

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

Form 10-Q

(Mark One)

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

For the quarterly period ended **June 30, 2021**

or

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

For the transition period from _____ to _____.

Commission file number: **000-54483**

BankGuam Holding Company

(Exact name of registrant as specified in its charter)

Guam
(State or other jurisdiction of
incorporation or organization)

66-0770448
(IRS Employer
Identification No.)

**P.O. Box BW
Hagåtña, Guam 96932
(671) 472-5300**

(Address, including Zip Code, and telephone number, including area code, of the registrant's principal executive offices)

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

Title of each class	Trading Symbol(s)	Name of each exchange on which registered
None	N/A	N/A

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

Title of each class	Trading Symbol(s)	Name of each exchange on which registered
Common Stock, \$0.2083 par value per share	"BKGM"	Not listed

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit such files). Yes No

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

Large accelerated filer	<input type="checkbox"/>	Accelerated filer	<input type="checkbox"/>
Non-accelerated filer	<input type="checkbox"/>	Smaller reporting company	<input checked="" type="checkbox"/>
Emerging growth company	<input type="checkbox"/>		

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

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

As of August 12, 2021, there were 9,723,465 shares outstanding

BANKGUAM HOLDING COMPANY
FORM 10-Q
QUARTERLY REPORT
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Cautionary Note Regarding Forward-Looking Statements

For purposes of this Quarterly Report, the terms the “Company,” “we,” “us” and “our” refer to BankGuam Holding Company and its subsidiaries. This Quarterly Report on Form 10-Q contains statements that are not historical in nature, are predictive in nature, or that depend upon or refer to future events or conditions or contain forward-looking statements within the meaning of Section 21E of the Securities Exchange Act of 1934, as amended, and the Private Securities Litigation Reform Act of 1995. Forward-looking statements may be preceded by, followed by or include the words “expects,” “anticipates,” “intends,” “plans,” “believes,” “seeks,” “estimates,” “will,” “is designed to” and similar expressions as well as other statements regarding our future operations, financial condition and prospects, and business strategies. We claim the protection of the safe harbor for forward-looking statements contained in the Private Securities Litigation Reform Act of 1995 for all forward-looking statements.

We have based these forward-looking statements on our current expectations and projections about future events. These forward-looking statements are subject to risks, uncertainties and assumptions about our business that could affect our future results and could cause those results or other outcomes to differ materially from those expressed or implied in the forward-looking statements. We are not able to predict all of the factors that may affect future results. These include, among other things, the following risks:

- Competition for loans and deposits and failure to attract or retain deposits and loans;
- Local, regional, national and global economic conditions, and the impact they may have on us and our customers, and our assessment of that impact on our estimates, including the allowance for loan losses and fair value measurements;
- The effects of the COVID-19 pandemic, including reduced tourism in Guam, volatility in the international and national economy and credit markets, quarantines or other travel or health-related restrictions, the length and severity of the COVID-19 pandemic and the pace of recovery following the COVID-19 pandemic;
- Risks associated with concentrations in real estate related loans;
- Changes in the level of nonperforming assets and charge-offs and other credit quality measures, and their impact on the adequacy of our allowance for loan losses and our provision for loan losses;
- The effects of and changes in trade, monetary and fiscal policies and laws, including the interest rate policies of the Federal Open Market Committee of the Federal Reserve Board; and the anticipated elimination of the London Interbank Offered Rate (“LIBOR”) as a benchmark interest rate;
- Stability of funding sources and continued availability of borrowings;
- The effect of changes in laws and regulations with which the Company and Bank of Guam must comply, including any change in Federal Deposit Insurance Corporation insurance premiums;
- Our ability to raise capital or incur debt on reasonable terms;
- Regulatory limits on Bank of Guam’s ability to pay dividends to the Company;
- The effect of changes in accounting policies and practices, as may be adopted by the regulatory agencies, as well as the Public Company Accounting Oversight Board, the Financial Accounting Standards Board and other accounting standard setters;
- Changes in the deferred tax asset valuation allowance in future quarters;
- The costs and effects of legal and regulatory developments, including resolution of legal proceedings or regulatory or other governmental inquiries, and the results of regulatory examinations or reviews;
- Our ability to increase market share and control expenses;
- Any interruption or security breach of our information systems, or the information systems of our third party service providers, resulting in failures or disruptions in customer services or confidentiality; and
- Our success in managing the risks involved in the foregoing items.

Other factors that might cause or contribute to such differences include, but are not limited to, those discussed in “Risk Factors” included in filings we make from time to time with the U.S. Securities and Exchange Commission (“SEC”), including our Quarterly Reports on Form 10-Q to be filed by us in our fiscal year ending December 31, 2021. We have no obligation to publicly update or revise any forward-looking statements, whether as a result of new information, future events or risks, except to the extent required by applicable securities laws. If we do update one or more forward-looking statements, no inference should be drawn that we will make additional updates with respect to those or other forward-looking statements. New information, future events or risks could cause the forward-looking events we discuss in this Quarterly Report not to occur. You should not place undue reliance on these forward-looking statements, which reflect our opinions only as of the date of this Quarterly Report.

PART I. FINANCIAL INFORMATION

Item 1. Condensed Consolidated Financial Statements (Unaudited)

BankGuam Holding Company
 Unaudited Condensed Consolidated Statements of Financial Condition
 (in Thousands, Except Par Value)

	June 30, 2021	December 31, 2020
<u>ASSETS</u>		
Cash and due from banks	\$ 41,947	\$ 42,875
Interest bearing deposits in banks	751,421	244,753
Total cash and cash equivalents	793,368	287,628
Restricted cash	150	150
Investment in unconsolidated subsidiary	7,744	7,719
Investment securities available-for-sale, at fair value	507,063	510,111
Investment securities held-to-maturity, at amortized cost (Fair Value \$153,563 at 6/30/2021 and \$46,911 at 12/31/2020)	153,496	46,584
Federal Home Loan Bank stock, at cost	2,814	2,335
Loans, net of allowance for loan losses (\$36,093 at 06/30/2021 and \$34,805 at 12/31/2020)	1,357,589	1,392,722
Accrued interest receivable	7,285	8,068
Premises and equipment, net	20,328	19,921
Other assets	80,019	77,123
Total assets	<u>\$ 2,929,856</u>	<u>\$ 2,352,361</u>
<u>LIABILITIES AND STOCKHOLDERS' EQUITY</u>		
Liabilities:		
Deposits:		
Non-interest bearing	\$ 1,213,264	\$ 770,037
Interest bearing	1,469,318	1,348,807
Total deposits	2,682,582	2,118,844
Accrued interest payable	58	77
Subordinated debt, net	34,745	14,777
Other liabilities	43,984	41,607
Total liabilities	2,761,369	2,175,305
Commitments and contingencies (Note 6)		
Stockholders' equity:		
Common stock \$0.2083 par value; 48,000 shares authorized; 9,754 and 9,734 shares issued and 9,723 and 9,702 shares outstanding at 6/30/2021 and 12/31/2020, respectively	2,033	2,029
Preferred stock \$100 par value; 300 shares authorized; 9.8 shares issued and outstanding	980	980
Additional paid-in capital, Common stock	24,961	24,777
Additional paid-in capital, Preferred stock	8,803	8,803
Retained earnings	144,638	137,646
Accumulated other comprehensive (loss) income	(12,638)	3,111
Common stock in treasury, at cost (32 shares)	(290)	(290)
Total stockholders' equity	168,487	177,056
Total liabilities and stockholders' equity	<u>\$ 2,929,856</u>	<u>\$ 2,352,361</u>

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

BankGuam Holding Company
Unaudited Condensed Consolidated Statements of Income
(Dollar and Share Amounts in Thousands, Except Per Share Amounts)

	<u>Three Months Ended June 30,</u>		<u>Six Months Ended June 30,</u>	
	<u>2021</u>	<u>2020</u>	<u>2021</u>	<u>2020</u>
Interest income:				
Loans	\$ 17,645	\$ 19,327	\$ 35,892	\$ 39,094
Investment securities	2,400	1,260	4,599	3,234
Deposits with banks	148	66	215	423
Total interest income	<u>20,193</u>	<u>20,653</u>	<u>40,706</u>	<u>42,751</u>
Interest expense:				
Savings deposits	112	391	214	865
Time deposits	8	21	20	38
Other borrowed funds	238	238	476	479
Total interest expense	<u>358</u>	<u>650</u>	<u>710</u>	<u>1,382</u>
Net interest income	19,835	20,003	39,996	41,369
Provision for loan losses	475	2,400	2,950	4,607
Net interest income, after provision for loan losses	<u>19,360</u>	<u>17,603</u>	<u>37,046</u>	<u>36,762</u>
Non-interest income:				
Service charges and fees	1,836	1,563	3,506	3,302
Gain on sale of investment securities	-	-	272	-
Income from merchant services, net	758	331	1,406	874
Cardholders income, net	991	143	1,245	300
Trustee fees	149	445	301	1,079
Other income	1,741	739	2,955	1,737
Total non-interest income	<u>5,475</u>	<u>3,221</u>	<u>9,685</u>	<u>7,292</u>
Non-interest expense:				
Salaries and employee benefits	8,004	7,937	16,700	17,461
Occupancy	2,132	2,126	4,261	4,282
Equipment and depreciation	3,083	2,982	6,024	5,954
Insurance	515	474	1,005	947
Telecommunications	389	372	756	714
FDIC assessment	516	324	860	603
Professional services	627	541	1,192	1,119
Contract services	719	521	1,340	1,037
Other real estate owned	13	(14)	27	14
Stationery and supplies	(48)	(2)	73	198
Training and education	40	21	84	206
General, administrative and other	1,399	1,704	2,939	3,682
Total non-interest expense	<u>17,389</u>	<u>16,986</u>	<u>35,261</u>	<u>36,217</u>
Income before income taxes	7,446	3,838	11,470	7,837
Income tax expense	1,536	1,081	2,265	1,835
Net income	5,910	2,757	9,205	6,002
Preferred stock dividend	(136)	(136)	(271)	(272)
Net income attributable to common stockholders	<u>\$ 5,774</u>	<u>\$ 2,621</u>	<u>\$ 8,934</u>	<u>\$ 5,730</u>
Earnings per common share (EPS):				
Basic and diluted EPS	<u>\$ 0.59</u>	<u>\$ 0.27</u>	<u>\$ 0.92</u>	<u>\$ 0.59</u>
Dividends declared per common share	<u>\$ 0.10</u>	<u>\$ 0.10</u>	<u>\$ 0.20</u>	<u>\$ 0.20</u>
Basic and diluted weighted average common shares	<u>9,715</u>	<u>9,682</u>	<u>9,710</u>	<u>9,678</u>

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

BankGuam Holding Company
 Unaudited Condensed Consolidated Statements of Comprehensive Income (Loss)
 (in Thousands)

	<u>Three Months Ended June 30,</u>		<u>Six Months Ended June 30,</u>	
	<u>2021</u>	<u>2020</u>	<u>2021</u>	<u>2020</u>
Net income	\$ 5,910	\$ 2,757	\$ 9,205	\$ 6,002
Other comprehensive income (loss):				
Unrealized holding gain (loss) on available-for-sale securities arising during the period, net of tax	4,898	940	(15,590)	5,509
Reclassification for (gain) realized on available-for-sale securities	-	-	(272)	-
Amortization of post-transfer unrealized holding loss on held-to-maturity securities during the period, net of tax	88	73	113	147
Total other comprehensive income (loss)	4,986	1,013	(15,749)	5,656
Total comprehensive income (loss)	<u>\$ 10,896</u>	<u>\$ 3,770</u>	<u>\$ (6,544)</u>	<u>\$ 11,658</u>

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

BankGuam Holding Company
Unaudited Condensed Consolidated Statements of Cash Flows
(in Thousands)

	Six Months Ended June 30,	
	2021	2020
Cash flows from operating activities:		
Net income	\$ 9,205	\$ 6,002
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for loan losses	2,950	4,607
Depreciation	2,065	2,020
Amortization of debt issuance costs	13	13
Amortization of fees, discounts and premiums	219	498
Gain on sales of other real estate owned, net	-	45
Proceeds from sales of loans held for sale	17,915	9,813
Origination of loans held for sale	(17,915)	(9,813)
(Increase) decrease in mortgage servicing rights	(190)	17
Gross realized gains on sale of available-for-sale securities	(272)	-
Realized gain on sale of premises and equipment	6	2
Noncash lease expense	1,463	1,381
Net change in operating assets and liabilities:		
Accrued interest receivable	783	(1,988)
Other assets	(4,174)	528
Accrued interest payable	(19)	(33)
Lease liability	(1,323)	445
Other liabilities	3,700	3,038
Net cash provided by operating activities	<u>14,426</u>	<u>16,575</u>
Cash flows from investing activities:		
Purchases of available-for-sale securities	(223,497)	(93,759)
Purchases of held-to-maturity securities	-	(16,250)
Proceeds from sales of available-for-sale securities	46,993	-
Maturities, prepayments and calls of available-for-sale securities	33,321	97,344
Maturities, prepayments and calls of held-to-maturity securities	23,623	2,069
Loan originations and principal collections, net	32,183	(89,706)
Income from equity investment in unconsolidated subsidiary	(1,180)	(432)
Dividends received from unconsolidated subsidiary	1,154	416
Cost from FHLB stock purchase	(479)	(68)
Proceeds from sales of other real estate owned	-	87
Proceeds from sales of premises and equipment	8	3
Purchases of premises and equipment	(2,480)	(2,511)
Net cash used in investing activities	<u>(90,354)</u>	<u>(102,807)</u>
Cash flows from financing activities:		
Net increase in deposits	563,738	332,700
Proceeds from issuance of subordinated debt, net	19,955	-
Proceeds from issuance of common stock	188	175
Dividends paid	(2,213)	(2,208)
Net cash provided by financing activities	<u>581,668</u>	<u>330,667</u>
Net change in cash, cash equivalents and restricted cash	505,740	244,435
Cash, cash equivalents and restricted cash at beginning of period	287,778	132,116
Cash, cash equivalents and restricted cash at end of period	<u>\$ 793,518</u>	<u>\$ 376,551</u>
Supplemental disclosure of cash flow information:		
Cash paid during the period for:		
Interest	\$ 176	\$ 819
Income taxes	\$ 3,220	\$ 2,698
Supplemental disclosure of noncash investing and financing activities:		
Net change in unrealized loss on held-to-maturity securities, net of tax	\$ 113	\$ 147
Net change in unrealized gain on available-for-sale securities, net of tax	\$ (15,862)	\$ 5,509
Transfer of securities from available-for-sale securities	\$ 130,471	\$ -
Transfer of securities to held-to-maturity securities	\$ (130,471)	\$ -

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

BankGuam Holding Company
Notes to Condensed Consolidated Financial Statements
(In thousands, except per share data)
(Unaudited)

Note 1 – Nature of Business

Organization

The accompanying condensed consolidated financial statements include the accounts of BankGuam Holding Company (“Company”) and its wholly-owned subsidiaries, Bank of Guam (“Bank”) and BankGuam Investment Services (“BGIS”). The Company is a Guam corporation organized on October 29, 2010, to act as the holding company of the Bank, a Guam banking corporation, an 18-branch bank serving the communities in Guam, the Commonwealth of the Northern Mariana Islands (CNMI), the Federated States of Micronesia (FSM), the Republic of the Marshall Islands (RMI), the Republic of Palau (ROP), and San Francisco, California. BGIS was incorporated in Guam in 2015 and initially capitalized during the first quarter of 2016. During July 2016, the Company executed an agreement to purchase up to 70% of ASC Trust LLC, formerly ASC Trust Corporation. On July 6, 2021 the Company completed its final purchase of 25% of the voting common stock of ASC Trust LLC under the agreement, as amended to date, bringing the Company’s ownership of ASC Trust LLC to 70%.

Other than holding the shares of the Bank, BGIS and ASC Trust LLC, the Company conducts no significant activities, although it is authorized, with the prior approval of its principal regulator, the Board of Governors of the Federal Reserve System (the “Federal Reserve Board”), to engage in a variety of activities related to the business of banking. Currently, substantially all of the Company’s operations are conducted and substantially all of the assets are owned by the Bank, which accounts for substantially all of our consolidated revenues, expenses and operating income. The Bank provides a variety of financial services to individuals, businesses and governments through its branches. The Bank’s headquarters is located in Hagåtña, Guam. The Bank currently has seven branches in Guam, four in the CNMI, four in the FSM, one in the RMI, one in the ROP, and one in San Francisco, California. The Bank’s primary deposit products are demand deposits, savings and time certificate accounts, and its primary lending products are consumer, commercial and real estate loans. Effective January 29, 2021, the Bank permanently closed the Dededo and Harmon branches in Guam. The COVID-19 pandemic has accelerated the adoption of digital channels by our customers, which was considered in our decision to close those branches.

For ease of reference we will sometimes refer to the Company and the Bank as “we”, “us” or “our”.

Note 2 – Summary of Significant Accounting Policies and Recent Accounting Pronouncements

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with the instructions to Form 10-Q and, therefore, do not include all footnotes that would be required for a full presentation of financial condition, results of operations, changes in cash flows and comprehensive income in accordance with generally accepted accounting principles in the United States (“GAAP”). However, these interim financial statements reflect all adjustments (consisting of normal recurring adjustments and accruals) which, in the opinion of our management, are necessary for a fair presentation of our financial condition, results of operations and cash flows for the interim periods presented.

These unaudited condensed consolidated financial statements have been prepared on a basis consistent with prior periods, and should be read in conjunction with our audited consolidated financial statements as of and for the year ended December 31, 2020, and the notes thereto, included in our Annual Report on Form 10-K for the year ended December 31, 2020, as filed with the U.S. Securities and Exchange Commission (“SEC”) under the Exchange Act on March 22, 2021.

Our condensed consolidated financial condition at June 30, 2021, and the condensed consolidated results of operations for the three and six months ended June 30, 2021, are not necessarily indicative of what our financial condition will be at December 31, 2021, or of the results of our operations that may be expected for the full year ending December 31, 2021.

Use of Estimates

The preparation of condensed consolidated financial statements in accordance with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the condensed consolidated financial statements, and the reported amounts of income and expenses during the periods presented. Actual results could differ from those estimates.

Restricted Cash

Interest-bearing deposits in banks that mature within one year are carried at cost. \$150 thousand of these deposits are held by the Bank jointly under the names of Bank of Guam and the Guam Insurance Commissioner, and serve as a bond for the Bank of Guam Trust Department.

Leases

In February 2016, the FASB issued Accounting Standards Update (“ASU”) 2016-02, “*Leases (Topic 842)*”, a new Topic which, as modified by ASU 2018-10 and ASU 2018-12, is intended to increase transparency and comparability among organizations by recognizing lease assets and lease liabilities on the balance sheet and disclosing key information about leasing arrangements on the basis that it is important that users of financial statements have a complete and understandable picture of an entity’s leasing activities. The new standard allows for several transition practical expedients. The Company elected the package of practical expedients, which permits the Company to forgo reassessing lease identification, lease classification, and initial direct costs. The Company applied the hindsight practical expedient when evaluating the lease term and assessing impairment of Right of Usage (“ROU”) assets. The Company also elected to combine the lease and non-lease components, such as maintenance fees, as a single lease component and elected to use the remaining lease term instead of total lease term in determining the incremental borrowing rate. The Company made an accounting policy election to not recognize lease liabilities and ROU assets for short-term leases, which are leases with initial terms of 12 months or less and for which there is not a purchase option that is reasonably certain to be exercised. All leases within the Company’s portfolio are classified as operating leases.

COVID-19

On March 11, 2020, the World Health Organization declared the outbreak of a novel coronavirus (“COVID-19”) as a global pandemic, which continues to spread throughout the United States and around the world. The declaration of a global pandemic indicates that almost all public commerce and related business activities may be, to varying degrees, curtailed with the goal of decreasing the rate of new infections. The outbreak of COVID-19 has adversely impacted a broad range of industries in which the Company’s customers operate and, in some instances, impaired their ability to fulfill their financial obligations to the Company. On March 3, 2020, the Federal Open Market Committee reduced the target range for federal funds by 50 basis points to 1.00% - 1.25%. This rate was further reduced to a target range of 0% - 0.25% on March 16, 2020. In September 2020, the Federal Open Market Committee announced that it will allow inflation to exceed 2% to support employment, and forecasted that the federal funds rate would remain unchanged through 2023. These reductions in interest rates and other effects of the COVID-19 outbreak had an adverse affect on the Company’s financial condition and results of operations. As a result of the spread of the COVID-19 coronavirus, economic uncertainties have negatively impacted net interest income and noninterest income.

