

**CoastalSouth Bancshares, Inc.  
and Subsidiary**

*Report on Consolidated Financial Statements*

*As of and for the years ended December 31, 2021 and 2020*

# CoastalSouth Bancshares, Inc. and Subsidiary

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## **Independent Auditor's Report**

The Board of Directors  
CoastalSouth Bancshares, Inc.

### **Opinion**

We have audited the consolidated financial statements of CoastalSouth Bancshares, Inc. and Subsidiary (the "Company"), which comprise the consolidated balance sheets as of December 31, 2021 and 2020, the related consolidated statements of operations, comprehensive income, changes in stockholders' equity, and cash flows for the years then ended, and the related notes to the consolidated financial statements (collectively, the "financial statements").

In our opinion, the accompanying financial statements present fairly, in all material respects, the financial position of the Company as of December 31, 2021 and 2020, and the results of its operations and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

### **Basis for Opinion**

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

### **Responsibilities of Management for the Financial Statements**

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

In preparing the financial statements, management is required to evaluate whether there are conditions or events, considered in the aggregate, that raise substantial doubt about the Company's ability to continue as a going concern within one year after the date that the financial statements are issued (or within one year after the date that the financial statements are available to be issued when applicable).

### **Auditor's Responsibilities for the Audit of the Financial Statements**

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

In performing an audit in accordance with GAAS, we:

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

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

A handwritten signature in black ink that reads "Elliott Davis, PLLC". The signature is written in a cursive, flowing style.

Raleigh, North Carolina  
March 10, 2022

**CoastalSouth Bancshares, Inc. and Subsidiary**  
**Consolidated Balance Sheets**  
**For the years ended December 31, 2021 and 2020**

(in thousands of dollars except share and per share amounts)

|   | 2021         | 2020         |
|---|--------------|--------------|
| <b>Assets</b>   |              |              |
| Cash and cash equivalents:  |              |              |
| Cash and due from banks   | \$ 7,748     | \$ 6,906     |
| Interest-bearing accounts with other banks  | 7,600        | 513          |
| Federal funds sold and securities purchased under agreements to resell  | 209,011      | 149,584      |
| Total cash and cash equivalents   | 224,359      | 157,003      |
| Investments   |              |              |
| Securities available-for-sale, at fair value  | 293,225      | 119,557      |
| Equity securities   | -            | 163          |
| Non-marketable equity securities  | 1,529        | 1,487        |
| Total investments   | 294,754      | 121,207      |
| Loans held for sale   | 81,453       | 113,481      |
| Loans held for investment   | 938,116      | 702,518      |
| Allowance for loan losses   | (8,148)      | (7,041)      |
| Loans held for investment, net  | 929,968      | 695,477      |
| Bank-owned life insurance   | 29,039       | 18,950       |
| Premises, furniture and equipment, net  | 17,650       | 16,357       |
| Deferred tax asset  | 14,498       | 10,111       |
| Goodwill  | 4,708        | 4,708        |
| Intangible assets   | 2,856        | 1,614        |
| Other real estate owned   | 640          | 810          |
| Other assets  | 11,732       | 7,814        |
| Total assets  | \$ 1,611,657 | \$ 1,147,532 |
| <b>Liabilities</b>  |              |              |
| Deposits  |              |              |
| Non-interest bearing transaction accounts   | \$ 432,631   | \$ 229,361   |
| Interest-bearing transaction accounts   | 178,614      | 134,934      |
| Savings and money market  | 629,974      | 377,381      |
| Time deposits   | 182,898      | 149,876      |
| Total deposits  | 1,424,117    | 891,552      |
| Other borrowings  | 44,587       | 146,036      |
| SBA contingency reserve   | 5,323        | -            |
| Other liabilities   | 12,696       | 7,956        |
| Total liabilities   | 1,486,723    | 1,045,544    |
| <b>Stockholders' Equity</b>   |              |              |
| Voting common stock, \$1 par value at December 31, 2021 and 2020; 50,000,000 shares authorized at December 31, 2021 and 2020; 6,614,228 and 6,003,146 shares issued and outstanding at December 31, 2021 and 2020, respectively | 6,614        | 6,003        |
| Nonvoting common stock, \$1 par value at December 31, 2021 and 2020; 10,000,000 shares authorized at December 31, 2021 and 2020; 1,990,507 shares issued and outstanding at December 31, 2021 and 2020                          | 1,991        | 1,991        |
| Capital surplus   | 131,792      | 121,756      |
| Accumulated deficit   | (18,276)     | (30,598)     |
| Accumulated other comprehensive income  | 2,813        | 2,836        |
| Total stockholders' equity  | 124,934      | 101,988      |
| Total liabilities and stockholders' equity  | \$ 1,611,657 | \$ 1,147,532 |

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

**CoastalSouth Bancshares, Inc. and Subsidiary**  
**Consolidated Statements of Operations**  
**For the years ended December 31, 2021 and 2020**

(in thousands of dollars, except per share amounts)

|  | 2021      | 2020      |
|--|-----------|-----------|
| <b>Interest income</b>                                       |           |           |
| Loans, including fees  |           |           |
| Loans held for investment                                    | \$ 35,714 | \$ 28,677 |
| Loans held for sale  | 5,524     | 5,834     |
| Investments  |           |           |
| Taxable  | 3,014     | 2,117     |
| Non-taxable  | 527       | 364       |
| Non-marketable equity securities                             | 55        | 77        |
| Federal funds sold and resell agreements                     | 1,141     | 512       |
| Other earning assets from banks                              | 24        | 96        |
| Total  | 45,999    | 37,677    |
| <b>Interest expense</b>                                      |           |           |
| Interest-bearing deposits                                    | 3,567     | 5,094     |
| Other borrowings   | 1,187     | 672       |
| Total  | 4,754     | 5,766     |
| <b>Net interest income</b>                                   | 41,245    | 31,911    |
| Provision for credit losses                                  | 1,326     | 3,236     |
| <b>Net interest income after provision for credit losses</b> | 39,919    | 28,675    |
| <b>Noninterest income</b>                                    |           |           |
| Income from mortgage originations                            | 3,015     | 2,150     |
| Gain on sale of government guaranteed loans                  | 2,920     | 1,263     |
| Bargain purchase gain  | 1,649     | -         |
| Interchange income and card fees                             | 1,002     | 742       |
| Bank-owned life insurance                                    | 931       | 416       |
| Service charges on deposit accounts                          | 643       | 547       |
| Securities (loss) gains, net                                 | (59)      | 948       |
| Other noninterest income                                     | 1,095     | 358       |
| Total noninterest income                                     | 11,196    | 6,424     |
| <b>Noninterest expenses</b>                                  |           |           |
| Salaries and employee benefits                               | 22,236    | 17,475    |
| Other professional fees                                      | 2,939     | 1,470     |
| Occupancy and equipment                                      | 2,312     | 1,644     |
| Software and other technology expense                        | 2,085     | 1,350     |
| Data processing  | 1,631     | 1,256     |
| Regulatory assessment  | 1,012     | 621       |
| Loss on other real estate owned, net                         | 382       | 228       |
| Other noninterest expense                                    | 3,052     | 2,834     |
| Total noninterest expense                                    | 35,649    | 26,878    |
| <b>Income before taxes</b>                                   | 15,466    | 8,221     |
| Income tax provision   | 3,144     | 1,853     |
| <b>Net income</b>  | \$ 12,322 | \$ 6,368  |
| <b>Net income per common share:</b>                          |           |           |
| Basic  | \$ 1.51   | \$ 0.80   |
| Diluted  | \$ 1.48   | \$ 0.80   |

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

## CoastalSouth Bancshares, Inc. and Subsidiary

### Consolidated Statements of Comprehensive Income

For the years ended December 31, 2021 and 2020

| <i>(In thousands of dollars)</i>   | <u>2021</u>      | <u>2020</u>     |
|--|------------------|-----------------|
| <b>Net income</b>  | \$ 12,322        | \$ 6,368        |
| <b>Other comprehensive income</b>  |                  |                 |
| Change in unrealized (loss) gain on available-for-sale securities  | (1,836)          | 3,874           |
| Reclassification adjustment for net loss (gain) on sale of securities included in net income   | 64               | (953)           |
| Reclassification adjustment for net loss (gain) on fair value hedged component of available-for-sale securities included in net income | 726              | (25)            |
| Income tax effect  | 198              | (608)           |
| Unrealized (loss) gain on available-for-sale securities, net of tax  | (848)            | 2,288           |
| <b>Unrealized gains on derivatives:</b>  |                  |                 |
| Change in unrealized gain on cash flow hedges  | 1,086            | 1               |
| Income tax effect  | (261)            | -               |
| Unrealized gain on derivative instruments, net of tax  | 825              | 1               |
| <b>Other comprehensive (loss) income, net of tax</b>   | (23)             | 2,289           |
| <b>Comprehensive income</b>  | <u>\$ 12,299</u> | <u>\$ 8,657</u> |

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

**CoastalSouth Bancshares, Inc. and Subsidiary**  
**Consolidated Statements of Changes in Stockholders' Equity**  
**For the years ended December 31, 2021 and 2020**

(In thousands of dollars except share amounts)

|  | Common Stock     |                 |                  |                 | Capital<br>Surplus | Accumulated<br>Deficit | Accumulated<br>Other<br>Comprehensive<br>Income/ (Loss) | Total             |
|--|------------------|-----------------|------------------|-----------------|--------------------|------------------------|---|-------------------|
|  | Voting           |                 | Nonvoting        |                 |                    |                        |   |                   |
|  | Shares           | Amount          | Shares           | Amount          |                    |                        |   |                   |
| <b>Balance as of December 31, 2019</b>                                       | 6,202,746        | \$ 6,203        | 1,753,507        | \$ 1,754        | \$ 120,756         | \$ (36,966)            | \$ 547  | \$ 92,294         |
| Issuance of common stock under incentive plan                                | 37,400           | 37              | -                | -               | (37)               | -                      | -   | -                 |
| Conversion of shares from voting to nonvoting                                | (237,000)        | (237)           | 237,000          | 237             | -                  | -                      | -   | -                 |
| Stock-based compensation expense   | -                | -               | -                | -               | 1,037              | -                      | -   | 1,037             |
| Net income   | -                | -               | -                | -               | -                  | 6,368                  | -   | 6,368             |
| Other comprehensive income, net of tax                                       | -                | -               | -                | -               | -                  | -                      | 2,289   | 2,289             |
| <b>Balance as of December 31, 2020</b>                                       | <b>6,003,146</b> | <b>\$ 6,003</b> | <b>1,990,507</b> | <b>\$ 1,991</b> | <b>\$ 121,756</b>  | <b>\$ (30,598)</b>     | <b>\$ 2,836</b>   | <b>\$ 101,988</b> |
| Issuance of common stock under incentive plan                                | 37,400           | 37              | -                | -               | (37)               | -                      | -   | -                 |
| Issuance of common stock for the acquisition of Cornerstone Bancshares, Inc. | 573,682          | 574             | -                | -               | 8,892              | -                      | -   | 9,466             |
| Stock-based compensation expense   | -                | -               | -                | -               | 1,181              | -                      | -   | 1,181             |
| Net income   | -                | -               | -                | -               | -                  | 12,322                 | -   | 12,322            |
| Other comprehensive loss, net of tax   | -                | -               | -                | -               | -                  | -                      | (23)  | (23)              |
| <b>Balance as of December 31, 2021</b>                                       | <b>6,614,228</b> | <b>\$ 6,614</b> | <b>1,990,507</b> | <b>\$ 1,991</b> | <b>\$ 131,792</b>  | <b>\$ (18,276)</b>     | <b>\$ 2,813</b>   | <b>\$ 124,934</b> |

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

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
(Dollars in Thousands Except Share and Per Share Amounts)

**CoastalSouth Bancshares, Inc. and Subsidiary**

**Consolidated Statements of Cash Flows**

**For the years ended December 31, 2021 and 2020**

| <i>(In thousands of dollars)</i>   | 2021        | 2020        |
|--|-------------|-------------|
| <b>Operating activities</b>  |             |             |
| Net income   | \$ 12,322   | \$ 6,368    |
| Adjustments to reconcile net income to net cash provided (used) by operating activities: |             |             |
| Provision for credit losses  | 1,326       | 3,236       |
| Depreciation expense   | 985         | 784         |
| Increase in cash value of bank-owned life insurance                                      | (484)       | (416)       |
| Stock-based compensation   | 1,181       | 1,037       |
| Net loss (gain) on sale of securities available-for-sale                                 | 64          | (953)       |
| Amortization of operating lease right-of-use assets                                      | 496         | 346         |
| Amortization of debt issuance costs  | 48          | 14          |
| Impairment of commercial mortgage servicing rights                                       | 3           | -           |
| (Increase) decrease in fair value of equity securities                                   | (6)         | 5           |
| Writedown on other real estate owned   | 387         | 265         |
| Net gain on sale of premises, furniture and equipment                                    | (25)        | (12)        |
| Net gain on sale of other real estate owned  | (5)         | (37)        |
| Gain on sale of government guaranteed loans, including originations of servicing rights  | (2,920)     | (1,263)     |
| Income from mortgage operations  | (3,015)     | (2,150)     |
| Bargain purchase gain  | (1,649)     | -           |
| Discount accretion and premium amortization on securities available-for-sale             | 605         | 288         |
| Amortization of intangible assets  | 441         | 398         |
| Deferred income tax (benefit) expense  | (609)       | 61          |
| Change in SBA contingency reserve  | (74)        | -           |
| Originations of loans held for sale  | (5,164,361) | (4,877,490) |
| Proceeds from loans held for sale  | 5,227,393   | 4,862,500   |
| Increase in other assets   | (2,268)     | (3,622)     |
| Increase in other liabilities  | 1,044       | 2,853       |
| Net cash provided (used) by operating activities   | 70,879      | (7,788)     |
| <b>Investing activities</b>  |             |             |
| Purchase of securities available-for-sale  | (177,356)   | (82,496)    |
| Proceeds from sales of securities available-for-sale                                     | 3,009       | 19,426      |
| Proceeds from paydowns, calls, and maturities on securities available-for-sale           | 14,105      | 8,477       |
| Net sale of non-marketable equity securities   | 233         | (537)       |
| Loan originations and principal collections, net   | (135,688)   | (248,772)   |
| Net purchase of premises, furniture and equipment  | (2,190)     | (2,849)     |
| Proceeds from sales of other real estate owned   | 280         | 787         |
| Purchases of bank-owned life insurance   | (10,000)    | (5,000)     |
| Proceeds from bank-owned life insurance death benefits                                   | 395         | -           |
| Net cash received in business combination  | 80,911      | -           |
| Net cash used by investing activities  | (226,301)   | (310,964)   |

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
(Dollars in Thousands Except Share and Per Share Amounts)

**CoastalSouth Bancshares, Inc. and Subsidiary**

**Consolidated Statements of Cash Flows - Continued**

**For the years ended December 31, 2021 and 2020**

| <i>(In thousands of dollars)</i>   | <b>2021</b> | <b>2020</b> |
|--|-------------|-------------|
| <b>Financing activities</b>  |             |             |
| Net increase in deposits   | 324,275     | 290,460     |
| Net proceeds of Federal Home Loan Bank advances                              | -           | 10,000      |
| Net repayment of Federal Reserve Bank advances                               | (111,497)   | 111,497     |
| Proceeds from issuance of subordinated debt, net of debt issuance costs      | -           | 14,525      |
| Proceeds from commercial line of credit                                      | 10,000      | -           |
| Net cash provided by financing activities                                    | 222,778     | 426,482     |
| <b>Net increase in cash and cash equivalents</b>                             | 67,356      | 107,730     |
| <b>Cash and cash equivalents, beginning of year</b>                          | 157,003     | \$ 49,273   |
| <b>Cash and cash equivalents, end of year</b>                                | \$ 224,359  | \$ 157,003  |
| <b>Cash paid during the year for:</b>  |             |             |
| Interest   | \$ 5,501    | \$ 5,733    |
| Income taxes   | 4,423       | 1,458       |
| <b>Noncash investing and financing activities:</b>                           |             |             |
| Unrealized (loss) gain on securities available-for-sale, net                 | (848)       | 2,288       |
| Unrealized gain on derivatives, net  | 825         | 1           |
| Transfers of loans to other real estate owned                                | 492         | 320         |
| Transfers from loans held for investment to loans held for sale              | 25,018      | 13,775      |
| Right-of-use assets obtained in exchange for new operating lease liabilities | 1,320       | 1,987       |
| Lease liabilities arising from obtaining right-of-use assets                 | 1,756       | 1,987       |

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

**CoastalSouth Bancshares, Inc. and Subsidiary**  
**Notes to Consolidated Financial Statements**  
*(Amounts in Thousands Except Share and Per Share Amounts)*

**Note 1. Summary of Significant Accounting Policies**

Organization

CoastalSouth Bancshares, Inc. (the "Company"), headquartered in Hilton Head Island, South Carolina, is a registered bank holding company with one banking subsidiary, Coastal States Bank ("CSB"). CSB operates retail banking branches in three main retail markets, including Hilton Head Island/Bluffton, South Carolina, Savannah, Georgia, and north metro Atlanta, Georgia. CSB also has other commercial lines of business that operate on a national platform, such as government guaranteed lending, including both Small Business Association ("SBA") and United States Department of Agriculture ("USDA") lending, senior housing lending, and the Mortgage Banker Finance division, which provides warehouse lending to independent mortgage originators. The deposits of CSB are insured by the Federal Deposit Insurance Corporation ("FDIC"). CSB has one wholly owned subsidiary, Coastal States Mortgage, Inc. ("CSM"), a mortgage company focused on originating and selling residential mortgages to investors and to retain in the portfolio. The Company was organized on September 28, 2003 as a Virginia corporation, with no activity until August 9, 2004. CSB was organized as a South Carolina state-chartered bank on July 30, 2004 and opened on August 9, 2004.

Nature of Business

The Company offers full-service banking services designed to meet the needs of retail and commercial customers in the markets in which it operates. The services offered include transaction and savings deposit accounts, commercial and consumer lending, mortgage banking, and other activities related to commercial banking. The Company and CSB are subject to the regulations of certain federal and state agencies and are periodically examined by those regulatory agencies. CSM is an approved mortgage lender with the Federal Housing Administration, Department of Veterans Affairs, Federal Home Loan Mortgage Corporation, and USDA, and an approved servicer with Federal National Mortgage Association.

Use of Estimates in the Preparation of Financial Statements

The accounting and reporting policies of the Company and its subsidiaries are in accordance with accounting principles generally accepted in the United States of America ("US GAAP" or "GAAP") and also conform to general industry practices. Some of our significant accounting principles require complex judgments to estimate the values of assets and liabilities, for instance, the Allowance for Loan Losses ("ALL"), among others. All intercompany accounts and transactions have been eliminated in consolidation. Assets and liabilities of purchased companies are stated at estimated fair values at the date of acquisition. Results of operations of companies purchased are included from the date of acquisition. Certain reclassifications have been made to prior period amounts to conform to the current period presentation.

The impact of the global pandemic caused by the 2019 Novel Coronavirus (or "COVID-19") continues to evolve as variants of COVID-19 emerge and the extent of the impact will depend on a number of factors, including the duration and severity of the pandemic. The Company continues to monitor the impact to certain asset classes that may have higher risk of default that may be affected by the macroeconomic impact of government measures to contain the spread of the virus as well as any related government stimulus measures. As a result of the impacts of the COVID-19 pandemic, certain estimates and assumptions, including the allowance for loan losses and the fair values of certain financial instruments required increased judgment and carry a higher degree of variability and volatility that could result in material changes to our estimates in future periods.

