

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 March 31, 2022

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
State or other jurisdiction of
incorporation or organization

26-2326676
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 ☐
Non-accelerated filer ☒

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: 8,255,601 shares of common stock outstanding as of May 5, 2022.

Oak Valley Bancorp
March 31, 2022

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PART I – FINANCIAL STATEMENTS

Item 1. Financial Statements

OAK VALLEY BANCORP
CONDENSED CONSOLIDATED BALANCE SHEETS (UNAUDITED)

(in thousands)

	March 31, 2022	December 31, 2021
ASSETS		
Cash and due from banks	\$ 627,775	\$ 735,332
Federal funds sold	41,450	42,935
Cash and cash equivalents	669,225	778,267
Securities - available for sale	349,142	262,889
Securities - equity investments	3,229	3,391
Loans, net of allowance for loan losses of \$10,762 and \$10,738 at March 31, 2022 and December 31, 2021, respectively	846,878	847,847
Cash surrender value of life insurance	29,652	29,469
Bank premises and equipment, net	15,224	15,422
Goodwill and other intangible assets, net	3,625	3,647
Interest receivable and other assets	29,044	23,546
	<u>\$ 1,946,019</u>	<u>\$ 1,964,478</u>
LIABILITIES AND SHAREHOLDERS' EQUITY		
Deposits	\$ 1,799,305	\$ 1,806,966
Interest payable and other liabilities	15,065	14,900
Total liabilities	1,814,370	1,821,866
Shareholders' equity		
Common stock, no par value; 50,000,000 shares authorized, 8,255,601 and 8,239,099 shares issued and outstanding at March 31, 2022 and December 31, 2021, respectively	25,435	25,435
Additional paid-in capital	4,752	4,689
Retained earnings	107,433	106,300
Accumulated other comprehensive (loss) income, net of tax	(5,971)	6,188
Total shareholders' equity	<u>131,649</u>	<u>142,612</u>
	<u>\$ 1,946,019</u>	<u>\$ 1,964,478</u>

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 MARCH 31,	
	2022	2021
INTEREST INCOME		
Interest and fees on loans	\$ 9,122	\$ 11,184
Interest on securities	1,813	1,238
Interest on federal funds sold	10	6
Interest on deposits with banks	256	49
Total interest income	11,201	12,477
INTEREST EXPENSE		
Deposits	243	235
Total interest expense	243	235
Net interest income	10,958	12,242
Provision for loan losses	0	0
Net interest income after provision for loan losses	10,958	12,242
NON-INTEREST INCOME		
Service charges on deposits	376	295
Debit card transaction fee income	413	381
Earnings on cash surrender value of life insurance	182	164
Mortgage commissions	35	31
Other	162	305
Total non-interest income	1,168	1,176
NON-INTEREST EXPENSE		
Salaries and employee benefits	5,676	4,742
Occupancy expenses	1,035	966
Data processing fees	559	494
Regulatory assessments (FDIC & DFPI)	261	117
Other operating expenses	1,591	1,401
Total non-interest expense	9,122	7,720
Net income before provision for income taxes	3,004	5,698
Total provision for income taxes	635	1,341
Net Income	\$ 2,369	\$ 4,357
Net income per share	\$ 0.29	\$ 0.54
Net income per diluted share	\$ 0.29	\$ 0.53

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 MARCH 31,	
	2022	2021
Net income	\$ 2,369	\$ 4,357
Other comprehensive loss:		
Unrealized holding loss arising during the period	(17,263)	(1,392)
Tax benefit related to items of other comprehensive loss	5,104	412
Total other comprehensive loss	(12,159)	(980)
Comprehensive (loss) income	<u>\$ (9,790)</u>	<u>\$ 3,377</u>

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

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

(dollars in thousands)	THREE MONTHS ENDED MARCH 31, 2022 AND 2021					
	Common Stock		Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total Shareholders' Equity
	Shares	Amount				
Balances, January 1, 2021	8,218,873	\$ 25,435	\$ 4,216	\$ 92,349	\$ 7,694	\$ 129,694
Restricted stock issued	22,207	0	0	0	0	0
Restricted stock surrendered for tax withholding	(5,141)	0	(84)	0	0	(84)
Cash dividends declared \$0.145 per share of common stock	0	0	0	(1,192)	0	(1,192)
Stock based compensation	0	0	147	0	0	147
Other comprehensive loss	0	0	0	0	(980)	(980)
Net income	0	0	0	4,357	0	4,357
Balances, March 31, 2021	<u>8,235,939</u>	<u>\$ 25,435</u>	<u>\$ 4,279</u>	<u>\$ 95,514</u>	<u>\$ 6,714</u>	<u>\$ 131,942</u>
Balances, January 1, 2022	8,239,099	\$ 25,435	\$ 4,689	\$ 106,300	\$ 6,188	142,612
Restricted stock issued	21,797	0	0	0	0	0
Restricted stock forfeited	(300)	0	0	0	0	0
Restricted stock surrendered for tax withholding	(4,995)	0	(95)	0	0	(95)
Cash dividends declared \$0.150 per share of common stock	0	0	0	(1,236)	0	(1,236)
Stock based compensation	0	0	158	0	0	158
Other comprehensive loss	0	0	0	0	(12,159)	(12,159)
Net income	0	0	0	2,369	0	2,369
Balances, March 31, 2022	<u>8,255,601</u>	<u>\$ 25,435</u>	<u>\$ 4,752</u>	<u>\$ 107,433</u>	<u>\$ (5,971)</u>	<u>\$ 131,649</u>

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

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

	THREE MONTHS ENDED MARCH 31,	
	2022	2021
(dollars in thousands)		
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	\$ 2,369	\$ 4,357
Adjustments to reconcile net income to net cash from operating activities:		
(Decrease) increase in deferred fees/costs, net	(329)	1,469
Depreciation	333	334
Amortization of investment securities, net	221	91
Stock based compensation	158	147
Earnings on cash surrender value of life insurance	(182)	(164)
Increase in interest payable and other liabilities	165	1,839
(Increase) decrease in interest receivable	(167)	608
Increase in other assets	(206)	(1,405)
Net cash from operating activities	2,362	7,276
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchases of available for sale securities	(107,779)	(5,792)
Purchases of equity securities	(16)	(16)
Proceeds from maturities, calls, and principal paydowns of securities available for sale	4,220	6,037
Investment in LIHTC	0	(147)
Net decrease (increase) in loans	1,298	(15,646)
Purchases of premises and equipment	(135)	(308)
Net cash used in investing activities	(102,412)	(15,872)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Shareholder cash dividends paid	(1,236)	(1,192)
Net (decrease) increase in demand deposits and savings accounts	(6,906)	149,169
Net (decrease) increase in time deposits	(755)	807
Tax withholding payments on vested restricted shares surrendered	(95)	(84)
Net cash (used in) from financing activities	(8,992)	148,700
NET (DECREASE) INCREASE IN CASH AND CASH EQUIVALENTS	(109,042)	140,104
CASH AND CASH EQUIVALENTS, beginning of period	778,267	226,646
CASH AND CASH EQUIVALENTS, end of period	\$ 669,225	\$ 366,750
SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION:		
Cash paid during the period for:		
Interest	\$ 241	\$ 236
NON-CASH INVESTING ACTIVITIES:		
Change in unrealized gain on securities	\$ (17,263)	\$ (1,392)
Lease right-of-use assets	\$ 287	\$ 1,030
NON-CASH FINANCING ACTIVITIES:		
Present value of lease obligations	\$ (297)	\$ (1,015)