In the United States, the government enacted the Coronavirus Aid, Relief, and Economic Security Act (the “CARES Act”) on March 27, 2020. The CARES Act, among other things, created a \$670 billion loan program (the “Paycheck Protection Program” or the “PPP”) for fully guaranteed loans (which may be forgiven) to small businesses for certain qualifying expenses. The PPP was modified and extended multiple times prior to its expiration on May 31, 2021.

Due to the Company’s concerns for the health and safety of its customers and employees, in March 2020 the Bank temporarily closed seven of its branches in Guam and one of its branches in the CNMI, and limited the number of customers allowed to be in its remaining facilities at any one time to 50. During 2020, the Bank re-opened four of its branches in Guam, while four of the branches remain closed. The Bank continues to limit the number of customers allowed in its facilities to be in compliance with local regulations related to the COVID-19 pandemic. The Bank continues to provide a secure telecommuting program for those personnel who are able to perform their responsibilities remotely, the computer hardware and software needed to support those tasks, and established teleconferencing capabilities to reduce the number of people in attendance at all of its larger group meetings. In recognition of the potential difficulties that may be faced by our commercial and consumer customers, the Bank initiated a temporary program in March 2020 under which affected customers may have their loan payments deferred or otherwise adjusted. This program applied to both commercial and consumer loans for a period of 90 days, and expired on June 30, 2020. Although these actions taken in response to the heightened risks posed by COVID-19 are costly, it is not possible at the time of this filing to estimate the final consequences of these impacts on economic performance or the results of the Company’s operations, its financial condition or its cash flows. However, despite these potential disruptions the Company has not materially changed its accounting policies or procedures due to COVID-19.

Recently Adopted Accounting Pronouncements

None.

Recently Issued but Not Yet Adopted Accounting Pronouncements

In June 2016, the FASB issued ASU 2016-13, “*Financial Instruments – Credit Losses (Topic 326)*”, to amend the standards for the measurement of credit losses on financial instruments by replacing the historical incurred loss impairment methodology of determining the level of the allowance for loan and lease losses (“ALLL”), including losses associated with available-for-sale securities, with a more decision-useful methodology that reflects expected credit losses over the life of a financial instrument based upon historical experience, current conditions, and reasonable and supportable forecasts in determining the ALLL level, as well as the reserve for off-balance-sheet credit exposures. The Company was preparing to implement ASU 2016-13 when it was scheduled to become effective January 1, 2020, but the FASB announced on October 16, 2019, a delay of the effective date for smaller reporting companies until January 1, 2023. Management expects to recognize a one-time cumulative effect adjustment to the allowance for loan losses as of the first reporting period in which the new standard is effective, but cannot yet estimate the magnitude of the adjustment or the overall impact of the new guidance on the Company’s financial position, results of operations or cash flows.

In March 2020, the FASB issued ASU 2020-04, “*Reference Rate Reform (Topic 848), Facilitation of the Effects of Reference Rate Reform on Financial Reporting*,” which provides temporary optional expedients to ease the financial reporting burdens of the expected market transition from London Interbank Offered Rate (LIBOR) to an alternative reference rate such as Secured Overnight Financing Rate (SOFR). The guidance was effective upon issuance and generally can be applied through December 31, 2022. We are currently evaluating this guidance to determine the impact of adoption on the Company.

Note 3 – Earnings Per Common Share

Basic earnings per common share represent income available to common stockholders divided by the weighted-average number of common shares outstanding during the period. Potential common shares that may be issued by the Company relate to shares subscribed but not yet issued in 2021 and 2020 under the Employee Stock Purchase Plan, and are reported as dilutive options. No shares were subscribed but not issued at June 30, 2021, and 2020.

Earnings per common share are computed based on reported net income, preferred stock dividends and the following common share data:

	<u>Three Months Ended June 30,</u>		<u>Six Months Ended June 30,</u>	
	<u>2021</u>	<u>2020</u>	<u>2021</u>	<u>2020</u>
Net income	\$ 5,910	\$ 2,757	\$ 9,205	\$ 6,002
Less preferred stock dividends	(136)	(136)	(271)	(272)
Net income attributable to common stockholders	<u>\$ 5,774</u>	<u>\$ 2,621</u>	<u>\$ 8,934</u>	<u>\$ 5,730</u>
Weighted average number of common shares outstanding - used to calculate basic and diluted earnings per common share	<u>9,715</u>	<u>9,682</u>	<u>9,710</u>	<u>9,678</u>
Earnings per common share (EPS):				
Basic and diluted EPS	<u>\$ 0.59</u>	<u>\$ 0.27</u>	<u>\$ 0.92</u>	<u>\$ 0.59</u>

Note 4 – Investment Securities

The amortized cost and fair value of investment securities, with gross unrealized gains and losses, follows:

	June 30, 2021			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Securities Available-for-Sale				
U.S. government agency and government sponsored enterprise (GSE) debt securities	\$ 254,887	\$ -	\$ (8,002)	\$ 246,885
U.S. government agency pool securities	24,236	6	(114)	24,128
U.S. government agency or GSE residential mortgage-backed securities	232,969	3,292	(211)	236,050
Total	\$ 512,092	\$ 3,298	\$ (8,327)	\$ 507,063
Securities Held-to-Maturity				
U.S. government agency and government sponsored enterprise (GSE) debt securities	\$ 143,056	\$ 433	\$ (489)	\$ 143,000
U.S. government agency pool securities	3,908	13	(34)	3,887
U.S. government agency or GSE residential mortgage-backed securities	6,532	165	(21)	6,676
Total	\$ 153,496	\$ 611	\$ (544)	\$ 153,563
	December 31, 2020			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Securities Available-for-Sale				
U.S. government agency and government sponsored enterprise (GSE) debt securities	\$ 300,440	\$ 54	\$ (2,348)	\$ 298,146
U.S. government agency pool securities	28,783	29	(206)	28,606
U.S. government agency or GSE residential mortgage-backed securities	176,912	6,447	-	183,359
Total	\$ 506,135	\$ 6,530	\$ (2,554)	\$ 510,111
Securities Held-to-Maturity				
U.S. government agency and government sponsored enterprise (GSE) debt securities	\$ 33,221	\$ 93	\$ (15)	\$ 33,299
U.S. government agency pool securities	4,515	15	(36)	4,494
U.S. government agency or GSE residential mortgage-backed securities	8,848	280	(10)	9,118
Total	\$ 46,584	\$ 388	\$ (61)	\$ 46,911

At June 30, 2021, and December 31, 2020, investment securities with a carrying value of \$542.8 million and \$360.6 million, respectively, were pledged to secure various government deposits and to meet other public requirements.

Proceeds and gross realized gains from the sales of available-for-sale investment securities for the six months ended June 30, 2021, and 2020, are shown below. There were no sales of investment securities for the three months ended June 30, 2021 and 2020.

	Six Months Ended June 30,	
	2021	2020
Proceeds from sales	\$ 46,993	\$ -
Gross realized gains from sales	\$ 272	\$ -
Gross realized losses from sales	\$ -	\$ -

The amortized cost and estimated fair value of investment securities by contractual maturity at June 30, 2021, and December 31, 2020, are shown below. Actual maturities may differ from contractual maturities because issuers may have the right to call or borrowers the right to prepay obligations with or without call or prepayment penalties. At June 30, 2021, obligations of U.S. government corporations and agencies with amortized costs totaling \$665.6 million consisted of residential mortgage-backed securities totaling \$239.5 million and Small Business Administration agency pool securities totaling \$28.1 million whose contractual maturity, or principal repayment, will follow the repayment of the underlying small business loans or mortgages. For purposes of the following table, the entire outstanding balance of these mortgage-backed securities issued by U.S. government corporations and agencies and SBA pools is categorized based on final maturity date. At June 30, 2021, the Bank estimates the average remaining life of these mortgage-backed securities and SBA pools to be approximately 3.8 years and 3.6 years, respectively.

	June 30, 2021			
	Available-for-Sale		Held-to-Maturity	
	Amortized Cost	Estimated Fair Value	Amortized Cost	Estimated Fair Value
Due within one year	\$ 7	\$ 7	\$ -	\$ -
Due after one but within five years	4,447	4,439	1,942	1,970
Due after five but within ten years	179,573	177,008	24,645	24,313
Due after ten years	328,065	325,609	126,909	127,280
Total	<u>\$ 512,092</u>	<u>\$ 507,063</u>	<u>\$ 153,496</u>	<u>\$ 153,563</u>

	December 31, 2020			
	Available-for-Sale		Held-to-Maturity	
	Amortized Cost	Estimated Fair Value	Amortized Cost	Estimated Fair Value
Due within one year	\$ 5,115	\$ 5,121	\$ 11,990	\$ 12,070
Due after one but within five years	13,255	13,432	2,325	2,358
Due after five but within ten years	129,708	131,340	26,214	26,348
Due after ten years	358,057	360,218	6,055	6,135
Total	<u>\$ 506,135</u>	<u>\$ 510,111</u>	<u>\$ 46,584</u>	<u>\$ 46,911</u>

Temporarily Impaired Securities

The following table shows the gross unrealized losses and fair value of the Company's investments with unrealized losses that are not deemed to be other-than-temporarily impaired, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position at June 30, 2021, and December 31, 2020.

	June 30, 2021					
	Less Than Twelve Months		More Than Twelve Months		Total	
	Unrealized Losses	Estimated Fair Value	Unrealized Losses	Estimated Fair Value	Unrealized Losses	Estimated Fair Value
Securities Available for Sale						
U.S. government agency and government sponsored enterprise (GSE) debt securities	\$ (8,002)	\$ 246,885	\$ -	\$ -	\$ (8,002)	\$ 246,885
U.S. government agency pool securities	(2)	625	(112)	21,720	(114)	22,345
U.S. government agency or GSE residential mortgage-backed securities	(211)	84,674	-	-	(211)	84,674
Total	\$ (8,215)	\$ 332,184	\$ (112)	\$ 21,720	\$ (8,327)	\$ 353,904

Securities Held to Maturity						
US government agency and sponsored Agencies (GSE) debt securities	\$ (489)	\$ 54,021	\$ -	\$ -	\$ (489)	\$ 54,021
U.S. government agency pool securities	-	-	(34)	2,460	(34)	2,460
U.S. government agency or GSE residential mortgage-backed securities	(12)	1,411	(9)	459	(21)	1,870
Total	\$ (501)	\$ 55,432	\$ (43)	\$ 2,919	\$ (544)	\$ 58,351

	December 31, 2020					
	Less Than Twelve Months		More Than Twelve Months		Total	
	Unrealized Losses	Estimated Fair Value	Unrealized Losses	Estimated Fair Value	Unrealized Losses	Estimated Fair Value
Securities Available for Sale						
U.S. government agency and government sponsored enterprise (GSE) debt securities	\$ (2,348)	\$ 243,089	\$ -	\$ -	\$ (2,348)	\$ 243,089
U.S. government agency pool securities	(22)	3,735	(184)	22,672	(206)	26,407
Total	\$ (2,370)	\$ 246,824	\$ (184)	\$ 22,672	\$ (2,554)	\$ 269,496

Securities Held to Maturity						
U.S. government agency and government sponsored enterprise (GSE) debt securities	\$ (15)	\$ 14,985	\$ -	\$ -	\$ (15)	\$ 14,985
U.S. government agency pool securities	-	-	(36)	2,923	(36)	2,923
U.S. government agency or GSE residential mortgage-backed securities	(10)	506	-	-	(10)	506
Total	\$ (25)	\$ 15,491	\$ (36)	\$ 2,923	\$ (61)	\$ 18,414

The investment securities that were in an unrealized loss position as of June 30, 2021, which comprised a total of 104 securities were not other-than-temporarily impaired. Specifically, the 104 securities are comprised of the following: 34 Small Business Administration Pool securities, 1 mortgage-backed security issued by Government National Mortgage Association, 23 agency securities issued by Federal Home Loan Bank (FHLB), 20 agency securities issued by Federal Home Loan Mortgage Corporation (FHLMC), 10 mortgaged-backed securities and 1 agency security issued by Federal National Mortgage Association (FNMA), and 15 agency securities issued by Federal Farm Credit Banks (FFCB).

Total gross unrealized losses were primarily attributable to changes in market interest rates, relative to when the investment securities were purchased, and not due to any change in the credit quality of the investment securities. The Company does not intend to sell the investment securities that were in an unrealized loss position and it is not likely that the Company will be required to sell the investment securities before recovery of their amortized cost, which may be at maturity. However, the Company may elect to sell certain investment securities with an unrealized loss position in its “available for sale” portfolio as needed to replenish its liquidity.

Investment in Unconsolidated Subsidiary

On July 6, 2021, with the approval of the Federal Reserve Bank of San Francisco, the Company used \$6.2 million of the proceeds from the subordinated notes totaling \$20 million that were issued on June 29, 2021, to acquire an additional 25% of the voting common stock of ASC Trust LLC at the third and final closing, pursuant to the Stock Purchase Agreement (the “Agreement”) dated May 27, 2016, between the Company and David J. John, as amended to date. This transaction brought the Company’s interest in ASC Trust LLC to 70%. The Company’s Chief Executive Officer serves on the Board of Directors of ASC Trust LLC. Another of the Company’s Board members also serves as a non-minority voting member of an entity that owns 5% of the common stock of ASC Trust LLC. The Agreement contains customary warranties, representations and indemnification provisions.

Note 5 – Loans Held for Sale, Loans and Allowance for Loan Losses

Loans Held for Sale

In its normal course of business, the Bank originates mortgage loans held for sale to the FHLMC. The Bank has elected to measure its residential mortgage loans held for sale at cost. Origination fees and costs are recognized in earnings at the time of origination. Loans are sold to FHLMC at par.

During the six months ended June 30, 2021, the Bank originated and sold \$17.9 million in FHLMC mortgage loans. During the six months ended June 30, 2020, the Bank originated and sold \$9.8 million in FHLMC loans.

Mortgage loans serviced for others are not included in the accompanying condensed consolidated statements of financial condition. The unpaid principal balances of mortgage loans serviced for others were \$188.3 million at June 30, 2021, and \$186.9 million at December 31, 2020. The increase of \$1.4 million (0.7%) during the six months ended June 30, 2021, was due to new loans, partially offset by the principal paydowns and payoffs during the period.

We retain mortgage servicing rights on mortgage loans that we sell. Such rights represent the net positive cash flows generated from the servicing of such mortgage loans and we recognize such rights as assets on our statements of financial condition based on their estimated fair values. We receive servicing fees, less any subservicing costs, on the unpaid principal balances of such mortgage loans. Those fees are collected from the monthly payments made by the mortgagors or from the proceeds of the sale or foreclosure and liquidation of the underlying real property collateralizing the loans. At June 30, 2021, and December 31, 2020, mortgage servicing rights totaled \$1.9 million and \$1.7 million, respectively, and are included in other assets in the accompanying condensed consolidated statements of financial condition. The Bank accounts for mortgage servicing rights at fair value with changes in fair value recorded as a part of service fees and charges in the condensed consolidated statements of income.

Loans

Outstanding loan balances are presented net of unearned income, deferred loan fees, and unamortized discount and premium totaling \$4.0 million at June 30, 2021, and \$4.2 million at December 31, 2020. As of June 30, 2021, our 10 largest borrowing relationships totaled \$340.2 million in commitments, or approximately 24.3% of our total gross loans compared to \$345.0 million, or approximately 24.1% at December 31, 2020. Loans subject to ASC Topic 310-30, “*Loans and Debt Securities Acquired with Deteriorated Credit Quality*,” are presented net of the related accretable yield.

The loan portfolio consisted of the following at:

	June 30, 2021		December 31, 2020	
	Amount	Percent	Amount	Percent
Commercial				
Commercial & industrial	\$ 341,060	24.4%	\$ 366,942	25.6%
Commercial mortgage	713,593	51.1%	685,138	47.9%
Commercial construction	33,605	2.4%	51,785	3.6%
Commercial agriculture	611	0.0%	629	0.0%
Total commercial	1,088,869	77.9%	1,104,494	77.1%
Consumer				
Residential mortgage	130,160	9.3%	127,371	8.9%
Home equity	2,040	0.1%	2,076	0.1%
Automobile	19,429	1.4%	19,923	1.4%
Other consumer loans ¹	157,176	11.2%	177,822	12.5%
Total consumer	308,805	22.1%	327,192	22.9%
Gross loans	1,397,674	100.0%	1,431,686	100.0%
Deferred loan (fees) costs, net	(3,992)		(4,159)	
Allowance for loan losses	(36,093)		(34,805)	
Loans, net	<u>\$ 1,357,589</u>		<u>\$ 1,392,722</u>	

¹ Comprised of other revolving credit, installment loans, and overdrafts.

Paycheck Protection Program

With the passage of the Paycheck Protection Program, or PPP, administered by the Small Business Administration, the Bank actively participated in assisting its customers with applications for resources through the program. PPP loans have either a two-year or a five-year term and earn interest at 1%. The Bank believes that the majority of these loans will ultimately be forgiven by the SBA in accordance with the terms of the program. In 2020, the Bank approved and funded over \$93.4 million in PPP loans. At June 30, 2021, the outstanding principal balance of PPP loans was \$73.6 million. As of August 6, 2021, a total of \$83.9 million in PPP loans have been forgiven, of which \$76.2 million were forgiven in 2021 and \$7.7 million in 2020. On January 13, 2021, the SBA re-opened the PPP program and began accepting applications for PPP loans. As of August 6, 2021, the Bank has approved and funded over \$56.6 million in additional PPP loans. It is the Bank's understanding that loans funded through the PPP program are fully guaranteed by the U.S. government. Should those circumstances change, the Bank could be required to establish an additional allowance for loan loss through additional credit loss expense charged to earnings.

Allowance for Loan Losses

The allowance for loan losses is evaluated on a quarterly basis by Bank management, and is based upon management's periodic review of the collectability of loans in light of historical experience, the nature and volume of the loan portfolio, adverse situations that may affect the borrower's ability to repay, estimated value of any underlying collateral, and prevailing economic conditions. This evaluation is inherently subjective, as it requires estimates that are susceptible to significant revision as more information becomes available or conditions change.

The allowance consists of allocated and general components. The allocated component relates to loans that are classified as impaired. ASC 310-10 defines an impaired loan as one for which there is uncertainty concerning collection of all principal and interest per the original contractual terms of the loan. For those loans that are classified as impaired, an allowance is established when the discounted cash flow (or the collateral value or the observable market price) of the impaired loan is lower than the carrying value of the loan. The general component covers unimpaired loans, and is estimated using a loss migration analysis based on historical charge-off experience and expected loss, given the default probability derived from the Bank's internal risk rating process. The loss migration analysis tracks twelve rolling quarters of loan loss history and industry loss factors to determine historical losses by classification category for each loan type, except certain consumer loans. These calculated loss factors are then applied to outstanding loan balances for all non-impaired loans. Additionally, a qualitative factor that is determined utilizing external economic factors and internal assessments is applied to each homogeneous loan pool. We also conduct individual loan review analyses, as part of the allowance for loan loss allocation process, applying specific monitoring policies and procedures in analyzing the existing loan portfolio.

In the three and six months ended June 30, 2021, management adjusted the economic risk factors to incorporate the current economic implications, which include reduced tourism and higher unemployment due to the COVID-19 pandemic.

Set forth below is a summary of the Bank's activity in the allowance for loan losses during the three and six months ended June 30, 2021, and 2020, and the year ended December 31, 2020:

	Three Months Ended June 30, 2021	Three Months Ended June 30, 2020	Six Months Ended June 30, 2021	Six Months Ended June 30, 2020	Year Ended December 31, 2020
Balance, beginning of period	\$ 36,283	\$ 29,065	\$ 34,805	\$ 27,870	\$ 27,870
Charged off loans	(1,160)	(1,038)	(2,756)	(2,529)	(5,628)
Recoveries on loans previously charged off	495	457	1,094	936	2,205
Provision for loan losses	475	2,400	2,950	4,607	10,358
Balance, end of period	<u>\$ 36,093</u>	<u>\$ 30,884</u>	<u>\$ 36,093</u>	<u>\$ 30,884</u>	<u>\$ 34,805</u>

Set forth below is information regarding loan balances and the related allowance for loan losses, by portfolio type, for the three and six months ended June 30, 2021, and 2020, and the year ended December 31, 2020, respectively.

