

**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

**FORM 10-Q**

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

For the quarterly period ended September 30, 2020

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 001-38595

**FIRST WESTERN FINANCIAL, INC.**

(Exact name of registrant as specified in its charter)

Colorado  
(State or other jurisdiction of  
incorporation or organization)

1900 16th Street, Suite 1200  
Denver, CO  
(Address of principal executive offices)

37-1442266  
(I.R.S. Employer  
Identification No.)

80202  
(Zip Code)

Registrant's telephone number, including area code: 303.531.8100

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

Title of each class	Trading Symbol	Name of each exchange on which registered
Common Stock, no par value	MYFW	The Nasdaq Stock Market LLC

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

Accelerated filer

Non-accelerated filer

Smaller reporting company

Emerging growth company

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

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

Indicate the number of shares outstanding of each of the registrant's classes of common stock, as of the latest practicable date.

Common Stock, no par value

Shares outstanding as of  
October 30, 2020  
7,951,749

**FIRST WESTERN FINANCIAL, INC.  
TABLE OF CONTENTS**

	Page
<a href="#">PART I. FINANCIAL INFORMATION</a>	
<a href="#">Item 1. Financial Statements</a>	6
<a href="#">Condensed Consolidated Balance Sheets as of September 30, 2020 (Unaudited) and December 31, 2019</a>	6
<a href="#">Condensed Consolidated Statements of Income (Unaudited) for the Three Months and Nine Months Ended September 30, 2020 and September 30, 2019</a>	7
<a href="#">Condensed Consolidated Statements of Comprehensive Income (Unaudited) for the Three Months and Nine Months Ended September 30, 2020 and September 30, 2019</a>	8
<a href="#">Condensed Consolidated Statements of Changes in Shareholders' Equity (Unaudited) for the Three Months and Nine Months Ended September 30, 2020 and September 30, 2019</a>	9
<a href="#">Condensed Consolidated Statements of Cash Flows (Unaudited) for the Nine Months Ended September 30, 2020 and September 30, 2019</a>	10
<a href="#">Notes to Condensed Consolidated Financial Statements (Unaudited)</a>	11
<a href="#">Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations</a>	41
<a href="#">Item 3. Quantitative and Qualitative Disclosures about Market Risk</a>	72
<a href="#">Item 4. Controls and Procedures</a>	73
<a href="#">PART II. OTHER INFORMATION</a>	73
<a href="#">Item 1. Legal Proceedings</a>	73
<a href="#">Item 1A. Risk Factors</a>	74
<a href="#">Item 2. Unregistered Sales of Equity Securities and Use of Proceeds</a>	76
<a href="#">Item 3. Defaults upon Senior Securities</a>	76
<a href="#">Item 4. Mine Safety Disclosures</a>	76
<a href="#">Item 5. Other Information</a>	76
<a href="#">Item 6. Exhibits</a>	77
<a href="#">SIGNATURES</a>	78

**Important Notice about Information in this Quarterly Report**

Unless we state otherwise or the context otherwise requires, references in this Quarterly Report to “we,” “our,” “us,” “the Company” and “First Western” refer to First Western Financial, Inc. and its consolidated subsidiaries, including First Western Trust Bank, which we sometimes refer to as “the Bank” or “our Bank.”

The information contained in this Quarterly Report is accurate only as of the date of this Quarterly Report on Form 10-Q and as of the dates specified herein.

## CAUTIONARY NOTE REGARDING FORWARD-LOOKING STATEMENTS

This Quarterly Report on Form 10-Q contains forward-looking statements. These forward-looking statements reflect our current views with respect to, among other things, future events and our financial performance. These statements are often, but not always, made through the use of words or phrases such as “may,” “should,” “could,” “predict,” “potential,” “believe,” “will likely result,” “expect,” “continue,” “will,” “anticipate,” “seek,” “estimate,” “intend,” “plan,” “projection,” “would” and “outlook,” or the negative version of those words or other comparable words or phrases of a future or forward-looking nature. These forward-looking statements are not historical facts, and are based on current expectations, estimates and projections about our industry, management’s beliefs and certain assumptions made by management, many of which, by their nature, are inherently uncertain and beyond our control, particularly with regard to developments related to COVID-19. Accordingly, we caution you that any such forward-looking statements are not guarantees of future performance and are subject to risks, assumptions and uncertainties that are difficult to predict. Although we believe that the expectations reflected in these forward-looking statements are reasonable as of the date made, actual results may prove to be materially different from the results expressed or implied by the forward-looking statements.

There are or will be important factors that could cause our actual results to differ materially from those indicated in these forward-looking statements, including, but not limited to, the following:

- The impact of the COVID-19 pandemic and actions taken by governmental authorities in response to the pandemic;
- geographic concentration in Colorado, Arizona, Wyoming and California;
- changes in the economy affecting real estate values and liquidity;
- our ability to continue to originate residential real estate loans and sell such loans;
- risks specific to commercial loans and borrowers;
- claims and litigation pertaining to our fiduciary responsibilities;
- competition for investment managers and professionals and our ability to retain our associates;
- fluctuation in the value of our investment securities;
- the terminable nature of our investment management contracts;
- changes to the level or type of investment activity by our clients;
- investment performance, in either relative or absolute terms;
- changes in interest rates;
- the adequacy of our allowance for loan losses;
- weak economic conditions and global trade;
- legislative changes or the adoption of tax reform policies;
- external business disruptors in the financial services industry;
- liquidity risks;
- our ability to maintain a strong core deposit base or other low-cost funding sources;

- continued positive interaction with and financial health of our referral sources;
- retaining our largest trust clients;
- our ability to achieve our strategic objectives;
- competition from other banks, financial institutions and wealth and investment management firms;
- our ability to implement our internal growth strategy and manage the risks associated with our anticipated growth;
- the acquisition of other banks and financial services companies and integration risks and other unknown risks associated with acquisitions;
- the accuracy of estimates and assumptions;
- our ability to protect against and manage fraudulent activity, breaches of our information security, and cybersecurity attacks;
- our reliance on communications, information, operating and financial control systems technology and related services from third-party service providers;
- technological change;
- our ability to attract and retain clients;
- unforeseen or catastrophic events, including pandemics, terrorist attacks, extreme weather events or other natural disasters;
- new lines of business or new products and services;
- regulation of the financial services industry;
- legal and regulatory proceedings, investigations and inquiries, fines and sanctions;
- limited trading volume and liquidity in the market for our common stock;
- fluctuations in the market price of our common stock;
- potential impairment of goodwill recorded on our balance sheet and possible requirements to recognize significant charges to earnings due to impairment of intangible assets;
- actual or anticipated issuances or sales of our common stock or preferred stock in the future;
- the initiation and continuation of securities analysts coverage of the Company;
- future issuances of debt securities;
- our ability to manage our existing and future indebtedness;
- available cash flows from the Bank; and
- other factors that are discussed in “Item 1A - Risk Factors” in our Annual Report on Form 10-K.

The foregoing factors should not be construed as exhaustive and should be read together with the other cautionary statements included in the section titled Risk Factors in Part I, Item 1A of our Annual Report on Form 10-K, filed with the U.S. Securities and Exchange Commission (“SEC”) on March 12, 2020, in the section titled Risk Factors in Part II, Item 1A of our Form 10-Q filed with the SEC on April 30, 2020 and in the section titled Risk Factors in Part II, Item 1A of our Form 10-Q filed with the SEC on August 6, 2020. If one or more events related to these or other risks or uncertainties materialize, or if our underlying assumptions prove to be incorrect, actual results may differ materially from what we anticipate. Accordingly, you should not place undue reliance on any such forward-looking statements. Any forward-looking statement speaks only as of the date on which it is made, and we do not undertake any obligation to publicly update or review any forward-looking statement, whether as a result of new information, future developments or otherwise. New factors emerge from time to time, and it is not possible for us to predict which will arise. In addition, we cannot assess the impact of each factor on our business or the extent to which any factor, or combination of factors, may cause actual results to differ materially from those contained in any forward-looking statements.

**PART I. FINANCIAL INFORMATION****ITEM 1. FINANCIAL STATEMENTS**

**FIRST WESTERN FINANCIAL, INC.**  
**CONDENSED CONSOLIDATED BALANCE SHEETS (UNAUDITED)**  
**(in thousands, except share amounts)**

	September 30, 2020	December 31, 2019
<b>ASSETS</b>		
Cash and cash equivalents:		
Cash and due from banks	\$ 2,867	\$ 4,180
Interest-bearing deposits in other financial institutions	247,491	74,458
Total cash and cash equivalents	250,358	78,638
Available-for-sale securities, at fair value	40,654	58,903
Correspondent bank stock, at cost	1,295	585
Mortgage loans held for sale	89,872	48,312
Loans, net of allowance of \$11,845 and \$7,875	1,494,231	990,132
Premises and equipment, net	5,116	5,218
Accrued interest receivable	6,730	3,048
Accounts receivable	4,821	5,238
Other receivables	1,497	1,006
Other real estate owned, net	558	658
Goodwill	24,191	19,686
Other intangible assets, net	72	28
Deferred tax assets, net	6,405	5,047
Company-owned life insurance	15,359	15,086
Other assets	28,738	16,544
Assets held for sale	3,000	3,553
Total assets	\$ 1,972,897	\$ 1,251,682
<b>LIABILITIES</b>		
Deposits:		
Noninterest-bearing	\$ 472,963	\$ 240,068
Interest-bearing	1,090,709	846,716
Total deposits	1,563,672	1,086,784
Borrowings:		
Federal Home Loan Bank Topeka and Federal Reserve borrowings	222,075	10,000
Subordinated notes	14,447	6,560
Accrued interest payable	347	299
Other liabilities	22,639	20,244
Liabilities held for sale	141	117
Total liabilities	1,823,321	1,124,004
<b>SHAREHOLDERS' EQUITY</b>		
Preferred stock - no par value; 10,000,000 shares authorized; 0 issued and outstanding	—	—
Convertible preferred stock - no par value; 150,000 shares authorized; 0 shares issued and outstanding	—	—
Common stock - no par value; 90,000,000 shares authorized; 7,951,749 and 7,940,168 shares issued and outstanding at September 30, 2020 and December 31, 2019, respectively	—	—
Additional paid-in capital	144,048	142,797
Retained earnings (accumulated deficit)	4,705	(14,955)
Accumulated other comprehensive income (loss)	823	(164)
Total shareholders' equity	149,576	127,678
Total liabilities and shareholders' equity	\$ 1,972,897	\$ 1,251,682

See accompanying notes to condensed consolidated financial statements.

**FIRST WESTERN FINANCIAL, INC.**  
**CONDENSED CONSOLIDATED STATEMENTS OF INCOME (UNAUDITED)**  
(in thousands, except per share amounts)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2020	2019	2020	2019
<b>Interest and dividend income:</b>				
Loans, including fees	\$ 14,138	\$ 10,672	\$ 37,342	\$ 31,490
Investment securities	173	312	692	954
Federal funds sold and other	99	489	358	1,254
Total interest and dividend income	14,410	11,473	38,392	33,698
<b>Interest expense:</b>				
Deposits	1,067	3,363	4,779	9,268
Other borrowed funds	425	170	968	559
Total interest expense	1,492	3,533	5,747	9,827
Net interest income	12,918	7,940	32,645	23,871
Less: provision for loan losses	1,496	100	3,987	216
Net interest income, after provision for loan losses	11,422	7,840	28,658	23,655
<b>Non-interest income:</b>				
Trust and investment management fees	4,814	4,824	14,154	14,186
Net gain on mortgage loans	12,304	3,291	24,958	8,009
Bank fees	340	283	929	912
Risk management and insurance fees	483	176	912	838
Income on company-owned life insurance	91	95	273	284
Net gain on sale of securities	—	119	—	119
Total non-interest income	18,032	8,788	41,226	24,348
Total income before non-interest expense	29,454	16,628	69,884	48,003
<b>Non-interest expense:</b>				
Salaries and employee benefits	10,212	8,504	25,384	23,821
Occupancy and equipment	1,619	1,388	4,574	4,193
Professional services	1,288	745	3,542	2,557
Technology and information systems	1,032	961	2,994	3,046
Data processing	1,038	854	2,922	2,282
Marketing	395	272	1,063	991
Amortization of other intangible assets	4	52	44	366
Goodwill impairment	—	—	—	1,572
Net loss on assets held for sale	—	—	553	—
Provision for other real estate owned	100	—	100	—
Other	944	666	2,747	1,873
Total non-interest expense	16,632	13,442	43,923	40,701
<b>Income before income taxes</b>	12,822	3,186	25,961	7,302
Income tax expense	3,192	780	6,301	1,865
<b>Net income available to common shareholders</b>	\$ 9,630	\$ 2,406	\$ 19,660	\$ 5,437
<b>Earnings per common share:</b>				
Basic	\$ 1.22	\$ 0.30	\$ 2.49	\$ 0.69
Diluted	\$ 1.20	\$ 0.30	\$ 2.47	\$ 0.69

See accompanying notes to condensed consolidated financial statements.

**FIRST WESTERN FINANCIAL, INC.**  
**CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (UNAUDITED)**  
**(in thousands)**

	<u>Three Months Ended September 30,</u>		<u>Nine Months Ended September 30,</u>	
	<u>2020</u>	<u>2019</u>	<u>2020</u>	<u>2019</u>
Net income	\$ 9,630	\$ 2,406	\$ 19,660	\$ 5,437
Other comprehensive income items:				
Net change in unrealized gains on available-for-sale securities	(28)	321	1,305	2,364
Income tax effect	7	(83)	(318)	(611)
Total other comprehensive income (loss) items	(21)	238	987	1,753
Comprehensive income	<u>\$ 9,609</u>	<u>\$ 2,644</u>	<u>\$ 20,647</u>	<u>\$ 7,190</u>

See accompanying notes to condensed consolidated financial statements.



**FIRST WESTERN FINANCIAL, INC.**  
**CONDENSED CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY (UNAUDITED)**  
(in thousands, except share amounts)

	<u>Shares</u>		<u>Retained Earnings (Accumulated Deficit)</u>	<u>Accumulated Other Comprehensive Income (Loss)</u>	<u>Total</u>
	<u>Common Stock</u>	<u>Additional Paid-In Capital</u>			
Balance at July 1, 2019	7,983,866	\$ 142,095	\$ (19,933)	\$ (5)	\$ 122,157
Net income	—	—	2,406	—	2,406
Share repurchase	(582)	(8)	—	—	(8)
Other comprehensive income, net of tax	—	—	—	238	238
Stock-based compensation	—	939	—	—	939
Balance at September 30, 2019	<u>7,983,284</u>	<u>\$ 143,026</u>	<u>\$ (17,527)</u>	<u>\$ 233</u>	<u>\$ 125,732</u>
Balance at July 1, 2020	7,939,024	\$ 143,498	\$ (4,925)	\$ 844	\$ 139,417
Net income	—	—	9,630	—	9,630
Settlement of share awards	12,725	(88)	—	—	(88)
Other comprehensive loss, net of tax	—	—	—	(21)	(21)
Stock-based compensation	—	638	—	—	638
Balance at September 30, 2020	<u>7,951,749</u>	<u>\$ 144,048</u>	<u>\$ 4,705</u>	<u>\$ 823</u>	<u>\$ 149,576</u>
Balance at January 1, 2019	7,968,420	\$ 141,359	\$ (23,199)	\$ (1,285)	\$ 116,875
Net income	—	—	5,437	—	5,437
Settlement of share awards	15,446	(110)	—	—	(110)
Adoption of ASU 2018-02	—	—	235	(235)	—
Stock repurchase	(582)	(8)	—	—	(8)
Other comprehensive income, net of tax	—	—	—	1,753	1,753
Stock-based compensation	—	1,785	—	—	1,785
Balance at September 30, 2019	<u>7,983,284</u>	<u>\$ 143,026</u>	<u>\$ (17,527)</u>	<u>\$ 233</u>	<u>\$ 125,732</u>
Balance at January 1, 2020	7,940,168	\$ 142,797	\$ (14,955)	\$ (164)	\$ 127,678
Net income	—	—	19,660	—	19,660
Other comprehensive income, net of tax	—	—	—	987	987
Settlement of share awards	34,260	(258)	—	—	(258)
Stock repurchases	(22,679)	(370)	—	—	(370)
Stock-based compensation	—	1,879	—	—	1,879
Balance at September 30, 2020	<u>7,951,749</u>	<u>\$ 144,048</u>	<u>\$ 4,705</u>	<u>\$ 823</u>	<u>\$ 149,576</u>

See accompanying notes to condensed consolidated financial statements.

**FIRST WESTERN FINANCIAL, INC.**  
**CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)**  
(in thousands)

	<b>Nine Months Ended September 30,</b>	
	<b>2020</b>	<b>2019</b>
<b>Cash flows from operating activities</b>		
Net income	\$ 19,660	\$ 5,437
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Depreciation and amortization	826	1,363
Deferred income tax benefit	(1,699)	(727)
Stock-based compensation	1,879	1,785
Provision for loan losses	3,987	216
Net amortization of investment securities	346	118
Stock dividends received on correspondent bank stock	(12)	(25)
Increase in cash surrender value of company-owned life insurance	(273)	(284)
Net gain on mortgage loans	(24,958)	(8,009)
Origination of mortgage loans held for sale	(917,524)	(442,790)
Proceeds from mortgage loans	889,208	393,886
Gain on sale of securities	—	(119)
Loss on assets held for sale	553	—
Loss on impairment of goodwill	—	1,572
Provision for other real estate owned	100	—
Net changes in operating assets and liabilities:		
Accounts receivable	492	(468)
Accrued interest receivable and other assets	(5,531)	(81)
Accrued interest payable and other liabilities	3,394	1,847
Net cash used in operating activities	<u>(29,552)</u>	<u>(46,279)</u>
<b>Cash flows from investing activities</b>		
Activity in available-for-sale securities:		
Maturities, prepayments, and calls	20,890	6,202
Sales	—	7,506
Purchases	(2,000)	(29,750)
Purchases of correspondent bank stock	(698)	(1,237)
Redemption of correspondent bank stock	—	3,168
Purchases of premises and equipment	(708)	(380)
Proceeds from sale of premises and equipment	10	—
Net cash paid on acquisitions (Note 2)	(61,316)	—
Loan and note receivable originations and principal collections, net	<u>(388,048)</u>	<u>(32,439)</u>
Net cash used in investing activities	<u>(431,870)</u>	<u>(46,930)</u>
<b>Cash flows from financing activities</b>		
Net change in deposits	413,808	171,146
Proceeds from subordinated notes	8,000	—
Settlement of restricted stock	(258)	(110)
Recognition of capitalized subordinated notes issuance costs	(113)	—
Repurchase of common stock	(370)	(8)
Payments to Federal Reserve borrowings	(238)	—
Proceeds from Federal Reserve borrowings	204,313	—
Payments to Federal Home Loan Bank Topeka borrowings	(27,000)	(72,346)
Proceeds from Federal Home Loan Bank Topeka borrowings	<u>35,000</u>	<u>67,346</u>
Net cash provided by financing activities	<u>633,142</u>	<u>166,028</u>
Net change in cash and cash equivalents	171,720	72,819
Cash and cash equivalents, beginning of year	78,638	73,357
<b>Cash and cash equivalents, end of period</b>	<u>\$ 250,358</u>	<u>\$ 146,176</u>
Supplemental cash flow information:		
Interest paid on deposits and borrowed funds	\$ 5,699	\$ 9,702
Income tax payment, net of refunds received	6,417	1,562
Cash paid for amounts included in the measurement of lease liabilities	4,267	4,091
Supplemental noncash disclosures:		
Adoption of ASU 2018-02 - Reclassification of stranded tax effects	—	235
Change in unrealized gain	1,305	2,364
Lease right-of-use-asset obtained in exchange for lease liabilities	649	16,580
Reclass of held for sale assets, net of liabilities	\$ 10	\$ 3,442

See accompanying notes to condensed consolidated financial statements.

**FIRST WESTERN FINANCIAL, INC.**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)**

**NOTE 1 - ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

**Business and Basis of Presentation:** The condensed consolidated financial statements include the accounts of First Western Financial, Inc. (“FWFI”), incorporated in Colorado on July 18, 2002, and its direct and indirect wholly-owned subsidiaries listed below (collectively referred to as the “Company” or “we”, “us”, or “our”).

FWFI is a bank holding company with financial holding company status registered with the Board of Governors of the Federal Reserve System. FWFI wholly owns the following subsidiaries: First Western Trust Bank (the “Bank”), First Western Capital Management Company (“FWCM”), and Ryder, Stilwell Inc. (“RSI”). The Bank wholly owns the following subsidiaries, which are therefore indirectly wholly-owned by FWFI: First Western Merger Corporation (“Merger Corp.”), and RRI, LLC (“RRI”). RSI and RRI are not active operating entities.

The Company provides a fully-integrated suite of wealth management services including, private banking, personal trust, investment management, mortgage loans, and institutional asset management services to individual and corporate clients principally in Colorado (metro Denver, Aspen, Boulder, Fort Collins and Vail Valley), Arizona (Phoenix and Scottsdale), California (Century City, Los Angeles) and Wyoming (Jackson Hole and Laramie). The Company’s revenues are generated from its full range of product offerings as noted above, but principally from net interest income (the interest income earned on the Bank’s assets net of funding costs), fee-based wealth advisory, investment management, asset management and personal trust services, and net gains earned on selling mortgage loans.

The condensed consolidated financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America (“GAAP”) for interim financial information and pursuant to the rules and regulations of the U.S. Securities and Exchange Commission (“SEC”). Accordingly, they do not include all the information and footnotes required by GAAP for complete financial statements. The December 31, 2019 condensed consolidated balance sheet has been derived from the audited financial statements for the year ended December 31, 2019.

In the opinion of management, all adjustments that were recurring in nature and considered necessary have been included for fair presentation of the Company’s financial position and results of operations. Operating results for the three and nine months ended September 30, 2020 are not necessarily indicative of results that may be expected for the full year ending December 31, 2020. In preparing the condensed consolidated financial statements, the Company is required to make estimates and assumptions that affect the reported amount of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could be significantly different from those estimates.

The condensed consolidated financial statements and notes should be read in conjunction with the Company’s Annual Report on Form 10-K for the year ended December 31, 2019 as filed with the SEC.

**Consolidation:** The Company’s policy is to consolidate all majority-owned subsidiaries in which it has a controlling financial interest and variable-interest entities where the Company is deemed to be the primary beneficiary. All material intercompany accounts and transactions have been eliminated in consolidation.

On May 15, 2020, the Company completed a branch purchase and assumption transaction (“Branch Acquisition”) with Simmons Bank (“Simmons”). Management concluded that the acquisition represented a business combination, which is accounted for using the acquisition method, with the results of operations included in the Company’s consolidated financial statements as of the acquisition date. For additional information, see Note 2.

**Use of Estimates:** To prepare financial statements in conformity with GAAP, management makes estimates and assumptions based on available information. These estimates and assumptions affect the amounts reported in the consolidated financial statements and the disclosures provided, and actual results could differ. Information available which could affect these judgments include, but are not limited to, changes in interest rates, changes in the performance of the economy, including the impact of the COVID-19 pandemic, and changes in the financial condition of borrowers. Material estimates that are particularly susceptible to significant change include: the determination of the allowance for loan losses, the evaluation of goodwill impairment, and the fair value of financial instruments.

The Company could experience a material adverse effect on its business as a result of the impact of the COVID-19 pandemic, and the resulting governmental actions to curtail its spread. It is at least reasonably possible that information which was available at the date of the financial statements will change in the near term due to the COVID-19 pandemic and that the effect of the change would be material to the financial statements. The extent to which the COVID-19 pandemic will impact our estimates and assumptions is highly uncertain.

**Concentration of Risk:** Most of the Company's lending activity is to clients located in and around Denver, Colorado; Phoenix and Scottsdale, Arizona; and Jackson Hole, Wyoming. The Company does not believe it has significant concentrations in any one industry or client. At September 30, 2020 and December 31, 2019, 62.8%, and 71.7%, respectively, of the Company's loan portfolio was secured by real estate collateral. Declines in real estate values in the primary markets the Company operates in could negatively impact the Company.

**Revenue Recognition:** In accordance with the Financial Accounting Standards Board ("FASB"), Revenue from Contracts with Customers ("Topic 606"), trust and investment management fees are earned by providing trust and investment services to clients. The Company's performance obligation under these contracts is satisfied over time as the services are provided. Fees are recognized monthly based on the average monthly value of the assets under management and the corresponding fee rate based on the terms of the contract. Performance based incentive fees earned with respect to investment management contracts for the three and nine months ended September 30, 2020 and the year ended December 31, 2019 were immaterial. Receivables are recorded on the condensed consolidated balance sheet in the accounts receivable line item. Income related to trust and investment management fees, bank fees, and risk management and insurance fees on the condensed consolidated statement of operations for the three and nine months ended September 30, 2020 and September 30, 2019 are considered in scope of Topic 606.

**Transition of LIBOR to an Alternative Reference Rate:** In July 2017, the United Kingdom's Financial Conduct Authority, which regulates the London Interbank Offered Rate ("LIBOR"), announced that after 2021 it will no longer persuade or compel banks to submit rates for the calculation of LIBOR. In response, the Federal Reserve Board and the Federal Reserve Bank of New York convened the Alternative Reference Rates Committee to identify a set of alternative reference interest rates for possible use as market benchmarks. This committee has proposed the Secured Overnight Financing Rate ("SOFR") as its recommended alternative to U.S. dollar LIBOR, and the Federal Reserve Bank of New York began publishing SOFR rates in the second quarter of 2018. SOFR is based on a broad segment of the overnight Treasury repurchase market and is intended to be a measure of the cost of borrowing cash overnight collateralized by Treasury securities.