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

Oak Valley Bancorp (“the Company”, “us”, “our”) is the parent holding company for Oak Valley Community Bank (the “Bank”). 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 Quarterly Report on Form 10-Q 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-month period ended March 31, 2022 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, 2021.

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 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.

In August 2021, FASB issued ASU 2021-06 – *Presentation of Financial Statements (Topic 205), Financial Services- Depository and Lending (Topic 942, and Financial Services- Investment Companies (Topic 946)*. This ASU amends various SEC paragraphs pursuant to the issuance of SEC Release No. 33-10786, Amendments to Financial Disclosures about Acquired and Disposed Businesses. This ASU became effective upon issuance in August 2021. This ASU did not have a material impact on our consolidated financial statements.

NOTE 3 – SECURITIES

Equity Securities

The Company held equity securities with fair values of \$3,229,000 and \$3,391,000 as of March 31, 2022 and December 31, 2021, respectively. There were no sales of equity securities during the three-month periods ended March 31, 2022 and 2021. 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 a loss of \$177,000 during the three months ended March 31, 2022, as compared to a loss of \$45,000 during the same period of 2021.

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 March 31, 2022 are as follows:

(dollars in thousands)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Available-for-sale securities:				
U.S. agencies	\$ 31,095	\$ 154	\$ (385)	\$ 30,864
Collateralized mortgage obligations	806	1	(30)	777
Municipalities	231,459	2,793	(9,063)	225,189
SBA pools	3,361	10	(13)	3,358
Corporate debt	34,521	23	(1,719)	32,825
Asset backed securities	56,377	183	(431)	56,129
	<u>\$ 357,619</u>	<u>\$ 3,164</u>	<u>\$ (11,641)</u>	<u>\$ 349,142</u>

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 March 31, 2022.

(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	\$ 7,629	\$ (384)	\$ 77	\$ (1)	\$ 7,706	\$ (385)
Collateralized mortgage obligations	305	(7)	414	(23)	719	(30)
Municipalities	112,332	(9,063)	0	0	112,332	(9,063)
SBA pools	0	0	1,583	(13)	1,583	(13)
Corporate debt	26,377	(1,623)	2,404	(96)	28,781	(1,719)
Asset backed securities	34,287	(397)	3,183	(34)	37,470	(431)
Total temporarily impaired securities	<u>\$ 180,930</u>	<u>\$ (11,474)</u>	<u>\$ 7,661</u>	<u>\$ (167)</u>	<u>\$ 188,591</u>	<u>\$ (11,641)</u>

As of March 31, 2022, one corporate debt, three U.S. agencies, four Small Business Administration (“SBA”) pools, one collateralized mortgage obligation and two asset backed securities make up the total debt securities in an unrealized loss position for greater than 12 months. As of March 31, 2022, eighteen asset backed securities, eight corporate debts, twelve U.S. agencies, fifty-nine municipalities, and one collateralized mortgage obligation 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.

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The amortized cost and estimated fair value of debt securities as of March 31, 2022, 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	38,258	37,518
Due after one year through five years	95,941	96,424
Due after five years through ten years	156,282	148,569
Due after ten years	67,138	66,631
	<u>\$ 357,619</u>	<u>\$ 349,142</u>

The amortized cost and estimated fair values of debt securities as of December 31, 2021 are as follows:

(dollars in thousands)

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Available-for-sale securities:				
U.S. agencies	\$ 21,776	\$ 450	\$ (56)	\$ 22,170
Collateralized mortgage obligations	916	5	(22)	899
Municipalities	168,033	8,308	(99)	176,242
SBA pools	3,703	16	(11)	3,708
Corporate debt	19,524	127	(165)	19,486
Asset backed securities	40,151	278	(45)	40,384
	<u>\$ 254,103</u>	<u>\$ 9,184</u>	<u>\$ (398)</u>	<u>\$ 262,889</u>

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 as of December 31, 2021.

(dollars in thousands)

Description of Securities	Less than 12 months		12 months or more		Total	
	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
U.S. agencies	\$ 4,978	\$ (55)	\$ 79	\$ (1)	\$ 5,057	\$ (56)
Collateralized mortgage obligations	0	0	482	(22)	482	(22)
Municipalities	12,805	(99)	0	0	12,805	(99)
SBA pools	0	0	1,777	(11)	1,777	(11)
Corporate debt	7,863	(137)	2,472	(28)	10,335	(165)
Asset backed securities	11,393	(26)	4,511	(19)	15,904	(45)
Total temporarily impaired securities	<u>\$ 37,039</u>	<u>\$ (317)</u>	<u>\$ 9,321</u>	<u>\$ (81)</u>	<u>\$ 46,360</u>	<u>\$ (398)</u>

As of December 31, 2021, three asset-backed securities, four Small Business Administration pools, one corporate debt, three U.S. agencies, and one collateralized mortgage obligations make up the total debt securities in an unrealized loss position for greater than 12 months. As of December 31, 2021, eight asset backed securities, seven municipalities, three corporate debts and three U.S. agencies make up the total debt securities in a loss position for less than 12 months.

The Company recognized no gains or losses on called securities during the three-months periods ended March 31, 2022 and 2021. There were no sales of available-for-sale securities during the three-months ended March 31, 2022 and 2021.