	<u>Commercial</u>	<u>Residential Mortgages</u>	<u>Consumer</u>	<u>Total</u>
	(Dollars in thousands)			
Six Months Ended June 30, 2021				
Allowance for loan losses:				
Balance at beginning of period	\$ 21,213	\$ 1,990	\$ 11,602	\$ 34,805
Charge-offs	(77)	(4)	(2,675)	(2,756)
Recoveries	156	-	938	1,094
Provision	2,134	367	449	2,950
Ending balance	<u>\$ 23,426</u>	<u>\$ 2,353</u>	<u>\$ 10,314</u>	<u>\$ 36,093</u>
Allowance balance at end of period related to:				
Loans individually evaluated for impairment	\$ 3,503	\$ -	\$ 1,041	\$ 4,544
Loans collectively evaluated for impairment	19,923	2,353	9,273	31,549
Ending balance	<u>\$ 23,426</u>	<u>\$ 2,353</u>	<u>\$ 10,314</u>	<u>\$ 36,093</u>
Loan balances at end of period:				
Loans individually evaluated for impairment	\$ 61,338	\$ 2,141	\$ 1,162	\$ 64,641
Loans collectively evaluated for impairment	1,027,531	130,059	175,443	1,333,033
Ending balance	<u>\$ 1,088,869</u>	<u>\$ 132,200</u>	<u>\$ 176,605</u>	<u>\$ 1,397,674</u>
Six Months Ended June 30, 2020				
Allowance for loan losses:				
Balance at beginning of period	\$ 18,360	\$ 1,490	\$ 8,020	\$ 27,870
Charge-offs	(484)	-	(2,045)	(2,529)
Recoveries	166	-	770	936
Provision	2,259	381	1,967	4,607
Ending balance	<u>\$ 20,301</u>	<u>\$ 1,871</u>	<u>\$ 8,712</u>	<u>\$ 30,884</u>
Allowance balance at end of period related to:				
Loans individually evaluated for impairment	\$ 4,391	\$ 2	\$ 901	\$ 5,294
Loans collectively evaluated for impairment	15,910	1,869	7,811	25,590
Ending balance	<u>\$ 20,301</u>	<u>\$ 1,871</u>	<u>\$ 8,712</u>	<u>\$ 30,884</u>
Loan balances at end of period:				
Loans individually evaluated for impairment	\$ 32,867	\$ 4,183	\$ 984	\$ 38,034
Loans collectively evaluated for impairment	1,016,962	122,250	218,411	1,357,623
Ending balance	<u>\$ 1,049,829</u>	<u>\$ 126,433</u>	<u>\$ 219,395</u>	<u>\$ 1,395,657</u>
Year Ended December 31, 2020				
Allowance for loan losses:				
Balance at beginning of year	\$ 18,360	\$ 1,490	\$ 8,020	\$ 27,870
Charge-offs	(1,069)	-	(4,559)	(5,628)
Recoveries	399	-	1,806	2,205
Provision	3,523	500	6,335	10,358
Ending balance	<u>\$ 21,213</u>	<u>\$ 1,990</u>	<u>\$ 11,602</u>	<u>\$ 34,805</u>
Allowance balance at end of year related to:				
Loans individually evaluated for impairment	\$ 3,500	\$ 4	\$ 1,264	\$ 4,768
Loans collectively evaluated for impairment	17,713	1,986	10,338	30,037
Ending balance	<u>\$ 21,213</u>	<u>\$ 1,990</u>	<u>\$ 11,602</u>	<u>\$ 34,805</u>
Loan balances at end of year:				
Loans individually evaluated for impairment	\$ 36,031	\$ 2,730	\$ 1,343	\$ 40,104
Loans collectively evaluated for impairment	1,068,463	126,717	196,402	1,391,582
Ending balance	<u>\$ 1,104,494</u>	<u>\$ 129,447</u>	<u>\$ 197,745</u>	<u>\$ 1,431,686</u>

Credit Quality

The following table provides a summary of the delinquency status of the Bank's loans by portfolio type:

	30-59 Days Past Due	60-89 Days Past Due	90 Days and Greater Non- Accrual	90 Days and Greater Still Accruing	Total Past Due	Current	Total Loans Outstanding
June 30, 2021							
Commercial							
Commercial & industrial	\$ 220	\$ 126	\$ 7,645	\$ 125	\$ 8,116	\$ 332,944	\$ 341,060
Commercial mortgage	3,868	1,573	4,624	564	10,629	702,964	713,593
Commercial construction	-	-	-	-	-	33,605	33,605
Commercial agriculture	-	-	-	-	-	611	611
Total commercial	4,088	1,699	12,269	689	18,745	1,070,124	1,088,869
Consumer							
Residential mortgage	1,998	2,488	936	140	5,562	124,598	130,160
Home equity	-	-	-	-	-	2,040	2,040
Automobile	332	99	-	-	431	18,998	19,429
Other consumer ¹	1,890	963	54	931	3,838	153,338	157,176
Total consumer	4,220	3,550	990	1,071	9,831	298,974	308,805
Total	\$ 8,308	\$ 5,249	\$ 13,259	\$ 1,760	\$ 28,576	\$1,369,098	\$ 1,397,674
December 31, 2020							
Commercial							
Commercial & industrial	\$ 13,712	\$ 3,857	\$ 8,119	\$ 387	\$ 26,075	\$ 340,867	\$ 366,942
Commercial mortgage	9,183	36,562	913	471	47,129	638,009	685,138
Commercial construction	-	-	-	-	-	51,785	51,785
Commercial agriculture	-	-	-	-	-	629	629
Total commercial	22,895	40,419	9,032	858	73,204	1,031,290	1,104,494
Consumer							
Residential mortgage	4,758	1,833	1,147	129	7,867	119,504	127,371
Home equity	-	-	-	-	-	2,076	2,076
Automobile	580	184	-	43	807	19,116	19,923
Other consumer ¹	3,472	1,502	108	1,096	6,178	171,644	177,822
Total consumer	8,810	3,519	1,255	1,268	14,852	312,340	327,192
Total	\$ 31,705	\$ 43,938	\$ 10,287	\$ 2,126	\$ 88,056	\$1,343,630	\$ 1,431,686

¹ Comprised of other revolving credit, installment loans, and overdrafts.

Generally, the accrual of interest on a loan is discontinued when principal or interest payments become more than 90 days past due, unless management believes the loan is adequately collateralized and is in the process of collection, with the exception of automobile and other consumer loans which, rather than being placed on non-accrual status, are charged off once they become 120 days delinquent. When a loan is placed on non-accrual status, previously accrued but unpaid interest is reversed against current income. Subsequent collections of cash are applied as principal reductions when received, except when the ultimate collectability of principal is probable, in which case interest payments are credited to income. Non-accrual loans may be restored to accrual status when in receipt of six consecutive payments, and principal and interest become current and full repayment is expected.

The following table provides information as of June 30, 2021, and December 31, 2020, with respect to loans on non-accrual status, by portfolio type:

	<u>June 30, 2021</u>	<u>December 31, 2020</u>
	(Dollars in thousands)	
Non-accrual loans:		
Commercial		
Commercial & industrial	\$ 7,645	\$ 8,750
Commercial mortgage	37,998	6,618
Total commercial	45,643	15,368
Consumer		
Residential mortgage	\$ 1,978	\$ 2,575
Other consumer ¹	182	196
Total consumer	2,160	2,771
Total non-accrual loans	<u>\$ 47,803</u>	<u>\$ 18,139</u>

¹ Comprised of other revolving credit, installment loans, and overdrafts.

Credit Quality Indicators

The Bank uses several credit quality indicators to manage credit risk, including an internal credit risk rating system that categorizes loans into pass, special mention, substandard, formula classified, doubtful or loss categories. Credit risk ratings are applied individually to those classes of loans that have significant or unique credit characteristics and that benefit from a case-by-case evaluation. These are typically loans to businesses or individuals in the classes which comprise the commercial portfolio segment. Groups of loans that are underwritten and structured using standardized criteria and characteristics, such as statistical models (e.g., credit scoring or payment performance), are typically risk-rated and monitored collectively. These are typically loans to individuals in the classes which comprise the consumer portfolio segment.

The following are the definitions of the Bank's credit quality indicators:

Pass (A): Exceptional: Essentially risk-free credit. These are loans of the highest quality that pose virtually no risk of loss to the Bank. This includes loans fully collateralized by means of a savings account(s) and time certificate(s) of deposit, and by at least 110% of the loan amount. Borrowers should have strong financial statements, good liquidity and excellent credit.

Pass (B): Standard: Multiple, strong sources of repayment. These are loans to borrowers with a demonstrated history of financial and managerial performance. The risk of loss is considered to be low. Loans are well-structured, with clearly identified primary and readily available secondary sources of repayment. These loans may be secured by an equal amount of funds in a savings account or time certificate of deposit. These loans may also be secured by marketable collateral whose value can be reasonably determined through outside appraisals. The borrower characteristically has well supported cash flows and low leverage.

Pass (C): Acceptable: Good primary and secondary sources of repayment. These are loans to borrowers of average financial condition, stability and management expertise. The borrower should be a well-established individual or company with adequate financial resources to withstand short-term fluctuations in the marketplace. The borrower's financial ratios and trends are favorable. The loans may be unsecured or supported by non-real estate collateral for which the value is more difficult to determine, represent a reasonable credit risk and require an average amount of account officer attention. The borrower's ability to repay unsecured credit is to be of unquestionable strength.

Pass (D): Monitor: Sufficient primary sources of repayment and an acceptable secondary source of repayment. Acceptable business or individual credit, but the borrower's operations, cash flows or financial conditions carry average levels of risk. These loans are considered to be collectable in full, but may require a greater-than-average amount of loan officer monitoring. Borrowers are capable of absorbing normal setbacks without failing to meet the terms of the loan agreement.

Special Mention: A Special Mention asset has potential weaknesses that deserve a heightened degree of monitoring. These potential weaknesses may result in a deterioration of the repayment prospects for the asset or in the institution's credit position at some future date. Special Mention assets are not adversely classified and do not expose an institution to sufficient risk to warrant adverse classification. The Special Mention classification should neither be a compromise between a pass grade and substandard, nor should it be a "catch all" grade to identify any loan that has a policy exception.

Substandard: A Substandard asset is inadequately protected by the current sound worth and payment capacity of the obligor or the collateral pledged. Assets so classified must have a well-defined weakness or weaknesses that jeopardize the liquidation of the debt. Assets classified as substandard are characterized by the distinct possibility that the institution will sustain some loss if the deficiencies are not corrected.

Formula Classified: Formula Classified loans are all loans and credit cards delinquent 90 days and over which have yet to be formally classified Special Mention, Substandard or Doubtful by the Bank's Loan Committee. In most instances, the monthly formula total is comprised primarily of residential real estate loans, consumer loans, credit cards and commercial loans under \$250 thousand. However, commercial loans are typically formally classified by the Loan Committee no later than their 90-day delinquency, and those do not become part of the formula classification. Real estate loans 90-days delinquent that are in the foreclosure process, which is typically completed within another 60 days, are not formally classified during this period.

Doubtful: A loan with weaknesses well enough defined that eventual repayment in full, on the basis of currently existing facts, conditions and values, is highly questionable, even though certain factors may be present which could improve the status of the loan. The probability of some loss is extremely high, but because of certain known factors that may work to the advantage of strengthening of the assets (i.e. capital injection, perfecting liens on additional collateral, refinancing plans, etc.), its classification as an estimated loss is deferred until its more exact status can be determined.

Loss: Loans classified as "Loss" are considered uncollectible, and are either unsecured or are supported by collateral that is of little to no value. As such, their continuance as recorded assets is not warranted. While this classification does not mandate that a loan has no ultimate recovery value, losses should be taken in the period during which these loans are deemed to be uncollectible. Loans identified as loss are immediately approved for charge-off. The Bank may refer loans to outside collection agencies, attorneys, or its internal collection division to continue collection efforts. Any subsequent recoveries are credited to the Allowance for Loan Losses.

The Bank classifies its loan portfolios using internal credit quality ratings, as discussed above under *Allowance for Loan Losses*. The following table provides a summary of loans by portfolio type and the Bank's internal credit quality ratings as of June 30, 2021, and December 31, 2020:

	June 30, 2021	December 31, 2020
	(Dollars in thousands)	
Pass:		
Commercial & industrial	\$ 284,521	\$ 314,201
Commercial mortgage	651,181	626,477
Commercial construction	33,605	51,785
Commercial agriculture	611	629
Residential mortgage	126,408	123,017
Home equity	2,040	2,076
Automobile	19,429	19,880
Other consumer	156,059	176,522
Total pass loans	<u>1,273,854</u>	<u>1,314,587</u>
Special Mention:		
Commercial & industrial	20,916	6,643
Commercial mortgage	15,624	16,285
Residential mortgage	1,679	1,695
Total special mention loans	<u>38,219</u>	<u>24,623</u>
Substandard:		
Commercial & industrial	27,978	37,920
Commercial mortgage	46,066	41,654
Residential mortgage	91	433
Other consumer	5	7
Total substandard loans	<u>74,140</u>	<u>80,014</u>
Formula Classified:		
Residential mortgage	1,982	2,226
Automobile	-	43
Other consumer	1,112	1,293
Total formula classified loans	<u>3,094</u>	<u>3,562</u>
Doubtful:		
Commercial & industrial	7,645	8,178
Commercial mortgage	722	722
Total doubtful loans	<u>8,367</u>	<u>8,900</u>
Total outstanding loans, gross	<u>\$ 1,397,674</u>	<u>\$ 1,431,686</u>

Impaired Loans

A loan is considered impaired when, based on current information and events, it is probable that the Bank will be unable to collect the scheduled payments of principal and interest when due according to the original contractual terms of the loan agreement. Factors considered by management in determining impairment include payment status, collateral value, and the probability of collecting scheduled principal and interest payments when due. Loans that experience insignificant payment delays and payment shortfalls generally are not classified as impaired. Management determines the significance of payment delays and payment shortfalls on a case-by-case basis, taking into consideration all of the circumstances surrounding the loan and the borrower, including the length of the delay, the reasons for the delay, the borrower's prior payment record, and the amount of the shortfall in relation to the principal and interest owed.

Impaired loans include loans that are in non-accrual status and other loans that have been modified in Troubled Debt Restructurings (TDRs), where economic concessions have been granted to borrowers experiencing financial difficulties. These concessions typically result from the Bank's loss mitigation actions, and could include reductions in the interest rate, payment extensions, forbearance, or other actions taken with the intention of maximizing collections.

Impairment is measured on a loan-by-loan basis for commercial and real estate loans by either the present value of expected future cash flows discounted at the loan's effective interest rate, the loan's obtainable market price, or the fair value of the collateral (if the loan is collateral-dependent). Large groups of smaller-balance homogeneous loans, such as consumer loans, are collectively evaluated for impairment. Impairment reserves for these groups of consumer loans are determined using historical loss given default rates for similar loans.

The following table sets forth information regarding non-accrual loans and restructured loans, at June 30, 2021, and December 31, 2020:

	<u>June 30, 2021</u>	<u>December 31, 2020</u>
	(Dollars in thousands)	
Impaired loans:		
Restructured loans:		
Non-accruing restructured loans	\$ 35,079	\$ 4,718
Accruing restructured loans	13,897	15,937
Total restructured loans	48,976	20,655
Other impaired loans	15,665	19,450
Total impaired loans	<u>\$ 64,641</u>	<u>\$ 40,105</u>
Impaired loans less than 90 days delinquent and included in total impaired loans	<u>\$ 49,529</u>	<u>\$ 27,664</u>

The table below contains additional information with respect to impaired loans, by portfolio type, at June 30, 2021, and December 31, 2020:

	<u>Recorded Investment</u>	<u>Unpaid Principal Balance</u>	<u>Average Recorded Investment</u>	<u>Interest Income Recognized</u>
	(Dollars in thousands)			
June 30, 2021, With no related allowance recorded:				
Commercial & industrial	\$ 21,491	\$ 21,491	\$ 22,056	\$ 96
Commercial mortgage	39,761	40,008	38,786	26
Residential mortgage	91	91	92	-
Other consumer	5	5	5	-
Total impaired loans with no related allowance	<u>\$ 61,348</u>	<u>\$ 61,595</u>	<u>\$ 60,939</u>	<u>\$ 122</u>
June 30, 2021, With a related allowance recorded:				
Commercial & industrial	\$ 53	\$ 53	\$ 62	\$ -
Commercial mortgage	33	48	34	-
Residential mortgage	2,050	2,059	2,153	(22)
Other consumer	1,157	1,157	1,427	11
Total impaired loans with a related allowance	<u>\$ 3,293</u>	<u>\$ 3,317</u>	<u>\$ 3,676</u>	<u>\$ (11)</u>
December 31, 2020, With no related allowance recorded:				
Commercial & industrial	\$ 23,745	\$ 23,745	\$ 23,986	\$ 102
Commercial mortgage	11,954	12,201	9,030	45
Residential mortgage	432	432	692	-
Other consumer	7	7	7	-
Total impaired loans with no related allowance	<u>\$ 36,138</u>	<u>\$ 36,385</u>	<u>\$ 33,715</u>	<u>\$ 147</u>
December 31, 2020, With a related allowance recorded:				
Commercial & industrial	\$ 294	\$ 607	\$ 282	\$ 4
Commercial mortgage	39	54	95	-
Residential mortgage	2,298	2,308	2,887	(27)
Automobile	43	43	71	-
Other consumer	1,293	1,292	884	27
Total impaired loans with a related allowance	<u>\$ 3,967</u>	<u>\$ 4,304</u>	<u>\$ 4,219</u>	<u>\$ 4</u>

Troubled Debt Restructurings

In accordance with FASB's Accounting Standards Update No. 2011-02, "A Creditor's Determination of Whether a Restructuring is a Troubled Debt Restructuring" (ASU No. 2011-02), the Bank had \$49.0 million of troubled debt restructurings ("TDRs") as of June 30, 2021, up by \$28.3 million from \$20.7 million at December 31, 2020, primarily in commercial mortgage loans. The restructured loans recorded with the Bank have been modified for the purpose of alleviating temporary impairments to the borrower's financial condition. The modifications that the Bank has extended to borrowers have come in the form of a change in the repayment terms. The restructuring plan between the borrower and the Bank is designed to provide a bridge for cash flow shortfalls in the near term. As the borrower works through the near-term issues, in most cases, the original contractual terms will be reinstated.

The CARES Act provided guidance around the modification of loans as a result of the COVID-19 pandemic, which outlined, among other criteria, that short-term modifications made on a good faith basis to borrowers who were current as defined by 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. Borrowers are considered current under the CARES Act if they are less than 30 days past due on their contractual payments at the time a modification program is implemented.

Additional information regarding performing and nonperforming TDRs at June 30, 2021, and December 31, 2020, is set forth in the following table:

	Number of Loans	Pre- Modification Outstanding Recorded Investment	Principal Modifications	Post- Modification Outstanding Recorded Investment	Outstanding Balance	
					June 30, 2021	December 31, 2020
Performing						
Residential mortgage	-	\$ -	\$ -	\$ -	\$ -	\$ -
Commercial & industrial	6	16,440	-	16,440	13,429	-
Commercial mortgage	2	435	-	435	423	15,936
Consumer	1	49	-	49	45	-
Total performing	9	16,924	-	16,924	13,897	15,936
Nonperforming						
Commercial & industrial	1	176	-	176	103	-
Commercial mortgage	10	37,408	-	37,408	34,976	4,671
Consumer	-	-	-	-	-	48
Total nonperforming	11	37,584	-	37,584	35,079	4,719
Total Troubled Debt Restructurings (TDRs)	20	\$ 54,508	\$ -	\$ 54,508	\$ 48,976	\$ 20,655

Principal modification includes principal forgiveness at the time of modification, contingent principal forgiveness granted over the life of the loan based on borrower performance.

In an effort to constructively work with borrowers affected by the COVID-19 pandemic, the Bank initiated a temporary program in March 2020 to allow for 90-day deferrals for residential mortgage and commercial loans upon request from the borrower, and a 90-day deferral for all consumer and automobile loans. The Bank did not identify these loans that were deferred and were over 30 days delinquent as TDRs. The Bank identified a specific reserve for consumer loans totaling \$3.4 million at June 30, 2021. The Bank also increased its environmental factors for the reserve to account for the effects of the COVID-19 pandemic.