Management's Estimates

The preparation of consolidated financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting

**CoastalSouth Bancshares, Inc. and Subsidiary**  
**Notes to Consolidated Financial Statements - Continued**  
**(Amounts in Thousands Except Share and Per Share Amounts)**

period. Actual results could differ from those estimates. Material estimates that are particularly susceptible to significant changes include:

- Determination of the Allowance for Loan Losses ("ALL") and provision for credit losses
- Income taxes, including tax provisions and realization of deferred tax assets
- Fair value of assets and liabilities acquired, including intangible assets and goodwill
- Determination of contingency reserves

Debt Securities

The Company classifies debt investment securities into three categories: trading, held-to-maturity, and available-for-sale. Management determines the appropriate classification of investment securities at the time of purchase. Debt investment securities are classified as held-to-maturity when the Company has the positive intent and ability to hold the investment securities to maturity. Held-to-maturity investment securities are carried at amortized cost. At December 31, 2021 and 2020, the Company had no investment securities classified as held-to-maturity.

Investment securities classified as trading are held principally for resale in the near term and are recorded at fair value. Gains or losses, either unrealized or realized, are reported in noninterest income. At December 31, 2021 and 2020, the Company had no investment securities classified as trading.

Investment securities not classified as either held-to-maturity or trading are classified as available-for-sale. Investment securities available-for-sale are stated at fair value, with the unrealized gains and losses, net of tax, reported as a separate component of Accumulated other comprehensive income ("AOCI") in the Consolidated Statements of Comprehensive Income.

The amortized cost of debt investment securities classified as either held-to-maturity or available-for-sale is adjusted for amortization of premiums and accretion of discounts to maturity or call, or in the case of mortgage-backed securities, over the estimated life of the security. Such amortization is considered an adjustment to yield on the security and included in interest income from investments. Interest and dividends are included in interest on investment securities in the Consolidated Statements of Operations.

Gains and losses realized from the sales of investment securities are determined by specific identification and are included in noninterest income. Available-for-sale and held-to-maturity investment securities are reviewed quarterly for potential impairment. The Company determines whether it has the intent to sell a debt security or whether it is more likely than not it will be required to sell the debt security before the recovery of its amortized cost basis. If either condition is met, the Company will recognize, in earnings, an impairment loss necessary to reduce the carrying value of the debt security to fair value. For all other debt investment securities for which the Company does not expect to recover the entire amortized cost basis of the security and do not meet either condition, an other-than-temporary loss is considered to have occurred and the Company records the credit loss portion of impairment in earnings and the impairment related to all other factors in other comprehensive loss.

Equity Securities

Equity securities are recorded at fair value, with changes in fair value presented in other noninterest income. The fair value of equity securities is based on observable market prices.

**CoastalSouth Bancshares, Inc. and Subsidiary**  
**Notes to Consolidated Financial Statements - Continued**  
**(Amounts in Thousands Except Share and Per Share Amounts)**

Non-Marketable Equity Securities

Equity securities without readily determinable fair values (non-marketable) that are not held for trading purposes includes Federal Home Loan Bank (“FHLB”) of Atlanta capital stock and various other non-marketable equity investments. Investment in the FHLB of Atlanta is a condition of borrowing from the FHLB of Atlanta, and the stock is pledged to collateralize such borrowings. FHLB stock is carried at cost, classified as a non-marketable security, and periodically evaluated for impairment based on ultimate recovery of par value. Both cash and stock dividends are reported as income. At December 31, 2021 and 2020, the Company’s investment in FHLB stock was \$1,529 and \$1,487, respectively. Dividends received on non-marketable equity securities are included as a separate component in interest income.

Loans Held for Sale

Loans held for sale (“LHFS”) includes loans acquired through the Company’s Mortgage Banker Finance (“MBF”) line of business that are acquired with the intent to sell. Interest income on LHFS is recognized in the period earned using the effective interest method. These LHFS are accounted for at the lower of cost or fair value; as of December 31, 2021, and 2020, respectively, there have been no fair value adjustments recorded on this type of LHFS.

LHFS also represents mortgage loans originated by CSM with the intent to sell. Generally, loans originated by CSM with the intent to sell are accounted for at fair value. These loans are initially recorded and carried at fair value, with changes in fair value recognized in income from mortgage originations. There were no LHFS of this type on December 31, 2021 and 2020.

Additionally, the Company may periodically decide to sell other commercial and consumer loans and may reclassify loans from held for investment to held for sale when appropriate. At the time of transfer, the amount by which the amortized cost basis of the LHFS exceeds fair value may be accounted for as a valuation allowance or direct write-down.

Loans Held for Investment

Loans held for investment (“LHFI” or “Loans”) are stated at their amortized cost basis, net of any charge-offs, on the balance sheet. Interest income on loans is computed based upon the unpaid principal balance. Interest income on loans is recognized in the period earned and is computed using the effective interest method. Loan origination fees and certain direct loan origination costs, as well as purchase premiums and discounts, are deferred and amortized to income over the contractual life of the related loans or commitments, adjusted for prepayments, using a method that approximates a level yield.

Loan processing fees received on Paycheck Protection Program (“PPP”) loans ranged from 1% - 5% of the original note amount, with a minimum origination fee of \$2.50 or \$0 for 2021 and 2020 originations, respectively, and are recognized ratably over the life of the loans. Unamortized fees associated with PPP loans were \$1,095 and \$2,764 as of December 31, 2021 and 2020, respectively. PPP fees recognized as income were \$4,855 and \$2,613 for the years ended December 31, 2021 and 2020, respectively. Costs related to the origination of these loans are deferred. When loans are forgiven or paid off, any unrecognized amount of the net processing fees are recognized.

Loans are considered past due or delinquent when the contractual principal or interest due in accordance with the terms of the loan agreement or any portion thereof remains unpaid after the due date of the scheduled payment. Loans are placed on non-accrual status when it becomes probable that interest is not fully collectable,

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generally when the loan becomes 90 days past due. Once loans are placed on non-accrual status, previously accrued but unpaid interest is reversed from interest income, and the accrual of interest income is suspended. Future payments received are applied to the principal balance of the loan. If and when borrowers demonstrate the sustained ability to repay such loans in accordance with the loan's contractual terms, the loan may be returned to accrual status. Loans which become 90 days past due are reviewed for collectability of principal. Principal amounts deemed uncollectable are charged off against the ALL, unless such loans are in the process of modification, collection through repossession, or foreclosure. Certain consumer loans are not placed on non-accrual but are monitored and charged-off at 120 days past due.

*Purchased Credit-Impaired Loans*

Purchased credit-impaired ("PCI") loans are those loans acquired with evidence of deterioration of credit quality since origination for which it is probable, at acquisition, that the Company will be unable to collect all contractually required payments. At the time of acquisition, PCI loans are either accounted for as specifically-reviewed or as part of a loan pool. The Company may elect to group PCI loans into pools based upon common risk characteristics.

Periodically, the Company re-estimates expected cash flows for each pool or specifically-reviewed loan. Estimated fair values for acquired loans are based upon a discounted cash flows methodology that considers various factors including the type of loan, collateral, credit quality, fixed or variable interest rate, historical payment performance, term of loan and whether or not the loan was amortizing, prepayment speed assumptions, and a discount rate reflecting effective yield of the pool.

Interest income on PCI loans is recognized through accretion of the difference between the recorded investment of the loan pool and the gross expected cash flows, from such pool, on a level-yield basis over the loans' estimated life. For loan pools where the recorded investment has been fully recovered, income is recognized as cash is received utilizing the cost recovery method. PCI loans are excluded from being classified as non-accrual when the Company can reasonably estimate cash flows.

*Impaired Loans*

The Company considers a loan to be impaired when, based upon current information and events, it believes it is probable that the Company will be unable to collect all amounts due according to the contractual terms of the loan agreement. Management reviews all impaired loans over \$100, and certain loans judgmentally identified under this threshold, individually to determine if a specific allowance based upon the borrower's overall financial condition, resources and payment record, support from guarantors and the realizable value of any collateral is necessary. Specific allowances are based upon discounted cash flows using a loan's initial effective interest rate or the net realizable value of the collateral for collateral-dependent loans. If the recorded investment in the impaired loan exceeds its fair value, a valuation allowance is required as a component of the ALL. Interest income on impaired loans is recorded on a cash basis once the loan's principal has been fully recovered.

*Troubled Debt Restructurings*

A loan is also considered impaired if its terms are modified in a troubled debt restructuring ("TDR"). A restructuring of debt constitutes a TDR if the Company, for economic or legal reasons related to a borrower's financial difficulties, grants a concession to a borrower that it would not otherwise consider. Concessions granted generally involve forgiving or forbearing a portion of interest or principal on any loans or making loans at a rate that is less than prevailing market rates. Prior to modifying a borrower's loan terms, the Company performs an evaluation of the borrower's financial condition and ability to service the debt under the potential modified loan terms. If a loan is accruing at the time of modification, the loan remains on accrual status and is subject to the

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Company's charge-off and non-accrual policies. If a loan is on non-accrual before it is determined to be a TDR, then the loan remains on non-accrual. TDRs may be returned to accrual status if there has been a sustained period of repayment performance by the borrower.

Allowance for Loan Losses

The ALL represents management's estimate of probable and reasonably estimable credit losses incurred in loans held for investment as of the balance sheet date. The estimate of the ALL is based upon management's evaluation of the loan portfolio including such factors as past loan loss experience, known and inherent risks in the portfolio, adverse situations that may affect the borrower's ability to repay (including the timing of future payments), the estimated value of any underlying collateral, composition of the loan portfolio, current market and economic conditions, borrower's payment status, internal credit risk ratings and other relevant factors. This evaluation is inherently subjective as it requires material estimates including the amounts and timing of future cash flows expected to be received on impaired loans that may be susceptible to significant changes. Loans are charged off when management believes that the ultimate collectability of the loan is unlikely. Allocation of the ALL may be made for specific loans, but the entire allowance is available for any loan that, in management's judgment, is deemed to be uncollectable. The ALL is increased by provisions charged to expense and decreased by actual charge-offs, net of recoveries.

The ALL adequacy assessment begins with a process of estimating probable and reasonably estimable credit losses incurred within the loan portfolio. These estimates are established by category and based upon the Company's internal system of credit risk ratings and historical loss data. Periodically, management reassesses certain assumptions in the calculation of allowance for loan losses in order to further refine the estimation methodology, as appropriate. The estimate of probable and reasonably estimable credit losses incurred within the loan portfolio may then be adjusted for management's estimate of additional probable and reasonably estimable credit losses as a result of specific credit exposures, trends in delinquent and nonaccrual loans, as well as other factors such as prevailing economic conditions, lending strategies, and other influencing factors.

Bank-Owned Life Insurance

Bank Owned Life Insurance ("BOLI") is long-term life insurance on the lives of certain employees where the insurance policy benefits and ownership are retained by the employer. To date, the Company has purchased life insurance policies on certain senior officers. BOLI is recorded at the cash surrender value, which can be adjusted for charges due at settlement at the balance sheet date. The cash value accumulation on BOLI is permanently tax deferred if the policy is held until the insured person's death.

Core Deposit Intangible

As a result of business combinations, identifiable intangible assets were recorded representing the estimated value of core deposits assumed. The Company amortizes the intangible assets over their estimated useful lives. Core deposit intangibles are periodically reviewed for reasonableness and are evaluated for impairment whenever events or changes in circumstances indicate the carrying amount of the assets may not be recoverable.

Commercial Mortgage Servicing Rights

The Company's commercial mortgage servicing rights ("CMSRs") arise from the sale of participating interests in government guaranteed loans to third parties where servicing is retained by the Company. The Company defines its classes of servicing assets relationship to the government guarantor, such as USDA or SBA guaranteed loans. The Company initially records servicing assets at fair value at the time the sale is recognized. The determination of fair value is based on a discounted cash flow analysis using the contractual terms of the associated loan being

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serviced and considers assumptions such as discount rate and prepayment speed. Subsequently, the Company amortizes these servicing assets over the expected life of the related loan, adjusting for expected prepayments. Periodically, the Company evaluates these assets for impairment. When the carrying value exceeds the fair value of a class of servicing assets, the Company recognizes impairment of the servicing assets. CMSRs are included in the intangible assets and were \$1,736 and \$899 at December 31, 2021 and 2020, respectively.

Goodwill

Goodwill represents the excess of the purchase price over the fair value of net assets acquired in a business combination. Goodwill is not amortized but tested for impairment on an annual basis, or more often, if events or circumstances indicate there may be impairment. Goodwill impairment exists when a reporting unit's carrying value of goodwill exceeds its implied fair value.

If the fair value of the reporting unit exceeds its carrying value, no further testing is required. If the carrying value exceeds the fair value, further analysis is required to determine whether an impairment charge must be recorded based upon the implied fair value of goodwill and, if so, the amount of such charge. The Company performs its Goodwill testing at least on an annual basis unless it is determined that conditions exist to indicate impairment.

Liabilities for Representations and Warranties

The Company is exposed to certain liabilities under representations and warranties made to purchasers of mortgage loans and servicing rights that require indemnification or repurchase of loans. At the time it issues a guarantee, the Company is required to recognize an initial liability for the fair value of obligations assumed under the guarantee.

The Company establishes a contingency reserve for its liabilities under representations and warranties provided to purchasers of its mortgage loans. This reserve is maintained at a level considered appropriate by management to provide adequately for known and inherent losses. The reserve is based upon a continuing review of past loss experience, estimates and assumptions of risk elements and future economic conditions. Additions to the reserve are recorded in other expenses.

Management's judgment about the adequacy of the reserve is based upon a number of assumptions about future events which it believes to be reasonable. There is no assurance that additional increases in the reserve will not be required. The Company may from time-to-time be required to repurchase loans previously sold to investors due to loan nonperformance. At December 31, 2021 and 2020, the Company had a contingency reserve of \$104 and \$159, respectively, for potential mortgage indemnifications to other third-party purchasers.

The Company also establishes a contingency reserve for repairs or denials of guarantees on certain SBA loans sold into the secondary market where the guarantee could be at risk in the SBA Contingency Reserve. Management's judgment about the adequacy of the reserve is based on assumptions about future events which it believes to be reasonable. There is no assurance that additional increases in the reserve will not be required. At December 31, 2021, the Company had a SBA contingency reserve of \$5,323 for denials or repairs of SBA guarantees on loans sold to third-party purchasers that were related to SBA loans acquired from Cornerstone Bank. There was no SBA contingency reserve at December 31, 2020.

Premises, Furniture and Equipment

Premises, furniture, and equipment are stated at cost, less accumulated depreciation. The provision for depreciation is computed by the straight-line method, based on the estimated useful lives for buildings of 30 to

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40 years and software, furniture, and equipment of 3 to 10 years. Leasehold improvements are amortized over the shorter of the life of the respective leases or the useful life of the asset. The cost of assets sold or otherwise disposed of and the related allowance for depreciation are eliminated from the accounts and the resulting gains or losses are reflected in the Consolidated Statements of Operations when incurred. Routine maintenance and repairs are charged to current expense. The costs of major repairs and improvements are capitalized. Premises and equipment are evaluated for impairment whenever events or changes in circumstances indicate that the carrying value of the asset may not be recoverable.

*Other Real Estate Owned*

Other real estate owned ("OREO") includes assets that have been acquired in satisfaction of debt through foreclosure. OREO is recorded at the lower of cost or fair value, minus estimated costs to sell. Subsequent to foreclosure, losses resulting from the periodic revaluation of the property are charged to loss on other real estate owned, net and a new carrying value is established. Any gains or losses realized at the time of disposal or subsequent write-downs are reflected in the Consolidated Statements of Operations. Expenses to maintain such assets are included in net cost of operation of other real estate owned.

*Other Borrowings*

The FHLB allows the Company to obtain advances through its credit program. These advances are secured by securities owned by the Company and held in safekeeping by the FHLB, FHLB stock owned by the Company, and certain qualifying loans secured by real estate, including residential mortgage loans, home equity lines of credit and commercial real estate loans.

The Company also obtains advances through the Federal Reserve Bank of Richmond ("FRB") through the discount window. Discount window advances are secured by investment securities pledged to the FRB. The Company also had access to the Paycheck Protection Program Liquidity Facility ("PPPLF") provided through the FRB which was secured by PPP loans. The PPPLF program ended on July 31, 2021.

The Company also has issued subordinated notes to certain qualified institutional buyers and institutional accredited investors and opened a commercial line of credit with a third party commercial bank that is used for general corporate purposes, including continued growth and maintenance of the bank level regulatory capital ratios.

*Derivative Financial Instruments*

The Company is exposed to certain risks relating to its ongoing business operations and uses interest rate derivatives as part of its asset-liability management strategy to help manage its interest rate risk position. The Company records all derivative assets and liabilities on the Consolidated Balance Sheets at fair value. The accounting for changes in the fair value of derivatives depends on the intended use of the derivative, whether the Company has elected to designate a derivative in a hedging relationship and apply hedge accounting and whether the hedging relationship has satisfied the criteria necessary to apply hedge accounting in accordance with ASC 815, *Derivatives and Hedging*. The Company currently has derivatives that are designated as qualifying hedging relationships. There are no other derivatives that are not designated as qualifying hedging relationships.

Changes in fair value of the Company's cash flow hedges are recognized in AOCI and reclassified to earnings in the period during which the hedged transaction affects earnings and is presented in the same income statement line item as the earnings effect of the hedged item. For fair value hedges, the gain or loss on the derivative as well as

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the offsetting gain or loss on the hedged item are recognized in current earnings as fair value changes. The change in fair value of the hedged item is recorded as a basis adjustment to the hedged assets or liabilities.

For fair value hedges meeting certain specific criteria, the Company applies the shortcut method of hedge accounting. For other derivatives that do not fall under shortcut method, the Company assesses the effectiveness of each hedging relationship by comparing the changes in the cash flows of the derivative hedging instrument with the changes in cash flows of the designated hedged transactions.

Income Taxes

Income tax expense is based upon income before income taxes and generally differs from income taxes paid due to deferred income taxes and benefits arising from income and expenses being recognized in different periods for financial and income tax reporting purposes, as well as permanent differences. The Company uses the asset and liability method to account for deferred income taxes. The objective of the asset and liability method is to establish deferred tax assets and liabilities for the temporary differences between the financial reporting basis and the income tax basis of the Company's assets and liabilities at the effective rates expected to be in effect when such amounts are realized or settled. The Company evaluates the realization of deferred tax assets based upon all positive and negative evidence available at the balance sheet date. Realization of deferred tax assets is based upon the Company's judgments, including taxable income within any applicable carryback periods, future projected taxable income, reversal of taxable temporary differences and other tax-planning strategies to maximize realization of the deferred tax assets. A valuation allowance is recognized for a deferred tax asset if, based upon the weight of available evidence, it is more likely than not that some portion or all of the deferred tax asset will not be realized. In computing the income tax provision or benefit, the Company evaluates the technical merits of its income tax positions based upon current legislative, judicial, and regulatory guidance.

The Company continually monitors and evaluates the potential impact of current events on the estimates used to establish income tax expense and income tax liabilities. The Company and its Subsidiary file a consolidated federal income tax return and separate state income tax returns based upon current tax law, positions taken by various tax auditors within the jurisdictions that the Company is required to file income tax returns, as well as potential or pending audits or assessments by such tax auditors. If the Company incurs interest and/or penalties related to income tax matters it will report them as a part of income tax expense.