Certain of the Company's assets and liabilities are indexed to LIBOR, with exposure extending past December 31, 2021. The Company is currently evaluating and planning for the eventual replacement of the LIBOR benchmark interest rate, including the possibility of SOFR as the dominant replacement. In general, the transition away from LIBOR may result in increased market risk, credit risk, operational risk and business risk for the Company. The Company has developed a LIBOR transition plan, which addresses governance, risk management, legal, operational, systems and operations, fallback language, and other aspects of planning.

**COVID-19 and CARES Act:** On March 11, 2020 the World Health Organization declared the outbreak of COVID-19 a global pandemic, which continues to spread throughout the United States and the around the world. In response to the COVID-19 pandemic, the President signed the Coronavirus Aid, Relief and Economic Security Act ("CARES Act") into law on March 27, 2020. The objective of the CARES Act is to prevent a severe economic downturn using various measures, including economic stimulus to significantly impacted industry sectors. We continue to monitor the impact of COVID-19 closely, as well as any effects that may result from the CARES Act and other government actions. However, the extent to which the COVID-19 pandemic will impact our operations and financial results is highly uncertain.

The CARES Act created the Paycheck Protection Program ("PPP"), which is administered by the Small Business Administration ("SBA"). The PPP is intended to provide loans to small businesses to pay their employees, rent, mortgage interest and utilities. The loans may be forgiven conditioned upon the client providing payroll documentation evidencing their compliant use of funds and otherwise complying with the terms of the program. The Bank is an approved SBA lender and supported the community and clients by originating PPP loans during the nine months ended September 30, 2020. PPP loans are classified in the Cash, Securities and Other portion of the loan portfolio. See Note 4 for further discussion on our PPP loans.

As a result of the COVID-19 pandemic, a loan modification program was designed and implemented to assist our clients experiencing financial stress resulting from the economic impacts caused by the global pandemic. The Company offered loan extensions, temporary payment moratoriums, and financial covenant waivers for commercial and consumer borrowers impacted by the pandemic and had a risk rating of "pass" and had not been delinquent in making interest or principal payment by more than 30 days during the last two years.

The CARES Act provides banks optional, temporary relief from accounting for certain loan modifications as troubled debt restructurings ("TDR"). The modifications must be related to the adverse effects of COVID-19, and certain other criteria are required to be met in order to apply the relief. Interagency guidance from Federal Reserve and the Federal Deposit Insurance Corporation ("FDIC") confirmed with the FASB that short-term modifications made on a good faith basis in response to COVID-19 to borrowers who were current prior to any relief, are not to be considered a TDR. We

believe our loan modification program meets that definition and have not classified any of these modifications as a TDR at September 30, 2020. See Note 4 for further discussion on our loan modification program.

The Company is a participant in the Federal Reserve's Main Street Lending Program ("MSLP") to support lending to small and medium-sized for profit businesses and nonprofit organizations that were in sound financial condition before the onset of the COVID-19 pandemic. The Company may sell a 95% participation in a new MSLP loan to the Main Street Special Purpose Vehicle ("SPV") at par value. The Company must retain 5% of the MSLP loan until (i) it matures or (ii) neither the Main Street SPV nor a Governmental Assignee holds an interest in MSLP Loan in any capacity, whichever comes first. See Note 4 for further discussion on our participation in the program.

Reclassifications: Certain items in prior year financial statements were reclassified to conform to the current presentation. Such reclassifications had no impact on net income or total shareholders' equity.

Recently adopted accounting pronouncements: The following reflects recent accounting pronouncements that were adopted by the Company since the end of the Company's fiscal year ended December 31, 2019.

In August 2018, the FASB issued ASU 2018-13, Fair Value Measurement—Changes to the Disclosure Requirements for Fair Value Measurement (Topic 820) ("ASU 2018-13"). ASU 2018-13 modifies the disclosure requirements on fair value measurements by requiring that Level 3 fair value disclosures include the range and weighted average of significant unobservable inputs used to develop those fair value measurements. For certain unobservable inputs, an entity may disclose other quantitative information in lieu of the weighted average if the entity determines that other quantitative information would be a more reasonable and rational method to reflect the distribution of unobservable inputs used to develop Level 3 fair value measurements. ASU 2018-13 was effective for the Company on January 1, 2020 and did not have a material impact on the Company's financial statement disclosures.

In April 2020, the FASB issued ASU 2020-04, "Reference Rate Reform (Topic 848): Facilitation of the Effects of Reference Rate Reform on Financial Reporting." ("ASU 2020-04"), ASU 2020-04 is intended to provide relief for companies preparing for discontinuation of interest rates based on LIBOR. The ASU provides optional expedients and exceptions for applying GAAP to contract modifications and hedging relationships, subject to meeting certain criteria, that reference LIBOR or other reference rates expected to be discontinued. ASU 2020-04 also provides for a one-time sale and/or transfer to AFS or trading to be made for HTM debt securities that both reference an eligible reference rate and were classified as HTM before January 1, 2020. ASU 2020-04 was effective for all entities as of March 12, 2020 and through December 31, 2022. Companies can apply the ASU as of the beginning of the interim period that includes March 12, 2020 or any date thereafter. The guidance requires companies to apply the guidance prospectively to contract modifications and hedging relationships while the one-time election to sell and/or transfer debt securities classified as HTM may be made any time after March 12, 2020. ASU 2020-04 was effective for the Company on March 12, 2020 and did not have a material impact on the Company's financial statement disclosures.

Recently issued accounting pronouncements, not yet adopted: The following reflects pending pronouncements with an update to the expected impact since the end of the Company's fiscal year ended December 31, 2019.

In February 2016, the FASB issued ASU 2016-13, Financial Instruments—Credit Losses (Topic 326) ("ASU 2016-13"). ASU 2016-13 replaces the incurred loss model with an expected loss model, which is referred to as the current expected credit loss ("CECL") model. The CECL model is applicable to the measurement of credit losses on the financial assets measured at amortized cost, including loan receivables, held-to-maturity debt securities, and reinsurance receivables. It also applies to off-balance sheet credit exposures not accounted for as insurance (loan commitments, standby letters of credit, financial guarantees, and other similar instruments) and net investments in leases recognized by a lessor. For all other assets within the scope of CECL, a cumulative-effect adjustment will be recognized in retained earnings and the allowance for loan losses as of the beginning of the first reporting period in which the guidance is effective. ASU 2016-13 was set to be effective for most public companies on January 1, 2020. However, at the October 16, 2019 FASB meeting, the FASB voted unanimously to delay the effective date of CECL adoption for smaller reporting companies ("SRCs") to January 1, 2023.

During the three months ended September 30, 2020, the CECL committee of the Company continued to work through its implementation plan. The Company has integrated historical and current loan level data as required by CECL and is working with its third-party vendor solution to begin evaluating the methodologies available under the CECL model on its loan portfolios. The Company also continues to evaluate documentation requirements, internal control structure, relevant data sources, and system configurations. The Company has completed a successful integration of the required fields and historical data for key loan, client and collateral data within the third-party solution and has been able to run parallels of our current ALLL calculation in the software to compare to our internal calculation and reconcile known differences. The Company has started the process of selecting the methodologies to be used for each segment of its loan

portfolio and started preliminarily testing to determine the impact of each methodology. Currently, we are unable to estimate the impact the adoption of this update will have on the consolidated financial statements and disclosures. However, the Company expects the impact of the adoption will be significantly influenced by the composition and characteristics of its loan portfolios along with economic conditions prevalent as of the date of adoption. The Company expects to implement the new standard beginning January 1, 2023.

In January 2017, the FASB issued ASU 2017-04, *Intangibles—Goodwill and Other (Topic 350): Simplifying the Test for Goodwill Impairment* ("ASU 2017-04"), which amended existing guidance to simplify the subsequent measurement of goodwill by eliminating Step 2 from the goodwill impairment test. The amendments require an entity to perform its annual, or interim, goodwill impairment test by comparing the fair value of a reporting unit with its carrying amount and recognizing an impairment charge of the amount by which the carrying amount exceeds the reporting unit's fair value, not to exceed the total amount of goodwill allocated to that reporting unit. ASU 2017-04 was set to be effective for the Company on January 1, 2021. However, ASU 2019-10 amended the mandatory effective date for ASU 2014-07 to January 1, 2023 for SRC's, with earlier adoption permitted. This update is not expected to have a significant impact on the financial statements and disclosures.

## NOTE 2 - ACQUISITIONS

On February 10, 2020, the Company entered into a branch purchase and assumption agreement with Simmons Bank, a subsidiary of Simmons First National Corporation, to acquire all of the Simmons' Colorado locations, including three branches and one loan production office located in Denver, as well as certain deposits, loans and other assets. The transaction closed on May 15, 2020 with an aggregate purchase price of \$61.6 million, including a deposit premium of 6.06%.

During the third quarter 2020, the Company closed two of the branches and the loan production office acquired in the Branch Acquisition completed in May 2020.

Goodwill of \$4.5 million was recognized in the transaction and represents expected synergies and cost savings resulting from combining the expanded footprint and expertise of the associates.

The following table summarizes the estimated fair values of the assets acquired and liabilities assumed in the May 15, 2020 transaction with Simmons, and reflects all adjustments made to the fair value of the opening balance sheet through September 30, 2020 (in thousands):

	May 15, 2020
<b>Fair value of consideration transferred</b>	
Cash consideration	\$ 61,599
Total fair value of consideration transferred	61,599
<b>Assets acquired</b>	
Cash and due from banks	283
Loans, net	119,552
Core deposit intangible <sup>(1)</sup>	53
Accrued income and other assets	382
Total assets acquired	120,270
<b>Liabilities assumed</b>	
Deposits	63,080
Accrued expenses and other liabilities	96
Total liabilities assumed	63,176
Net assets acquired	57,094
Goodwill recognized	\$ 4,505

<sup>(1)</sup> The core deposit intangible was determined to have an estimated life of 10 years.

The fair value of net assets acquired includes fair value adjustments to loans as of the acquisition date. The fair value adjustments were determined using discounted expected cash flows. Loans had a fair value of \$119.6 million and a contractual balance of \$120.6 million as of May 15, 2020. The discount on the loans acquired in this transaction due to

anticipated credit loss, as well as considerations for market interest rates, totaled \$1.1 million, representing 0.9% of their contractual balances. No allowance for loan losses related to acquired loans was brought over as a result of the Branch Acquisition. Loans acquired included short-term modifications made on a good faith basis by Simmons, in response to COVID-19. All of the modification were given additional review prior to the closing of the purchase and management determined that loans were performing prior to modification and were not considered impaired at purchase. There were no loans acquired that were considered to be purchased credit impaired ("PCI") loans.

The composition of the acquired loan portfolio as of May 15, 2020 is detailed in the table below (in thousands):

	May 15, 2020
Cash, Securities and Other	\$ 13,457
Construction and Development	40,407
1-4 Family Residential	7,252
Non-Owner Occupied Commercial Real Estate ("CRE")	545
Owner Occupied CRE	321
Commercial and Industrial	58,660
<b>Total gross loans</b>	<b>\$ 120,642</b>

The Company incurred \$0.1 million in expenses related to the acquisition during the three months ended September 30, 2020. Acquisition expenses, including professional fees, are included in the total noninterest expense line item in the condensed consolidated statement of income.

### NOTE 3 - INVESTMENT SECURITIES

The following presents the amortized cost and fair value of securities available-for-sale, with gross unrealized gains and losses recognized in accumulated other comprehensive income as of September 30, 2020 and December 31, 2019 (in thousands):

September 30, 2020	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
<b>Investment securities available-for-sale:</b>				
U.S. Treasury debt	\$ 250	\$ 6	\$ —	\$ 256
Corporate bonds	2,000	48		2,048
Government National Mortgage Association ("GNMA") mortgage-backed securities – residential	28,844	944	—	29,788
Federal National Mortgage Association ("FNMA") mortgage-backed securities – residential	2,626	90	—	2,716
Corporate collateralized mortgage obligations ("CMO") and mortgage-backed securities ("MBS")	5,826	93	(73)	5,846
<b>Total securities available-for-sale</b>	<b>\$ 39,546</b>	<b>\$ 1,181</b>	<b>\$ (73)</b>	<b>\$ 40,654</b>

December 31, 2019	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
<b>Investment securities available-for-sale:</b>				
U.S. Treasury debt	\$ 250	\$ 4	\$ —	\$ 254
GNMA mortgage-backed securities – residential	45,490	157	(335)	45,312
FNMA mortgage-backed securities – residential	2,935	11	(29)	2,917
Corporate CMO and MBS	10,425	40	(45)	10,420
<b>Total securities available-for-sale</b>	<b>\$ 59,100</b>	<b>\$ 212</b>	<b>\$ (409)</b>	<b>\$ 58,903</b>

At September 30, 2020, the amortized cost and estimated fair value of available-for-sale securities have contractual maturity dates shown in the table below (in thousands). Expected maturities will differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties. Securities not due at a single maturity date are shown separately.

<b>September 30, 2020</b>	<b>Amortized Cost</b>	<b>Fair Value</b>
Due after one year through five years	\$ 250	\$ 256
Due after ten years	2,000	2,048
Securities (agency and CMO)	37,296	38,350
Total	<u>\$ 39,546</u>	<u>\$ 40,654</u>

In 2014, the Company began investing in a small business investment company (“SBIC”) fund administered by the Small Business Administration. During the nine months ended September 30, 2020 and the year ended December 31, 2019, the Company invested \$0.5 million and \$0.4 million, respectively, in SBIC. At September 30, 2020, the Company held a balance of \$2.1 million with SBIC which is included in other assets in the accompanying consolidated balance sheets. The Company may be obligated to invest up to an additional \$0.9 million in future SBIC investments.

At September 30, 2020 and December 31, 2019, securities with carrying values totaling \$4.2 million and \$5.5 million, respectively, were pledged to secure various public deposits and credit facilities of the Company.

At September 30, 2020 and December 31, 2019, there were no holdings of securities of any one issuer, other than the U.S. Government sponsored entities and agencies, in an amount greater than 10% of shareholders’ equity.

At September 30, 2020 and December 31, 2019, seven securities and twenty-six securities, respectively, were in an unrealized loss position, with unrealized losses totaling \$0.1 million and \$0.4 million, respectively. Two of the securities in an unrealized loss position at September 30, 2020 have been in a continuous unrealized loss position for more than twelve months, and the remaining securities in a loss position have been in a continuous unrealized loss position for less than twelve months. The unrealized loss positions were caused primarily by interest rate changes and market assumptions about prepayments of principal and interest on the underlying mortgages. Because the decline in market value is attributable to market conditions, not credit quality, and because the Company has the ability and intent to hold these investments until a recovery of fair value, which may be near or at maturity, the Company does not consider these investments to be other-than-temporarily impaired at September 30, 2020.

The following table summarizes securities with unrealized losses at September 30, 2020 and December 31, 2019, aggregated by major security type and length of time in a continuous unrealized loss position (in thousands, before tax):

<b>September 30, 2020</b>	<b>Less than 12 Months</b>		<b>12 Months or Longer</b>		<b>Total</b>	
	<b>Fair Value</b>	<b>Unrealized Losses</b>	<b>Fair Value</b>	<b>Unrealized Losses</b>	<b>Fair Value</b>	<b>Unrealized Losses</b>
Corporate CMO and MBS	1,553	(54)	590	(19)	2,143	(73)
Total	<u>\$ 1,553</u>	<u>\$ (54)</u>	<u>\$ 590</u>	<u>\$ (19)</u>	<u>\$ 2,143</u>	<u>\$ (73)</u>

  

<b>December 31, 2019</b>	<b>Less than 12 Months</b>		<b>12 Months or Longer</b>		<b>Total</b>	
	<b>Fair Value</b>	<b>Unrealized Losses</b>	<b>Fair Value</b>	<b>Unrealized Losses</b>	<b>Fair Value</b>	<b>Unrealized Losses</b>
GNMA mortgage-backed securities - residential	\$ 28,203	\$ (193)	\$ 4,450	\$ (142)	\$ 32,653	\$ (335)
FNMA mortgage-backed securities - residential	—	—	2,347	(29)	2,347	(29)
Corporate CMO and MBS	7,780	(45)	—	—	7,780	(45)
Total	<u>\$ 35,983</u>	<u>\$ (238)</u>	<u>\$ 6,797</u>	<u>\$ (171)</u>	<u>\$ 42,780</u>	<u>\$ (409)</u>

The Company did not sell any securities during the three and nine months ended September 30, 2020. The Company sold \$7.5 million of securities and realized \$0.1 million of gains, from the sale of securities using the specific identification method for the three and nine months ended September 30, 2019.



**NOTE 4 - LOANS AND THE ALLOWANCE FOR LOAN LOSSES**

The following presents a summary of the Company's loans as of the dates noted (in thousands):

	September 30, 2020	December 31, 2019
Cash, Securities and Other <sup>(1)</sup>	\$ 371,481	\$ 146,701
Construction and Development	105,717	28,120
1-4 Family Residential	446,959	400,134
Non-Owner Occupied CRE	243,564	165,179
Owner Occupied CRE	154,138	127,968
Commercial and Industrial	185,625	128,457
Total loans held for investment	1,507,484	996,559
Deferred costs (fees) and unamortized premiums/(unaccreted discounts), net	(1,408)	1,448
Allowance for loan losses	(11,845)	(7,875)
Loans, net	<u>\$ 1,494,231</u>	<u>\$ 990,132</u>

<sup>(1)</sup> Includes PPP loans of \$206.1 million as of September 30, 2020.

As of September 30, 2020, total loans held for investment include \$124.7 million of performing loans purchased as part of the Branch Acquisition. See Note 2 – Acquisitions for more information.

The CARES Act created the PPP, which is administered by the SBA. The PPP is intended to provide loans to small businesses to pay their employees, rent, mortgage interest and utilities. The loans may be forgiven conditioned upon the client providing payroll documentation evidencing their compliant use of funds and otherwise complying with the terms of the program. The Bank is an approved SBA lender and at September 30, 2020 the Cash, Securities and Other portion of the loan portfolio included \$206.1 million of PPP loans, or 55.5% of the total category.

The Company is a participant in the Federal Reserve's MSLP to support lending to small and medium-sized for profit businesses and nonprofit organizations that were in sound financial condition before the onset of the COVID-19 pandemic. As of September 30, 2020, the Company's Commercial and Industrial loans included one MSLP loan with the net carrying amount of \$2.4 million.

*Loan Modifications*

As a result of the COVID-19 pandemic, a loan modification program was designed and implemented to assist our clients experiencing financial stress resulting from the economic impacts caused by the global pandemic. The Company was offering loan extensions, temporary payment moratoriums, and financial covenant waivers for commercial and consumer borrowers impacted by the pandemic who have a pass risk rating and have not been delinquent over 30 days on payments in the last two years.

As of September 30, 2020, the Company's loans include forty-four modified loans, including acquired loans, across multiple industries in the amount of \$66.7 million.

The following presents loan modifications as a result of COVID-19 as of September 30, 2020 (dollars in thousands):

	Total Loans	# of Modified Loans	Outstanding Balance of Modified Loans	% of Total Loan Balance Modified
Cash, Securities and Other	\$ 371,481	1	\$ 1,496	0.40 %
Construction and Development	105,717	—	—	—
1-4 Family Residential	446,959	6	4,441	0.99
Non-Owner Occupied CRE	243,564	22	38,229	15.70
Owner Occupied CRE	154,138	10	17,524	11.37
Commercial and Industrial	185,625	5	5,048	2.72
Total Loans	<u>\$ 1,507,484</u>	<u>44</u>	<u>\$ 66,738</u>	<u>4.43 %</u>

The CARES Act provides banks optional, temporary relief from accounting for certain loan modifications as a TDR. The modifications must be related to the adverse effects of COVID-19, and certain other criteria are required to be met in order to apply the relief. Interagency guidance from Federal Reserve and the FDIC confirmed with the FASB that

short-term modifications made on a good faith basis in response to COVID-19 to borrowers who were current prior to any relief, are not to be considered TDRs. We believe our loan modification program meets that definition. In accordance with that guidance, the Company is recognizing interest income on all loans modified for temporary payment moratoriums, primarily for a period of 180 days or less.

All loans modified in response to COVID-19 are classified as performing and pass rated as of September 30, 2020. These loans are included in the allowance for loan loss general reserve in accordance with ASC 450-20. Management has increased our loan level reviews and portfolio monitoring to address the changing environment. The Company continues to meet regularly with clients who could be more highly impacted by the recent COVID-19 pandemic. These are borrowers in accommodations, transportation and restaurant industries, we believe may be more impacted by the pandemic, for instance those loans where there may be a greater than 50% probability of a downgrade, covenant violation or 20% reduction in collateral position. The portion of our credit exposure to the highest risk industries impacted by COVID-19, such as accommodations, transportation and restaurants, is less than 3.0% of our loan portfolio. Management believes the diversity of the loan portfolio is prudent and remains consistent with the credit culture and goals of the Bank.

Interest accrued during the modification term on modified loans is deferred to the end of the loan term. As of September 30, 2020, no allowance for loan loss was deemed necessary on the accrued interest balances related to loan modifications.

The following presents, by class, an aging analysis of the recorded investments (excluding accrued interest receivable, deferred costs (fees) and unamortized premiums/ (unaccreted discounts) which are not material) in loans past due as of September 30, 2020 and December 31, 2019 (in thousands):

	30-59 Days Past Due	60-89 Days Past Due	90 or More Days Past Due	Total Loans Past Due	Current	Total Recorded Investment
<b>September 30, 2020</b>						
Cash, Securities and Other	\$ 30	\$ —	\$ 66	\$ 96	\$ 371,385	\$ 371,481
Construction and Development	—	—	—	—	105,717	105,717
1-4 Family Residential	4,883	1,197	—	6,080	440,879	446,959
Non-Owner Occupied CRE	1,022	—	—	1,022	242,542	243,564
Owner Occupied CRE	—	—	—	—	154,138	154,138
Commercial and Industrial	522	—	3,679	4,201	181,424	185,625
<b>Total</b>	<b>\$ 6,457</b>	<b>\$ 1,197</b>	<b>\$ 3,745</b>	<b>\$ 11,399</b>	<b>\$ 1,496,085</b>	<b>\$ 1,507,484</b>
	30-59 Days Past Due	60-89 Days Past Due	90 or More Days Past Due	Total Loans Past Due	Current	Total Recorded Investment
<b>December 31, 2019</b>						
Cash, Securities and Other	\$ 525	\$ —	\$ —	\$ 525	\$ 146,176	\$ 146,701
Construction and Development	—	—	—	—	28,120	28,120
1-4 Family Residential	5,688	—	—	5,688	394,446	400,134
Non-Owner Occupied CRE	—	—	—	—	165,179	165,179
Owner Occupied CRE	—	—	—	—	127,968	127,968
Commercial and Industrial	—	3,110	907	4,017	124,440	128,457
<b>Total</b>	<b>\$ 6,213</b>	<b>\$ 3,110</b>	<b>\$ 907</b>	<b>\$ 10,230</b>	<b>\$ 986,329</b>	<b>\$ 996,559</b>

At September 30, 2020 and December 31, 2019, the Company did not have any loans which were more than 90 days delinquent and accruing interest.

#### Non-Accrual Loans and Troubled Debt Restructurings

The following presents the recorded investment in non-accrual loans by class as of the dates noted (in thousands):

	September 30, 2020	December 31, 2019
Cash, Securities and Other	\$ 66	\$ 2,803
Commercial and Industrial	3,679	4,412
<b>Total</b>	<b>\$ 3,745</b>	<b>\$ 7,215</b>

Non-accrual loans classified as TDR accounted for \$3.7 million of the recorded investment at September 30, 2020 and \$7.2 million at December 31, 2019, respectively. Non-accrual loans are classified as impaired loans and individually evaluated for impairment.

The following presents a summary of the unpaid principal balance of loans classified as TDRs by loan type and delinquency status as of the dates noted (in thousands):

	September 30, 2020	December 31, 2019
<b>Accruing</b>		
Commercial and Industrial	\$ 6,136	\$ 5,055
<b>Non-accrual</b>		
Cash, Securities, and Other	64	2,803
Commercial and Industrial	3,679	4,412
<b>Allowance for loan losses associated with TDR</b>	<b>(1,421)</b>	<b>(833)</b>
Net recorded investment	<u>\$ 8,458</u>	<u>\$ 11,437</u>

The Company extended additional principal allowed under the commitment to a Commercial and Industrial borrower for operational needs, subsequent to the loan being classified as a TDR, in the amounts of \$1.3 million and \$0.2 million at September 30, 2020 and December 31, 2019, respectively. The majority owner for this borrower provided \$1.5 million of pledged cash as collateral in 2019 which is still held by the Company, in exchange for this additional funding.

The Company did not modify any loans into TDR status during the three months ended September 30, 2020. The Company modified one loan into a TDR during the nine months ended September 30, 2020. The Borrower was having difficulty making payments in accordance with the original contract terms. The Company restructured the loan including receiving a large paydown and extended the maturity and lowered the interest rate as a result of the Borrower's financial difficulties. The loan has paid off in full as of September 30, 2020.

The Company modified one borrower relationship with two loans into a TDR for the year ended December 31, 2019. The borrower, who has loans that are classified as Commercial and Industrial, was not making payments in accordance with the original contract terms. The modification included an extension of the maturity date that the Company would not have otherwise considered as a result of the Borrower's difficulties. The extension of maturity was for a period of approximately nine months. These two loans are currently on non-accrual and the borrower was not making payments as agreed for the three and nine months ended September 30, 2020.

TDRs are reviewed individually for impairment and are included in the Company's specific reserves in the allowance for loan losses. If charged off, the amount of the charge-off is included in the Company's charge-off factors, which impact the Company's reserves on non-impaired loans.

