing capacity to cover all obligations in the ordinary course of business from well-defined primary and secondary sources.
- Consistent strong earnings.
- A solid equity base.

3A. Better than Acceptable Loan - In the interest of better delineating the loan portfolio's true credit risk for reserve allocation, further granularity has been sought by splitting the grade 3 category into three classifications. The distinction between the three are bank-defined guidelines and represent a further refinement of the regulatory definition of a pass, or grade 3 loan. Grade 3A is characterized by:

- Strong earnings with no loss in last three years and ample cash flow to service all debt well above policy guidelines.
- Long term experienced management with depth and defined management succession.
- The loan has no exceptions to policy.
- Loan-to-value on real estate secured transactions is 10% to 20% less than policy guidelines.
- Very liquid balance sheet that may have cash available to pay off our loan completely.
- Little to no debt on balance sheet.

3B. Acceptable Loan - 3B loans are simply defined as all loans that are less qualified than 3A loans and are stronger than 3C loans. These loans are characterized by acceptable sources of repayment that conform to bank policy and regulatory requirements. Repayment risks are acceptable for these loans. Credit or collateral exceptions are minimal, are in the process of correction, and do not represent repayment risk. These loans:

- Are those where the borrower has average financial strengths, a history of profitable operations and experienced management.
- Are those where the borrower can be expected to handle normal credit needs in a satisfactory manner.

3C. Marginally Acceptable Loan - 3C loans have similar characteristics as that of 3Bs with the following additional characteristics:

- Requires collateral.
- A credit facility where the borrower has average financial strengths, but usually lacks reliable secondary sources of repayment other than the subject collateral.
- Other common characteristics can include some or all of the following: minimal background experience of management, lacking continuity of management, a start-up operation, erratic historical profitability (acceptable reasons-well identified), lack of or marginal sponsorship of guarantor, and government guaranteed loans.

4(W). Watch Acceptable Loan - Watch grade will be assigned to any credit that is adequately secured and performing but monitored for a number of indicators. These characteristics may include:

- Any unexpected short-term adverse financial performance from budgeted projections or a prior period's results (i.e., declining profits, sales, margins, cash flow, or increased reliance on leverage, including adverse balance sheet ratios, trade debt issues, etc.).
- Any managerial or personal problems with company management, decline in the entire industry or local economic conditions, or failure to provide financial information or other documentation as requested.
- Issues regarding delinquency, overdrafts, or renewals.
- Any other issues that cause concern for the company.
- Loans to individuals or loans supported by guarantors with marginal net worth and/or marginal collateral.
- Weaknesses that are identified are short-term in nature.
- Loans in this category are usually accounts the Bank would want to retain providing a positive turnaround can be expected within a reasonable time frame. Grade 4(W) loans are considered Pass.

5. Special Mention Loan - A special mention extension of credit is defined as having potential weaknesses that deserve management's close attention. If left uncorrected, these potential weaknesses may, at some future date result in the deterioration of the repayment prospects for the credit or the institution's credit position. Extensions of credit that might be detailed in this category include the following:

- The lending officer may be unable to properly supervise the credit because of an inadequate loan or credit agreement.
- Questions exist regarding the condition of and/or control over collateral.
- Economic or market conditions may unfavorably affect the obligor in the future.
- A declining trend in the obligor's operations or an imbalanced position in the balance sheet exists, but not to the point that repayment is jeopardized.

6. Substandard Loan - A "substandard" extension of credit is inadequately protected by the current sound worth and paying capacity of the obligor or of the collateral pledged, if any. Extensions of credit so classified must have a well-defined weakness or weaknesses that jeopardize the liquidation of the debt. They are characterized by the distinct possibility that the Bank will sustain some loss if the deficiencies are not corrected. Loss potential, while existing in the aggregate amount of substandard credits, does not have to exist in individual extensions of credit classified as substandard.

7. Doubtful Loan - An extension of credit classified as "doubtful" has all the weaknesses inherent in one classified substandard, with the added characteristic that the weaknesses make collection or liquidation in full, on the basis of currently existing facts, conditions, and values, highly questionable and improbable. The possibility of loss is extremely high but because of certain important and reasonably specific pending factors that may work to the advantage of and strengthen the credit, its classification as an estimated loss is deferred until its more exact status may be determined. Pending factors may include a proposed merger or acquisition, liquidation proceedings, capital injection, perfecting liens on additional collateral or refinancing plans. The entire loan need not be classified as doubtful when collection of a specific portion appears highly probable. An example of proper use of the doubtful category is the case of a company being liquidated, with the trustee-in-bankruptcy indicating a minimum disbursement of 40 percent and a maximum of 65 percent to unsecured creditors, including the Bank. In this situation, estimates are based on liquidation value appraisals with actual values yet to be realized. By definition, the only portion of the credit that is doubtful is the 25 percent difference between 40 and 65 percent.

A proper classification of such a credit would show 40 percent substandard, 25 percent doubtful, and 35 percent loss. A credit classified as doubtful should be resolved within a 'reasonable' period of time. Reasonable is generally defined as the period between examinations. In other words, a credit classified as doubtful at an examination should be cleared up before the next exam. However, there may be situations that warrant continuation of the doubtful classification a while longer.

8. Loss - Extensions of credit classified as "loss" are considered uncollectible and of such little value that their continuance as bankable assets is not warranted. This classification does not mean that the credit has absolutely no recovery or salvage value, but rather that it is not practical or desirable to defer writing off, even though partial recovery may be affected in the future. It should not be the Company's practice to attempt long-term recoveries while the credit remains on the books. Losses should be taken in the period in which they surface as uncollectible.

As of June 30, 2021 and December 31, 2020, there are no loans that are classified with risk grades of *8- Loss.*

The following table presents weighted average risk grades of the Company's loan portfolio:

	June 30, 2021	December 31, 2020
	Weighted Average Risk Grade	Weighted Average Risk Grade
Commercial real estate:		
Commercial real estate - construction	3.00	3.16
Commercial real estate - mortgages	3.08	3.11
Land	3.95	3.94
Farmland	3.08	3.06
Commercial and industrial	3.00	3.02
Consumer	1.66	1.74
Consumer residential	3.01	3.00
Agriculture	3.23	3.05
Total gross loans	3.06	3.08

The following table presents risk grade totals by class of loans as of June 30, 2021 and December 31, 2020. Risk grades 1 through 4(W) have been aggregated in the "Pass" line.

(in thousands)	Commercial R.E. Construction	Commercial R.E. Mortgages	Land	Farmland	Commercial and Industrial	Consumer	Consumer Residential	Agriculture	Total
June 30, 2021									
Pass	$ 18,383	$ 547,763	$ 4,330	$ 79,034	$ 230,296	$ 514	$ 27,577	$ 22,723	$ 930,620
Special mention	-	8,814	826	-	-	-	-	-	9,640
Substandard	-	362	-	2,015	1,198	22	37	-	3,634
Total loans	$ 18,383	$ 556,939	$ 5,156	$ 81,049	$ 231,494	$ 536	$ 27,614	$ 22,723	$ 943,894
December 31, 2020									
Pass	$ 32,459	$ 531,507	$ 4,469	$ 81,972	$ 290,504	$ 613	$ 30,849	$ 28,007	$ 1,000,380
Special mention	-	9,049	849	-	-	-	-	-	9,898
Substandard	-	-	-	1,026	1,502	23	38	248	2,837
Total loans	$ 32,459	$ 540,556	$ 5,318	$ 82,998	$ 292,006	$ 636	$ 30,887	$ 28,255	$ 1,013,115

Allowance for Loan Losses. The allowance for loan losses is a reserve established by the Company through a provision for loan losses charged to expense, which represents management's best estimate of probable losses that have been incurred within the existing portfolio of loans. The allowance, in the judgment of management, is necessary to reserve for estimated loan losses and risks inherent in the loan portfolio. The allowance for loan loss methodology includes allowance allocations calculated in accordance with ASC Topic 310, "Receivables" and allowance allocations calculated in accordance with ASC Topic 450, "Contingencies." Accordingly, the methodology is based on historical loss experience by type of credit and internal risk grade, specific homogeneous risk pools and specific loss allocations, with adjustments for current events and conditions. The process for determining the appropriate level of the allowance for loan losses is designed to account for credit deterioration as it occurs. The provision for loan losses reflects loan quality trends, including the levels of and trends related to non-accrual loans, past due loans, potential problem loans, criticized loans and net charge-offs or recoveries, among other factors. The provision for loan losses also reflects the totality of actions taken on all loans for a particular period. In other words, the amount of the provision reflects not only the necessary increases in the allowance for loan losses related to newly identified criticized loans, but it also reflects actions taken related to other loans including, among other things, any necessary increases or decreases in required allowances for specific loans or loan pools.

The level of the allowance reflects management's continuing evaluation of industry concentrations, specific credit risks, loan loss experience, current loan portfolio quality, present economic, political and regulatory conditions and unidentified losses inherent in the current loan portfolio. Portions of the allowance may be allocated for specific credits; however, the entire allowance is available for any credit that, in management's judgment, should be charged off. While management utilizes its best judgment and information available, the ultimate adequacy of the allowance is dependent upon a variety of factors beyond the Company's control, including, among other things, the performance of the Company's loan portfolio, the economy, changes in interest rates and the view of the regulatory authorities toward loan classifications.

The Company's allowance for loan losses consists of three elements: (i) specific valuation allowances determined in accordance with ASC Topic 310 based on probable losses on specific loans; (ii) historical valuation allowances determined in accordance with ASC Topic 450 based on historical loan loss experience for similar loans with similar characteristics and trends, adjusted, as necessary, to reflect the impact of current conditions; and (iii) general valuation allowances determined in accordance with ASC Topic 450 based on general economic conditions and other qualitative risk factors both internal and external to the Bank and the Company.

The allowances established for probable losses on specific loans are based on a regular analysis and evaluation of problem loans. Loans are classified based on an internal credit risk grading process that evaluates, among other things: (i) the obligor's ability to repay; (ii) the underlying collateral, if any; and (iii) the economic environment and industry in which the borrower operates. This analysis is performed at the relationship manager level for all commercial loans. When a loan has a calculated grade of 5 or higher, a special assets officer analyzes the loan to determine whether the loan is impaired and, if impaired, the need to specifically allocate a portion of the allowance for loan losses to the loan. Specific valuation allowances are determined by analyzing the borrower's ability to repay amounts owed, collateral deficiencies, the relative risk grade of the loan and economic conditions affecting the borrower's industry, among other things.

Historical valuation allowances are calculated based on the historical loss experience of specific types of loans and the internal risk grade of such loans at the time they were charged-off. The Company calculates historical loss ratios for pools of similar loans with similar characteristics based on the proportion of actual charge-offs experienced to the total population of loans in the pool. The historical loss ratios are periodically updated based on actual charge-off experience. A historical valuation allowance is established for each pool of similar loans based upon the product of the historical loss ratio and the total dollar amount of the loans in the pool. The Company's pools of similar loans include similarly risk-graded groups of commercial and industrial loans, commercial real estate loans, consumer residential, consumer and agriculture.

General valuation allowances are based on general economic conditions and other qualitative risk factors both internal and external to the Bank and the Company. In general, such valuation allowances are determined by evaluating, among other things: (i) the experience, ability and effectiveness of the Bank's lending management and staff; (ii) the effectiveness of the Bank's loan policies, procedures and internal controls; (iii) changes in asset quality; (iv) changes in loan portfolio volume; (v) the composition and concentrations of credit; (vi) the impact of competition on loan structuring and pricing; (vii) the effectiveness of the internal loan review function; (viii) the impact of environmental risks on portfolio risks; and (ix) the impact of rising interest rates on portfolio risk. Management evaluates the degree of risk that each one of these components has on the quality of the loan portfolio on a quarterly basis. Each component is determined to have either a high, moderate or low degree of risk. The results are then input into a "general allocation matrix" to determine an appropriate general valuation allowance.