Debt securities carried at \$209,089,000 and \$202,610,000 as of March 31, 2022 and December 31, 2021, 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 March 31, 2022, approximately 83% of the Company's loans are commercial real estate loans, which include construction loans. Approximately 11% 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 \$17,699,000. Additionally, 3% of the Company's loans are for residential real estate and other consumer loans. The remaining 3% are agriculture loans. Loan totals were as follows:

(in thousands)	March 31, 2022	December 31, 2021
Commercial real estate:		
Commercial real estate- construction	\$ 21,204	\$ 25,737
Commercial real estate- mortgages	595,207	583,620
Land	3,003	3,101
Farmland	89,809	76,670
Commercial and industrial	97,654	109,554
Consumer	380	416
Consumer residential	28,320	28,439
Agriculture	23,186	32,500
Total loans	858,763	860,037
Less:		
Deferred loan fees and costs, net	(1,123)	(1,452)
Allowance for loan losses	(10,762)	(10,738)
Net loans	<u>\$ 846,878</u>	<u>\$ 847,847</u>

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. 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 in 2020, \$282 million in 2021 and \$13 million during the first three months of 2022. 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 as of December 31, 2020. During 2021, the Company received approvals with the SBA for 924 Second Draw PPP loans, representing approximately \$100,698,000 in funding. PPP outstanding balances totaled \$30,503,000 as of December 31, 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 half 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, 2021 and March 31, 2022, one borrowing relationship totaling \$8,092,745 in outstanding loans 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 until mid-2022. 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 March 31, 2022 approximately 40% of the outstanding principal balance of commercial real estate loans were secured by owner-occupied properties, as compared to 39% as of December 31, 2021.

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.

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No loans were on non-accrual status as of March 31, 2022 and December 31, 2021, as compared to \$362,000 as of March 31, 2021. Had non-accrual loans performed in accordance with their original contract terms, the Company would have recognized additional interest income of approximately \$4,000 in the three-month period ended March 31, 2021, respectively.

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 March 31, 2022 (in thousands):

	30-59 Days Past Due	60-89 Days Past Due	90 Days or More Past Due	Total Past Due	Current	Total	90 Days or More Past Due and Still Accruing
March 31, 2022							
Commercial real estate:							
Commercial R.E. - construction	\$ 0	\$ 0	\$ 0	\$ 0	\$ 21,204	\$ 21,204	\$ 0
Commercial R.E. - mortgages	0	0	0	0	595,207	595,207	0
Land	0	0	0	0	3,003	3,003	0
Farmland	0	0	0	0	89,809	89,809	0
Commercial and industrial	0	0	0	0	97,654	97,654	0
Consumer	0	0	0	0	380	380	0
Consumer residential	0	0	0	0	28,320	28,320	0
Agriculture	0	0	0	0	23,186	23,186	0
Total	<u>\$ 0</u>	<u>\$ 0</u>	<u>\$ 0</u>	<u>\$ 0</u>	<u>\$ 858,763</u>	<u>\$ 858,763</u>	<u>\$ 0</u>

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, 2021 (in thousands):

	30-59 Days Past Due	60-89 Days Past Due	90 Days or More Past Due	Total Past Due	Current	Total	90 Days or More Past Due and Still Accruing
December 31, 2021							
Commercial real estate:							
Commercial R.E. - construction	\$ 0	\$ 0	\$ 0	\$ 0	\$ 25,737	\$ 25,737	\$ 0
Commercial R.E. - mortgages	0	0	0	0	583,620	583,620	0
Land	0	0	0	0	3,101	3,101	0
Farmland	0	0	0	0	76,670	76,670	0
Commercial and industrial	0	0	0	0	109,554	109,554	0
Consumer	0	0	0	0	416	416	0
Consumer residential	0	0	0	0	28,439	28,439	0
Agriculture	0	0	0	0	32,500	32,500	0
Total	<u>\$ 0</u>	<u>\$ 0</u>	<u>\$ 0</u>	<u>\$ 0</u>	<u>\$ 860,037</u>	<u>\$ 860,037</u>	<u>\$ 0</u>

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 were no impaired loans as of March 31, 2022. There was no interest income realized on impaired loans for the three-months ended March 31, 2022 and 2021.

Average recorded investment in impaired loans outstanding as of March 31, 2022 and 2021 is set forth in the following table.

(in thousands)	Average Recorded Investment for the Three Months Ended March 31,	
	2022	2021
Commercial real estate:		
Commercial R.E. - construction	\$ 0	\$ 0
Commercial R.E. - mortgages	0	133
Land	0	0
Farmland	0	0
Commercial and Industrial	0	0
Consumer	0	0
Consumer residential	0	0
Agriculture	0	0
Total	<u>\$ 0</u>	<u>\$ 133</u>

Impaired loans as of December 31, 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	Average Recorded Investment
December 31, 2021						
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	166
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	0
Agriculture	0	0	0	0	0	0
Total	<u>\$ 0</u>	<u>\$ 0</u>	<u>\$ 0</u>	<u>\$ 0</u>	<u>\$ 0</u>	<u>\$ 166</u>

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 March 31, 2022, there was one consumer loan classified as a troubled debt restructuring with an outstanding balance of \$21,000, as compared to no loans classified as troubled debt restructurings as of December 31, 2021. During the three-months ended March 31, 2022, this same \$21,000 consumer loan was the only loan modified as a troubled debt restructuring, as compared to no loans that were modified as troubled debt restructurings in the same period of 2021. The consumer loan of \$21,000 was modified by extending the term of the loan. There were no loans modified as troubled debt restructurings within the previous twelve months and for which there was a payment default during the three-month periods ended March 31, 2022 and 2021. 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 March 31, 2022 and December 31, 2021, 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:

	March 31, 2022	December 31, 2021
	Weighted Average Risk Grade	Weighted Average Risk Grade
Commercial real estate:		
Commercial real estate - construction	3.00	3.00
Commercial real estate - mortgages	3.06	3.08
Land	3.00	3.00
Farmland	3.08	3.09
Commercial and industrial	2.99	3.01
Consumer	1.95	1.81
Consumer residential	3.00	3.00
Agriculture	3.25	3.23
Total gross loans	3.06	3.07

The following table presents risk grade totals by class of loans as of March 31, 2022 and December 31, 2021. 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
March 31, 2022									
Pass	\$ 21,204	\$ 586,364	\$ 3,003	\$ 89,033	\$ 95,466	\$ 359	\$ 28,286	\$ 23,186	\$ 846,901
Special mention	-	8,843	-	-	1,641	-	-	-	10,484
Substandard	-	-	-	776	547	21	34	-	1,378
Total loans	<u>\$ 21,204</u>	<u>\$ 595,207</u>	<u>\$ 3,003</u>	<u>\$ 89,809</u>	<u>\$ 97,654</u>	<u>\$ 380</u>	<u>\$ 28,320</u>	<u>\$ 23,186</u>	<u>\$ 858,763</u>
December 31, 2021									
Pass	\$ 25,737	\$ 574,774	\$ 3,101	\$ 75,889	\$ 107,154	\$ 395	\$ 28,404	\$ 32,500	\$ 847,954
Special mention	-	8,846	-	-	1,647	-	-	-	10,493
Substandard	-	-	-	781	753	21	35	-	1,590
Total loans	<u>\$ 25,737</u>	<u>\$ 583,620</u>	<u>\$ 3,101</u>	<u>\$ 76,670</u>	<u>\$ 109,554</u>	<u>\$ 416</u>	<u>\$ 28,439</u>	<u>\$ 32,500</u>	<u>\$ 860,037</u>