The following table presents impaired loans by portfolio and related valuation allowance as of the periods presented (in thousands):

	September 30, 2020			December 31, 2019		
	Total Recorded Investment	Unpaid Contractual Principal Balance	Allowance for Loan Losses	Total Recorded Investment	Unpaid Contractual Principal Balance	Allowance for Loan Losses
<b>Impaired loans with a valuation allowance:</b>						
Cash, Securities, and Other	\$ 2	\$ 2	\$ 2	\$ —	\$ —	\$ —
Commercial and Industrial	3,419	3,419	1,421	4,412	4,412	833
Total	<u>\$ 3,421</u>	<u>\$ 3,421</u>	<u>\$ 1,423</u>	<u>\$ 4,412</u>	<u>\$ 4,412</u>	<u>\$ 833</u>
<b>Impaired loans with no related valuation allowance:</b>						
Cash, Securities, and Other	\$ 64	\$ 64	\$ —	\$ 2,803	\$ 2,803	\$ —
Commercial and Industrial	6,396	6,396	—	5,055	5,055	—
Total	<u>\$ 6,460</u>	<u>\$ 6,460</u>	<u>\$ —</u>	<u>\$ 7,858</u>	<u>\$ 7,858</u>	<u>\$ —</u>
<b>Total impaired loans:</b>						
Cash, Securities, and Other	\$ 66	\$ 66	\$ 2	\$ 2,803	\$ 2,803	\$ —
Commercial and Industrial	9,815	9,815	1,421	9,467	9,467	833
Total	<u>\$ 9,881</u>	<u>\$ 9,881</u>	<u>\$ 1,423</u>	<u>\$ 12,270</u>	<u>\$ 12,270</u>	<u>\$ 833</u>

The recorded investment in loans in the previous tables excludes accrued interest, deferred costs (fees) and unamortized premiums/ (unaccreted discounts) which are not material. Interest income, if any, was recognized on the cash basis on non-accrual loans.

The average balance of impaired loans and interest income recognized on impaired loans during the three months ended September 30, 2020 and 2019 are included in the table below (in thousands):

	Three Months Ended September 30,			
	2020		2019	
	Average Recorded Investment	Interest Income Recognized	Average Recorded Investment	Interest Income Recognized
<b>Impaired loans with a valuation allowance:</b>				
Cash, Securities, and Other	\$ 1	\$ —	\$ 185	\$ —
Commercial and Industrial	3,427	—	1,035	—
Total	<u>\$ 3,428</u>	<u>\$ —</u>	<u>\$ 1,220</u>	<u>\$ —</u>
<b>Impaired loans with no related valuation allowance:</b>				
Cash, Securities, and Other	\$ 779	\$ —	\$ 5,062	\$ —
Commercial and Industrial	6,462	85	5,958	138
1-4 Family Residential	—	—	1,213	26
Total	<u>\$ 7,241</u>	<u>\$ 85</u>	<u>\$ 12,233</u>	<u>\$ 164</u>
<b>Total impaired loans:</b>				
Cash, Securities, and Other	\$ 780	\$ —	\$ 5,247	\$ —
Commercial and Industrial	9,889	85	6,993	138
1-4 Family Residential	—	—	1,213	26
Total	<u>\$ 10,669</u>	<u>\$ 85</u>	<u>\$ 13,453</u>	<u>\$ 164</u>

The average balance of impaired loans and interest income recognized on impaired loans during the nine months ended September 30, 2020 and 2019 are included in the table below (in thousands):

	Nine Months Ended September 30,			
	2020		2019	
	Average Recorded Investment	Interest Income Recognized	Average Recorded Investment	Interest Income Recognized
<b>Impaired loans with a valuation allowance:</b>				
Cash, Securities, and Other	\$ 1	\$ —	\$ 185	\$ —
Commercial and Industrial	3,462	—	1,310	—
Total	<u>\$ 3,463</u>	<u>\$ —</u>	<u>\$ 1,495</u>	<u>\$ —</u>
<b>Impaired loans with no related valuation allowance:</b>				
Cash, Securities, and Other	\$ 1,463	\$ —	\$ 8,088	\$ —
Commercial and Industrial	6,088	250	5,463	326
1-4 Family Residential	—	—	1,213	77
Total	<u>\$ 7,551</u>	<u>\$ 250</u>	<u>\$ 14,764</u>	<u>\$ 403</u>
<b>Total impaired loans:</b>				
Cash, Securities, and Other	\$ 1,464	\$ —	\$ 8,273	\$ —
Commercial and Industrial	9,550	250	6,773	326
1-4 Family Residential	—	—	1,213	77
Total	<u>\$ 11,014</u>	<u>\$ 250</u>	<u>\$ 16,259</u>	<u>\$ 403</u>

*Allowance for Loan Losses*

The provision for loan losses for the nine months ended September 30, 2020 was \$4.0 million compared to \$0.2 million for the same period in 2019, primarily reflecting an increase based on the additional variability surrounding the COVID-19 loan modifications made during the prior quarter and increased economic uncertainty along with strong loan growth.

Allocation of a portion of the allowance for loan losses to one category of loans does not preclude its availability to absorb losses in other categories. The following presents the activity in the Company's allowance for loan losses by portfolio class for the periods presented (in thousands):

	Cash, Securities and Other	Construction and Development	1-4 Family Residential	Non-Owner Occupied CRE	Owner Occupied CRE	Commercial and Industrial	Total
<b>Changes in allowance for loan losses for the three months ended September 30, 2020</b>							
Beginning balance	\$ 2,425	\$ 484	\$ 2,708	\$ 1,483	\$ 760	\$ 2,494	\$ 10,354
Provision for (recovery of) loan losses	192	249	392	207	309	147	1,496
Charge-offs	(6)	—	—	—	—	—	(6)
Recoveries	1	—	—	—	—	—	1
Ending balance	<u>\$ 2,612</u>	<u>\$ 733</u>	<u>\$ 3,100</u>	<u>\$ 1,690</u>	<u>\$ 1,069</u>	<u>\$ 2,641</u>	<u>\$ 11,845</u>
<b>Changes in allowance for loan losses for the nine months ended September 30, 2020</b>							
Beginning balance	\$ 1,058	\$ 200	\$ 2,850	\$ 1,176	\$ 911	\$ 1,680	\$ 7,875
Provision for (recovery of) loan losses	1,571	533	250	514	158	961	3,987
Charge-offs	(30)	—	—	—	—	—	(30)
Recoveries	13	—	—	—	—	—	13
Ending balance	<u>\$ 2,612</u>	<u>\$ 733</u>	<u>\$ 3,100</u>	<u>\$ 1,690</u>	<u>\$ 1,069</u>	<u>\$ 2,641</u>	<u>\$ 11,845</u>
<b>Allowance for loan losses at September 30, 2020 allocated to loans evaluated for impairment:</b>							
Individually	\$ 2	\$ —	\$ —	\$ —	\$ —	\$ 1,421	\$ 1,423
Collectively	2,610	733	3,100	1,690	1,069	1,220	10,422
Ending balance	<u>\$ 2,612</u>	<u>\$ 733</u>	<u>\$ 3,100</u>	<u>\$ 1,690</u>	<u>\$ 1,069</u>	<u>\$ 2,641</u>	<u>\$ 11,845</u>
<b>Loans at September 30, 2020, evaluated for impairment:</b>							
Individually	\$ 66	\$ —	\$ —	\$ —	\$ —	\$ 9,815	\$ 9,881
Collectively	371,415	105,717	446,959	243,564	154,138	175,810	1,497,603
Ending balance	<u>\$ 371,481</u>	<u>\$ 105,717</u>	<u>\$ 446,959</u>	<u>\$ 243,564</u>	<u>\$ 154,138</u>	<u>\$ 185,625</u>	<u>\$ 1,507,484</u>
<b>Changes in allowance for loan losses for the three months ended September 30, 2019</b>							
Beginning balance	\$ 1,049	\$ 290	\$ 2,650	\$ 1,086	\$ 800	\$ 1,700	\$ 7,575
Provision for (recovery of) loan losses	258	18	27	(68)	76	(211)	100
Charge-offs	—	—	—	—	—	—	—
Recoveries	—	—	—	—	—	—	—
Ending balance	<u>\$ 1,307</u>	<u>\$ 308</u>	<u>\$ 2,677</u>	<u>\$ 1,018</u>	<u>\$ 876</u>	<u>\$ 1,489</u>	<u>\$ 7,675</u>
<b>Changes in allowance for loan losses for the nine months ended September 30, 2019</b>							
Beginning balance	\$ 764	\$ 232	\$ 2,552	\$ 1,264	\$ 789	\$ 1,850	\$ 7,451
Provision for (recovery of) loan losses	535	76	125	(246)	87	(361)	216
Charge-offs	—	—	—	—	—	—	—
Recoveries	8	—	—	—	—	—	8
Ending balance	<u>\$ 1,307</u>	<u>\$ 308</u>	<u>\$ 2,677</u>	<u>\$ 1,018</u>	<u>\$ 876</u>	<u>\$ 1,489</u>	<u>\$ 7,675</u>
<b>Allowance for loan losses at December 31, 2019 allocated to loans evaluated for impairment:</b>							
Individually	\$ —	\$ —	\$ —	\$ —	\$ —	\$ 833	\$ 833
Collectively	1,058	200	2,850	1,176	911	847	7,042
Ending balance	<u>\$ 1,058</u>	<u>\$ 200</u>	<u>\$ 2,850</u>	<u>\$ 1,176</u>	<u>\$ 911</u>	<u>\$ 1,680</u>	<u>\$ 7,875</u>
<b>Loans at December 31, 2019, evaluated for impairment:</b>							
Individually	\$ 2,803	\$ —	\$ —	\$ —	\$ —	\$ 9,467	\$ 12,270
Collectively	143,898	28,120	400,134	165,179	127,968	118,990	984,289
Ending balance	<u>\$ 146,701</u>	<u>\$ 28,120</u>	<u>\$ 400,134</u>	<u>\$ 165,179</u>	<u>\$ 127,968</u>	<u>\$ 128,457</u>	<u>\$ 996,559</u>

The Company categorizes loans into risk categories based on relevant information about the ability of the borrowers to service their debt such as: current financial information, historical payment experience, credit documentation,

public information, and current economic trends, among other factors. The Company analyzes loans individually by classifying the loans by credit risk on a quarterly basis. The Company uses the following definitions for risk ratings:

**Special Mention**—Loans classified as special mention have a potential weakness or borrowing relationships that require more than the usual amount of management attention. Adverse industry conditions, deteriorating financial conditions, declining trends, management problems, documentation deficiencies or other similar weaknesses may be evident. Ability to meet current payment schedules may be questionable, even though interest and principal are still being paid as agreed. The asset has potential weaknesses that may result in deteriorating repayment prospects if left uncorrected. Loans in this risk grade are not considered adversely classified.

**Substandard**—Substandard loans are considered “classified” and are inadequately protected by the current net worth and paying capacity of the obligor or by the collateral pledged, if any. Loans so classified have a well-defined weakness or weaknesses that jeopardizes the liquidation of the debt. They are characterized by the distinct possibility that the Bank will sustain some loss if the deficiencies are not corrected. Loans in this category may be placed on non-accrual status and may individually be evaluated for impairment if indicators of impairment exist.

**Doubtful**—Loans graded doubtful are considered “classified” and have all the weaknesses inherent in those classified as substandard with the added characteristic that the weaknesses make collection or liquidation in full, on the basis of currently known facts, conditions and values, highly questionable and improbable. However, the amount of certainty of eventual loss is not known because of specific pending factors.

Loans not meeting any of the three criteria above are considered to be pass-rated loans. The following presents, by class and by credit quality indicator, the recorded investment in the Company’s loans as of September 30, 2020 and December 31, 2019 (in thousands):

<b>September 30, 2020</b>	<b>Pass</b>	<b>Special Mention</b>	<b>Substandard</b>	<b>Total</b>
Cash, Securities and Other	\$ 371,415	\$ —	\$ 66	\$ 371,481
Construction and Development	105,717	—	—	105,717
1-4 Family Residential	442,076	—	4,883	446,959
Non-Owner Occupied CRE	232,010	11,554	—	243,564
Owner Occupied CRE	153,656	482	—	154,138
Commercial and Industrial	173,061	—	12,564	185,625
<b>Total</b>	<b>\$ 1,477,935</b>	<b>\$ 12,036</b>	<b>\$ 17,513</b>	<b>\$ 1,507,484</b>

<b>December 31, 2019</b>	<b>Pass</b>	<b>Special Mention</b>	<b>Substandard</b>	<b>Total</b>
Cash, Securities and Other	\$ 143,898	\$ —	\$ 2,803	\$ 146,701
Construction and Development	28,120	—	—	28,120
1-4 Family Residential	395,224	—	4,910	400,134
Non-Owner Occupied CRE	164,021	1,158	—	165,179
Owner Occupied CRE	127,968	—	—	127,968
Commercial and Industrial	114,241	—	14,216	128,457
<b>Total</b>	<b>\$ 973,472</b>	<b>\$ 1,158</b>	<b>\$ 21,929</b>	<b>\$ 996,559</b>

The Company had no loans graded doubtful as of September 30, 2020 and December 31, 2019.

**NOTE 5 - GOODWILL**

Changes in the carrying amount of goodwill were as follows (in thousands):

	September 30, 2020			December 31, 2019		
	Wealth Management	Capital Management	Consolidated	Wealth Management	Capital Management	Consolidated
Beginning balance	\$ 15,994	\$ 3,692	\$ 19,686	\$ 15,994	\$ 8,817	\$ 24,811
Impairment	—	—	—	—	(1,572)	(1,572)
Reclass to held for sale	—	—	—	—	(3,553)	(3,553)
Acquisition activity	4,505	—	4,505	—	—	—
Ending balance	\$ 20,499	\$ 3,692	\$ 24,191	\$ 15,994	\$ 3,692	\$ 19,686

During the nine months ended September 30, 2020, the Company recorded \$4.5 million of goodwill as a result of the Branch Acquisition on May 15, 2020. For additional information on goodwill and other intangible related to the acquisition, see Note 2 – Acquisitions.

In 2019, an interim goodwill analysis resulted in the recognition of a goodwill impairment loss of \$1.6 million in the Capital Management segment. Additionally, the Capital Management goodwill was allocated based on the relative fair value, and \$3.6 million was reclassified to assets held for sale in 2019. As of September 30, 2020, the remaining value of goodwill in the Capital Management segment was \$3.7 million. For changes related to the portion of goodwill reclassified to assets held for sale, see Note 15 – Assets and Other Liabilities Classified as Held for Sale.

Goodwill is tested annually for impairment on October 31 or earlier upon the occurrence of certain events. The Company performed a qualitative assessment of significant events and circumstances as of September 30, 2020 including reporting units historical and current results, assumptions regarding future performance, overall economic factors, including COVID-19, and macroeconomic developments, to determine the existence of potential indicators of impairment and assess if it is more likely than not that the fair value of reporting units are less than their carrying value. The qualitative assessment indicated that it was more likely than not that the carrying value of the reporting unit exceeded its fair value. Therefore, the Company proceeded to complete the two-step impairment test.

Step 1 of the goodwill impairment analysis includes the determination of the carrying value of the reporting unit, including the existing goodwill, and estimating the fair value of the reporting unit. If the carrying amount of a reporting unit exceeds its fair value, we are required to perform the second step to the impairment test.

Our Step 1 goodwill impairment analysis as of September 30, 2020 indicated that the Step 2 analysis was unnecessary.

**NOTE 6 - LEASES**

A lease is defined as a contract that conveys the right to control the use of identified property, plant, or equipment (an identified asset) for a period of time in exchange for consideration. The Company adopted ASC 842 on January 1, 2019 and recorded an initial right-of-use asset and related lease liability of \$12.9 million and \$16.6 million, respectively, on the adoption date. There was no cumulative effect upon adoption.

Leases in which the Company is determined to be the lessee are primarily operating leases comprised of real estate property and office space for our corporate headquarters and profit centers with terms that extend to 2025. Certain properties contained portions that were subleased these terms ended during the third quarter 2020. In accordance with ASC 842, operating leases are required to be recognized as a right-of-use asset with a corresponding lease liability.

The following table presents the classification of the right-of-use asset and corresponding liability within the condensed consolidated balance sheet. The Company elected to not include short-term leases with initial terms of twelve months or less, on the condensed consolidated balance sheet, (in thousands).

		September 30, 2020	December 31, 2019
<b>Lease Right-of-Use Assets</b>	<b>Classification</b>		
Operating lease right-of-use assets	Other assets	\$ 9,000	\$ 10,308
<b>Lease Liabilities</b>	<b>Classification</b>		
Operating lease liabilities	Other liabilities	\$ 11,731	\$ 13,480



The Company's operating lease agreements typically include an option to renew the lease at the Company's discretion. To the extent the Company is reasonably certain it will exercise the renewal option at the inception of the lease, the Company will include the extended term in the calculation of the right-of-use asset and lease liability. ASC 842 requires the use of the rate implicit in the lease when it is readily determinable. As this rate is typically not readily determinable, at the inception of the lease, the Company uses its collateralized incremental borrowing rate over a similar term. The amount of the right-of-use asset and lease liability are impacted by the discount rate used to calculate the present value of the minimum lease payments over the term of the lease.

	September 30, 2020	December 31, 2019
<b>Weighted-Average Remaining Lease Term</b>		
Operating leases	4.41 years	4.91 years
<b>Weighted-Average Discount Rate</b>		
Operating leases	3.65 %	3.71 %

The Company's operating leases contain fixed and variable lease components and it has elected to account for all classes of underlying assets as a single lease component. Variable lease costs primarily represent common area maintenance and parking. The following table represents the Company's net lease costs, (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2020	2019	2020	2019
<b>Lease Costs</b>				
Operating lease cost	\$ 786	\$ 810	\$ 2,401	\$ 2,382
Variable lease cost	557	395	1,516	1,168
Sublease income	(33)	(99)	(232)	(298)
Lease costs, net	<u>\$ 1,310</u>	<u>\$ 1,106</u>	<u>\$ 3,685</u>	<u>\$ 3,252</u>

The following table presents a maturity analysis of the Company's operating lease liabilities on an annual basis for each of the first five years and total amounts thereafter as of September 30, 2020:

<b>Twelve months Ended</b>	<b>Operating Leases</b>
September 30, 2021	\$ 3,082
September 30, 2022	2,804
September 30, 2023	2,586
September 30, 2024	2,369
September 30, 2025	1,835
Thereafter	26
Total future minimum lease payments	<u>\$ 12,702</u>
Less: Imputed interest	(971)
Present value of net future minimum lease payments	<u>\$ 11,731</u>

#### NOTE 7 - DEPOSITS

The following presents the Company's interest-bearing deposits at the dates noted (in thousands):

	September 30, 2020	December 31, 2019
Money market deposit accounts	\$ 805,634	\$ 615,575
Time deposits	177,391	134,913
Negotiable order of withdrawal accounts	101,708	91,921
Savings accounts	5,976	4,307
Total interest-bearing deposits	<u>\$ 1,090,709</u>	<u>\$ 846,716</u>
Aggregate time deposits of \$250,000 or greater	<u>\$ 67,496</u>	<u>\$ 61,596</u>

Deposits acquired through acquisitions during the year ended 2020 totaled \$63.1 million. See Note 2 – Acquisitions for more information.

Overdraft balances classified as loans totaled an immaterial amount at September 30, 2020 and December 31, 2019.

## NOTE 8 - BORROWINGS

The Bank has executed a blanket pledge and security agreement with the Federal Home Loan Bank of Topeka ("FHLB") that requires certain loans and securities be pledged as collateral for any outstanding borrowings under the agreement. The collateral pledged as of September 30, 2020 and December 31, 2019 amounted to \$612.1 million and \$515.5 million, respectively. Based on this collateral and the Company's holdings of FHLB stock, the Company was eligible to borrow an additional \$401.9 million at September 30, 2020. Each advance is payable at its maturity date.

The Company had the following borrowings from FHLB Topeka at the dates noted (in thousands):

<u>Maturity Date</u>	<u>Rate %</u>	<u>September 30, 2020</u>	<u>December 31, 2019</u>
August 26, 2020	1.94	—	10,000
October 23, 2020 <sup>(1)</sup>	—	3,000	—
April 22, 2022	0.37	5,000	—
May 5, 2023	0.76	10,000	—
Total		<u>\$ 18,000</u>	<u>\$ 10,000</u>

<sup>(1)</sup> FHLB COVID-19 Relief Advance

To bolster the effectiveness of the SBA's PPP, the Federal Reserve is supplying liquidity to participating financial institutions through term financing collateralized by PPP loans to small businesses. The Paycheck Protection Program Liquidity Facility ("PPPLF") extends credit to eligible financial institutions that originate PPP loans, taking the loans as collateral at face value. As of September 30, 2020 the Company is utilizing \$204.1 million under the PPPLF program which is included in the Federal Home Loan Bank Topeka and Federal Reserve borrowings line of the condensed consolidated balance sheets.

The Bank has borrowing capacity associated with three unsecured federal funds lines of credit up to \$10.0 million, \$19.0 million, and \$25.0 million. As of September 30, 2020 and December 31, 2019, there were no amounts outstanding on any of the federal funds lines.

As of September 30, 2020 and 2019, subordinated notes (the "2016 Sub Notes") issued to various investors totaled \$6.6 million. The 2016 Sub Notes accrue interest at a rate of 7.25% per annum until December 31, 2021, at which time the rate will adjust each quarter to the then current 90 day London Interbank Offered Rate ("LIBOR") plus 587 basis points, mature on December 31, 2026, are redeemable at the option of the Company after January 1, 2022, and pay interest quarterly.

On March 17, 2020, the Company completed the issuance and sale of subordinated notes (the "2020 Sub Notes") to one investor totaling \$8.0 million in aggregate principal amount. The issuance included \$0.1 million of issuance costs resulting in a net balance of \$7.9 million as of September 30, 2020 included in the Subordinated notes line of the condensed consolidated balance sheets. The 2020 Sub Notes accrue interest at a rate of 5.125% per annum until March 31, 2025, at which time the rate will adjust each quarter to the then current three-month LIBOR, or an alternative rate determined in accordance with the terms of the 2020 Sub Notes, plus 450 basis points; mature on March 31, 2030; are redeemable at the option of the Company on or after March 31, 2025; and pay interest quarterly.

The Company's borrowing facilities include various financial and other covenants, including, but not limited to, a requirement that the Bank maintains regulatory capital that is deemed "well capitalized" by federal banking agencies (see Note 17 – Regulatory Capital Matters). As of September 30, 2020 and December 31, 2019, the Company was in compliance with the covenant requirements.

The Company had a Restated Revolving Credit Note (the "Credit Note") with a correspondent lending partner which matured on June 30, 2020 and was renewed under a new Business Loan Agreement and associated Promissory Note (the "Note") dated June 30, 2020. The Note is secured by stock of the Bank and bears interest at the one month ICE Benchmark Administration (ICE) LIBOR plus 2.5%. As of September 30, 2020 and December 31, 2019, there were no amounts outstanding and the borrowing capacity associated with each facility was \$5.0 million.

**NOTE 9 - COMMITMENTS AND CONTINGENCIES**

The Bank is party to credit-related financial instruments with off-balance sheet risk in the normal course of business to meet the financing needs of its clients. These financial instruments include commitments to extend credit. Such commitments involve, to varying degrees, elements of credit and interest rate risk in excess of the amount recognized in the condensed consolidated balance sheets. Commitments may expire without being utilized. The Bank's exposure to loan loss is represented by the contractual amount of these commitments, although material losses are not anticipated. The Bank follows the same credit policies in making commitments as it does for on-balance sheet instruments.

The following presents the Company's financial instruments whose contract amounts represent credit risk, as of the dates noted (in thousands):

	<u>September 30, 2020</u>		<u>December 31, 2019</u>	
	<u>Fixed Rate</u>	<u>Variable Rate</u>	<u>Fixed Rate</u>	<u>Variable Rate</u>
Unused lines of credit	\$ 74,726	\$ 327,326	\$ 32,896	\$ 290,653
Standby letters of credit	1,754	17,324	1,759	24,197
Commitments to make loans to sell	419,035	—	47,354	—
Commitments to make loans	\$ 23,496	\$ 33,691	\$ —	\$ —

Unused lines of credit are agreements to lend to a client 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. Several of the commitments may expire without being drawn upon. Therefore, the total commitment amounts do not necessarily represent future cash requirements. The amount of collateral obtained, if it is deemed necessary by the Bank, is based on management's credit evaluation of the client.

Unused lines of credit under commercial lines of credit, revolving credit lines and overdraft protection agreements are commitments for possible future extensions of credit to existing clients. These lines of credit are uncollateralized and usually do not contain a specified maturity date and may not be drawn upon to the total extent to which the Bank is committed.

Standby letters of credit are conditional commitments issued by the Bank to guarantee the performance of a client's obligation to a third party. Those letters of credit are primarily issued to support public and private borrowing arrangements. Substantially 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 clients. The Bank holds collateral supporting those commitments if deemed necessary.

Commitments to make loans to sell are agreements to sell a loan to an investor in the secondary market for which the interest rate has been locked with the client, provided there is no violation of any condition within the contract with either party. Commitments to make loans to sell have fixed interest rates. Since commitments may expire without being extended, total commitment amounts may not necessarily represent cash requirements.

Commitments to make loans are agreements to lend to a client, provided there is no violation of any condition within the contract. Commitments to make loans generally have fixed expiration dates or other termination clauses. Since commitments may expire without being extended, total commitment amounts may not necessarily represent cash requirements.

**Litigation, Claims and Settlements**

The Company is, from time to time, involved in various legal actions arising in the normal course of business. While the ultimate outcome of any such proceedings cannot be predicted with certainty, it is the opinion of management, after consulting with our legal counsel, that no proceedings exist, either individually or in the aggregate, which, if determined adversely to the Company, would have a material effect on the Company's condensed consolidated financial statements.

Without admitting or denying the SEC's findings, FWCM agreed on July 16, 2020 to settle claims that FWCM failed reasonably to supervise its investment adviser representatives who purchased securities sold in reliance on Rule 144A under the Securities Act of 1933, as amended (the "Securities Act"), for advisory clients when the clients were not qualified institutional buyers in a Rule 144A transaction, and to adopt and implement written policies and procedures reasonably designed to prevent violations of the Investment Advisers Act of 1940 and the rules thereunder by the adviser and its supervised persons. FWCM paid a previously accrued fine of \$0.2 million to the SEC, and replaced the FWCM President and FWCM compliance team in place at that time.

