

FINANCIAL STATEMENTS
AND INDEPENDENT AUDITOR'S REPORT

VERUS BANK OF COMMERCE

December 31, 2022 and 2021

FORTNER, BAYENS, LEVKULICH
■
& GARRISON, P.C.

INDEPENDENT AUDITOR'S REPORT

Board of Directors
Verus Bank of Commerce
Fort Collins, Colorado

Opinion

We have audited the financial statements of Verus Bank of Commerce, which comprise the balance sheets as of December 31, 2022 and 2021, and the related statements of income, changes in stockholders' equity, and cash flows for the years then ended, and the related notes to the financial statements.

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

Basis for Opinion

We conducted our audits in accordance with auditing standards generally accepted in the United States of America (GAAS). Our responsibilities under those standards are further described in the Auditor's Responsibilities for the Audit of the Financial Statements section of our report. We are required to be independent of Verus Bank of Commerce, 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 Verus Bank of Commerce's ability to continue as a going concern for one year after the date that the financial statements are available to be issued.

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 Verus Bank of Commerce'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 Verus Bank of Commerce'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.

Fortner, Bayens, Lavkulich & Garrison, P.C.

Denver, Colorado
April 12, 2023

Verus Bank of Commerce

BALANCE SHEETS

		December 31,	
		2022	2021
		(in thousands)	
ASSETS			
Cash and due from banks	\$	5,874	\$ 4,003
Interest-bearing deposits with banks		14,124	103,570
Federal funds sold		17,340	522
Cash and cash equivalents		37,338	108,095
Interest-bearing time deposits with banks		21,349	1,245
Nonmarketable equity securities		1,236	1,411
Loans		149,136	168,248
Less allowance for loan losses		(1,394)	(2,094)
		147,742	166,154
Premises and equipment		551	101
Accrued interest receivable		452	435
Other assets		662	870
	\$	209,330	\$ 278,311
LIABILITIES AND STOCKHOLDERS' EQUITY			
Liabilities			
Deposits			
Noninterest-bearing	\$	77,882	\$ 101,390
Interest-bearing		90,786	128,784
		168,668	230,174
Federal Home Loan Bank borrowings		1,500	8,000
Accrued interest payable		23	36
Other liabilities		4,333	3,443
Total liabilities		174,524	241,653
Commitments (notes C and G)			
Stockholders' equity			
Preferred stock - \$1,000 par value, 8,766 shares authorized; 0 shares issued and outstanding at December 31, 2022 and 2021, respectively			
		-	-
Common stock - \$2.50 par value, 7,000,000 shares authorized; 5,383,133 and 5,404,526 shares issued and outstanding at December 31, 2022 and 2021, respectively			
		13,458	13,511
Capital surplus		13,319	13,404
Retained earnings		8,029	9,743
		34,806	36,658
	\$	209,330	\$ 278,311

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

Verus Bank of Commerce
STATEMENTS OF INCOME

	Years Ended December 31,	
	2022	2021
	(in thousands)	
Interest and dividend income		
Interest and fees on loans	\$ 8,038	\$ 10,823
Federal funds sold	9	-
Interest-bearing deposits with banks	1,022	136
Dividends	59	62
Total interest and dividend income	9,128	11,021
Interest expense		
Deposits	742	1,254
Federal Home Loan Bank borrowings	106	173
Total interest expense	848	1,427
Net interest income	8,280	9,594
Provision for (reduction in) loan losses	(700)	(625)
Net interest income after provision for loan losses	8,980	10,219
Noninterest income		
Service charges on deposit accounts	529	819
Fees from servicing government-guaranteed loans	1	1
Other	187	233
Total noninterest income	717	1,053
Noninterest expense		
Salaries and employee benefits	3,642	3,590
Occupancy and equipment	406	399
Other expenses	1,178	1,272
Total noninterest expense	5,226	5,261
Income before income taxes	4,471	6,011
Income tax expense	1,124	1,511
NET INCOME	\$ 3,347	\$ 4,500

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

Verus Bank of Commerce

STATEMENTS OF STOCKHOLDERS' EQUITY

Years ended December 31, 2022 and 2021

	Common Stock	Capital Surplus	Retained Earnings	Total
Balance at December 31, 2020	\$ 13,428	\$ 13,261	\$ 10,161	\$ 36,850
Issuance of 38,846 shares of common stock	97	168	\$ -	265
Repurchase of 5,671 shares of common stock	(14)	(25)	-	(39)
Comprehensive income				
Net income	-	-	4,500	4,500
Common stock dividends declared	-	-	(4,918)	(4,918)
Balance at December 31, 2021	13,511	13,404	9,743	36,658
Repurchase of 21,393 shares of common stock	(53)	(85)	-	(138)
Comprehensive income				
Net income	-	-	3,347	3,347
Common stock dividends declared	-	-	(5,061)	(5,061)
Balance at December 31, 2022	\$ 13,458	\$ 13,319	\$ 8,029	\$ 34,806