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-months ended March 31, 2022 and 2021. 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 Months Ended March 31, 2022 and 2021

(in thousands)

	Commercial Real Estate	Commercial and Industrial	Consumer	Consumer Residential	Agriculture	Total
Three Months Ended March 31, 2022						
Beginning balance	\$ 9,404	\$ 711	\$ 6	\$ 327	\$ 290	\$ 10,738
Charge-offs	0	0	(8)	0	0	(8)
Recoveries	31	0	1	0	0	32
Provision for (reversal of) loan losses	104	(10)	7	(16)	(85)	0
Ending balance	<u>\$ 9,539</u>	<u>\$ 701</u>	<u>\$ 6</u>	<u>\$ 311</u>	<u>\$ 205</u>	<u>\$ 10,762</u>
Three Months Ended March 31, 2021						
Beginning balance	\$ 9,310	\$ 1,079	\$ 22	\$ 325	\$ 561	\$ 11,297
Charge-offs	0	0	(5)	0	0	(5)
Recoveries	16	0	4	0	0	20
Provision (reversal of) for loan losses	194	(64)	(2)	11	(139)	0
Ending balance	<u>\$ 9,520</u>	<u>\$ 1,015</u>	<u>\$ 19</u>	<u>\$ 336</u>	<u>\$ 422</u>	<u>\$ 11,312</u>

The following table details the allowance for loan losses and ending gross loan balances as of March 31, 2022 and December 31, 2021, summarized by collective and individual evaluation methods of impairment.

(in thousands)

	Commercial Real Estate	Commercial and Industrial	Consumer	Consumer Residential	Agriculture	Total
March 31, 2022						
Allowance for loan losses for loans:						
Individually evaluated for impairment	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0
Collectively evaluated for impairment	9,539	701	6	311	205	10,762
	<u>\$ 9,539</u>	<u>\$ 701</u>	<u>\$ 6</u>	<u>\$ 311</u>	<u>\$ 205</u>	<u>\$ 10,762</u>
Ending gross loan balances:						
Individually evaluated for impairment	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0
Collectively evaluated for impairment	709,223	97,654	380	28,320	23,186	858,763
	<u>\$ 709,223</u>	<u>\$ 97,654</u>	<u>\$ 380</u>	<u>\$ 28,320</u>	<u>\$ 23,186</u>	<u>\$ 858,763</u>
December 31, 2021						
Allowance for loan losses for loans:						
Individually evaluated for impairment	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0
Collectively evaluated for impairment	9,404	711	6	327	290	10,738
	<u>\$ 9,404</u>	<u>\$ 711</u>	<u>\$ 6</u>	<u>\$ 327</u>	<u>\$ 290</u>	<u>\$ 10,738</u>
Ending gross loan balances:						
Individually evaluated for impairment	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0
Collectively evaluated for impairment	689,128	109,554	416	28,439	32,500	860,037
	<u>\$ 689,128</u>	<u>\$ 109,554</u>	<u>\$ 416</u>	<u>\$ 28,439</u>	<u>\$ 32,500</u>	<u>\$ 860,037</u>

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

(in thousands)

	THREE MONTHS ENDED MARCH 31,	
	2022	2021
Balance, beginning of period	\$ 469	\$ 379
(Reversal) Provision to Operations for Off Balance Sheet Commitments	(6)	49
Balance, end of period	<u>\$ 463</u>	<u>\$ 428</u>

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 March 31, 2022 and December 31, 2021, loans carried at \$858,763,000 and \$860,037,000, 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 March 31, 2022 and December 31, 2021. 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-month periods ended March 31, 2022 and 2021.

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 March 31, 2022 were as follows:

(in thousands)	Carrying Amount	Fair Value	Hierarchy Valuation Level
Financial assets:			
Cash and cash equivalents	\$ 669,225	\$ 669,225	1
Restricted equity securities	5,493	5,493	2
Loans, net	846,878	844,599	3
Interest receivable	4,225	4,225	2
Financial liabilities:			
Deposits	(1,799,305)	(1,798,752)	3
Interest payable	(18)	(18)	2
Off-balance-sheet liabilities:			
Commitments and standby letters of credit		(1,794)	3

The estimated fair values of the Company's financial instruments not measured at fair value as of December 31, 2021 were as follows:

(in thousands)	Carrying Amount	Fair Value	Hierarchy Valuation Level
Financial assets:			
Cash and cash equivalents	\$ 778,267	\$ 778,267	1
Restricted equity securities	5,493	5,493	2
Loans, net	847,847	852,975	3
Interest receivable	4,058	4,058	2
Financial liabilities:			
Deposits	(1,806,966)	(1,807,032)	3
Interest payable	(20)	(20)	2
Off-balance-sheet assets (liabilities):			
Commitments and standby letters of credit		(1,811)	3

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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 March 31, 2022 and December 31, 2021.

(in thousands)	Fair Value Measurements as of March 31, 2022 Using			
	March 31, 2022	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	\$ 30,864	\$ 0	\$ 30,864	\$ 0
Collateralized mortgage obligations	777	0	777	0
Municipalities	225,189	0	225,189	0
SBA pools	3,358	0	3,358	0
Corporate debt	32,825	0	32,825	0
Asset backed securities	56,129	0	56,129	0
Equity Securities:				
Mutual fund	\$ 3,229	\$ 3,229	\$ 0	\$ 0
Assets and liabilities measured on a non-recurring basis:				
	N/A			

(in thousands)	Fair Value Measurements at December 31, 2021 Using			
	December 31, 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	\$ 22,170	\$ 0	\$ 22,170	\$ 0
Collateralized mortgage obligations	899	0	899	0
Municipalities	176,242	0	176,242	0
SBA pools	3,708	0	3,708	0
Corporate debt	19,486	0	19,486	0
Asset backed securities	40,384	0	40,384	0
Equity Securities:				
Mutual fund	\$ 3,391	\$ 3,391	\$ 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 three-month period ended March 31, 2022.

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.

The Company’s calculation of basic and diluted EPS for the three-month periods ended March 31, 2022 and 2021 are reflected in the tables below.

(In thousands)	THREE MONTHS ENDED MARCH 31,	
	2022	2021
BASIC EARNINGS PER SHARE		
Net income	\$ 2,369	\$ 4,357
Weighted average shares outstanding	8,158	8,135
Net income per common share	\$ 0.29	\$ 0.54
DILUTED EARNINGS PER SHARE		
Net income	\$ 2,369	\$ 4,357
Weighted average shares outstanding	8,158	8,135
Effect of dilutive non-vested restricted shares	39	31
Weighted average shares of common stock and common stock equivalents	8,197	8,166
Net income per diluted common share	\$ 0.29	\$ 0.53

NOTE 7 – RISKS AND UNCERTAINTIES

The most significant impact of the coronavirus (“COVID-19”) pandemic to date 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 March 31, 2022 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 March 31, 2022, the Company and the Bank's on-balance sheet liquidity was 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 risks related to COVID-19.