## **NOTE 10 - SHAREHOLDERS' EQUITY**

### **Common Stock**

The Company's common stock has no par value and each holder of common stock is entitled to one vote for each share (though certain voting restrictions may exist on non-vested restricted stock) held.

On June 14, 2019, the Company announced that its Board of Directors had authorized a share repurchase program under which the Company may repurchase up to 300,000 shares of its common stock and that the Board of Governors of the Federal Reserve System advised the Company that it had no objection to the Company's stock repurchase program. The repurchase program authorized the Company to purchase its common stock from time to time in privately negotiated transactions, in the open market, including pursuant to any trading plan that may be adopted in accordance with Rule 10b5-1 plan promulgated by the Securities and Exchange Commissions, or otherwise in a manner that complies with applicable federal securities laws. During the year ended December 31, 2019, the Company repurchased 43,698 shares at an average price of \$16.51. During the nine months ended September 30, 2020, the Company repurchased 22,679 shares at an average price of \$16.50. The share repurchase program expired in June 2020 and therefore no shares were repurchased during the three months ended September 30, 2020.

### **Restricted Stock Awards**

In 2017, the Company issued 105,264 shares of common stock ("Restricted Stock Awards") with a value of \$3.0 million to the sole member of EMC Holdings, LLC ("EMC"), subject to forfeiture based on his continued employment with the Company. Half of the Restricted Stock Awards (\$1.5 million or 52,632 shares) vests ratably over five-years. The remaining \$1.5 million, or 52,632 shares, may be earned based on performance of the mortgage division of the Company. During the nine months ended September 30, 2020, the Company recognized compensation expense of \$0.1 million, representing the remaining 14,114 shares, related to the performance based awards. During the year ended December 31, 2019, the Company recognized compensation expense of \$0.6 million, representing 38,518 shares, related to the performance-based awards. The performance based awards fully vested in the second quarter 2020, no expenses were recognized in the three months ended September 30, 2020.

As of September 30, 2020, the Restricted Stock Awards have a weighted-average grant date fair value of \$28.50 per share. The Company recognized compensation expense of \$0.1 million and \$0.5 million for the three months ended September 30, 2020 and 2019, for the Restricted Stock Awards. During the nine months ended September 30, 2020 and 2019, the Company has recognized compensation expense of \$0.3 million and \$0.7 million for the Restricted Stock Awards, respectively. As of September 30, 2020, the Company has \$0.6 million of unrecognized stock-based compensation expense related to the shares issued. As of September 30, 2020, the unrecognized stock-based compensation expense is expected to be recognized over a weighted average period of 1.5 years. Performance based Restricted Stock Awards representing 30,088 shares vested during the nine months ended September 30, 2020.

### **Stock-Based Compensation Plans**

As of September 30, 2020, there were a total of 504,397 shares available for issuance under the First Western Financial, Inc. 2016 Omnibus Incentive Plan ("the 2016 Plan"). If the Awards outstanding under the First Western 2008 Stock Incentive Plan ("the 2008 Plan") or the 2016 Plan are forfeited, cancelled or terminated with no consideration paid to the Company, those amounts will increase the number of shares eligible to be granted under the 2016 Plan.

#### *Stock Options*

The Company did not grant any stock options during the nine months ended September 30, 2020 and 2019.

During the three months ended September 30, 2020 and 2019, the Company recognized stock based compensation expense of \$0.1 million and \$0.1 million, respectively, associated with stock options. During the nine months ended September 30, 2020 and 2019, the Company recognized stock based compensation expense of \$0.2 million and \$0.2 million, respectively, associated with stock options. As of September 30, 2020, the Company has \$0.1 million of unrecognized stock-based compensation expense related to stock options which are unvested. As of September 30, 2020, the unrecognized cost is expected to be recognized over a weighted-average period of less than one year.

The following summarizes activity for nonqualified stock options for the nine months ended September 30, 2020:

	Number of Options	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term	Aggregate Intrinsic Value
Outstanding at December 31, 2019	419,197	\$ 29.02		
Granted	-	-		
Exercised	-	-		
Forfeited or expired	-	-		
Outstanding at September 30, 2020	419,197	\$ 29.02	2.9	(a)
Options fully vested / exercisable at September 30, 2020	396,916	\$ 29.20	2.7	(a)

(a) Nonqualified stock options outstanding at the end of the period and those fully vested / exercisable had immaterial aggregate intrinsic values.

As of September 30, 2020 and December 31, 2019, there were 396,916 and 394,020 options, respectively, that were exercisable. Exercise prices are between \$20.00 and \$40.00 per share, and the options are exercisable for a period of ten-years from the original grant date and expire on various dates between 2022 and 2026.

#### *Restricted Stock Units*

Pursuant to the 2016 Plan, the Company can grant associates and non-associate directors' long-term cash and stock-based compensation. During the nine months ended September 30, 2020, the Company granted certain associates restricted stock units which are earned over time or based on various performance measures and convert to common stock upon vesting, which are summarized here and expanded further below.

The following summarizes the activity for the Time Vesting Units, the Financial Performance Units and the Market Performance Units for the nine months ended September 30, 2020:

	Time Vesting Units	Financial Performance Units	Market Performance Units
Outstanding at December 31, 2019	209,444	69,426	14,862
Granted	109,607	60,859	-
Vested	(54,112)	-	-
Forfeited	(1,888)	(854)	-
Outstanding at September 30, 2020	263,051	129,431	14,862

During the three months ended September 30, 2020, the Company issued 12,725 shares of common stock upon the settlement of Time Vesting Units. The remaining 6,196 shares that vested during the period were surrendered with a combined market value at the date of settlement of \$0.1 million to cover employee withholding taxes. During the nine months ended September 30, 2020, the Company issued 34,260 shares of common stock upon the settlement of Time Vesting Units. The remaining 19,852 shares that vested during the period were surrendered with a combined market value at the dates of settlement of \$0.3 million to cover employee withholding taxes. During the three and nine months ended September 30, 2019 the Company issued 15,446 shares of common stock upon the settlement of Time Vesting Units. The remaining 7,835 shares that vested during the period were surrendered with a combined market value at the dates of settlement of \$0.1 million to cover employee withholding taxes.

#### **Time Vesting Units**

Time Vesting Units are granted to full-time associates and board members at the date approved by the Company's Board of Directors. The Company granted 109,607 Time Vesting Units with a five-year service period during the nine months ended September 30, 2020, that vest in equal installments of 20% on the anniversary of the grant date, assuming continuous employment through the scheduled vesting dates. Time Vesting Units granted in 2020 have a weighted-average grant-date fair value of \$12.84 per unit. During the three months ended September 30, 2020 and 2019, the Company recognized compensation expense of \$0.4 million and \$0.3 million, respectively. During the nine months ended September 30, 2020 and 2019, the company recognized compensation expense of \$1.0 million and \$0.7 million, respectively, for

Time Vesting Units. As of September 30, 2020, the Company has \$3.8 million of unrecognized stock-based compensation expense is expected to be recognized over a weighted-average period of approximately 2.0 years.

#### **Financial Performance Units Granted Prior to May 1, 2019**

Financial Performance Units were granted to certain key associates and are earned based on the Company achieving various financial performance metrics beginning on the grant date and ending on December 31, 2019. If the Company achieves the financial metrics, which include various thresholds from 0% up to 150%, then the Financial Performance Units will have a subsequent two-year service period vesting requirement ending on December 31, 2021. The end of the performance metrics period, December 31, 2019, resulted in accruing at 50% for half of the awards and at 100% for the remainder. The maximum shares that can be issued at the determined thresholds as of September 30, 2020 are approximately 10,000 shares. During the three and nine months ended September 30, 2020 and 2019, the Company recognized an immaterial amount of compensation expense for the Financial Performance Units. As of September 30, 2020, there was \$0.1 million of unrecognized compensation expense related to the Financial Performance Units. As of September 30, 2020, the Company has unrecognized stock-based compensation expense that is expected to be recognized over a weighted-average period of 1.3 years.

#### **Financial Performance Units Granted from May 1, 2019 through April 30, 2020**

The Company granted 1,866 Financial Performance Units during the nine months ended September 30, 2020. In 2019, the Company granted 62,569 Financial Performance Units to officers and other key associates. All Financial Performance Units granted between May 1, 2019 and May 1, 2020, have a five-year term and are earned based on the Company achieving various financial metrics beginning on the grant date and ending on December 31, 2021, which include various thresholds from 0% to 150%, then the Financial Performance Units will have a subsequent two-year service period vesting requirement ending on December 31, 2023. As of September 30, 2020, the Company is accruing at the maximum threshold for the awards. The maximum number of shares that can be issued at 150% as of September 30, 2020 was approximately 86,200 shares. During the three months ended September 30, 2020 and 2019, the Company recognized \$0.1 million of compensation expense, for Financial Performance Units. For the nine months ended September 30, 2020 and 2019, the Company recognized \$0.2 million and \$0.1 million, respectively. As of September 30, 2020, there was \$0.6 million of unrecognized compensation expense related to the Financial Performance Units. As of September 30, 2020, the unrecognized stock-based compensation expense is expected to be recognized over a weighted-average period of 3.3 years.

#### **Financial Performance Units Granted from May 1, 2020 through September 30, 2020**

The Company granted 699 and 58,993 Financial Performance Units during the three and nine months ended September 30, 2020. All Financial Performance Units granted on or after May 1, 2020, have a five-year term and are earned based on the Company achieving various financial metrics beginning on the grant date and ending on December 31, 2022, which include various thresholds from 0% to 150%, then the Financial Performance Units will have a subsequent two-year service period vesting requirement ending on December 31, 2023. As of September 30, 2020, the Company is accruing at maximum threshold for the awards. The maximum number of shares that can be issued at 150% as of September 30, 2020 was approximately 87,900 shares. During the three and nine months ended September 30, 2020, the Company recognized \$0.1 million of compensation expense for the Financial Performance Units. As of September 30, 2020, there was \$0.7 million of unrecognized compensation expense related to the Financial Performance Units. As of September 30, 2020, the unrecognized stock-based compensation expense is expected to be recognized over a weighted-average period of 4.3 years.

#### **Market Performance Units**

Market Performance Units were granted to certain key associates and are earned based on growth in the value of the Company's common stock and were dependent on the Company completing an initial public offering of stock during a defined period of time. If the Company's common stock is trading at or above certain prices, over a performance period which ended on June 30, 2020, the Market Performance Units would have been determined to be earned and vest following the completion of a subsequent service period ending on June 30, 2022. The Company's common stock did not trade at or above the required prices over the performance period, as a result no Market Performance Units are eligible to be earned.

On July 23, 2018, the Company completed its initial public offering and the Market Performance Units performance condition was met. Subsequent to the performance condition there is also a market condition as a vesting requirement for the Market Performance Units which affects the determination of the grant date fair value. The Company estimated the grant date fair value using various valuation assumptions. During the three and nine months ended

September 30, 2020 and 2019, the Company recognized an immaterial amount of compensation expense for the Market Performance Units. As of September 30, 2020, there was \$0.4 million of unrecognized compensation expense related to the Market Performance Units which is expected to be recognized over a weighted-average period of 1.8 years.

**NOTE 11 - EARNINGS PER COMMON SHARE**

The table below presents the calculation of basic and diluted earnings per common share for the periods indicated (amounts in thousands, except share and per share amounts):

	<u>Three Months Ended September 30,</u>		<u>Nine Months Ended September 30,</u>	
	2020	2019	2020	2019
<b>Earnings per common share - Basic</b>				
Numerator:				
Net income	\$ 9,630	\$ 2,406	\$ 19,660	\$ 5,437
Dividends on preferred stock	—	—	—	—
Net income available for common shareholders	<u>\$ 9,630</u>	<u>\$ 2,406</u>	<u>\$ 19,660</u>	<u>\$ 5,437</u>
Denominator:				
Basic weighted average shares	7,911,871	7,890,794	7,888,675	7,882,221
Earnings per common share - basic	<u>\$ 1.22</u>	<u>\$ 0.30</u>	<u>\$ 2.49</u>	<u>\$ 0.69</u>
<b>Earnings per common share - Diluted</b>				
Numerator:				
Net income	\$ 9,630	\$ 2,406	\$ 19,660	\$ 5,437
Dividends on preferred stock	—	—	—	—
Net income available for common shareholders	<u>\$ 9,630</u>	<u>\$ 2,406</u>	<u>\$ 19,660</u>	<u>\$ 5,437</u>
Denominator:				
Basic weighted average shares	7,911,871	7,890,794	7,888,675	7,882,221
Diluted effect of common stock equivalents:				
Stock options	—	—	—	—
Time Vesting Units	85,897	10,702	44,310	4,942
Financial Performance Units	7,786	123	16,176	41
Market Performance Units	13,453	13,175	13,347	13,357
Restricted Stock Awards	—	—	—	—
Total diluted effect of common stock equivalents	<u>107,136</u>	<u>24,000</u>	<u>73,833</u>	<u>18,340</u>
Diluted weighted average shares	8,019,007	7,914,794	7,962,508	7,900,561
Earnings per common share - diluted	<u>\$ 1.20</u>	<u>\$ 0.30</u>	<u>\$ 2.47</u>	<u>\$ 0.69</u>

Diluted earnings per share was computed without consideration to potentially dilutive instruments as their inclusion would have been anti-dilutive.

As of September 30, 2020 and 2019, potentially dilutive securities excluded from the diluted earnings per share calculation are as follows:

	<u>Three Months Ended</u>		<u>Nine Months Ended</u>	
	<u>September 30,</u>		<u>September 30,</u>	
	2020	2019	2020	2019
Stock options	419,197	423,197	419,197	438,364
Time Vesting Units	82,600	130,821	87,304	163,141
Financial Performance Units	116,051	55,028	70,769	47,008
Restricted Stock Awards	21,054	61,668	41,517	83,713
Total potentially dilutive securities	<u>638,902</u>	<u>670,714</u>	<u>618,787</u>	<u>732,226</u>

**NOTE 12 - INCOME TAXES**

During the three and nine months ended September 30, 2020, the Company recorded an income tax provision of \$3.2 million and \$6.3 million, respectively, reflecting an effective tax rate of 24.9% and 24.3%, respectively. During the

three and nine months ended September 30, 2019, the Company recorded an income tax provision of \$0.8 million and \$1.9 million, respectively, reflecting an effective tax rate of 24.5% and 25.5%, respectively.

#### NOTE 13 - RELATED-PARTY TRANSACTIONS

The Bank extends credit under Regulation O to certain covered parties including Company directors, executive officers and their affiliates. At September 30, 2020 and December 31, 2019, there were no delinquent or non-performing loans to any executive officer or director of the Company. These covered parties, along with principal owners, management, immediate family of management or principal owners, a parent company and its subsidiaries, trusts for the benefits of employees, and other parties, may be considered related parties. The following presents a summary of related-party loan activity as of the dates noted (in thousands):

	<u>September 30, 2020</u>	<u>December 31, 2019</u>
Balance, beginning of year	\$ 5,675	\$ 2,659
Funded loans	6,808	11,618
Payments collected	(7,161)	(8,602)
Balance, end of year	<u>\$ 5,322</u>	<u>\$ 5,675</u>

Deposits from related parties held by the Bank at September 30, 2020 and December 31, 2019 totaled \$21.8 million and \$28.5 million, respectively.

The Company leases office spaces from entities controlled by one of the Company's board members. During the nine months ended September 30, 2020 and 2019, the Company incurred expenses of \$0.1 million.

#### NOTE 14 - FAIR VALUE

Fair value is the exchange price that would be received for an asset or paid to transfer a liability (exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. There are three levels of inputs that may be used to measure fair values:

- Level 1: Quoted prices (unadjusted) for identical assets or liabilities in active markets that the entity has the ability to access as of the measurement date.
- Level 2: Significant other observable inputs other than Level 1 prices such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data.
- Level 3: Significant unobservable inputs that reflect a company's own assumptions about the assumptions that market participants would use in pricing an asset or liability.

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

Investment Securities: The fair values for investment securities are determined by quoted market prices, if available (Level 1). For securities where quoted prices are not available, fair values are calculated based on market prices of similar securities (Level 2). For securities where quoted prices or market prices of similar securities are not available, fair values are calculated using discounted cash flows or other market indicators (Level 3).

Guarantee asset and liability: The guarantee asset represents a financial guarantee to cover the second layer of any losses on loans sold to FHLB under the MPF 125 loan sales agreement. Significant inputs in the valuation analysis are Level 3, due to the nature of this asset and the lack of market quotes. The fair value of the guarantee asset is determined using a discounted cash flow model, for which significant unobservable inputs include assumed future prepayment rates and market discount rate (Level 3). An increase in prepayment rates or discount rate would generally reduce the estimated fair value of the guarantee asset. The guarantee liability is the fair value of the guarantee assets less amortization (Level 3).

Interest Rate Lock Commitments ("IRLC") and Forward Sale Commitments ("FSC"): Fair values of these mortgage derivatives are estimated based on changes in mortgage interest rates from the date the commitment related to the loan is locked. The fair value estimate is based on valuation models using market data from secondary market loan sales and direct contacts with third party investors as of the measurement date. IRLC fair value estimate is adjusted using unobservable pull through rates (Level 3). The FSC fair value estimate is adjusted for any pair-off fees from the individual investor (Level 3).

Derivative instruments are carried at fair value in the Company's financial statements. Changes in the fair value of a derivative instrument are accounted for within the condensed consolidated statements of income.



[Table of Contents](#)

The following presents assets and liabilities measured on a recurring basis at September 30, 2020 and December 31, 2019 (in thousands):

<b>September 30, 2020</b>	<b>Quoted Prices in Active Markets for Identical Assets (Level 1)</b>	<b>Significant Other Observable Inputs (Level 2)</b>	<b>Significant Unobservable Inputs (Level 3)</b>	<b>Reported Balance</b>
<b>Investment securities available-for-sale:</b>				
U.S. Treasury debt	\$ 256	\$ —	\$ —	\$ 256
Corporate bonds	—	2,048	—	2,048
GNMA mortgage-backed securities - residential	—	29,788	—	29,788
FNMA mortgage-backed securities - residential	—	2,716	—	2,716
Corporate CMO and MBS	—	5,846	—	5,846
<b>Total securities available-for-sale</b>	<b>\$ 256</b>	<b>\$ 40,398</b>	<b>\$ —</b>	<b>\$ 40,654</b>
Equity securities	\$ 732	\$ —	\$ —	\$ 732
Guarantee asset	\$ —	\$ —	\$ 245	\$ 245
IRLC and FSC, net	\$ —	\$ —	\$ 11,622	\$ 11,622
Guarantee liability	\$ —	\$ —	\$ 153	\$ 153

<b>December 31, 2019</b>	<b>Quoted Prices in Active Markets for Identical Assets (Level 1)</b>	<b>Significant Other Observable Inputs (Level 2)</b>	<b>Significant Unobservable Inputs (Level 3)</b>	<b>Reported Balance</b>
<b>Investment securities available-for-sale:</b>				
U.S. Treasury debt	\$ 254	\$ —	\$ —	\$ 254
GNMA mortgage-backed securities - residential	—	45,312	—	45,312
FNMA mortgage-backed securities - residential	—	2,917	—	2,917
Corporate CMO and MBS	—	10,420	—	10,420
<b>Total securities available-for-sale</b>	<b>\$ 254</b>	<b>\$ 58,649</b>	<b>\$ —</b>	<b>\$ 58,903</b>
Equity securities	\$ 713	\$ —	\$ —	\$ 713
IRLC and FSC, net	\$ —	\$ —	\$ 1,184	\$ 1,184

The following presents a reconciliation for level 3 instruments measured at fair value on a recurring basis (in thousands):

<b>Three Months Ended September 30, 2020</b>	<b>Guarantee Asset</b>	<b>IRLC and FSC, Net</b>	<b>Guarantee Liability</b>
Beginning balance	\$ 222	\$ 7,482	\$ 191
Gains (losses) in net income, net	39	1,066	(38)
Other settlements, net <sup>(1)</sup>	(16)	3,074	—
Ending balance	<b>\$ 245</b>	<b>\$ 11,622</b>	<b>\$ 153</b>

<sup>(1)</sup> Other settlements for IRLC and FSC includes the settlement of FSC and the transfer of the fair value of loan purchase or IRLC at the time loans are originated.

<b>Nine Months Ended September 30, 2020</b>	<b>Guarantee Asset</b>	<b>IRLC and FSC, Net</b>	<b>Guarantee Liability</b>
Beginning balance	\$ —	\$ 1,184	\$ —
Sales	245	—	244
Gains (losses) in net income, net	55	1,713	(91)
Other settlements, net <sup>(1)</sup>	(55)	8,725	—
Ending balance	<b>\$ 245</b>	<b>\$ 11,622</b>	<b>\$ 153</b>

<sup>(1)</sup> Other settlements for IRLC and FSC includes the settlement of FSC and the transfer of the fair value of loan purchase or IRLC at the time loans are originated.

Mutual funds and U.S. Treasury debt are reported at fair value utilizing Level 1 inputs. The remaining portfolio of securities are reported at fair value with Level 2 inputs provided by a pricing service. As of September 30, 2020 and

December 31, 2019, the majority of the securities had credit support provided by the Federal Home Loan Mortgage Corporation, GNMA, and FNMA. Factors used to value the securities by the pricing service include: benchmark yields, reported trades, interest spreads, prepayments, and other market research. In addition, ratings and collateral quality are considered.

As of September 30, 2020, equity securities and guarantee assets have been recorded at fair value within the other assets line item and the guarantee liabilities have been recorded at fair value with the other liabilities line item in the condensed consolidated balance sheet. All changes are recorded in the other line item in the condensed consolidated statement of income.

**Other Real Estate Owned:** Assets acquired through or instead of loan foreclosure are initially recorded at fair value less costs to sell when acquired, establishing a new cost basis. They are subsequently accounted for at lower of cost or fair value less estimated costs to sell. Fair value is commonly based on recent real estate appraisals which are updated no less frequently than on an annual basis. Appraisals may utilize a single valuation approach or a combination of approaches including comparable sales and the income approach. Adjustments are routinely made in the appraisal process by the independent appraisers to adjust for differences between comparable sales and income data available. Such adjustments can be significant and typically result in Level 3 classifications of the inputs for determining fair value. Other real estate owned is evaluated annually for additional impairment and adjusted accordingly.

**Impaired Loans:** The fair value of impaired loans with specific allocations of the allowance for loan losses is generally based on recent appraisals. These appraisals may utilize a single valuation approach or a combination of approaches including comparable sales and the income approach. Adjustments are routinely made in the appraisal process by the independent appraisers to adjust for differences between the comparable sales and income data available. Such adjustments can be significant and typically result in Level 3 classifications of the inputs for determining fair value. Impaired loans are evaluated monthly for additional impairment and adjusted accordingly.

Appraisals for both collateral-dependent impaired loans and other real estate owned are performed by certified general appraisers (for commercial properties) or certified residential appraisers (for residential properties) whose qualifications and licenses have been reviewed and verified by the Company. Once received, the Company reviews the assumptions and approaches utilized in the appraisal as well as the overall resulting fair value in comparison with independent data sources such as recent market data or industry-wide statistics.

The following presents assets measured on a nonrecurring basis as of September 30, 2020 and December 31, 2019 (in thousands):

	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Reported Balance
<b>September 30, 2020</b>				
Other real estate owned:				
Commercial properties	\$ —	\$ —	\$ 558	\$ 558
Total impaired loans <sup>(1)</sup> :				
Commercial and Industrial	\$ —	\$ —	\$ 1,998	\$ 1,998

<sup>(1)</sup> An immaterial Cash, Securities and Other loan was fully reserved for using a specific allowance at September 30, 2020.

	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Reported Balance
<b>December 31, 2019</b>				
Other real estate owned:				
Commercial properties	\$ —	\$ —	\$ 658	\$ 658
Total impaired loans:				
Commercial and Industrial	\$ —	\$ —	\$ 3,579	\$ 3,579

The sales comparison approach was utilized for estimating the fair value of non-recurring assets.

At September 30, 2020, other real estate owned decreased slightly from December 31, 2019 and had a carrying amount of \$0.6 million, which is the cost basis of \$2.4 million net of a valuation allowance of \$1.8 million.

At September 30, 2020, total impaired loans measured for impairment using the fair value of the collateral for collateral dependent loans had carrying values of \$3.4 million with valuation allowances of \$1.4 million and were classified as Level 3. As of December 31, 2019, impaired loans measured for impairment using the fair value of the collateral for collateral dependent loans had carrying values of \$4.4 million with valuation allowances of \$0.8 million and were classified as Level 3.

Impaired loans accounted for specific reserves of \$1.4 million and \$0.8 million as of September 30, 2020 and December 31, 2019. The Bank charged off an immaterial amount during the nine months ended September 30, 2020 from the specific reserve. The Bank charged off \$0.2 million during the year ended December 31, 2019 from the specific reserve.

The following presents quantitative information about the significant unobservable inputs used in the fair value measurement of recurring and nonrecurring non-financial instruments categorized within Level 3 of the fair value hierarchy as of September 30, 2020 and December 31, 2019 (dollars in thousands):

Quantitative Information about Level 3 Fair Value Measurements at September 30, 2020				
	Fair Value	Valuation Technique	Significant Unobservable Input	Range (Weighted Average)
Other real estate owned:				
Commercial properties	558	Sales contract	Commission, cost to sell, closing costs	3% - 10% (7%)
Total impaired loans <sup>(1)</sup> :				
Commercial and Industrial	1,998	Sales comparison, Market approach - guideline transaction method	Management discount for asset/property type	17% - 20% (20%)

<sup>(1)</sup> An immaterial Cash, Securities and Other loan was fully reserved for using a specific allowance at September 30, 2020.