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

Verus Bank of Commerce

STATEMENTS OF CASH FLOWS

	Years Ended December 31,	
	2022	2021
	(in thousands)	
Cash flows from operating activities		
Net income	\$ 3,347	\$ 4,500
Adjustments to reconcile net income to net cash flows from operating activities		
Depreciation and amortization of premises and equipment	180	30
Provision for (reduction in) loan losses	(700)	(625)
Federal Home Loan Bank stock dividends	(11)	(13)
Deferred income taxes	214	132
Principal reduction on operating lease liability	(134)	-
Net changes in:		
Accrued interest receivable and other assets	(23)	280
Accrued interest payable and other liabilities	433	(279)
Net cash provided by operating activities	3,306	4,025
Cash flows from investing activities		
Net change in interest-bearing time deposits with banks	(20,104)	1,490
Purchases of nonmarketable equity securities	-	(7)
Redemptions of nonmarketable equity securities	186	1,020
Loan originations and principal collections, net	19,112	50,111
Expenditures for premises and equipment	(52)	(81)
Net cash provided (used) by investing activities	(858)	52,533
Cash flows from financing activities		
Net change in deposits	(61,506)	(19,780)
Payments on long-term borrowings	(6,500)	(2,000)
Issuance of common stock	-	265
Repurchase of common stock	(138)	(39)
Cash dividends paid on common stock	(5,061)	(4,918)
Net cash used by financing activities	(73,205)	(26,472)
Net change in cash and cash equivalents	(70,757)	30,086
Cash and cash equivalents at beginning of year	108,095	78,009
Cash and cash equivalents at end of year	\$ 37,338	\$ 108,095
SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION		
Cash paid during the year for:		
Interest	\$ 861	\$ 1,458
Income taxes	757	1,318

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

Verus Bank of Commerce

NOTES TO FINANCIAL STATEMENTS

December 31, 2022 and 2021

NOTE A - SUMMARY OF ACCOUNTING POLICIES

Nature of Operations

The Verus Bank of Commerce (the Bank) provides a full range of banking and mortgage services to individual and corporate customers, principally in Larimer County, Colorado and the surrounding area. Verus Acquisition Group, Inc. (Verus), a Bank holding company located in Fort Collins, Colorado owns an 86% interest in the Bank.

The Bank provides banking services to individuals, businesses and other customers located in its community. A variety of deposit products are offered, including checking, savings, money market, individual retirement accounts and certificates of deposit. The principal market for the Bank's financial services is the community in which it is located and the areas immediately surrounding that community. The Bank is also subject to regulation by certain governmental agencies and undergoes periodic examinations by those regulatory agencies.

Use of Estimates

The financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America. In preparing the financial statements, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities as of the date of the balance sheet and revenues and expenses for the period. Actual results could differ significantly from those estimates.

Material estimates that are particularly susceptible to significant change in the near-term relate to the determination of the allowance for loan losses and the valuation of foreclosed real estate.

In connection with the determination of the allowance for loan losses and the valuation of foreclosed real estate, management obtains independent appraisals for significant properties and assesses estimated future cash flows from borrowers' operations and the liquidation of loan collateral.

Management believes that the allowance for loan losses is adequate. While management uses available information to recognize losses on loans, changes in economic conditions may necessitate revisions in future years.

Verus Bank of Commerce

NOTES TO FINANCIAL STATEMENTS (CONTINUED)

December 31, 2022 and 2021

Significant Group Concentrations of Credit Risk

Most of the Bank's activities are with customers located in the Larimer County, Colorado area. Note B discusses the types of lending that the Bank engages in.

Cash and Cash Equivalents

For purposes of the statements of cash flows, cash and cash equivalents include cash and balances due from banks, interest-bearing deposits with banks and federal funds sold.

Interest-Bearing Time Deposits with Banks

Interest-bearing time deposits with banks are carried at cost, mature within two years and are fully covered by federal deposit insurance.

Nonmarketable Equity Securities

Nonmarketable equity securities, consisting of Federal Home Loan Bank and Federal Reserve Bank stock, are recorded at cost.

Loans

The Bank primarily grants construction, land and land development and real estate loans to customers primarily in the Larimer County, Colorado area. The ability of the Bank's borrowers to honor their contracts is dependent upon the real estate and general economic conditions in this area.

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

Past due loans are any loans for which payments of interest, principal or both have not been received within the timeframes designated by the loan agreements. Loans with payments in arrears but for which borrowers have resumed making scheduled payments are considered past due until arrearages are brought current. Loans that experience insignificant payment delays or payment shortfalls generally are not considered past due. Management determines the significance of payment delays and payment shortfalls on a case-by-case basis, taking into consideration all of the circumstances surrounding the loan and the borrower, including the length of the delay, the reasons for the delay, the borrower's prior

Verus Bank of Commerce

NOTES TO FINANCIAL STATEMENTS (CONTINUED)

December 31, 2022 and 2021

payment record, and the amount of the shortfall in relation to the principal and interest owed.

The accrual of interest on all loans is discontinued at the time a loan is 90 days delinquent unless the loan is well secured and in process of collection. Additionally, loans are placed on nonaccrual at an earlier date if collection of principal or interest is considered doubtful. When placing a loan on nonaccrual status, interest accrued to date is generally reversed and is charged against the current year's interest income. Payments received on a loan on nonaccrual status are applied against the balance of the loan. A loan is returned to accrual status when principal and interest are no longer past due and collectability is no longer doubtful.

Troubled debt restructurings are loans for which concessions in terms have been made as a result of the borrower experiencing financial difficulty. Generally, concessions granted to customers include lower interest rates and modification of the payment stream to lower or defer payments. Interest on troubled debt restructurings is accrued under the new terms if the loans are performing and full collection of principal and interest is expected. However, interest accruals are discontinued on troubled debt restructurings that meet the Bank's nonaccrual criteria.