There were no defaults on troubled debt restructurings following the modification during the six months ended June 30, 2021 and 2020.

The Bank has one significant borrowing relationship in bankruptcy totaling \$7.6 million at June 30, 2021. The Bank has calculated a specific reserve within the allowance for this borrowing relationship in bankruptcy in the amount of \$3.5 million, and believes it has sufficient collateral for the remaining amount. As a result, the Bank's management believes that at June 30, 2021, there is sufficient coverage to protect the Bank's exposure to this relationship.

Note 6 – Commitments and Contingencies

The Bank is involved in certain legal actions and claims that arise in the ordinary course of business. Management believes that, as a result of its legal defenses and insurance arrangements, none of these matters is expected to have a material adverse effect on the Bank's, BGIS's or the Company's financial condition, results of operations or cash flows.

Note 7 – Regulatory Capital Requirements

The Bank is subject to various regulatory capital requirements administered by the United States 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, BGIS's and the Company's condensed consolidated financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Bank must meet specific capital guidelines that involve quantitative measures of their assets, liabilities and certain off-balance-sheet items, as calculated under regulatory accounting practices.

Quantitative measures established by regulation to ensure capital adequacy require the Bank to maintain minimum amounts and ratios (set forth in the following table) of Total and Tier 1 capital (as defined in the regulations) to risk weighted assets (as defined) and of Tier 1 capital (as defined) to average assets (as defined). As of June 30, 2021, and December 31, 2020, the Bank met all capital adequacy requirements to which it is subject.

As of June 30, 2021, the Bank's capital ratios each exceeded the Federal Deposit Insurance Corporation's well capitalized standards under the regulatory framework for prompt corrective action. To be categorized as well capitalized, an institution must maintain minimum Total risk-based, Tier 1 risk-based and Tier 1 leverage ratios as set forth in the following table. There are no conditions or events since the Bank's last regulatory examination that management believes have changed the Bank's category. The Bank continues to receive a large influx of deposits from the federal relief programs due to the COVID-19 pandemic resulting in an increase of approximately \$554.2 million in its average assets at June 30, 2021 to \$2.87 billion from \$2.31 billion in December 31, 2020, which had an adverse impact on its ratio of Tier 1 capital to average assets. Management believes that the Bank has the capacity to absorb the growth in total assets, and the tools needed to move deposits off of its balance sheet through its Trust services to continue to be above the well capitalized standards under the regulatory framework for prompt corrective action.

The Company's actual capital amounts and ratios as of June 30, 2021, and December 31, 2020, are presented in the table below.

	Actual		For Capital Adequacy Purposes		To Be Well Capitalized Under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
At June 30, 2021:						
Total capital (to Risk Weighted Assets)	\$ 233,763	16.056%	\$ 116,476	8.000%	\$ 145,594	10.000%
Tier 1 capital (to Risk Weighted Assets)	\$ 180,342	12.387%	\$ 87,357	6.000%	\$ 116,476	8.000%
Tier 1 capital (to Average Assets)	\$ 180,342	6.277%	\$ 114,931	4.000%	\$ 143,664	5.000%
Common Equity Tier 1 Capital (to Risk Weighted Assets)	\$ 170,560	11.715%	\$ 65,518	4.500%	\$ 94,636	6.500%
At December 31, 2020:						
Total capital (to Risk Weighted Assets)	\$ 206,381	14.307%	\$ 115,401	8.000%	\$ 144,252	10.000%
Tier 1 capital (to Risk Weighted Assets)	\$ 173,141	12.003%	\$ 86,551	6.000%	\$ 115,401	8.000%
Tier 1 capital (to Average Assets)	\$ 173,141	7.466%	\$ 92,765	4.000%	\$ 115,956	5.000%
Common Equity Tier 1 Capital (to Risk Weighted Assets)	\$ 163,359	11.325%	\$ 64,913	4.500%	\$ 93,764	6.500%

Note 8 – Off-Balance-Sheet Activities

The Bank is a party to credit-related financial instruments with off-balance-sheet risk to meet the financing needs of its customers in the normal course of business. These financial instruments include commitments to extend credit, standby letters of credit, and commercial letters of credit. Such commitments involve, to varying degrees, elements of credit and interest rate risk in addition to the amount reflected in the condensed consolidated financial statements.

The Bank's exposure to credit loss, in the event of nonperformance by the other parties to financial instruments for loan commitments and letters of credit, is represented by the contractual amount of these instruments. The Bank follows the same credit policies in making commitments and conditional obligations as it does for on-balance-sheet instruments.

A summary of financial instruments with off-balance-sheet risk at June 30, 2021, and December 31, 2020, is as follows:

	June 30, 2021	December 31, 2020
Commitments to extend credit	\$ 174,473	\$ 159,405
Letters of credit:		
Standby letters of credit	\$ 55,633	\$ 52,827
Commercial letters of credit	2,264	2,574
Total	\$ 57,897	\$ 55,401

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. The commitments for some lines of credit may expire without being drawn upon. Therefore, 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 it is deemed necessary by the Bank upon extension of credit, is based on management's credit evaluation of the customer.

Commercial and standby letters of credit are conditional commitments issued by the Bank to guarantee the performance of a customer to a third party or the shipment of merchandise from a third party. These letters of credit are primarily issued to support public and private borrowing arrangements. The majority of all letters of credit issued have expiration dates within one year. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loan facilities to customers, and similar credit underwriting standards are applied. The Bank generally holds collateral supporting those commitments.

The Bank considers its standby and other letters of credit to be payment guarantees. At June 30, 2021, the maximum undiscounted future payments that the Bank could be required to make for all outstanding letters of credit were \$57.9 million. All of these arrangements mature within one year. The Bank has recourse to recover from the customer any amounts paid under these guarantees. Most of the guarantees are fully collateralized; however, several are unsecured. The Bank had recorded \$45 thousand in reserve liabilities associated with these guarantees at June 30, 2021.

Note 9 – Income Taxes

We record an amount equal to the tax credits, tax loss carry-forwards and tax deductions ("tax benefits") that we believe will be available to offset or reduce the amounts of income taxes in future periods as a deferred tax asset on our condensed consolidated statements of financial condition. Under applicable federal and state income tax laws and regulations in the United States, such tax benefits will expire if not used within specified periods of time. Accordingly, the ability to fully use the deferred tax asset depends on the amount of taxable income that we generate during those time periods. At least once each year, or more frequently if warranted, we make an estimates of future taxable income that we believe we are likely to generate during those future periods. If we conclude, on the basis of those estimates and the amount of the tax benefits available to us, that it is more likely than not that we will be able to fully utilize those tax benefits prior to their expiration, we recognize the deferred tax asset in full on our balance sheet. On the other hand, if we conclude on the basis of those estimates and the amount of the tax benefits available to us that it has become more likely than not that we will be unable to utilize those tax benefits in full prior to their expiration, then we would establish a (or increase any existing) valuation allowance to reduce the deferred tax asset on our balance sheet to the amount which we believe we are more likely than not to be able to utilize. Such a reduction is implemented by recognizing a non-cash charge that would have the effect of increasing the provision, or reducing any credit, for income taxes that we would otherwise have recorded in our condensed consolidated statements of income. The determination of whether and the extent to which we will be able to utilize our deferred tax asset involves significant management judgments and assumptions that are subject to period-to-period changes as a result of changes in tax laws, changes in the market, or economic conditions that could affect our operating results or variances between our actual operating results and our projected operating results, as well as other factors.

A valuation allowance of \$588 thousand and \$1.3 million has been provided at June 30, 2021, and December 31, 2020, respectively, to reduce the deferred tax asset because, in management's opinion, it is more likely than not that less than the entire amount will be realized. The portion of the deferred tax asset with valuation allowance is attributable to a cumulative net operating loss carry forward from the Bank's CNMI operations, which losses management anticipates will continue. The charge from the net operating loss has already been realized in the accompanying condensed consolidated statements of income as a result of the Guam income tax code.

The difference between the effective income tax expense and the income tax expense computed at the Guam statutory rate of 21% was due to nontaxable interest income earned on loans to the Government of Guam.

In addition to filing a federal income tax return in Guam, the Bank files income tax returns in the CNMI and the State of California. The Bank is no longer subject to U.S. federal, state and local, or non-U.S. income tax examinations by tax authorities for years before 2012.

Note 10 – Fair Value Measurements

The Bank uses fair value measurements to record fair value adjustments to certain assets and liabilities and to determine fair value disclosures. In accordance with ASC Topic 820 "*Fair Value Measurements and Disclosures*", the fair value of a financial instrument is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Fair value is best determined based upon quoted market prices. However, in many instances there are no quoted market prices for the Bank's various financial instruments. In cases where quoted market prices are not available, fair values are based on estimates using present value or other valuation techniques. Those techniques are significantly affected by the assumptions used, including the discount rate and estimates of future cash flows. Accordingly, the fair value estimates may not be realized in an immediate settlement of the instrument. The fair value guidance of ASC Topic 820 provides a consistent definition of fair value, which focuses on exit price in an orderly transaction (that is, not a forced liquidation or distressed sale) between market participants at the measurement date under then-current market conditions. If there has been a significant decrease in the volume and level of activity for the asset or liability, a change in valuation technique or the use of multiple valuation techniques may be appropriate. In such instances, determining the price at which willing market participants would transact at the measurement date under then-current market conditions depends on the facts and circumstances, and requires the use of significant judgment. The fair value is a reasonable point within the range that is most representative of fair value under then-current market conditions.

Fair Value Hierarchy

In accordance with the guidance of ASC Topic 820, the Bank groups its financial assets and financial liabilities generally measured 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 fair value.

Level 1: Valuation is based on quoted prices in active markets for identical assets or liabilities that the reporting entity has the ability to access at the measurement date. Level 1 assets and liabilities generally include debt and equity securities that are traded in an active exchange market, as well as certain U.S. Treasury securities that are highly liquid and are actively traded in over-the-counter markets. Valuations are obtained from readily available pricing sources for market transactions involving identical assets or liabilities.

Level 2: Valuation is based on inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly. The valuation may be based on 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 for substantially the full term of the asset or liability.

Level 3: Valuation is based on unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets and liabilities. Level 3 assets and liabilities include financial instruments whose value is determined using pricing models, discounted cash flow methodologies, or similar techniques, as well as instruments for which determination of fair value requires significant management judgment or estimation.

A financial instrument's categorization within the valuation hierarchy is based upon the lowest level of input that is significant to the fair value measurement.

Financial assets measured at fair value on a recurring basis as of June 30, 2021, and December 31, 2020, are as follows:

	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total
At June 30, 2021				
U.S. treasury notes and bonds	\$ -	\$ -	\$ -	\$ -
U.S. government agency and government sponsored enterprise (GSE) debt securities	-	246,885	-	246,885
U.S. government agency pool securities	-	24,128	-	24,128
U.S. government agency or GSE	-	236,050	-	236,050
Total fair value of available-for-sale securities	-	507,063	-	507,063
Other assets:				
MSRs	-	-	1,873	1,873
Total fair value	<u>\$ -</u>	<u>\$ 507,063</u>	<u>\$ 1,873</u>	<u>\$ 508,936</u>
At December 31, 2020				
U.S. treasury notes and bonds	\$ 5,005	\$ -	\$ -	\$ 5,005
U.S. government agency and government sponsored enterprise (GSE) debt securities	-	293,142	-	293,142
U.S. government agency pool securities	-	28,606	-	28,606
U.S. government agency or GSE	-	183,358	-	183,358
Total fair value of available-for-sale securities	5,005	505,106	-	510,111
Other assets:				
MSRs	-	-	1,683	1,683
Total fair value	<u>\$ 5,005</u>	<u>\$ 505,106</u>	<u>\$ 1,683</u>	<u>\$ 511,794</u>

There were no liabilities measured at fair value on a recurring basis as of June 30, 2021, and December 31, 2020.

For the periods ended June 30, 2021, and December 31, 2020, the changes in Level 3 assets measured at fair value on a recurring basis are as follows:

	June 30, 2021	December 31, 2020
Beginning balance	\$ 1,683	\$ 1,704
Realized and unrealized net losses:		
Included in net income	190	(21)
Ending balance	<u>\$ 1,873</u>	<u>\$ 1,683</u>

The valuation technique used for Level 3 mortgage servicing rights (“MSRs”) is their discounted cash flow. Inputs considered in determining Level 3 pricing include the anticipated prepayment rates, discount rates, and cost to service. Significant increases or decreases in any of those inputs in isolation would result in a significantly lower or higher fair value measurement.

The following table presents quantitative information about the valuation technique and unobservable inputs applied to Level 3 fair value measurements for financial instruments measured at fair value on a recurring basis:

	Estimated Fair Value	Valuation Technique	Unobservable Inputs	Range of Inputs	Weighted Average Rate
June 30, 2021					
Financial instrument:					
MSRs	<u>\$ 1,873</u>	Discounted Cash Flow	Discount Rate	6.06% - 7.74%	6.30%
			Weighted Average Prepayment Rate (Public Securities Association)	125%	
December 31, 2020					
Financial instrument:					
MSRs	<u>\$ 1,683</u>	Discounted Cash Flow	Discount Rate	6.06% - 7.74%	6.30%
			Weighted Average Prepayment Rate (Public Securities Association)	125%	

There were no transfers into or out of the Bank's Level 3 financial instruments for the periods ended June 30, 2021, and December 31, 2020.

Nonrecurring Fair Value Measurements

Under certain circumstances, the Bank makes adjustments to fair value for assets and liabilities even though they are not measured at fair value on an ongoing basis. The Bank did not have any financial instruments carried on the consolidated statements of financial condition by caption and by level in fair value hierarchy for a nonrecurring change in fair value at June 30, 2021, and December 31, 2020, respectively.

The fair value of loans subject to write downs is estimated using the appraised value of the underlying collateral, discounted as necessary due to management's estimates of changes in economic conditions.

Additionally, the Bank also makes adjustments to nonfinancial assets and liabilities even though they are not measured at fair value on an ongoing basis. The Bank does not have nonfinancial assets or liabilities for which a nonrecurring change in fair value has been recorded during the periods ended June 30, 2021, and December 31, 2020.

The following methods and assumptions were used by the Bank in estimating fair value disclosures for financial instruments:

Cash and Cash Equivalents

The carrying amount of cash and short-term instruments approximates fair value based on the short-term nature of the assets.

Interest-Bearing Deposits in Banks

Fair values for other interest-bearing deposits are estimated using discounted cash flow analyses based on current interest rates or yields for similar types of deposits.

Federal Home Loan Bank Stock

The Bank is a member of the FHLB of Des Moines. As a member, we are required to own stock of the FHLB, the amount of which is based primarily on the level of our borrowings from that institution. We also have the right to acquire additional shares of stock in the FHLB; however, to date, we have not done so. It is not practicable to determine the fair value of FHLB stock due to restrictions placed on its transferability.

Investment Securities

When quoted prices are available in an active market, the Bank classifies the securities within Level 1 of the valuation hierarchy. Level 1 securities include U.S. Treasury notes and bonds.

If quoted market prices are not available, the Bank estimates fair values using pricing models and discounted cash flows that consider standard input factors such as observable market data, benchmark yields, interest rate volatilities, broker/dealer quotes, and credit spreads. Examples of such instruments, which would generally be classified within Level 2 of the valuation hierarchy, include U.S. GSE obligations, U.S. government agency pool securities, and other securities. Mortgage-backed securities are included in Level 2 if observable inputs are available. In certain cases where there is limited activity or less transparency around inputs to the valuation, the Bank would classify those securities in Level 3. At June 30, 2021, and December 31, 2020, the Bank did not have any Level 3 investment securities.

Loans

For variable-rate loans that re-price frequently and with no significant change in credit risk, fair values are based on carrying values. Fair values for other loans are estimated using discounted cash flow analyses, based upon interest rates currently being offered for loans with similar terms to borrowers of similar credit quality. Fair values for nonperforming loans are estimated using discounted cash flow analyses or underlying collateral values, where applicable. Loans are classified in Level 3.

Mortgage Servicing Rights

The fair value of MSR is determined using models which depend on estimates of prepayment rates, discount rates and costs to service. MSR is classified in Level 3.

Deposit Liabilities

The fair values disclosed for demand deposits (for example, interest and non-interest checking, passbook savings and certain types of money market accounts) are, by definition, equal to the amount payable on demand at the reporting date (that is, their carrying amounts). Fair values for fixed-rate certificates of deposit are estimated using a discounted cash flow calculation that applies current market interest rates on comparable instruments to a schedule of aggregated expected monthly maturities on time deposits. Deposit liabilities are classified in Level 3.

Short-Term Borrowings

The carrying amounts of federal funds purchased and FHLB advances maturing within ninety days approximate their fair values. We had no outstanding short-term borrowings at June 30, 2021, and December 31, 2020.

Long-Term Borrowings

The fair value of FHLB advances maturing after ninety days is determined based on expected present value techniques using current market interest rates for advances with similar terms and remaining maturities. We had no outstanding long-term borrowings at June 30, 2021, and December 31, 2020.

Accrued Interest

The carrying amount of accrued interest approximates fair value.

Off-Balance Sheet Commitments and Contingent Liabilities

Management does not believe it is practicable to provide an estimate of fair value for off-balance sheet commitments or contingent liabilities because of the uncertainty involved in attempting to assess the likelihood and timing of a commitment being drawn upon, coupled with a lack of an established market for these instruments and the wide diversity of fee structures.

Fair Value of Other Financial Instruments

The estimated fair values of the Bank's financial instruments, excluding those assets recorded at fair value on a recurring basis on the Bank's condensed consolidated statements of financial condition, are as follows:

	Carrying Amount	Estimated fair value		
		Level 1	Level 2	Level 3
(Dollars in thousands)				
June 30, 2021				
Financial assets:				
Cash and cash equivalents	\$ 793,368	\$ 793,368	\$ -	\$ -
Restricted cash	150	150	-	-
Federal Home Loan Bank stock	2,814	-	2,814	-
Investment securities held-to-maturity	153,496	-	153,563	-
Loans, net	1,357,589	-	-	1,405,140
Total	<u>\$ 2,307,417</u>	<u>\$ 793,518</u>	<u>\$ 156,377</u>	<u>\$ 1,405,140</u>
Financial liabilities:				
Deposits	2,682,582	-	-	2,694,806
Total	<u>\$ 2,682,582</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 2,694,806</u>
December 31, 2020				
Financial assets:				
Cash and cash equivalents	\$ 287,628	\$ 287,628	\$ -	\$ -
Restricted cash	150	150	-	-
Federal Home Loan Bank stock	2,335	-	2,335	-
Investment securities held-to-maturity	46,584	-	46,911	-
Loans, net	1,392,722	-	-	1,441,402
Total	<u>\$ 1,729,419</u>	<u>\$ 287,778</u>	<u>\$ 49,246</u>	<u>\$ 1,441,402</u>
Financial liabilities:				
Deposits	\$ 2,118,844	\$ -	\$ -	\$ 2,130,361
Total	<u>\$ 2,118,844</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 2,130,361</u>

Note 11 – Comprehensive Income (Loss)

The components of accumulated other comprehensive income (loss), included in stockholders' equity, are as follows:

	June 30, 2021	December 31, 2020
Net unrealized (loss) gain on available-for-sale securities	\$ (4,758)	\$ 4,241
Amounts reclassified from AOCI for (gain) on sale of investment securities available-for-sale included in net income	(272)	(265)
Tax effect	1,057	(835)
Unrealized holding (loss) gain on available-for-sale securities, net of tax	(3,973)	3,141
Gross unrealized holding loss on held-to-maturity securities	(8,778)	(285)
Amortization of unrealized holding loss on held-to-maturity during the period	113	255
Unrealized holding loss on held-to-maturity securities	(8,665)	(30)
Accumulated other comprehensive (loss) income	<u>\$ (12,638)</u>	<u>\$ 3,111</u>

Note 12 – Leases

The Bank leases certain land, office spaces, and storage spaces. Leases with an initial term of 12 months or less are not recorded on the balance sheet. Instead, the Bank recognizes lease expense for these leases on a straight-line basis over the lease term.