Quantitative Information about Level 3 Fair Value Measurements at December 31, 2019				
	Fair Value	Valuation Technique	Significant Unobservable Input	Range (Weighted Average)
Other real estate owned:				
Commercial properties	\$ 658	Appraisal value	Discount rate	50% (50%)
			Commission and cost to sell	1% - 10% (7%)
Total impaired loans:				
Commercial and Industrial	\$ 3,579	Sales comparison, Market approach - guideline transaction method	Management discount for asset/property type	0% - 50% (23%)

The following presents carrying amounts and estimated fair values for financial instruments as of September 30, 2020 and December 31, 2019 (in thousands):

September 30, 2020	Carrying Amount	Fair Value Measurements Using:		
		Level 1	Level 2	Level 3
<b>Assets:</b>				
Cash and cash equivalents	\$ 250,358	\$ 250,358	\$ —	\$ —
Securities available-for-sale	40,654	256	40,398	—
Loans, net	1,494,231	—	—	1,493,863
Mortgage loans held for sale	89,872	—	89,872	—
Accrued interest receivable	6,730	—	6,730	—
Equity securities	732	732	—	—
IRLC and FSC, net	11,622	—	—	11,622
Guarantee asset	245	—	—	245
<b>Liabilities:</b>				
Deposits	1,563,672	—	1,565,555	—
<b>Borrowings:</b>				
FHLB Topeka Borrowings – fixed rate	18,000	—	18,070	—
Federal Reserve Borrowings – fixed rate	204,075	—	204,075	—
Subordinated notes – fixed-to-floating rate	14,447	—	—	14,997
Accrued interest payable	347	—	347	—

Guarantee liability	\$ 153	\$ —	\$ —	\$ 153
<b>December 31, 2019</b>	<b>Carrying Amount</b>	<b>Fair Value Measurements Using:</b>		
		<b>Level 1</b>	<b>Level 2</b>	<b>Level 3</b>
<b>Assets:</b>				
Cash and cash equivalents	\$ 78,638	\$ 78,638	\$ —	\$ —
Securities available-for-sale	58,903	254	58,649	—
Loans, net	990,132	—	—	974,142
Mortgage loans held for sale	48,312	—	48,312	—
Accrued interest receivable	3,048	—	3,048	—
Equity securities	713	713	—	—
IRLC and FSC, net	1,184	—	—	1,184
<b>Liabilities:</b>				
Deposits	1,086,784	—	1,089,261	—
<b>Borrowings:</b>				
FHLB Topeka Borrowings – fixed rate	10,000	—	10,003	—
Subordinated notes – fixed-to-floating rate	6,560	—	—	6,004
Accrued interest payable	\$ 299	\$ —	\$ 299	\$ —

The fair value estimates presented and discussed above are based on pertinent information available to management as of the dates specified. The estimated fair value amounts are based on the exit price notion set forth by ASU 2016-01 effective January 1, 2018 on a prospective basis. Although management is not aware of any factors that would significantly affect the estimated fair values, such amounts have not been comprehensively revalued for purposes of these consolidated financial statements since the balance sheet dates. Therefore, current estimates of fair value may differ significantly from the amounts presented herein.

The methods and assumptions, not previously presented, used to estimate fair values are described as follows.

Cash and Cash Equivalents and Restricted Cash: The carrying amounts of cash and cash equivalents and restricted cash approximate fair values as maturities are less than 90 days and balances are generally in accounts bearing current market interest rates.

Loans, net: The fair values for all fixed-rate and variable-rate performing loans were estimated using the income approach and by discounting the projected cash flows of such loans. Principal and interest cash flows were projected based on the contractual terms of the loans, including maturity, contractual amortization and adjustments for prepayments and expected losses, where appropriate. A discount rate was developed based on the relative risk of the cash flows, taking into account the loan type, maturity and a required return on capital.

Mortgage Loans Held for Sale: The fair value of mortgage loans held for sale is estimated based upon contracts and quotes from third party investors and quoted prices in the market resulting in a Level 2 classification.

Accrued Interest Receivable and Payable: The carrying amounts of accrued interest approximate fair value due to their short-term nature.

Deposits: The fair values disclosed for demand deposits (e.g., interest and noninterest checking, passbook savings, and certain types of money market accounts) are, by definition, equal to the amounts payable on demand at the reporting date (i.e., their carrying amounts). The carrying amounts of variable-rate, fixed-term money market accounts and certificates of deposit approximate their fair values at the reporting dates. Fair values for fixed-rate certificates of deposit are estimated using a discounted cash flow calculation that applies interest rates currently being offered on certificates to a schedule of aggregated expected monthly maturities on time deposits.

Borrowings:

Variable Rate Borrowings: The carrying amounts of borrowings with variable rates approximate their fair values since the interest rates change to reflect current market borrowing rates for similar instruments and borrowers with similar credit ratings.

*Fixed Rate Borrowings:* Borrowings with fixed rates are valued using inputs such as discounted cash flows and current interest rates for similar instruments and borrowers with similar credit ratings.

**NOTE 15 – ASSETS AND OTHER LIABILITIES CLASSIFIED AS HELD FOR SALE**

In 2019, the Company committed to a plan to sell its Los Angeles-based fixed income portfolio management team and certain advisory and sub-advisory arrangements. Management is continuing to evaluate opportunities to divest the Los Angeles-based fixed income portfolio management team and, therefore, these assets and liabilities are classified as goodwill in a disposal group held for sale and are presented separately in the consolidated balance sheet.

On September 18, 2020, the Company entered into an agreement to sell the Company’s Los Angeles-based fixed income portfolio management team to Lido Advisors, LLC and Oakhurst Advisors, LLC. As of September 30, 2020, the sale was not yet completed. The Company performed a review of the fair value of assets held for sale as of the three months ended September 30, 2020 and determined that the value of the assets held for sale was reasonable and no adjustment was needed during the period.

The Company recorded a loss on the assets held for sale of \$0.6 million during the period ending March 31, 2020, the loss has been applied to reduce the carrying amount of the goodwill within the disposal group.

Assets and other liabilities in disposal groups held for sale are as follows at the dates noted (in thousands):

	September 30, 2020			December 31, 2019		
	Wealth Management	Capital Management	Consolidated	Wealth Management	Capital Management	Consolidated
<b>ASSETS</b>						
Goodwill	\$ —	\$ 3,000	\$ 3,000	\$ —	\$ 3,553	\$ 3,553
Assets in disposal groups held for sale	\$ —	\$ 3,000	\$ 3,000	\$ —	\$ 3,553	\$ 3,553
<b>LIABILITIES</b>						
Other liabilities	\$ —	\$ 141	\$ 141	\$ —	\$ 117	\$ 117
Liabilities in disposal groups held for sale	\$ —	\$ 141	\$ 141	\$ —	\$ 117	\$ 117

**NOTE 16 - SEGMENT REPORTING**

The Company’s reportable segments consist of Wealth Management, Capital Management, and Mortgage. The chief operating decision maker (“CODM”) is the Chief Executive Officer. The measure of profit or loss used by the CODM to identify and measure the Company’s reportable segments is income before income tax.

The Wealth Management segment consists of operations relative to the Company’s fully integrated wealth management products and services. Services provided include deposit, loan, insurance, and trust and investment management advisory products and services.

The Capital Management segment consists of operations relative to the Company’s institutional investment management services over proprietary fixed income, high yield, and equity strategies, including acting as the advisor of three owned, managed, and rated mutual funds. Capital Management products and services are financial in nature for which revenues are generally based on a percentage of assets under management or paid premiums.

The Mortgage segment consists of operations relative to the Company’s residential mortgage service offerings. Mortgage products and services are financial in nature for which premiums are recognized net of expenses, upon the sale of mortgage loans to third parties.

[Table of Contents](#)

The tables below present the financial information for each segment that is specifically identifiable or based on allocations using internal methods for the three months ended September 30, 2020 and 2019 (in thousands):

Three Months Ended September 30, 2020	Wealth Management	Capital Management	Mortgage	Consolidated
<b>Income Statement</b>				
Total interest income	\$ 14,410	\$ —	\$ —	\$ 14,410
Total interest expense	1,492	—	—	1,492
Provision for loan losses	1,496	—	—	1,496
Net interest income, after provision for loan losses	11,422	—	—	11,422
Non-interest income	4,810	899	12,323	18,032
Total income	16,232	899	12,323	29,454
Depreciation and amortization expense	252	8	14	274
All other non-interest expense	13,664	627	2,067	16,358
Income before income tax	\$ 2,316	\$ 264	\$ 10,242	\$ 12,822
Goodwill	\$ 20,499	\$ 3,692	\$ —	\$ 24,191
Assets held for sale	—	3,000	—	3,000
<b>Total assets</b>	<b>\$ 1,859,390</b>	<b>\$ 8,358</b>	<b>\$ 105,149</b>	<b>\$ 1,972,897</b>
<b>Three Months Ended September 30, 2019</b>				
<b>Income Statement</b>				
Total interest income	\$ 11,473	\$ —	\$ —	\$ 11,473
Total interest expense	3,533	—	—	3,533
Provision for loan losses	100	—	—	100
Net interest income, after provision for loan losses	7,840	—	—	7,840
Non-interest income	4,714	776	3,298	8,788
Total income	12,554	776	3,298	16,628
Depreciation and amortization expense	274	22	55	351
All other non-interest expense	10,434	701	1,956	13,091
Income before income tax	\$ 1,846	\$ 53	\$ 1,287	\$ 3,186
Goodwill	\$ 15,994	\$ 3,692	\$ —	\$ 19,686
Assets held for sale	—	3,553	—	3,553
<b>Total assets</b>	<b>\$ 1,195,340</b>	<b>\$ 8,528</b>	<b>\$ 68,057</b>	<b>\$ 1,271,925</b>
<b>Nine Months Ended September 30, 2020</b>				
<b>Income Statement</b>				
Total interest income	\$ 38,392	\$ —	\$ —	\$ 38,392
Total interest expense	5,747	—	—	5,747
Provision for loan losses	3,987	—	—	3,987
Net interest income, after provision for loan losses	28,658	—	—	28,658
Non-interest income	13,710	2,492	25,024	41,226
Total income	42,368	2,492	25,024	69,884
Depreciation and amortization expense	718	52	56	826
All other non-interest expense	34,619	2,772 <sup>(1)</sup>	5,706	43,097
Income (loss) before income tax	\$ 7,031	\$ (332)	\$ 19,262	\$ 25,961
Goodwill	\$ 20,499	\$ 3,692	\$ —	\$ 24,191
Assets held for sale	—	3,000	—	3,000
<b>Total assets</b>	<b>\$ 1,859,390</b>	<b>\$ 8,358</b>	<b>\$ 105,149</b>	<b>\$ 1,972,897</b>

(1) Includes loss on assets held for sale of \$0.6 million and \$0.2 million SEC penalty.

Nine Months Ended September 30, 2019	Wealth Management	Capital Management	Mortgage	Consolidated
<b>Income Statement</b>				
Total interest income	\$ 33,698	\$ —	\$ —	\$ 33,698
Total interest expense	9,827	—	—	9,827
Provision for loan losses	216	—	—	216
Net interest income, after provision for loan losses	23,655	—	—	23,655
Non-interest income	13,956	2,339	8,053	24,348
Total income	37,611	2,339	8,053	48,003
Depreciation and amortization expense	902	248	197	1,347
All other non-interest expense	30,935	3,709 <sup>(1)</sup>	4,710	39,354
Income (loss) before income tax	\$ 5,774	\$ (1,618)	\$ 3,146	\$ 7,302
Goodwill	\$ 15,994	\$ 3,692	\$ —	\$ 19,686
Assets held for sale	—	3,553	—	3,553
<b>Total assets</b>	<b>\$ 1,195,340</b>	<b>\$ 8,528</b>	<b>\$ 68,057</b>	<b>\$ 1,271,925</b>

(1) Includes goodwill impairment charge of \$1.6 million.

#### NOTE 17 - REGULATORY CAPITAL MATTERS

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

The Bank's capital amounts and classification is also subject to qualitative judgments by the regulators regarding components, risk weightings and other factors. The final rules implementing Basel Committee on Banking Supervision's capital guidelines for U.S. banks ("Basel III rules") has been fully phased in. The net unrealized gain or loss on available-for-sale securities is not included in computing regulatory capital. During the nine months ended September 30, 2020, the Company made a \$10.0 million capital injection into the Bank. Management believes as of September 30, 2020, the Bank meets all capital adequacy requirements to which it is subject to.

Prompt corrective action regulations for the Bank provide five classifications: well capitalized, adequately capitalized, undercapitalized, significantly undercapitalized, and critically undercapitalized, although these terms are not used to represent overall financial condition. If adequately capitalized, regulatory approval is required to accept brokered deposits. If undercapitalized, capital distributions are limited, as is asset growth and expansion, and capital restoration plans are required.

The standard ratios established by the Bank's primary regulators to measure capital require the Bank to maintain minimum amounts and ratios, set forth in the following table. These ratios are common equity Tier 1 capital ("CET 1"), Tier 1 capital and total capital (as defined in the regulations) to risk-weighted assets (as defined), and Tier 1 capital (as defined) to average assets (as defined).

The actual capital ratios of the Bank, along with the applicable regulatory capital requirements as of September 30, 2020, were calculated in accordance with the requirements of Basel III. The final rules of Basel III also established a "capital conservation buffer" of 2.5% above new regulatory minimum capital ratios, which are fully effective following minimum ratios: (i) a CET 1 ratio of 7.0%; (ii) a Tier 1 capital ratio of 8.5%; and (iii) a total capital ratio of 10.5%. Banks are subject to limitations on paying dividends, engaging in share repurchases, and paying discretionary bonuses if its capital level falls below the buffer amount. These limitations establish a maximum percentage of eligible retained income that can be utilized for such activities. At September 30, 2020, required ratios including the capital conservation buffer were (i) CET 1 of 7.0%; (ii) a Tier 1 capital ratio of 8.5%; and (iii) a total capital ratio of 10.5%.

As of September 30, 2020 and December 31, 2019, the most recent filings with the FDIC categorized the Bank as well capitalized under the regulatory guidelines. To be categorized as well capitalized, an institution must maintain

[Table of Contents](#)

minimum CET 1 risk-based, Tier 1 risk-based, total risk-based, and Tier 1 leverage ratios as set forth in the following table. Management believes there are no conditions or events since September 30, 2020, that have changed the categorization of the Bank as well capitalized. Management believes the Bank met all capital adequacy requirements to which it was subject as of September 30, 2020 and December 31, 2019.

The following presents the actual and required capital amounts and ratios as of September 30, 2020 and December 31, 2019 (in thousands):

September 30, 2020	Actual		Required for Capital Adequacy Purposes <sup>(1)</sup>		To be Well Capitalized Under Prompt Corrective Action Regulations	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
Tier 1 capital to risk-weighted assets						
Bank	\$ 127,441	10.28 %	\$ 74,391	6.0 %	\$ 99,188	8.0 %
Consolidated	122,987	9.88	N/A	N/A	N/A	N/A
Common Equity Tier 1(CET1) to risk-weighted assets						
Bank	127,441	10.28	55,793	4.5	80,591	6.5
Consolidated	122,987	9.88	N/A	N/A	N/A	N/A
Total capital to risk-weighted assets						
Bank	139,647	11.26	99,188	8.0	123,985	10.0
Consolidated	149,753	12.03	N/A	N/A	N/A	N/A
Tier 1 capital to average assets						
Bank	127,441	7.81	65,233	4.0	81,542	5.0
Consolidated	\$ 122,987	7.52 %	\$ N/A	N/A %	\$ N/A	N/A %

(1) Does not include capital conservation buffer.

December 31, 2019	Actual		Required for Capital Adequacy Purposes <sup>(1)</sup>		To be Well Capitalized Under Prompt Corrective Action Regulations	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
Tier 1 capital to risk-weighted assets						
Bank	\$ 99,461	10.67 %	\$ 55,954	6.0 %	\$ 74,606	8.0 %
Consolidated	105,821	11.31	N/A	N/A	N/A	N/A
Common Equity Tier 1(CET1) to risk-weighted assets						
Bank	99,461	10.67	41,966	4.5	60,617	6.5
Consolidated	105,821	11.31	N/A	N/A	N/A	N/A
Total capital to risk-weighted assets						
Bank	107,509	11.53	74,606	8.0	93,257	10.0
Consolidated	120,429	12.87	N/A	N/A	N/A	N/A
Tier 1 capital to average assets						
Bank	99,461	8.09	49,166	4.0	61,458	5.0
Consolidated	\$ 105,821	8.58 %	\$ N/A	N/A %	\$ N/A	N/A %

(1) Does not include capital conservation buffer.

**NOTE 18 – SUBSEQUENT EVENTS**

On November 3, 2020, the Company announced that its Board of Directors had authorized a share repurchase program under which the Company may repurchase up to 400,000 shares of its common stock and that the Board of Governors of the Federal Reserve System advised the Company that it had no objection to the Company's stock repurchase program. The repurchase program authorized the Company to purchase its common stock from time to time in privately negotiated transactions, in the open market, including pursuant to any trading plan that may be adopted in accordance with Rule 10b5-1 plan promulgated by the Securities and Exchange Commissions, or otherwise in a manner that complies with applicable federal securities laws.



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

The following discussion and analysis is intended to assist readers in understanding our financial condition and results of operations for the three and nine months ended September 30, 2020 and should be read in conjunction with our consolidated financial statements and the accompanying notes thereto included in this Quarterly Report on Form 10-Q (this “Form 10-Q”) and in our Annual Report on Form 10-K filed with the Securities and Exchange Commission (“SEC”) on March 12, 2020. Unless we state otherwise or the context otherwise requires, references in this Form 10-Q to “we,” “our,” “us,” “the Company” and “First Western” refer to First Western Financial, Inc. and its consolidated subsidiaries, including First Western Trust Bank, which we sometimes refer to as “the Bank” or “our Bank.”

The following discussion contains “forward-looking statements” that reflect our future plans, estimates, beliefs and expected performance. We caution that assumptions, expectations, projections, intentions or beliefs about future events may, and often do, vary from actual results and the differences can be material. See “Cautionary Note Regarding Forward-Looking Statements.” Also, see the risk factors and other cautionary statements described under the heading “Risk Factors” included in in our Annual Report Form 10-K filed with the SEC on March 12, 2020 and in Part II–Item 1A of this Form 10-Q. We do not undertake any obligation to publicly update any forward-looking statements except as otherwise required by applicable law.

### **Company Overview**

We are a financial holding company founded in 2002 and headquartered in Denver, Colorado. We provide a fully integrated suite of wealth management services to our clients including banking, trust and investment management products and services. Our mission is to be the best private bank for the Western wealth management client. We target entrepreneurs, professionals and high-net worth individuals, typically with \$1.0 million-plus in liquid net worth, and their related philanthropic and business organizations, which we refer to as the “Western wealth management client.” We believe that the Western wealth management client shares our entrepreneurial spirit and values our sophisticated, high-touch wealth management services that are tailored to meet their specific needs. We partner with our clients to solve their unique financial needs through our expert integrated services provided in a team approach.

We offer our services through a branded network of boutique private trust bank offices, which we believe are strategically located in affluent and high-growth markets in locations across Colorado, Arizona, Wyoming and California. Our profit centers, which are comprised of private bankers, lenders, wealth planners and portfolio managers, under the leadership of a local chairman and/or president, are also supported centrally by teams providing management services such as operations, risk management, credit administration, marketing, technology support, human capital and accounting/finance services, which we refer to as support centers.

From 2004, when we opened our first profit center, until September 30, 2020, we have expanded our footprint into ten full service profit centers, three loan production offices, two trust offices, and one registered investment advisor located across four states. Following the Branch Acquisition completed in the second quarter 2020, we added one full service profit center in Lone Tree, CO. During the third quarter 2020, we closed two branch locations which were acquired in the Branch Acquisition during the second quarter 2020. As of and for the nine months ended September 30, 2020, we had \$1.97 billion in total assets, \$69.9 million in total revenues and provided fiduciary and advisory services on \$6.13 billion of assets under management (“AUM”).

The spread of COVID-19 has caused significant disruptions in the U.S. economy since it was declared a pandemic in March 2020 by the World Health Organization. Disruptions include temporary closures of many businesses that have led to a loss of revenues and a rapid increase in unemployment, disrupted global supply chains, market downturns and volatility, changes in consumer behavior related to pandemic fears, related emergency response legislation and an expectation that Federal Reserve policy will maintain a low interest rate environment for the foreseeable future. The changes have impacted our clients, their industries, as well as the financial services industry. At this time, we cannot predict the impact or how long the economy or our impacted clients will be disrupted.

The Company activated its Business Continuity Plan in early February in response to the emergence of COVID-19 and has continued to adjust as the crisis continues to impact our markets, clients and business. Since March, a majority of our associates have been working remotely. All of our offices are open, functioning, and continue to operate in an appointment only model for client service to limit the risk of potential exposure to COVID-19 for our associates and clients. We are taking additional precautions within our profit centers, including enhanced cleaning procedures, to ensure the safety of our clients and our associates.

## Primary Factors Used to Evaluate the Results of Operations

As a financial institution, we manage and evaluate various aspects of both our results of operations and our financial condition. We evaluate the comparative levels and trends of the line items in our consolidated balance sheet and income statement as well as various financial ratios that are commonly used in our industry. The primary factors we use to evaluate our results of operations include net interest income, non-interest income and non-interest expense.

### *Net Interest Income*

Net interest income represents interest income less interest expense. We generate interest income on interest-earning assets, primarily loans and available-for-sale securities. We incur interest expense on interest-bearing liabilities, primarily interest-bearing deposits and borrowings. To evaluate net interest income, we measure and monitor: (i) yields on loans, available-for-sale securities and other interest-earning assets; (ii) the costs of deposits and other funding sources; (iii) the rates incurred on borrowings and other interest-bearing liabilities; and (iv) the regulatory risk weighting associated with the assets. Interest income is primarily impacted by loan growth and loan repayments, along with changes in interest rates on the loans. Interest expense is primarily impacted by changes in deposit balances along with the volume and type of interest-bearing liabilities. Net interest income is primarily impacted by changes in market interest rates, the slope of the yield curve, and interest we earn on interest-earning assets or pay on interest-bearing liabilities.

### *Non-Interest Income*

Non-interest income primarily consists of the following:

- *Trust and investment management fees*—fees and other sources of income charged to clients for managing their trust and investment assets, providing financial planning consulting services, 401(k) and retirement advisory consulting services, and other wealth management services. Trust and investment management fees are primarily impacted by rates charged and increases and decreases in AUM. AUM is primarily impacted by opening and closing of client advisory and trust accounts, contributions and withdrawals, and the fluctuation in market values.
- *Net gain on mortgage loans*—gain on originating and selling mortgages, origination fees, and borrower credits, less commissions to loan originators, lender credits, document review and other costs specific to originating and selling the loan. The market adjustments for interest rate lock commitments (“IRLC”) and gains and losses incurred on the mandatory trading of loans are also included in this line item. Net gain on mortgage loans are primarily impacted by the amount of loans sold, the type of loans sold and market conditions.
- *Bank fees*—income generated through bank-related service charges such as: electronic transfer fees, treasury management fees, bill pay fees, and other banking fees. Banking fees are primarily impacted by the level of business activities and cash movement activities of our clients.
- *Net gain on sale of securities*—proceeds from the sale of securities that exceed the Companies carrying value. Net gain on sale of securities are primarily impacted by the amount of securities sold and market conditions.
- *Risk management and insurance fees*—commissions earned on insurance policies we have placed for clients through our client risk management team who incorporate insurance services, primarily life insurance, to support our clients’ wealth planning needs. Our insurance revenues are primarily impacted by the type and volume of policies placed for our clients.
- *Income on company-owned life insurance*—income earned on the growth of the cash surrender value of life insurance policies we hold on certain key associates. The income on the increase in the cash surrender value is non-taxable income.

### *Non-Interest Expense*

Non-interest expense is comprised primarily of the following:

- *Salaries and employee benefits*—all forms of compensation related expenses including salary, incentive compensation, payroll-related taxes, stock-based compensation, benefit plans, health insurance, 401(k) plan match costs and other benefit-related expenses. Salaries and employee benefit costs are primarily impacted by changes in headcount and fluctuations in benefits costs.
- *Occupancy and equipment*—costs related to leasing our office space, depreciation charges for the furniture, fixtures and equipment, amortization of leasehold improvements, utilities and other occupancy-related expenses. Occupancy and equipment costs are primarily impacted by the number of locations we occupy.
- *Professional services*—costs related to legal, accounting, tax, consulting, personnel recruiting, insurance and other outsourcing arrangements. Professional services costs are primarily impacted by corporate activities requiring specialized services. Federal Deposit Insurance Corporation (“FDIC”) insurance expense is also included in this line and represents the assessments that we pay to the FDIC for deposit insurance.
- *Technology and information systems*—costs related to software and information technology services to support office activities and internal networks. Technology and information system costs are primarily impacted by the number of locations we occupy, the number of associates we have and the level of service we require from our third-party technology vendors.
- *Data processing*—costs related to processing fees paid to our third-party data processing system providers relating to our core private trust banking platform. Data processing costs are primarily impacted by the number of loan, deposit and trust accounts we have and the level of transactions processed for our clients.
- *Marketing*—costs related to promoting our business through advertising, promotions, charitable events, sponsorships, donations and other marketing-related expenses. Marketing costs are primarily impacted by the levels of advertising programs and other marketing activities and events held throughout the year.
- *Amortization of other intangible assets*—primarily represents the amortization of intangible assets including client lists and other similar items recognized in connection with acquisitions.
- *Goodwill impairment*—represents the \$1.6 million goodwill impairment charge in 2019 related to the Company’s Los Angeles-based fixed income team (a component of the Company’s Capital Management segment).
- *Net loss on assets held for sale*—represents the fair value adjustment on disposal groups held for sale.
- *Provision for other real estate owned*—represents the fair value adjustment for other real estate owned (“OREO”).
- *Other*—includes costs related to operational expenses associated with office supplies, postage, travel expenses, meals and entertainment, dues and memberships, costs to maintain or prepare OREO for sale, director compensation and travel, and other general corporate expenses that do not fit within one of the specific non-interest expense lines described above. Other operational expenses are generally impacted by our business activities and needs.