The Company believes that its income tax filing positions taken or expected to be taken in its tax returns will more likely than not be sustained upon audit by the taxing authorities and does not anticipate any adjustments that will result in a material adverse impact on the Company's financial condition, results of operations, or cash flow. Therefore, no reserves for uncertain income tax positions have been recorded.

Retirement Plan

The Company has a 401(k) profit sharing plan (the "Plan"), which provides retirement benefits to officers and employees who meet certain age and service requirements. The Plan includes a salary reduction feature pursuant to Section 401(k) of the Internal Revenue Code of 1986, as amended (the "Code"). At its discretion, the Bank makes matching contributions to the Plan. Employer contributions for the 401(k) profit sharing plan were \$482 and \$393 in 2021 and 2020, respectively, and are included in salaries and employee benefits.

Net Income Per Common Share

Basic net income per common share represents income available to stockholders divided by the weighted-average number of common shares outstanding during the period. Dilutive income per share reflects additional common

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shares that would have been outstanding if dilutive potential common shares had been issued. Potential common shares that may be issued by the Company relate solely to outstanding options, warrants and restricted stock units are determined using the treasury stock method. Potential common shares are not included in the denominator of the diluted per share computation when inclusion would be anti-dilutive.

Other Comprehensive Income (Loss)

Other comprehensive income is defined as the change in stockholders' equity during the period from transactions and other events and circumstances from nonowner sources. Accumulated other comprehensive income includes the reclassification for realized gains and losses from investment securities sales during the period, the unrealized holding gains and losses from investment securities available-for-sale, and change in fair value of derivatives.

Statement of Cash Flows

For purposes of reporting cash flows in the financial statements, the Company considers certain highly liquid debt instruments purchased with a maturity of three months or less to be cash equivalents. Cash equivalents include amounts due from banks, interest bearing accounts with other banks, resell agreements and federal funds sold. Generally, federal funds are sold for one-day periods. Resell agreements are sold for approximately 30-day periods.

Off-Balance Sheet Financial Instruments

In the ordinary course of business, the Company enters into off-balance sheet financial instruments consisting of commitments to extend credit and letters of credit. These financial instruments are recorded in the financial statements when they become payable by the customer.

Stock-Based Compensation

The Company grants stock options, restricted stock units, and other equity awards to purchase its common stock to certain key officers/employees and directors. Stock options are for a fixed number of shares with an exercise price equal to the fair value of the shares at the grant date. The fair value of stock options is determined using the Black-Scholes model. The fair value of restricted stock units when granted is the fair value of the stock on the grant date. Stock-based compensation expense is recognized in the Consolidated Statements of Operations on a straight-line basis over the vesting period. In addition, the Company estimates the number of awards for which vesting is probable and adjusts compensation cost accordingly. For nonqualified stock options, as compensation expense is recognized, a deferred tax asset is recorded that represents an estimate of the future tax deduction from exercise. At the time that stock-based awards are exercised, cancelled, or expire, the Company may be required to recognize an adjustment to income tax expense. For incentive stock options, the Company does not recognize an income tax benefit related to compensation expense in the period incurred or when exercised, unless there is a disqualifying disposition. The Company recognizes forfeitures of stock-based awards as they occur.

Fair Value

US GAAP requires the use of fair values in determining the carrying values of certain assets and liabilities, as well as for specific disclosures. Fair value is defined as the price that would be received to sell an asset or transfer a liability in an orderly transaction between willing market participants at the measurement date. When determining the fair value measurements for assets and liabilities, the Company considers the principal or most advantageous market in which those assets or liabilities are sold and considers assumptions that market participants would use when pricing those assets or liabilities.

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Individual fair value estimates are classified on a three-tiered scale based upon the relative reliability of the inputs used in the valuation. Fair values determined using Level 1 inputs rely on active and observable markets to price identical assets or liabilities. In situations where identical assets and liabilities are not traded in active markets, fair values may be determined based upon Level 2 inputs, which are used when observable data exists for similar assets and liabilities. Fair values for assets and liabilities that are not actively traded in observable markets are based upon Level 3 inputs, which are considered to be unobservable.

*Business Combinations*

The Company applies the acquisition method of accounting for all business combinations. The acquirer is the entity that obtains control of one or more businesses in the business combination and the acquisition date is the date the acquirer achieved control. The acquirer recognizes the fair value of assets acquired, liabilities assumed and any non-controlling interest in the acquiree at the acquisition date. If the fair value of assets purchased exceeded the fair value of liabilities assumed, it results in a gain on acquisition. If the consideration given exceeds the fair value of the net assets received, goodwill is recognized. Generally, fair values are subject to refinement for up to one year after the closing date of an acquisition as information relative to closing date fair values becomes available (the “measurement period”). During the measurement period, the Company may recognize adjustments to the initial amounts recorded as if the accounting for the business combination had been completed at the acquisition date. Adjustments are typically recorded as a result of new information received after the acquisition date that is necessary to identify and measure identifiable assets acquired and liabilities assumed. In many cases, the determination of acquisition-date fair values requires management to make estimates about discount rates, future expected cash flows, market conditions, and other future events that are subjective in nature and subject to change.

The following is a description of the methods used to determine the fair values of significant assets and liabilities acquired:

Cash and Due from Banks

The carrying amount of these assets is expected to reasonably approximate fair value given the short-term nature of the assets.

Investment Securities Available-for-sale

The fair value of investment securities is determined by quoted market prices at the time of acquisition.

Loans

The fair value of acquired loans is based upon a discounted cash flow methodology that considered factors including the type of loans and related collateral, classification status, fixed or variable interest rate, loan term, whether or not the loan was amortizing, and a market discount rate reflecting risks inherent in the acquired loans, including potential prepayments. The fair value of acquired loans includes both a rate-based valuation mark, representing the carrying value of discount required to establish the appropriate effective yield for acquired loans, as well as a credit-based valuation mark representing the valuation adjustment applied to acquired loans related to credit loss assumptions.

Other Real Estate Owned

The fair value of other real estate owned is estimated based upon the value that management expects to receive when the property is sold, net of related costs of disposal.

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Core Deposit Intangibles

The fair value of core deposit intangibles is estimated based upon a discounted cash flow methodology that gives consideration to expected customer attrition rates, cost of the deposit base, and the net maintenance cost attributable to customer deposits.

Premises and Equipment

The fair value of premises and equipment is estimated based upon independent appraisals or broker price opinions.

Other Assets

Other assets generally include accrued interest that has been earned on borrowers' loans or investment securities not yet received and prepaid expenses. The carrying value of these assets is expected to reasonably approximate fair value.

Deposits

The fair values used for the transaction, money market, and savings accounts acquired closely approximate the amount payable on demand at the acquisition date and thus reasonably approximate fair value. The fair value of time deposits is estimated based upon a discounted cash flow methodology. The discount rate is estimated using market rates currently offered for deposits of similar remaining maturities.

Deferred Tax Assets and Liabilities

Deferred tax assets and liabilities are temporary differences between the carrying amount of an asset or a liability recognized in the Consolidated Balance Sheets and the related tax basis for the asset or liability using enacted tax rates in effect for the year in which the differences are expected to be recovered.

SBA Contingency Reserve

The SBA Contingency Reserve is an estimate of the Company's exposures related to denials or repairs of government guarantees on SBA 7A loans that have been sold in the secondary market. This estimate considers the balance of sold loans and considers the risk of loss and probability of denial or repair of government guarantee given historical information from the acquired entity.

Other Liabilities

Other liabilities generally include accrued interest on deposit accounts, accrued expenses, and additional accounts held in escrow. The carrying value of these liabilities is expected to reasonably approximate fair value.

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Operating Segments

Accounting standards require that information be reported about a company's operating segments using a "management approach." Reportable segments are identified in these standards as those revenue producing components for which separate financial information is produced internally and which are subject to evaluation by the chief operating decision maker. While the chief operating decision maker monitors the revenue streams of the various products and services, operations are managed, and financial performance is evaluated on a Company-wide basis. Accordingly, all of the financial service operations are considered by management to be aggregated in one reportable segment.

Reclassifications

Certain captions and amounts in the 2020 consolidated financial statements were reclassified to conform with the 2021 presentation. These reclassifications had no effect on the net results of operations or stockholders' equity.

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Recently Issued Accounting Pronouncements

The Company's common stock is quoted on OTCQX, (Ticker: COSO), and as a result, the Company is classified as a public business entity for the purposes of adopting new accounting pronouncements. The table below summarizes Accounting Standard Updates ("ASUs") which update various topics of the Accounting Standards Codification ("ASC") recently issued by the Financial Accounting Standards Board ("FASB") that could have a material effect on the Company's financial statements.

There were no new ASUs pronouncements that were adopted during the year ended December 31, 2021. The following table presents new ASUs pronouncements that are not yet adopted:

| Standards Not Yet Adopted  |  |   |   |
|--|--|---|---|
| Standard   | Description  | Required Date of Adoption   | Effect on the Financial Statements or Other Significant Matters   |
| ASU 2021-08, Business Combinations (Topic 805) — <i>Accounting for Contract Assets and Contract Liabilities From Contracts With Customers</i>  | This ASU amends ASC 805 to require acquiring entities to apply Topic 606 to recognize and measure contract assets and contract liabilities in a business combination. Under current GAAP, an acquirer generally recognizes such items at fair value on the acquisition date. This Update is intended to improve the accounting for acquired revenue contracts with customers in a business combination by addressing diversity in practice and inconsistency related to:<br><br>(1) Recognition of an acquired contract liability, and<br>(2) Payment terms and their effect on subsequent revenue recognized by the acquirer.   | Fiscal years beginning after December 15, 2022, including interim periods within those fiscal years<br><br>The amendments should be applied prospectively to business combinations occurring on or after the effective date of the amendments.<br><br>Early adoption is permitted | The Company is currently evaluating the impact that this ASU might have on its consolidated financial statements and related disclosures. |
| ASU 2020-04, Reference Rate Reform (Topic 848): <i>Facilitation of the Effects of Reference Rate Reform on Financial Reporting, as amended</i> | This ASU addresses the expected cessation of the London Interbank Offered Rate (LIBOR), the most commonly used benchmark interest rate in the world, which is expected to cease publication after 2021. This ASU provides optional guidance, for a limited time, to ease the potential burden in accounting for or recognizing the effects of reference rate reform on financial reporting. The amendments in this Update are elective and apply to all entities, subject to meeting certain criteria, that have contracts, hedging relationships, and other transactions that reference LIBOR or another reference rate expected to be discontinued because of reference rate reform. The optional expedients for contract modifications apply consistently for all contracts or transactions within the relevant Codification Topic, Subtopic, or Industry Subtopic that contains the guidance that otherwise would be required to be applied, while those for hedging relationships can be elected on an individual hedging relationship basis. | March 12, 2020 Through December 31, 2022  | The Company is currently evaluating the impact that this ASU might have on its consolidated financial statements and related disclosures. |

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|   |   |  |  |
|---|---|--|--|
| ASU 2016-13, <i>Measurement of Credit Losses on Financial Instruments, as amended</i> | The ASU amends ASC Topic 326, Financial Instruments-Credit Losses, to replace the incurred loss impairment methodology with a current expected credit loss (“CECL”) methodology for financial instruments measured at amortized cost and other commitments to extend credit. For this purpose, expected credit losses reflect losses over the remaining contractual life of an asset, considering the effect of voluntary prepayments and considering available information about the collectability of cash flows, including information about past events, current conditions, and reasonable and supportable forecasts. The resulting allowance for credit losses reflects the portion of the amortized cost basis that the entity does not expect to collect. Additional quantitative and qualitative disclosures are required upon adoption. The CECL model does not apply to available-for-sale (“AFS”) debt securities; however, the ASU requires entities to record an allowance when recognizing credit losses for AFS securities, rather than recording a direct write-down of the carrying amount. | January 1, 2023<br><br>Early adoption is permitted | The Company is evaluating the impact that this ASU will have on its consolidated financial statements and related disclosures, and currently anticipates that an increase to the allowance for credit losses will be recognized upon adoption to provide for the expected credit losses over the estimated life of the financial assets. In addition to our allowance for loan losses, we may also be required to record an allowance for credit losses on debt securities instead of applying the impairment model currently utilized, and may be required to record a reserve for unfunded commitments. However, since the magnitude of the anticipated increase in the allowance for credit losses will be impacted by economic conditions and trends in the Company’s portfolio at the time of adoption, the quantitative impact cannot yet be reasonably estimated. |
|---|---|--|--|

Other accounting standards that have been issued or proposed by the FASB or other standards-setting bodies are not expected to have a material impact on the Company’s financial position, results of operations, or cash flows.

**Note 2. Cash and Cash Equivalents**

Cash and cash equivalents include Cash and due from banks, Interest-bearing accounts with other banks, Federal funds sold, and Securities purchased under agreements to resell. Cash on hand, cash items in the process of collection, and amounts due from correspondent banks are included in Cash and due from banks.

The Company is required to maintain cash balances with its correspondent banks to cover all cash letter transactions. At December 31, 2021 and 2020, the requirement was met by the cash balance in the vault and balances on deposit with other banks.

The table below shows a breakout between federal funds sold and securities purchased under agreements to resell (“resell agreements”) as of December 31, 2021 and 2020. The Company uses these resell agreements as short-term investments, in lieu of selling federal funds. Balances will fluctuate based on Company’s liquidity needs. The Company obtains possession of collateral with a market value equal to or in excess of the principal amount loaned under resell agreements.

|                    | <b>2021</b>       | <b>2020</b>       |
|--------------------|-------------------|-------------------|
| Federal funds sold | \$ 125,956        | \$ 67,435         |
| Resell agreements  | 83,055            | 82,149            |
|                    | <u>\$ 209,011</u> | <u>\$ 149,584</u> |

**Note 3. Business Combinations**

Cornerstone Bancshares, Inc.

On October 1, 2021, the Company acquired 100% of the outstanding shares of Cornerstone Bancshares, Inc. (“Cornerstone”), the parent company of Georgia state-chartered Cornerstone Bank (“CRNB”), headquartered in Atlanta, Georgia. Upon consummation of the acquisition, Cornerstone was merged with and into the Company,

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with the Company as the surviving entity in the merger; concurrently, CRNB was merged with and into CSB. Through the acquisition, the Company expanded its footprint and deposit base in Atlanta, Georgia.

Under the terms of the acquisition, Cornerstone's accredited common shareholders received 0.047168 shares of the Company's common stock in exchange for each share of Cornerstone common stock and \$0.07392 in cash. Cornerstone shareholders also received cash in lieu of fractional shares based on the share issuance price of \$16.50. Nonaccredited investors and certain other shareholders received \$0.85219 in cash for each share of Cornerstone common stock in lieu of shares of the Company's stock. There were 144 Cornerstone accredited common shareholders who received the Company's common stock. The \$11,459 of total consideration transferred was comprised of 573,682 shares of the Company's voting common stock issued at \$16.50 per share, \$1,593 in cash in lieu of common stock, and \$400 of contingent consideration. The share issuance price per the merger agreement of \$16.50 approximated the 60-day day weighted average closing price of the Company's stock and was considered to be the fair value of the stock, given the Company's low trading volume.

The contingent consideration arrangement identifies a specific population of twelve problem loan relationships and specifies that if they are resolved within twelve months of the date of acquisition then the Company will pay additional consideration. The range of consideration possible from the arrangement is from \$0 to \$5,732. Given the likelihood of recovery and anticipated timing of recovery, management estimated that the value of contingent consideration was \$400 at the time of acquisition.

A bargain purchase of \$1,649 was realized as a result of this acquisition. The bargain purchase gain was driven by conservative underwriting and the Company's willingness to take on risks and uncertainties related to the acquired loan portfolio.

Acquisition- related costs of \$2,076 were included in other noninterest expense in the Company's Consolidated Statements of Operations for the year ended December 31, 2021.

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The following table summarizes the consideration paid for Cornerstone and the amounts of the assets and liabilities acquired and assumed, respectively, recognized at the acquisition date:

|   | Carrying Value Acquired | Purchase Adjustments | As Recorded by CSB |
|---|-------------------------|----------------------|--------------------|
| <b>Assets</b>                                 |                         |                      |                    |
| Cash and due from banks                       | \$ 82,504               | \$ -                 | \$ 82,504          |
| Investment securities                         | 15,942                  | 31                   | 15,973             |
| Loans held for investment, net                | 128,597                 | (2,886)              | 125,711            |
| Premises, furniture and equipment, net        | 90                      | (27)                 | 63                 |
| Intangible assets                             | 232                     | 941                  | 1,173              |
| Deferred tax asset                            | -                       | 3,841                | 3,841              |
| Other assets                                  | 1,853                   | 10                   | 1,863              |
| <b>Total assets acquired</b>                  | <b>\$ 229,218</b>       | <b>\$ 1,910</b>      | <b>\$ 231,128</b>  |
| <b>Liabilities</b>                            |                         |                      |                    |
| <b>Deposits</b>                               |                         |                      |                    |
| Noninterest-bearing                           | 67,428                  | -                    | 67,428             |
| Interest-bearing                              | 139,357                 | 1,505                | 140,862            |
| <b>Total deposits</b>                         | <b>206,785</b>          | <b>1,505</b>         | <b>208,290</b>     |
| SBA contingency reserve                       | 1,149                   | 4,248                | 5,397              |
| Other liabilities                             | 3,154                   | 1,179                | 4,333              |
| <b>Total liabilities assumed</b>              | <b>211,088</b>          | <b>6,932</b>         | <b>218,020</b>     |
| <b>Net identifiable assets acquired</b>       | <b>\$ 18,130</b>        | <b>\$ (5,022)</b>    | <b>\$ 13,108</b>   |
| <b>Consideration</b>                          |                         |                      |                    |
| Voting common stock                           |                         |                      | \$ 9,466           |
| Cash  |                         |                      | 1,593              |
| Contingent consideration                      |                         |                      | 400                |
| <b>Total consideration transferred to CRN</b> |                         |                      | <b>11,459</b>      |
| <b>Bargain Purchase Gain</b>                  |                         |                      | <b>\$ (1,649)</b>  |

Acquired loans held for investment had gross contractual amounts receivable of \$146,356. At the acquisition date, CSB's current estimate of expected cash flows to be collected was \$142,730. Acquired loans were evaluated to determine if they were purchased credit-impaired ("PCI"). PCI loans are loans with evidence of deterioration of credit quality since origination for which it is probable, at acquisition, that the Company will be unable to collect all contractually required payments receivable. PCI loans that were identified as part of this business combination amounted to \$39,625 and was comprised of 143 loans. The determination of the basis of PCI loans is presented in the table below:

|   | October 1, 2021  |
|---|------------------|
| Contractual principal and interest at acquisition               | \$ 52,461        |
| Nonaccretable difference  | 56,659           |
| Expected Cash flows at acquisition                              | 46,795           |
| Accretable yield  | 7,171            |
| <b>Basis in PCI loans at acquisition - estimated fair value</b> | <b>\$ 39,625</b> |

**CoastalSouth Bancshares, Inc. and Subsidiary**  
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**Note 4. Investment Securities**

The amortized cost and estimated fair values of securities available-for-sale at December 31, 2021 and 2020 are shown in the tables below:

|                                     | 2021              |                              |                               |                   |
|-------------------------------------|-------------------|------------------------------|-------------------------------|-------------------|
|                                     | Amortized<br>Cost | Gross<br>Unrealized<br>Gains | Gross<br>Unrealized<br>Losses | Fair<br>Value     |
| U.S. Treasuries                     | \$ 25,957         | \$ -                         | \$ 103                        | \$ 25,854         |
| Municipal obligations               | 65,916            | 1,616                        | 858                           | 66,674            |
| Mortgage-backed securities          | 117,394           | 425                          | 965                           | 116,854           |
| Asset-backed securities             | 52,093            | 686                          | 77                            | 52,702            |
| Corporate debt securities           | 30,026            | 1,151                        | 36                            | 31,141            |
| Total securities available-for-sale | <u>\$ 291,386</u> | <u>\$ 3,878</u>              | <u>\$ 2,039</u>               | <u>\$ 293,225</u> |

  

|                                     | 2020              |                              |                               |                   |
|-------------------------------------|-------------------|------------------------------|-------------------------------|-------------------|
|                                     | Amortized<br>Cost | Gross<br>Unrealized<br>Gains | Gross<br>Unrealized<br>Losses | Fair<br>Value     |
| Municipal obligations               | \$ 37,544         | \$ 1,806                     | \$ 53                         | \$ 39,297         |
| Mortgage-backed securities          | 38,538            | 966                          | 43                            | 39,461            |
| Asset-backed securities             | 17,597            | 677                          | -                             | 18,274            |
| Corporate debt securities           | 22,268            | 396                          | 139                           | 22,525            |
| Total securities available-for-sale | <u>\$ 115,947</u> | <u>\$ 3,845</u>              | <u>\$ 235</u>                 | <u>\$ 119,557</u> |

Proceeds from sales of securities available-for-sale during 2021 and 2020 were \$3,009 and \$19,426, respectively, resulting in gross realized (loss)/gains of \$(64) and \$953, respectively.