Most leases include one or more options to renew, with renewal terms that can extend the lease term from one to 50 years or more. The exercise of lease renewal options is at our sole discretion. The depreciable life of assets and leasehold improvements are limited by the expected lease terms, unless there is a transfer of title or purchase option reasonably certain of exercise.

Certain of our lease agreements include rental payments based on a percentage of the prevailing market value of the lease and the average of the Treasury Bill Rate and the Guam Consumer Price Index figure, and others include rental payments adjusted periodically for inflation. The Bank's lease agreements do not contain any material residual value guarantees or material restrictive covenants.

The Bank leases certain facilities from two separate entities in which two of its directors have separate ownership interests. Lease payments made to these entities during the six months ended June 30, 2021 and 2020, approximated \$205 thousand and \$149 thousand, respectively. During the three months ended June 30, 2021 and 2020, lease payments made to these entities approximated \$143 thousand and \$89 thousand, respectively.

Additionally, the Bank leases office space to third parties, with original lease terms ranging from 1 to 3 years with option periods ranging up to 12 years. At June 30, 2021, minimum future rents to be received under non-cancelable operating sublease agreements were \$21 thousand, \$38 thousand, and \$26 thousand for the periods ending December 31, 2021, 2022, and 2023, respectively.

The cash flow from operating leases included in the measurement of lease liabilities during the six months ended June 30, 2021 and 2020, were each \$1.8 million, respectively.

The following table summarizes the lease-related assets and liabilities recorded as part of other assets and other liabilities, respectively, in our condensed consolidated statements of financial condition at June 30, 2021, and December 31, 2020:

	June 30, 2021	December 31, 2020
Assets		
Operating lease right-of-use assets	\$ 24,651	\$ 26,113
Total lease assets	<u>\$ 24,651</u>	<u>\$ 26,113</u>
Liabilities		
Current		
Operating	\$ 2,213	\$ 2,510
Noncurrent		
Operating	23,086	24,112
Total lease liabilities	<u>\$ 25,299</u>	<u>\$ 26,622</u>

The operating lease costs and variable lease costs were \$959 thousand and \$1.9 million during the three and six months ended June 30, 2021, respectively, and \$976 thousand and \$1.9 million during the three and six months ended June 30, 2020, respectively.

The following table provides the maturities of lease liabilities at June 30, 2021:

	Operating Leases (a)	Total
2021	\$ 1,642	\$ 1,642
2022	2,780	2,780
2023	2,532	2,532
2024	2,420	2,420
2025	2,288	2,288
After 2025	35,569	35,569
Total lease payments	<u>47,231</u>	<u>47,231</u>
Less: Interest (b)	21,932	21,932
Present value of lease liabilities (c)	<u>\$ 25,299</u>	<u>\$ 25,299</u>

Note: For leases commencing prior to 2019, minimum lease payments exclude payments to landlords for real estate taxes and common area maintenance.

- (a) Operating lease payments include \$21.5 million related to options to extend lease terms that are reasonably certain of being exercised.
- (b) Calculated using the incremental borrowing rate based on the lease term for each lease.
- (c) Includes the current portion of \$2.2 million for operating leases.

The following table provides the weighted-average lease term and discount rate at June 30, 2021:

	<u>June 30, 2021</u>	<u>December 31, 2020</u>
Weighted-average remaining lease term (years)		
Operating leases	25.1	24.6
Weighted-average discount rate		
Operating leases	4.12%	4.09%

Note 13 – Subordinated Debt

On June 29, 2021, the Company issued \$20.0 million in aggregate principal amount of its 4.75% Fixed-to-Floating Rate Subordinated Notes due July 1, 2031 (the “2031 Notes”).

The 2031 Notes have a ten-year term and initially bear interest at a fixed annual rate of 4.75%. Beginning July 1, 2026, the interest rate will reset quarterly to the then-current three-month SOFR plus 413 basis points. The Company is required to pay interest semi-annually during the fixed period, and quarterly during the floating rate period. The principal sum of the 2031 Notes plus any unpaid interest are due on the maturity date.

On June 27, 2019, the Company issued \$15.0 million in aggregate principal amount of its 6.35% Fixed-to-Floating Rate Subordinated Notes due June 30, 2029 (the “2029 Notes” and together with the 2031 Notes, the “Notes”).

The 2029 Notes have a ten-year term and initially bear interest at a fixed annual rate of 6.35%. Beginning June 30, 2024, the interest rate will reset quarterly to the then-current three-month LIBOR plus 466 basis points. The Company is required to pay interest only semi-annually during the fixed period, and quarterly during the floating rate period. The principal sum of the 2029 Notes plus any unpaid interest are due on the maturity date.

Both notes are unsecured, subordinated obligations of the Company only and are not obligations of, and are not guaranteed by, any subsidiary of the Company. The Notes rank junior in right to payment to the Company’s current and future senior indebtedness.

Note 14 – Subsequent Events

On July 6, 2021, with the approval of the Federal Reserve Bank of San Francisco, the Company used \$6.2 million of the proceeds from the 2031 Notes to acquire an additional 25% of the stock of ASC Trust LLC at the third and final closing pursuant to the 2016 Stock Purchase Agreement between the Company and David J. John. The Company intends to use the remainder of the proceeds from the 2031 Notes for general corporate purposes.

Management has reviewed the events occurring through the date of this report, and other than the aforementioned transaction, there were no subsequent events that require additional disclosure to the accompanying financial statements.

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

The following discussion provides information about the results of operations, financial condition, liquidity, and capital resources of the Company and its wholly-owned subsidiaries, the Bank and BGIS. This information is intended to facilitate the understanding and assessment of significant changes and trends related to our financial condition and the results of operations. This discussion and analysis should be read in conjunction with our condensed consolidated financial statements and the accompanying notes presented elsewhere in this Quarterly Report.

Overview

BankGuam Holding Company (the “Company”) is a Guam corporation organized on October 29, 2010, to act as a holding company of Bank of Guam (the “Bank”), a 18-branch bank serving the communities in Guam, the Commonwealth of the Northern Mariana Islands (“CNMI”), the Federated States of Micronesia (“FSM”), the Republic of the Marshall Islands (“RMI”), the Republic of Palau (“ROP”), and San Francisco, California. On August 15, 2011, the Company acquired all of the outstanding common stock of the Bank in a holding company formation transaction.

In August 2015, the Company chartered a second subsidiary, BankGuam Investment Services (“BGIS”), in an effort to enhance the options and opportunities of our customers to build future income and wealth. BGIS is a registered investment company, primarily involved in providing investment advisory services and trading securities for its customers.

In May 2016, the Company entered into a Stock Purchase Agreement (the “Agreement”) to acquire up to 70% of ASC Trust LLC, formerly ASC Trust Corporation, a Guam trust company. In July 2016, subsequent to the approval of the Federal Reserve Bank of San Francisco in June 2016, the first purchase of 25% of ASC Trust LLC was completed. In July 2019, the Company completed the second purchase of an additional 20% of ASC Trust LLC, bringing its ownership to 45%. As stated in *Note 4 – Investment Securities*, and with the approval of the Federal Reserve Bank of San Francisco, an additional 25% of ASC Trust LLC was purchased by the Company in July 2021. This transaction brought the Company’s ownership of ASC Trust LLC to 70%, and completes the transactions contemplated by the Agreement. ASC Trust LLC is primarily involved in administering 401(k) retirement plans and other employee benefit programs for its customers.

Other than holding the shares of the Bank, BGIS and ASC Trust LLC, the Company conducts no significant activities, although it is authorized, with the prior approval of its principal regulator, the Board of Governors of the Federal Reserve System, to engage in a variety of activities related to the business of banking. Currently, substantially all of the Company’s operations are conducted and substantially all of its assets are owned by the Bank, which accounts for substantially all of our consolidated revenues, expenses and operating income. The Bank’s headquarters is located in Hagåtña, Guam, and the Bank provides a variety of financial services to individuals, businesses and government entities through its branch network. The Bank’s primary deposit products are demand deposits, savings and time certificates of deposit, and its primary lending products are consumer, commercial and real estate loans. The Bank also provides many other financial services to its customers. Effective January 29, 2021, the Bank closed the Dededo and Harmon branches in Guam. These two branches have not operated since March 2020 as a result of the COVID-19 measures. The Bank has been adding digital channels to its product delivery system for several years. The COVID-19 pandemic accelerated the adoption of those digital channels by our customers, which was considered in our decision to close those branches.

The COVID-19 pandemic and resulting governmental responses impacted our operations in 2020 and 2021. See “Note 2 – Summary of Significant Accounting Policies – COVID-19” for discussion.

Summary of Operating Results

The following table provides unaudited comparative information with respect to our results of operations for the three and six months ended June 30, 2021, and 2020, respectively:

	Three Months Ended June 30,			Six Months Ended June 30,		
	2021 Amount	2020 Amount	% Change	2021 Amount	2020 Amount	% Change
Interest income	\$ 20,193	\$ 20,653	-2.2%	\$ 40,706	\$ 42,751	-4.8%
Interest expense	358	650	-44.9%	710	1,382	-48.6%
Net interest income, before provision for loan losses	19,835	20,003	-0.8%	39,996	41,369	-3.3%
Provision for loan losses	475	2,400	-80.2%	2,950	4,607	-36.0%
Net interest income, after provision for loan losses	19,360	17,603	10.0%	37,046	36,762	0.8%
Non-interest income	5,475	3,221	70.0%	9,685	7,292	32.8%
Non-interest expense	17,389	16,986	2.4%	35,261	36,217	-2.6%
Income before income taxes	7,446	3,838	94.0%	11,470	7,837	46.4%
Income tax expense	1,536	1,081	42.1%	2,265	1,835	23.4%
Net income	\$ 5,910	\$ 2,757	114.4%	\$ 9,205	\$ 6,002	53.4%
Earnings per common share (EPS):						
Basic and diluted EPS	\$ 0.59	\$ 0.27		\$ 0.92	\$ 0.59	

As the above table indicates, our net income increased in the three and six months ended June 30, 2021, as compared to the corresponding periods in 2020. In the three months ended June 30, 2021, we recorded net income after taxes of \$5.9 million, an increase of \$3.2 million (or 114.4%) as compared to the same period in 2020. The primary reasons for the increase were the \$2.3 million increase in non-interest income, a \$2.0 million reversal in provision for loan losses, partially offset by the \$168 thousand decrease in net interest income, and an increase of \$403 thousand in non-interest expense. The increase in non-interest income is largely due to the \$1.3 million increase in merchant and cardholder net income, and the \$579 thousand increase in income from the Company's investment in ASC Trust LLC. The reversal in the provision for loan losses in June 2021 was due to declining risk in the loan portfolio, resulting from the decreases in the delinquency ratio, and net charge-offs, and a declining consumer loan portfolio.

In the six months ended June 30, 2021, we recorded \$9.2 million in net income, an increase of \$3.2 million (or 53.4%) from \$6.0 million during the same period in 2020. The primary reasons for the increase were an increase of \$2.4 million in non-interest income, a \$1.7 million reduction in the provision for loan losses, and a reduction of \$956 thousand in non-interest expense, partially offset by a reduction in net-interest income by \$1.4 million. The increase in non-interest income is primarily due to the \$1.5 million increase in merchant and cardholder net income, and the \$748 thousand increase in income from the Company's investment in ASC Trust LLC. The reduction in the provision for loan losses is primarily due to the \$2.0 million reversal in June 2021.

The following table shows the decrease in our net interest margin in the three and six months ended June 30, 2021, and it also indicates the impact that the increase in our net income had on our annualized returns on average assets and average equity. Our return on average equity increased by 8.07% and 3.93%, respectively, during the three and six months ended June 30, 2021, as compared to the corresponding period in 2020, and our return on average assets increased by 33 basis points and 13 basis points during the same comparative periods, primarily due to the increase in net income, partially offset by the increase in average assets:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2021	2020	2021	2020
Net interest margin	2.86%	3.77%	3.15%	4.12%
Return on average assets	0.82%	0.49%	0.69%	0.56%
Return on average equity	14.45%	6.39%	10.98%	7.05%

Critical Accounting Policies

The Company's significant accounting policies are set forth in Note 2 in the Notes to the Company's Annual Report on Form 10-K for 2020 filed with the SEC on March 22, 2021, and Note 2 of Item 1 in this report. Our unaudited condensed consolidated financial statements are prepared in accordance with generally accepted accounting principles in the United States of America ("GAAP") and general practices in the banking industry. Certain of those accounting policies are considered critical accounting policies because they require us to make assumptions and judgments regarding circumstances or trends that could affect the carrying values of our material assets, such as assumptions regarding economic conditions or trends that could impact our ability to fully collect our outstanding loans or ultimately realize the carrying values of certain of our other assets, such as securities that are available for sale. If adverse changes were to occur in the events, trends or other circumstances on which our assumptions or judgments have been based, or other unanticipated events were to happen that might affect our operating results, it could become necessary under GAAP for us to reduce

the carrying values of the affected assets in our condensed consolidated statements of financial condition. In addition, because reductions in the carrying values of assets are sometimes effectuated by or require charges to income, such reductions also may have the effect of reducing our income.

Results of Operations

Net Interest Income

Net interest income, the primary component of the Bank's income, refers to the difference between the interest earned on loans, investment securities and other interest-earning assets, and the interest paid on deposits and other borrowed funds. Our interest income and interest expense are affected by a number of factors, some of which are outside of our control, including national and local economic conditions, the monetary policies of the Federal Reserve's Open Market Committee which affect interest rates, competition in the marketplace for loans and deposits, the demand for loans and the ability of borrowers to meet their payment obligations. Net interest income, when expressed as a percentage of average earning assets, is a banking organization's "net interest margin."

The following table sets forth our interest income, interest expense and net interest income, and our annualized net interest margin for the three and six months ended June 30, 2021, and 2020, respectively:

	Three Months Ended June 30,			Six Months Ended June 30,		
	2021	2020	% Change	2021	2020	% Change
Interest income	20,193	\$ 20,653	-2.23%	\$ 40,706	\$ 42,751	-4.78%
Interest expense	358	650	-44.92%	710	1,382	-48.63%
Net interest income	<u>19,835</u>	<u>\$ 20,003</u>	-0.84%	<u>\$ 39,996</u>	<u>\$ 41,369</u>	-3.32%
Net interest margin	2.86%	3.77%	-0.91%	3.15%	4.12%	-0.98%

Net interest income decreased by 0.84% and 3.32%, respectively for the three and six months ended June 30, 2021, as compared to the corresponding periods in 2020.

For the three and six months ended June 30, 2021, net interest income decreased by \$168 thousand and \$1.4 million, respectively, as compared to the same period in 2020. Total interest income decreased by \$460 thousand due to decreases of \$1.7 million in earnings on loans, partially offset by \$1.1 million in interest income from investment securities during the three months ended June 30, 2021, compared to the previous year. The decrease is primarily due to the 150 basis points (1.50%) cut in March 2020. The reduction in our net interest margin was the result of a decrease of 0.98% in the yield on our average earning assets in the three months ended June 30, 2021, as compared to the corresponding period of 2020, the effect of which was partially offset by an increase in our average earning assets of 30.5% compared to the same comparative period. Total interest income decreased by \$2.0 million in the six months ended June 30, 2021, compared to the previous year because of the reduction of \$3.2 million in loan interest earnings, partially offset by \$1.4 million in earnings on investment securities compared to the corresponding period of 2020.

On March 3, 2020, the Federal Open Market Committee reduced the target federal funds rate by 50 basis points to 1.00% - 1.25%. This rate was further reduced to a target range of 0% - 0.25% on March 16, 2020. In September 2020, the Federal Open Market Committee announced that it will allow inflation to exceed 2% to support employment, and forecasted that the federal funds rate would remain unchanged through 2023. These reductions in interest rates and other effects of the COVID-19 outbreak have had an adverse effect on the Company's financial condition and results of operations. As a result of the spread of the COVID-19 coronavirus, economic uncertainties have risen which are likely to continue to negatively impact net interest income.

Average Balances

Distribution, Rate and Yield

The following table sets forth information regarding our average balance sheet, annualized yields on interest-earning assets and interest rates on interest-bearing liabilities, the interest rate spread and the interest rate margin for the three and six months ended June 30, 2021, and 2020:

	Three Months Ended June 30,					
	2021			2020		
	Average Balance	Interest Earned/Paid	Average Yield/Rate	Average Balance	Interest Earned/Paid	Average Yield/Rate
Interest earning assets:						
Short term investments ¹	\$ 733,908	\$ 148	0.08%	\$ 329,301	\$ 66	0.08%
Investment Securities ²	627,809	2,400	1.53%	419,259	1,260	1.20%
Loans ³	1,407,787	17,645	5.01%	1,374,079	19,327	5.63%
Total earning assets	2,769,504	20,193	2.92%	2,122,639	20,653	3.89%
Noninterest earning assets	121,873			126,741		
Total assets	<u>\$ 2,891,377</u>			<u>\$ 2,249,380</u>		
Interest-bearing liabilities:						
Interest-bearing checking accounts	\$ 346,348	\$ 26	0.03%	\$ 291,953	\$ 76	0.10%
Savings accounts	1,140,536	86	0.03%	1,009,511	315	0.12%
Certificates of deposit	28,653	8	0.11%	25,025	21	0.34%
Subordinated debt	21,667	238	4.39%	14,762	238	6.45%
Total interest-bearing liabilities	1,537,204	358	0.09%	1,341,251	650	0.19%
Non-interest bearing liabilities	1,190,614			735,413		
Total liabilities	2,727,818			2,076,664		
Stockholders' equity	163,559			172,716		
Total liabilities and stockholders' equity	<u>\$ 2,891,377</u>			<u>\$ 2,249,380</u>		
Net interest income		<u>\$ 19,835</u>			<u>\$ 20,003</u>	
Interest rate spread			<u>2.82%</u>			<u>3.70%</u>
Net interest margin			<u>2.86%</u>			<u>3.77%</u>

	Six Months Ended June 30,					
	2021			2020		
	Average Balance	Interest Earned/Paid	Average Yield/Rate	Average Balance	Interest Earned/Paid	Average Yield/Rate
Interest earning assets:						
Short term investments ¹	\$ 533,633	\$ 215	0.08%	\$ 238,846	\$ 423	0.35%
Investment securities ²	592,848	4,599	1.55%	425,217	3,234	1.52%
Loans ³	1,416,142	35,892	5.07%	1,341,941	39,094	5.83%
Total earning assets	2,542,623	40,706	3.20%	2,006,004	42,751	4.26%
Noninterest earning assets	127,742			121,207		
Total assets	<u>\$ 2,670,365</u>			<u>\$ 2,127,211</u>		
Interest-bearing liabilities:						
Interest-bearing checking accounts	\$ 334,843	\$ 50	0.03%	\$ 289,424	\$ 162	0.11%
Savings accounts	1,110,466	164	0.03%	945,108	703	0.15%
Certificates of deposit	28,757	20	0.14%	25,831	38	0.29%
Subordinated debt	18,333	476	5.19%	14,758	479	6.49%
Total interest-bearing liabilities	1,492,399	710	0.10%	1,275,121	1,382	0.22%
Non-interest bearing liabilities	1,010,358			681,927		
Total liabilities	2,502,757			1,957,048		
Stockholders' equity	167,608			170,163		
Total liabilities and stockholders' equity	<u>\$ 2,670,365</u>			<u>\$ 2,127,211</u>		
Net interest income		<u>\$ 39,996</u>			<u>\$ 41,369</u>	
Interest rate spread			<u>3.11%</u>			<u>4.05%</u>
Net interest margin			<u>3.15%</u>			<u>4.12%</u>

¹ Short term investments consist of interest-bearing deposits that we maintain with other financial institutions.

² Includes all investment securities in the Available-for-Sale and the Held-to-Maturity classifications. The Bank did not own any tax exempt securities during 2021 and 2020.

³ Loans include the average balance of non-accrual loans. Loan interest income includes loan fees of \$1.0 million and \$2.2 million in the three and six months ended June 30, 2021, respectively, and \$775 thousand and \$1.4 million in the three and six months ended June 30, 2020, respectively.