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

Forward-Looking Statements

Some matters discussed in this Quarterly Report on 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.

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 2021 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 management's 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.

Introduction

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") 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 and Outlook

The most significant impact to date of the coronavirus ("COVID-19") pandemic 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. In 2020, the Company 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. In 2021, the financial stress subsided to some degree and credit quality improved allowing the Company to reverse \$635,000 in loan loss provisions. The allowance for loan losses decreased to \$10,762,000 and \$10,738,000 as of March 31, 2022 and December 31, 2021, respectively, as compared with \$11,297,000 as of December 31, 2020. The allowance for loan losses as a percentage of total loans increased from 1.12% as of December 31, 2020 to 1.25% as of December 31, 2021 and March 22, 2022, as loan loss reserves relative to gross loans remain at acceptable levels and credit quality remains stable. The increase compared to 1.12% as of December 31, 2020 was due to the decrease in outstanding PPP loans that do not require a loan loss reserve as they are guaranteed by the federal government through the SBA program.

There is no certainty that the allowance for loan losses as of March 31, 2022 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.

Net interest income has already been impacted by the COVID-19 since early 2020 and certain risks still exist. Interest and fees on PPP loans are only temporary and given that \$327 million of the \$345 million in funded PPP loans have been forgiven as of March 31, 2022, we have seen a decrease in PPP related net interest income, compared to the prior year, which will continue to decrease as loans are forgiven and paid down. There is potential for 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.

Notwithstanding the foregoing, in May 2022, the Federal Open Market Committee ("FOMC") announced an increase in the federal funds rate target range by 0.50%, resulting in a range of 0.75% to 1.00%, and while uncertain, it is expected that the Federal Reserve will continue to increase interest rates in 2022 to slow the effects of economic inflation tied to the COVID-19 pandemic. The Federal Reserve's decision-making policies for short-term interest rates will continue to impact the amount of net interest income we earn in the future. Further, as of March 31, 2022, the Company and the Bank's on-balance sheet liquidity was 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 risks related to COVID-19.

Critical Accounting Estimates

Critical accounting estimates are those estimates made in accordance with generally accepted accounting principles that involve a significant level of estimation and uncertainty and have had or are reasonably likely to have a material impact on our financial condition and results of operations. We consider accounting estimates to be critical to our financial results if (i) the accounting estimate requires management to make assumptions about matters that are highly uncertain, (ii) management could have applied different assumptions during the reported period, and (iii) changes in the accounting estimate are reasonably likely to occur in the future and could have a material impact on our financial statements. Management has determined the following accounting estimates and related policies to be critical:

Goodwill Impairment

The Company applies a qualitative analysis of conditions in order to determine if it is more likely than not that the carrying value is impaired. In the event that the qualitative analysis suggests that the carrying value of goodwill may be impaired, the Company uses several quantitative valuation methodologies in evaluating goodwill for impairment that includes assumptions and estimates made concerning the future earnings potential of the organization, and a market-based approach that looks at values for organizations of comparable size, structure and business model.

Estimates of fair value are based on a complex model using, among other things, estimated cash flows and industry pricing multiples. The Company tests its goodwill for impairment annually as of December 31 (the Measurement Date), and quarterly if a triggering event causes concern of a possible goodwill impairment charge. At each Measurement Date, the Company, in accordance with ASC 350-20-35-3, evaluates, based on the weight of evidence, the significance of all qualitative factors to determine whether it is more likely than not that the fair value of each of the reporting units is less than its carrying amount.

The assessment of qualitative factors at the most recent Measurement Date (December 31, 2021), indicated that it was not more likely than not that impairment existed; as a result, no further testing was performed.

Allowance for Loan Losses

Credit risk is inherent in the business of lending and making commercial loans. Accounting for our 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, our 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 allowance for loan losses is an estimate of probable incurred losses with regard to our loans. Our loan loss provision for each period is dependent upon many factors, including loan growth, net charge-offs, changes in the composition of the loans, delinquencies, management's assessment of the quality of the loans, the valuation of problem loans and the general economic conditions in our market area. We base our allowance for loan losses on an estimation of probable losses inherent in our loan portfolio.

Our methodology for assessing loan loss allowances are intended to reduce the differences between estimated and actual losses and involves a detailed analysis of our loan portfolio, in three phases:

- the specific review of individual loans,
- the segmenting and review of loan pools with similar characteristics, and
- our judgmental estimate based on various subjective factors:

The first phase of our methodology involves the specific review of individual loans to identify and measure impairment. We evaluate 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. We determine the calculated loss ratio to each loan pool based on its historical net losses and benchmark it against the levels of other peer banks.

In the third phase, we consider relevant internal and external factors that may affect the collectability of loan portfolio and each group of loan pool. 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.

Management estimates the probable effect of such conditions based on our 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 our 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 month-end 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.

Central to our credit risk management and our assessment of appropriate loss allowance is our 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 other liabilities), the adequacy of the allowance is considered in its entirety.

It is the policy of management to maintain the allowance for loan losses at a level adequate for risks inherent in the overall loan portfolio, however, the loan portfolio can be adversely affected if the state of California's economic conditions and its real estate market in our general market area were to further deteriorate or weaken. Additionally, further weakness of a prolonged nature in the agricultural and general economy would have a negative impact on the local market. The effect of such economic events, although uncertain and unpredictable at this time, could result in an increase in the levels of nonperforming loans and additional loan losses, which could adversely affect our future growth and profitability. No assurance of the level of predicted credit losses can be given with any certainty.

Income Taxes

Deferred income taxes are provided for the temporary differences between the financial reporting basis and the tax basis of our 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.

We file income tax returns in the U.S. federal jurisdiction, and the state of California. With few exceptions, we are no longer subject to U.S. federal or state/local income tax examinations by tax authorities for years before 2017.

Fair Value Measurements

We use fair value measurements to record fair value adjustments to certain assets and liabilities and to determine fair value disclosures. We base our 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, we 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.

We have established and documented a process for determining fair value. We maximize 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, our recorded earnings or disclosures could have been materially different from those reflected in these financial statements. For detailed information on our use of fair value measurements and our related valuation methodologies, see Note 5 to the Consolidated Financial Statements Item 1 of this report.