The following is a summary of maturities of securities available-for-sale as of December 31, 2021. The amortized cost and estimated fair values are based on the contractual maturity dates. Actual maturities may differ from contractual maturities because borrowers may have the right to call or repay obligations with or without penalty. Mortgaged-backed securities are not presented by maturity date because pay-downs are expected before contractual maturity dates.

|   | Amortized<br>Cost | Estimated<br>Fair Value |
|---|-------------------|-------------------------|
| Three months or less                      | \$ -              | \$ -                    |
| Over three months through one year        | -                 | -                       |
| Due after one year but within five years  | 66,867            | 68,056                  |
| Due after five years but within ten years | 89,225            | 90,256                  |
| Due after ten years                       | 17,900            | 18,059                  |
| Mortgage backed securities                | 117,394           | 116,854                 |
| Total                                     | <u>\$ 291,386</u> | <u>\$ 293,225</u>       |

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The following table shows gross unrealized losses and fair value of securities available for sale, aggregated by investment category, and length of time that individual securities have been in a continuous unrealized loss position at December 31, 2021:

|                            | Less than<br>Twelve months |                      | Twelve months<br>or more |                      | Total      |                      |
|----------------------------|----------------------------|----------------------|--------------------------|----------------------|------------|----------------------|
|                            | Fair Value                 | Unrealized<br>losses | Fair Value               | Unrealized<br>losses | Fair Value | Unrealized<br>losses |
|                            | U.S. Treasuries            | \$ 15,846            | \$ 103                   | \$ -                 | \$ -       | \$ 15,846            |
| Municipal obligations      | 25,856                     | 714                  | 3,434                    | 144                  | 29,290     | 858                  |
| Mortgage-backed securities | 76,749                     | 947                  | 1,807                    | 18                   | 78,556     | 965                  |
| Asset-backed securities    | 13,853                     | 77                   | -                        | -                    | 13,853     | 77                   |
| Corporate debt securities  | 2,964                      | 36                   | -                        | -                    | 2,964      | 36                   |
|                            | \$ 135,268                 | \$ 1,877             | \$ 5,241                 | \$ 162               | \$ 140,509 | \$ 2,039             |

The following table shows gross unrealized losses and fair value of securities available for sale, aggregated by investment category, and length of time that individual securities have been in a continuous unrealized loss position at December 31, 2020:

|                            | Less than<br>Twelve months |                      | Twelve months<br>or more |                      | Total      |                      |
|----------------------------|----------------------------|----------------------|--------------------------|----------------------|------------|----------------------|
|                            | Fair Value                 | Unrealized<br>losses | Fair Value               | Unrealized<br>losses | Fair Value | Unrealized<br>losses |
|                            | Municipal obligations      | \$ 5,004             | \$ 53                    | \$ -                 | \$ -       | \$ 5,004             |
| Mortgage-backed securities | 128                        | 6                    | 3,788                    | 37                   | 3,916      | 43                   |
| Corporate debt securities  | 7,692                      | 139                  | -                        | -                    | 7,692      | 139                  |
|                            | \$ 12,824                  | \$ 198               | \$ 3,788                 | \$ 37                | \$ 16,612  | \$ 235               |

Securities classified as available-for-sale are recorded at fair market value. Of the securities in an unrealized loss position at December 31, 2021, thirteen securities were in a continuous loss position for twelve months or more. The Company believes, based on industry analyst reports, credit ratings and/or government guarantees, that the deterioration in value is attributable to changes in market interest rates and is not in the credit quality of the issuer and therefore, these losses are not considered other-than-temporary.

The Company evaluates securities available-for-sale for other-than-temporary impairment on a quarterly basis. As a result of this evaluation, at December 31, 2021, the Company has determined that the declines summarized in the tables above are not deemed to be other-than-temporary. There can be no assurance that the Company will not conclude in future periods that conditions existing at that time indicate some or all of these securities may be sold or are other than temporarily impaired, which would require a charge to earnings in such periods.

During 2021 and 2020, the Company recognized a net gain/(loss) on changes in market value of \$6 and \$(5), respectively, to reflect the change in fair value of equity securities.

At December 31, 2021 and 2020, investment securities with a book value of \$48,904 and \$34,286, respectively, and a market value of \$50,389 and \$35,957, respectively, were pledged to secure federal funds lines of credit and Federal Home Loan Bank borrowings.

**Note 5. Loans and Allowance for Loan Losses**

Composition of Loan Portfolio

The Company engages in a full complement of lending activities, including real estate-related loans, construction loans, commercial and industrial loans, and consumer purpose loans. While risk of loss in the Company's portfolio is primarily tied to the credit quality of the various borrowers, risk of loss may increase due to factors beyond the Company's control, such as local, regional and/or national economic downturns. General conditions in the real estate market may also impact the relative risk in the real estate portfolio.

Construction and land loans include loans for the development of residential neighborhoods, construction of one-to-four family residential construction loans to builders, commercial real estate construction loans, primarily for owner-occupied properties, and other loans for land investment. Construction loans generally carry a higher degree of risk than long-term financing of existing properties because repayment depends upon the ultimate completion of the project and usually on the subsequent lease-up and/or sale of the property. The Company limits its construction lending risk through adherence to established underwriting procedures.

Commercial real estate loans include loans secured by owner-occupied commercial buildings for office, storage, retail, farmland, and warehouse space. They also include non-owner-occupied commercial buildings such as leased retail and office space, multi-family properties, and senior housing developments. The primary risk associated with loans secured with income-producing property is the inability of that property to produce adequate cash flow to service the debt. High unemployment, generally weak economic conditions and/or an oversupply in the market may result in our customers having difficulty achieving adequate occupancy rates. Payments on such loans are often dependent on successful operation or management of the properties.

Commercial and industrial loans include both secured and unsecured loans for working capital, expansion, and other business purposes. Short-term working capital loans may be secured by non-real estate collateral such as accounts receivable, inventory, and/or equipment. The Company evaluates the financial strength, cash flow, management, credit history of the borrower and the quality of the collateral securing the loan. Repayment is primarily dependent on the ability of the borrower to achieve business results consistent with those projected at loan origination resulting in cash flow sufficient to service the debt. To the extent that a borrower's business results are significantly unfavorable versus the original projections, the ability for the loan to be serviced on a basis consistent with the contractual terms may be at risk. The Company often requires personal guarantees and secondary sources of repayment on commercial and industrial loans.

The Paycheck Protection Program was introduced during 2020 as part of the Coronavirus Aid, Relief, and Economic Security Act ("CARES Act") in response to the COVID-19 pandemic. These 100% government guaranteed unsecured commercial loans were originated to small businesses seeking aid due to difficulties caused by COVID-19. Under the program, the SBA will forgive loans, in whole or in part, made by approved lenders to eligible borrowers for payroll and other permitted purposes in accordance with the requirements of the program. These loans carry a fixed rate of 1.00% and a term of two or five years, depending on the origination date, if not forgiven. The loan application, qualifications for credit, and loan terms are defined by the SBA and United States Department of the Treasury and are underwritten and approved according to the terms of the program. If proceeds from the loans were used for qualified purposes as specified in the program, the loans are 100% forgivable by the SBA. The borrower is not required to make any payments until the forgiveness amount is remitted to the lender by the SBA. Because these loans are 100% guaranteed by the SBA, the Company has not currently assigned any allowance for loan losses to this loan type.

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Residential real estate loans include permanent mortgage financing, construction loans to individual consumers, and home equity lines of credit. These loans are secured by residential properties. Significant and rapid declines in real estate values can result in residential mortgage loan borrowers having debt levels in excess of the current market value of the collateral.

Consumer other purpose loans primarily includes student loans and other secured and unsecured consumer purpose loans. Certain loans are secured by marine vessels, recreational vehicles, and other such tangible property. These types of loans may be impacted by negative macroeconomic conditions impacting individual consumers, such as increased unemployment, which can reduce a borrower's ability to repay the loan.

Loans held for sale are comprised of loans acquired through mortgage warehouse lending activities and origination of mortgage loans. The Company serves as a warehouse lender by purchasing loans originated by third-party mortgage originators and selling these loans to other third-party investors. The Company also originates mortgage loans with customers through CSM and sells the majority of these loans to third-party investors.

The Company also has a portfolio of PCI loans at December 31, 2021. See Note 1, "Summary of Significant Accounting Policies" for additional information regarding PCI loans. The Company did not have any PCI loans as of December 31, 2020.

Following is a summary of the composition of the loan portfolio at December 31, 2021 and 2020:

|  | 2021       | 2020       |
|--|------------|------------|
| Commercial loans:                      |            |            |
| Construction and land                  | \$ 76,547  | \$ 62,079  |
| Commercial real estate                 | 404,797    | 261,102    |
| Commercial and industrial              | 167,360    | 104,955    |
| Paycheck Protection Program            | 47,655     | 122,517    |
| Consumer loans:                        |            |            |
| Residential real estate                | 101,198    | 67,215     |
| Other consumer                         | 104,664    | 84,650     |
| Purchased Credit Impaired (PCI) loans: |            |            |
| Construction and land                  | 702        | -          |
| Commercial real estate                 | 26,843     | -          |
| Commercial and industrial              | 5,935      | -          |
| Residential real estate                | 2,412      | -          |
| Other consumer                         | 3          | -          |
| Total gross LHFI                       | 938,116    | 702,518    |
| Less allowance for loan losses         | (8,148)    | (7,041)    |
| LHFI, net                              | \$ 929,968 | \$ 695,477 |
| LHFS                                   | \$ 81,453  | \$ 113,481 |

### Credit Quality Indicators

The Company monitors the credit quality of its commercial loan portfolio using internal credit risk ratings. These credit risk ratings are based upon established regulatory guidance and are assigned upon initial approval of credit to borrowers. Credit risk ratings are updated periodically after the initial assignment or whenever management becomes aware of information affecting the borrowers' ability to fulfill their obligations. The Company utilizes the following categories of credit grades to evaluate its commercial loan portfolio:

**Pass** - Loans classified as pass are higher quality loans that do not fit any of the other categories below.

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**Special Mention** - Loans classified as special mention have a potential weakness that deserves management's close attention. If left uncorrected, these potential weaknesses may result in deterioration of the repayment prospects for the loan or of the Company's credit position at some future date.

**Substandard** - Loans classified as substandard are inadequately protected by the current net worth and paying capacity of the obligor or of the collateral pledged, if any. Loans so classified have a well-defined weakness or weaknesses that jeopardize the liquidation of the debt. They are characterized by the distinct possibility that the Company will sustain some loss if the deficiencies are not corrected.

**Doubtful** - Loans classified as doubtful have all the weaknesses inherent in those classified as 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 high, but because of certain important and reasonably specific pending factors that may work to the advantage and strengthening of the credit quality of the loan, its classification as an estimated loss is deferred until its more exact status may be determined. Pending factors include proposed merger, acquisition, or liquidation procedures, capital injection, perfecting liens on additional collateral and refinancing plans.

The following table shows the credit quality indicators associated with the Company's commercial loan portfolio, excluding PCI loans, as of December 31, 2021:

|                 | Construction and Land | Commercial Real Estate | Commercial and Industrial | Paycheck Protection Program | Total      |
|-----------------|-----------------------|------------------------|---------------------------|-----------------------------|------------|
| Pass            | \$ 73,712             | \$ 399,380             | \$ 166,797                | \$ 47,655                   | \$ 687,544 |
| Special mention | 2,835                 | 3,328                  | 403                       | -                           | 6,566      |
| Substandard     | -                     | 2,089                  | 160                       | -                           | 2,249      |
| Doubtful        | -                     | -                      | -                         | -                           | -          |
| Total           | \$ 76,547             | \$ 404,797             | \$ 167,360                | \$ 47,655                   | \$ 696,359 |

The following table shows the credit quality indicators associated with the Company's commercial loan portfolio, excluding PCI loans, as of December 31, 2020:

|                 | Construction and Land | Commercial Real Estate | Commercial and Industrial | Paycheck Protection Program | Total      |
|-----------------|-----------------------|------------------------|---------------------------|-----------------------------|------------|
| Pass            | \$ 62,079             | \$ 252,684             | \$ 103,861                | \$ 122,517                  | \$ 541,141 |
| Special mention | -                     | 4,291                  | 556                       | -                           | 4,847      |
| Substandard     | -                     | 4,127                  | 538                       | -                           | 4,665      |
| Doubtful        | -                     | -                      | -                         | -                           | -          |
| Total           | \$ 62,079             | \$ 261,102             | \$ 104,955                | \$ 122,517                  | \$ 550,653 |

The Company monitors the credit quality of its consumer portfolio based primarily on payment activity and credit scores. Payment activity is the primary factor considered in determining whether a consumer loan should be classified as nonperforming.

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The following table shows the credit quality indicators associated with the Company's consumer loan portfolio, excluding PCI loans, as of December 31, 2021:

|               | Residential<br>Real Estate | Other<br>Consumer | Total      |
|---------------|----------------------------|-------------------|------------|
| Performing    | \$ 100,132                 | \$ 104,664        | \$ 204,796 |
| Nonperforming | 1,066                      | -                 | 1,066      |
| Total         | \$ 101,198                 | \$ 104,664        | \$ 205,862 |

The following table shows the credit quality indicators associated with the Company's consumer loan portfolio, excluding PCI loans, as of December 31, 2020:

|               | Residential<br>Real Estate | Other<br>Consumer | Total      |
|---------------|----------------------------|-------------------|------------|
| Performing    | \$ 66,678                  | \$ 84,650         | \$ 151,328 |
| Nonperforming | 537                        | -                 | 537        |
| Total         | \$ 67,215                  | \$ 84,650         | \$ 151,865 |

**Delinquency**

The following is a summary of past due and nonaccrual loans, excluding PCI loans, as of December 31, 2021:

|                             | 30-59 Days<br>Past Due | 60-89 Days<br>Past Due | Over 90 Days<br>and Accruing | Nonaccrual | Total<br>Past Due and<br>Nonaccrual | Current    | Total Loans<br>Receivable |
|-----------------------------|------------------------|------------------------|------------------------------|------------|-------------------------------------|------------|---------------------------|
| Construction and land       | \$ -                   | \$ -                   | \$ -                         | \$ -       | \$ -                                | \$ 76,547  | \$ 76,547                 |
| Commercial real estate      | -                      | -                      | -                            | 959        | 959                                 | 403,839    | 404,798                   |
| Commercial and industrial   | 75                     | -                      | -                            | 160        | 235                                 | 167,125    | 167,360                   |
| Paycheck Protection Program | 583                    | 26                     | 24                           | -          | 633                                 | 47,022     | 47,655                    |
| Residential real estate     | 5,102                  | 95                     | -                            | 1,065      | 6,262                               | 94,936     | 101,198                   |
| Other consumer              | 4                      | -                      | -                            | -          | 4                                   | 104,660    | 104,664                   |
|                             | \$ 5,764               | \$ 121                 | \$ 24                        | \$ 2,184   | \$ 8,093                            | \$ 894,129 | \$ 902,222                |

The following is a summary of past due and nonaccrual loans, excluding PCI loans, as of December 31, 2020:

|                             | 30-59 Days<br>Past Due | 60-89 Days<br>Past Due | Over 90 Days<br>and Accruing | Nonaccrual | Total<br>Past Due and<br>Nonaccrual | Current    | Total Loans<br>Receivable |
|-----------------------------|------------------------|------------------------|------------------------------|------------|-------------------------------------|------------|---------------------------|
| Construction and land       | \$ 1,694               | \$ -                   | \$ -                         | \$ -       | \$ 1,694                            | \$ 60,385  | \$ 62,079                 |
| Commercial real estate      | 1,557                  | -                      | -                            | 2,020      | 3,577                               | 257,525    | 261,102                   |
| Commercial and industrial   | -                      | -                      | -                            | 192        | 192                                 | 104,763    | 104,955                   |
| Paycheck Protection Program | -                      | -                      | -                            | -          | -                                   | 122,517    | 122,517                   |
| Residential real estate     | 196                    | -                      | -                            | 1,282      | 1,478                               | 65,737     | 67,215                    |
| Other consumer              | 144                    | -                      | -                            | -          | 144                                 | 84,506     | 84,650                    |
|                             | \$ 3,591               | \$ -                   | \$ -                         | \$ 3,494   | \$ 7,085                            | \$ 695,433 | \$ 702,518                |

**Purchased Credit-Impaired ("PCI") Loans**

At December 31, 2021, the unpaid principal balance of PCI loans was \$41,139. Changes in the amount of accretable yield on PCI loans for the year ended December 31, 2021 was as follows:

|   | 2021     | 2020 |
|---|----------|------|
| Accretable yield, beginning of period               | \$ -     | \$ - |
| Additions   | 7,171    | -    |
| Accretion   | (556)    | -    |
| Reclassification from (to) nonaccretable difference | -        | -    |
| Other changes, net                                  | -        | -    |
| Accretable yield, end of period                     | \$ 6,615 | \$ - |

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The following table shows the credit quality indicators associated with the Company's commercial PCI loan portfolio as of December 31, 2021:

|                 | Construction and Land | Commercial Real Estate | Commercial and Industrial | Paycheck Protection Program | Total     |
|-----------------|-----------------------|------------------------|---------------------------|-----------------------------|-----------|
| Pass            | 613                   | 15,818                 | 3,543                     | -                           | 19,974    |
| Special mention | -                     | 4,535                  | -                         | -                           | 4,535     |
| Substandard     | 89                    | 6,490                  | 2,392                     | -                           | 8,971     |
| Doubtful        | -                     | -                      | -                         | -                           | -         |
| Total           | \$ 702                | \$ 26,843              | \$ 5,935                  | \$ -                        | \$ 33,480 |