Included in the general valuation allowances are allocations for groups of similar loans with risk characteristics that exceed certain concentration limits established by management. Concentration risk limits have been established, among other things, for certain industry concentrations, large balance and highly leveraged credit relationships that exceed specified risk grades, and loans originated with policy exceptions that exceed specified risk grades.

Loans identified as losses by management, internal loan review and/or bank examiners are charged-off. Furthermore, consumer loan accounts are charged-off automatically based on regulatory requirements.

The following table details activity in the allowance for loan losses by portfolio segment for the three and six-months ended June 30, 2021 and 2020. Allocation of a portion of the allowance to one category of loans does not preclude its availability to absorb losses in other categories.

Allowance for Loan Losses
For the Three and Six Months Ended June 30, 2021 and 2020

(in thousands)

Three Months Ended June 30, 2021	Commercial Real Estate	Commercial and Industrial	Consumer	Consumer Residential	Agriculture	Total
Beginning balance	$ 9,520	$ 1,015	$ 19	$ 336	$ 422	$ 11,312
Charge-offs	0	0	(3)	0	0	(3)
Recoveries	16	0	1	1	0	18
Provision for (reversal of) loan losses	(12)	14	0	(23)	21	0
Ending balance	$ 9,524	$ 1,029	$ 17	$ 314	$ 443	$ 11,327
Six Months Ended June 30, 2021						
Beginning balance	$ 9,310	$ 1,079	$ 22	$ 325	$ 561	$ 11,297
Charge-offs	0	0	(8)	0	0	(8)
Recoveries	32	0	5	1	0	38
Provision for (reversal of) loan losses	182	(50)	(2)	(12)	(118)	0
Ending balance	$ 9,524	$ 1,029	$ 17	$ 314	$ 443	$ 11,327
Three Months Ended June 30, 2020						
Beginning balance	$ 7,691	$ 1,068	$ 33	$ 328	$ 466	$ 9,586
Charge-offs	0	0	(5)	0	0	(5)
Recoveries	0	0	2	0	0	2
Provision for (reversal of) loan losses	1,743	45	4	(7)	75	1,860
Ending balance	$ 9,434	$ 1,113	$ 34	$ 321	$ 541	$ 11,443
Six Months Ended June 30, 2020						
Beginning balance	$ 7,277	$ 1,000	$ 38	$ 306	$ 525	$ 9,146
Charge-offs	0	0	(16)	(2)	0	(18)
Recoveries	0	0	4	1	0	5
Provision for loan losses	2,157	113	8	16	16	2,310
Ending balance	$ 9,434	$ 1,113	$ 34	$ 321	$ 541	$ 11,443

The following table details the allowance for loan losses and ending gross loan balances as of June 30, 2021 and December 31, 2020, summarized by collective and individual evaluation methods of impairment.

(in thousands)

June 30, 2021	Commercial Real Estate	Commercial and Industrial	Consumer	Consumer Residential	Agriculture	Total
Allowance for loan losses for loans:						
Individually evaluated for impairment	$ 0	$ 0	$ 0	$ 0	$ 0	$ 0
Collectively evaluated for impairment	9,524	1,029	17	314	443	11,327
	$ 9,524	$ 1,029	$ 17	$ 314	$ 443	$ 11,327
Ending gross loan balances:						
Individually evaluated for impairment	$ 362	$ 0	$ 0	$ 0	$ 0	$ 362
Collectively evaluated for impairment	661,165	231,494	536	27,614	22,723	943,532
	$ 661,527	$ 231,494	$ 536	$ 27,614	$ 22,723	$ 943,894
December 31, 2020						
Allowance for loan losses for loans:						
Individually evaluated for impairment	$ 0	$ 0	$ 0	$ 0	$ 0	$ 0
Collectively evaluated for impairment	9,310	1,079	22	325	561	11,297
	$ 9,310	$ 1,079	$ 22	$ 325	$ 561	$ 11,297
Ending gross loan balances:						
Individually evaluated for impairment	$ 0	$ 0	$ 0	$ 0	$ 0	$ 0
Collectively evaluated for impairment	661,331	292,006	636	30,887	28,255	1,013,115
	$ 661,331	$ 292,006	$ 636	$ 30,887	$ 28,255	$ 1,013,115

Changes in the reserve for off-balance-sheet commitments were as follows:

(in thousands)	THREE MONTHS ENDED JUNE 30,		SIX MONTHS ENDED JUNE 30,	
	2021	2020	2021	2020
Balance, beginning of period	$ 428	$ 396	$ 379	$ 427
Provision (Reversal) to Operations for Off Balance Sheet Commitments	7	23	56	(8)
Balance, end of period	$ 435	$ 419	$ 435	$ 419

The method for calculating the reserve for off-balance-sheet loan commitments is based on a reserve percentage which is less than other outstanding loan types because they are at a lower risk level. This reserve percentage, based on many factors including historical losses and existing economic conditions, is evaluated by management periodically and is applied to the total undisbursed loan commitment balance to calculate the reserve for off-balance-sheet commitments. Reserves for off-balance-sheet commitments are recorded in interest payable and other liabilities on the condensed consolidated balance sheets.

At June 30, 2021 and December 31, 2020, loans carried at $943,894,000 and $1,013,115,000, respectively, were pledged as collateral on advances from the Federal Home Loan Bank.

NOTE 5 — FINANCIAL INSTRUMENTS AND FAIR VALUE MEASUREMENTS

Fair values of financial instruments — The condensed consolidated financial statements include various estimated fair value information as of June 30, 2021 and December 31, 2020. Such information, which pertains to the Company’s financial instruments, does not purport to represent the aggregate net fair value of the Company. Further, the fair value estimates are based on various assumptions, methodologies, and subjective considerations, which vary widely among different financial institutions and which are subject to change.

We determine the fair values of our financial instruments based on the fair value hierarchy established under applicable accounting guidance which requires an

entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value:
Level 1: Inputs to the valuation methodology are quoted prices (unadjusted) for identical assets or liabilities in active markets.
Level 2: Inputs to the valuation methodology include quoted prices for similar assets and liabilities in active markets and inputs that are observable for the asset or liability, either directly or indirectly, for substantially the full term of the financial instrument.
Level 3: Inputs to the valuation methodology are unobservable and significant to the fair value measurement.

In certain cases, the inputs used to measure fair value may fall into different levels of the fair value hierarchy. In such cases, the level in the fair value hierarchy within which the fair value measurement in its entirety falls has been determined based on the lowest level input that is significant to the fair value measurement in its entirety. The Company's assessment of the significance of a particular input to the fair value measurement in its entirety requires judgment and considers factors specific to the asset or liability. Transfers between levels of the fair value hierarchy are recognized on the actual date of the event or circumstance that caused the transfer, which generally corresponds with the Company's quarterly valuation process. There were no transfers between levels during the three and six-month periods ended June 30, 2021 and 2020.

Following is a description of valuation methodologies used for assets and liabilities in the tables below:

Cash and cash equivalents — The carrying amounts of cash and cash equivalents approximate their fair value and are considered a level 1 valuation.

Restricted Equity Securities — The carrying amounts of the stock the Company owns in Federal Reserve Bank ("FRB") and FHLB approximate their fair value and are considered a level 2 valuation.

Loans receivable — The fair value of the loan portfolio is estimated using discounted cash flow analyses, using interest rates currently being offered for loans with similar terms to borrowers of similar credit quality. The Company's fair value model takes into account many inputs including loan discounts due to credit risk, current market rates on new loans, the U.S. treasury yield curve, LIBOR yield curve, rate floors, rate ceilings, remaining maturity, and average life based on specific loan type. The exit price rather than the entrance price is used to determine the fair value of loans not measured at fair value on a non-recurring basis. Loans are considered to be a level 3 valuation.

Deposit liabilities — The fair values estimated for demand deposits (interest and non-interest checking, savings, and certain types of money market accounts) are, by definition, equal to the amount payable on demand at the reporting date (i.e. their carrying amounts). The carrying amounts for variable-rate, fixed-term money market accounts and certificates of deposit approximate their fair values at the reporting date. Fair values for fixed-rate certificates of deposit are estimated using a discounted cash flow calculation that applies interest rates currently being offered on certificates to a schedule of the aggregate expected monthly maturities on time deposits. The fair value of deposits is determined by the Company's internal assets and liabilities modeling system that accounts for various inputs such as decay rates, rate floors, FHLB yield curve, maturities and current rates offered on new accounts. Fair value on deposits is considered a level 3 valuation.

Interest receivable and payable — The carrying amounts of accrued interest approximate their fair value and are considered to be a level 2 valuation.

Off-balance-sheet instruments — Fair values for the Bank's off-balance-sheet lending commitments are based on fees currently charged to enter into similar agreements, taking into account the remaining terms of the agreements and the credit standing of the counterparties. The Company considers the Bank's off-balance sheet instruments to be a level 3 valuation.

The estimated fair values of the Company's financial instruments not measured at fair value as of June 30, 2021 were as follows:

(in thousands)	Carrying Amount	Fair Value	Hierarchy Valuation Level
Financial assets:			
Cash and cash equivalents	$ 525,802	$ 525,802	1
Restricted equity securities	5,493	5,493	2
Loans, net	927,543	937,840	3
Interest receivable	4,568	4,568	2
Financial liabilities:			
Deposits	(1,614,480)	(1,614,497)	3
Interest payable	(17)	(17)	2
Off-balance-sheet liabilities:			
Commitments and standby letters of credit		1,671	3

The estimated fair values of the Company's financial instruments not measured at fair value as of December 31, 2020 were as follows:

(in thousands)	Carrying Amount	Fair Value	Hierarchy Valuation Level
Financial assets:			
Cash and cash equivalents	$ 226,656	$ 226,656	1
Restricted equity securities	4,757	4,757	2
Loans, net	997,246	1,006,335	3
Interest receivable	5,689	5,689	2
Financial liabilities:			
Deposits	(1,367,809)	(1,367,874)	3
Interest payable	(20)	(20)	2
Off-balance-sheet liabilities:			
Commitments and standby letters of credit		1,457	3

The following table presents the carrying value of recurring and nonrecurring financial instruments that were measured at fair value and that were still held in the condensed consolidated balance sheets at each respective period end, by level within the fair value hierarchy as of June 30, 2021 and December 31, 2020.

(in thousands)	Fair Value Measurements as of June 30, 2021 Using			
	June 30, 2021	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets and liabilities measured on a recurring basis:				
Available-for-sale securities:				
U.S. agencies	$ 25,318	$ 0	$ 25,318	$ 0
Collateralized mortgage obligations	1,067	0	1,067	0
Municipalities	143,997	0	143,997	0
SBA pools	4,487	0	4,487	0
Corporate debt	14,949	0	14,949	0
Asset backed securities	46,957	0	46,957	0
Equity Securities:				
Mutual fund	$ 3,413	$ 3,413	$ 0	$ 0
Assets and liabilities measured on a non-recurring basis:				
Impaired loans:				
Commercial real estate - mortgages	$ 362	$ 0	$ 0	$ 362

(in thousands)	December 31, 2020	Fair Value Measurements at December 31, 2020 Using Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets and liabilities measured on a recurring basis:				
Available-for-sale securities:				
U.S. agencies	$ 23,692	$ 0	$ 23,692	$ 0
Collateralized mortgage obligations	1,223	0	1,223	0
Municipalities	125,602	0	125,602	0
SBA pools	5,008	0	5,008	0
Corporate debt	14,352	0	14,352	0
Asset backed securities	47,287	0	47,287	0
Equity Securities:				
Mutual fund	$ 3,425	$ 3,425	$ 0	$ 0
Assets and liabilities measured on a non-recurring basis:	N/A			

Available-for-sale and equity securities - Investment securities are recorded at fair value on a recurring basis. Fair value measurement is based upon quoted market prices, if available. If quoted market prices are not available, fair values are measured using independent pricing models or other model-based valuation techniques such as the present value of future cash flows, adjusted for the security's credit rating, prepayment assumptions, and other factors such as credit loss assumptions. Level 1 securities include those traded on an active exchange, such as the New York Stock Exchange, U.S. Treasury securities that are traded by dealers or brokers in active over-the-counter markets and money market funds. Level 2 securities include mortgage-backed securities issued by government sponsored entities, municipal bonds and corporate debt securities. Securities classified as Level 3 include asset-backed securities in less liquid markets where significant inputs are unobservable.