Generally, loans are charged off in whole or in part on a loan-by-loan basis after they become significantly past due and based upon management's review of the collectability of all or a portion of the loan unless the loan is in the process of restructuring. Charge off amounts are determined based upon the carrying amount of loans and the amount estimated to be collectible as determined by analyses of expected future cash flows and the liquidation of loan collateral.

Allowance for Loan Losses

The allowance for loan losses is a valuation allowance for probable incurred credit losses, and is established through a provision for loan losses charged to earnings. Loan losses are charged against the allowance when management believes the uncollectibility of a loan balance is confirmed. Subsequent recoveries, if any, are credited to the allowance.

The allowance consists of specific and general components as follows:

The specific component relates to loans that are considered impaired, and is comprised of valuation allowances calculated on a loan-by-loan basis. Impaired loans are all specifically identified loans for which it is probable that the Bank will not collect all amounts due according to the contractual terms of the loan agreement. Factors considered by management in determining whether a loan is impaired include payment status, collateral value, the borrower's financial condition and overall loan quality as determined by an internal loan grading system. Included in impaired loans are all nonaccrual loans and all accruing troubled debt restructurings. Loans that experience

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NOTES TO FINANCIAL STATEMENTS (CONTINUED)

December 31, 2022 and 2021

insignificant payment delays or payment shortfalls generally are not considered impaired. For impaired loans for which repayment is expected solely from the collateral, impairment is measured based on the fair value of the collateral. For other impaired loans, impairment may be measured based on the fair value of the collateral or on the present value of expected future cash flows discounted at the loan's original effective interest rate. When the measure of the impaired loan is less than the recorded investment in the loan, the impairment is recorded through a valuation allowance.

The general component relates to non-impaired loans, and is based on historical loss experience adjusted for the effects of qualitative factors that are likely to cause estimated credit losses as of the evaluation date to differ from the portfolio's historical loss experience. Qualitative factors include the following: economic conditions; industry conditions; changes in lending policies and procedures; trends in the volume and terms of loans; the experience, ability and depth of lending staff; levels and trends in delinquencies; levels and trends in charge-off and recovery activity; levels and trends of loan quality as determined by an internal loan grading system; and portfolio concentrations.

Although the allowance contains a specific component, the entire allowance is available for any loan that, in management's judgment, should be charged-off.

On a monthly basis, management estimates the allowance balance required using the criteria identified above in relation to the relevant risks for each of the Bank's major loan segments. Significant overall risk factors for both the Bank's real estate, commercial and consumer portfolios include the strength of the real estate market and the strength of economy in the Bank's lending area.

The quality of the Bank's loan portfolio is assessed as a function of the levels of past due loans and impaired loans, and internal credit quality ratings which are updated monthly by management. The ratings on the Bank's internal credit scale are broadly grouped into the categories "non-classified" and "classified." Non-classified loans are those loans with minimal identified credit risk, as well as loans with potential credit weaknesses which deserve management's attention but for which full collection of contractual principal and interest is not significantly at risk. Classified loans are those loans that have well-defined weakness that put full collection of contractual principal or interest at risk, and classified loans for which it is probable that the Bank will not collect all contractual principal or interest are also considered impaired. The credit quality ratings are an important part of the Bank's overall credit risk management process and are considered in the determination of the allowance for loan losses.

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NOTES TO FINANCIAL STATEMENTS (CONTINUED)

December 31, 2022 and 2021

Determination of the allowance is inherently subjective as it requires estimates that are susceptible to significant revision as more information becomes available. In addition, various regulatory agencies, as an integral part of their examination process, periodically review the Bank's allowance. Such agencies may require the Bank to recognize additional losses based on their judgments about information available to them at the time of their examination.

Off- Balance Sheet Financial Instruments

In the ordinary course of business, the Bank enters into off-balance-sheet financial instruments consisting of commitments to extend credit, unused lines of credit, standby letters of credit and undisbursed loans in process. These financial instruments are recorded in the financial statements when they are funded.

In conjunction with the determination of the allowance for loan losses, and using the same criteria, the Bank determines the extent of credit risk on its off-balance sheet financial instruments and whether there are probable incurred credit losses on those instruments for which a loss provision is necessary. The Bank has determined that there is minimal credit risk on its off-balance sheet financial instruments, and accordingly has not recorded a loss provision or allowance for those instruments.

Foreclosed Real Estate

Real estate acquired through, or in lieu of, loan foreclosure, are held for sale and are initially recorded at fair value less cost to sell at the date of foreclosure, establishing a new cost basis. Subsequent to foreclosure, valuations are periodically performed by management and the assets are carried at the lower of carrying amount or fair value less cost to sell. Revenue and expenses from operations and changes in the valuation allowance are included in other expenses.

Premises and Equipment

Land is carried at cost. Buildings, leasehold improvements, furniture, and equipment are carried at cost, less accumulated depreciation computed on the straight-line method over the estimated useful lives of the assets or the expected terms of the lease for financial statement purposes. Expected terms include lease option periods to the extent that the exercise of such option is reasonable assured. Normal costs of maintenance and repairs are charged to expense as incurred.