The following table shows the credit quality indicators associated with the Company's consumer PCI loan portfolio as of December 31, 2021:

|               | Residential Real Estate | Other Consumer | Total    |
|---------------|-------------------------|----------------|----------|
| Performing    | \$ 2,412                | \$ 3           | \$ 2,415 |
| Nonperforming | -                       | -              | -        |
| Total         | \$ 2,412                | \$ 3           | \$ 2,415 |

For PCI loans, if the Company has a reasonable expectation about the timing and amount of cash flows expected to be collected, the loans meet the criteria for the recognition of income and are considered to be accruing loans. The following is a summary of past due and nonaccrual PCI loans of December 31, 2021:

|                           | 30-59 Days Past Due | 60-89 Days Past Due | Over 90 Days and Accruing | Nonaccrual | Total Past Due and Nonaccrual | Current   | Total Loans Receivable |
|---------------------------|---------------------|---------------------|---------------------------|------------|-------------------------------|-----------|------------------------|
| Construction and land     | \$ -                | \$ -                | \$ 89                     | \$ -       | \$ 89                         | \$ 613    | \$ 702                 |
| Commercial real estate    | 1,554               | -                   | 1,246                     | -          | 2,800                         | 24,043    | 26,843                 |
| Commercial and industrial | 209                 | -                   | 30                        | -          | 239                           | 5,696     | 5,935                  |
| Residential real estate   | 459                 | -                   | -                         | -          | 459                           | 1,953     | 2,412                  |
| Other consumer            | -                   | 1                   | -                         | -          | 1                             | 2         | 3                      |
|                           | \$ 2,222            | \$ 1                | \$ 1,365                  | \$ -       | \$ 3,588                      | \$ 32,307 | \$ 35,895              |

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Impaired Loans

The following summarizes the Company's impaired loans, excluding PCI loans, at December 31, 2021:

|  | Recorded<br>Investment | Unpaid<br>Principal<br>Balance | Related<br>Allowance | Average<br>Recorded<br>Investment | Interest<br>Income<br>Recognized |
|--|------------------------|--------------------------------|----------------------|-----------------------------------|----------------------------------|
| <b>With no related allowance needed:</b> |                        |                                |                      |                                   |                                  |
| Construction and land                    | \$ -                   | \$ -                           | \$ -                 | \$ -                              | \$ -                             |
| Commercial real estate                   | 959                    | 1,127                          | -                    | 1,023                             | -                                |
| Commercial and industrial                | 160                    | 191                            | -                    | 176                               | -                                |
| Paycheck Protection Program              | -                      | -                              | -                    | -                                 | -                                |
| Residential real estate                  | 1,452                  | 1,741                          | -                    | 1,473                             | 36                               |
| Other consumer                           | 7                      | 7                              | -                    | 8                                 | 1                                |
| Ending balance                           | <u>\$ 2,578</u>        | <u>\$ 3,066</u>                | <u>\$ -</u>          | <u>\$ 2,680</u>                   | <u>\$ 37</u>                     |
| <b>With an allowance recorded:</b>       |                        |                                |                      |                                   |                                  |
| Construction and land                    | \$ -                   | \$ -                           | \$ -                 | \$ -                              | \$ -                             |
| Commercial real estate                   | -                      | -                              | -                    | -                                 | -                                |
| Commercial and industrial                | -                      | -                              | -                    | -                                 | -                                |
| Paycheck Protection Program              | -                      | -                              | -                    | -                                 | -                                |
| Residential real estate                  | -                      | -                              | -                    | -                                 | -                                |
| Other consumer                           | -                      | -                              | -                    | -                                 | -                                |
| Ending balance                           | <u>\$ -</u>            | <u>\$ -</u>                    | <u>\$ -</u>          | <u>\$ -</u>                       | <u>\$ -</u>                      |
| <b>Total:</b>                            |                        |                                |                      |                                   |                                  |
| Construction and land                    | \$ -                   | \$ -                           | \$ -                 | \$ -                              | \$ -                             |
| Commercial real estate                   | 959                    | 1,127                          | -                    | 1,023                             | -                                |
| Commercial and industrial                | 160                    | 191                            | -                    | 176                               | -                                |
| Paycheck Protection Program              | -                      | -                              | -                    | -                                 | -                                |
| Residential real estate                  | 1,452                  | 1,741                          | -                    | 1,473                             | 36                               |
| Other consumer                           | 7                      | 7                              | -                    | 8                                 | 1                                |
| Ending balance                           | <u>\$ 2,578</u>        | <u>\$ 3,066</u>                | <u>\$ -</u>          | <u>\$ 2,680</u>                   | <u>\$ 37</u>                     |

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The following summarizes the Company's impaired loans, excluding PCI loans, at December 31, 2020:

|  | Recorded<br>Investment | Unpaid<br>Principal<br>Balance | Related<br>Allowance | Average<br>Recorded<br>Investment | Interest<br>Income<br>Recognized |
|--|------------------------|--------------------------------|----------------------|-----------------------------------|----------------------------------|
| <b>With no related allowance needed:</b> |                        |                                |                      |                                   |                                  |
| Construction and land                    | \$ -                   | \$ -                           | \$ -                 | \$ -                              | \$ -                             |
| Commercial real estate                   | 966                    | 1,215                          | -                    | 1,236                             | 2                                |
| Commercial and industrial                | 161                    | 272                            | -                    | 184                               | -                                |
| Paycheck Protection Program              | -                      | -                              | -                    | -                                 | -                                |
| Residential real estate                  | 805                    | 1,003                          | -                    | 1,034                             | 15                               |
| Other consumer                           | 10                     | 21                             | -                    | 11                                | 1                                |
| Ending balance                           | \$ 1,942               | \$ 2,511                       | \$ -                 | \$ 2,465                          | \$ 18                            |
| <b>With an allowance recorded:</b>       |                        |                                |                      |                                   |                                  |
| Construction and land                    | \$ -                   | \$ -                           | \$ -                 | \$ -                              | \$ -                             |
| Commercial real estate                   | 1,085                  | 1,198                          | 285                  | 1,231                             | -                                |
| Commercial and industrial                | 31                     | 34                             | 32                   | 38                                | -                                |
| Paycheck Protection Program              | -                      | -                              | -                    | -                                 | -                                |
| Residential real estate                  | 675                    | 675                            | 49                   | 682                               | 40                               |
| Other consumer                           | -                      | -                              | -                    | -                                 | -                                |
| Ending balance                           | \$ 1,791               | \$ 1,907                       | \$ 366               | \$ 1,951                          | \$ 40                            |
| <b>Total:</b>                            |                        |                                |                      |                                   |                                  |
| Construction and land                    | \$ -                   | \$ -                           | \$ -                 | \$ -                              | \$ -                             |
| Commercial real estate                   | 2,051                  | 2,413                          | 285                  | 2,467                             | 2                                |
| Commercial and industrial                | 192                    | 306                            | 32                   | 222                               | -                                |
| Paycheck Protection Program              | -                      | -                              | -                    | -                                 | -                                |
| Residential real estate                  | 1,480                  | 1,678                          | 49                   | 1,716                             | 55                               |
| Other consumer                           | 10                     | 21                             | -                    | 11                                | 1                                |
| Ending balance                           | \$ 3,733               | \$ 4,418                       | \$ 366               | \$ 4,416                          | \$ 58                            |

Allowance for Loan Losses

The following is a summary of information pertaining to the allowance for loan losses at December 31, 2021:

|                                   | Construction<br>and Land | Commercial<br>Real Estate | Commercial<br>and<br>Industrial | Paycheck<br>Protection<br>Program | Residential<br>Real Estate | Other<br>Consumer | Total      |
|-----------------------------------|--------------------------|---------------------------|---------------------------------|-----------------------------------|----------------------------|-------------------|------------|
| <b>Allowance for loan losses:</b> |                          |                           |                                 |                                   |                            |                   |            |
| Beginning balance:                | \$ 926                   | \$ 3,394                  | \$ 1,115                        | \$ -                              | \$ 625                     | \$ 981            | \$ 7,041   |
| Charge-offs                       | -                        | -                         | -                               | -                                 | (100)                      | (244)             | (344)      |
| Recoveries                        | -                        | -                         | 25                              | -                                 | 83                         | 17                | 125        |
| Provision (Release)               | 543                      | (196)                     | 118                             | -                                 | 212                        | 649               | 1,326      |
| Ending balance                    | \$ 1,469                 | \$ 3,198                  | \$ 1,258                        | \$ -                              | \$ 820                     | \$ 1,403          | \$ 8,148   |
| Ending balances:                  |                          |                           |                                 |                                   |                            |                   |            |
| Individually evaluated            |                          |                           |                                 |                                   |                            |                   |            |
| for impairment                    | \$ -                     | \$ -                      | \$ -                            | \$ -                              | \$ -                       | \$ -              | \$ -       |
| Collectively evaluated            |                          |                           |                                 |                                   |                            |                   |            |
| for impairment                    | \$ 1,469                 | \$ 3,198                  | \$ 1,258                        | \$ -                              | \$ 820                     | \$ 1,403          | \$ 8,148   |
| <b>Loans held for investment:</b> |                          |                           |                                 |                                   |                            |                   |            |
| Ending balance - total            | \$ 76,547                | \$ 404,797                | \$ 167,360                      | \$ 47,655                         | \$ 101,198                 | \$ 104,664        | \$ 902,221 |
| Ending balances:                  |                          |                           |                                 |                                   |                            |                   |            |
| Individually evaluated            |                          |                           |                                 |                                   |                            |                   |            |
| for impairment                    | \$ -                     | \$ 959                    | \$ 160                          | \$ -                              | \$ 1,452                   | \$ 7              | \$ 2,578   |
| Collectively evaluated            |                          |                           |                                 |                                   |                            |                   |            |
| for impairment                    | \$ 76,547                | \$ 403,838                | \$ 167,200                      | \$ 47,655                         | \$ 99,746                  | \$ 104,657        | \$ 899,643 |

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The following is a summary of information pertaining to the allowance for loan losses at December 31, 2020:

|                                   | Construction<br>and Land | Commercial<br>Real Estate | Commercial<br>and<br>Industrial | Paycheck<br>Protection<br>Program | Residential<br>Real Estate | Other<br>Consumer | Total      |
|-----------------------------------|--------------------------|---------------------------|---------------------------------|-----------------------------------|----------------------------|-------------------|------------|
| <b>Allowance for loan losses:</b> |                          |                           |                                 |                                   |                            |                   |            |
| Beginning balance:                | \$ 331                   | \$ 1,687                  | \$ 1,258                        | \$ -                              | \$ 485                     | \$ 175            | \$ 3,936   |
| Charge-offs                       | -                        | (19)                      | (100)                           | -                                 | (74)                       | (219)             | (412)      |
| Recoveries                        | -                        | 2                         | 64                              | -                                 | 206                        | 9                 | 281        |
| Provision (Release)               | 595                      | 1,724                     | (107)                           | -                                 | 8                          | 1,016             | 3,236      |
| Ending balance                    | \$ 926                   | \$ 3,394                  | \$ 1,115                        | \$ -                              | \$ 625                     | \$ 981            | \$ 7,041   |
| Ending balances:                  |                          |                           |                                 |                                   |                            |                   |            |
| Individually evaluated            |                          |                           |                                 |                                   |                            |                   |            |
| for impairment                    | \$ -                     | \$ 285                    | \$ 32                           | \$ -                              | \$ 49                      | \$ -              | \$ 366     |
| Collectively evaluated            |                          |                           |                                 |                                   |                            |                   |            |
| for impairment                    | \$ 926                   | \$ 3,109                  | \$ 1,083                        | \$ -                              | \$ 576                     | \$ 981            | \$ 6,675   |
| <b>Loans held for investment:</b> |                          |                           |                                 |                                   |                            |                   |            |
| Ending balance - total            | \$ 62,079                | \$ 261,102                | \$ 104,955                      | \$ 122,517                        | \$ 67,215                  | \$ 84,650         | \$ 702,518 |
| Ending balances:                  |                          |                           |                                 |                                   |                            |                   |            |
| Individually evaluated            |                          |                           |                                 |                                   |                            |                   |            |
| for impairment                    | \$ -                     | \$ 2,051                  | \$ 192                          | \$ -                              | \$ 1,480                   | \$ 10             | \$ 3,733   |
| Collectively evaluated            |                          |                           |                                 |                                   |                            |                   |            |
| for impairment                    | \$ 62,079                | \$ 259,051                | \$ 104,763                      | \$ 122,517                        | \$ 65,735                  | \$ 84,640         | \$ 698,785 |

There was no allowance for PCI loans at December 31, 2021 and 2020.

**Troubled Debt Restructurings**

The following table summarizes the carrying balance of troubled debt restructurings ("TDRs") as of December 31, 2021 and 2020:

|                    | 2021   | 2020   |
|--------------------|--------|--------|
| Performing TDRs    | \$ 394 | \$ 239 |
| Nonperforming TDRs | 144    | 157    |
| Total TDRs         | \$ 538 | \$ 396 |

Loans classified as TDRs may be removed from this status for disclosure purposes after a specified period of time if a subsequent restructured agreement specifies an interest rate equal to or greater than the rate that the lender was willing to accept at the time of the restructuring for a new loan with comparable risk, and the loan is performing in accordance with the terms specified by the restructured agreement.

There were no TDRs identified during the year ended December 31, 2021 or 2020. There were no TDRs that were restructured in the previous twelve months which re-defaulted during the years ended December 31, 2021 and 2020.

The Coronavirus Aid, Relief, and Economic Security Act of 2020 ("CARES Act") signed into law on March 27, 2020, amended GAAP with respect to the modification of loans to borrowers affected by the COVID-19 pandemic. Among other criteria, this guidance provided that short-term loan modifications made on a good faith basis to borrowers who were current as defined under the CARES Act prior to any relief, are not TDRs. This includes short-term (e.g. six months) modifications such as payment deferrals, fee waivers, extensions of repayment terms, or other delays in payment that are insignificant. To qualify as an eligible loan under the CARES Act, a loan modification must be 1) related to COVID-19; 2) executed on a loan that was not more than 30 days past due as of December 31, 2019; and 3) executed between March 1, 2020, and the earlier of a) 60 days after the date of

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termination of the national emergency by the President or b) December 31, 2020. On April 7, 2020, the federal banking regulators issued a revised interagency statement on loan modifications and the reporting for financial institutions working with customers affected by the COVID-19 pandemic ("Interagency Statement"). The Interagency Statement confirmed that COVID-19 related short-term loan modifications (e.g., payment deferrals of six months or less) provided to borrowers that were current (less than 30 days past due) at the time the relief was granted are not TDR loans. Borrowers that do not meet the criteria in the CARES Act or the Interagency Statement are assessed for TDR loan classification in accordance with the Company's accounting policies.

Beginning in March 2020, the Company provided payment accommodations to customers, consisting generally of 90-day interest-only payments or 90-day full payment deferrals, for most customers, or 180-day full payment deferrals for USDA guaranteed loans. The Company processed principal deferments under the CARES Act on 210 loans, with an aggregate loan balance of \$103,171, during the period ending December 31, 2020. These borrowers were current prior to relief and not experiencing financial difficulty prior to COVID-19 and were determined not to be considered TDRs. Of the 210 loans that received payment accommodations in 2020, there were 4 loans in deferral as of December 31, 2020 with an aggregate principal balance of \$1,600. At December 31, 2021 there was only 1 loan in deferral with a principal balance of \$192.

**Note 6. Premises, Furniture and Equipment**

Premises, furniture, and equipment owned and utilized in the operations of the Company are summarized as follows as of December 31:

|   | 2021             | 2020             |
|---|------------------|------------------|
| Buildings and improvements                      | \$ 12,022        | \$ 10,934        |
| Land  | 4,023            | 4,023            |
| Furniture and equipment                         | 3,538            | 4,062            |
| Leasehold and land improvements                 | 2,903            | 2,399            |
| Software  | 888              | 1,129            |
| Vehicles  | 19               | 19               |
| Construction in progress                        | 44               | 1,267            |
| Total   | 23,437           | 23,833           |
| Less: accumulated depreciation and amortization | (5,787)          | (7,476)          |
| Premises, furniture and equipment, net          | <u>\$ 17,650</u> | <u>\$ 16,357</u> |

Depreciation expense for the years ended December 31, 2021 and 2020 was \$985 and \$784, respectively.

**Note 7. Other Assets**

Other assets consisted of the following as of December 31:

|                             | 2021             | 2020            |
|-----------------------------|------------------|-----------------|
| Accrued interest receivable | \$ 3,928         | \$ 3,751        |
| Right-of-use assets         | 2,977            | 2,154           |
| Derivative assets           | 1,710            | 1               |
| Prepaid expenses            | 1,345            | 957             |
| Other                       | 1,772            | 951             |
| Total                       | <u>\$ 11,732</u> | <u>\$ 7,814</u> |

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**Note 8. Other Real Estate Owned**

The following summarizes the activity in the other real estate owned for the years ended December 31:

|                            | 2021          | 2020          |
|----------------------------|---------------|---------------|
| Balance, beginning of year | \$ 810        | \$ 1,505      |
| Additions - foreclosures   | 492           | 320           |
| Sales                      | (275)         | (750)         |
| Writedowns                 | (387)         | (265)         |
| Balance, end of year       | <u>\$ 640</u> | <u>\$ 810</u> |

A net gain of \$5 and \$37 was recognized on the sale of other real estate owned for the years ended December 31, 2021 and 2020, respectively, and are included in the net loss on other real estate owned in the Consolidated Statements of Operations. Other real estate expenses for the years ended December 31, 2021 and 2020 were \$103 and \$176, respectively, and are included in other noninterest expense.

There were no repossessed assets at December 31, 2021 and 2020, respectively. There were no repossessed asset write-downs for the years ended December 31, 2021 and 2020.

There were no residential real estate loans in the process of foreclosure at December 31, 2021, and no residential real estate loans in the process of foreclosure at December 31, 2020.

**Note 9. Goodwill and Intangible Assets**

The Company's carrying amount of goodwill at December 31, 2021, and 2020 and changes to the goodwill are summarized as follows:

|                   | 2021            | 2020            |
|-------------------|-----------------|-----------------|
| Beginning of year | \$ 4,708        | \$ 4,708        |
| Acquired goodwill | -               | -               |
| Impairment        | -               | -               |
| End of year       | <u>\$ 4,708</u> | <u>\$ 4,708</u> |

Goodwill was recognized as a result of the Company's acquisition of First Citizens Financial Corporation in 2018. As of October 1, 2021, the Company performed its annual goodwill impairment evaluation conducting a comprehensive business valuation analysis using a quantitative method for determining the fair value. The Company determined the fair value of our reporting unit exceeded its carrying amount and that goodwill was not impaired. There are no events that have occurred since the last annual goodwill impairment assessment that would necessitate an interim goodwill impairment. No goodwill was recognized in conjunction with the acquisition of Cornerstone in 2021.