For the three and six months ended June 30, 2021, our total average earning assets increased by \$646.9 million and \$536.6 million, respectively, as compared to the same period in 2020. The increase during the three months ended June 30, 2021, compared to the same period in 2020, is attributed to the \$404.6 million increase in our average short term investments, a \$208.6 million increase in our average investment securities, and a \$33.7 million increase in our average loan portfolio. Average noninterest earning assets decreased by \$4.9 million. In the three and six months ended June 30, 2021, average total interest-bearing liabilities increased by \$196.0 million and \$217.3 million, respectively, in comparison to the same period in 2020. In the three months ended June 30, 2021, the increase was comprised of the \$131.0 million increase in average savings accounts, a \$54.4 million increase in average interest-bearing checking accounts, a \$6.9 million increase in subordinated debt, and a \$3.6 million increase in average certificate of deposit accounts. The overall increase in average interest-bearing liabilities resulted from an increase in our deposit base, primarily in consumer savings, and government checking and savings accounts as result of the funds received by depositors from the CARES Act. This was supplemented by an increase of \$455.2 million in average non-interest bearing liabilities during the three months ended June 30, 2021, compared to the same period in 2020, primarily in traditional checking accounts, moderated an overall increase of \$545.7 million in average total liabilities. During the three and six months ended June 30, 2021, average stockholders' equity decreased by \$9.2 million (5.3%) and \$2.6 million (1.5%), respectively, in comparison to the year-earlier period.

Our interest rate spread decreased by 94 basis points (0.94%), and our net interest margin decreased by 98 basis points (0.98%) in the six months ended June 30, 2021, as compared to the same period in 2020. During the six months ended June 30, 2021, the decrease in our interest rate spread is attributed to the 106 basis points (1.06%) decrease in the average yield on our interest earning assets, from 4.26% to 3.20%, partially offset by the decrease in the average rate on our interest-bearing liabilities by 12 basis points from 0.22% to 0.10%. The decrease in our interest income is primarily due to the 150 basis point (1.50%) rate cut in March 2020 by the Federal Open Market Committee. This impacted our loan portfolio, investment securities, and short term deposits in other banks, including the Federal Reserve Bank of San Francisco.

The following table provides information regarding the changes in interest income and interest expense, attributable to changes in rates and changes in volumes, that contributed to the total change in net interest income for the three and six months ended June 30, 2021, in comparison to the three and six months ended June 30, 2020:

	Three Months Ended June 30, 2021 vs. 2020		
	(In thousands)		
	Net Change in Interest Income/Expense	Attributable to:	
		Change in Rate	Change in Volume
Interest income:			
Short term investments	\$ 82	\$ 2	\$ 80
Investment securities	1,140	1,371	(231)
Loans	(1,682)	(8,418)	6,736
Total interest income	(460)	(7,045)	6,585
Interest expense:			
Interest-bearing checking accounts	(50)	(216)	166
Savings accounts	(229)	(956)	727
Certificates of deposit	(13)	(56)	43
Other borrowings	-	(303)	303
Total interest expense	(292)	(1,531)	1,239
Net interest income	<u>\$ (168)</u>	<u>\$ (5,514)</u>	<u>\$ 5,346</u>

	Six Months Ended June 30, 2021 vs. 2020		
	(In thousands)		
	Net Change in Interest Income/Expense	Attributable to:	
		Change in Rate	Change in Volume
Interest income:			
Short term investments	\$ (208)	\$ (654)	\$ 446
Investment securities	1,365	129	1,236
Loans	(3,202)	(10,165)	6,963
Total interest income	(2,045)	(10,690)	8,645
Interest expense:			
Interest-bearing checking accounts	(112)	(238)	126
Savings accounts	(539)	(1,127)	588
Certificates of deposit	(18)	(40)	22
Other borrowings	(3)	(192)	189
Total interest expense	(672)	(1,597)	925
Net interest income	<u>\$ (1,373)</u>	<u>\$ (9,093)</u>	<u>\$ 7,720</u>

Provision for Loan Losses

We maintain allowances for probable loan losses that are incurred as a normal part of the banking business. As more fully discussed in Note 5 of the notes to the unaudited condensed consolidated financial statements in Item 1 of this Quarterly Report on Form 10-Q, an allowance for loan losses has been established by management in order to provide for those loans which, for a variety of reasons, may not be repaid in their entirety. The allowance is maintained at a level considered by management to be adequate to provide for probable losses that are accrued as of the balance sheet date and based on methodologies applied on a consistent basis with the prior year. Management's review of the adequacy of the allowance includes, among other things, loan growth, changes in the composition of the loan portfolio, an analysis of past loan loss experience and management's evaluation of the loan portfolio under current economic conditions.

The allowance for loan losses is based on estimates, and ultimate losses will vary from current estimates. The Bank recognizes that credit losses will be experienced and the risk of loss will vary with, among other things: general economic conditions; the type of loan being made; the credit worthiness of the borrower over the term of the loan; and, in the case of a collateralized loan, the quality and valuation of the collateral for such loan. The allowance for loan losses represents the Bank's best estimate of the allowance necessary to provide for probable losses in the portfolio as of the balance sheet date.

If management determines that it is necessary to increase the allowance for loan losses, a provision for loan losses is recorded. For the three months ended June 30, 2021, the Bank's provision for loan losses was \$475 thousand, which was \$1.9 million lower than the corresponding period of 2020. For the six months ended June 30, 2021, the Bank's provision for loan losses was \$2.9 million, which was \$1.7 million lower than during the corresponding period of 2020. The primary reason for the decrease in the provision for loan losses in both periods was due to the \$2.0 million reversal in June 30, 2021 due to declining risk in the loan portfolio resulting from the decreases in the delinquency ratio, and net charge-offs, and a declining consumer loan portfolio. In the three and six months ended June 30, 2021, management adjusted the economic risk factors to incorporate the current economic conditions, which includes fluctuations in tourism and unemployment due to the COVID-19 pandemic.

Management believes that the provision recorded was sufficient to offset the incremental risk of loss inherent in the gross loan portfolio of \$1.40 billion at June 30, 2021, a decrease of \$34.0 million from December 31, 2020. The allowance for loan losses at June 30, 2021, was at \$36.0 million or 2.58% of total gross loans outstanding as of the balance sheet date, an increase of \$1.3 million from December 31, 2020. We recorded net loan charge-offs of \$665 thousand and \$1.7 million for the three and six months ended June 30, 2021. See "Analysis of Allowance for Loan Losses" in the Financial Condition Section of Management's Discussion and Analysis of Financial Condition and Results of Operations for more detailed information.

Non-Interest Income

The table below represents the major components of non-interest income and the changes therein for the three and six months ended June 30, 2021, and 2020:

	Three Months Ended June 30,				Six Months Ended June 30,			
	2021	2020	Amount	Percent	2021	2020	Amount	Percent
	Amount	Amount	Change	Change	Amount	Amount	Change	Change
Non-interest income								
Service charges and fees	\$ 1,836	\$ 1,563	\$ 273	17.5%	\$ 3,506	\$ 3,302	\$ 204	6.2%
Gain on sale of investment securities	-	-	-	0.0%	272	-	272	100.0%
Income from merchant services, net	758	331	427	129.0%	1,406	874	532	60.9%
Income from cardholders, net	991	143	848	593.0%	1,245	300	945	315.0%
Trustee fees	149	445	(296)	-66.5%	301	1,079	(778)	-72.1%
Other income	1,741	739	1,002	135.6%	2,955	1,737	1,218	70.1%
Total non-interest income	<u>\$ 5,475</u>	<u>\$ 3,221</u>	<u>\$ 2,254</u>	70.0%	<u>\$ 9,685</u>	<u>\$ 7,292</u>	<u>\$ 2,393</u>	32.8%

For the three months ended June 30, 2021, non-interest income totaled \$5.5 million, which represented an increase of \$2.3 million (70.0%) as compared to the three months ended June 30, 2020. The increase during the three months ended June 30, 2021, is primarily attributed to the increases in income of \$848 thousand from net income from merchant services, \$1.0 million from other income, of which \$579 thousand is from income from ASC, \$427 thousand from net income from merchant services, and \$273 thousand from service charges and fees, partially offset by \$296 thousand from trustee fees.

For the six months ended June 30, 2021, non-interest income totaled \$9.7 million, which was an increase of \$2.4 million (32.8%) as compared to the six months ended June 30, 2020. The increase during the six months ended June 30, 2021, is primarily attributed the \$1.2 million from other income, of which \$748 thousand is from income from ASC Trust LLC, and increases of \$945 thousand in net income from cardholders, \$532 thousand in net income from merchant services, \$272 thousand from gain on sale of investment securities, and \$204 thousand in service charges and fees, partially offset by \$778 thousand from trustee fees.

Non-interest Expense

The table below represents the major components of non-interest expense and the changes for the three and six months ended June 30, 2021 and 2020:

	Three Months Ended June 30,				Six Months Ended June 30,			
	2021 Amount	2020 Amount	Amount Change	Percent Change	2021 Amount	2020 Amount	Amount Change	Percent Change
Non-interest expense:								
Salaries and employee benefits	\$ 8,004	\$ 7,937	\$ 67	0.8%	\$ 16,700	\$ 17,461	\$ (761)	-4.4%
Occupancy	2,132	2,126	6	0.3%	4,261	4,282	(21)	-0.5%
Equipment and depreciation	3,083	2,982	101	3.4%	6,024	5,954	70	1.2%
Insurance	515	474	41	8.6%	1,005	947	58	6.1%
Telecommunications	389	372	17	4.6%	756	714	42	5.9%
FDIC insurance assessment	516	324	192	59.3%	860	603	257	42.6%
Professional services	627	541	86	15.9%	1,192	1,119	73	6.5%
Contract services	719	521	198	38.0%	1,340	1,037	303	29.2%
Other real estate owned	13	(14)	27	-192.9%	27	14	13	92.9%
Stationery and supplies	(48)	(2)	(46)	2300.0%	73	198	(125)	-63.1%
Training and education	40	21	19	90.5%	84	206	(122)	-59.2%
General, administrative and other	1,399	1,704	(305)	-17.9%	2,939	3,682	(743)	-20.2%
Total non-interest expense	<u>\$ 17,389</u>	<u>\$ 16,986</u>	<u>\$ 403</u>	<u>2.4%</u>	<u>\$ 35,261</u>	<u>\$ 36,217</u>	<u>\$ (956)</u>	<u>-2.6%</u>

For the three months ended June 30, 2021, non-interest expense totaled \$17.4 million, which was an increase of \$403 thousand (2.4%) as compared to the same period in 2020. The increase is attributed to the increases of \$198 thousand increase in contract services, \$192 thousand in the FDIC insurance assessment, \$101 thousand in equipment and depreciation, \$86 thousand in professional services, and \$67 thousand in salaries and employee benefits, partially offset by a decrease of \$305 thousand in general, administrative, and other expenses, primarily due to the decrease of \$302 thousand in advertising expenses as compared to the corresponding period.

For the six months ended June 30, 2021, non-interest expense totaled \$35.3 million, which represented a decrease of \$956 thousand (2.6%) as compared to the same period in 2020. The decreases are primarily attributed to the \$761 thousand decrease in salaries and employee benefits, \$743 thousand decrease in general, administrative, and other expense, the \$125 thousand decrease in stationery and supplies, and the \$122 thousand decrease in training and education. The decrease in salaries and employee benefits is largely due to the cost recovery from the origination costs from processing the PPP loan originations in accordance with ASC 310-20, "Nonrefundable fees and Other Costs", while the decrease in general, administrative and other expense is primarily due to reduction in advertising expenses. These expenses were offset by an increase of \$303 thousand in contract services, and \$257 thousand in the FDIC insurance assessment. The decrease in general, administrative and other expenses are primarily due to reduction of \$442 thousand in advertising expense, \$221 thousand in public relations expense, and \$111 thousand in postage and mail expenses.

The Bank has some discretionary capital expenditures that have been temporarily delayed as result of COVID-19. Some of these planned expenditures may be reassessed due to our customers converting to electronic banking channels.

Income Tax Expense

For the three and six months ended June 30, 2021, the Bank recorded income tax expenses of \$1.5 million and \$2.3 million, respectively. The expense for the three and six months ended June 30, 2021, was \$455 thousand and \$430 thousand higher, respectively, than the income tax expense recorded for the corresponding periods in 2020.

Financial Condition

Assets

As of June 30, 2021, total assets were \$2.93 billion, an increase of 24.6% from the \$2.35 billion at December 31, 2020. This \$577.5 million increase was comprised largely of the \$506.7 million increase in interest bearing deposits in banks, a \$103.9 million increase in our net investment securities portfolio, and a \$2.9 million in other assets, partially offset by the reduction of \$35.1 million in net loans. The decrease in net loans and the increase in total assets resulted in the proportion of net loans to total assets decreasing from 59.2% at December 31, 2020, to 46.3% at June 30, 2021. The growth in assets was associated with the \$563.7 million increase in total deposits as a result of the various funds received by depositors from the CARES Act, a \$20.0 million increase in subordinated debt, a \$2.4 million increase in other liabilities, and a \$7.0 million increase in retained earnings, partially offset by the \$15.7 million decrease in accumulated other comprehensive loss, which is due to the increase in market rates.

Interest-Earning Assets

The following table sets forth the composition of our interest-earning assets at June 30, 2021, as compared to December 31, 2020:

	June 30, 2021	December 31, 2020	Variance
Interest-earning deposits with financial institutions (including restricted cash)	\$ 751,571	\$ 244,903	\$ 506,668
Federal Home Loan Bank stock, at cost	2,814	2,335	479
Investment securities available-for-sale	507,063	510,111	(3,048)
Investment securities held-to-maturity	153,496	46,584	106,912
Loans, gross	1,397,674	1,431,686	(34,012)
Total interest-earning assets	<u>\$ 2,812,618</u>	<u>\$ 2,235,619</u>	<u>\$ 576,999</u>

Loans

Commercial & industrial loans are loans to businesses to finance capital purchases and improvements, or to provide cash flow for operations. Commercial mortgage loans include loans secured by real property for purposes such as the purchase or improvement of that property, wherein repayment is derived from the income generated by the real property or from business operations. Residential mortgage loans are loans to consumers to finance the purchase, improvement, or refinance of real property secured by 1-4 family housing units. Consumer loans include loans to individuals to finance personal needs and are either closed- or open-ended loans. Automobile loans fall under the consumer loan category, but the bulk of consumer loans is typically unsecured extensions of credit such as credit card debt and personal signature loans.

A summary of the balances of loans at June 30, 2021, and December 31, 2020, follows:

	June 30, 2021		December 31, 2020	
	Amount	Percent	Amount	Percent
Commercial				
Commercial & industrial	\$ 341,060	24.4%	\$ 366,942	25.6%
Commercial mortgage	713,593	51.1%	685,138	47.9%
Commercial construction	33,605	2.4%	51,785	3.6%
Commercial agriculture	611	0.0%	629	0.0%
Total commercial	<u>1,088,869</u>	<u>77.9%</u>	<u>1,104,494</u>	<u>77.1%</u>
Consumer				
Residential mortgage	130,160	9.3%	127,371	8.9%
Home equity	2,040	0.1%	2,076	0.1%
Automobile	19,429	1.4%	19,923	1.4%
Other consumer loans ¹	157,176	11.2%	177,822	12.5%
Total consumer	<u>308,805</u>	<u>22.1%</u>	<u>327,192</u>	<u>22.9%</u>
Gross loans	<u>1,397,674</u>	<u>100.0%</u>	<u>1,431,686</u>	<u>100.0%</u>
Deferred loan (fees) costs, net	(3,992)		(4,159)	
Allowance for loan losses	(36,093)		(34,805)	
Loans, net	<u>\$ 1,357,589</u>		<u>\$ 1,392,722</u>	

¹ Comprised of other revolving credit, installment loans, and overdrafts.

At June 30, 2021, total gross loans decreased by \$34.0 million, to \$1.398 billion, from \$1.432 billion at December 31, 2020. The decrease in loans was largely attributed to a \$18.4 million decrease in total consumer loans, to \$308.8 million at June 30, 2021, from \$327.2 million at December 31, 2020. The underlying decreases were comprised of other consumer loans by \$20.6 million, and automobile by \$494 thousand, partially offset by \$2.8 million in residential mortgage. In addition, commercial loans decreased by \$15.6 million to \$1.09 billion at June 30, 2021, from \$1.10 billion at December 31, 2020. The underlying decrease was primarily due to the decreases of \$25.9 million in commercial & industrial loans, and \$18.2 million in commercial construction, partially offset by the increase of \$28.5 million in commercial mortgage loans.

In recognition of the potential difficulties that may be faced by our commercial, real estate and consumer customers due to the COVID-19 pandemic, the Bank initiated a temporary program in March 2020 under which affected commercial and consumer customers that may have their loan payments deferred or otherwise adjusted for a period of up to 90 days. This temporary program ended on June 30, 2020. The Bank continues to process commercial and consumer deferral requests on a case-by-case basis.

With the passage of the Paycheck Protection Program, administered by the Small Business Administration, the Bank actively participated in assisting its customers with applications for resources through the program. PPP loans have either a two-year or five-year term and earn interest at 1%. The Bank believes that the majority of these loans will ultimately be forgiven by the SBA in accordance with the terms of the program. In 2020, the Bank approved and funded over \$93.4 million in PPP loans. At June 30, 2021, the outstanding principal balance of PPP loans was at \$73.6 million. As of August 6, 2021, a total of \$83.9 million in PPP loans have been forgiven, of which \$76.2 million were forgiven in 2021 and \$7.7 million in 2020. On January 13, 2021, the SBA re-opened the PPP program and began accepting applications for PPP loans until the program ended on May 31, 2021. As of August 6, 2021, the Bank has approved and funded over \$56.6 million in additional PPP loans in 2021. It is the Bank's understanding that loans funded through the PPP program are fully guaranteed by the U.S. government. Should those circumstances change, the Bank could be required to establish an additional allowance for loan loss through additional credit loss expense charged to earnings.

At June 30, 2021, loans outstanding were comprised of approximately 67.75% in variable rate loans and 32.25% in fixed rate loans.

Since it first opened in 1972, the Bank has expanded its operations and its branch network, first in Guam, then in the other islands of our region and in San Francisco, California. In the interests of enhancing performance and stability through market and industry diversification, the Bank has increased its focus on growth in the San Francisco area in recent years, adding personnel with experience and expertise in the Bay Area. The following table provides figures for gross loans in the Bank's administrative regions for June 30, 2021, and December 31, 2020:

	June 30, 2021	December 31, 2020
Guam	\$ 743,383	\$ 775,687
Commonwealth of the Northern Mariana Islands	\$ 139,280	\$ 145,150
The Freely Associated States of Micronesia *	\$ 86,976	\$ 92,901
California	\$ 428,035	\$ 417,948
Total	\$ 1,397,674	\$ 1,431,686

* The Freely Associated States (FAS) are comprised of the Federated States of Micronesia (Chuuk, Kosrae, Pohnpei and Yap), the Republic of the Marshall Islands and the Republic of Palau.

As the table indicates, the Bank's total gross loans decreased by 2.38% during the six months ended June 30, 2021. By way of comparison, loans in Guam decreased by \$32.3 million, or 4.2%, during the six months ended June 30, 2021. Loans in the Commonwealth of the Northern Mariana Islands decreased by \$5.9 million, or 4.0%, and the Freely Associated States of Micronesia decreased by \$5.9 million, or 6.4%, during the same period. In the California region loans increased by \$10.1 million, or 2.4%, during the six months ended June 30, 2021, as the California region provided continued support for the expansion of the Bank.

Interest-Earning Deposits and Investment Securities

In the current lending and interest rate environment, and in order to maintain sufficient liquidity in the ordinary course of business, and to account for disbursement of the funds received from the CARES Act, the Bank held \$751.4 million in unrestricted interest-earning deposits with financial institutions at June 30, 2021, an increase of \$506.7 million, or 207.0%, from the \$244.8 million in such deposits at December 31, 2020. This significant increase is the result of the various funds received by depositors from the CARES Act, which were held in cash balances with the Federal Reserve Bank at the end of the reporting period. From December 31, 2020, to June 30, 2021, the Bank's combined investment portfolio increased by \$103.9 million, or 18.7%, from \$556.7 million to \$660.6 million. The growth in the investment portfolio was comprised of a \$106.9 million increase in our holdings of held-to-maturity securities, which increased by 229.5%, from \$46.6 million to \$153.5 million, partially offset by a \$3.0 million decrease in available-for-sale securities, which decreased by 0.6%, from \$510.1 million to \$507.1 million. The increase in the held-to-maturity portfolio was a result of a classification transfer totaling \$130.5 million on April 30, 2021 from the available-for-sale portfolio. This

transfer was done to mitigate the risk to the quarterly market valuation on the available-for-sale portfolio when rates rise. Management believes that the Bank maintains an adequate level of liquidity.