Verus Bank of Commerce

NOTES TO FINANCIAL STATEMENTS (CONTINUED)

December 31, 2022 and 2021

Income Taxes

Deferred income tax assets and liabilities are determined using the liability (or balance sheet) method. Under this method, the net deferred tax asset or liability is determined based on the tax effects of the temporary differences between the book and tax bases of the various balance sheet assets and liabilities and gives current recognition to changes in tax rates and laws.

The Bank has adopted guidance issued by the Financial Accounting Standards Board with respect to accounting for uncertainty in income taxes. A tax position is recognized as a benefit only if it is “more likely than not” that the tax position would be sustained in a tax examination, with a tax examination being presumed to occur. The amount recognized is the largest amount of tax benefit that is greater than 50% likely of being realized on examination. For tax purposes, not meeting the “more likely than not” test, no tax benefit is recorded. Deferred tax assets are reduced by a valuation allowance if, based on the weight of evidence available, it is more likely than not that a portion of the deferred tax asset may not be realized within a year.

Transfers of Financial Assets

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

Fair Value Measurement

Fair value is the exchange price that would be received for an asset or paid to transfer a liability (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. There are three levels of inputs that may be used to measure fair values:

Level 1 – Quoted prices (unadjusted) for identical assets or liabilities in active markets that the entity has the ability to access as of the measurement date.

Level 2 – Significant other observable inputs other than Level 1 prices such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data.

Level 3 – Significant unobservable inputs that reflect a bank’s own assumptions about the assumptions that market participants would use in pricing an asset or liability.

Verus Bank of Commerce

NOTES TO FINANCIAL STATEMENTS (CONTINUED)

December 31, 2022 and 2021

Noninterest Income

Noninterest income is substantially comprised of service charges on deposit accounts, ATM, and debit card income. Service charges on deposit accounts consist of monthly account fees, stop payment charges, and charges on deposit items returned for non-sufficient funds or paid as an overdraft (net of fees waived or refunded). ATM and debit card income is comprised of ATM charges for non-customer use of Bank ATMs and debit card interchange income. In all instances, noninterest income is recognized concurrent with the Bank's satisfaction of the underlying performance obligation, which typically occurs at a single point in time as a transaction or statement cycle is completed. Charges for deposit accounts continuously overdrawn are equivalent to interest and included as a component of interest and fees on loans.

Subsequent Events

Management evaluates events occurring after the balance sheet date, through the date the financial statements are eligible to be issued, to determine whether the events require recognition or disclosure in the financial statements. If a subsequent event evidences conditions existing at the balance sheet date, the effects are recognized in the financial statements (recognized subsequent event). If a subsequent event evidences conditions arising after the balance sheet date, the effects are not recognized in the financial statements but rather disclosed in the notes to the financial statements (non-recognized subsequent events). The effects of subsequent events are only recognized if material or disclosed if the financial statements would otherwise be misleading.

With respect to the December 31, 2022 financial statements, Management has considered subsequent events through April 12, 2023.

New Accounting Pronouncements

In 2022, the Company adopted Accounting Standards Update (ASU) 2016-02, Leases (Topic 842). As a result of adoption, the Company recorded a lease liability for the present value of fixed lease payments not yet paid and also recorded a corresponding right-of-use asset. Additionally, interest on the lease liability and amortization of the right-of-use asset began being recorded as rent expense such that the combination of interest and amortization results in straight-line lease expense over the lease terms. The cumulative amount of straight-line rent expense to be recorded over the lease terms is equal to the total undiscounted fixed lease payments under the lease agreements. The right-of-use asset and related accumulated amortization are classified with premises and equipment. The lease liability is classified with other liabilities. The new standard resulted in an immaterial increase in assets and liabilities with no cumulative effect adjustment to equity. Variable lease costs, such as pass-through operating costs of the lessors, continue to be expensed as incurred. Additionally, right-of-use assets and lease liabilities are not recorded for equipment leases based on immateriality.

Verus Bank of Commerce

NOTES TO FINANCIAL STATEMENTS (CONTINUED)

December 31, 2022 and 2021

Significant Accounting Standards Updates Not Yet Effective

The FASB issued ASU 2016-03, Financial Instruments – Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments. Under the standard, the Bank will be required to convert from the existing incurred-loss model for determining the allowance for loan losses to an expected-loss model. An expected-loss model will determine the allowance for loan losses balance based upon credit losses expected to be incurred over the life of the loan portfolio and will consider not only current credit conditions but also reasonable supportable expectations as to future credit conditions. The standard will also require securities held to maturity to be evaluated for impairment under an expected-loss model. The standard is effective for the Bank beginning January 1, 2023. Management has determined that the impact is not expected to be significant.

Comprehensive Income

Comprehensive income consists of net income and other comprehensive income. The Bank has no other comprehensive income for the years ended December 31, 2022 and 2021.

Verus Bank of Commerce

NOTES TO FINANCIAL STATEMENTS (CONTINUED)

December 31, 2022 and 2021

NOTE B - LOANS AND ALLOWANCE FOR LOAN LOSSES

A summary of the balances of loans follows:

	December 31,	
	2022	2021
	(in thousands)	
Construction, land and land development		
Residential 1-4 family	\$ 864	\$ 3,726
Other	8,830	5,880
	9,694	9,606
Real estate		
Residential 1-4 family	19,844	21,588
Multifamily	1,770	1,981
Commercial	105,003	121,347
Farmland	278	1,303
	126,895	146,219
Commercial and industrial	12,466	12,366
Consumer and other	81	57
	\$ 149,136	\$ 168,248

At December 31, 2022, the Bank had approximately \$21,090,000 of SBA 504 and \$65,000 of SBA 7A loans. Management believes these loans are considered liquid assets given the active and mature secondary market for these loans as well as their associated premiums. Management includes these assets as part of its liquidity measurement and includes them in the Bank's Contingent Liquidity Plan, which is updated quarterly. These loans may be periodically sold for liquidity purposes and to manage industry concentrations and interest rate risk.