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The Company also had other intangible assets at December 31, 2021 and 2020, presented in the following table:

|                                      | 2021                  |                          |                    | 2020                  |                          |                    |
|--------------------------------------|-----------------------|--------------------------|--------------------|-----------------------|--------------------------|--------------------|
|                                      | Gross Carrying Amount | Accumulated Amortization | Net Carrying Value | Gross Carrying Amount | Accumulated Amortization | Net Carrying Value |
| Definite-lived intangible assets:    |                       |                          |                    |                       |                          |                    |
| Core deposit intangibles             | \$ 1,850              | \$ 730                   | \$ 1,120           | \$ 1,240              | \$ 525                   | \$ 715             |
| Commercial mortgage servicing rights | 2,359                 | 623                      | 1,736              | 1,283                 | 384                      | 899                |
| <b>Total</b>                         | <b>\$ 4,209</b>       | <b>\$ 1,353</b>          | <b>\$ 2,856</b>    | <b>\$ 2,523</b>       | <b>\$ 909</b>            | <b>\$ 1,614</b>    |

Core deposit intangibles are amortized over their estimated useful lives, which the Company determined is ten years. Amortization expense of \$205 and \$200 at December 31, 2021 and 2020, respectively, was recognized in other noninterest expense.

Commercial mortgage servicing rights arise from the sale of participating interests in government guaranteed loans to third parties where servicing is retained by the Company. These assets are amortized over the expected remaining life of the related loan. Amortization expense of \$239 and \$198 at December 31, 2021 and 2020, respectively, was recognized in other noninterest income related to these intangible assets.

The Company's estimated future amortization of intangible assets at December 31, 2021 is presented in the following table:

|                                    |           |              |
|------------------------------------|-----------|--------------|
| 2022                               | \$        | 596          |
| 2023                               |           | 493          |
| 2024                               |           | 405          |
| 2025                               |           | 328          |
| 2026                               |           | 238          |
| <b>Thereafter</b>                  |           | <b>796</b>   |
| <b>Total expected amortization</b> | <b>\$</b> | <b>2,856</b> |

Contractually specified servicing fees related to commercial mortgage servicing rights of \$814 and \$391 was recognized in other noninterest income during the years ended December 31, 2021, and 2020, respectively. The principal balance of loans serviced for third parties was \$127,990 and \$58,386 at December 31, 2021 and 2020, respectively.

A rollforward of each class of commercial mortgage servicing rights is presented as follows:

|                                   | For the years ended December 31, |               |               |               |
|-----------------------------------|----------------------------------|---------------|---------------|---------------|
|                                   | 2021                             |               | 2020          |               |
|                                   | SBA                              | USDA          | SBA           | USDA          |
| Beginning carrying value, net     | \$ 541                           | \$ 358        | \$ 468        | \$ 335        |
| Amortization                      | (186)                            | (50)          | (164)         | (34)          |
| Servicing rights originated       | 292                              | 221           | 237           | 57            |
| Servicing rights purchased        | 563                              | -             | -             | -             |
| Servicing rights sold             | -                                | -             | -             | -             |
| Impairment                        | (3)                              | -             | -             | -             |
| <b>Ending carrying value, net</b> | <b>\$ 1,207</b>                  | <b>\$ 529</b> | <b>\$ 541</b> | <b>\$ 358</b> |

The estimated fair value of the commercial mortgage servicing rights was \$1,797 and \$974 at December 31, 2021 and 2020, respectively.

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**Note 10. Deposits**

At December 31, 2021, the scheduled maturities of certificates of deposit were as follows:

| Maturing In         | Amount            |
|---------------------|-------------------|
| 2022                | \$ 124,220        |
| 2023                | 31,838            |
| 2024                | 18,924            |
| 2025                | 5,821             |
| 2026 and thereafter | 2,095             |
| Total               | <u>\$ 182,898</u> |

The Company had \$916 and \$1,272 in brokered deposits at December 31, 2021 and 2020, respectively. The Company also had reciprocal deposits of \$68,802 and \$31,510 at December 31, 2021 and 2020.

Time deposits that exceed the FDIC Insurance limit of \$250 at December 31, 2021 and 2020 were \$39,123 and \$33,109, respectively.

**Note 11. Other Borrowings**

The Company had the following other borrowings at December 31, 2021 and 2020:

|  | Average Interest Rate |       | Maturity Date | Amount           |                   |
|--|-----------------------|-------|---------------|------------------|-------------------|
|  | 2021                  | 2020  |               | 2021             | 2020              |
| Federal Home Loan Bank advances            |                       |       |               |                  |                   |
| Bermudan 10-year advance with 3 month call | 0.82%                 | 0.82% | 11/20/2029    | \$ 10,000        | \$ 10,000         |
| Bermudan 10-year advance with 3 month call | 0.68%                 | 0.68% | 2/6/2030      | 10,000           | 10,000            |
| Federal Reserve Bank advances              | -                     | 0.35% | Various       | -                | 111,497           |
| Revolving commercial line of credit        | 3.25%                 | -     | 12/10/2023    | 10,000           | -                 |
| Subordinated debt                          | 5.95%                 | 5.95% | 9/15/2030     | 14,587           | 14,539            |
| Total                                      |                       |       |               | <u>\$ 44,587</u> | <u>\$ 146,036</u> |

The Company had pledged investment securities at December 31, 2021 and 2020, totaling \$16,704 and \$20,582, respectively, as collateral for the FHLB advances. The Company's FHLB stock is also pledged to secure the borrowings. In addition, the Company has pledged blanket liens on its first mortgages 1-4 family residential loans, second mortgages 1-4 family residential loans, including open-ended loans and closed-end 1-4 family residential properties, and commercial real estate loans. The aggregate balance of identified pledgable loans totaled \$125,728 and \$126,362 at December 31, 2021 and 2020, respectively.

On December 10, 2021, the Company ("Borrower") entered into a Loan and Security Agreement with ServisFirst Bank ("Lender"), for the Lender to extend a revolving line of credit in the maximum principal amount of \$18,000 (the "Loan") and commitment. Interest on the principal balance of the Loan from time to time outstanding is payable at a per annum rate (the "Interest Rate") equal to the greater of (i) the Prime Rate in effect from time to time; or (ii) a floor rate of three and twenty-five hundredths percent (3.25%). At December 31, 2021, the Company had \$10,000 of the Loan outstanding.

The Company had pledged investment securities at December 31, 2021 and 2020, totaling \$1,517 and \$1,790, respectively, as collateral for federal funds purchased. The Company had pledged investment securities at

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December 31, 2021 and 2020 totaling \$29,507 and \$13,585, respectively, as collateral at the Federal Reserve Bank. The Company had no PPPLF pledged loans with the Federal Reserve Bank at December 31, 2021, and \$111,497 at December 31, 2020. The PPPLF terminated on July 30, 2021.

On September 9, 2020, the Company issued a private placement of \$15,000 of 5.95% fixed-to-floating rate subordinated notes due 2030 (the "Notes") to certain qualified institutional buyers and institutional accredited investors (the "Private Placement"). The Notes have been structured to qualify as Tier 2 capital for regulatory capital purposes. The Notes are unsecured and have a ten-year term, maturing September 15, 2030, and bear interest at a fixed annual rate of 5.95%, payable semi-annually in arrears, for the first five years of the term. Thereafter, the interest rate will reset quarterly to an interest rate per annum equal to the then current three-month Secured Overnight Financing Rate ("Three-Month SOFR"), plus a spread of 582 basis points, payable quarterly in arrears, provided, however, that, in the event the Three-Month SOFR is less than zero, the Three-Month SOFR shall be deemed to be zero. As provided in the Notes, under specified conditions, the interest rate on the Notes during the Floating Rate Period may be determined based upon a rate other than Three-Month SOFR. The Company may redeem the Notes, in whole or in part, on any interest payment date on or after September 15, 2025, and to redeem the Notes at any time in whole upon certain other specified events. Unamortized debt issuance costs related to the subordinated debt were \$413 and \$461 at December 31, 2021 and 2020, respectively.

The Company incurred \$945 and \$295 of interest expense related to subordinated debt for the year ended December 31, 2021 and 2020, respectively.

**Note 12. Income Taxes**

Income tax expense for the years ended December 31, 2021 and 2020 is summarized as follows:

|                                       | 2021            | 2020            |
|---------------------------------------|-----------------|-----------------|
| Current portion:                      |                 |                 |
| Federal                               | \$ 3,147        | \$ 1,507        |
| State                                 | 606             | 285             |
|                                       | 3,753           | 1,792           |
| Deferred income tax (benefit) expense | (609)           | 61              |
| Total tax expense                     | <u>\$ 3,144</u> | <u>\$ 1,853</u> |

A reconciliation between the income tax expense and the amount computed by applying the Federal statutory rate of 21% to income before income taxes follows:

|  | 2021            | 2020            |
|--|-----------------|-----------------|
| Tax at U.S. Statutory Rate                         | \$ 3,248        | \$ 1,727        |
| Increase (decrease) resulting from:                |                 |                 |
| State income tax, net of federal income tax effect | 379             | 211             |
| Stock-based compensation                           | 92              | 54              |
| Tax exempt income                                  | (98)            | (60)            |
| Bank-owned life insurance                          | (194)           | (88)            |
| Bargain purchase gain                              | (346)           | -               |
| Other items, net                                   | 63              | 9               |
| Total tax expense                                  | <u>\$ 3,144</u> | <u>\$ 1,853</u> |

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The gross amounts of deferred tax assets and deferred tax liabilities at December 31, 2021 and 2020 are as follows:

|  | 2021      | 2020      |
|--|-----------|-----------|
| <b>Deferred tax assets</b>                       |           |           |
| Net operating loss carryforward                  | \$ 9,007  | \$ 8,205  |
| Purchase accounting adjustments                  | 2,453     | -         |
| Allowance for loan losses                        | 1,927     | 1,644     |
| Lease liability                                  | 921       | 484       |
| Accrued expenses                                 | 599       | 403       |
| Origination costs and fees                       | 442       | 4         |
| Depreciation                                     | 244       | 331       |
| Stock-based compensation                         | 225       | 192       |
| Other real estate owned                          | 260       | 99        |
| Nonaccrual loan interest                         | 36        | 17        |
| Other  | 28        | 51        |
| Total deferred tax asset                         | 16,142    | 11,430    |
| <b>Deferred tax liabilities</b>                  |           |           |
| Lease right-of-use asset                         | (693)     | (487)     |
| Unrealized gain on hedging                       | (261)     | -         |
| Unrealized gain on securities available for sale | (555)     | (754)     |
| Prepaid expenses                                 | (72)      | (34)      |
| Other  | (63)      | (44)      |
| Total deferred tax liabilities                   | (1,644)   | (1,319)   |
| Net deferred tax asset                           | \$ 14,498 | \$ 10,111 |

Deferred tax assets represent the future benefit of deductible differences and, if it is more likely than not that a tax asset will not be realized, a valuation allowance is required to reduce the recorded deferred tax assets to net realizable value. After review of all positive and negative factors and potential tax planning strategies, as of December 31, 2021 and 2020, management has determined that a valuation allowance is not necessary. Management has determined that it is more likely than not that the remaining deferred tax asset at December 31, 2021 will be realized, and accordingly, has not established a valuation allowance.

In October 2021, the Company acquired Cornerstone Bancshares, Inc. and its wholly owned subsidiary Cornerstone Bank and recorded \$3,841 in acquired deferred tax assets. These entities incurred an ownership change within the meaning of Section 382 of the Internal Revenue Code. As such, the Company's ability to benefit from the use of Cornerstone's pre-ownership change net operating loss carry forwards will be limited to \$159 annually. Management only recorded a deferred tax asset for the loss carryforwards determined to be utilizable under the annual Section 382 limitations.

The Company has federal net operating losses of \$38,065 and \$34,868 at December 31, 2021 and 2020, respectively. These net operating losses expire at various times from 2028 through 2037. The Company's ability to benefit from the use of these net operating loss carryforwards is limited annually under Section 382 of the Internal Revenue Code. The Company has state net operating losses of \$26,805 and \$23,904 at December 31, 2021 and 2020, respectively. These net operating losses expire at various times from 2028 through 2038.

The Company has analyzed the tax positions taken or expected to be taken in its tax returns and concluded it has no liability related to uncertain tax positions in accordance with applicable regulations. Tax returns for 2018 and subsequent years are subject to examination by taxing authorities.

**CoastalSouth Bancshares, Inc. and Subsidiary**  
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**Note 13. Leases**

The Company has entered into several operating leases for properties for branch banking and other banking operations. The leases have various initial terms and expire on various dates. The lease agreements generally provide that the Bank is responsible for ongoing repairs and maintenance, insurance, and real estate taxes. The leases also provide for renewal options and certain scheduled increases in monthly lease payments. The Company does not consider exercise of any lease renewal options reasonably certain.

Leases with an initial term of 12 months or less are not recorded on the balance sheet. For these short-term leases, lease expense is recognized on a straight-line basis over the lease term and were immaterial. At December 31, 2021 and 2020, the Company had no leases classified as finance leases.

At December 31, 2021 and 2020, the Company had an operating lease Right-of-Use (“ROU”) asset of \$2,977 and \$2,154 and an operating lease liability of \$3,956 and \$2,139, respectively. The ROU asset and operating lease liability are recorded in other assets and other liabilities, respectively, in the Consolidated Balance Sheets.

Rental expenses recorded under leases for the years ended December 31, 2021 and 2020 were \$678 and \$415, respectively.

The weighted-average remaining lease term and the weighted-average discount rate for operating leases were 6.41 years and 1.26%, respectively, at December 31, 2021.

At December 31, 2021, future maturities of the Company's operating lease liabilities with initial terms of one year or more are summarized as follows:

|                      |    |              |
|----------------------|----|--------------|
| 2022                 | \$ | 844          |
| 2023                 |    | 660          |
| 2024                 |    | 670          |
| 2025                 |    | 679          |
| 2026                 |    | 353          |
| Thereafter           |    | 972          |
| Total lease payments | \$ | <u>4,178</u> |

**Note 14. Other Noninterest Expense**

A summary of the components of other noninterest expense is as follows for the years ended December 31:

|                                    | 2021            | 2020            |
|------------------------------------|-----------------|-----------------|
| General and administrative expense | \$ 746          | \$ 602          |
| Other loan expense                 | 411             | 334             |
| Marketing and business development | 398             | 248             |
| Board of directors fees            | 265             | 159             |
| Amortization expense               | 241             | 259             |
| Dues, subscriptions, and licenses  | 208             | 254             |
| Other                              | 783             | 978             |
|                                    | <u>\$ 3,052</u> | <u>\$ 2,834</u> |

**CoastalSouth Bancshares, Inc. and Subsidiary**  
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**Note 15. Related Party Transactions**

Certain parties (principally certain directors and executive officers of the Company, their immediate families and business interests) were loan customers of and had other transactions in the normal course of business with the Company. Related party loans are made on substantially the same terms, including interest rates and collateral, as those prevailing at the time for comparable transactions with unrelated persons and do not involve more than the normal risk of collectability. Related party loans totaled \$575 and \$1,756 as of December 31, 2021 and 2020, respectively. At December 31, 2021 and 2020, total deposits held by related parties were \$11,556 and \$10,045, respectively.

**Note 16. Commitments and Contingencies**

The Company is subject to claims and lawsuits which arise primarily in the ordinary course of business. Management is not aware of any legal proceedings which could have a material adverse effect on the financial position or operating results of the Company.

**Note 17. Stock-Based Compensation**

In 2017, the stockholders of the Company approved the CoastalSouth Bancshares, Inc. 2017 Incentive Plan (“2017 Plan”) to motivate, attract and retain the services of employees, officers, and directors. The 2017 Plan originally provided 627,450 shares to be available for stock-based awards, including options, stock appreciation rights, restricted stock, restricted stock units, deferred stock units, or any other right or interest related to stock or cash granted to a participant. In 2019, the number of shares available under the plan increased to 704,000, following the acquisition of First Citizens Financial Corporation (“FCFC”). In 2020, the Board of Directors approved an additional 150,943 shares to the plan, bringing the total shares available under the plan to 854,943. In 2021, the Board of Directors approved an additional 56,965 shares to the plan following the Cornerstone acquisition, bringing to the total awards to 911,908. The terms of each stock-based award are indicated in an award certificate. At December 31, 2021, there were 88,358 remaining shares available to be awarded under the 2017 Plan.

The Company granted stock options in 2021 and 2020 which vest 25% each year on the anniversary date of the grant date over four years of continuous service, as well as, in 2020, options which vest 100% on the fourth anniversary of the grant following four years of continuous service. The terms of all of the options are for ten years expiring on the tenth anniversary of the grant date. A summary of stock option activity for the years ended December 31, 2021 and 2020 is below:

|                                  | Number of<br>Shares | Weighted Average<br>Exercise Price | Weighted Average<br>Grant Date<br>Fair Value |
|----------------------------------|---------------------|------------------------------------|--|
| Outstanding at December 31, 2019 | 546,000             | \$ 13.66                           | \$ 4.89                                      |
| Granted                          | 156,750             | 10.46                              | 4.30   |
| Exercised                        | -                   | -                                  | -  |
| Forfeited or Expired             | (6,500)             | 14.20                              | 5.69   |
| Outstanding at December 31, 2020 | 696,250             | \$ 12.93                           | \$ 4.75                                      |
| Granted                          | 44,000              | 16.37                              | 8.19   |
| Exercised                        | -                   | -                                  | -  |
| Forfeited or Expired             | (10,500)            | 15.29                              | 6.02   |
| Outstanding at December 31, 2021 | 729,750             | \$ 13.11                           | \$ 4.94                                      |

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|   | Number of<br>Shares | Weighted<br>Average<br>Exercise Price | Weighted<br>Average<br>Remaining<br>Contractual Life | Aggregate<br>Intrinsic Award<br>Value <sup>(1)</sup> |
|---|---------------------|---------------------------------------|--|--|
| Outstanding at December 31, 2020          | 696,250             | \$ 12.93                              |  |  |
| Outstanding at December 31, 2021          | 729,750             | \$ 13.11                              | 6.92   | \$ 3,028,463   |
| Vested & exercisable at December 31, 2020 | 321,500             | \$ 13.44                              |  |  |
| Vested & exercisable at December 31, 2021 | 470,247             | \$ 13.39                              | 6.19   | \$ 1,819,856   |

<sup>(1)</sup> Presented in thousands and considering a \$17.26 market value at December 31, 2021.

The grant date fair value of stock options is determined using the Black-Scholes model. Volatility is based on a peer group of similar community banks in the southeast United States. The risk-free rate is the treasury rate that most closely relates to the expected life on the grant date.

A summary of assumptions used in the valuation for stock options granted during the years ended December 31, 2021 and 2020 is below:

|                          | 2021 Black-<br>Scholes Inputs | 2020 Black-<br>Scholes Inputs |
|--------------------------|-------------------------------|-------------------------------|
| Expected dividend yield  | 0.00%                         | 0.00%                         |
| Expected volatility      | 42.87% - 46.51%               | 46.72% - 49.02%               |
| Risk-free interest rate  | 0.60% - 1.32%                 | 0.49% - 0.54%                 |
| Expected life (in years) | 6.25                          | 7.00 - 6.25                   |

The Company also awarded restricted stock units in 2017 which vest over four years of continuous service, with 50% vesting on the third anniversary of the grant date and the remaining 50% vesting on the fourth anniversary of the grant date; as of December 31, 2021 all of these awards were vested and shares were released. In 2021 and 2020, 9,900 and 9,900 restricted stock units with a one-year vesting period were granted to members of the Board of Directors, respectively. Additionally, in 2021, 10,000 restricted stock units were granted to members of management which vest over three years with 34% vesting in the first year, 33% vesting in the second year, and 33% vesting in the third year.