Impaired loans - ASC Topic 820 applies to loans measured for impairment using the practical expedients permitted by ASC Topic 310, *Accounting by Creditors for Impairment of a Loan*. The Company does not record loans at fair value on a recurring basis. However, from time to time, a loan is considered impaired and an allowance for loan losses is established. Loans for which it is probable that payment of interest and principal will not be made in accordance with the contractual terms of the loan agreement are considered impaired. Impaired loans where an allowance is established based on the fair value of collateral less the cost related to liquidation of the collateral require classification in the fair value hierarchy. When the fair value of the collateral is based on an observable market price or a current appraised value, the Company records the impaired loan as non-recurring Level 3. Likewise, when an appraised value is not available or management determines the fair value of the collateral is further impaired below the appraised value and there is no observable market price, the Company records the impaired loan as non-recurring Level 3.

There have been no significant changes in the valuation techniques during the six-month period ended June 30, 2021.

NOTE 6 – EARNINGS PER SHARE

Earnings per share ("EPS") are based upon the weighted average number of common shares outstanding during each year. The following table shows: (1) weighted average basic shares, (2) effect of dilutive securities related to non-vested restricted stock, and (3) weighted average shares of common stock and common stock equivalents. Net income available to common stockholders is calculated as net income reduced by dividends accumulated on preferred stock, if any. Basic EPS is calculated by dividing net income available to common stockholders by the weighted average number of common shares outstanding during each period, excluding unvested restricted stock awards. Diluted EPS is calculated using the weighted average diluted shares, which reflects the potential dilution that could occur if securities or other contracts to issue common stock were exercised or converted into common stock. The dilutive shares included in year-to-date diluted EPS is a weighted average of the dilutive shares included in each quarterly diluted EPS computation under the treasury stock method. The Company has two forms of outstanding common stock: fully vested common stock and unvested restricted stock awards. Holders of restricted stock awards receive non-forfeitable dividends at the same rate as common stockholders and they both share equally in undistributed earnings. Therefore, under the two-class method the difference in EPS is not significant for these participating securities.

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The Company's calculation of basic and diluted EPS for the three and six-month periods ended June 30, 2021 and 2020 are reflected in the tables below.

(In thousands)	THREE MONTHS ENDED JUNE 30, 2021	2020
BASIC EARNINGS PER SHARE		
Net income	$ 3,960	$ 2,581
Weighted average shares outstanding	8,146	8,124
Net income per common share	$ 0.49	$ 0.32
DILUTED EARNINGS PER SHARE		
Net income	$ 3,960	$ 2,581
Weighted average shares outstanding	8,146	8,124
Effect of dilutive non-vested restricted shares	32	6
Weighted average shares of common stock and common stock equivalents	8,178	8,130
Net income per diluted common share	$ 0.48	$ 0.32

(In thousands)	SIX MONTHS ENDED JUNE 30, 2021	2020
BASIC EARNINGS PER SHARE		
Net income	$ 8,316	$ 5,290
Weighted average shares outstanding	8,140	8,119
Net income per common share	$ 1.02	$ 0.65
DILUTED EARNINGS PER SHARE		
Net income	$ 8,316	$ 5,290
Weighted average shares outstanding	8,140	8,119
Effect of dilutive non-vested restricted shares	32	13
Weighted average shares of common stock and common stock equivalents	8,172	8,132
Net income per diluted common share	$ 1.02	$ 0.65

NOTE 7 – RISKS AND UNCERTAINTIES

The coronavirus ("COVID-19") pandemic and the Federal Reserve's response to the economic challenges has resulted in an uncertain and rapidly evolving economy. In the early stages of the pandemic, a significant portion of staff worked remotely, but essentially all staff have returned to the office as of June 30, 2021. The remote work arrangements did not adversely impact the ability to serve clients and did not have an impact on the Company's financial reporting systems or the internal controls over financial reporting, disclosures and related procedures.

The most significant impact of COVID-19 on the Company's business has been to the quality of the loan portfolio and to net interest income as short-term interest rates have sharply declined. The Company has increased the qualitative factors used in the determination of the adequacy of the allowance for loan and lease loss in anticipation of the impact that COVID-19 will have on clients and their ability to fulfill their obligations. There is no certainty that the allowance for loan losses as of June 30, 2021 will be sufficient to absorb the losses that stem from the impact of COVID-19 on the Company's clients. As the longer-term effects on clients from the COVID-19 pandemic become more apparent, it may be necessary to charge-off some or all of the balance on certain loans and make further provisions to increase the allowance for loan and lease losses. These potential additional provisions for loan and lease losses will have a direct impact upon capital, including the potential need to reevaluate a valuation allowance on our deferred tax asset. At this time, the Company does not expect that there would be any material impairment to the valuation of other long-lived assets, right of use assets, or our investment securities.

Increased demand for liquidity by clients is another impact that could occur should the COVID-19 effects be prolonged. As of June 30, 2021, the Company and the Bank's on-balance sheet liquidity was very strong and combined with contingent liquidity resources, management believes that the Bank has sufficient resources to meet the liquidity needs of its clients. In response to COVID-19, the Federal Reserve has made other provisions that could assist the Bank in satisfying its liquidity needs, such as reducing the reserve requirement to zero, expanding access to the discount window through collateral pledging and extension of term borrowings.

The extent to which the COVID-19 pandemic affects the Company's future financial results and operations will depend on future developments which are highly uncertain and cannot be predicted, including new information which may emerge concerning the duration and broad impacts of the pandemic, and current or future actions in response thereto. See "Management's Discussion and Analysis of Financial Position and Results of Operations" and Part II, Item 1A, Risk Factors, for an additional discussion of risk related to COVID-19.

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

The following discussion explains the significant factors affecting the Company's operations and financial position for the periods presented. The discussion should be read in conjunction with the Company's financial statements and the notes related thereto which appear or that are referenced to elsewhere in this report, and with the audited consolidated financial statements and accompanying notes included in the Company's 2020 Annual Report on Form 10-K. Average balances, including balances used in calculating certain financial ratios, are generally comprised of average daily balances.

The discussion and analysis of the Company's financial condition and results of operations is based upon the Company's financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States of America. The preparation of these financial statements requires management to make estimates and judgments that affect the reported amounts of assets and liabilities, revenues and expenses, and related disclosures of contingent assets and liabilities at the date of the Company's financial statements. Actual results may differ from these estimates under different assumptions or conditions. This discussion and analysis includes executive management's ("Management") insight of the Company's financial condition and results of operations of Oak Valley Bancorp and its subsidiary. Unless otherwise stated, the "Company" refers to the consolidated entity, Oak Valley Bancorp, while the "Bank" refers to Oak Valley Community Bank.

Forward-Looking Statements

Some matters discussed in this Form 10-Q may be "forward-looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995 and therefore may involve risks, uncertainties and other factors which may cause the Company's actual results to be materially different from the results expressed or implied by the Company's forward-looking statements. These statements generally appear with words such as "anticipate," "believe," "estimate," "may," "intend," and "expect." Although management believes that the assumptions and expectations reflected in such forward-looking statements are reasonable, it can give no assurance that such expectations will prove to be correct. Factors that could cause actual results to differ from results discussed in forward-looking statements include, but are not limited to: the credit exposure of certain loan products and other components of our business that could be impacted by the COVID-19 pandemic, changes in monetary, fiscal or tax policy to address the continuing impact of COVID-19, any of which could cause us to incur additional loan losses and adversely affect our results of operations in the future, economic conditions (both generally and in the markets where the Company operates); the continuing impact of the COVID-19 pandemic on our employees and customers; the success of our efforts to mitigate the impact of the COVID-19 pandemic; competition from other providers of financial services offered by the Company; changes in government regulation and legislation; changes in interest rates; material unforeseen changes in the financial stability and liquidity of the Company's credit customers; risks associated with concentrations in real estate related loans; changes in accounting standards and interpretations; and other risks as may be detailed from time to time in the Company's filings with the Securities and Exchange Commission, all of which are difficult to predict and which may be beyond the control of the Company. Many of the foregoing risks and uncertainties are, and will be, exacerbated by the COVID-19 pandemic and any worsening of the global business and economic environment as a result. The Company undertakes no obligation to revise forward-looking statements to reflect events or changes after the date of this discussion or to reflect the occurrence of unanticipated events.

Forward-looking statements speak only as of the date they are made, and the Company does not undertake to update forward-looking statements to reflect circumstances or events that occur after the date the forward-looking statements are made, whether as a result of new information, future developments or otherwise, except as may be required by law.

Introduction

In July 2008, Oak Valley Community Bank became a subsidiary of Oak Valley Bancorp, a newly established bank holding company. Oak Valley Bancorp operates Oak Valley Community Bank as a community bank in the general commercial banking business, with our primary market encompassing the California Central Valley around Oakdale and Modesto, and the Eastern Sierras. As such, unless otherwise noted, all references are about Oak Valley Bancorp.

Oak Valley Community Bank ("the Bank") commenced operations in May 1991. The Bank is an insured bank under the Federal Deposit Insurance Act and is a member of the Federal Reserve. Since its formation, the Bank has provided basic banking services to individuals and business enterprises in Oakdale, California and the surrounding areas. The focus of the Bank is to offer a range of commercial banking services designed for both individuals and small to medium-sized businesses in the Central Valley and the Eastern Sierras.

The Bank offers a complement of business checking and savings accounts for its business customers. The Bank also offers commercial and real estate loans, as well as lines of credit. Real estate loans are generally of a short-term nature for both residential and commercial purposes. Longer-term real estate loans are generally made with adjustable interest rates and contain normal provisions for acceleration. In addition, the Bank offers traditional residential mortgages through a third party.

The Bank also offers other services for both individuals and businesses including online banking, remote deposit capture, merchant services, night depository, extended hours, traveler's checks, wire transfer of funds, note collection, and automated teller machines in a national network. The Bank does not currently offer international banking or trust services although the Bank may make such services available to the Bank's customers through financial institutions with which the Bank has correspondent banking relationships. The Bank does not offer stock transfer services, nor does it directly issue credit cards.

COVID-19 Impact

The coronavirus ("COVID-19") pandemic and the Federal Reserve's response to the economic challenges during the 2020 and 2021 has resulted in an uncertain and rapidly evolving economy. In the early stages of the pandemic, a significant portion of staff worked remotely, but essentially all staff have returned to the office as of June 30, 2021. In addition to remote work arrangements, the Company has taken many other measures to protect employees and customers, including, adherence to state mask wearing mandates, social distancing, sanitizing protocols and posting of public safety notices on branch buildings.