### *Operating Segments*

We measure the overall profitability of operating segments based on income before income tax. We believe this is a more useful measurement as our wealth management products and services are fully integrated with our private trust bank. We allocate costs to our segments, which consist primarily of compensation and overhead expense directly attributable to the products and services within Wealth Management, Capital Management and Mortgage segments. We measure the profitability of each segment based on a post-allocation basis as we believe it better approximates the operating

cash flows generated by our reportable operating segments. A description of each segment is provided in Note 16 - Segment Reporting of the accompanying Notes to the Condensed Consolidated Financial Statements.

### **Primary Factors Used to Evaluate our Balance Sheet**

The primary factors we use to evaluate our balance sheet include asset and liability levels, asset quality, capital, liquidity, and potential profit production from assets.

We manage our asset levels to ensure our lending initiatives are efficiently and profitably supported and to ensure we have the necessary liquidity and capital to meet the required regulatory capital ratios. Funding needs are evaluated and forecasted by communicating with clients, reviewing loan maturity and draw expectations, and projecting new loan opportunities.

We manage the diversification and quality of our assets based upon factors that include the level, distribution, severity and trend of problem assets such as those determined to be classified, delinquent, non-accrual, non-performing or restructured; the adequacy of our allowance for loan losses; the diversification and quality of loan and investment portfolios; the extent of counterparty risks, credit risk concentrations, and other factors.

We manage our liquidity based upon factors that include the level and quality of capital and our overall financial condition, the trend and volume of problem assets, our balance sheet risk exposure, the level of deposits as a percentage of total loans, the amount of non-deposit funding used to fund assets, the availability of unused funding sources and off-balance sheet obligations, the availability of assets to be readily converted into cash without undue loss, the amount of cash and liquid securities we hold, and other factors.

Financial institution regulators have established guidelines for minimum capital ratios for banks and bank holding companies. In 2015, we adopted the Basel III regulatory capital framework. At September 30, 2020, the Bank's capital ratios exceeded the current well capitalized regulatory requirements established under Basel III.

### **Branch Acquisition**

On February 10, 2020, the Company entered into a branch purchase and assumption agreement ("Branch Acquisition") with Simmons Bank, pursuant to which the Company agreed to acquire all of Simmons' Colorado locations, including three branches and one loan production office located in metro Denver, as well as certain deposits and loans and other assets. On May 15, 2020, the Branch Acquisition was successfully completed. See Note 2 - Acquisitions of the accompanying Notes to Condensed Consolidated Financial Statements for additional information.

### **Recent Events**

A provision in the Coronavirus Aid, Relief and Economic Security Act ("CARES Act") created the Paycheck Protection Program ("PPP"), which is administered by the Small Business Administration ("SBA"). The PPP is intended to provide loans to small businesses to pay their employees, rent, mortgage interest and utilities. The loans may be forgiven conditioned upon the client providing payroll documentation evidencing their compliant use of funds and otherwise complying with the terms of the program. The Bank is an approved SBA lender and began accepting applications for the program on April 3, 2020. As of September 30, 2020, we held 668 PPP loans for a total of \$206.1 million with an average loan size of \$0.3 million. As of October 16<sup>th</sup>, the Company had submitted 236 loans with original loan amounts of \$85.2 million to the SBA for forgiveness and had received forgiveness on 46 loans totaling \$2.1 million.

As a result of the COVID-19 pandemic, a loan modification program was designed and implemented to assist our clients experiencing financial stress resulting from the economic impacts caused by the global pandemic. The Company has offered loan extensions, temporary payment moratoriums, and financial covenant waivers for commercial and consumer borrowers impacted by the pandemic who have a pass risk rating and have not been delinquent over 30 days on payments in the last two years. As of September 30, 2020, the Company had entered into modification programs on one hundred loans across multiple industries in the amount of \$179.0 million. Forty-four loans, in the amount of \$66.7 million, were still in the modification period at September 30, 2020. The CARES Act provides banks optional, temporary relief from accounting for certain loan modifications as troubled debt restructuring ("TDR"). The modifications must be related to the adverse effects of COVID-19, and certain other criteria are required to be met in order to apply the relief. Interagency guidance from the Federal Reserve and the FDIC confirmed with the FASB that short-term modifications made on a good faith basis in response to COVID-19 to borrowers who were current prior to any relief, are not to be considered TDRs. We believe our loan modification program satisfies the applicable requirements.

The Company will continue to closely monitor the performance of COVID-19 impacted clients. Additionally, the Company will continue to review and revise its provision for loan losses as more information becomes available including the resolution of certain uncertainties some of our impacted clients face related to the government mandated shutdowns

and shelter-in-place orders and the resulting financial stress. The extent to which the COVID-19 pandemic and government actions taken in response to the pandemic will impact our operations and financial results is highly uncertain.

During the third quarter 2020, the Company began lending under the Federal Reserve's Main Street Lending Program ("MSLP") to support lending to small and medium-sized for profit businesses and nonprofit organizations that were in sound financial condition before the onset of the COVID-19 pandemic. Further details of the MSLP are provided in Note 4 – Loans and the Allowance for Loan Losses of the accompanying Notes to the Condensed Consolidated Financial Statements.

On September 18, 2020, the Company entered into an agreement to sell its Los Angeles-based fixed income portfolio management team and certain related advisory and sub-advisory arrangements to Lido Advisors, LLC and Oakhurst Advisors, LLC. The sale of the Los Angeles-based fixed income team is expected to be earnings neutral to the Company, as the revenue decrease will be approximately in-line with the expected expense reduction. The sale is not expected to have an impact on First Western's bank clients, but will reduce the Company's assets under management by approximately \$300 million. The transaction is expected to close in the fourth quarter of 2020.

## Results of Operations

### Overview

*The three months ended September 30, 2020 compared with the three months ended September 30, 2019.* We reported net income available to common shareholders of \$9.6 million for the three months ended September 30, 2020, compared to \$2.4 million of net income available to common shareholders for the three months ended September 30, 2019, a \$7.2 million, or 300.2%, increase. For the three months ended September 30, 2020, our income before income tax was \$12.8 million, a \$9.6 million, or 302.4%, increase from the three months ended September 30, 2019. The increase was primarily driven by a \$9.0 million increase in net gain on mortgage loans and a \$5.0 million increase in net interest income, offset partially by a \$3.2 million increase in non-interest expense and a \$1.4 million increase in provision for loan losses. The increase in net gain on mortgage loans was due to an increase in origination volume and a corresponding increase in IRLC volume and associated net gains on those IRLC, as of September 30, 2020. The increase in net interest income was due to a reduction in our average cost of funds and an increase in average loan balances. The increase in non-interest expense was primarily due to an increase in salaries and employee benefits related to added personnel from the Branch Acquisition and an increase in incentive compensation accruals driven by the strong financial performance of the Company. The increase in provision for loan losses primarily resulted from an increase based on the additional variability surrounding the COVID-19 loan modifications, increased economic uncertainty and strong loan growth during the quarter.

*The nine months ended September 30, 2020 compared with the nine months ended September 30, 2019.* We reported net income available to common shareholders of \$19.7 million for the nine months ended September 30, 2020, compared to \$5.4 million of net income available to common shareholders for the nine months ended September 30, 2019, a \$14.2 million, or 261.6%, increase. For the nine months ended September 30, 2020, our income before income tax was \$26.0 million, an \$18.7 million, or 255.5%, increase from the nine months ended September 30, 2019. The increase was primarily driven by a \$16.9 million increase in net gain on mortgage loans, an \$8.8 million increase in net interest income, offset partially by a \$3.2 million increase in non-interest expense and a \$3.8 million increase in provision for loan losses. The increase in net gain on mortgage loans was due to an increase in origination volume and a corresponding increase in IRLC volume and associated net gains on those IRLC, as of September 30, 2020. The increase in net interest income was due to a reduction in our average cost of funds and an increase in average loan balances. The increase in non-interest expense was primarily due to an increase in salaries and employee benefits related to added personnel from the Branch Acquisition and an increase in incentive compensation accruals driven by the strong financial performance of the Company. The increase in provision for loan losses primarily resulted from an increase based on the additional variability surrounding the COVID-19 loan modifications, increased economic uncertainty and strong loan growth during the quarter.

### Net Interest Income

*The three months ended September 30, 2020 compared with the three months ended September 30, 2019.* For the three months ended September 30, 2020, net interest income, before the provision for loan losses, was \$12.9 million, an increase of \$5.0 million, or 62.7%, compared to the three months ended September 30, 2019. This increase was partially attributable to a \$525.6 million increase in average outstanding loan balances compared to September 30, 2019, along with a decrease in our cost of funds to 0.35% from 1.33%. For the three months ended September 30, 2020, our net interest margin was 3.07% and our net interest spread was 2.96%. For the three months ended September 30, 2019, our net interest margin was 2.95% and our net interest spread was 2.58%.

*The nine months ended September 30, 2020 compared with the nine months ended September 30, 2019.* For the nine months ended September 30, 2020, net interest income, before the provision for loan losses, was \$32.6 million, an increase of \$8.8 million, or 36.8%, compared to the nine months ended September 30, 2019. This increase was partially attributable to a \$321.9 million increase in average outstanding loan balances compared to September 30, 2019, along with a decrease in our cost of funds to 0.55% from 1.28%. For the nine months ended September 30, 2020, our net interest margin was 3.10% and our net interest spread was 2.91%. For the nine months ended September 30, 2019, our net interest margin was 3.03% and our net interest spread was 2.63%.

The increase in average loans outstanding for the three and nine months ended September 30, 2020 compared to the same periods in 2019 was due to three primary factors: organic growth, PPP loan originations and the Branch Acquisition. PPP loan originations contributed \$0.7 million and \$1.3 million, respectively, to net interest income for the three and nine months ended September 30, 2020. The increase in interest income on our loan portfolio due to an increase in average loans outstanding was partially offset by lower average loan yields. Loan yields were 3.87% for the three months ended September 30, 2020, compared to 4.55% for the three months ended September 30, 2019. The reduction in loan yields was driven by two primary factors: a lower interest rate environment and PPP Loan originations. Average loan yields were negatively impacted by 31 basis points as a result of PPP loan originations during the three months ended September 30, 2020.

Interest income on our available-for-sale securities portfolio decreased as a result of lower average yield for the three and nine months ended September 30, 2020 compared to the same periods in 2019. Our average yield on available-for-sale securities during the three and nine months ended September 30, 2020 was 1.71% and 1.92%, a 72 and 55 basis point decrease, compared to the same periods in 2019. Our average available-for-sale securities balance during the three and nine months ended September 30, 2020 was \$40.5 million and \$48.1 million, a decrease of \$10.8 million and \$3.4 million, respectively, compared to the same periods in 2019.

Interest expense on deposits decreased during the three and nine months ended September 30, 2020 compared to the same periods in 2019. The decrease was driven primarily by a 100 and 73 basis point decline in cost of deposits for the three and nine months ended September 30, 2020 compared to the same periods in 2019. The decrease in cost of deposits was driven by a reduction in deposit rates consistent with the lower interest rate environment. The reduction in cost of deposits was partially offset by an increase in average interest-bearing deposit accounts of \$218.8 million and \$159.1 million, for the three and nine months ended September 30, 2020, compared to the same periods in 2019.

Net interest income is also impacted by changes in the amount and type of interest earning assets and interest bearing liabilities. To evaluate net interest income, we measure and monitor the yields on our loans and other interest earning assets and the costs of our deposits and other funding sources. The following tables present an analysis of net interest income and net interest margin for the periods presented, using daily average balances for each major category of

interest-earning assets and interest-bearing liabilities, the interest earned or paid and the average rate earned or paid on those assets or liabilities.

	As of and For the Three Months Ended September 30,					
	2020			2019		
(Dollars in thousands)	Average Balance <sup>(1)</sup>	Interest Earned / Paid	Average Yield / Rate	Average Balance <sup>(1)</sup>	Interest Earned / Paid	Average Yield / Rate
<b>Assets</b>						
Interest-earning assets:						
Interest-bearing deposits in other financial institutions	\$ 178,756	\$ 99	0.22 %	\$ 88,782	\$ 489	2.20 %
Available-for-sale securities <sup>(2)</sup>	40,528	173	1.71	51,368	312	2.43
Loans <sup>(3)</sup>	1,462,872	14,138	3.87	937,260	10,672	4.55
Interest-earning assets <sup>(4)</sup>	1,682,156	14,410	3.43	1,077,410	11,473	4.26
Mortgage loans held for sale <sup>(5)</sup>	94,714	643	2.72	52,546	454	3.46
Total interest-earning assets, plus mortgage loans held for sale	\$ 1,776,870	\$ 15,053	3.39 %	\$ 1,129,956	\$ 11,927	4.22 %
Allowance for loan losses	(10,965)			(7,584)		
Noninterest-earning assets	101,874			81,171		
Total assets	<u>\$ 1,867,779</u>			<u>\$ 1,203,543</u>		
<b>Liabilities and Shareholders' Equity</b>						
Interest-bearing liabilities:						
Interest-bearing deposits	\$ 1,045,321	\$ 1,067	0.41 %	\$ 826,490	\$ 3,363	1.63 %
Federal Home Loan Bank Topeka and Federal Reserve borrowings	222,225	204	0.37	10,567	51	1.93
Subordinated notes	14,445	221	6.12	6,560	119	7.26
Total interest-bearing liabilities	<u>\$ 1,281,991</u>	<u>\$ 1,492</u>	<u>0.47 %</u>	<u>\$ 843,617</u>	<u>\$ 3,533</u>	<u>1.68 %</u>
Noninterest-bearing liabilities:						
Noninterest-bearing deposits	417,502			215,721		
Other liabilities	22,564			19,881		
Total noninterest-bearing liabilities	<u>\$ 440,066</u>			<u>\$ 235,602</u>		
Total shareholders' equity	145,722			124,324		
Total liabilities and shareholders' equity	<u>\$ 1,867,779</u>			<u>\$ 1,203,543</u>		
Net interest rate spread <sup>(6)</sup>			2.96 %			2.58 %
Net interest income <sup>(7)</sup>		<u>\$ 12,918</u>			<u>\$ 7,940</u>	
Net interest margin <sup>(8)</sup>			3.07 %			2.95 %

(Dollars in thousands)	As of and For the Nine Months Ended September 30,					
	2020			2019		
	Average Balance <sup>(1)</sup>	Interest Earned / Paid	Average Yield / Rate	Average Balance <sup>(1)</sup>	Interest Earned / Paid	Average Yield / Rate
<b>Assets</b>						
Interest-earning assets:						
Interest-bearing deposits in other financial institutions	\$ 108,010	\$ 358	0.44 %	\$ 71,799	\$ 1,254	2.33 %
Available-for-sale securities <sup>(2)</sup>	48,117	692	1.92	51,565	954	2.47
Loans <sup>(3)</sup>	1,250,052	37,342	3.98	928,112	31,490	4.52
Interest-earning assets <sup>(4)</sup>	1,406,179	38,392	3.64	1,051,476	33,698	4.27
Mortgage loans held for sale <sup>(5)</sup>	67,010	1,519	3.02	32,569	872	3.57
Total interest-earning assets, plus mortgage loans held for sale	\$ 1,473,189	\$ 39,911	3.61 %	\$ 1,084,045	\$ 34,570	4.25 %
Allowance for loan losses	(9,230)			(7,599)		
Noninterest-earning assets	91,924			86,047		
Total assets	<u>\$ 1,555,883</u>			<u>\$ 1,162,493</u>		
<b>Liabilities and Shareholders' Equity</b>						
Interest-bearing liabilities:						
Interest-bearing deposits	\$ 935,689	\$ 4,779	0.68 %	\$ 776,575	\$ 9,268	1.59 %
Federal Home Loan Bank Topeka and Federal Reserve borrowings	99,379	384	0.52	12,964	202	2.08
Subordinated notes	12,256	584	6.35	6,560	357	7.26
Total interest-bearing liabilities	<u>\$ 1,047,324</u>	<u>\$ 5,747</u>	<u>0.73 %</u>	<u>\$ 796,099</u>	<u>\$ 9,827</u>	<u>1.65 %</u>
Noninterest-bearing liabilities:						
Noninterest-bearing deposits	350,475			225,512		
Other liabilities	20,426			19,376		
Total noninterest-bearing liabilities	<u>\$ 370,901</u>			<u>\$ 244,888</u>		
Shareholders' equity	137,658			121,506		
Total liabilities and shareholders' equity	<u>\$ 1,555,883</u>			<u>\$ 1,162,493</u>		
Net interest rate spread <sup>(6)</sup>			2.91 %			2.63 %
Net interest income <sup>(7)</sup>		<u>\$ 32,645</u>			<u>\$ 23,871</u>	
Net interest margin <sup>(8)</sup>			3.10 %			3.03 %

(1) Average balance represents daily averages, unless otherwise noted.

(2) Available-for-sale securities represents monthly averages.

(3) Non-performing loans are included in the respective average loan balances. Income, if any, on such loans is recognized on a cash basis.

(4) Tax-equivalent yield adjustments are immaterial.

(5) Mortgage loans held for sale are separated from the interest-earning assets above, as these loans are held for a short period of time until sold in the secondary market and are not held for investment purposes, with interest income recognized in the net gain on mortgage loans line in the condensed consolidated statements of income. These balances are excluded from the margin calculations in these tables.

(6) Net interest spread is the average yield on interest-earning assets (excluding mortgage loans held for sale) minus the average rate on interest-bearing liabilities.

(7) Net interest income is the difference between income earned on interest-earning assets, which does not include interest earned on mortgage loans held for sale, and expense paid on interest-bearing liabilities.

(8) Net interest margin is equal to net interest income divided by average interest-earning assets (excluding mortgage loans held for sale).

The following tables present the dollar amount of changes in interest income and interest expense for the periods presented, for each component of interest-earning assets and interest-bearing liabilities (excluding mortgage loans held for



sale) and distinguishes between changes attributable to volume and interest rates. Changes attributable to both rate and volume that cannot be separated have been allocated to volume.

<i>(Dollars in thousands)</i>	Three Months Ended September 30, 2020 Compared to 2019			Nine Months Ended September 30, 2020 Compared to 2019		
	Increase (Decrease) Due to Change in:		Total Increase (Decrease)	Increase (Decrease) Due to Change in:		Total Increase (Decrease)
	Volume	Rate		Volume	Rate	
<b>Interest-earning assets:</b>						
Interest-bearing deposits in other financial institutions	\$ 50	\$ (440)	\$ (390)	\$ 120	\$ (1,016)	\$ (896)
Available-for-sale securities	(46)	(93)	(139)	(50)	(212)	(262)
Loans	5,080	(1,614)	3,466	9,617	(3,765)	5,852
<b>Total increase (decrease) in interest income</b>	<b>\$ 5,084</b>	<b>\$ (2,147)</b>	<b>\$ 2,937</b>	<b>\$ 9,687</b>	<b>\$ (4,993)</b>	<b>\$ 4,694</b>
<b>Interest-bearing liabilities:</b>						
Interest-bearing deposits	223	(2,519)	(2,296)	813	(5,302)	(4,489)
Federal Home Loan Bank Topeka and Federal Reserve borrowings	194	(41)	153	333	(151)	182
Subordinated notes	121	(19)	102	272	(45)	227
<b>Total increase (decrease) in interest expense</b>	<b>\$ 538</b>	<b>\$ (2,579)</b>	<b>\$ (2,041)</b>	<b>\$ 1,418</b>	<b>\$ (5,498)</b>	<b>\$ (4,080)</b>
<b>Increase in net interest income</b>	<b>\$ 4,546</b>	<b>\$ 432</b>	<b>\$ 4,978</b>	<b>\$ 8,269</b>	<b>\$ 505</b>	<b>\$ 8,774</b>

*Non-Interest Income*

*The three months ended September 30, 2020 compared with the three months ended September 30, 2019.* For the three months ended September 30, 2020 compared with the three months ended September 30, 2019, non-interest income increased \$9.2 million, or 105.2%, to \$18.0 million. The increase in non-interest income during the three months ended September 30, 2020 was primarily a result of a \$9.0 million increase in net gain on mortgage loans, compared to the same period in 2019.

*The nine months ended September 30, 2020 compared with the nine months ended September 30, 2019.* For the nine months ended September 30, 2020 compared with the nine months ended September 30, 2019, non-interest income increased \$16.9 million, or 69.3%, to \$41.2 million. The increase in non-interest income during the nine months ended September 30, 2020 was primarily a result of a \$16.9 million increase in net gain on mortgage loans, compared to the same period in 2019.

The table below presents the significant categories of our non-interest income for the three and nine months ended September 30, 2020 and 2019:

<i>(Dollars in thousands)</i>	<b>Three Months Ended</b>		<b>Change</b>	
	<b>September 30,</b>	<b>September 30,</b>	<b>\$</b>	<b>%</b>
	<b>2020</b>	<b>2019</b>		
<b>Non-interest income:</b>				
Trust and investment management fees	\$ 4,814	\$ 4,824	\$ (10)	(0.2)%
Net gain on mortgage loans	12,304	3,291	9,013	273.9
Banking fees	340	283	57	20.1
Risk management and insurance fees	483	176	307	174.4
Net gain on sale of securities	—	119	(119)	*
Income on company-owned life insurance	91	95	(4)	(4.2)
<b>Total non-interest income</b>	<b>\$ 18,032</b>	<b>\$ 8,788</b>	<b>\$ 9,244</b>	<b>105.2 %</b>
	<b>Nine Months Ended</b>		<b>Change</b>	
<i>(Dollars in thousands)</i>	<b>September 30,</b>	<b>September 30,</b>	<b>\$</b>	<b>%</b>
	<b>2020</b>	<b>2019</b>		
<b>Non-interest income:</b>				
Trust and investment management fees	\$ 14,154	\$ 14,186	\$ (32)	(0.2)%
Net gain on mortgage loans	24,958	8,009	16,949	211.6
Bank fees	929	912	17	1.9
Risk management and insurance fees	912	838	74	8.8
Net gain on sale of securities	—	119	(119)	*
Income on company-owned life insurance	273	284	(11)	(3.9)
<b>Total non-interest income</b>	<b>\$ 41,226</b>	<b>\$ 24,348</b>	<b>\$ 16,878</b>	<b>69.3 %</b>

\* Not meaningful

*Trust and investment management fees*—For the three and nine months ended September 30, 2020 compared to the same periods in 2019, our trust and investment management fees remained relatively unchanged.

*Net gain on mortgage loans*—For the three months ended September 30, 2020 compared to the same period in 2019, our net gain on mortgage loans increased by \$9.0 million, or 273.9%, to \$12.3 million. For the three months ended September 30, 2020 and 2019, our origination volume was \$376.3 million and \$214.5 million, respectively, and a corresponding increase in IRLC volume and associated net gains on those IRLC, as of September 30, 2020. For the nine months ended September 30, 2020 compared to the same period in 2019, our net gain on mortgage loans increased by \$16.9 million, or 211.6%, to \$25.0 million. For the nine months ended September 30, 2020 and 2019, our origination volume was \$917.5 million and \$442.8 million, respectively, and a corresponding increase in IRLC volume and associated net gains on those IRLC, as of September 30, 2020. The net gain on mortgage loans will fluctuate with the amount and type of loans sold and market conditions. The increase in origination volume for the three and nine month period was primarily related to lower market rates driving an increase in refinance activity, a strong residential real estate market in our footprint and management’s commitment and ability to capitalize on the mortgage environment.

*Bank fees*— For the three and nine months ended September 30, 2020 compared to the same periods in 2019, our bank fees remained relatively unchanged.

*Risk management and insurance fees*—Risk management fees include fees earned by our risk management product group as a result of assisting clients with obtaining life insurance policies and fees from the trailing annuity revenue streams. During the three months ended September 30, 2020 and 2019, the Company recognized \$0.5 million and \$0.2 million of risk management fees. For the nine months ended September 30, 2020, we recognized \$0.9 million of risk management fees as compared to \$0.8 million for the same period in 2019. The change in revenue is primarily attributable to the average size of client policies placed and will fluctuate from period to period.

*Net gain on sale of securities*—For the three and nine months ended September 30, 2020 the Company did not sell securities. For the three and nine months ended September 30, 2019 the Company recognized a net gain on sale of securities of \$0.1 million.

*Provision for Loan Losses*

For the three months ended September 30, 2020, we recorded \$1.5 million of provision for loan losses, primarily based on the additional variability surrounding the loan modifications in place during the quarter and increased economic uncertainty related to the impact of the COVID-19 pandemic. We have a dedicated problem loan resolution team comprised of associates from our credit, senior leadership, risk and accounting teams that meets frequently to ensure that watch list and problem credits are identified early and actively managed. We work to identify potential losses in a timely manner and proactively manage the problem credits to minimize losses. For the nine months ended September 30, 2020, we recorded \$4.0 million of provision for loan losses, primarily resulting from an increase based on the additional variability surrounding the loan modifications made during the second quarter along with increased economic uncertainty related to the impact of the COVID-19 pandemic and overall loan growth.

The Company has increased loan level reviews and portfolio monitoring to address the changing environment. We identified clients who could be more highly impacted by the recent COVID-19 pandemic and economic disruption and are meeting regularly with them. The analysis reviewed the borrowers in industries we believe may be more impacted including those the lenders believed would have one or more of the following characteristics: greater than 50% probability of a downgrade, a covenant violation or 20% reduction in collateral position. The Company receives and reviews current financial data and cash flow forecasts from borrowers with loan modification agreements.