A summary of restricted stock unit activity for the years ended December 31, 2021 and 2020 is below:

|                                  | Number of<br>Shares | Weighted Average<br>Grant Date<br>Fair Value |
|----------------------------------|---------------------|--|
| Outstanding at December 31, 2019 | 55,000              | \$ 13.00                                     |
| Granted                          | 9,900               | 12.55  |
| Delivered                        | (37,400)            | 12.88  |
| Forfeited                        | -                   | -  |
| Outstanding at December 31, 2020 | 27,500              | \$ 13.00                                     |
| Granted                          | 19,900              | 14.84  |
| Delivered                        | (37,400)            | 12.88  |
| Forfeited                        | -                   | -  |
| Outstanding at December 31, 2021 | 10,000              | \$ 17.11                                     |

Stock-based awards are recognized over the vesting period and reflected as salaries and employee benefits within the Consolidated Statements of Operations, which was \$1,181 and \$1,036 for the years ended December 31, 2021 and 2020, respectively. Total unrecognized compensation cost associated with outstanding awards at December 31, 2021 was \$1,119.

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**Note 18. Stock Warrants**

In conjunction with the July 28, 2017 capital raise, the Company issued stock warrants in conjunction with the issuance of voting common stock and preferred stock. At the time of the capital raise, insufficient shares of common stock were authorized to permit classification of the warrants as equity, and \$1,335 was recorded as a liability to reflect the fair value of warrants on July 28, 2017. Following the authorization of the nonvoting common stock class at the Company's shareholder meeting on September 22, 2017, the fair value of the warrants was reclassified to equity. The warrants vested immediately upon issuance and are outstanding for five years. Under the warrants, there are 385,204 shares of nonvoting common stock permitted for purchase with an exercise price of \$13.00 per share. At December 31, 2021 and 2020, none of the warrants had been exercised. At December 31, 2021, all warrants are considered in-the-money.

**Note 19. Net Income Per Common Share**

Basic net income per common share is computed by dividing net income by the weighted-average number of common shares outstanding. Diluted income per share is computed by dividing net income by the weighted-average number of common shares outstanding and dilutive common share equivalents using the treasury stock method. Dilutive common share equivalents include common shares issuable upon exercise of outstanding in-the-money stock warrants and options, as well as restricted stock units. Potential common shares are not included in the denominator of the diluted per share computation when inclusion would be anti-dilutive. As of December 31, 2021, and 2020, there were 143,034 and 696,250, potential common shares that were not included in the potentially dilutive stock options, restricted stock units and warrants, respectively.

Net income per common share were calculated as follows:

|  | <u>2021</u>      | <u>2020</u>      |
|--|------------------|------------------|
| <b>Net income per share - basic computation:</b> |                  |                  |
| Net income available to common stockholders      | \$ 12,322        | \$ 6,368         |
| Average common shares outstanding - basic        | 8,144,215        | 7,963,767        |
| Basic net income per share                       | <u>\$ 1.51</u>   | <u>\$ 0.80</u>   |
| <b>Diluted net income per share computation:</b> |                  |                  |
| Net income available to common stockholders      | \$ 12,322        | \$ 6,368         |
| Average common shares outstanding - basic        | 8,144,215        | 7,963,767        |
| Incremental shares from assumed conversions      |                  |                  |
| Stock options                                    | 83,395           | -                |
| Restricted stock units                           | 20,012           | 23,185           |
| Stock warrants                                   | 76,090           | -                |
| Average common shares outstanding - diluted      | <u>8,323,712</u> | <u>7,986,952</u> |
| Diluted net income per share                     | <u>\$ 1.48</u>   | <u>\$ 0.80</u>   |

**Note 20. Regulatory Matters**

CSB is subject to various regulatory capital requirements administered by the federal banking agencies. Failure to meet minimum capital requirements can initiate certain mandatory, and possibly additional discretionary actions by regulators that, if undertaken, could have a direct adverse material effect on the Company's financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, CSB must meet specific capital guidelines that involve quantitative measures of CSB's assets, liabilities, and certain off-

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balance-sheet items as calculated under regulatory accounting practices. CSB's capital amounts and classifications are also subject to qualitative judgments by the regulators about components, risk weightings, and other factors.

Quantitative measures established by regulation to ensure capital adequacy require the Bank to maintain minimum ratios (set forth in the table below) of Tier 1 Capital, Common Equity Tier 1 (CET1), and total capital as a percentage of assets and off-balance-sheet exposures, adjusted for risk-weights ranging from 0% to 150%. Tier 1 capital of the CSB consists of common stockholders' equity, excluding the unrealized gain or loss on securities available-for-sale, minus certain intangible assets, while CET1 is comprised of Tier 1 capital, adjusted for certain regulatory deductions and limitations. Tier 2 capital consists of the allowance for loan losses subject to certain limitations. Total capital for purposes of computing the capital ratios consists of the sum of Tier 1 and Tier 2 capital.

CSB is also required to maintain capital at a minimum level based on total assets, which is known as the Tier 1 leverage ratio. Only the strongest banks are allowed to maintain capital at the minimum requirement of 3%. All others are subject to maintaining ratios 1% to 2% above the minimum.

Effective March 31, 2015, quantitative measures established by applicable regulatory standards, including the newly implemented Basel III revised capital adequacy standards and relevant provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd Frank Act"), require CSB to maintain (i) a minimum ratio of Tier 1 capital to average total assets, after certain adjustments, of 4.00%, (ii) a minimum ratio of Tier 1 capital to risk-weighted assets of 6.00%, (iii) a minimum ratio of total-capital to risk-weighted assets of 8.00% and (iv) a minimum ratio of CET1 to risk-weighted assets of 4.50%. A "well-capitalized" institution must generally maintain capital ratios 2% higher than the minimum guidelines. Because the Company is a small bank holding company under the guidelines of the Federal Reserve System and is not required to report consolidated capital ratios for regulatory purposes, capital ratios are presented for CSB only.

In order to avoid restrictions on capital distributions or discretionary bonus payments to executives, CSB is required to maintain a "capital conservation buffer" in addition to its minimum risk-based capital requirements. This buffer is required to consist solely of CET1, but the buffer applies to all three risk-based measurements (CET1, Tier 1 and total capital). The capital conservation buffer was phased in incrementally over time, beginning January 1, 2016 at 0.625% and became fully effective on January 1, 2019, and ultimately consists of an additional amount of Tier 1 capital equal to 2.5% of risk-weighted assets. The capital conservation buffer in effect for the year ended December 31, 2021 was 3.63%.

*Prompt Corrective Action* - In July 2013, the final rules implementing Basel III capital guidelines increased regulatory capital requirements of U.S. banking organizations in a manner that more closely reflected risk exposures and brought the regulatory capital framework into compliance with Basel III. The final rules revised the level at which the Bank becomes subject to corrective action. The federal banking agencies have broad powers with which to require companies to take prompt corrective action to resolve problems of insured depository institutions that do not meet minimum capital requirements. The law establishes five capital categories for this purpose: (i) well-capitalized; (ii) adequately capitalized; (iii) undercapitalized; (iv) significantly undercapitalized; and (v) critically undercapitalized. The final rules amended the thresholds in the prompt corrective action framework to reflect the higher capital ratios required.

Even though the prompt corrective action rules apply to banks and not bank holding companies, the FRB is authorized to take actions at the holding company level. Failure to meet applicable capital standards could subject the bank holding company or the financial institution to a variety of enforcement remedies available to the federal

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regulatory authorities. These include limitations on the ability to pay dividends, the issuance by the regulatory authorities of a capital directive to increase capital, and the termination of deposit insurance by the FDIC. CoastalSouth Bancshares, Inc. is not subject to the provisions of prompt corrective action.

The following table summarizes the capital amounts and ratios of CSB and the regulatory minimum requirements at December 31, 2021 and 2020:

| December 31, 2021            | Actual     |        | For Capital Adequacy Purposes |       | To Be Well-Capitalized Under Prompt Corrective Action Provisions |        |
|------------------------------|------------|--------|-------------------------------|-------|--|--------|
|                              | Amount     | Ratio  | Amount                        | Ratio | Amount   | Ratio  |
| <b>Coastal States Bank</b>   |            |        |                               |       |  |        |
| Total capital                | \$ 139,006 | 11.63% | \$ 95,650                     | 8.00% | \$ 119,563   | 10.00% |
| Tier 1 capital               | 130,858    | 10.94% | 71,738                        | 6.00% | 95,650   | 8.00%  |
| Tier 1 leverage              | 130,858    | 8.25%  | 63,431                        | 4.00% | 79,289   | 5.00%  |
| Common Equity Tier 1 Capital | 130,858    | 10.94% | 53,803                        | 4.50% | 77,716   | 6.50%  |
| <b>December 31, 2020</b>     |            |        |                               |       |  |        |
| <b>Coastal States Bank</b>   |            |        |                               |       |  |        |
| Total capital                | \$ 98,547  | 12.34% | \$ 63,880                     | 8.00% | \$ 79,849  | 10.00% |
| Tier 1 capital               | 91,506     | 11.46% | 47,910                        | 6.00% | 63,880   | 8.00%  |
| Tier 1 leverage              | 91,506     | 9.15%  | 39,990                        | 4.00% | 49,987   | 5.00%  |
| Common Equity Tier 1 Capital | 91,506     | 11.46% | 35,932                        | 4.50% | 51,902   | 6.50%  |

The Bank's regulatory capital ratios are currently well in excess of the minimum standards and continue to be in the "well-capitalized" regulatory classification.

**Note 21. Lines of Credit**

As of December 31, 2021, and 2020, the Company had unused lines of credit to purchase federal funds from unrelated banks totaling \$49,325 and \$55,500, respectively, a portion of which is secured by investment securities. These lines of credit are available on a one-day basis for general corporate purposes. The Company had no outstanding balances under these lines of credit at December 31, 2021 and 2020.

As of December 31, 2021 and 2020, the Company had an unused line of credit to borrow from the Federal Reserve Bank of Richmond discount window totaling \$27,858 and \$12,840, respectively, which was fully secured by investment securities. This line of credit was available on an overnight basis for general corporate purposes. As of December 31, 2021 and 2020, the Company had no outstanding balances.

CSB had the ability to borrow an additional \$88,893 and \$99,297 at December 31, 2021 and 2020, respectively, from the FHLB secured by a blanket lien on one-to-four family first mortgage loans, multifamily residential loans, and revolving, open-end loans, marketable securities or cash. FHLB has approved borrowings up to 20% of CSB's total assets less advances outstanding. The borrowings are available by pledging collateral and purchasing additional stock in the FHLB. All of the lines discussed above can be revoked at the lender's discretion.

The Company also has an revolving commercial line of credit with a maximum principal amount of \$18,000 through ServisFirst Bank. Refer to Note 11, *Other Borrowings*, for additional information about this line of credit.

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**Note 22. Stockholders' Equity**

**Voting Common Stock** – On April 16, 2020, 237,000 shares of voting common stock were converted into nonvoting common stock. The Company issued 37,400 and 37,400 shares of voting common stock for vested restricted stock units ("RSU's") in 2021 and 2020, respectively. At December 31, 2021, there were 6,614,228 shares of \$1.00 par value voting common stock outstanding. On October 1, 2021, 573,682 shares of voting common stock were issued as consideration for Cornerstone Bank acquisition.

**Nonvoting Common Stock** – On April 16, 2020, 237,000 shares of voting common stock were converted into nonvoting common stock. At December 31, 2021, there were 1,990,507 shares of \$1.00 par value nonvoting common stock outstanding.

**Dividends** – The ability of the Company to pay cash dividends to stockholders is dependent upon receiving cash in the form of dividends from its banking subsidiary. However, certain restrictions exist regarding the ability of the subsidiary to transfer funds in the form of cash dividends to the Company. South Carolina banking regulators restrict the amount of dividends that can be paid to stockholders. All of CSB's dividends to the Company are payable only from the undivided profits of CSB. At December 31, 2021, CSB had an accumulated deficit of \$3,509.

As a State chartered bank under South Carolina law, the Bank is authorized to pay cash dividends up to 100% of net income in any calendar year without obtaining the prior approval of the South Carolina State Board of Financial Institutions ("State Board") or the Commissioner of Banking provided that the Bank received a composite rating of one or two at the last examination conducted by the State or Federal regulatory authority. Otherwise, the Bank must file an income and expense report and obtain the specific approval of the State Board. Under Federal Reserve Board regulations, the amount of loans or advances from the banking subsidiary to the parent company are also restricted.

**Note 23. Financial Instruments with Off-Balance-Sheet Risk**

The Company is a party to financial instruments with off-balance-sheet risk in the normal course of business to meet the financing needs of its customers. These financial instruments consist of commitments to extend credit and standby letters of credit. Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. A commitment involves, to varying degrees, elements of credit and interest rate risk in excess of the amount recognized in the balance sheet. The Company's exposure to credit loss in the event of nonperformance by the other party to the instrument is represented by the contractual notional amount of the instrument. Since certain commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. The Company uses the same credit policies in making commitments to extend credit as it does for on-balance-sheet instruments. Letters of credit are conditional commitments issued to guarantee a customer's performance to a third party and have essentially the same credit risk as other lending facilities. Collateral held for commitments to extend credit and letters of credit varies but may include accounts receivable, inventory, property, plant, equipment and income-producing commercial properties.

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The following table summarizes the Bank's off-balance-sheet financial instruments at December 31, 2021 and 2020 whose contract amounts represent credit risk:

|                              | 2021              | 2020              |
|------------------------------|-------------------|-------------------|
| Commitments to extend credit | \$ 295,948        | \$ 160,577        |
| Letters of credit            | 837               | 1,005             |
| Total                        | <u>\$ 296,785</u> | <u>\$ 161,582</u> |

**Note 24. Fair Value of Financial Instruments**

US GAAP provides a framework for measuring and disclosing fair value which requires disclosures about the fair value of assets and liabilities recognized in the balance sheet, whether the measurements are made on a recurring basis (for example, available-for-sale investment securities) or on a nonrecurring basis (for example, impaired loans).

Fair value is defined as the exchange in price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. US GAAP also establishes a fair value hierarchy, which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value.

The Company utilizes fair value measurements to record fair value adjustments to certain assets and to determine fair value disclosures. Securities available-for-sale are recorded at fair value on a recurring basis. Additionally, from time to time, the Company may be required to record at fair value other assets on a nonrecurring basis, such as loans held for sale, loans held for investment and certain other assets. These nonrecurring fair value adjustments typically involve application of lower of cost or market accounting or write-downs of individual assets.

Fair Value Hierarchy

The Company groups assets and liabilities at fair value in three levels, based on the markets in which the assets and liabilities are traded and the reliability of the assumptions used to determine the fair value. These levels are:

- Level 1** Valuation is based upon quoted prices for identical instruments traded in active markets.
- Level 2** Valuation is based upon quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active, and model-based valuation techniques for which all significant assumptions are observable in the market.
- Level 3** Valuation is generated from model-based techniques that use at least one significant assumption not observable in the market. These unobservable assumptions reflect estimates of assumptions that market participants would use in pricing the asset or liability. Valuation techniques include the use of option pricing models, discounted cash flow models and similar techniques.

Following is a description of valuation methodologies used for assets and liabilities recorded at fair value.

**Investment Securities Available-for-Sale** - Investment securities available-for-sale are recorded at fair value on a recurring basis. Fair value measurement is based upon quoted prices, if available. If quoted prices are not available, fair values are measured using independent pricing models or other model-based valuation techniques

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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, 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.

**Equity Securities** – Equity securities are recorded at fair value on a recurring basis. Fair value measurement is based upon quoted prices.

**Loans Held for Sale** - Loans held for sale are comprised of loans originated for sale in the ordinary course of business. The fair value of loans originated for sale in the secondary market is based on purchase commitments or quoted prices for the same or similar loans and are classified as recurring Level 2. There were no loans held for sale requiring fair value adjustments at December 31, 2021 and 2020.

**Impaired Loans** - 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 loss 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 are considered impaired. Once a loan is identified as individually impaired, management measures impairment. The fair value of impaired loans is estimated using one of several methods, including the collateral value, market value of similar debt, enterprise value, liquidation value and discounted cash flows. Those impaired loans not requiring a specific allowance represents loans for which the fair value of expected repayments or collateral exceed the recorded investment in such loans. At December 31, 2021 and 2020, substantially all of the impaired loans were evaluated based upon the fair value of the collateral. Impaired loans where an allowance is established based on the fair value of 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 loan as nonrecurring Level 2. 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 loan as nonrecurring Level 3.

**OREO** - Foreclosed assets are adjusted to fair value upon transfer of the loans to OREO. Real estate acquired in settlement of loans is recorded initially at estimated fair value of the property less estimated selling costs at the date of foreclosure. The initial recorded value may be subsequently reduced by additional allowances, which are charges to earnings if the estimated fair value of the property less estimated selling costs declines below the initial recorded value. OREO presented as measured on a non-recurring basis includes only those properties that had changes in valuation. Fair value is based upon independent market prices, appraised values of the collateral or management's estimation of the value of the collateral.

**Derivative Financial Instruments** – The Company's derivative financial instruments, which are interest rate contracts, are valued using a discounted cash flow method that incorporates current market interest rates.

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The table below presents the balances of assets and liabilities measured at fair value on a recurring basis by level within the hierarchy at December 31, 2021 and 2020:

|                                      | December 31, 2021 |         |            |         |
|--------------------------------------|-------------------|---------|------------|---------|
|                                      | Total             | Level 1 | Level 2    | Level 3 |
| <b>Assets:</b>                       |                   |         |            |         |
| <b>Available-for-sale securities</b> |                   |         |            |         |
| U.S. Treasuries                      | \$ 25,854         | \$ -    | \$ 25,854  | \$ -    |
| Municipal obligations                | 66,674            | -       | 66,674     | -       |
| Mortgage-backed securities           | 116,854           | -       | 116,854    | -       |
| Asset-backed securities              | 52,702            | -       | 52,702     | -       |
| Corporate debt securities            | 31,141            | -       | 30,641     | 500     |
| Total                                | \$ 293,225        | \$ -    | \$ 292,725 | \$ 500  |
| <b>Other</b>                         |                   |         |            |         |
| Derivative assets                    | \$ 1,710          | \$ -    | \$ 1,710   | \$ -    |
| <br>                                 |                   |         |            |         |
|                                      | December 31, 2020 |         |            |         |
|                                      | Total             | Level 1 | Level 2    | Level 3 |
| <b>Assets:</b>                       |                   |         |            |         |
| <b>Available-for-sale securities</b> |                   |         |            |         |
| U.S. Treasuries                      | \$ -              | \$ -    | \$ -       | \$ -    |
| Municipal obligations                | 39,297            | -       | 39,297     | -       |
| Mortgage-backed securities           | 39,461            | -       | 39,461     | -       |
| Asset-backed securities              | 18,274            | -       | 18,274     | -       |
| Corporate debt securities            | 22,525            | -       | 22,025     | 500     |
| Total                                | \$ 119,557        | \$ -    | \$ 119,057 | \$ 500  |
| <b>Other</b>                         |                   |         |            |         |
| Equity securities                    | \$ 163            | \$ 163  | \$ -       | \$ -    |
| Derivative assets                    | 1                 | -       | 1          | -       |
| <b>Liabilities:</b>                  |                   |         |            |         |
| Derivative liabilities               | (25)              | -       | (25)       | -       |

The changes in Level 3 assets and liabilities measured at fair value on a recurring basis are summarized as follows:

|  | Corporate<br>Debt Securities |
|--|------------------------------|
| <b>Balance at December 31, 2019</b>              | \$ 500                       |
| Total net gains included in:                     |                              |
| Net income                                       | -                            |
| Other comprehensive income                       | -                            |
| Purchases, sales, issuances and settlements, net | -                            |
| Transfers into/out of Level 3                    | -                            |
| <b>Balance at December 31, 2020</b>              | 500                          |
| Total net gains included in:                     |                              |
| Net income                                       | -                            |
| Other comprehensive income                       | -                            |
| Purchases, sales, issuances and settlements, net | -                            |
| Transfers into/out of Level 3                    | -                            |
| <b>Balance at December 31, 2021</b>              | <u>\$ 500</u>                |

Certain assets and liabilities are measured at fair value on a nonrecurring basis; that is, the instruments are not measured at fair value on an ongoing basis but are subject to fair value adjustments in certain circumstances (for

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example, when there is evidence of impairment). The following table presents the assets and liabilities carried on the balance sheet by caption and by level within the valuation hierarchy (as described above) for which a nonrecurring change in fair value has been recorded during the years ended December 31, 2021 and 2020.

|                     | December 31, 2021 |         |         |          |
|---------------------|-------------------|---------|---------|----------|
|                     | Total             | Level 1 | Level 2 | Level 3  |
| Impaired loans, net | \$ 2,578          | \$ -    | \$ -    | \$ 2,578 |
| Total               | \$ 2,578          | \$ -    | \$ -    | \$ 2,578 |

  

|                         | December 31, 2020 |         |         |          |
|-------------------------|-------------------|---------|---------|----------|
|                         | Total             | Level 1 | Level 2 | Level 3  |
| Other real estate owned | \$ 252            | \$ -    | \$ -    | \$ 252   |
| Impaired loans, net     | 3,367             | -       | -       | 3,367    |
| Total                   | \$ 3,619          | \$ -    | \$ -    | \$ 3,619 |

There were no liabilities measured at fair value on a nonrecurring basis at December 31, 2021 and 2020.