The most significant impact of COVID-19 on our business has been to the quality of our loan portfolio and to net interest income as short-term interest rates have sharply declined. The Company has increased the qualitative factors used in the determination of the adequacy of the allowance for loan and lease loss in anticipation of the impact that COVID-19 will have on clients and their ability to fulfill their obligations. There is no certainty that the allowance for loan losses as of June 30, 2021 will be sufficient to absorb the losses that stem from the impact of COVID-19 on the Company's clients. No loan loss provisions were warranted during the first six months of 2021 because credit quality remained strong with only one outstanding loan with a balance of $362,000 on non-accrual status, and PPP loans do not require a reserve because they are guaranteed by the federal government through the SBA program. The Company funded new PPP loans totaling $101 million under the Second Draw PPP during the first six months of 2021 which partially contributed to total PPP interest and fee income of $2,202,000 and $4,793,000 recorded during the three and six months ended June 30, 2021, respectively. As of June 30, 2021, only one borrowing relationship consisting of 4 loans totaling $8,381,000 has experienced economic hardship related to COVID-19 during 2021 and the Bank responded by deferring principal payments, and thus converting the loans to interest-only for the remainder of 2021. As the longer-term effects on clients from the COVID-19 pandemic become more apparent, it may be necessary to charge-off some or all of the balance on certain loans and make further provisions to increase the allowance for loan and lease losses. These potential additional provisions for loan and lease losses will have a direct impact upon capital, including the potential need to reevaluate a valuation allowance on our deferred tax asset. At this time, the Company does not expect that there would be any material impairment to the valuation of other long-lived assets, right of use assets, or our investment securities. The Company completed its funding of PPP loans during the second quarter of 2021 and does not expect to fund any other PPP loans as the funding phase of the program has expired. The Company expects the vast majority of outstanding PPP loans to be forgiven during 2021, which should result in relatively high levels of loan fees recognized during the third and fourth quarters of 2021, but is expected to drop off significantly in 2022.

Increased demand for liquidity by clients is another impact that could occur should the COVID-19 effects be prolonged. As of June 30, 2021, the Company and the Bank's on-balance sheet liquidity was very strong and combined with contingent liquidity resources, management believes that the Bank has sufficient resources to meet the liquidity needs of its clients. In response to COVID-19, the Federal Reserve has made other provisions that could assist the Bank in satisfying its liquidity needs, such as reducing the reserve requirement to zero, expanding access to the discount window through collateral pledging and extension of term borrowings.

The extent to which the COVID-19 pandemic affects the Company's future financial results and operations will depend on future developments which are highly uncertain and cannot be predicted, including new information which may emerge concerning the duration and broad impacts of the pandemic, and current or future actions in response thereto. Management is working closely with our Board of Directors as we plan and execute our response to the significant disruption caused by the crisis. See the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2020, for additional discussion of risks related to the COVID-19 pandemic.

Critical Accounting Estimates

Management has determined the following five accounting estimates to be critical:

Allowance for Loan Losses

Accounting for allowance for loan losses involves significant judgment and assumptions by management and is based on historical data and management's view of the current economic environment. At least on a quarterly basis, management reviews the methodology and adequacy of allowance for loan losses and reports its assessment to the Board of Directors for its review and approval.

The Company bases the allowance for loan losses on an estimation of probable losses inherent in the loan portfolio. The Company's methodology for assessing loan loss allowances are intended to reduce the differences between estimated and actual losses and involves a detailed analysis of the loan portfolio in three phases:

- the specific review of individual loans,
- the segmenting and review of loan pools with similar characteristics, and
- management's estimate based on various subjective factors.

The first phase of the methodology involves the specific review of individual loans to identify and measure impairment. The Company evaluates each loan by use of a risk rating system, except for homogeneous loans, such as automobile loans and home mortgages. Specific risk rated loans are deemed impaired if all amounts, including principal and interest, will likely not be collected in accordance with the contractual terms of the related loan agreement. Impairment for commercial and real estate loans is measured either based on the present value of the loan's expected future cash flows or, if collection on the loan is collateral dependent, the estimated fair value of the collateral, less selling and holding costs.

The second phase involves the segmenting of the remainder of the risk rated loan portfolio into groups or pools of loans, together with loans with similar characteristics, for evaluation. The Company determines the calculated loss ratio for each loan pool based on its historical net losses and benchmarks it against the levels of other peer banks.

In the third phase, the Company considers relevant internal and external factors that may affect the collectability of the loan portfolio and each group of loans. The factors considered are, but are not limited to:

- concentration of credits,
- nature and volume of the loan portfolio,
- delinquency trends,
- non-accrual loan trends,
- problem loan trends,
- loss and recovery trends,
- quality of loan review,
- lending and management staff,
- lending policies and procedures,
- economic and business conditions, and
- other external factors, including regulatory review.

Management estimates the probable effect of such conditions based on management's judgment, experience and known or anticipated trends. Such estimation may be reflected as an additional allowance to each group of loans, if necessary. Management reviews these conditions with the Company's senior credit officers. To the extent that any of these conditions is evidenced by a specifically identifiable problem credit or portfolio segment as of the evaluation date, management's estimate of the effect of such condition may be reflected as a specific allowance applicable to such credit or portfolio segment. Where any of these conditions is not evidenced by a specific, identifiable problem credit or portfolio segment as of the evaluation date, management's evaluation of the inherent loss related to such condition is reflected in the unallocated allowance.

Central to credit risk management and management's assessment of appropriate loss allowance is the internal loan risk rating system. Under this system, the originating credit officer assigns borrowers an initial risk rating based on a thorough analysis of each borrower's financial capacity in conjunction with industry and economic trends. Approvals are made based upon the amount of inherent credit risk specific to the transaction and are reviewed for appropriateness by senior line and credit administration personnel. Credits are monitored by line and credit administration personnel for deterioration in a borrower's financial condition which may impact the ability of the borrower to perform under the contract. Although management has allocated a portion of the allowance to specific loans, specific loan pools, and off-balance sheet credit exposures (which are reported separately as part of interest payable and other liabilities), the adequacy of the allowance is considered in its entirety.

Non-Accrual Loan Policy

Interest on loans is credited to income as earned and is accrued only if deemed collectible. Accrual of interest is discontinued when a loan is over 90 days delinquent or if management believes that collection is highly uncertain. Generally, payments received on non-accrual loans are recorded as principal reductions. Interest income is recognized after all principal has been repaid or an improvement in the condition of the loan has occurred that would warrant resumption of interest accruals. Loans are considered past due if the required principal and interest payments have not been received as of the date such payments were due.

Asset Impairment Judgments

Certain assets are carried in the condensed consolidated balance sheets at fair value or at the lower of cost or fair value. Valuation allowances are established when necessary to recognize impairment of such assets. The Company periodically performs analyses to test for impairment of various assets. In addition to management's impairment analyses related to loans, another significant impairment analysis relates to other than temporary declines in the value of investment securities.

Loans for which it is probable that payment of interest and principal will not be made in accordance with the contractual terms of the loan agreement are considered impaired and are carried at fair value or below. Appraisals are done periodically on impaired loans and if required an allowance is established based on the fair value of collateral less the cost related to liquidation of the collateral. In some circumstances, an impaired loan may be charged off to bring the carrying value to fair value.

Other Real Estate Owned ("OREO") acquired through, or in lieu of, foreclosure, are held-for-sale and are initially recorded at fair value, less selling costs. Any write-downs to fair value at the time of transfer to OREO are charged to the allowance for loan losses, subsequent to foreclosure. Appraisals or evaluations are then done periodically and any subsequent declines in the fair value of the OREO property after the date of transfer are recorded through a write-down of the asset. Any subsequent operating expenses or income, reduction in estimated fair values, and gains or losses on disposition of such properties are charged or credited to current operations.

Net realizable value of the underlying collateral is the fair value of the collateral less estimated selling costs and any prior liens. Appraisals, recent comparable sales, offers and listing prices are factored in when valuing the collateral. The Company reviews and verifies the qualifications and licenses of the certified general appraisers used for appraising commercial properties or certified residential appraisers for residential properties. Real estate appraisals may utilize a combination of approaches including replacement cost, sales comparison and the income approach. Comparable sales and income data are analyzed by the appraisers and adjusted to reflect differences between them and the subject property such as type, leasing status and physical condition. When the appraisals are received, Management reviews the assumptions and methodology utilized in the appraisal, as well as the overall resulting value in conjunction with independent data sources such as recent market data and industry-wide statistics. The Company generally uses a 6% discount for selling costs which is applied to all properties, regardless of size. Appraised values may be adjusted to reflect changes in market conditions that have occurred subsequent to the appraisal date, or for revised estimates regarding the timing or cost of the property sale. These adjustments are based on qualitative judgments made by management on a case-by-case basis.

The available for sale investment portfolio is carried at estimated fair value, with any unrealized gains and losses, net of taxes, reported as accumulated other comprehensive income in shareholders' equity. The Company conducts a periodic review and evaluation of the securities portfolio to determine if the value of any security has declined below its carrying value and whether such decline is other than temporary. If such decline is deemed other than temporary, the Company would adjust the carrying amount of the security by writing down the security to fair market value through a charge to current period income. The market values of investment securities are significantly affected by changes in interest rates.

In general, as interest rates rise, the market value of fixed-rate securities will decrease; as interest rates fall, the market value of fixed-rate securities will increase. With significant changes in interest rates, the Company evaluates the intent and ability to hold the security for a sufficient time to recover the recorded principal balance. Estimated fair values for securities are based on published or securities dealers' market values. Market volatility is unpredictable and may impact such values.

Fair Value Measurements

The Company uses fair value measurements to record fair value adjustments to certain assets and liabilities and to determine fair value disclosures. The Company bases fair values on the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Securities available for sale, derivatives, and loans held for sale, if any, are recorded at fair value on a recurring basis. Additionally, from time to time, the Company may be required to record certain assets at fair value on a non-recurring basis, such as certain impaired loans held for investment and securities held to maturity that are other-than-temporarily impaired. These non-recurring fair value adjustments typically involve write-downs of individual assets due to application of lower-of-cost or market accounting.

The Company has established and documented a process for determining fair value. The Company maximizes the use of observable inputs and minimize the use of unobservable inputs when developing fair value measurements. Whenever there is no readily available market data, management uses its best estimate and assumptions in determining fair value, but these estimates involve inherent uncertainties and the application of management's judgment. As a result, if other assumptions had been used, the recorded earnings or disclosures could have been materially different from those reflected in these financial statements.

Income Taxes

Deferred income taxes are provided for the temporary differences between the financial reporting basis and the tax basis of the Company's assets and liabilities. Deferred tax assets and liabilities are reflected at currently enacted income tax rates applicable to the period in which the deferred tax assets or liabilities are expected to be realized or settled using the liability method. As changes in tax laws or rates are enacted, deferred tax assets and liabilities are adjusted through the provision for income taxes.

The Company files income tax returns in the U.S. federal jurisdiction, and the state of California. The Company is no longer subject to U.S. federal or state/local income tax examinations by tax authorities for years before 2016.

Overview of Results of Operations and Financial Condition

The purpose of this summary is to provide an overview of the items that management focuses on when evaluating the condition of the Company and its success in implementing its business and shareholder value strategies. The Company's business strategy is to operate the Bank as a well-capitalized, profitable and independent community-oriented bank. The Company's shareholder value strategy has three major objectives: (1) enhancing shareholder value; (2) making its retail banking franchise more valuable; and (3) efficiently utilizing its capital.

Management believes the following were important factors in the Company's performance during the three and six-month period ended June 30, 2021:

- The Company recognized net income of $3,960,000 and $8,316,000 for the three and six-month periods ended June 30, 2021, respectively, as compared to $2,581,000 and $5,290,000 for the same periods in 2020. The second quarter and year-to-date net income increase was mainly due to growth of earning assets and corresponding net interest income, and a decrease in loan loss provision.