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-month period ended March 31, 2022:

- The Company recognized net income of \$2,369,000 for the three-month period ended March 31, 2022, as compared to \$4,357,000 for the same period in 2021. The first quarter net income decrease was mainly due to a decrease in loan interest and fees recognized on PPP loans.
- The Company recognized no loan loss provisions during the three-month periods ended March 31, 2022 and 2021. No provisions were warranted during the first three months of 2022, as our allowance for loan loss model determined that reserves were adequate throughout the quarter.
- Net interest income decreased \$1,284,000 or 10.5% for the three-month period ended March 31, 2022, compared to the same period in 2021, due a decrease in loan interest and fees recognized on PPP loans, which totaled \$487,000 during the three-months ended March 31, 2022, as compared to \$2,590,000 compared to the same period of 2021, which was offset in part by the growth in earning assets.
- Non-interest income decreased by \$8,000 or 0.7% for the three-months ended March 31, 2022, as compared to the same period in 2021. The decrease was primarily due to fair value changes in one equity security.
- Non-interest expense increased by \$1,402,000 or 18.2% for the three-month period ended March 31, 2022, as compared to the same period in 2021. 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 decreased \$18,459,000 or 0.9%, total net loans decreased by \$969,000 or 0.1% and investment securities increased by \$86,091,000 or 32.3% in each case from December 31, 2021 to March 31, 2022, while deposits decreased by \$7,661,000 or 0.4% for the same period. Consequently, cash and cash equivalent balances decreased by \$109,042,000. The March 31, 2022 balance sheet totals include \$17.7 million in outstanding PPP loans. Total funding since commencement of the PPP loan program in 2020 was \$345 million and as of March 31, 2022, we have received \$327 million in forgiveness payments from the SBA.

Income Summary

For the three-month period ended March 31, 2022, the Company recorded net income of \$2,369,000, representing a decrease of \$1,988,000, as compared to the same period in 2021. Return on average assets (annualized) was 0.50% for the three-months ended March 31, 2022, as compared to 1.12% for the same period in 2021. Annualized return on average common equity was 6.84% for the three-months ended March 31, 2022, as compared to 13.44% for the same period in 2021. Net income before provisions for income taxes decreased by \$2,694,000 for the three-month period ended March 31, 2022, from the comparable 2021 period. The income statement components of these variances are as follows:

Pre-Tax Income Variance Summary:

(In thousands)	Effect on Pre-Tax Income Increase (Decrease) Three Months Ended March 31, 2022
Change from 2021 to 2022 in:	
Net interest income	\$ (1,284)
Provision for loan losses	0
Non-interest income	(8)
Non-interest expense	(1,402)
Change in net income before income taxes	\$ (2,694)

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-month period ended March 31, 2022, net interest income was \$10,958,000, which represented a decrease of \$1,284,000 or 10.5%, from the comparable period in 2021. The decrease was primarily due to a decrease in interest and fees on PPP loans from \$2,590,000 during the first quarter of 2021 to \$487,000 during the three-months ended March 31, 2022.

The net interest margin (net interest income as a percentage of average interest earning assets) was 2.51% for the three-month period ended March 31, 2022, compared to 3.43% for the same period in 2021. The decrease in net interest margin is primarily due to the decrease in PPP loan interest and fees, strong deposit growth resulting in high levels of low-yielding cash equivalent balances, and the negative impact that the 2020 FOMC interest rate cuts had on our yield on earning assets. Earning asset yield decreased by 92 basis points for the three-month period ended March 31, 2022, as compared to the same period of 2021. 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 3 basis points for the three-month period of 2022, respectively, as compared to the same period in 2021. The Company continues to recognize strong core deposit growth as evidenced by the increase in average non-interest-bearing demand deposit balances of \$112 million, for the three-month period ended March 31, 2022, as compared to the same period of 2021. Deposit balances were bolstered by funded PPP loans during the first quarter of 2021, as the funded amounts were credited directly to the borrowers' deposit accounts.

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-month periods ended March 31, 2022 and 2021:

Net Interest Analysis

	Three months ended March 31, 2022			Three months ended March 31, 2021		
	Average Balance	Interest Income / Expense	Avg Rate/ Yield (5)	Average Balance	Interest Income / Expense	Avg Rate/ Yield (5)
<i>(in thousands)</i>						
Assets:						
Earning assets:						
Gross loans (1) (2)	\$ 847,994	\$ 9,143	4.37%	\$ 1,024,144	\$ 11,205	4.44%
Investment securities (2)	306,690	2,110	2.79%	208,159	1,457	2.84%
Federal funds sold	24,174	10	0.17%	30,732	6	0.08%
Interest-earning deposits	642,101	256	0.16%	212,733	49	0.09%
Total interest-earning assets	1,820,959	11,519	2.57%	1,475,768	12,717	3.49%
Total noninterest earning assets	112,833			103,006		
Total assets	1,933,792			1,578,774		
Liabilities and Shareholders' Equity:						
Interest-bearing liabilities:						
Interest-earning DDA	446,906	94	0.09%	339,519	102	0.12%
Money market deposits	411,677	104	0.10%	322,331	89	0.11%
Savings deposits	160,930	21	0.05%	126,419	16	0.05%
Time deposits \$250,000 and under	2,185	14	0.26%	21,818	15	0.28%
Time deposits over \$250,000	18,427	11	0.24%	16,354	14	0.35%
Total interest-bearing liabilities	1,060,125	244	0.09%	826,441	236	0.12%
Noninterest-bearing liabilities:						
Noninterest-bearing deposits	718,256			605,790		
Other liabilities	15,031			15,118		
Total noninterest-bearing liabilities	733,287			620,908		
Shareholders' equity	140,380			131,425		
Total liabilities and shareholders' equity	1,933,792			1,578,774		
Net interest income		\$ 11,275			\$ 12,481	
Net interest spread (3)			2.47%			3.38%
Net interest margin (4)			2.51%			3.43%

(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-month periods ended March 31, 2022 and 2021. 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 March 31, 2022 vs 2021		
	Increase (Decrease) in interest income and expense due to changes in:		
	Volume	Rate	Total
Interest income:			
Gross loans (1) (2)	\$ (1,927)	\$ (135)	\$ (2,062)
Investment securities (2)	690	(37)	653
Federal funds sold	(1)	5	4
Interest-earning deposits	100	107	207
Total interest income	\$ (1,138)	\$ (60)	\$ (1,198)
Interest expense:			
Interest-earning DDA	\$ 32	\$ (40)	\$ (8)
Money market deposits	25	(10)	15
Savings deposits	4	1	5
Time deposits \$250,000 and under	0	(1)	(1)
Time deposits over \$250,000	2	(5)	(3)
Total interest expense	\$ 63	\$ (55)	\$ 8
Change in net interest income	\$ (1,201)	\$ (5)	\$ (1,206)

(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 a decrease of \$1,201,000 in net interest income due to changes in volume combined with the overall change in mix of balances during the first quarter of 2022 as compared to the same period of 2021. This reduction was mainly due to a decrease in PPP loan balances in the first quarter of 2022 compared to the same period of 2021. Changes in earning asset yields and rates on interest-bearing liabilities resulted in a decrease of \$5,000 to net interest income, over the same period. This decrease was mainly due to a decline in PPP loan fees as described above, which was partially offset by the increase in gross loan yield due to the reduction of PPP loan balances that yielded just 1%.