The following tables presents quantitative information about the unobservable inputs used in Level 3 fair value measurements at December 31, 2021 and 2020:

| December 31, 2021    |                    |  |                                       |                 |
|----------------------|--------------------|--|---------------------------------------|-----------------|
| Financial Instrument | Net Carrying Value | Valuation Technique  | Unobservable Input                    | Range of Inputs |
| Impaired loans, net  | \$ 2,578           | Collateral dependent - Third party appraisal or broker's price opinion | Management discount for costs to sell | 0% -10%         |

  

| December 31, 2020       |                    |  |                                       |                 |
|-------------------------|--------------------|--|---------------------------------------|-----------------|
| Financial Instrument    | Net Carrying Value | Valuation Technique  | Unobservable Input                    | Range of Inputs |
| Other real estate owned | \$ 252             | Third party appraisal or broker's price opinion                        | Management discount for costs to sell | 10%             |
| Impaired loans, net     | \$ 3,367           | Collateral dependent - Third party appraisal or broker's price opinion | Management discount for costs to sell | 0% -10%         |

**Fair Value of Financial Instruments**

The following tables includes the estimated fair value of the Company's financial assets and financial liabilities. The methodologies for estimating the fair value of financial assets and financial liabilities measured on a recurring and nonrecurring basis are discussed above. The methodologies for estimating the fair value for other financial assets and financial liabilities are discussed below. The estimated fair value amounts have been determined by the Company using available market information and appropriate valuation methodologies. However, considerable judgement is required to interpret market data in order to develop the estimates of fair value. Accordingly, the estimates presented below are not necessarily indicative of the amounts the Company could realize in a current market exchange. The use of different market assumptions and/or estimation techniques may have a material effect on the estimated fair value amounts at December 31, 2021.

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|                                  | December 31, 2021  |            |            |           |         |
|----------------------------------|--------------------|------------|------------|-----------|---------|
|                                  | Carrying<br>Amount | Fair Value | Level 1    | Level 2   | Level 3 |
| <i>Financial Assets:</i>         |                    |            |            |           |         |
| Cash and cash equivalents        | \$ 224,359         | \$ 224,359 | \$ 224,359 | \$ -      | \$ -    |
| Loans held for sale              | 81,453             | 81,453     | -          | 81,453    | -       |
| Loans held for investment, net   | 929,968            | 929,992    | -          | -         | 929,992 |
| Non-marketable equity securities | 1,529              | 1,529      | -          | -         | 1,529   |
| <i>Financial Liabilities:</i>    |                    |            |            |           |         |
| Deposits                         | 1,424,117          | 1,359,790  | -          | 1,359,790 | -       |
| Other borrowings                 | 44,587             | 46,544     | -          | 46,544    | -       |
| December 31, 2020                |                    |            |            |           |         |
|                                  | Carrying<br>Amount | Fair Value | Level 1    | Level 2   | Level 3 |
| <i>Financial Assets:</i>         |                    |            |            |           |         |
| Cash and cash equivalents        | \$ 157,003         | \$ 157,003 | \$ 157,003 | \$ -      | \$ -    |
| Loans held for sale              | 113,481            | 113,481    | -          | 113,481   | -       |
| Loans held for investment, net   | 695,477            | 695,910    | -          | -         | 695,910 |
| Non-marketable equity securities | 1,650              | 1,650      | -          | -         | 1,650   |
| <i>Financial Liabilities:</i>    |                    |            |            |           |         |
| Deposits                         | 891,552            | 881,831    | -          | 881,831   | -       |
| Other borrowings                 | 146,036            | 149,254    | -          | 149,254   | -       |

### Cash and cash equivalents

The carrying amounts of cash and due from banks, federal funds sold and resell agreements approximates their fair values.

### Loans held for sale

Loans held for sale are carried at the lower of cost or fair value. These loans currently consist of one-to-four family residential real estate loans originated for sale to qualified third parties. Fair value is based upon the contractual price to be received from these third parties, which may be different than cost.

### Loans held for investment, net

Fair values are estimated for portfolios of loans with similar financial characteristics if collateral-dependent. Loans are segregated by type. The fair value of performing loans is calculated by discounting scheduled cash flows through the estimated maturity using estimated market discount rates that reflect observable market information incorporating the credit, liquidity, yield and other risks inherent in the loan. The estimate of maturity is based upon the Company's historical experience with repayments for each loan classification, modified, as required, by an estimate of the effect of the current economic and lending conditions. Fair value for significant non-performing loans is generally based upon recent external appraisals. If appraisals are not available, estimated cash flows are discounted using a rate commensurate with the risk associated with the estimated cash flows. Assumptions regarding credit risk, cash flows and discounted rates are judgmentally determined using available market information and specific borrower information.

### Non-marketable equity securities

Non-marketable equity securities are carried at original cost basis, as cost approximates fair value and there is no ready market for such investments.

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**Deposits**

The fair value of deposits with no stated maturity date, such as noninterest-bearing demand deposits, savings and money market and checking accounts, is based on the discounted value of estimated cash flows. The fair value of time deposits is based upon the discounted value of contractual cash flows. The discount rate is estimated using the rates currently offered for deposits of similar remaining maturities.

**Other borrowings**

The fair value of the Company's FHLB, PPPLF, line of credit and subordinated debt advances are estimated based upon the discounted value of contractual cash flows. The fair value of investment securities sold under agreements to repurchase approximates the carrying amount because of the short maturity of these borrowings. The discount rate is estimated using rates quoted for the same or similar issues or the current rates offered to the Company for debt of the same remaining maturities.

**Note 25. Revenue Recognition**

The Company's sources of revenue are generated from both interest and noninterest revenue streams. Revenue streams generated by fees and interest from financial instruments, investments, and transfers and servicing of these assets are excluded from this disclosure.

The Company has certain revenue streams within the scope of ASC 606, *Revenue from Contracts with Customers*, contained within noninterest income. The Company's contracts with customers generally do not contain terms that require significant judgement to determine the amount of revenue to recognize.

The table below presents the revenue streams within the scope of the standard and is followed by a description of each noninterest income revenue stream for the years ended December 31, 2021 and 2020:

|   | December 31, 2021 |                 |                  |
|---|-------------------|-----------------|------------------|
|   | Within Scope      | Out of Scope    | Total            |
| <b>Noninterest income:</b>                  |                   |                 |                  |
| Income from mortgage originations           | \$ -              | \$ 3,015        | \$ 3,015         |
| Gain on sale of government guaranteed loans | -                 | 2,920           | 2,920            |
| Bargain purchase gain                       | -                 | 1,649           | 1,649            |
| Interchange income and card fees            | 1,002             | -               | 1,002            |
| Bank-owned life insurance                   | -                 | 931             | 931              |
| Service charges on deposit accounts         | 643               | -               | 643              |
| Securities loss, net                        | -                 | (59)            | (59)             |
| Other noninterest income                    | 45                | 1,050           | 1,095            |
| Total noninterest income                    | <u>\$ 1,690</u>   | <u>\$ 9,506</u> | <u>\$ 11,196</u> |

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|   | December 31, 2020 |                 |                 |
|---|-------------------|-----------------|-----------------|
|   | Within Scope      | Out of Scope    | Total           |
| Noninterest income:                         |                   |                 |                 |
| Income from mortgage originations           | \$ -              | \$ 2,150        | \$ 2,150        |
| Gain on sale of government guaranteed loans | -                 | 1,263           | 1,263           |
| Interchange income and card fees            | 742               | -               | 742             |
| Bank-owned life insurance                   | -                 | 416             | 416             |
| Service charges on deposit accounts         | 547               | -               | 547             |
| Securities gains, net                       | -                 | 948             | 948             |
| Other noninterest income                    | 52                | 306             | 358             |
| Total noninterest income                    | <u>\$ 1,341</u>   | <u>\$ 5,083</u> | <u>\$ 6,424</u> |

**Gain on sale of government guaranteed loans**

The Company records a gain from the sale of government guaranteed loans to third parties at the time the transfer is complete. The gain on sale is recognized as a result of the recognition of mortgage servicing rights and premiums paid by the buyer for the purchase of the loan.

**Income from mortgage originations**

The Company earns mortgage production income which is comprised primarily of activity related to the sale of consumer mortgage loans as well as loan origination fees such as closing charges, document review fees, application fees, other loan origination fees, and loan processing fees.

**Bargain purchase gain**

A bargain purchase gain was recognized from the acquisition of Cornerstone on October 1, 2021. This was a result of the fair value of net assets acquired exceeding consideration paid for the acquisition. Refer to Note 3, *Business Combinations*, for more information.

**Interchange income and card fees**

The Company earns interchange fees from debit cardholder transactions conducted through a payment network. Interchange fees from cardholder transactions represent a percentage of the underlying transaction value and are earned daily.

**Bank-owned life insurance**

The Company's income from bank-owned life insurance primarily represents changes in the cash surrender value of such life insurance policies held on certain key employees, for which the Company is the owner and beneficiary. Revenue is recognized in each period based on the change in cash surrender value during the period.

**Service charges on deposit accounts**

The Company earns fees from its deposit customers for transaction-based, account maintenance, and overdraft services. Transaction-based fees, which include services such as ATM use fees and stop payment charges, are recognized at the time the transaction is executed as that is the point in time the Company fulfills the customer's request. Account maintenance fees, which relate primarily to monthly maintenance, are earned over the course of a month, representing the period over which the Company satisfies the performance obligation. Overdraft fees are recognized at the point in time that the overdraft occurs. Service charges are withdrawn from the customer's account balance.

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**Securities gains and loss, net**

The Company recognizes realized gains or losses from the sale of its available-for-sale securities at the trade date and recognizes periodic mark-to-market adjustments on equity securities resulting from changes in fair value.

**Other noninterest income**

Other noninterest income consists primarily of loan fees, which are out of the scope of ASC Topic 606. The items within scope of the standard primarily relate to contracts with third parties for miscellaneous referral or broker income.

**Contract assets and liabilities**

A contract asset balance typically occurs when an entity performs a service for a customer before the customer payment of consideration, creating a contract receivable, or before payment is due, creating a contract asset. In contrast, a contract liability balance is an entity's obligation to transfer a service to a customer for which the entity has already received payment of consideration from the customer. The Company's noninterest revenue streams that are within the scope of ASC 606 are largely based on transactional activity which typically occurs at a point in time immediately after the performance obligations have been satisfied. Consideration is often received immediately or shortly after the Company satisfies its performance obligation and revenue is recognized. The Company does not typically enter into long-term revenue contracts with customers. Therefore, the Company does not experience significant contract balances. As of December 31, 2021 and 2020, the Company did not have any significant contract balances.

**Note 26. Derivative Financial Instruments**

The Company utilizes interest rate swaps agreements as part of its asset-liability management strategy to help mitigate its interest rate risk. The notional amount of the interest rate swaps does not represent amounts exchanged by the parties. The amount exchanged is determined by reference to the notional amount and the other terms of the individual interest rate swap agreements. Derivative financial instruments are recorded in the Consolidated Balance Sheets as either an asset or a liability (in other assets or other liabilities, respectively) and measured at fair value.

*Fair Value Hedges*

Fair value hedge interest rate swaps mature on various dates with a combined notional amount of \$38,110 at December 31, 2021. The risk management objective with respect to the fair value hedges is to hedge the risk of certain corporate and municipal securities. These fair value hedges convert the fixed rates of the bonds to a 3-Month LIBOR synthetic floating rate bond. The hedges were determined to be effective during the periods presented. The Company expects these hedges to remain effective during the remaining term of the swap.

*Cash Flow Hedge*

The cash flow hedge interest rate swap matures on October 21, 2030 and has a notional amount of \$25,000 as of December 31, 2021. The risk management objective with respect to the cash flow hedge is to hedge the risk of variability in the Company's cash flows (future interest payments) attributable to changes in the 3-month LIBOR rate pertaining to fluctuations in market interest rates on \$25,000 of FHLB, brokered CDs or other fixed rate advances for that period. The objective of the hedge is to offset the variability of cash flows due to the rollover of its fixed-rate 3-month FHLB or another fixed rate advance every quarter from October 31, 2022 to October 21, 2030. The hedge was determined to be effective during the periods presented. The Company expects the hedge

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to remain effective during the remaining term of the swap.

The Company did not have any derivatives that are not designated as hedges as of December 31, 2021 and 2020.

The following table presents the amounts recorded on the balance sheet related to cumulative basis adjustment for the fair value hedges as of December 31, 2021 and 2020:

| Line Item in the Balance Sheet in Which the Hedged Item is Included | Carrying Amount of the Hedged Assets (Liabilities) |           | Cumulative Amount of Fair Value Hedging Adjustment Included in the Carrying Amount of the Hedged Assets (Liabilities) |       |
|---|--|-----------|---|-------|
|   | 2021   | 2020      | 2021  | 2020  |
| Securities available for sale                                       | \$ 39,009  | \$ 12,814 | \$ (533)  | \$ 19 |
| Deferred tax assets   | \$ (168)   | \$ 6      | \$ (168)  | \$ 6  |

The Company presents derivative position gross on the balance sheet. The following table reflects the derivatives recorded on the balance sheet as of December 31, 2021 and 2020:

|  | 2021            |            | 2020            |            |
|--|-----------------|------------|-----------------|------------|
|  | Notional Amount | Fair Value | Notional Amount | Fair Value |
| <b>Included in Other assets:</b>                 |                 |            |                 |            |
| Derivatives designated as hedges:                |                 |            |                 |            |
| Interest rate swaps related to cash flow hedges  | \$ 25,000       | \$ 1,087   | \$ 25,000       | \$ 1       |
| Interest rate swaps related to fair value hedges | 38,110          | 623        | -               | -          |
| Total included in other assets                   |                 | \$ 1,710   |                 | \$ 1       |
| <b>Included in Other liabilities:</b>            |                 |            |                 |            |
| Derivatives designated as hedges:                |                 |            |                 |            |
| Interest rate swaps related to fair value hedges | \$ -            | \$ -       | \$ 12,575       | \$ 25      |
| Total included in Other liabilities              |                 | \$ -       |                 | \$ 25      |

The following table summarizes information about the starting interest rate swaps designated as fair value hedges at December 31, 2021:

|   |    |        |
|---|----|--------|
| Notional Amount of <i>non-forward</i> starting fair value hedges  | \$ | 12,575 |
| Weighted average fixed pay rate   |    | 0.389% |
| Weighted average LIBOR receive rate   |    | 0.165% |
| Weighted average maturity in years  |    | 3.19   |
| During the next 12 months, the estimated amount to be reclassified as a decrease to interest income from Basis Adjustment | \$ | 16,038 |
| During the next 12 months, the estimated amount to be reclassified as a decrease to interest income from Deferred Tax     | \$ | 5,065  |

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The following table summarizes information about the forward starting interest rate swaps designated as fair value hedges at December 31, 2021:

|  |    |        |
|--|----|--------|
| Notional Amount of <i>forward starting</i> fair value hedges | \$ | 25,535 |
| Weighted average maturity in years                           |    | 7.99   |

The effect of fair value hedge accounting on the statements of operations for the years ended December 31, 2021 and 2020 are as follows:

|                                  | Location and Amount of Gain or Loss<br>Recognized in Income on<br>Fair Value Hedging Relationships |                 |                    |                 |
|----------------------------------|--|-----------------|--------------------|-----------------|
|                                  | 2021   |                 | 2020               |                 |
|                                  | Interest<br>Income   | Other<br>Income | Interest<br>Income | Other<br>Income |
| Fair value hedging effects:      |  |                 |                    |                 |
| Gain (loss) on fair value hedges | \$ 647   | \$ -            | \$ (25)            | \$ -            |
| Hedged items                     | (725)  | -               | 25                 | -               |

The effect of cash flow hedge accounting on accumulated other comprehensive income for the years ended December 31, 2021 and 2020 are as follows:

|  | 2021   |  |  |
|--|--|--|--|
|  | Amount of Gain<br>(Loss) Recognized<br>in OCI<br>on Derivative | Location of Gain<br>(Loss) Reclassified<br>from OCI<br>into Income | Amount of Gain<br>(Loss) Reclassified<br>from OCI<br>into Income |
|  | Interest rate swap contracts                                   | \$ 825   | Interest income  |

  

|  | 2020   |  |  |
|--|--|--|--|
|  | Amount of Gain<br>(Loss) Recognized<br>in OCI<br>on Derivative | Location of Gain<br>(Loss) Reclassified<br>from OCI<br>into Income | Amount of Gain<br>(Loss) Reclassified<br>from OCI<br>into Income |
|  | Interest rate swap contracts                                   | \$ 1   | Interest income  |

The following table summarizes information about the interest rate swap designated as a cash flow hedge at December 31, 2021:

|   |    |        |
|---|----|--------|
| Notional Amount - 10/21/2022 Forward Starting   | \$ | 25,000 |
| Weighted average fixed pay rate   |    | 1.059% |
| Weighted average 3-month LIBOR receive rate   |    | N/A    |
| Weighted average maturity in years  |    | 8.81   |
| During the next twelve months, the Company estimates that will be reclassified from OCI as an increase to interest expense.         | \$ | 5,648  |
| During the next twelve months, the Company estimates that will be reclassified from Deferred Tax as an increase to interest expense | \$ | 1,784  |

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**Note 27. Subsequent Events**

Subsequent events are events or transactions that occur after the balance sheet date but before financial statements are issued. Recognized subsequent events are events or transactions that provide additional evidence about conditions that existed at the date of the balance sheet, including the estimates inherent in the process of preparing financial statements. Nonrecognized subsequent events are events that provide evidence about conditions that did not exist at the date of the balance sheet but arose after that date.

The Company evaluated subsequent events through the date its financial statements were issued, and there were no subsequent events noted through March 10, 2022.