- The Company recognized no loan loss provisions during the three and six-month periods ended June 30, 2021, as compared to $1,860,000 and $2,310,000 for the comparable periods of 2020. No provisions were warranted during the first six months of 2021 because core loans, which exclude PPP loans, decreased by $9 million year-to-date, and PPP loans do not require a reserve, as they are guaranteed by the SBA.

- Net interest income increased $842,000 or 7.6% and 2,856,000 or 13.4% for the three and six-month periods ended June 30, 2021, respectively, compared to the same periods in 2020. The increase was primarily due to an increase in earning assets including PPP loans, which earned interest and fees of $2,202,000 and $4,793,000 during the three and six-months ended June 30, 2021, respectively, which was offset by lower yields on all earning assets due to the FOMC rate cuts in March 2020.

- Non-interest income increased by $382,000 or 37.3% and $273,000 or 11.8% for the three and six-months ended June 30, 2021, respectively, as compared to the same periods in 2020. The increase was primarily due to an increase in service charges on deposit accounts, an increase in debit card transaction fees, and a decrease in the unrealized loss on one equity security.

- Non-interest expense increased by $1,341,000 or 19.5% and $1,612,000 or 11.3% for the three and six-month periods ended June 30, 2021, respectively, as compared to the same periods in 2020. The increase was primarily due to staffing increases and general operating costs related to servicing the growing loan and deposit portfolios, and a reduction in deferred costs associated with funded PPP loans recorded against salary expense.

- Total assets increased $252,986,000 or 16.7%, total net loans decreased by $69,703,000 or 7.0% and investment securities increased by $19,599,000 or 8.9% in each case from December 31, 2020 to June 30, 2021, while deposits increased by $246,671,000 or 18.0% for the same period. Consequently, cash and cash equivalent balances increased by $299,146,000. The June 30, 2021 balance sheet totals were bolstered by the $151 million outstanding in PPP loans that began to fund during the second quarter of 2020. Total funding since commencement of the PPP loan program was $345 million and as of June 30, 2021, we've received $194 million in forgiveness payments from the SBA. The PPP loans consequently increased total deposits, as the PPP funded amounts were credited directly to the borrowers' deposit accounts.

Income Summary

For the three and six-month periods ended June 30, 2021, the Company recorded net income of $3,960,000 and $8,316,000, respectively, representing increases of $1,379,000 and $3,026,000, as compared to the same periods in 2020. Return on average assets (annualized) was 0.93% and 1.02% for the three and six-months ended June 30, 2021, respectively, as compared to 0.75% and 0.84% for the same periods in 2020. Annualized return on average common equity was 11.77% and 12.59% for the three and six-months ended June 30, 2021, respectively, as compared to 8.80% and 9.15% for the same periods in 2020. Net income before provisions for income taxes increased by $1,743,000 and $3,827,000 for the three and six-month periods ended June 30, 2021, respectively, from the comparable 2020 periods. The income statement components of these variances are as follows:

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Pre-Tax Income Variance Summary:

(In thousands)		Effect on Pre-Tax Income *Increase (Decrease)* Three Months Ended June 30, 2021		Effect on Pre-Tax Income *Increase (Decrease)* Six Months Ended June 30, 2021
Change from 2020 to 2021 in:				
Net interest income	$	842	$	2,856
Provision for loan losses		1,860		2,310
Non-interest income		382		273
Non-interest expense		(1,341)		(1,612)
Change in net income before income taxes	$	1,743	$	3,827

These variances will be explained in the discussion below.

Net Interest Income

Net interest income is the largest source of the Company's operating income. For the three and six-month periods ended June 30, 2021, net interest income was $11,988,000 and $24,230,000, respectively, which represented increases of $842,000 or 7.6% and $2,856,000 or 13.4%, from the comparable periods in 2020. The increase was primarily due to an increase in earning assets including PPP loans which earned interest and fees of $2,202,000 and $4,793,000 during the three and six-months ended June 30, 2021, respectively, compared to $1,092,000 in both the three and six-month periods of 2020.

The net interest margin (net interest income as a percentage of average interest earning assets) was 3.09% and 3.56% for the three and six-month periods ended June 30, 2021, respectively, compared to 3.55% and 3.72% for the same periods in 2020. The decrease in net interest margin is primarily due to strong deposit growth resulting in high levels of low-yielding cash equivalent balances, and the negative impact that the FOMC interest rate cuts had on our yield on earning assets. The PPP loan production further compressed the interest margin because PPP loans earn an interest rate of only 1%. Earning asset yield decreased by 49 and 51 basis points for the three and six-month periods ended June 30, 2021, respectively, as compared to the same periods of 2020. Lessening this downward trend, was the deployment of low yielding cash equivalent balances into the organic loan portfolio and investment security portfolio.

The cost of funds on interest-bearing liabilities decreased by 5 and 7 basis points for the three and six-month periods of 2020, respectively, as compared to the same periods in 2020. The Company continues to recognize strong core deposit growth as evidenced by the increase in average non-interest-bearing demand deposit balances of $162 million, for the six-month period ended June 30, 2021, as compared to the same period of 2020. Deposit balances were bolstered by the PPP loans, as the funded amounts were credited directly to the borrowers' deposit accounts.

Net interest income has already been impacted by the COVID-19 since early 2020 and certain risks still exist. Net interest income has in fact steadily increased since the pandemic began, however this is primarily due to interest and fees on PPP loans which is only temporary and there may be additional negative effects to net interest income related to the pandemic. First, interest rates declined sharply at the end of the first quarter of 2020 causing a reduction in the yield on our earning assets which will continue as assets mature and reprice. Second, if the economy worsens to the point of another economic recession, it could reduce the demand for loans and cause credit quality deterioration leading to more non-accrual loans, for which interest income is not recognized. Third, an increase in demand for liquidity by our clients could result in a decrease in deposits and force us to rely on our lines of credit, which could potentially increase our cost of funds. As of June 30, 2021, the Company and the Bank's on-balance sheet liquidity was very strong and combined with our contingent liquidity resources, we believe that the Bank has sufficient resources to meet the liquidity needs of our clients.

The following tables show the relative impact of changes in average balances of interest earning assets and interest-bearing liabilities, and interest rates earned and paid by the Company on those assets and liabilities for the three and six-month periods ended June 30, 2021 and 2020:

Net Interest Analysis

	Three Months Ended June 30, 2021			Three Months Ended June 30, 2020		
(in thousands)	**Average Balance**	**Interest Income / Expense**	**Avg Rate/ Yield (5)**	**Average Balance**	**Interest Income / Expense**	**Avg Rate/ Yield (5)**
Assets:						
Earning assets:						
Gross loans (1) (2)	$ 992,690	$ 10,886	4.40%	$ 935,119	$ 9,842	4.22%
Investment securities (2)	222,176	1,529	2.76%	240,900	1,833	3.05%
Federal funds sold	33,970	7	0.08%	19,261	4	0.08%
Interest-earning deposits	337,739	76	0.09%	92,890	29	0.13%
Total interest-earning assets	1,586,575	12,498	3.16%	1,288,170	11,708	3.65%
Total noninterest earning assets	112,411			90,695		
Total Assets	1,698,986			1,378,865		
Liabilities and Shareholders' Equity:						
Interest-bearing liabilities:						
Interest-earning DDA	368,301	122	0.13%	283,008	119	0.17%
Money market deposits	350,887	91	0.10%	263,398	103	0.16%
Savings deposits	139,639	17	0.05%	94,190	11	0.05%
Time deposits $250,000 and under	21,812	15	0.28%	19,582	14	0.29%
Time deposits over $250,000	17,359	14	0.32%	17,755	28	0.63%
Other Borrowings	0	0	0.00%	41,099	32	0.31%
Total interest-bearing liabilities	897,998	259	0.12%	719,032	307	0.17%
Noninterest-bearing liabilities:						
Noninterest-bearing deposits	567,522			527,059		
Other liabilities	98,527			15,110		
Total noninterest-bearing liabilities	666,049			542,169		
Shareholders' equity	134,939			117,664		
Total liabilities and shareholders' equity	$ 1,698,986			$ 1,378,865		
Net interest income		$ 12,239			$ 11,401	
Net interest spread (3)			3.04%			3.47%
Net interest margin (4)			3.09%			3.55%

(1) Loan fees have been included in the calculation of interest income.
(2) Yields and interest income on municipal securities and loans have been adjusted to their fully-taxable equivalents, based on a federal marginal tax rate of 21.0%.
(3) Represents the average rate earned on interest-earning assets less the average rate paid on interest-bearing liabilities.
(4) Represents net interest income as a percentage of average interest-earning assets.
(5) Annual interest rates are computed by dividing the interest income/expense by the number of days in the period multiplied by 365.

(in thousands)	Six months ended June 30, 2021 Average Balance	Interest Income / Expense	Avg Rate/ Yield (5)	Six months ended June 30, 2020 Average Balance	Interest Income / Expense	Avg Rate/ Yield (5)
Assets:						
Earning assets:						
Gross loans (1) (2)	$ 1,008,330	$ 22,092	4.42%	$ 845,169	$ 18,654	4.43%
Investment securities (2)	215,206	2,986	2.80%	217,441	3,342	3.08%
Federal funds sold	32,360	14	0.09%	16,424	46	0.56%
Interest-earning deposits	275,581	125	0.09%	95,665	396	0.83%
Total interest-earning assets	1,531,477	25,217	3.32%	1,174,699	22,438	3.83%
Total noninterest earning assets	107,735			86,050		
Total assets	1,639,212			1,260,749		
Liabilities and Shareholders' Equity:						
Interest-bearing liabilities:						
Interest-earning DDA	353,990	224	0.13%	268,356	296	0.22%
Money market deposits	336,688	181	0.11%	249,744	204	0.16%
Savings deposits	133,066	33	0.05%	88,652	21	0.05%
Time deposits $250,000 and under	21,811	30	0.28%	19,761	27	0.27%
Time deposits over $250,000	16,863	28	0.33%	17,521	57	0.64%
Other Borrowings	0	0	0.00%	20,549	32	0.31%
Total interest-bearing liabilities	862,418	496	0.12%	664,913	637	0.19%
Noninterest-bearing liabilities:						
Noninterest-bearing deposits	627,510			465,184		
Other liabilities	16,092			14,752		
Total noninterest-bearing liabilities	643,602			479,936		
Shareholders' equity	133,192			115,900		
Total liabilities and shareholders' equity	$ 1,639,212			$ 1,260,749		
Net interest income		$ 24,721			$ 21,801	
Net interest spread (3)			3.20%			3.64%
Net interest margin (4)			3.26%			3.72%

(1) Loan fees have been included in the calculation of interest income.
(2) Yields and interest income on municipal securities and loans have been adjusted to their fully-taxable equivalents, based on a federal marginal tax rate of 21.0%.
(3) Represents the average rate earned on interest-earning assets less the average rate paid on interest-bearing liabilities.
(4) Represents net interest income as a percentage of average interest-earning assets.
(5) Annual interest rates are computed by dividing the interest income/expense by the number of days in the period multiplied by 365.

Shown in the following tables are the relative impacts on net interest income of changes in the average outstanding balances (volume) of earning assets and interest-bearing liabilities and the rates earned and paid by the Company on those assets and liabilities for the three and six-month periods ended June 30, 2021 and 2020. Changes in interest income and expense that are not attributable specifically to either rate or volume are allocated to the rate column below.