Management believes the financial strength of the Bank's clientele and the diversity of the portfolio continues to mitigate the credit risk within the portfolio.

### Non-Interest Expense

The table below presents the significant categories of our non-interest expense for the periods noted:

(Dollars in thousands)	Three Months Ended September 30,		Change	
	2020	2019	\$	%
<b>Non-interest expense:</b>				
Salaries and employee benefits	\$ 10,212	\$ 8,504	\$ 1,708	20.1 %
Occupancy and equipment	1,619	1,388	231	16.6
Professional services	1,288	745	543	72.9
Technology and information systems	1,032	961	71	7.4
Data processing	1,038	854	184	21.5
Marketing	395	272	123	45.2
Amortization of other intangible assets	4	52	(48)	(92.3)
Provision for other real estate owned	100	—	100	*
Other	944	666	278	41.7
<b>Total non-interest expense</b>	<b>\$ 16,632</b>	<b>\$ 13,442</b>	<b>\$ 3,190</b>	<b>23.7 %</b>

(Dollars in thousands)	Nine Months Ended September 30,		Change	
	2020	2019	\$	%
<b>Non-interest expense:</b>				
Salaries and employee benefits	\$ 25,384	\$ 23,821	\$ 1,563	6.6 %
Occupancy and equipment	4,574	4,193	381	9.1
Professional services	3,542	2,557	985	38.5
Technology and information systems	2,994	3,046	(52)	(1.7)
Data processing	2,922	2,282	640	28.0
Marketing	1,063	991	72	7.3
Amortization of other intangible assets	44	366	(322)	(88.0)
Goodwill impairment	—	1,572	(1,572)	(100.0)
Net loss on assets held for sale	553	—	553	*
Provision for other real estate owned	100	—	100	*
Other	2,747	1,873	874	46.7
<b>Total non-interest expense</b>	<b>\$ 43,923</b>	<b>\$ 40,701</b>	<b>\$ 3,222</b>	<b>7.9 %</b>

\* Not meaningful

The increase in non-interest expense of 23.7% to \$16.6 million for the three months ended September 30, 2020 was primarily due to a \$1.7 million increase in salaries and employee benefits. The increase in salaries and employee benefits was primarily due to an increase in salaries and employee benefits related to added personnel from the Branch Acquisition and an increase in incentive compensation accruals driven by the strong financial performance of the Company. The increase in non-interest expense of 7.9% to \$43.9 million for the nine months ended September 30, 2020 was primarily due to an increase in salaries and employee benefits, professional services and data processing. The increase in salaries and employee benefits was primarily due to added personnel from the Branch Acquisition and an increase in incentive compensation accruals driven by the strong financial performance of the Company, offset partially by an increase in deferred compensation related to PPP loan originations. The increase in professional services and data processing was driven by the Branch Acquisition and organic growth in our business. The increase in salaries and employee benefits, professional services and data processing was partially offset by a reduction due to the impact of a \$1.6 million goodwill impairment charge related to Capital Management in the nine months ended September 30, 2019.

### Income Tax

The Company recorded an income tax provision of \$3.2 million and \$0.8 million, respectively, for the three months ended September 30, 2020 and 2019, reflecting an effective tax rate of 24.9% and 24.5%, respectively. The increase in effective tax rate was primarily attributable to adjustments related to the vesting of restricted stock awards. For the nine months ended September 30, 2020 and 2019, the Company recorded an income tax provision of \$6.3 million and \$1.9 million reflecting an effective tax rate of 24.3% and 25.5%, respectively. The decline in effective tax rate was primarily attributable to tax-planning strategies driven by the impact of research and development tax credits and deferred tax adjustments related to the vesting of Restricted Stock Units during 2019.

## Segment Reporting

We have three reportable operating segments: Wealth Management, Capital Management and Mortgage. Our Wealth Management segment consists of operations relating to the Company's fully integrated wealth management products and services. Services provided include deposit, loan, insurance, and trust and investment management advisory products and services. Our Capital Management segment consists of operations relating to the Company's institutional investment management services over proprietary fixed income, high yield and equity strategies, including acting as the advisor of three owned, managed and rated proprietary mutual funds. Capital Management products and services are financial in nature, with revenues generally based on a percentage of assets under management or paid premiums. Our Mortgage segment consists of operations relating to the Company's residential mortgage service offerings. Mortgage products and services are financial in nature, for which premiums are recognized net of expenses, upon the sale of mortgage loans to third parties. Services provided by our Mortgage segment include soliciting, originating and selling mortgage loans into the secondary market. Mortgage loans originated and held for investment purposes are recorded in the Wealth Management segment, as this segment provides ongoing services to our clients.

The following table presents key metrics related to our segments:

<i>(Dollars in thousands)</i>	Three Months Ended September 30, 2020				Nine Months Ended September 30, 2020			
	Wealth	Capital	Mortgage	Consolidated	Wealth	Capital	Mortgage	Consolidated
	Management	Management			Management	Management		
Income <sup>(1)</sup>	\$ 16,232	\$ 899	\$ 12,323	\$ 29,454	\$ 42,368	\$ 2,492	\$ 25,024	\$ 69,884
Income (loss) before taxes	\$ 2,316	\$ 264	\$ 10,242	\$ 12,822	\$ 7,031	\$ (332)	\$ 19,262	\$ 25,961
Profit margin	14.3 %	29.4 %	83.1 %	43.5 %	16.6 %	(13.3)%	77.0 %	37.1 %

<i>(Dollars in thousands)</i>	Three Months Ended September 30, 2019				Nine Months Ended September 30, 2019			
	Wealth	Capital	Mortgage	Consolidated	Wealth	Capital	Mortgage	Consolidated
	Management	Management			Management	Management		
Income <sup>(1)</sup>	\$ 12,554	\$ 776	\$ 3,298	\$ 16,628	\$ 37,611	\$ 2,339	\$ 8,053	\$ 48,003
Income (loss) before taxes	\$ 1,846	\$ 53	\$ 1,287	\$ 3,186	\$ 5,774	\$ (1,618)	\$ 3,146	\$ 7,302
Profit margin	14.7 %	6.8 %	39.0 %	19.2 %	15.4 %	(69.2)%	39.1 %	15.2 %

(1) Net interest income after provision plus non-interest income.

The tables below present selected financial metrics of each segment as of and for the periods presented:

*Wealth Management*

<i>(Dollars in thousands)</i>	As of and For the Three Months Ended September 30,			
	2020	2019	\$ Change	% Change
Total interest income	\$ 14,410	\$ 11,473	\$ 2,937	25.6 %
Total interest expense	1,492	3,533	(2,041)	(57.8)
Provision for loan losses	1,496	100	1,396	1,396.0
Net interest income, after provision for loan losses	11,422	7,840	3,582	45.7
Non-interest income	4,810	4,714	96	2.0
Total income	16,232	12,554	3,678	29.3
Depreciation and amortization expense	252	274	(22)	(8.0)
All other non-interest expense	13,664	10,434	3,230	31.0
Income before income tax	\$ 2,316	\$ 1,846	\$ 470	25.5 %
Goodwill	\$ 20,499	\$ 15,994	\$ 4,505	28.2 %
<b>Total assets</b>	<b>\$ 1,859,390</b>	<b>\$ 1,195,340</b>	<b>\$ 664,050</b>	<b>55.6 %</b>

<i>(Dollars in thousands)</i>	As of and For the Nine Months Ended September 30,			
	2020	2019	\$ Change	% Change
Total interest income	\$ 38,392	\$ 33,698	\$ 4,694	13.9 %
Total interest expense	5,747	9,827	(4,080)	(41.5)
Provision for loan losses	3,987	216	3,771	1,745.8
Net interest income, after provision for loan losses	28,658	23,655	5,003	21.1
Non-interest income	13,710	13,956	(246)	(1.8)
Total income	42,368	37,611	4,757	12.6
Depreciation and amortization expense	718	902	(184)	(20.4)
All other non-interest expense	34,619	30,935	3,684	11.9
Income before income tax	\$ 7,031	\$ 5,774	\$ 1,257	21.8 %
Goodwill	\$ 20,499	\$ 15,994	\$ 4,505	28.2 %
<b>Total assets</b>	<b>\$ 1,859,390</b>	<b>\$ 1,195,340</b>	<b>\$ 664,050</b>	<b>55.6 %</b>

The Wealth Management segment reported income before income tax of \$2.3 million and \$7.0 million for the three and nine months ended September 30, 2020, respectively, compared to \$1.8 million and \$5.8 million for the same period in 2019. The increase for the three and nine month period is primarily driven by an increase in average outstanding loan balances and a decrease in the cost of funds, offset partially by increasing provision for loan losses and non-interest expense. During three and nine months ended September 30, 2020 average loans increased \$525.6 million and \$321.9 million and the cost of funds decreased to 0.35% from 1.33% and to 0.55% from 1.28% compared to the same periods in 2019.

### Capital Management

<i>(Dollars in thousands)</i>	As of and For the Three Months Ended September 30,			
	2020	2019	\$ Change	% Change
Total interest income	\$ —	\$ —	\$ —	— %
Total interest expense	—	—	—	—
Provision for loan losses	—	—	—	—
Net interest income, after provision for loan losses	—	—	—	—
Non-interest income	899	776	123	15.9
Total income	899	776	123	15.9
Depreciation and amortization expense	8	22	(14)	(63.9)
All other non-interest expense	627	701	(74)	(10.5)
Income before income tax	\$ 264	\$ 53	\$ 211	398.1 %
Goodwill	\$ 3,692	\$ 3,692	\$ —	— %
Assets held for sale	3,000	3,553	(553)	(15.6)
<b>Total assets</b>	\$ 8,358	\$ 8,528	\$ (170)	(2.0)%

<i>(Dollars in thousands)</i>	As of and For the Nine Months Ended September 30,			
	2020	2019	\$ Change	% Change
Total interest income	\$ —	\$ —	\$ —	— %
Total interest expense	—	—	—	—
Provision for loan losses	—	—	—	—
Net interest income, after provision for loan losses	—	—	—	—
Non-interest income	2,492	2,339	153	6.5
Total income	2,492	2,339	153	6.5
Depreciation and amortization expense	52	248	(196)	(79.0)
All other non-interest expense	2,772 <sup>(1)</sup>	3,709 <sup>(2)</sup>	(937)	(25.3)
Loss before income tax	\$ (332)	\$ (1,618)	\$ 1,286	(79.5)%
Goodwill	\$ 3,692	\$ 3,692	\$ —	— %
Assets held for sale	3,000	3,553	(553)	(15.6)
<b>Total assets</b>	\$ 8,358	\$ 8,528	\$ (170)	(2.0)%

(1) Includes loss on assets held for sale of \$0.6 million and \$0.2 million SEC penalty.

(2) Includes goodwill impairment charge of \$1.6 million.

The Capital Management segment reported income before income tax of \$0.3 million and a loss of \$0.3 million for three and nine months ended September 30, 2020, compared to income of \$0.1 million and a loss \$1.6 million for the same periods in 2019. Income before income tax for the nine months ended September 30, 2020 was negatively impacted by a \$0.6 million loss on assets held for sale and a \$0.2 million SEC penalty. Income before income tax for the nine months ended September 30, 2019 was negatively impacted by a \$1.6 million goodwill impairment charge.

*Mortgage*

<i>(Dollars in thousands)</i>	As of and For the Three Months Ended September 30,			
	2020	2019	\$ Change	% Change
Total interest income	\$ —	\$ —	\$ —	— %
Total interest expense	—	—	—	—
Provision for loan losses	—	—	—	—
Net interest income, after provision for loan losses	—	—	—	—
Non-interest income	12,323	3,298	9,025	273.7
Total income	12,323	3,298	9,025	273.7
Depreciation and amortization expense	14	55	(41)	(74.5)
All other non-interest expense	2,067	1,956	111	5.7
Income before income tax	\$ 10,242	\$ 1,287	\$ 8,955	695.8 %
<b>Total assets</b>	\$ 105,149	\$ 68,057	\$ 37,092	54.5 %

<i>(Dollars in thousands)</i>	As of and For the Nine Months Ended September 30,			
	2020	2019	\$ Change	% Change
Total interest income	\$ —	\$ —	\$ —	— %
Total interest expense	—	—	—	—
Provision for loan losses	—	—	—	—
Net interest income, after provision for loan losses	—	—	—	—
Non-interest income	25,024	8,053	16,971	210.7
Total income	25,024	8,053	16,971	210.7
Depreciation and amortization expense	56	197	(141)	(71.6)
All other non-interest expense	5,706	4,710	996	21.1
Income before income tax	\$ 19,262	\$ 3,146	\$ 16,116	512.3 %
<b>Total assets</b>	\$ 105,149	\$ 68,057	\$ 37,092	54.5 %

The Mortgage segment reported income before income tax of \$10.2 million and \$19.3 million for the three and nine months ended September 30, 2020, compared to \$1.3 million and \$3.1 million, for the same periods in 2019. The overall increase in non-interest income was primarily related to lower market rates driving an increase in refinance activity, a strong residential real estate market in our footprint and management's commitment and ability to capitalize on the mortgage environment. For the three months ended September 30, 2020 and 2019, our origination volume was \$376.3 million and \$214.5 million, respectively. For the nine months ended September 30, 2020 and 2019, our origination volume was \$917.5 million and \$442.8 million, respectively, and a corresponding increase in IRLC volume and associated net gains on those IRLC, as of September 30, 2020.



## Financial Condition

The table below presents our condensed consolidated balance sheets as of the dates presented:

<i>(Dollars in thousands)</i>	<u>September 30,</u>	<u>December 31,</u>	<u>\$ Change</u>	<u>% Change</u>
	<u>2020</u>	<u>2019</u>		
<b>Balance Sheet Data:</b>				
Cash and cash equivalents	\$ 250,358	\$ 78,638	\$ 171,720	218.4 %
Investments	40,654	58,903	(18,249)	(31.0)
Loans	1,506,076	998,007	508,069	50.9
Allowance for loan losses	(11,845)	(7,875)	(3,970)	50.4
Loans, net of allowance	1,494,231	990,132	504,099	50.9
Mortgage loans held for sale	89,872	48,312	41,560	86.0
Goodwill & other intangible assets, net	24,263	19,714	4,549	23.1
Company-owned life insurance	15,359	15,086	273	1.8
Other assets	55,160	37,344	17,816	47.7
Assets held for sale	3,000	3,553	(553)	(15.6)
<b>Total assets</b>	<b>\$ 1,972,897</b>	<b>\$ 1,251,682</b>	<b>\$ 721,215</b>	<b>57.6 %</b>
Deposits	\$ 1,563,672	\$ 1,086,784	\$ 476,888	43.9 %
Borrowings	236,522	16,560	219,962	1,328.3
Other liabilities	22,986	20,543	2,443	11.9
Liabilities held for sale	141	117	24	20.5
<b>Total liabilities</b>	<b>1,823,321</b>	<b>1,124,004</b>	<b>699,317</b>	<b>62.2</b>
Total shareholders' equity	149,576	127,678	21,898	17.2
<b>Total liabilities and shareholders' equity</b>	<b>\$ 1,972,897</b>	<b>\$ 1,251,682</b>	<b>\$ 721,215</b>	<b>57.6 %</b>

Cash and cash equivalents increased by \$171.7 million, or 218.4%, to \$250.4 million at September 30, 2020 compared to December 31, 2019. The increase in liquidity was driven by organic growth in deposits related to new client relationships, in addition to increases in existing client accounts, and corporate initiatives to support current and future balance sheet growth. During the same period, investments decreased by \$18.2 million, or 31.0%, to \$40.7 million at September 30, 2020.

Total loans increased by \$508.1 million, or 50.9%, to \$1.51 billion at September 30, 2020 compared to December 31, 2019. The increase was driven by three primary factors: organic growth, PPP loan originations and the Branch Acquisition. We experienced growth in our all major loan categories with the largest growth coming in the Cash, Securities and Other category that includes \$206.1 million in PPP loans.

Mortgage loans held for sale increased \$41.6 million, or 86.0%, to \$89.9 million at September 30, 2020 compared to December 31, 2019. This increase corresponds to the increase in mortgage origination volume as noted in the Mortgage segment activity.

Goodwill and other intangible assets, net, increased by \$4.5 million, or 23.1% to \$24.3 million at September 30, 2020 compared to December 31, 2019. The increase was driven by the recording of \$4.5 million in goodwill and \$0.1 million of core deposit intangibles related to the Branch Acquisition.

Other assets increased by \$17.8 million, or 47.7%, to \$55.2 million at September 30, 2020 compared to December 31, 2019. This was primarily related to a \$10.5 million increase in balances related to unfunded mortgage IRLC, a \$3.7 million increase in accrued interest receivable as a result of payment moratoriums related to loan modifications, a \$1.7 million increase in mortgage hedge collateral and a \$1.4 million increase in deferred tax assets. Unfunded mortgage IRLC volume directly corresponds to the increase in mortgage origination volume.

Total deposits increased \$476.9 million, or 43.9%, to \$1.56 billion at September 30, 2020 compared to December 31, 2019. The increase in total deposits from December 31, 2019 was attributable to organic growth and the Branch Acquisition. We experienced growth in our all major deposit categories with the largest increases coming from non-interest bearing accounts and money market deposit accounts.

Total interest-bearing deposits increased \$244.0 million, or 28.8%, to \$1.09 billion and noninterest-bearing deposits increased \$232.9 million, or 97.0%, to \$473.0 million during this period. Money market deposit accounts increased \$190.1 million, or 30.9%, to \$805.6 million at September 30, 2020 compared to December 31, 2019. Time deposit accounts increased \$42.5 million, or 31.5%, from December 31, 2019 to \$177.4 million at September 30, 2020. Negotiable order of withdrawal, or NOW accounts, increased \$9.8 million, or 10.6%, to \$101.7 million from December 31, 2019 to September 30, 2020.

Total borrowings increased \$220.0 million, or 1,328.3%, to \$236.5 million at September 30, 2020 compared to December 31, 2019. The increase is primarily attributed to participation in the Paycheck Protection Program Loan Facility from the Federal Reserve in the amount of \$204.3 million. Borrowing from this facility is expected to match fund the balances of PPP loans.

Total shareholders' equity increased \$21.9 million, or 17.2%, from December 31, 2019 to \$149.6 million at September 30, 2020. The increase is primarily due to an increase in net income.

**Assets Under Management**

<i>(Dollars in millions)</i>	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2020	2019	2020	2019
<b>Managed Trust Balance at Beginning of Period</b>	<b>\$ 1,520</b>	<b>\$ 1,670</b>	<b>\$ 1,750</b>	<b>\$ 1,380</b>
New relationships	—	2	13	43
Closed relationships	(1)	(1)	(12)	(2)
Contributions	11	4	75	14
Withdrawals	(10)	(12)	(110)	(100)
Market change, net	140	119	(56)	447
<b>Ending Balance</b>	<b>\$ 1,660</b>	<b>\$ 1,782</b>	<b>\$ 1,660</b>	<b>\$ 1,782</b>
Yield*	0.19 %	0.17 %	0.19 %	0.16 %
<b>Directed Trust Balance at Beginning of Period</b>	<b>\$ 883</b>	<b>\$ 931</b>	<b>\$ 989</b>	<b>\$ 789</b>
New relationships	9	4	14	132
Closed relationships	—	—	(5)	—
Contributions	9	2	33	31
Withdrawals	(21)	(4)	(91)	(45)
Market change, net	28	13	(32)	39
<b>Ending Balance</b>	<b>\$ 908</b>	<b>\$ 946</b>	<b>\$ 908</b>	<b>\$ 946</b>
Yield*	0.08 %	0.07 %	0.08 %	0.07 %
<b>Investment Agency Balance at Beginning of Period</b>	<b>\$ 1,956</b>	<b>\$ 1,911</b>	<b>\$ 2,009</b>	<b>\$ 1,846</b>
New relationships	18	13	97	44
Closed relationships	(2)	—	(11)	(56)
Contributions	71	37	178	110
Withdrawals	(45)	(64)	(174)	(210)
Market change, net	41	23	(60)	186
<b>Ending Balance</b>	<b>\$ 2,039</b>	<b>\$ 1,920</b>	<b>\$ 2,039</b>	<b>\$ 1,920</b>
Yield*	0.67 %	0.69 %	0.65 %	0.68 %
<b>Custody Balance at Beginning of Period</b>	<b>\$ 474</b>	<b>\$ 460</b>	<b>\$ 452</b>	<b>\$ 356</b>
New relationships	7	1	7	11
Closed relationships	—	—	(2)	(2)
Contributions	2	3	78	80
Withdrawals	(57)	(5)	(72)	(51)
Market change, net	36	12	(1)	77
<b>Ending Balance</b>	<b>\$ 462</b>	<b>\$ 471</b>	<b>\$ 462</b>	<b>\$ 471</b>
Yield*	0.03 %	0.03 %	0.03 %	0.03 %
<b>401(k)/Retirement Balance at Beginning of Period</b>	<b>\$ 919</b>	<b>\$ 997</b>	<b>\$ 988</b>	<b>\$ 864</b>
New relationships	8	—	12	6
Closed relationships	(2)	(6)	(46)	(26)
Contributions	41	—	101	60
Withdrawals	(20)	2	(61)	(44)
Market change, net	116	3	68	136
<b>Ending Balance<sup>(1)</sup></b>	<b>\$ 1,062</b>	<b>\$ 996</b>	<b>\$ 1,062</b>	<b>\$ 996</b>
Yield*	0.14 %	0.21 %	0.15 %	0.22 %
<b>Total Assets Under Management at Beginning of Period</b>	<b>\$ 5,752</b>	<b>\$ 5,969</b>	<b>\$ 6,188</b>	<b>\$ 5,235</b>
New relationships	42	20	143	236
Closed relationships	(5)	(7)	(76)	(86)
Contributions	134	46	465	295
Withdrawals	(153)	(83)	(508)	(450)
Market change, net	361	170	(81)	885
<b>Total Assets Under Management</b>	<b>\$ 6,131</b>	<b>\$ 6,115</b>	<b>\$ 6,131</b>	<b>\$ 6,115</b>
Yield*	0.31 %	0.32 %	0.31 %	0.31 %

\* Trust & investment management fees divided by period end balance.

<sup>(1)</sup> AUM shown is one period in arrears

The three months ended September 30, 2020 compared with the three months ended September 30, 2019. Assets under management increased \$379.0 million and \$146.0 million, or 6.6% and 2.4%, for the three months ended September 30, 2020 and 2019, respectively. The increase during the three months ended September 30, 2020 was primarily related to market gains. Yield on the overall portfolio for the three months ended September 30, 2020 compared to September 30, 2019 remained relatively flat.

The nine months ended September 30, 2020 compared with the nine months ended September 30, 2019. Assets under management decreased \$57.0 million and increased \$880.0 million, or a decrease of 0.9% and an increase of 16.8%, for the nine months ended September 30, 2020 and 2019, respectively. The increase during the nine months ended September 30, 2019 was primarily related to an increase in market valuations and net new relationships. Yield on the overall portfolio for the nine months ended September 30, 2020 compared to September 30, 2019 remained relatively flat.

*Available-for-sale securities*

Investments we intend to hold for an indefinite period of time, but not necessarily to maturity, are classified as available-for-sale and are recorded at fair value using current market information from a pricing service, with unrealized gains and losses excluded from earnings and reported in other comprehensive income, net of tax. All our investments in securities were classified as available-for-sale for the periods presented below. The carrying values of our investment securities classified as available-for-sale are adjusted for unrealized gain or loss, and any gain or loss is reported on an after-tax basis as a component of other comprehensive income in shareholders' equity.

The following table summarizes the amortized cost and estimated fair value of our investment securities as of September 30, 2020:

	September 30, 2020			Fair Value
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	
<i>(Dollars in thousands)</i>				
<b>Investment securities available-for-sale:</b>				
U.S. Treasury debt	\$ 250	\$ 6	\$ —	\$ 256
Corporate bonds	2,000	48	—	2,048
Government National Mortgage Association ("GNMA") mortgage-backed securities—residential	28,844	944	—	29,788
Federal National Mortgage Association ("FNMA") mortgage-backed securities—residential	2,626	90	—	2,716
Corporate collateralized mortgage obligations ("CMO") and mortgage-backed securities ("MBS")	5,826	93	(73)	5,846
Total securities available-for-sale	<u>\$ 39,546</u>	<u>\$ 1,181</u>	<u>\$ (73)</u>	<u>\$ 40,654</u>

The following table summarizes the amortized cost and estimated fair value of our investment securities as of December 31, 2019:

	December 31, 2019			Fair Value
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	
<i>(Dollars in thousands)</i>				
<b>Investment securities available-for-sale:</b>				
U.S. Treasury debt	\$ 250	\$ 4	\$ —	\$ 254
GNMA mortgage -backed securities—residential	45,490	157	(335)	45,312
FNMA mortgage-backed securities—residential	2,935	11	(29)	2,917
Corporate CMO and MBS	10,425	40	(45)	10,420
Total securities available-for-sale	<u>\$ 59,100</u>	<u>\$ 212</u>	<u>\$ (409)</u>	<u>\$ 58,903</u>

The following tables represent the book value of our contractual maturities and weighted average yield for our investment securities as of the dates presented. Contractual maturities may differ from expected maturities because issuers have the right to call or prepay obligations without penalties. Our investments are taxable securities. Weighted average

yields are not presented on a taxable equivalent basis. Securities not due at a single maturity date are included as after ten years.