Verus Bank of Commerce

NOTES TO FINANCIAL STATEMENTS (CONTINUED)

December 31, 2022 and 2021

Transactions in the allowance for loan losses are as follows:

	Year ended December 31, 2022 (in thousands)				
	Construction, land and land development	Real estate	Commercial and industrial	Consumer and other	Total
Balance at December 31, 2021	\$ 106	\$ 1,870	\$ 117	\$ 1	\$ 2,094
Provision for loan losses	(19)	(670)	(11)	-	(700)
Charge-offs	-	-	-	-	-
Recoveries	-	-	-	-	-
Net (charge-offs) recoveries	-	-	-	-	-
Balance at December 31, 2022	<u>\$ 87</u>	<u>\$ 1,200</u>	<u>\$ 106</u>	<u>\$ 1</u>	<u>\$ 1,394</u>

	Year ended December 31, 2021 (in thousands)				
	Construction, land and land development	Real estate	Commercial and industrial	Consumer and other	Total
Balance at December 31, 2020	\$ 190	\$ 2,379	\$ 101	\$ 1	\$ 2,671
Provision for loan losses	(132)	(509)	16	-	(625)
Charge-offs	-	-	-	-	-
Recoveries	48	-	-	-	48
Net (charge-offs) recoveries	<u>48</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>48</u>
Balance at December 31, 2021	<u>\$ 106</u>	<u>\$ 1,870</u>	<u>\$ 117</u>	<u>\$ 1</u>	<u>\$ 2,094</u>

Verus Bank of Commerce

NOTES TO FINANCIAL STATEMENTS (CONTINUED)

December 31, 2022 and 2021

Components of the allowance for losses, and the related carrying amount of loans for which the allowance is determined, are as follows:

	December 31, 2022 (in thousands)				
	Construction, land and land development	Real estate	Commercial and industrial	Consumer and other	Total
<u>Allocation of Allowance To:</u>					
Impaired loans - evaluated individually	\$ -	\$ -	\$ -	\$ -	\$ -
Impaired loans - evaluated collectively	-	-	-	-	-
Total impaired loans	-	-	-	-	-
Unimpaired loans - evaluated collectively	87	1,200	106	1	1,394
	<u>\$ 87</u>	<u>\$ 1,200</u>	<u>\$ 106</u>	<u>\$ 1</u>	<u>\$ 1,394</u>
<u>Recorded Investment In:</u>					
Impaired loans - evaluated individually	\$ -	\$ -	\$ -	\$ -	\$ -
Impaired loans - evaluated collectively	-	-	-	-	-
Total impaired loans	-	-	-	-	-
Unimpaired loans - evaluated collectively	9,694	126,895	12,466	81	149,136
	<u>\$ 9,694</u>	<u>\$ 126,895</u>	<u>\$ 12,466</u>	<u>\$ 81</u>	<u>\$ 149,136</u>

Verus Bank of Commerce

NOTES TO FINANCIAL STATEMENTS (CONTINUED)

December 31, 2022 and 2021

	December 31, 2021 (in thousands)				
	Construction, land and land development	Real estate	Commercial and industrial	Consumer and other	Total
<u>Allocation of Allowance To:</u>					
Impaired loans - evaluated individually	\$ -	\$ -	\$ -	\$ -	\$ -
Impaired loans - evaluated collectively	-	-	-	-	-
Total impaired loans	-	-	-	-	-
Unimpaired loans - evaluated collectively	106	1,870	117	1	2,094
	\$ 106	\$ 1,870	\$ 117	\$ 1	\$ 2,094
<u>Recorded Investment In:</u>					
Impaired loans - evaluated individually	\$ -	\$ -	\$ -	\$ -	\$ -
Impaired loans - evaluated collectively	-	-	-	-	-
Total impaired loans	-	-	-	-	-
Unimpaired loans - evaluated collectively	9,606	146,219	12,366	57	168,248
	\$ 9,606	\$ 146,219	\$ 12,366	\$ 57	\$ 168,248

The Bank had no impaired loans as of December 31, 2022 and 2021.

There was no interest income recognized on impaired loans for the years ended December 31, 2022 and 2021.

The Bank had no troubled debt restructurings as of December 31, 2022 and 2021.