Rate / Volume Variance Analysis
(In thousands)

(in thousands)	For the Three Months Ended June 30, 2021 vs 2020 Increase (Decrease) in interest income and expense due to changes in:		
	Volume	**Rate**	**Total**
Interest income:			
Gross loans (1) (2)	$ 606	$ 438	$ 1,044
Investment securities (2)	(142)	(162)	(304)
Federal funds sold	3	0	3
Interest-earning deposits	76	(29)	47
Total interest income	**$ 543**	**$ 247**	**$ 790**
Interest expense:			
Interest-earning DDA	36	(33)	3
Money market deposits	34	(46)	(12)
Savings deposits	5	1	6
Time deposits $250,000 and under	2	(1)	1
Time deposits over $250,000	(1)	(13)	(14)
Other Borrowings	(32)	0	(32)
Total interest expense	**$ 44**	**$ (92)**	**$ (48)**
Change in net interest income	**$ 499**	**$ 339**	**$ 838**

(1) Loan fees have been included in the calculation of interest income.
(2) Interest income on municipal securities and loans has been adjusted to their fully-taxable equivalents, based on a federal marginal tax rate of 21.0%.

The table above reflects an increase of $499,000 in net interest income due to growth of earning asset balances combined with the overall change in mix of balances during the second quarter of 2021 as compared to the same period of 2020. Changes in earning asset yields and rates on interest-bearing liabilities resulted in an increase of $339,000 to net interest income, over the same period. This increase was mainly due to interest and fees on PPP loans as described above.

(in thousands)	For the Six Months Ended June 30, 2021 vs 2020 Increase (Decrease) in interest income and expense due to changes in:		
	Volume	Rate	Total
Interest income:			
Gross loans (1) (2)	$ 3,601	$ (163)	$ 3,438
Investment securities (2)	(34)	(322)	(356)
Federal funds sold	45	(77)	(32)
Interest-earning deposits	746	(1,017)	(271)
Total interest income	**$ 4,358**	**$ (1,579)**	**$ 2,779**
Interest expense:			
Interest-earning DDA	$ 94	$ (166)	$ (72)
Money market deposits	71	(94)	(23)
Savings deposits	11	1	12
Time deposits $250,000 and under	3	0	3
Time deposits over $250,000	(2)	(27)	(29)
Other Borrowings	(32)	0	(32)
Total interest expense	$ 145	$ (286)	$ (141)
Change in net interest income	**$ 4,213**	**$ (1,293)**	**$ 2,920**

(1) Loan fees have been included in the calculation of interest income.
(2) Interest income on municipal securities and loans has been adjusted to their fully-taxable equivalents, based on a federal marginal tax rate of 21.0%.

The table above reflects an increase of $4,213,000 in net interest income due to growth of earning asset balances combined with the overall change in mix of balances during the first six months of 2021 as compared to the same periods of 2021. The decrease in earning asset yields and rates on interest-bearing liabilities triggered by recent FOMC rate cuts resulted in a decrease of $1,293,000 to net interest income, over the same period.

Provision for Loan Losses

The Company makes provisions for loan losses when required to bring the total allowance for loan and lease losses to a level deemed appropriate for the level of risk in the loan portfolio. At least quarterly, management conducts an assessment of the overall quality of the loan portfolio and general economic trends in the local market. The determination of the appropriate level for the allowance is based on that review, considering such factors as historical experience, the volume and type of lending conducted, the amount of and identified potential loss associated with specific non-performing loans, regulatory policies, general economic conditions, and other factors related to the collectability of loans in the portfolio.

The Company recorded no loan loss provisions during the three and six-months ended June 30, 2021, as compared to $1,860,000 and $2,310,000 during the same periods of 2020. No loan loss provisions were warranted during the first six months of 2021 because credit quality remained strong with only one outstanding loan with a balance of $362,000 on non-accrual status. The gross loan decrease during the quarter was mainly related to PPP loans, which do not require a reserve because they are guaranteed by the federal government through the SBA program. The provisions recorded during 2020 were primarily due to the impact of the COVID-19 pandemic. Management reviewed the qualitative factors within the allowance for loan loss calculation and determined that a macro-economic adjustment was necessary to account for the potential negative impact of the financial strain that is being experienced by certain borrowers. Management will continue to closely monitor the economic impacts to our loan portfolio and may need to make further qualitative adjustments depending on the severity and longevity of the COVID-19 pandemic. In particular, the loan loss provision of $1.86 million during the three months ended June 30, 2020 was mainly attributable to qualitative risk factor adjustments corresponding to the COVID-19 pandemic.

Non-Interest Income

Non-interest income represents service charges on deposit accounts and other non-interest related charges and fees, including fees from mortgage commissions and investment service fee income. For the three and six-month periods ended June 30, 2021, non-interest income was $1,405,000 and $2,580,000, respectively, representing increases of $382,000 or 37.3% and 273,000 or 11.8%, compared to the same periods in 2020. The increase is partially due to higher debit card transaction fee income as business and consumer spending patterns have shifted to electronic payment methods amid the COVID-19 pandemic.

The following tables show the major components of non-interest income:

(in thousands)	For the Three Months Ended June 30,			
	2021	2020	$ change	% change
Service charges on deposits	$ 323	$ 269	$ 54	20.1%
Debit card transaction fee income	427	312	115	36.9%
Earnings on cash surrender value of life insurance	184	176	8	4.5%
Mortgage commissions	52	6	46	766.7%
Gains on calls of available-for-sale securities	1	1	0	0.0%
Other income	418	259	159	61.4%
Total non-interest income	$ 1,405	$ 1,023	$ 382	37.3%

(in thousands)	For the Six Months Ended June 30,			
	2021	2020	$ change	% change
Service charges on deposits	$ 618	$ 656	$ (38)	-5.8%
Debit card transaction fee income	808	607	201	33.1%
Earnings on cash surrender value of life insurance	348	350	(2)	-0.6%
Mortgage commissions	84	51	33	64.7%
Gains on calls of available-for-sale securities	1	1	0	0.0%
Other income	721	642	79	12.3%
Total non-interest income	$ 2,580	$ 2,307	$ 273	11.8%

Service charges on deposits increased by $54,000 and decreased by $38,000 for the three and six-months ended June 30, 2021, respectively, compared to the same periods in 2020. The second quarter increase was due to strong growth of our core customer base and corresponding service fee income related to servicing loan and deposit accounts. The year-to-date decrease was due to higher deposit account balances corresponding to PPP loans and government stimulus payments, coupled with changes in customer spending patterns amid the COVID-19 pandemic resulting in lower overdraft fees in 2021 compared to 2020.

Debit card transaction fee income increased by $115,000 and $201,000 for the three and six-months ended June 30, 2021, respectively, compared to the same periods in 2020. The increase during 2021 is attributable to changes in business and consumer spending patterns have shifted to electronic payment methods amid the COVID-19 pandemic.

Earnings on cash surrender value of life insurance increased by $8,000 and decreased by $2,000 for the three and six-months ended June 30, 2021, respectively, compared to the same periods in 2020, corresponding to normal fluctuations in yields paid from the insurance carriers.

Mortgage commissions increased by $46,000 and $33,000 for the three and six-months ended June 30, 2021, respectively, as compared to the same periods of 2020, as the demand for home purchases and refinancing has increased from last year.

Other income increased by $159,000 and $79,000 for the three and six-month periods ended June 30, 2021, respectively, as compared to the same periods of 2020, mainly due to an increase in investment advisory fee income.

Non-Interest Expense

Non-interest expense represents salaries and benefits, occupancy expenses, professional expenses, outside services, and other miscellaneous expenses necessary to conduct business.

The following tables show the major components of non-interest expenses:

(in thousands)	For the Three Months Ended June 30,			
	2021	2020	$ Change	% Change
Salaries and employee benefits	$ 5,052	$ 3,947	$ 1,105	28.0%
Occupancy expenses	985	886	99	11.2%
Data processing fees	531	505	26	5.1%
Regulatory assessments (FDIC & DFPI)	132	72	60	83.3%
Other operating expenses	1,515	1,464	51	3.5%
Total non-interest expense	$ 8,215	$ 6,874	$ 1,341	19.5%

(in thousands)	For the Six Months Ended June 30,			
	2021	2020	$ Change	% Change
Salaries and employee benefits	$ 9,795	$ 8,548	$ 1,247	14.6%
Occupancy expenses	1,951	1,754	197	11.2%
Data processing fees	1,025	999	26	2.6%
Regulatory assessments (FDIC & DFPI)	249	102	147	144.1%
Other operating expenses	2,915	2,920	(5)	-0.2%
Total non-interest expense	$ 15,935	$ 14,323	$ 1,612	11.3%

Non-interest expenses increased by $1,341,000 or 19.5% and $1,612,000 or 11.3% for the three and six-months ended June 30, 2021, respectively, as compared to the same periods of 2020. Salaries and employee benefits increased $1,105,000 and $1,247,000 for the three and six-months ended June 30, 2021, respectively, as compared to the same periods of 2020. The increase is due to additional staffing expense required to support the continued loan and deposit growth and a decrease in deferred cost adjustments on funded PPP loans that are recorded against salary expense.

Occupancy expenses increased by $99,000 and $197,000 for the three and six-months ended June 30, 2021, respectively, as compared to the same periods of 2020, mainly due to depreciation expense on new ATM machines that were placed into service during the second quarter of 2020.

Data processing fees increased by $26,000 for the three and six-month periods ended June 30, 2021 and 2020. The number of loan and deposit accounts has increased resulting in the slight increase which was partially offset by a lower pricing structure that was negotiated with our third-party core service provider.

FDIC and California Department of Financial Protection and Innovation (DFPI) regulatory assessments increased by $60,000 and $147,000 for the three and six-months ended June 30, 2021, respectively as compared to the same periods in 2020. In January 2019, the FDIC sent notification that small banks less than $10 billion would receive assessment credits for the portion of their assessments that contributed to the growth in the Deposit Insurance Fund Reserve Ratio from 1.15% to 1.35%, to be applied when the reserve ratio reached 1.38%. That threshold was met in the early part of 2019 and therefore the Company did not recognize any expense for FDIC assessments during the last six months of 2019 and the first quarter of 2020. The Company resumed its expense accrual during the second quarter of 2020, when the credit was fully utilized. Additionally, the initial base assessment rate for financial institutions varies based on the overall risk profile of the institution as defined by the FDIC and the Company's risk profile has remained at stable levels in 2020 and 2021 thus far, resulting in a relatively low assessment rate. However, management recognizes that it could be offset by deposit growth throughout the remainder of 2021 and into 2022, as the FDIC assessment rates are applied to average quarterly total liabilities as the primary basis.

Other expense increased by $51,000 and decreased by $5,000 for the three and six-months ended June 30, 2021, respectively, as compared to the same periods in 2020, due to increases in a variety of general operating expenses which is typical given the Company's business portfolios continued expansion.

Management anticipates that non-interest expense will continue to increase as the Company continues to grow. However, management remains committed to cost-control and efficiency, and expects to keep these increases to a minimum relative to growth.

Income Taxes

The Company reported provisions for income taxes of $1,218,000 and $2,559,000 for the three and six-month periods ended June 30, 2021, respectively, representing increases of $364,000 and $801,000 compared to the provisions reported in the comparable periods of 2020. The effective income tax rate on income from continuing operations was 23.5% for the three and six-months ended June 30, 2021, compared to 24.9% for the comparable periods of 2020. These provisions reflect accruals for taxes at the applicable rates for federal income tax and California franchise tax based upon reported pre-tax income, and adjusted for the effects of all permanent differences between income for tax and financial reporting purposes (such as earnings on qualified municipal securities, bank owned life insurance and certain tax-exempt loans). The disparity between the effective tax rates for 2021 as compared to 2020 is primarily due to tax credits from low income housing projects as well as tax free-income on municipal securities and loans that comprised a larger proportion of pre-tax income in 2021 as compared to 2020.

Asset Quality

Non-performing assets consist of loans on non-accrual status, including loans restructured on non-accrual status, where the terms of repayment have been renegotiated resulting in a reduction or deferral of interest or principal, loans 90 days or more past due and still accruing interest and OREO.