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-months ended March 31, 2022 and no provisions during the same period of 2021. No loan loss provisions were warranted during the first three months of 2022 because credit quality remained strong as evidenced by non-accrual loans remaining at a zero balance and the allowance for loan loss model determined that reserves were adequate throughout the quarter. 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. Qualitative risk factor adjustments of approximately \$1.6 million were made to the allowance for loan loss reserve during 2020 related 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.

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-month period ended March 31, 2022, non-interest income was \$1,168,000, representing a decrease of \$8,000 or 0.7%, compared to the same period in 2021.

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

(in thousands)

	For the Three Months Ended March 31,			
	2022	2021	\$ Change	% Change
Service charges on deposits	\$ 376	\$ 295	\$ 81	27.5%
Debit card transaction fee income	413	381	32	8.4%
Earnings on cash surrender value of life insurance	182	164	18	11.0%
Mortgage commissions	35	31	4	12.9%
Other income	162	305	(143)	-46.9%
Total non-interest income	<u>\$ 1,168</u>	<u>\$ 1,176</u>	<u>\$ (8)</u>	<u>-0.7%</u>

Service charges on deposits increased by \$81,000 for the three-months ended March 31, 2022, compared to the same period in 2021. The first quarter increase 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 that resulted in lower overdraft fees in 2021 compared to 2022. This trend is in addition to strong growth of our core customer base and corresponding service fee income related to servicing loan and deposit accounts.

Debit card transaction fee income increased by \$32,000 for the three-months ended March 31, 2022, compared to the same period in 2021. The increase during 2022 is attributable to changes that begun in 2020 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 \$18,000 for the three-months ended March 31, 2022, compared to the same period in 2021, corresponding to the purchase of new life insurance policies on certain directors and officers during the second quarter of 2021.

Mortgage commissions increased by \$4,000 for the three-months ended March 31, 2022, as compared to the same period of 2021, as the demand for home purchases and refinancing has increased from last year.

Other income decreased by \$143,000 for the three-month period ended March 31, 2022, as compared to the same period of 2021. The first quarter decrease was mainly due to an increase in fair value changes on one equity security.

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 March 31,			
	2022	2021	\$ Change	% Change
Salaries and employee benefits	\$ 5,676	\$ 4,742	\$ 934	19.7%
Occupancy expenses	1,035	966	69	7.1%
Data processing fees	559	494	65	13.2%
Regulatory assessments (FDIC & DFPI)	261	117	144	123.1%
Other operating expenses	1,591	1,401	190	13.6%
Total non-interest expense	<u>\$ 9,122</u>	<u>\$ 7,720</u>	<u>\$ 1,402</u>	<u>18.2%</u>

Non-interest expenses increased by \$1,402,000 or 18.2% for the three-months ended March 31, 2022, as compared to the same period of 2021. Salaries and employee benefits increased \$934,000 for the three-months ended March 31, 2022, as compared to the same period of 2021. 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 \$69,000 for the three-months ended March 31, 2022, as compared to the same period of 2021, mainly due to rent expense and general operating costs related to branch facilities.

Data processing fees increased by \$65,000 for the three-month period ended March 31, 2022, as compared to the same period of 2021, primarily due to servicing costs on the growing number of loan and deposit accounts.

FDIC and California Department of Financial Protection and Innovation (DFPI) regulatory assessments increased by \$144,000 for the three-months ended March 31, 2022, as compared to the same period in 2021, mainly due to substantial increases in our deposit balances. 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 but there were modest increases in the assessment rate during 2021 and 2022 related to normal business cycles. The assessment rate remains at a relatively low level due to our strong credit quality, earnings and risk-based capital ratios. Management recognizes that assessments could increase further depending on deposit growth throughout the remainder of 2022, as the FDIC assessment rates are applied to average quarterly total liabilities as the primary basis.

Other expense increased by \$190,000 for the three-months ended March 31, 2022, as compared to the same period in 2021, due to increases in a variety of general operating expenses, which is not unusual given the expansion of the Company's business portfolios.

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 \$635,000 for the three-month period ended March 31, 2022, representing a decrease of \$706,000 compared to the provisions reported in the comparable period of 2021. The effective income tax rate on income from continuing operations was 21.1% for the three-months ended March 31, 2022, compared to 23.5% for the comparable period of 2021. 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 the year-to-date period of 2022 as compared to 2021 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 2022 as compared to 2021.

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 \$0 as of March 31, 2022 and December 31, 2021. As of March 31, 2022 there was one consumer loan totaling \$21,000 classified as a troubled debt restructuring that was modified by extending the term. As of December 31, 2021, the Company did not have any loans classified as troubled debt restructurings.

OREO as of March 31, 2022 and December 31, 2021 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 three months of 2022 and 2021.

The following table presents information about the Bank's non-performing assets, including asset quality ratios as of March 31, 2022 and December 31, 2021:

Non-Performing Assets

(in thousands)

	March 31, 2022	December 31, 2021
Loans in non-accrual status	\$ 0	\$ 0
Loans past due 90 days or more and accruing	0	0
Total non-performing loans	0	0
Other real estate owned	0	0
Total non-performing assets	\$ 0	\$ 0
Allowance for loan losses	\$ 10,762	\$ 10,738
Asset quality ratios:		
Non-performing assets to total assets	0.00%	0.00%
Non-performing loans to total loans	0.00%	0.00%
Allowance for loan losses to total loans	1.25%	1.25%
Allowance for loan losses to total non-performing loans	NA	NA

Non-performing assets remained at \$0 as of March 31, 2022 and December 31, 2021, due to strong credit quality within our loan portfolio.

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-months ended March 31, 2022 and 2021.

Provisions of approximately \$1.6 million were made in 2020 to adjust for 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.

The allowance for loan losses increased by \$24,000 to \$10,762,000 as of March 31, 2022, as compared to \$10,738,000 as of December 31, 2021, due to net loan recoveries of \$24,000 during the first three months of 2022. The PPP loans were paid down to \$17.7 million outstanding as of March 31, 2022 and do not require a loan loss reserve as they are guaranteed by the federal government through the SBA program. These factors combined with the decrease in the gross loan balance had no impact on the allowance for loan losses as a percentage of total loans as it remained at 1.25% as of March 31, 2022 and December 31, 2021.