Verus Bank of Commerce

NOTES TO FINANCIAL STATEMENTS (CONTINUED)

December 31, 2022 and 2021

The carrying amounts of loans by performance status and credit quality indicator are as follows:

		December 31, 2022 (in thousands)							
		Loans By Past Due and Performance Status				Loans By Credit Quality Indicator			
		Accruing Loans				Classified			
		Current	30-89 Days Past Due	90 Days or More Past Due	Nonaccrual Loans	Total Loans	Non- classified	Unimpaired	Impaired
Construction, land and land development									
Residential 1-4 family	\$	864	\$ -	\$ -	\$ -	\$ 864	\$ 864	\$ -	\$ -
Other		8,830	-	-	-	8,830	8,830	-	-
		9,694	-	-	-	9,694	9,694	-	-
Real estate									
Residential 1-4 family		19,844	-	-	-	19,844	19,792	52	-
Multifamily		1,770	-	-	-	1,770	1,770	-	-
Commercial		105,003	-	-	-	105,003	103,652	1,351	-
Farmland		278	-	-	-	278	278	-	-
		126,895	-	-	-	126,895	125,492	1,403	-
Commercial and industrial		12,466	-	-	-	12,466	12,411	55	-
Consumer and other		81	-	-	-	81	81	-	-
	\$	149,136	\$ -	\$ -	\$ -	\$ 149,136	\$ 147,678	\$ 1,458	\$ -

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NOTES TO FINANCIAL STATEMENTS (CONTINUED)

December 31, 2022 and 2021

December 31, 2021
(in thousands)

	Loans By Past Due and Performance Status				Loans By Credit Quality Indicator			
	Accruing Loans				Total Loans	Classified		
	Current	30-89 Days Past Due	90 Days or More Past Due	Nonaccrual Loans		Non- classified	Unimpaired	Impaired
Construction, land and land development								
Residential 1-4 family	\$ 3,726	\$ -	\$ -	\$ -	\$ 3,726	\$ 3,726	\$ -	\$ -
Other	5,880	-	-	-	5,880	5,880	-	-
	9,606	-	-	-	9,606	9,606	-	-
Real estate								
Residential 1-4 family	21,588	-	-	-	21,588	21,588	-	-
Multifamily	1,981	-	-	-	1,981	1,981	-	-
Commercial	121,347	-	-	-	121,347	115,750	5,597	-
Farmland	1,303	-	-	-	1,303	1,303	-	-
	146,219	-	-	-	146,219	140,622	5,597	-
Commercial and industrial	12,366	-	-	-	12,366	12,303	63	-
Consumer and other	57	-	-	-	57	57	-	-
	<u>\$ 168,248</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 168,248</u>	<u>\$ 162,588</u>	<u>\$ 5,660</u>	<u>\$ -</u>

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NOTES TO FINANCIAL STATEMENTS (CONTINUED)

December 31, 2022 and 2021

NOTE C - PREMISES AND EQUIPMENT

Premises and equipment, less accumulated depreciation and amortization consisted of the following:

	December 31,	
	2022	2021
	(in thousands)	
Right-of-use asset for premises operating lease	\$ 578	\$ -
Leasehold improvements	678	659
Furniture, fixtures and equipment	1,529	1,496
	2,785	2,155
Accumulated depreciation and amortization	(2,234)	(2,054)
	\$ 551	\$ 101

At December 31, 2022, the Bank's operating lease liability for leased premises totaled \$445,000 and is included as a component of other liabilities. Total rent expense for the premises operating lease, including variable costs, was \$192,000 and \$200,000 in 2022 and 2021, respectively.

Future undiscounted minimum rent commitments for the premises operating lease are as follows:

Years ending December 31,	(in thousands)
2023	\$ 144
2024	148
2025	151
2026	13
	\$ 456

The \$11,000 difference between the lease liability and the rent commitment total in the table above is the future interest component of the liability to be included in rent expense over the remaining term of the lease.

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NOTES TO FINANCIAL STATEMENTS (CONTINUED)

December 31, 2022 and 2021

NOTE D – DEPOSITS

The aggregate amount of time deposits in denominations of \$250,000 or more at December 31, 2022 and 2021 was approximately \$16,997,000 and \$22,055,000, respectively.

At December 31, 2022, the scheduled maturities of certificates of deposit are as follows:

Years ending <u>December 31,</u>	(in thousands)
2023	\$ 5,690
2024	14,683
2025	565
2026	98
2027	18
	<u>\$ 21,054</u>

NOTE E – BORROWINGS

As of December 31, 2022 and 2021, the Bank had term advances outstanding with the Federal Home Loan Bank totaling \$1,500,000 with an average weighted rate of 3.18%. The Bank has executed a blanket pledge and security agreement with the Federal Home Loan Bank, which encompasses certain loans as collateral for these credit facilities.

The scheduled maturities of term advances as of December 31, 2022 are as follows.

Years ending <u>December 31,</u>	(in thousands)
2023	\$ 1,500
	<u>\$ 1,500</u>

As of December 31, 2022 and 2021, the Bank had no short-term borrowings.

At December 31, 2022 and 2021, loans totaling \$89,702,000 and \$99,598,000 were pledged to secure all Federal Home Loan Bank borrowings. At December 31, 2022, the Bank had additional borrowing capacity at the Federal Home Loan Bank of approximately \$58,659,000.

At December 31, 2022, the Bank maintained various additional short and long-term lines of credit, with available facilities of \$29,700,000.