Loans are generally placed on non-accrual status when they become 90 days past due, unless management believes the loan is adequately collateralized and in the process of collection. The past due loans may or may not be adequately collateralized, but collection efforts are continuously pursued. Loans may be restructured by management when a borrower has experienced some changes in financial status, causing an inability to meet the original repayment terms, and where management believes the borrower will eventually overcome those circumstances and repay the loan in full. OREO consists of properties acquired by foreclosure or similar means and which management intends to offer for sale.

Non-accrual loans totaled $362,000 and $0 as of June 30, 2021 and December 31, 2020, respectively. The non-accrual loans as of June 30, 2021 are loans made to one borrower for commercial real estate. As of June 30, 2021 and December 31, 2020, the Company did not have any loans classified as troubled debt restructurings.

OREO as of June 30, 2021 and December 31, 2020 consisted of one property, a residential land property acquired through foreclosure that was written down to a zero balance because the public utilities have not been obtainable, therefore, rendering these land lots unmarketable at this time. There were no sales, acquisitions or fair value adjustments of OREO properties during the first six months of 2021 and 2020.

The following table presents information about the Bank's non-performing assets, including asset quality ratios as of June 30, 2021 and December 31, 2020:

Non-Performing Assets

(in thousands)	**June 30, 2021**	**December 31, 2020**
Loans in non-accrual status	$ 362	$ 0
Loans past due 90 days or more and accruing	0	0
Total non-performing loans	362	0
Other real estate owned	0	0
Total non-performing assets	$ 362	$ 0
Allowance for loan losses	$ 11,327	$ 11,297
Asset quality ratios:		
Non-performing assets to total assets	0.02%	0.00%
Non-performing loans to total loans	0.04%	0.00%
Allowance for loan losses to total loans	1.20%	1.12%
Allowance for loan losses to total non-performing loans	3129.16%	NA

Non-performing assets increased by $362,000 as of June 30, 2021, as compared to December 31, 2020, due to one commercial real estate loan that was placed on non-accrual status during the first quarter due to delinquent payments.

Allowance for Loan and Lease Losses

Due to credit risk inherent in the lending business, the Company routinely sets aside allowances through charges to earnings. Such charges are not only made for the outstanding loan portfolio, but also for off-balance sheet items, such as commitments to extend credits or letters of credit. Charges for the outstanding loan portfolio have been credited to the allowance for loan losses, whereas charges for off-balance sheet items have been credited to the reserve for off-balance sheet items, which is presented as a component of other liabilities. The Company recorded no loan loss provisions during the three and six-months ended June 30, 2021, as compared to $1,860,000 and $2,310,000 in the same periods of 2020.

The provisions during 2020 were due mainly to the impact of the COVID-19 pandemic. Management reviewed the qualitative factors within the allowance for loan loss calculation and determined that a macro-economic adjustment was necessary to account for the potential negative impact of the financial strain that is being experienced by certain borrowers. Management will continue to closely monitor the economic impacts to our loan portfolio and may need to make further qualitative adjustments depending on the severity and longevity of the COVID-19 pandemic. In particular, the loan loss provision of $1.86 million during the three months ended June 30, 2020 was mainly related to qualitative risk factor adjustments corresponding to the COVID-19 pandemic.

The allowance for loan losses increased by $30,000 to $11,327,000 as of June 30, 2021, as compared to $11,297,000 as of December 31, 2020, due to net loan recoveries of $30,000 during the first six months of 2021. These factors combined with the decrease in the gross loan balance resulted in an increase in the allowance for loan losses as a percentage of total loans to 1.20% as of June 30, 2021, as compared to 1.12% as of December 31, 2020. This increase is mainly due to paydowns of the PPP loans outstanding at June 30, 2021 that do not require a loan loss reserve as they are guaranteed by the federal government through the SBA program.

The Company will continue to monitor the adequacy of the allowance for loan losses and make additions to the allowance in accordance with the analysis referred to above. Because of uncertainties inherent in estimating the appropriate level of the allowance for loan losses, actual results may differ from management’s estimate of credit losses and the related allowance.

The Company makes provisions for loan losses when required to bring the total allowance for loan and lease losses to a level deemed appropriate for the level of risk in the loan portfolio. At least quarterly, management conducts an assessment of the overall quality of the loan portfolio and general economic trends in the local market. The determination of the appropriate level for the allowance is based on that review, considering such factors as historical experience, the volume and type of lending conducted, the amount of and identified potential loss associated with specific non-performing loans, regulatory policies, general economic conditions, and other factors related to the collectability of loans in the portfolio.

Although management believes the allowance as of June 30, 2021 was adequate to absorb probable losses from any known and inherent risks in the portfolio, no assurance can be given that the adverse effect of current and future economic conditions on the Company’s service areas, or other variables, will not result in increased losses in the loan portfolio in the future.

Investment Activities

Investments are a key source of interest income. Management of the investment portfolio is set in accordance with strategies developed and overseen by the Company’s Investment Committee. Investment balances, including cash equivalents and interest-bearing deposits in other financial institutions, are subject to change over time based on the Company’s asset/liability funding needs and interest rate risk management objectives. The Company’s liquidity levels take into consideration anticipated future cash flows and all available sources of credits, and are maintained at levels management believes are appropriate to assure future flexibility in meeting anticipated funding needs.

Cash Equivalents

The Company holds federal funds sold, unpledged available-for-sale securities and salable government guaranteed loans to help meet liquidity requirements and provide temporary holdings until the funds can be otherwise deployed or invested. As of June 30, 2021, and December 31, 2020, the Company had $525,802,000 and $226,656,000, respectively, in cash and cash equivalents.

Investment Securities

Management of the investment securities portfolio focuses on providing an adequate level of liquidity and establishing an interest rate-sensitive position, while earning an adequate level of investment income without taking undue risk. Investment securities that the Company intends to hold until maturity are classified as held-to-maturity securities, and all other investment securities are classified as available-for-sale or equity securities. Currently, all of the investment securities are classified as available-for-sale except for one mutual fund classified as an equity security with a carrying value of $3,413,000 as of June 30, 2021. The carrying values of available-for-sale investment securities are adjusted for unrealized gains or losses as a valuation allowance and any gain or loss is reported on an after-tax basis as a component of other comprehensive income. The carrying values of equity securities are adjusted for unrealized gains or losses through noninterest income in the consolidated statement of income.

Management has evaluated the investment securities portfolio to determine if the impairment of any security in an unrealized loss position is temporary or other than temporary. The Company conducts a periodic review and evaluation of the securities portfolio to determine if the value of any security has declined below its carrying value. If such decline is determined to be other than temporary, the Company would adjust the carrying amount of the security by writing down the security to fair value through a charge to current period income or a charge to accumulated other comprehensive income depending on the nature of the impairment and managements intent or requirement to sell the security. Management has determined that no investment security is other than temporarily impaired. The unrealized losses are due primarily to interest rate changes.

Deposits

Total deposits as of June 30, 2021 were $1,614,480,000, a $246,671,000 or 18.0% increase from the deposit total of $1,367,809,000 as of December 31, 2020. Average deposits increased by $359,831,000 to $1,489,928,000 for the six-month period ended June 30, 2021 as compared to the same period in 2020, mainly due to core deposit growth as the PPP Program provided opportunities to win the business of various business clients. PPP loan funds were consequently credited directly to borrowers' deposit accounts. Management believes the Company attracted deposits due to the safety and soundness of the Bank and our focus on customer service.

Deposits Outstanding

(in thousands)	June 30, 2021	December 31, 2020	Six Month Change $	Six Month Change %
Demand	$ 1,075,111	$ 907,913	167,198	18.4%
MMDA	360,265	301,506	58,759	19.5%
Savings	140,098	120,552	19,546	16.2%
Time < $250K	21,619	16,134	5,485	34.0%
Time > $250K	17,387	21,704	(4,317)	(19.9%)
	$ 1,614,480	**$ 1,367,809**	**$ 246,671**	**18.0%**

Because the Company's client base is comprised primarily of commercial and industrial accounts, individual account balances are generally higher than those of consumer-oriented banks. Seven clients carry deposit balances of more than 1% of total deposits, but none had a deposit balance of more than 3% of total deposits as of June 30, 2021. Management believes that the Company's funding concentration risk is not significant and is mitigated by the ample sources of funds the Bank has access to.

Since the deposit growth strategy emphasizes core deposit growth, the Company has avoided relying on brokered deposits as a consistent source of funds. The Company had no brokered deposits as of June 30, 2021 and December 31, 2020.

Borrowings

Although deposits are the primary source of funds for lending and investment activities and for general business purposes, the Company may obtain advances from the Federal Home Loan Bank ("FHLB") as an alternative to retail deposit funds. The Company took out a $50 million FHLB advance in April 2020 in anticipation of funding a large volume of PPP loans, which was fully paid off during July 2020. As of June 30, 2021 and December 31, 2020, there were no outstanding FHLB advances or borrowings of any kind, as the Company continues to rely on deposit growth as its primary source of funding. See "Liquidity Management" below for the details on the FHLB borrowings program.

Capital Ratios

The Company is regulated by the FRB and is subject to the securities registration and public reporting regulations of the Securities and Exchange Commission. As a California state-chartered bank, the Company's banking subsidiary is subject to primary supervision, examination and regulation by the DFPI and the Federal Reserve Board. The Federal Reserve Board is the primary federal regulator of state member banks. The Bank is also subject to regulation by the FDIC, which insures the Bank's deposits as permitted by law. Management is not aware of any recommendations of regulatory authorities or otherwise which, if they were to be implemented, would have a material effect on the Company's or Bank's liquidity, capital resources, or operations.

Under the Basel III rules, we must maintain a ratio of common equity Tier 1 capital to risk-weighted assets of at least 4.5%, a ratio of Tier 1 capital to risk-weighted assets of at least 6%, a ratio of total capital to risk-weighted assets of at least 8% and a minimum Tier 1 leverage ratio of 4.0%. In addition to the preceding requirements, all financial institutions subject to the Rules, including both the Company and the Bank, are required to establish a "conservation buffer," consisting of common equity Tier 1 capital, which is at least 2.5% above each of the preceding common equity Tier 1 capital ratio, the Tier 1 risk-based ratio and the total risk-based ratio. An institution that does not meet the conservation buffer will be subject to restrictions on certain activities including payment of dividends, stock repurchases and discretionary bonuses to executive officers.

Failure to meet minimum capital requirements can trigger regulatory actions that could have a material adverse effect on the Company's financial statements and operations. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Company and Bank must meet specific capital guidelines that rely on quantitative measures of assets, liabilities and certain off-balance-sheet items as calculated under regulatory accounting practices. The Company's and Bank's amounts and classification are also subject to qualitative judgments by the regulators about components, risk weightings, and other factors.