Nonperforming Loans and Other Nonperforming Assets

Nonperforming loans consist of (i) loans on non-accrual status because we have ceased accruing interest on these loans; (ii) loans 90 days or more past due and still accruing interest; and (iii) restructured loans. Other nonperforming assets consist of real estate properties (OREO) that have been acquired through foreclosure or similar means and which management intends to offer for sale. Loans are placed on non-accrual status when, in the opinion of management, the full and timely collection of principal or interest is in doubt. Generally, the accrual of interest is discontinued when principal or interest payment becomes 90 days past due, unless the loan is adequately collateralized and the loan is in the process of collection. When a loan is placed in non-accrual status, accrued but unpaid interest is reversed against current income. Subsequently, when payments are received on such loans, the amounts are applied to reduce principal, except when the ultimate collectability of principal is probable, in which case accrued loans may be restored to accrual status when principal and interest becomes current and full repayment is expected. Interest income is recognized on an accrual basis for impaired loans not meeting the non-accrual criteria.

The following table contains information regarding our nonperforming assets as well as restructured loans as of June 30, 2021, and December 31, 2020:

	June 30, 2021	December 31, 2020
Non-accrual loans:		
Commercial & industrial	\$ 7,645	\$ 8,750
Commercial mortgage	37,998	6,618
Residential mortgage	1,978	2,575
Other consumer ¹	182	196
Total non-accrual loans	<u>47,803</u>	<u>18,139</u>
Loans past due 90 days and still accruing:		
Commercial & industrial	125	387
Commercial mortgage	564	471
Residential mortgage	140	129
Automobile	-	43
Other consumer ¹	931	1,097
Total loans past due 90 days and still accruing	<u>1,760</u>	<u>2,127</u>
Total nonperforming loans	<u>49,563</u>	<u>20,266</u>
Other real estate owned (OREO):		
Commercial real estate	-	-
Residential real estate	-	-
Total other real estate owned	-	-
Total nonperforming assets	<u>\$ 49,563</u>	<u>\$ 20,266</u>
Restructured loans:		
Accruing loans	\$ 13,897	\$ 15,937
Non-accruing loans (included in nonaccrual loans above)	35,079	4,718
Total restructured loans	<u>\$ 48,976</u>	<u>\$ 20,655</u>

¹ Comprised of other revolving credit, installment loans, and overdrafts.

The above table indicates that nonperforming loans increased by \$29.3 million during the six months ended June 30, 2021, which resulted from the increase in total non-accrual loans by \$29.7 million, from \$18.1 million to \$47.8 million. The increases in total non-accrual loans were due to the increases of \$31.4 million in commercial mortgage, partially offset by decreases of \$1.1 million in commercial & industrial loans, and \$597 thousand in residential mortgage loans. In addition, total loans past due 90 days and still accruing decreased by \$367 thousand from \$2.1 million to \$1.8 million. The decreases were \$262 thousand in commercial & industrial loans, and \$166 thousand in other consumer loans. These were partially offset by the increase of \$93 thousand in commercial mortgage loans.

At June 30, 2021, the Bank's largest nonperforming loans are four commercial mortgage loans totaling \$34.4 million from four relationships of \$28.9 million, \$3.2 million \$1.3 million and \$1.0 million, respectively, and one commercial & industrial loan relationship totaling \$7.6 million. These loans were placed on non-accrual due to deficiencies in the underlying cash flow to service the monthly loan payments and meet operating expenses. At this time, management believes that the collateral and the allocated allowance for loan losses is adequate to cover these loans; however, should property values deteriorate, additional write-downs or additional provisions may be necessary.

Analysis of Allowance for Loan Losses

The allowance for loan losses was \$36.1 million, or 2.58% of outstanding gross loans, as of June 30, 2021, as compared to \$34.8 million, or 2.43% of outstanding gross loans, at December 31, 2020.

Management maintains an allowance for loan losses to absorb estimated credit losses associated with the loan portfolio. The adequacy of the allowance is determined by management through ongoing quarterly loan quality assessments.

Management assesses the estimated credit losses inherent in the non-classified and classified portions of our loan portfolio by considering a number of factors or elements including:

- Management's evaluation of the collectability of the loan portfolio;
- Historical loss experience in the loan portfolio;
- Levels of and trends in delinquency, classified assets, non-performing and impaired loans;
- Effects of changes in underwriting standards and other changes in lending policies, procedures and practices;
- Experience, ability, and depth of lending management and other relevant staff;
- Local, regional, and national trends and conditions, including industry-specific conditions;
- The effect of changes in credit concentration; and
- External factors such as competition, legal and regulatory conditions, as well as typhoons, pandemics such as COVID-19 and other natural disasters.

Management determines the allowance for the classified loan portfolio and for non-classified loans by applying a percentage loss estimate that is calculated based on the above noted factors and trends. Management normally writes down impaired loans after determining the loan collateral fair value versus the outstanding loan balance. Our analysis of the adequacy of the allowance incorporates the provisions made for our non-classified loans and classified loans.

While management believes it uses the best information available for calculating the allowance, the results of operation could be significantly affected if circumstances differ substantially from the assumptions used in determining the allowance. The current qualitative and quantitative factors used to calculate the allowance are inherently subjective. The estimates and assumptions are subject to changes in economic prospects and regulatory guidelines, and other circumstances over which management has no control. The allowance may prove in the future to be insufficient to cover all of the losses the Bank may incur and it may be necessary to increase the allowance from time to time as a result of monitoring its adequacy.

The following table summarizes the changes in our allowance for loan losses:

	<u>Commercial</u>	<u>Residential Mortgages</u>	<u>Consumer</u>	<u>Total</u>
	(Dollars in thousands)			
Six Months Ended June 30, 2021				
Allowance for loan losses:				
Balance at beginning of period	\$ 21,213	\$ 1,990	\$ 11,602	\$ 34,805
Charge-offs	(77)	(4)	(2,675)	(2,756)
Recoveries	156	-	938	1,094
Provision	2,134	367	449	2,950
Balance at end of period	<u>\$ 23,426</u>	<u>\$ 2,353</u>	<u>\$ 10,314</u>	<u>\$ 36,093</u>
Allowance balance at end of period related to:				
Loans individually evaluated for impairment	\$ 3,503	\$ -	\$ 1,041	\$ 4,544
Loans collectively evaluated for impairment	19,923	2,353	9,273	31,549
Ending balance	<u>\$ 23,426</u>	<u>\$ 2,353</u>	<u>\$ 10,314</u>	<u>\$ 36,093</u>
Loan balances at end of period:				
Loans individually evaluated for impairment	\$ 61,338	\$ 2,141	\$ 1,162	\$ 64,641
Loans collectively evaluated for impairment	1,027,531	130,059	175,443	1,333,033
Ending balance	<u>\$ 1,088,869</u>	<u>\$ 132,200</u>	<u>\$ 176,605</u>	<u>\$ 1,397,674</u>
Six Months Ended June 30, 2020				
Allowance for loan losses:				
Balance at beginning of period	\$ 18,360	\$ 1,490	\$ 8,020	\$ 27,870
Charge-offs	(484)	-	(2,045)	(2,529)
Recoveries	166	-	770	936
Provision	2,259	381	1,967	4,607
Ending balance	<u>\$ 20,301</u>	<u>\$ 1,871</u>	<u>\$ 8,712</u>	<u>\$ 30,884</u>
Allowance balance at end of period related to:				
Loans individually evaluated for impairment	\$ 4,391	\$ 2	\$ 901	\$ 5,294
Loans collectively evaluated for impairment	15,910	1,869	7,811	25,590
Ending balance	<u>\$ 20,301</u>	<u>\$ 1,871</u>	<u>\$ 8,712</u>	<u>\$ 30,884</u>
Loan balances at end of period:				
Loans individually evaluated for impairment	\$ 32,867	\$ 4,183	\$ 984	\$ 38,034
Loans collectively evaluated for impairment	1,016,962	122,250	218,411	1,357,623
Ending balance	<u>\$ 1,049,829</u>	<u>\$ 126,433</u>	<u>\$ 219,395</u>	<u>\$ 1,395,657</u>
Year Ended December 31, 2020				
Allowance for loan losses:				
Balance at beginning of year	\$ 18,360	\$ 1,490	\$ 8,020	\$ 27,870
Charge-offs	(1,069)	-	(4,559)	(5,628)
Recoveries	399	-	1,806	2,205
Provision	3,523	500	6,335	10,358
Ending balance	<u>\$ 21,213</u>	<u>\$ 1,990</u>	<u>\$ 11,602</u>	<u>\$ 34,805</u>
Allowance balance at end of year related to:				
Loans individually evaluated for impairment	\$ 3,500	\$ 4	\$ 1,264	\$ 4,768
Loans collectively evaluated for impairment	17,713	1,986	10,338	30,037
Ending balance	<u>\$ 21,213</u>	<u>\$ 1,990</u>	<u>\$ 11,602</u>	<u>\$ 34,805</u>
Loan balances at end of year:				
Loans individually evaluated for impairment	\$ 36,031	\$ 2,730	\$ 1,343	\$ 40,104
Loans collectively evaluated for impairment	1,068,463	126,717	196,402	1,391,582
Ending balance	<u>\$ 1,104,494</u>	<u>\$ 129,447</u>	<u>\$ 197,745</u>	<u>\$ 1,431,686</u>

Management evaluates all impaired loans not less frequently than quarterly in conjunction with our calculation and determination of the adequacy of the allowance for loan losses.

The Bank has one significant borrowing relationship in bankruptcy totaling \$7.6 million at June 30, 2021. The Bank has calculated a specific reserve within the allowance for this borrowing relationship in bankruptcy in the amount of \$3.5 million, and believes it has sufficient collateral for the remaining amount. As a result, the Bank's management believes at June 30, 2021, there is sufficient coverage to protect the Bank's exposure to this relationship.

Total Cash and Cash Equivalents

Total cash and cash equivalents were \$793.4 million and \$287.6 million at June 30, 2021, and December 31, 2020, respectively. This significant increase is the result of the various funds received from the CARES Act, largely from the American Rescue Plan Act totaling \$356.9 million, which were held in cash balances with the Federal Reserve Bank at the end of the reporting period. This balance, which is comprised of cash and due from bank balances and interest-bearing deposits that we maintain at other financial institutions (including the Federal Reserve Bank of San Francisco, but excepting restricted cash), will vary depending on daily cash settlement activities, the amount of highly liquid assets needed based on known events such as the repayment of borrowings and scheduled withdrawals, and actual cash on hand in the Bank's branches.

The following table sets forth the composition of our cash and cash equivalent balances at June 30, 2021, and December 31, 2020:

	June 30, 2021	December 31, 2020	Variance
Cash and due from banks	\$ 41,947	\$ 42,875	\$ (928)
Interest-bearing deposits with financial institutions	751,421	244,753	506,668
Total cash and cash equivalents	<u>\$ 793,368</u>	<u>\$ 287,628</u>	<u>\$ 505,740</u>

Investment Securities

The Bank manages its securities portfolio to provide a source of both liquidity and earnings. The Bank has an Asset/Liability Committee ("ALCO") that develops and recommends current investment policies to the Board of Directors based on its operating needs and market circumstances. The Bank's overall investment policy is formally reviewed and approved annually by the Board of Directors, and the Asset/Liability Committee is responsible for monitoring and reporting compliance with the investment policy. Investment portfolio reports are provided to the Board of Directors on a monthly basis.

At June 30, 2021, the carrying value of the investment securities portfolio (excluding ASC Trust LLC stock and Federal Home Loan Bank stock) totaled \$660.6 million, which represents a \$103.9 million increase from the portfolio balance of \$556.7 million at December 31, 2020. The table below sets forth the amortized cost and fair value of our investment securities portfolio, with gross unrealized gains and losses, at June 30, 2021, and December 31, 2020:

	June 30, 2021			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Securities Available-for-Sale				
U.S. government agency and government sponsored enterprise (GSE) debt securities	\$ 254,887	\$ -	\$ (8,002)	\$ 246,885
U.S. government agency pool securities	24,236	6	(114)	24,128
U.S. government agency or GSE residential mortgage-backed securities	232,969	3,292	(211)	236,050
Total	\$ 512,092	\$ 3,298	\$ (8,327)	\$ 507,063
Securities Held-to-Maturity				
U.S. government agency and government sponsored enterprise (GSE) debt securities	\$ 143,056	\$ 433	\$ (489)	\$ 143,000
U.S. government agency pool securities	3,908	13	(34)	3,887
U.S. government agency or GSE residential mortgage-backed securities	6,532	165	(21)	6,676
Total	\$ 153,496	\$ 611	\$ (544)	\$ 153,563
	December 31, 2020			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Securities Available-for-Sale				
U.S. government agency and government sponsored enterprise (GSE) debt securities	\$ 300,440	\$ 54	\$ (2,348)	\$ 298,146
U.S. government agency pool securities	28,783	29	(206)	28,606
U.S. government agency or GSE residential mortgage-backed securities	176,912	6,447	-	183,359
Total	\$ 506,135	\$ 6,530	\$ (2,554)	\$ 510,111
Securities Held-to-Maturity				
U.S. government agency and government sponsored enterprise (GSE) debt securities	\$ 33,221	\$ 93	\$ (15)	\$ 33,299
U.S. government agency pool securities	4,515	15	(36)	4,494
U.S. government agency or GSE residential mortgage-backed securities	8,848	280	(10)	9,118
Total	\$ 46,584	\$ 388	\$ (61)	\$ 46,911

At June 30, 2021, and December 31, 2020, investment securities with a carrying value of \$542.8 million and \$360.6 million, respectively, were pledged to secure various government deposits and other public requirements.

The amortized cost and fair value of investment securities by contractual maturity at June 30, 2021, and December 31, 2020, follows:

	June 30, 2021			
	Available-for-Sale		Held-to-Maturity	
	Amortized Cost	Estimated Fair Value	Amortized Cost	Estimated Fair Value
Due within one year	\$ 7	\$ 7	\$ -	\$ -
Due after one but within five years	4,447	4,439	1,942	1,970
Due after five but within ten years	179,573	177,008	24,645	24,313
Due after ten years	328,065	325,609	126,909	127,280
Total	<u>\$ 512,092</u>	<u>\$ 507,063</u>	<u>\$ 153,496</u>	<u>\$ 153,563</u>

	December 31, 2020			
	Available-for-Sale		Held-to-Maturity	
	Amortized Cost	Estimated Fair Value	Amortized Cost	Estimated Fair Value
Due within one year	\$ 5,115	\$ 5,121	\$ 11,990	\$ 12,070
Due after one but within five years	13,255	13,432	2,325	2,358
Due after five but within ten years	129,708	131,340	26,214	26,348
Due after ten years	358,057	360,218	6,055	6,135
Total	<u>\$ 506,135</u>	<u>\$ 510,111</u>	<u>\$ 46,584</u>	<u>\$ 46,911</u>

Temporarily Impaired Securities

The following table shows the gross unrealized losses and fair value of investments with unrealized losses that are not deemed to be other-than-temporarily impaired, aggregated by investment category and the length of time that individual securities have been in a continuous unrealized loss position at June 30, 2021, and December 31, 2020:

	June 30, 2021					
	Less Than Twelve Months		More Than Twelve Months		Total	
	Unrealized Losses	Estimated Fair Value	Unrealized Losses	Estimated Fair Value	Unrealized Losses	Estimated Fair Value
Securities Available for Sale						
U.S. government agency and government sponsored enterprise (GSE) debt securities	\$ (8,002)	\$ 246,885	\$ -	\$ -	\$ (8,002)	\$ 246,885
U.S. government agency pool securities	(2)	625	(112)	21,720	(114)	22,345
U.S. government agency or GSE residential mortgage-backed securities	(211)	84,674	-	-	(211)	84,674
Total	\$ (8,215)	\$ 332,184	\$ (112)	\$ 21,720	\$ (8,327)	\$ 353,904
Securities Held to Maturity						
US government agency and sponsored Agencies (GSE) debt securities	\$ (489)	\$ 54,021	\$ -	\$ -	\$ (489)	\$ 54,021
U.S. government agency pool securities	-	-	(34)	2,460	(34)	2,460
U.S. government agency or GSE residential mortgage-backed securities	(12)	1,411	(9)	459	(21)	1,870
Total	\$ (501)	\$ 55,432	\$ (43)	\$ 2,919	\$ (544)	\$ 58,351
	December 31, 2020					
	Less Than Twelve Months		More Than Twelve Months		Total	
	Unrealized Losses	Estimated Fair Value	Unrealized Losses	Estimated Fair Value	Unrealized Losses	Estimated Fair Value
Securities Available for Sale						
U.S. government agency and government sponsored enterprise (GSE) debt securities	\$ (2,348)	\$ 243,089	\$ -	\$ -	\$ (2,348)	\$ 243,089
U.S. government agency pool securities	(22)	3,735	(184)	22,672	(206)	26,407
Total	\$ (2,370)	\$ 246,824	\$ (184)	\$ 22,672	\$ (2,554)	\$ 269,496
Securities Held to Maturity						
U.S. government agency and government sponsored enterprise (GSE) debt securities	\$ (15)	\$ 14,985	\$ -	\$ -	\$ (15)	\$ 14,985
U.S. government agency pool securities	-	-	(36)	2,923	(36)	2,923
U.S. government agency or GSE residential mortgage-backed securities	(10)	506	-	-	(10)	506
Total	\$ (25)	\$ 15,491	\$ (36)	\$ 2,923	\$ (61)	\$ 18,414

The Company does not believe that any of the investment securities that were in an unrealized loss position as of June 30, 2021, which included a total of 104 securities, were other-than-temporarily impaired. Specifically, the 104 securities were comprised of 34 Small Business Administration Pool securities, 1 mortgage-backed security issued by Government National Mortgage Association, 23 agency securities issued by Federal Home Loan Bank (FHLB), 20 agency securities issued by Federal Home Loan Mortgage Corporation (FHLMC), 10 mortgaged-backed securities and 1 agency security issued by Federal National Mortgage Association (FNMA), and 15 agency securities issued by Federal Farm Credit Banks (FFCB).

Total gross unrealized losses were primarily attributable to changes in interest rates relative to when the investment securities were purchased, and not due to changes in the credit quality of the investment securities. The Bank does not intend to sell the investment securities that are in an unrealized loss position and it is not likely that, except as needed to fund our liquidity position, the Bank will be required to sell the investment securities before recovery of their amortized cost bases, which may be at maturity.

Deposits

At June 30, 2021, total deposit liabilities increased by \$563.7 million from the approximately \$2.1 billion at December 31, 2020. Interest-bearing deposits increased by \$120.5 million, to \$1.47 billion at June 30, 2021, compared to \$1.35 billion at December 31, 2020, and non-interest bearing deposits increased by \$443.2 million, to \$1.21 billion at June 30, 2021, from \$770.0 million at December 31, 2020. The 26.6% increase in total deposits was primarily due to the receipt of funds from various COVID-19 federal relief programs of which \$356.9 million is from ARP.

The following table sets forth the composition of our interest-bearing deposit portfolio with the balances and average interest rates at June 30, 2021, and December 31, 2020, respectively:

	June 30, 2021		December 31, 2020	
	Balance	Average rate	Balance	Average rate
Interest-bearing checking accounts	\$ 321,935	0.03%	\$ 322,933	0.12%
Savings accounts	797,293	0.03%	754,042	0.18%
Certificates of deposit	350,090	0.11%	271,832	0.36%
Total interest-bearing deposits	<u>\$ 1,469,318</u>	0.03%	<u>\$ 1,348,807</u>	0.17%

As mentioned earlier, the Bank has expanded its operations and its branch network since it first opened in 1972, first in Guam, then in the other islands of our region and in San Francisco, California. As time has passed, the Bank has gathered market share in each of the islands. In recent years, in order to diversify its geographic market, the Bank has increased its focus on growth in the California region. The following table provides figures for deposits in the Bank's administrative regions at June 30, 2021, and December 31, 2020:

	June 30, 2021	December 31, 2020
Guam	\$ 1,317,230	\$ 1,197,656
Commonwealth of the Northern Mariana Islands	796,465	363,875
The Freely Associated States of Micronesia *	520,736	509,817
California	48,151	47,496
Total	<u>\$ 2,682,582</u>	<u>\$ 2,118,844</u>

* The Freely Associated States (FAS) are comprised of the Federated States of Micronesia (Chuuk, Kosrae, Pohnpei and Yap), the Republic of the Marshall Islands and the Republic of Palau.