Verus Bank of Commerce

NOTES TO FINANCIAL STATEMENTS (CONTINUED)

December 31, 2022 and 2021

NOTE F – INCOME TAXES

Following is an analysis of income taxes included in the statements of income:

	2022	2021
	(in thousands)	
Current tax expense (benefit)		
Federal	\$ 747	\$ 1,126
State	163	253
	910	1,379
 Deferred tax expense (benefit)		
Federal	187	116
State	27	16
	214	132
	\$ 1,124	\$ 1,511

Listed below are the components of the net deferred tax assets, which are included in other assets:

	December 31,	
	2022	2021
	(in thousands)	
Deferred tax assets		
Allowance for loan losses	\$ 341	\$ 514
Deferred loan fees	72	114
Other, net	44	48
Total deferred tax assets	457	676
 Deferred tax liabilities		
FHLB dividends	(20)	(25)
Total deferred tax liabilities	(20)	(25)
 Net deferred tax asset before valuation allowance	437	651
Less valuation allowance	-	-
 Net deferred tax asset	\$ 437	\$ 651

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NOTES TO FINANCIAL STATEMENTS (CONTINUED)

December 31, 2022 and 2021

The reasons for the differences between the statutory federal income tax rate and the effective tax rate are summarized as follows:

	Year Ended December 31,	
	2022	2021
	(percentage)	
Statutory federal tax rate	21.00	21.00
Increase (decrease) resulting from:		
State tax, net of federal tax benefit	3.36	3.54
Other	0.78	0.60
Effective rate	25.14	25.14

NOTE G - FINANCIAL INSTRUMENTS WITH OFF-BALANCE SHEET RISK

The Bank is a party to financial instruments with off-balance sheet risk in the normal course of business to meet the financing needs of its customers. These financial instruments include commitments to extend credit and stand-by letters of credit.

Those instruments involve, to a varying degree, elements of credit risk in excess of the amount recognized in the statement of financial position. The contract amounts of those instruments reflect the extent of involvement the Bank has in particular classes of financial instruments.

The Bnk's exposure to credit loss in the event of non-performance by the other party to the financial instrument for commitments to extend credit and stand-by letters of credit is represented by the contractual notional amount of those instruments. The Bank uses the same credit policies in making commitments and conditional obligations as it does for on-balance sheet instruments.

At December 31, 2022 and 2021, the following financial instruments were outstanding whose contract amounts represent credit risk:

	2022		2021	
	(in thousands)			
Commitments to extend credit	\$	23,697	\$	36,614
Letters of credit		844		1,264

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NOTES TO FINANCIAL STATEMENTS (CONTINUED)

December 31, 2022 and 2021

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.

Since many of the commitments may expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. The Bank evaluates each customer's creditworthiness on a case-by-case basis. The amount of collateral obtained if deemed necessary by the Bank upon extension of credit is based on management's credit evaluation. Collateral held varies, but may include accounts receivable, inventory, property, plant and equipment and income-producing commercial properties.

Stand-by letters of credit are conditional commitments issued by the Bank to guarantee the performance of a customer to a third party. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loan facilities to customers.

NOTE H - EMPLOYEE BENEFIT AND COMPENSATION PLANS

401(k) Plan

The Bank maintains a 401(k) retirement plan whereby substantially all employees who meet certain age and length of service requirements may participate in the plan. For 2022 and 2021, expense attributable to the Plan amounted to approximately \$60,000 and \$64,000, respectively.

Employment Agreements

The Bank has employment agreements with its CEO and President. The agreements establish a salary that is increased annually based on performance factors relating to Bank earnings, asset growth and asset quality. The CEO and President are also entitled to participate in annual bonuses based on Bank earnings and asset quality. These are subject to annual review and approval by the Board.

Stock Appreciation Rights

The Bank has a Stock Appreciation Rights (SAR) plan for senior officers. Under the plan, participants are granted a number of SARs at the discretion of the Bank's Board of Directors. Each SAR entitles the holder to the book value appreciation in one share of the Bank's common stock for the periods following the date of grant. The value of the stock appreciation vests immediately, at which time the holder is entitled to receive the value in cash. Expense attributable to the plan in 2022 and 2021 was \$561,000 and \$617,000, respectively. All expenses were paid as part of 2022 and 2021 compensation, and no liability related to this expense existed as of December 31, 2022 and 2021.

Verus Bank of Commerce

NOTES TO FINANCIAL STATEMENTS (CONTINUED)

December 31, 2022 and 2021

NOTE I – RELATED PARTY TRANSACTIONS

In the ordinary course of business, the Bank may make loans to executive officers, directors and principal shareholders of the Bank, including their immediate families and companies in which they are principal owners. At December 31, 2022 and 2021, total loans to these persons approximated \$692,000 and \$1,114,000, respectively. Deposits by related parties held by the Bank at December 31, 2022 and 2021 were approximately \$8,310,000 and \$10,036,000, respectively.

NOTE J – STOCKHOLDERS' EQUITY AND DIVIDENDS

Federal banking regulations place certain restrictions on dividends paid by the Bank to its shareholders. Approval by the banking regulators is required if the total of all dividends declared by the Bank exceeds the total of its net profits for the year combined with its retained net profits of the preceding two years.

In addition, dividends paid by the Bank would be prohibited if the effect thereof would cause the Bank's capital to be deemed below the applicable minimum capital requirements.

NOTE K - MINIMUM REGULATORY CAPITAL REQUIREMENTS

The Bank is subject to various regulatory capital requirements administered by state and federal banking agencies. Failure to meet minimum capital requirements can initiate certain mandatory and possibly additional discretionary actions by regulators that, if undertaken, could have a direct material effect on the Bank's financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Bank must meet specific capital guidelines that involve quantitative measures of their assets, liabilities, and certain off-balance sheet items as calculated under regulatory accounting practices. The capital amounts and classification are also subject to other factors. The net unrealized gain or loss on available for sale securities is not included in computing regulatory capital. Management believes, as of December 31, 2022 and 2021, that the Bank meets all capital adequacy requirements to which it is subject.