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 March 31, 2022 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 March 31, 2022, and December 31, 2021, the Company had \$669,225,000 and \$778,267,000, 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 \$3,229,000 as of March 31, 2022. 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 management's 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 March 31, 2022 were \$1,799,305,000, a \$7,661,000 or 0.4% decrease from the deposit total of \$1,806,966,000 as of December 31, 2021. Average deposits increased by \$346,150,000 to \$1,778,381,000 for the three-month period ended March 31, 2022 as compared to the same period in 2021. 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)	March 31,	December 31,	Three Month Change	
	2022	2021	\$	%
Demand	\$ 1,171,157	\$ 1,210,153	\$ (38,996)	(3.2%)
MMDA	421,386	401,072	20,314	5.1%
Savings	167,007	155,231	11,776	7.6%
Time < \$250K	21,699	21,948	(249)	(1.1%)
Time > \$250K	18,056	18,562	(506)	(2.7%)
	<u>\$ 1,799,305</u>	<u>\$ 1,806,966</u>	<u>\$ (7,661)</u>	<u>(0.4%)</u>

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. Four 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 March 31, 2022. 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 March 31, 2022 and December 31, 2021.

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. As of March 31, 2022 and December 31, 2021, 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 Federal Reserve Bank ("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 California Department of Financial Protection and Innovation ("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.

The U.S. Basel III rules contain capital standards regarding the composition of capital, minimum capital ratios and counter-party credit risk capital requirements. The Basel III rules also include a definition of common equity Tier 1 capital and require that certain levels of such common equity Tier 1 capital be maintained. The rules also include a capital conservation buffer, which imposes a common equity requirement above the new minimum that can be depleted under stress and could result in restrictions on capital distributions and discretionary bonuses under certain circumstances, as well as a new standardized approach for calculating risk-weighted assets. 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.

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

(in thousands)

Capital ratios for Bank:	Actual		Regulatory Minimum	
	Amount	Ratio	Amount	Ratio
As of March 31, 2022				
Total capital (to Risk- Weighted Assets)	\$ 144,950	12.9%	\$ 118,128	>10.5%
Tier I capital (to Risk- Weighted Assets)	\$ 133,725	11.9%	\$ 95,627	>8.5%
Common Equity Tier 1 Capital (to Risk Weighted Assets)	\$ 133,725	11.9%	\$ 78,752	>7.0%
Tier I capital (to Average Assets)	\$ 133,725	6.9%	\$ 77,023	>4.0%
As of December 31, 2021				
Total capital (to Risk- Weighted Assets)	\$ 143,871	13.6%	\$ 110,780	>10.5%
Tier I capital (to Risk- Weighted Assets)	\$ 132,664	12.6%	\$ 89,679	>8.5%
Common Equity Tier 1 Capital (to Risk Weighted Assets)	\$ 132,664	12.6%	\$ 73,853	>7.0%
Tier I capital (to Average Assets)	\$ 132,664	7.00%	\$ 76,310	>4.0%
Capital ratios for the Company:				
As of March 31, 2022				
Total capital (to Risk- Weighted Assets)	\$ 145,220	12.9%	\$ 118,144	>10.5%
Tier I capital (to Risk- Weighted Assets)	\$ 133,995	11.9%	\$ 95,640	>8.5%
Common Equity Tier 1 Capital (to Risk Weighted Assets)	\$ 133,995	11.9%	\$ 78,762	>7.0%
Tier I capital (to Average Assets)	\$ 133,995	7.0%	\$ 77,027	>4.0%
As of December 31, 2021				
Total capital (to Risk- Weighted Assets)	\$ 143,984	13.7%	\$ 110,784	>10.5%
Tier I capital (to Risk- Weighted Assets)	\$ 132,777	12.6%	\$ 89,683	>8.5%
Common Equity Tier 1 Capital (to Risk Weighted Assets)	\$ 132,777	12.6%	\$ 73,856	>7.0%
Tier I capital (to Average Assets)	\$ 132,777	7.0%	\$ 76,313	>4.0%

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 stockholders. The Company's liquid assets as of March 31, 2022 were \$839.2 million compared to \$858.2 million as of December 31, 2021. The Company's liquidity level measured as the percentage of liquid assets to total assets was 43.1% as of March 31, 2022, compared to 43.7% as of December 31, 2021. Liquid assets decreased during the first three months of 2022, mainly due to the deposit decrease of \$7.7 million and core loan growth, excluding PPP loans, of \$11.5 million, resulting in lower 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 March 31, 2022, the Company's borrowing capacity from the FHLB was approximately \$329.1 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 March 31, 2022.

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 March 31, 2022 and December 31, 2021, the Company had commitments to extend credit of \$179.4 million and \$181.1 million, respectively, which includes obligations under letters of credit of \$3.0 million and \$3.3 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 2021 Annual Report on Form 10-K. As of March 31, 2022, the Company’s exposures to market risk have not changed materially since December 31, 2021. 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 March 31, 2022 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 related to the COVID-19 pandemic. All of our employees that were working remotely have returned to the office, but the design of our processes and controls allow for remote execution with accessibility to secure data if the need arises again in the future. 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, 2021, filed with the Securities and Exchange Commission on March 31, 2022.

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.

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 March 31, 2022, formatted in Inline XBRL: (i) Condensed Consolidated Balance Sheets at March 31, 2022 (Unaudited) and December 31, 2021, (ii) Condensed Consolidated Statements of Income for the three-month periods ended March 31, 2022 and March 31, 2021 (Unaudited), (iii) Condensed Consolidated Statements of Comprehensive Income for the three-month periods ended March 31, 2022 and March 31, 2021 (Unaudited), (iv) Condensed Consolidated Statements of Changes of Shareholders' Equity for the three-month periods ended March 31, 2022 and March 31, 2021 (Unaudited), (v) Condensed Consolidated Statements of Cash Flows for the three-month periods ended March 31, 2022 and March 31, 2021 (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.

Date: May 13, 2022

Oak Valley Bancorp

By: _____ /s/ JEFFREY A. GALL

Jeffrey A. Gall

**Senior Vice President and Chief Financial Officer
(Principal Financial Officer and duly authorized
signatory)**

**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: May 13, 2022

/s/ CHRISTOPHER M. COURTNEY

Christopher M. Courtney
Chief Executive Officer

**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: May 13, 2022

/s/ JEFFREY A. GALL

Jeffrey A. Gall
Chief Financial Officer

**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 March 31, 2022, 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: May 13, 2022

/s/ CHRISTOPHER M. COURTNEY

Christopher M. Courtney
Chief Executive Officer

Dated: May 13, 2022

/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.