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The following tables present a comparison of our actual capital ratios to the minimum required ratios as of the dates indicated:

(in thousands)	Actual		Regulatory Minimum (1)	
Capital ratios for Bank:	**Amount**	**Ratio**	**Amount**	**Ratio**
As of June 30, 2021				
Total capital (to Risk- Weighted Assets)	$ 137,219	13.7%	$ 104,980	>10.5%
Tier I capital (to Risk- Weighted Assets)	$ 125,457	12.6%	$ 84,984	>8.5%
Common Equity Tier 1 Capital (to Risk Weighted Assets)	$ 125,457	12.6%	$ 69,986	>7.0%
Tier I capital (to Average Assets)	$ 125,457	7.5%	$ 67,404	>4.0%
As of December 31, 2020				
Total capital (to Risk- Weighted Assets)	$ 129,654	13.1%	$ 103,632	>10.5%
Tier I capital (to Risk- Weighted Assets)	$ 117,978	12.0%	$ 83,893	>8.5%
Common Equity Tier 1 Capital (to Risk Weighted Assets)	$ 117,978	12.0%	$ 69,088	>7.0%
Tier I capital (to Average Assets)	$ 117,978	8.0%	$ 59,306	>4.0%
Capital ratios for the Company:				
As of June 30, 2021				
Total capital (to Risk- Weighted Assets)	$ 137,407	13.7%	$ 104,986	>10.5%
Tier I capital (to Risk- Weighted Assets)	$ 125,645	12.6%	$ 84,989	>8.5%
Common Equity Tier 1 Capital (to Risk Weighted Assets)	$ 125,645	12.6%	$ 69,991	>7.0%
Tier I capital (to Average Assets)	$ 125,645	7.5%	$ 67,409	>4.0%
As of December 31, 2020				
Total capital (to Risk- Weighted Assets)	$ 129,936	13.2%	$ 103,637	>10.5%
Tier I capital (to Risk- Weighted Assets)	$ 118,260	12.0%	$ 83,896	>8.5%
Common Equity Tier 1 Capital (to Risk Weighted Assets)	$ 118,260	12.0%	$ 69,091	>7.0%
Tier I capital (to Average Assets)	$ 118,260	8.0%	$ 59,309	>4.0%

(1) The adequately capitalized thresholds in the table above are reflected on a fully phased-in basis, which occurred in January 2019.

Liquidity Management

Since the Company is a holding company and does not conduct regular banking operations, its primary sources of liquidity are dividends from the Bank. Under the California Financial Code, payment of a dividend from the Bank to the Company is restricted to the lesser of the Bank's retained earnings or the amount of the Bank's undistributed net profits from the previous three fiscal years. The primary uses of funds for the Company are stockholder dividends, investment in the Bank and ordinary operating expenses. Management anticipates that there will be sufficient earnings at the Bank level to provide dividends to the Company to meet its funding requirements for the next twelve months.

Maintenance of adequate liquidity requires that sufficient resources be available at all times to meet the Company's cash flow requirements. Liquidity in a banking institution is required primarily to provide for deposit withdrawals and the credit needs of its customers and to take advantage of investment opportunities as they arise. Liquidity management involves the ability to convert assets into cash or cash equivalents without incurring significant loss, and to raise cash or maintain funds without incurring excessive additional cost. For this purpose, the Company maintains a portion of funds in cash and cash equivalents, salable government guaranteed loans and securities available for sale. The Company obtains funds from the repayment and maturity of loans as well as deposit inflows, investment security maturities and paydowns, Federal funds purchased, FHLB advances, and other borrowings. The Company's primary use of funds are the origination of loans, the purchase of investment securities, withdrawals of deposits, maturity of certificate of deposits, repayment of borrowings and dividends to common and preferred stockholders. The Company's liquid assets as of June 30, 2021 were $601.1 million compared to $336.6 million as of December 31, 2020. The Company's liquidity level measured as the percentage of liquid assets to total assets was 34.1% as of June 30, 2021, compared to 22.3% as of December 31, 2020. Liquid assets increased during the first six months of 2021, mainly due to the deposit increase of $246.7 million, resulting in higher levels of cash. Management anticipates that cash and cash equivalents on hand and other sources of funds will provide adequate liquidity for operating, investing and financing needs and regulatory liquidity requirements for at least the next twelve months. Management monitors the Company's liquidity position daily, balancing loan funding/payments with changes in deposit activity and overnight investments.

As a secondary source of liquidity, the Company relies on advances from the FHLB to supplement the supply of lendable funds and to meet deposit withdrawal requirements. Advances from the FHLB are typically secured by a portion of the loan portfolio. The FHLB determines limitations on the amount of advances by assigning a percentage to each eligible loan category that will count towards the borrowing capacity. As of June 30, 2021, the Company's borrowing capacity from the FHLB was approximately $331.4 million and there were no outstanding advances. The Company also maintains 2 lines of credit with correspondent banks to purchase up to $70 million in federal funds, for which there were no advances as of June 30, 2021.

During the period of uncertainty and volatility related to the COVID-19 pandemic, we will continue to monitor our liquidity.

Off-Balance Sheet Arrangements

During the ordinary course of business, the Company provides various forms of credit lines to meet the financing needs of customers. These commitments, which represent a credit risk to us, are not represented in any form on the balance sheets.

As of June 30, 2021 and December 31, 2020, the Company had commitments to extend credit of $167.1 million and $145.7 million, respectively, which includes obligations under letters of credit of $3.4 million and $2.9 million, respectively.

The effect on the Company's revenues, expenses, cash flows and liquidity from the unused portion of the commitments to provide credit cannot be reasonably predicted because there is no guarantee that the lines of credit will be used.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

For qualitative and quantitative disclosures about market risk, please see the sections entitled "Market Risk" and "Interest Rate Management" in Item 7 of the Company's 2020 Annual Report on Form 10-K. As of June 30, 2021, the Company's exposures to market risk have not changed materially since December 31, 2020. We will continue to monitor our exposures to market risk in light of the COVID-19 pandemic.

Item 4. Controls and Procedures

The Company's Chief Executive Officer and its Chief Financial Officer, after evaluating the effectiveness of the Company's disclosure controls and procedures, as defined in Exchange Act Rules 13a-15(e) and 15(d)-15(e) promulgated under the Exchange Act, as of the end of the period covered by this report (the "Evaluation Date") have concluded that as of the Evaluation Date, the Company's disclosure controls and procedures were effective to ensure that material information relating to the Company would be made known to them by others within the Company, particularly during the period in which this report was being prepared. Disclosure controls and procedures are designed to ensure that information required to be disclosed by management in the reports that the Company files or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by management in the reports that the Company files under the Exchange Act is accumulated and communicated to management, including the Company's Chief Executive Officer and Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosure.

There were no significant changes in the Company's internal control over financial reporting during the quarter ended June 30, 2021 that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting subsequent to the Evaluation Date. We have not experienced any significant impact to our internal controls over financial reporting despite the fact that most of our employees are working remotely due to the COVID-19 pandemic. The design of our processes and controls allow for remote execution with accessibility to secure data. We are continually monitoring and assessing the COVID-19 situation to minimize the impact, if any, on the design and operating effectiveness on our internal controls.

PART II - OTHER INFORMATION

Item 1. Legal Proceedings

There are no pending, or to management's knowledge, any threatened, material legal proceedings to which the Company is a defendant, or to which any of the Company's properties are subject. There are no material legal proceedings to which any director, any nominee for election as a director, any executive officer, or any associate of any such director, nominee or officer is a party adverse to the Company.

Item 1A. Risk Factors

As of the date of this Quarterly Report on Form 10-Q, there have been no material changes from the risk factors disclosed in our Annual Report on Form 10-K for the year ended December 31, 2020, filed with the Securities and Exchange Commission on June 30, 2021.

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

None.

Item 3. Defaults Upon Senior Securities

None.

Item 4. Mine Safety Disclosures

None.

Item 5. Other Information

None.

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Item 6. Exhibits

The following exhibits are filed as part of this report:

Exhibit No.	Exhibit Description
31.01*	Certification of Principal Executive Officer pursuant to Rule 13a-14(a)/15d-14(a) as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.02*	Certification of Principal Financial Officer pursuant to Rule 13a-14(a)/15d-14(a) as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.01**	Certification pursuant to 18 U.S.C. Section 1350 as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
101*	The following financial statements from the Company's Quarterly Report on Form 10-Q for the quarter ended June 30, 2021, formatted in Inline XBRL: (i) Condensed Consolidated Balance Sheets at June 30, 2021 (Unaudited) and December 31, 2020, (ii) Condensed Consolidated Statements of Income for the three-month periods ended June 30, 2021 and March 31, 2020 (Unaudited), (iii) Condensed Consolidated Statements of Comprehensive Income for the three-month periods ended June 30, 2021 and March 31, 2020 (Unaudited), (iv) Condensed Consolidated Statements of Changes of Shareholders' Equity for the three-month periods ended June 30, 2021 and March 31, 2020 (Unaudited), (v) Condensed Consolidated Statements of Cash Flows for the three-month periods ended June 30, 2021 and March 31, 2020 (Unaudited), and (vi) Notes to Condensed Consolidated Financial Statements, tagged as blocks of text and including detailed tags
104*	Cover Page Interactive Data File (formatted as Inline XBRL and contained in Exhibit 101)

* Filed herewith.
** Furnished, not filed.

SIGNATURES

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

	Oak Valley Bancorp	
Date: August 13, 2021	By:	/s/ JEFFREY A. GALL
		Jeffrey A. Gall
		Senior Vice President and Chief Financial Officer
		(Principal Financial Officer and duly authorized signatory)

Exhibit 31.01

CERTIFICATION OF CHIEF EXECUTIVE OFFICER
PURSUANT TO
SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002

I, Christopher M. Courtney, President and Chief Executive Officer, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Oak Valley Bancorp (the Registrant);

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the Registrant as of, and for, the periods presented in this report;

4. The Registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the Registrant and have:

(a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the Registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

(b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

(c) Evaluated the effectiveness of the Registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

(d) Disclosed in this report any change in the Registrant's internal control over financial reporting that occurred during the Registrant's most recent fiscal quarter (the Registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the Registrant's internal control over financial reporting; and

5. The Registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the Registrant's board of directors (or persons performing the equivalent functions):

(a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the Registrant's ability to record, process, summarize and report financial information; and

(b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the Registrant's internal control over financial reporting.

Date: August 13, 2021

/s/ CHRISTOPHER M. COURTNEY

Christopher M. Courtney
President and Chief Executive Officer

Exhibit 31.02

CERTIFICATION OF CHIEF FINANCIAL OFFICER
PURSUANT TO
SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002

I, Jeffrey A. Gall, Chief Financial Officer, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Oak Valley Bancorp (the Registrant);

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the Registrant as of, and for, the periods presented in this report;

4. The Registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the Registrant and have:

(a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the Registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

(b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

(c) Evaluated the effectiveness of the Registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

(d) Disclosed in this report any change in the Registrant's internal control over financial reporting that occurred during the Registrant's most recent fiscal quarter (the Registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the Registrant's internal control over financial reporting; and

5. The Registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the Registrant's auditors and the audit committee of the Registrant's board of directors (or persons performing the equivalent functions):

(a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the Registrant's ability to record, process, summarize and report financial information; and

(b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the Registrant's internal control over financial reporting.

Date: August 13, 2021

/s/ JEFFREY A. GALL

Jeffrey A. Gall
Chief Financial Officer

Exhibit 32.01

CERTIFICATION OF CHIEF EXECUTIVE OFFICER AND CHIEF FINANCIAL OFFICER PURSUANT TO 18 U.S.C. SECTION 1350, AS ADOPTED PURSUANT TO SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the quarterly report on Form 10-Q of Oak Valley Bancorp (the Registrant) for the quarter ended June 30, 2021, as filed with the Securities and Exchange Commission, the undersigned hereby certify pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

(1) such Form 10-Q fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and

(2) the information contained in such Form 10-Q fairly presents, in all material respects, the financial condition and results of operations of the Registrant.

Dated: August 13, 2021

/s/ CHRISTOPHER M. COURTNEY
Christopher M. Courtney
President and Chief Executive Officer

Dated: August 13, 2021

/s/ JEFFREY A. GALL
Jeffrey A. Gall
Chief Financial Officer

This certification accompanies each report pursuant to section 906 of the Sarbanes Oxley Act of 2002 and shall not, except to the extent required by the Sarbanes Oxley Act of 2002, be deemed filed by the Registrant for purposes of section 18 of the Securities and Exchange Act of 1934, as amended.