Prompt corrective action regulations provide five classifications: well capitalized, adequately capitalized, undercapitalized, significantly undercapitalized, and critically undercapitalized, although these terms are not used to represent overall financial condition. If adequately capitalized, regulatory approval is required to accept brokered deposits. If undercapitalized, capital distributions are limited, as is asset growth and expansion, and capital restoration plans are required. At year end 2022 and 2021, the most recent regulatory notification categorized the Bank as well capitalized under the regulatory framework for prompt corrective action. There are no conditions or events since that notification that management believes have changed the institution's category.

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NOTES TO FINANCIAL STATEMENTS (CONTINUED)

December 31, 2022 and 2021

In 2019, the federal banking agencies jointly issued a final rule that provides for an optional, simplified measure of capital adequacy the community bank leverage ratio framework (“CBLR framework”), for qualifying community banking organizations, consistent with Section 201 of Economic Growth, Regulatory Relief, and Consumer Protection Act. The final rule became effective on January 1, 2020 and was elected by the Bank as of December 31, 2020. In April 2020, the federal banking agencies issued an interim final rule that makes temporary changes to the CBLR framework, pursuant to section 4012 of the Coronavirus Aid, Relief, and Economic Security (“CARES”) Act, and a second interim final rule that provides a graduated increase in the community bank leverage ratio requirement after the expiration of the temporary changes implemented pursuant to section 4012 of the CARES Act.

The community bank leverage ratio removes the requirement for qualifying banking organizations to calculate and report risk-based capital but rather only requires a Tier 1 to average assets (leverage) ratio. Qualifying banking organizations that elect to use the CBLR framework and that maintain a leverage ratio of greater than required minimums will be considered to have satisfied the generally applicable risk based and leverage capital requirements in the agencies’ capital rules (generally applicable rule) and, if applicable, will be considered to have met the well capitalized ratio requirements for purposes of section 38 of the Federal Deposit Insurance Act. Under the interim final rules, the community bank leverage ratio minimum requirement is 8.5% for calendar year 2021, and 9% for calendar year 2022 and beyond. The interim rule allows for a two-quarter grace period to correct a ratio that falls below the required amount, provided that the bank maintains a leverage ratio of 7.5% for calendar year 2021, and 8% for calendar year 2022 and beyond.

Under the final rule, an eligible banking organization can opt out of the CBLR framework and revert back to the risk-weighting framework without restriction. As of December 31, 2022, the Bank was a qualifying community banking organization as defined by the federal banking agencies and elected to measure capital adequacy under the CBLR framework.

Verus Bank of Commerce

NOTES TO FINANCIAL STATEMENTS (CONTINUED)

December 31, 2022 and 2021

Actual and required capital amounts and ratios are presented below:

	Actual		To be well capitalized under Prompt Corrective Action Regulations (CBLR Framework)	
	Amount	Ratio	Amount	Ratio
	(in thousands)			
<u>As of December 31, 2022</u>				
Tier 1 capital (to average total assets)	\$ 34,154	15.7%	\$ 19,526	9.0%
<u>As of December 31, 2021</u>				
Tier 1 capital (to average total assets)	\$ 35,876	13.7%	\$ 22,197	8.5%

Regulatory authorities can initiate certain mandatory actions if the Bank fails to meet the minimum capital requirements, which could have a direct and material effect on the Bank’s financial statements. Management believes, as of December 31, 2022, that the Bank meets all capital adequacy requirements to which it is subject, and that the Bank exceeds the minimum levels necessary to be considered “well capitalized”.

Federal banking regulations place certain restrictions on dividends paid by the Bank. Approval by federal regulators is required if the total of all dividends declared by the Bank exceeds the total of its net profits for the year combined with its retained net profits of the preceding two years.

In addition, dividends paid by the Bank would be prohibited if the effect thereof would cause the Bank's capital to be deemed below the applicable minimum capital requirements.

NOTE L – FAIR VALUE MEASUREMENT

The Bank used the following methods and significant assumptions to estimate fair value:

Impaired loans – The Bank does not record loans at fair value on a recurring basis. However, from time to time, fair value adjustments are recorded on these loans to reflect (1) partial write-downs that are based on the current appraised or market-quoted value of the underlying collateral or (2) the full charge-off of the loan carrying value. In some cases, the properties for which market quotes or appraised values have been obtained are located in areas where comparable sales data is limited, outdated, or unavailable. Fair value estimates for impaired loans are obtained from real estate brokers or other third-party consultants (Level 3).

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NOTES TO FINANCIAL STATEMENTS (CONTINUED)

December 31, 2022 and 2021

Foreclosed Real Estate – Nonrecurring adjustments to certain commercial and residential real estate properties classified as foreclosed real estate are measured at the lower of carrying amount or fair value, less costs to sell. Fair values are generally based on third party appraisals of the property, resulting in Level 3 classification. In cases where the carrying amount exceeds the fair value, less costs to sell, an impairment loss is recognized.

At December 31, 2022 and 2021, there were no collateral dependent impaired loans and no foreclosed real estate. During 2022 and 2021, there were no changes or amounts in Level 3 assets or liabilities recorded at fair value on a recurring basis.