During the six months ended June 30, 2021, the Bank's deposits increased by \$563.7 million (26.6%) to \$2.68 billion compared to December 31, 2020. During this period the increase in our deposits were in our Guam branches by \$119.6 million, CNMI branches by \$432.6 million, FAS branches by \$10.9 million, and our California region by \$655 thousand. The significant increase in deposits in these regions is primarily from the various COVID-19 federal relief programs.

Borrowed Funds

The Bank has a variety of sources from which it may obtain secondary funding. These sources include, among others, the Federal Reserve Bank of San Francisco, the Federal Home Loan Bank of Des Moines, and credit lines established with our correspondent banks. Borrowings are obtained for a variety of reasons which include, but are not limited to, funding loan growth, the purchase of investments in the absence of core deposits, and to provide additional liquidity to meet the demands of depositors.

On June 29, 2021, the Company issued \$20.0 million of its 4.75% Fixed-to-Floating Rate Subordinated Notes, due July 1, 2031 (the "2031 Notes"). The 2031 Notes are intended to qualify as Tier 2 capital for regulatory capital purposes for the Company. The 2031 Notes have a ten-year term and initially bear interest at a fixed annual rate of 4.75%. Beginning July 1 2026, the interest rate will reset quarterly to the then-current three-month SOFR plus 413 basis points. On July 6, 2021, with the approval of the Federal Reserve Bank of San Francisco, the Company used \$6.2 million of the proceeds from the 2031 Notes to acquire an additional 25% of the stock of ASC Trust LLC at the third and final closing pursuant to the 2016 Stock Purchase Agreement between the Company and David J. John. The Company intends to use the remainder of the proceeds from the 2031 Notes for general corporate purposes.

On June 27, 2019, the Company issued \$15.0 million of its 6.35% Fixed-to-Floating Rate Subordinated Notes, due June 30, 2029 (the "2029 Notes"). The 2029 Notes are intended to qualify as Tier 2 capital for regulatory capital purposes for the Company. The 2029 Notes have a ten-year term and initially bear interest at a fixed annual rate of 6.35%. Beginning June 30, 2024, the interest rate will reset quarterly to the then-current three-month LIBOR plus 466 basis points. On July 1, 2019, with the approval of the Federal Reserve Bank of San Francisco, the Company used \$4.1 million of the proceeds from the 2029 Notes to acquire an additional 20% of the stock of ASC Trust LLC at the second closing pursuant to the 2016 Stock Purchase Agreement between the Company and David J.

John. On July 5, 2019, \$10.0 million of the balance of the proceeds from the 2029 Notes was also used to purchase ten (10) shares of Series B Common Stock from the Bank, with a par value of \$1.0 million per share, to support the Bank's strategic growth.

At June 30, 2021, and at December 31, 2020, the Company had no short-term borrowings.

Liquidity

We actively manage our liquidity to ensure that sufficient funds are available to meet our needs for cash, including cash needed to fund new loans and to accommodate deposit withdrawals and other transactions by our customers. We project future sources and uses of funds, and maintain additional liquid funds for unanticipated events. Our primary sources of cash include cash we have in deposits at other financial institutions, the repayment of loans, proceeds from the sale or maturity of investment securities, and increases in deposits. The primary uses of cash include funding new loans and making advances on existing lines of credit, purchasing investments, funding new residential mortgage loans, funding deposit withdrawals, and paying operating expenses. From time to time, we may maintain funds in overnight Federal Funds and other short-term investments to provide for short-term liquidity needs. We also have established, for contingency funding purposes, credit lines with the Federal Reserve Bank of San Francisco, the Federal Home Loan Bank-Seattle, and correspondent commercial banks in the U.S. We believe that our liquid assets, together with our available credit lines, will be sufficient to meet normal operating requirements for at least the next twelve months, including to enable us to meet any increase in withdrawals from depository accounts that might occur in the foreseeable future.

At June 30, 2021, our liquid assets, which include cash and due from banks, interest-earning deposits with financial institutions (excluding restricted cash), and investment securities available-for-sale totaled \$1.3 billion, up \$502.7 million from \$797.7 million at December 31, 2020. This increase is comprised of a \$506.7 million increase in interest bearing deposits in banks, partially offset by \$3.0 million in investment securities available-for-sale. The increase in interest bearing deposits in banks is primarily due to the receipt of \$356.9 million in American Rescue Plan Act funds that have yet to be disbursed.

Management believes we have sufficient cash to meet the demands of the distribution of funds under the CARES Act. However, we will monitor our vault cash on a daily basis, and if the need arises we will acquire additional cash by drawing down our deposits with other financial institutions, including the Federal Bank of San Francisco.

Contractual Obligations

The Bank utilizes facilities, equipment and land under various operating leases with terms, including renewal options, ranging from 1 to 99 years.

The following table provides the maturities of lease liabilities at June 30, 2021:

	Operating Leases (a)	Total
2021	\$ 1,642	\$ 1,642
2022	2,780	2,780
2023	2,532	2,532
2024	2,420	2,420
2025	2,288	2,288
After 2025	35,569	35,569
Total lease payments	47,231	47,231
Less: Interest (b)	21,932	21,932
Present value of lease liabilities (c)	\$ 25,299	\$ 25,299

Note: For leases commencing prior to 2019, minimum lease payments exclude payments to landlords for real estate taxes and common area maintenance.

- (a) Operating lease payments include \$21.5 million related to options to extend lease terms that are reasonably certain of being exercised.
- (b) Calculated using the incremental borrowing rate based on the lease term for each lease.
- (c) Includes the current portion of \$2.2 million for operating leases.

The Bank leases certain facilities from two separate entities in which two of its directors have separate ownership interests. Lease payments made to these entities during the six months ended June 30, 2021 and 2020, approximated \$205 thousand and \$149 thousand, respectively. During the three months ended June 30, 2021 and 2020, lease payments made to these entities approximated \$143 thousand and \$89 thousand, respectively.

Additionally, the Bank leases office space to third parties, with original lease terms ranging from 1 to 3 years with option periods ranging up to 12 years. At June 30, 2021, minimum future rents to be received under non-cancelable operating sublease agreements were \$21 thousand, \$38 thousand, and \$26 thousand for the periods ending December 31, 2021, 2022, and 2023, respectively.

A summary of rental activities for the three and six months ended June 30, 2021, respectively, is as follows:

	<u>Three Months Ended June 30,</u>		<u>Six Months Ended June 30,</u>	
	<u>2021</u>	<u>2020</u>	<u>2021</u>	<u>2020</u>
Rent expense	\$ 1,015	\$ 997	\$ 2,040	\$ 2,001
Total rent expense	<u>\$ 1,015</u>	<u>\$ 997</u>	<u>\$ 2,040</u>	<u>\$ 2,001</u>

Off Balance Sheet Arrangements

The Bank is a party to credit-related 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, standby letters of credit and commercial letters of credit. Such commitments involve, to varying degrees, elements of credit and interest rate risk in excess of the amount reflected in our condensed consolidated financial statements.

The Bank's exposure to credit loss, in the event of nonperformance by the other parties to financial instruments for loan commitments and letters of credit, is represented by the contractual amount of these instruments. The Bank follows essentially the same credit policies in making commitments and conditional obligations as it does for on-balance-sheet instruments.

A summary of financial instruments with off-balance-sheet risk at June 30, 2021, and December 31, 2020, is as follows:

	<u>June 30, 2021</u>	<u>December 31, 2020</u>
Commitments to extend credit	\$ 174,473	\$ 159,405
Letters of credit:		
Standby letters of credit	\$ 55,633	\$ 52,827
Commercial letters of credit	2,264	2,574
Total	<u>\$ 57,897</u>	<u>\$ 55,401</u>

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. The commitments for certain lines of credit may expire without being drawn upon. Therefore, the total commitment amounts do not necessarily represent future cash requirements. The Bank evaluates each customer's credit worthiness on a case-by-case basis. The amount of collateral obtained, if it is deemed necessary by the Bank upon extension of credit, is based on management's credit evaluation of the customer.

Commercial and standby letters of credit are conditional commitments issued by the Bank to guarantee the performance of a customer to a third party or the shipment of merchandise from a third party. Those letters of credit are primarily issued to support public and private borrowing arrangements. Almost all letters of credit issued have expiration dates within one year. The credit risk involved in issuing letters of credit is effectively the same as that involved in extending loan facilities to customers. The Bank generally holds collateral supporting those commitments.

The Bank considers its standby and commercial letters of credit to be guarantees. At June 30, 2021, the maximum undiscounted future payments that the Bank could be required to make was \$57.9 million. Almost all of these arrangements mature within one year. The Bank generally has recourse to recover from the customer any amounts paid under these guarantees. Most of the guarantees are fully collateralized; however, several that are extended to the Bank's most creditworthy customers are unsecured. The Bank has recorded \$45 thousand in reserve liabilities associated with commitments to extend credit and letters of credit at June 30, 2021.

Mortgage loans serviced for others are not included in the accompanying condensed consolidated statements of financial condition. The unpaid principal balances of mortgage loans serviced for others were \$188.3 million and \$186.9 million at June 30, 2021, and December 31, 2020, respectively. At June 30, 2021, and December 31, 2020, the Bank recorded mortgage servicing rights of \$1.9 million and \$1.7 million, respectively.

Capital Resources

The Company and the Bank are subject to various regulatory capital requirements administered by the United States federal banking agencies. Failure to meet minimum capital requirements can initiate certain mandatory and possibly additional discretionary actions by regulators that, if undertaken, could have a direct material effect on the Company's and the Bank's condensed consolidated financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Company and

the Bank must meet or exceed specific capital guidelines that involve quantitative measures of their assets, liabilities and certain off-balance-sheet items as calculated under regulatory accounting practices.

Quantitative measures established by regulation to ensure capital adequacy require the Company and the Bank to maintain minimum amounts and ratios (set forth in the following table) of total and Tier 1 capital and Common Equity Tier 1 capital (as defined in the regulations) to risk-weighted assets (as defined) and of Tier 1 capital (as defined) to average assets (as defined). As of June 30, 2021, and December 31, 2020, the Bank met all capital adequacy requirements to which it is subject.

As of June 30, 2021, the Bank's capital ratios each exceeded the Federal Deposit Insurance Corporation's well capitalized standards under the regulatory framework for prompt corrective action. To be categorized as well capitalized, an institution must maintain minimum total risk-based, Tier 1 risk-based and Tier 1 leverage ratios as set forth in the following table. There have been no conditions or events since the most recent FDIC notification that management believes have changed the Bank's category.

The Company's required and actual capital amounts and ratios as of June 30, 2021, and December 31, 2020, were as follows:

	Actual		For Capital Adequacy Purposes		To Be Well Capitalized Under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
At June 30, 2021:						
Total capital (to Risk Weighted Assets)	\$ 233,763	16.056%	\$ 116,476	8.000%	\$ 145,594	10.000%
Tier 1 capital (to Risk Weighted Assets)	\$ 180,342	12.387%	\$ 87,357	6.000%	\$ 116,476	8.000%
Tier 1 capital (to Average Assets)	\$ 180,342	6.277%	\$ 114,931	4.000%	\$ 143,664	5.000%
Common Equity Tier 1 Capital (to Risk Weighted Assets)	\$ 170,560	11.715%	\$ 65,518	4.500%	\$ 94,636	6.500%
At December 31, 2020:						
Total capital (to Risk Weighted Assets)	\$ 206,381	14.307%	\$ 115,401	8.000%	\$ 144,252	10.000%
Tier 1 capital (to Risk Weighted Assets)	\$ 173,141	12.003%	\$ 86,551	6.000%	\$ 115,401	8.000%
Tier 1 capital (to Average Assets)	\$ 173,141	7.466%	\$ 92,765	4.000%	\$ 115,956	5.000%
Common Equity Tier 1 Capital (to Risk Weighted Assets)	\$ 163,359	11.325%	\$ 64,913	4.500%	\$ 93,764	6.500%

Since the formation of BankGuam Holding Company in 2011, our assets have grown by 165.6% (\$1.8 billion), while our stockholders' equity has increased by 89.9% (79.8 million, including \$72.7 million in retained earnings). The growth in equity has helped to increase our capital ratios, and those ratios remain well above the well capitalized standards.

The Bank continues to receive a large influx of deposits from federal relief programs due to the COVID-19 pandemic, which largely increased its total cash and cash equivalents on its balance sheet resulting in an increase in its average assets in June 30, 2021 by approximately \$554.2 million to \$2.87 billion from \$2.31 billion in December 31, 2020. This growth resulted in an adverse impact on its ratio of Tier 1 capital to average assets. Management believes that the Bank has the capacity to absorb the growth in total assets, and the tools needed to move deposits off its balance through its Trust services to continue to be above the well capitalized standards under the regulatory framework for prompt corrective action.

Stock Purchase Plan

The Company's 2011 Employee Stock Purchase Plan (the "2011 Plan") was adopted by the Company's Board of Directors and approved by the Company's Stockholders on May 2, 2011, to replace the Company's 2001 Non-Statutory Stock Option Plan. This plan was subsequently adopted by the Company after the reorganization. The 2011 Plan is open to all employees of the Company and its subsidiaries who have met certain eligibility requirements.

Under the 2011 Plan, as amended and restated as of July 1, 2012, eligible employees can purchase, through payroll deductions, shares of common stock at a discount. The right to purchase stock is granted to eligible employees during a quarterly offer period that is established from time to time by the Board of Directors of the Company. Eligible employees cannot accrue the right to purchase more than \$25 thousand worth of stock at the fair market value at the beginning of each offer period. Eligible employees also may not purchase more than one thousand five hundred (1,500) shares of stock in any one offer period. The shares are purchased at 85% of the fair market price of the stock on the enrollment date.

Contingency Planning and Cybersecurity

The Bank has developed a comprehensive business continuity plan to manage disruptions that affect customers or internal processes, whether caused by man-made or natural events. In modern banking, technology has taken on an increasingly important role, and the Bank also has a technology recovery component incorporated into the business continuity plan that provides procedures for recovering from a technology failure. The technology recovery procedures are tested and implemented from time to time. The recovery time objectives for the Bank's major technological processes range from eight hours to 80 hours, with the goal of enabling the Bank to maintain or resume operations with a minimum impact on its customers. As the results of testing are analyzed and as technology continues to advance, improvements are made in the Bank's processes and procedures as the plan evolves, although there can be no assurance that business disruption or operational losses will not occur.

The rapid advances in computing and telecommunications technology over the past several decades have brought with them increasingly sophisticated methods of delivering financial services through electronic channels. Along with these advances, though, have come risks regarding the integrity and privacy of data, and these risks apply to banking, falling into the general classification of cybersecurity. The Bank has made substantial investments in multiple systems to ensure both the integrity of its data and the protection of the privacy of its customers' personal financial and identity information. While it is not possible for anyone to give an absolute guarantee that data will not be compromised, the Bank strives to provide a reasonable assurance that the financial and personal data that it holds are secure.

Item 4. Controls and Procedures

We maintain disclosure controls and procedures that are designed to ensure that information required to be disclosed in our reports filed under the Exchange Act, is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms, and that such information is accumulated and communicated to management, including our Chief Executive Officer and Chief Financial Officer, to allow timely decisions regarding required disclosure. In designing and evaluating our disclosure controls and procedures, our management recognized that any system of controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives, as ours are designed to do, and management necessarily was required to apply its judgment in evaluating the cost-benefit relationship of possible controls and procedures.

As required by Rules 13a-15(e) and 15d-15(e) under the Exchange Act, in connection with the filing of this Quarterly Report on Form 10-Q, an evaluation was performed under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures as of June 30, 2021. Based on the evaluation, our Chief Executive Officer and Chief Financial Officer have concluded that, as of June 30, 2021, the Company's disclosure controls and procedures were effective to provide reasonable assurance that information required to be disclosed by us in our reports filed under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC's Rules and forms and is accumulated and communicated to management, including our Chief Executive and Chief Financial Officers, as appropriate to allow timely decisions regarding required disclosure.

Changes in Internal Control over Financial Reporting

There were no changes in our internal control over financial reporting during the three months ended June 30, 2021, that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II. OTHER INFORMATION

Item 6. Exhibits

Exhibit No.	Exhibit
4.01	Form of 4.75% Fixed-to-Floating Rate Subordinated Notes due July 1, 2031 (attached as Exhibit A to Form of Subordinated Note Purchase Agreement)
10.01	Form of Subordinated Note Purchase Agreement dated June 29, 2021, by and among BankGuam Holding Company and the Purchasers (incorporated by reference to Exhibit 10.1 to the Company's Form 8-K filed on July 6, 2021)
31.01	Certification of Chief Executive Officer under Section 302 of the Sarbanes-Oxley Act of 2002
31.02	Certification of Chief Financial Officer under Section 302 of the Sarbanes-Oxley Act of 2002
32.01	Certification of Chief Executive Officer and Chief Financial Officer under Section 906 of the Sarbanes-Oxley Act of 2002
101.INS	Inline XBRL Instance Document – the instance document does not appear in the Interactive Data File because XBRL tags are embedded within the Inline XBRL document.
101.SCH	Inline XBRL Taxonomy Extension Schema Document
101.CAL	Inline XBRL Taxonomy Extension Calculation Linkbase Document
101.DEF	Inline XBRL Taxonomy Extension Definition Linkbase Document
101.LAB	Inline XBRL Taxonomy Extension Label Linkbase Document
101.PRE	Inline XBRL Taxonomy Extension Presentation Linkbase Document
104	Cover Page Interactive Data File (embedded within the Inline XBRL document)

SIGNATURES

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

BANKGUAM HOLDING COMPANY

Date: August 12, 2021

By: /s/ JOAQUIN P.L.G. COOK

Joaquin P.L.G. Cook,
President and Chief Executive Officer

Date: August 12, 2021

By: /s/ FRANCISCO M. ATALIG

Francisco M. Atalig,
Senior Vice President and Chief Financial Officer

**CERTIFICATION OF PRINCIPAL EXECUTIVE OFFICER PURSUANT TO
EXCHANGE ACT RULE 13a-14(a)/15d-14(a)
AS ADOPTED PURSUANT TO SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002**

I, Joaquin P.L.G. Cook, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of BankGuam Holding Company;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - a. Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - b. Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - c. Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - d. Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - a. All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - b. Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Dated: August 12, 2021

/s/ JOAQUIN P.L.G. COOK

Joaquin P.L.G. Cook
President and Chief Executive Officer
(Principal Executive Officer)

**CERTIFICATION OF PRINCIPAL FINANCIAL OFFICER PURSUANT TO
EXCHANGE ACT RULE 13a-14(a)/15d-14(a)
AS ADOPTED PURSUANT TO SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002**

I, Francisco M. Atalig, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of BankGuam Holding Company;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - a. Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - b. Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - c. Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - d. Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - a. All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - b. Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Dated: August 12, 2021

/s/ FRANCISCO M. ATALIG

Francisco M. Atalig
Senior Vice President and Chief Financial Officer
(Principal Financial Officer)

**CERTIFICATION OF PRINCIPAL EXECUTIVE OFFICER AND PRINCIPAL FINANCIAL OFFICER
PURSUANT TO SECTION 906 OF THE SARBANES-OXLEY ACT**

The certification set forth below is being submitted in connection with the report on Form 10-Q of BankGuam Holding Company for the purpose of complying with Rule 13a-14(b) or Rule 15d-14(b) of the Securities Exchange Act of 1934 and Section 1350 of Chapter 63 of Title 18 of the United States Code.

Joaquin P.L.G. Cook, the President and Chief Executive Officer of BankGuam Holding Company, and Francisco M. Atalig, the Senior Vice President and Chief Financial Officer of BankGuam Holding Company, each certifies that, to the best of their knowledge:

1. the Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
2. the information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of BankGuam Holding Company.

Date: August 12, 2021

By: /s/ JOAQUIN P.L.G. COOK
Joaquin P.L.G. Cook
President and Chief Executive Officer

Date: August 12, 2021

By: /s/ FRANCISCO M. ATALIG
Francisco M. Atalig
Senior Vice President and Chief Financial Officer