(Dollars in thousands)	Maturity as of September 30, 2020							
	One Year or Less		One to Five Years		Five to Ten Years		After Ten Years	
	Amortized Cost	Weighted Average Yield	Amortized Cost	Weighted Average Yield	Amortized Cost	Weighted Average Yield	Amortized Cost	Weighted Average Yield
Available-for-sale:								
U.S. Treasury debt	\$ —	— %	\$ 250	0.02 %	\$ —	— %	\$ —	— %
Corporate Bonds	—	—	—	—	—	—	2,000	0.25
GNMA mortgage-backed securities - residential	—	—	—	—	—	—	28,844	1.73
FNMA mortgage-backed securities - residential	—	—	—	—	—	—	2,626	0.18
Corporate CMO and MBS	—	—	—	—	45	—	5,781	0.44
Total available-for-sale	<u>\$ —</u>	<u>— %</u>	<u>\$ 250</u>	<u>0.02 %</u>	<u>\$ 45</u>	<u>— %</u>	<u>\$ 39,251</u>	<u>2.60 %</u>

(Dollars in thousands)	Maturity as of December 31, 2019							
	One Year or Less		One to Five Years		Five to Ten Years		After Ten Years	
	Amortized Cost	Weighted Average Yield	Amortized Cost	Weighted Average Yield	Amortized Cost	Weighted Average Yield	Amortized Cost	Weighted Average Yield
Available-for-sale:								
U.S. Treasury debt	\$ —	— %	\$ 250	0.01 %	\$ —	— %	\$ —	— %
GNMA mortgage-backed securities - residential	—	—	—	—	—	—	45,490	2.28
FNMA mortgage-backed securities - residential	—	—	—	—	—	—	2,935	0.14
Corporate CMO and MBS	—	—	—	—	52	—	10,373	0.66
Total available-for-sale	<u>\$ —</u>	<u>— %</u>	<u>\$ 250</u>	<u>0.01 %</u>	<u>\$ 52</u>	<u>— %</u>	<u>\$ 58,798</u>	<u>3.08 %</u>

At September 30, 2020 and December 31, 2019, there were no holdings of securities of any one issuer, other than the U.S. Government and its agencies, in an amount greater than 10% of shareholders' equity.

*Loan Portfolio*

Our primary source of interest income is derived through interest earned on loans to high net worth individuals, and their related commercial interests. Our senior lending and credit team consists of seasoned, experienced personnel and we believe that our officers are well versed in the types of lending in which we are engaged. Underwriting policies and decisions are managed centrally and the approval process is tiered based on loan size, making the process consistent, efficient and effective. The management team and credit culture demands prudent, practical, and conservative approaches to all credit requests in compliance with the loan policy guidelines to ensure strong credit underwriting practices.

In addition to originating loans for our own portfolio, we conduct mortgage banking activities in which we originate and sell, servicing-released, whole loans in the secondary market. Our mortgage banking loan sales activities are primarily directed at originating single family mortgages that are priced and underwritten to conform to previously agreed criteria before loan funding and are delivered to the investor shortly after funding. The level of future loan originations, loan sales and loan repayments depends on overall credit availability, the interest rate environment, the strength of the general economy, local real estate markets and the housing industry, and conditions in the secondary loan sale market. The amount of gain or loss on the sale of loans is primarily driven by market conditions and changes in interest rates, as well as our pricing and asset liability management strategies. As of September 30, 2020 and December 31, 2019, we had mortgage loans held for sale of \$89.9 million and \$48.3 million, respectively, in residential mortgage loans we originated.

As of September 30, 2020, loans, net of deferred costs (fees) and unamortized premiums/ (unaccreted discounts) includes period end balances of \$193.2 million added through PPP loans originated internally along with \$124.7 million, including PPP loans acquired, related to performing loans acquired in the Branch Acquisition. See Note 2 - Acquisitions of the accompanying Notes to Condensed Consolidated Financial Statements for additional information.

As of September 30, 2020, the Company has \$2.1 million in remaining fees to be recognized related to PPP. This is the net amount of the fees from the SBA for participation in PPP less the loan origination fees on these loans. The current amortization of this income is being recognized over a two-year period, however we expect much of that income to be recognized in the second half of 2020 as the borrowers are granted forgiveness. As of October 16, 2020, the Company had submitted to the SBA for forgiveness on 236 loans with original loan amounts of \$85.2 million and had received forgiveness on 46 loans totaling \$2.1 million.

The following table summarizes our loan portfolio by type of loan as of the dates indicated, in thousands:

<i>(Dollars in thousands)</i>	September 30,		December 31,	
	2020		2019	
	Amount	% of Total	Amount	% of Total
Cash, Securities and Other	\$ 371,481	24.6 %	\$ 146,701	14.7 %
Construction and Development	105,717	7.0	28,120	2.8
1-4 Family Residential	446,959	29.7	400,134	40.2
Non-Owner Occupied Commercial Real Estate ("CRE")	243,564	16.2	165,179	16.6
Owner Occupied CRE	154,138	10.2	127,968	12.8
Commercial and Industrial	185,625	12.3	128,457	12.9
Total loans held for investment <sup>(1)</sup>	\$ 1,507,484	100.0 %	\$ 996,559	100.0 %
Mortgage loans held for sale	\$ 89,872		\$ 48,312	

(1) Loans held for investment exclude deferred costs (fees) and unamortized premiums/ (unaccreted discounts), net of \$ (1.4) million and \$1.4 million as of September 30, 2020 and December 31, 2019, respectively.

- *Cash, Securities and Other*—consists of consumer and commercial purpose loans, which are primarily secured by securities managed and under custody with us, cash on deposit with us or life insurance policies. In addition, loans in this portfolio are collateralized with other sources of consumer collateral and an immaterial amount of each loan may be unsecured. This segment of our portfolio is affected by a variety of local and national economic factors affecting borrowers' employment prospects, income levels, and overall economic sentiment. PPP loans that are fully guaranteed by the SBA are classified within this line item as of September 30, 2020.
- *Construction and Development*—consists of loans to finance the construction of residential and non-residential properties. These loans are dependent on the strength of the industries of the related borrowers and the risks consistent with construction projects.
- *1-4 Family Residential*—consists of loans and home equity lines of credit secured by 1-4 family residential properties. These loans typically enable borrowers to purchase or refinance existing homes, most of which serve as the primary residence of the owner. In addition, some borrowers secure a commercial purpose loan with owner occupied or non-owner occupied 1-4 family residential properties. Loans in this segment are dependent on the industries tied to these loans as well as the national and local economies, and local residential and commercial real estate markets.
- *Commercial Real Estate, Owner Occupied and Non-Owner Occupied*—consists of commercial loans collateralized by real estate. These loans may be collateralized by owner occupied or non-owner occupied real estate, as well as multi-family residential real estate. These loans are dependent on the strength of the industries of the related borrowers and the success of their businesses.
- *Commercial and Industrial*—consists of commercial and industrial loans and industrial loans not secured by real estate, including working capital lines of credit, permanent working capital term loans, business asset loans, acquisition, expansion and development loans, and other loan products, primarily in our target markets. This portfolio primarily consists of term loans and lines of credit which are dependent on the strength of the industries of the related borrowers and the success of their businesses. Also, this category includes MSLP loans as of September 30, 2020.

The contractual maturity ranges of loans in our loan portfolio and the amount of such loans with fixed and floating interest rates in each maturity range, excluding deferred costs (fees) and unamortized premiums/ (unaccreted discounts), as of the date indicated are summarized in the following tables:

As of September 30, 2020				
<i>(Dollars in thousands)</i>	One Year or Less	One Through Five Years	After Five Years	Total
Cash, Securities and Other	\$ 54,451	\$ 304,824	\$ 12,206	\$ 371,481
Construction and Development	71,688	32,511	1,518	105,717
1-4 Family Residential	44,560	85,738	316,661	446,959
Non-Owner Occupied CRE	6,852	156,920	79,792	243,564
Owner Occupied CRE	8,252	43,226	102,660	154,138
Commercial and Industrial	55,160	103,191	27,274	185,625
Total loans	<u>\$ 240,963</u>	<u>\$ 726,410</u>	<u>\$ 540,111</u>	<u>\$ 1,507,484</u>
Amounts with fixed rates	\$ 79,503	\$ 504,454	\$ 222,934	\$ 806,891
Amounts with floating rates	161,460	221,956	317,177	700,593
Total loans	<u>\$ 240,963</u>	<u>\$ 726,410</u>	<u>\$ 540,111</u>	<u>\$ 1,507,484</u>

As of December 31, 2019				
<i>(Dollars in thousands)</i>	One Year or Less	One Through Five Years	After Five Years	Total
Cash, Securities and Other	\$ 66,634	\$ 68,326	\$ 11,741	\$ 146,701
Construction and Development	9,126	16,953	2,041	28,120
1-4 Family Residential	32,300	96,886	270,948	400,134
Non-Owner Occupied CRE	13,286	113,457	38,436	165,179
Owner Occupied CRE	9,540	32,861	85,567	127,968
Commercial and Industrial	37,341	78,022	13,094	128,457
Total loans	<u>\$ 168,227</u>	<u>\$ 406,505</u>	<u>\$ 421,827</u>	<u>\$ 996,559</u>
Amounts with fixed rates	\$ 58,289	\$ 251,378	\$ 128,452	\$ 438,119
Amounts with floating rates	109,938	155,127	293,375	558,440
Total loans	<u>\$ 168,227</u>	<u>\$ 406,505</u>	<u>\$ 421,827</u>	<u>\$ 996,559</u>

*Loan Modifications*

As a result of the COVID-19 pandemic, a loan modification program was designed and implemented to assist our clients experiencing financial stress resulting from the economic impacts caused by the global pandemic. The Company was offering loan extensions, temporary payment moratoriums, and financial covenant waivers for commercial and consumer borrowers impacted by the pandemic who have a pass risk rating and have not been delinquent over 30 days on payments in the last two years.

As of September 30, 2020, the Company's loans include forty-four modified loans, including acquired loans, across multiple industries in the amount of \$66.7 million, representing 4.43% of total loans.

The following presents loans modifications as a result of COVID-19 as of September 30, 2020 (dollars in thousands):

	Total Loans	# of Loans Modified	Outstanding Balance of Modified Loans	% of Total Loan Balance Modified
Cash, Securities and Other	\$ 371,481	1	\$ 1,496	0.40 %
Construction and Development	105,717	—	—	—
1-4 Family Residential	446,959	6	4,441	0.99
Non-Owner Occupied CRE	243,564	22	38,229	15.70
Owner Occupied CRE	154,138	10	17,524	11.37
Commercial and Industrial	185,625	5	5,048	2.72
Total Loans	<u>\$ 1,507,484</u>	<u>44</u>	<u>\$ 66,738</u>	<u>4.43 %</u>

The CARES Act provides banks optional, temporary relief from accounting for certain loan modifications as a TDR. The modifications must be related to the adverse effects of COVID-19, and certain other criteria are required to be

met in order to apply the relief. Interagency guidance from Federal Reserve and the FDIC confirmed with the FASB that short-term modifications made on a good faith basis in response to COVID-19 to borrowers who were current prior to any relief, are not to be considered TDRs. We believe our loan modification program meets that definition. In accordance with that guidance, the Company is recognizing interest income on all loans modified for temporary payment moratoriums, primarily for a period of 180 days or less.

All loans modified in response to COVID-19 are classified as performing and pass rated as of September 30, 2020. These loans are included in the allowance for loan loss general reserve in accordance with ASC 450-20. Management has increased our loan level reviews and portfolio monitoring to address the changing environment. The Company continues to meet regularly with clients who could be more highly impacted by the recent COVID-19 pandemic. These are borrowers in industries we believe may be more impacted by the pandemic, for instance those loans where there may be a greater than 50% probability of a downgrade, covenant violation or 20% reduction in collateral position. Management believes the diversity of the loan portfolio is prudent and remains consistent with the credit culture and goals of the Bank.

Interest accrued during the modification term on modified loans is deferred to the end of the loan term. As of September 30, 2020, no allowance for loan loss was deemed necessary on the accrued interest balances related to loan modifications.

#### *Non-Performing Assets*

Non-performing assets include non-accrual loans, TDRs, loans past due 90 days or more and still accruing interest, and OREO. The accrual of interest on loans is discontinued at the time the loan becomes 90 or more days delinquent unless the loan is well secured and in the process of collection. Past due status is based on the contractual terms of the loan. In all cases, loans are placed on non-accrual status or charged off if collection of interest or principal is considered doubtful.

OREO represents assets acquired through, or in lieu of, foreclosure. The amounts reported as OREO are supported by recent appraisals, with the appraised values adjusted, where applicable, for expected transaction fees likely to be incurred upon sale of the property. We incur recurring expenses relating to OREO in the form of maintenance, taxes, insurance and legal fees, among others, until the OREO parcel is disposed. While disposition efforts with respect to our OREO are generally ongoing, if these properties are appraised at lower-than-expected values or if we are unable to sell the properties at the prices for which we expect to be able to sell them, we may incur additional losses. As of September 30, 2020, we incurred \$0.1 million in losses as a result of sales contracts in place which were lower than the carrying value.

The amount of lost interest for non-accrual loans was an immaterial amount for the three months ended September 30, 2020 and \$0.1 million for the three months ended September 30, 2019. For the nine months ended September 30, 2020 and 2019, the amount of lost interest for non-accrual loans was \$0.2 million and \$0.3 million, respectively.

We had \$10.4 million in non-performing assets as of September 30, 2020 compared to \$12.9 million as of December 31, 2019. The \$2.5 million decrease in our non-performing assets was primarily related to principal paydowns received on a Cash, Securities, and Other loan for \$2.7 million, and \$0.7 million on a Commercial and Industrial loan. This was slightly offset by draws of \$1.1 million on a Commercial and Industrial loan.



The following table presents information regarding non-performing loans as of the dates indicated:

<i>(Dollars in thousands)</i>	September 30,	December 31,
	2020	2019
Non-accrual loans by category <sup>(1)</sup>		
Cash, Securities and Other	\$ 66	\$ 2,803
Construction and Development	—	—
1-4 Family Residential	—	—
Non-Owner Occupied CRE	—	—
Owner Occupied CRE	—	—
Commercial and Industrial	3,679	4,412
Total non-accrual loans	3,745	7,215
TDRs still accruing	6,136	5,055
Accruing loans 90 or more days past due	—	—
Total non-performing loans	9,881	12,270
OREO	558	658
Total non-performing assets	\$ 10,439	\$ 12,928
Ratio of non-performing loans to total loans <sup>(2)</sup>	0.66 %	1.23 %
Ratio of non-performing assets to total assets	0.53	1.03
Allowance as a percentage of non-performing loans	119.88 %	64.18 %

(1) As of September 30, 2020 one immaterial non-accrual loan was not also classified as a TDR. As of December 30, 2019 all non-accrual loans were also classified as TDRs. See Note 4 – Loans and the Allowance for Loan Losses to the consolidated financial statements.

(2) Excludes mortgage loans held for sale of \$89.9 million and \$48.3 million as of September 30, 2020 and December 31, 2019, respectively.

#### *Potential Problem Loans*

We categorize loans into risk categories based on relevant information about the ability of the borrowers to service their debt, such as: current financial information, historical payment experience, credit documentation, public information, and current economic trends, among other factors. We analyze loans individually by classifying the loans as to credit risk on a quarterly basis, which are segregated into the following definitions for risk ratings:

**Special Mention**—Loans classified as special mention have a potential weakness or borrowing relationships that require more than the usual amount of management attention. Adverse industry conditions, deteriorating financial conditions, declining trends, management problems, documentation deficiencies or other similar weaknesses may be evident. Ability to meet current payment schedules may be questionable, even though interest and principal are still being paid as agreed. The asset has potential weaknesses that may result in deteriorating repayment prospects if left uncorrected. Loans in this risk grade are not considered adversely classified.

**Substandard**—Substandard loans are considered “classified” and are inadequately protected by the current net worth and paying capacity of the obligor or by the collateral pledged, if any. Loans so classified have a well-defined weakness or weaknesses that jeopardizes the liquidation of the debt. They are characterized by the distinct possibility that the Bank will sustain some loss if the deficiencies are not corrected. Loans in this category may be placed on non-accrual status and may individually be evaluated for impairment if indicators of impairment exist.

**Doubtful**—Loans graded doubtful are considered “classified” and have all the weaknesses inherent in those classified as Substandard with the added characteristic that the weaknesses make collection or liquidation in full, on the basis of currently known facts, conditions and values, highly questionable and improbable. However, the amount or certainty of eventual loss is not known because of specific pending factors.

Loans not meeting any of the three criteria above are considered to be pass-rated loans.

As of September 30, 2020 and December 31, 2019 non-performing loans of \$9.9 million and \$12.3 million were included in the substandard category in the table below. The following tables present, by class and by credit quality indicator, the recorded investment in our loans as of the dates indicated:

<i>(Dollars in thousands)</i>	As of September 30, 2020				As of December 31, 2019			
	Pass	Special Mention	Substandard	Total	Pass	Special Mention	Substandard	Total
Cash, Securities and Other	\$ 371,415	\$ —	\$ 66	\$ 371,481	\$ 143,898	\$ —	\$ 2,803	\$ 146,701
Construction and Development	105,717	—	—	105,717	28,120	—	—	28,120
1-4 Family Residential	442,076	—	4,883	446,959	395,224	—	4,910	400,134
Non-Owner Occupied CRE	232,010	11,554	—	243,564	164,021	1,158	—	165,179
Owner Occupied CRE	153,656	482	—	154,138	127,968	—	—	127,968
Commercial and Industrial	173,061	—	12,564	185,625	114,241	—	14,216	128,457
Total	<u>\$ 1,477,935</u>	<u>\$ 12,036</u>	<u>\$ 17,513</u>	<u>\$ 1,507,484</u>	<u>\$ 973,472</u>	<u>\$ 1,158</u>	<u>\$ 21,929</u>	<u>\$ 996,559</u>

#### *Allowance for Loan Losses*

The allowance for loan losses is established through a provision for loan losses, which is a noncash charge to earnings. Loan losses are charged against the allowance when management believes that a loan balance is confirmed uncollectable. Subsequent recoveries, if any, are credited to the allowance for loan losses.

The allowance for loan losses is evaluated on a regular basis by management and is based upon management's periodic review of the collectability of the loans in light of historical experience, the nature and dollar volume of the loan portfolio, adverse situations that may affect the borrower's ability to repay, the estimated value of any underlying collateral and prevailing economic conditions. Allocations of the allowance may be made for specific loans, but the entire allowance is available for any loan that, in management's judgment, should be charged off.

We are closely monitoring the changing dynamics in the economy and the client impact driven by the COVID-19 pandemic. We have intensified our portfolio management, focusing on higher impacted industries and commercial property types. Our clientele is generally comprised of high net-worth individuals and commercial borrowers with strong credit profiles and multiple sources of repayment. The portion of our credit exposure to the highest risk industries impacted by COVID-19, such as accommodations, transportation and restaurants, is less than 3.0% of our loan portfolio. The Company has increased our loan level reviews and portfolio monitoring to address the changing environment and continues to engage in more frequent communication with these borrowers to better understand the impact on our borrower's cash flows and respond proactively. While the length of time some of these businesses are unable to operate or operate at full capacity is unknown, it could have a significant impact on many factors that impact our borrowers and our reserve requirement. During the third quarter of 2020, the Company continued to increase its allowance to account for the additional variability surrounding the loan modifications made during the quarter and increased economic uncertainty related to the COVID-19 pandemic. Management will continue to closely monitor the loan portfolio and analyze the economic data to assess the impact on the allowance for loan loss. We believe the allowance is adequate as of September 30, 2020.

[Table of Contents](#)

The following table presents summary information regarding our allowance for loan losses for the periods indicated:

<i>(Dollars in thousands)</i>	<b>Three Months Ended September 30,</b>		<b>Nine Months Ended September 30,</b>	
	<b>2020</b>	<b>2019</b>	<b>2020</b>	<b>2019</b>
Average loans outstanding <sup>(1)(2)</sup>	\$ 1,462,872	\$ 937,260	\$ 1,250,052	\$ 928,112
Gross loans outstanding at end of period <sup>(3)</sup>	\$ 1,506,076	\$ 926,586	\$ 1,506,076	\$ 926,586
Allowance for loan losses at beginning of period	\$ 10,354	\$ 7,575	\$ 7,875	\$ 7,451
Provision for loan losses	1,496	100	3,987	216
Charge-offs:				
Cash, Securities and Other	6	—	30	—
Construction and Development	—	—	—	—
1-4 Family Residential	—	—	—	—
Non-Owner Occupied CRE	—	—	—	—
Owner Occupied CRE	—	—	—	—
Commercial and Industrial	—	—	—	—
Total charge-offs	6	—	30	—
Recoveries:				
Cash, Securities and Other	1	—	13	8
Construction and Development	—	—	—	—
1-4 Family Residential	—	—	—	—
Non-Owner Occupied CRE	—	—	—	—
Owner Occupied CRE	—	—	—	—
Commercial and Industrial	—	—	—	—
Total recoveries	1	—	13	8
Net charge-offs (recoveries)	5	—	17	(8)
Allowance for loan losses at end of period	\$ 11,845	\$ 7,675	\$ 11,845	\$ 7,675
Ratio of allowance to end of period loans <sup>(4)</sup>	0.79 %	0.83 %	0.79 %	0.83 %
Ratio of net charge-offs to average loans <sup>(1)</sup>	— %	— %	— %	— %

(1) Average balances are average daily balances.

(2) Excludes average outstanding balances of mortgage loans held for sale of \$94.7 million and \$52.5 million for the three months ended September 30, 2020 and 2019 and \$67.0 million and \$32.6 million for the nine months ended September 30, 2020 and 2019, respectively.

(3) Excludes mortgage loans held for sale of \$89.9 million and \$69.2 million as of September 30, 2020 and 2019, respectively, and includes deferred costs (fees) and unamortized premiums/ (unaccrued discounts).

(4) End of period loans at September 30, 2020 include \$124.7 million in acquired loans and \$193.2 million in bank originated PPP loans, excluding these loans would result in an increase of the ratio for the three months ended September 30, 2020.

The following table represents the allocation of the allowance for loan losses among loan categories and other summary information. The allocation for loan losses by category should neither be interpreted as an indication of future charge-offs, nor as an indication that charge-offs in future periods will necessarily occur in these amounts or in the indicated proportions. The allocation of a portion of the allowance for loan losses to one category of loans does not preclude its availability to absorb losses in other categories.

<i>(Dollars in thousands)</i>	<b>As of September 30,</b>		<b>As of December 31,</b>	
	<b>2020</b>		<b>2019</b>	
	<b>Amount</b>	<b>%<sup>(1)</sup></b>	<b>Amount</b>	<b>%<sup>(1)</sup></b>
Cash, Securities and Other	\$ 2,612	24.6 %	\$ 1,058	14.7 %
Construction and development	733	7.0	200	2.8
1-4 Family Residential	3,100	29.7	2,850	40.2
Non-Owner Occupied CRE	1,690	16.2	1,176	16.6
Owner Occupied CRE	1,069	10.2	911	12.8
Commercial and Industrial	2,641	12.3	1,680	12.9
Total allowance for loan losses	\$ 11,845	100.0 %	\$ 7,875	100.0 %

(1) Represents the percentage of loans to total loans in the respective category.

### Deferred Tax Assets, Net

Deferred tax assets, net represent the differences in timing of when items are recognized for GAAP purposes as opposed to tax purposes, as well as our net operating losses. As a result of the Tax Cuts and Jobs Act of 2017, our deferred tax assets, net, are valued based on the amounts that are expected to be recovered in the future utilizing the tax rates in effect at the time recognized. As a result of book and tax basis differences, our deferred tax assets, net at September 30, 2020 increased \$1.4 million from December 31, 2019 primarily attributable to increased deferred loan origination fees primarily driven by loan growth and \$4.0 million of provision expense during the nine months ended September 30, 2020.

### Deposits

Our deposit products include money market accounts, demand deposit accounts, time-deposit accounts (typically certificates of deposit), NOW accounts (interest checking accounts), and saving accounts. Our accounts are federally insured by the FDIC up to the legal maximum amount.

Total deposits increased by \$476.9 million, or 43.9%, to \$1.56 billion at September 30, 2020 from December 31, 2019. Total average deposits for the three months ended September 30, 2020 were \$1.46 billion, an increase of \$420.6 million, or 40.4%, compared to \$1.04 billion as of September 30, 2019. The increase in total deposits from December 31, 2019 was attributable to organic growth and the Branch Acquisition. See Note 2 - Acquisitions of the accompanying Notes to Condensed Consolidated Financial Statements for additional information.

The following table presents the average balances and average rates paid on deposits for the periods below:

	As of and For the Three Month Period Ending September 30,			
	2020		2019	
(Dollars in thousands)	Average Balance	Average Rate	Average Balance	Average Rate
<b>Deposits</b>				
Money market deposit accounts	\$ 774,615	0.28 %	\$ 562,155	1.67 %
Demand deposit accounts	95,000	0.23	87,434	0.43
Certificates and other time deposits > \$250k	69,821	1.66	70,797	2.12
Certificates and other time deposits < \$250k	99,481	0.73	103,255	2.13
Total time deposits	169,302	1.11	174,052	2.13
Savings accounts	6,404	0.04	2,849	0.28
Total interest-bearing deposits	1,045,321	0.41	826,490	1.63
Noninterest-bearing accounts	417,502		215,721	
Total deposits	\$ 1,462,823	0.29 %	\$ 1,042,211	1.29 %
	As of and For the Nine Month Period Ending September 30,			
	2020		2019	
(Dollars in thousands)	Average Balance	Average Rate	Average Balance	Average Rate
<b>Deposits</b>				
Money market deposit accounts	\$ 689,911	0.53 %	\$ 526,103	1.66 %
Negotiable order of withdrawal accounts	88,852	0.27	72,734	0.33
Certificates and other time deposits > \$250k	58,839	1.92	72,632	1.98
Certificates and other time deposits < \$250k	92,661	1.43	102,439	1.89
Total time deposits	151,500	1.62	175,071	1.93
Savings accounts	5,426	0.09	2,667	0.15
Total interest-bearing deposits	935,689	0.68	776,575	1.59
Noninterest-bearing accounts	350,475		225,512	
Total deposits	\$ 1,286,164	0.50 %	\$ 1,002,087	1.23 %

Average noninterest-bearing deposits to average total deposits was 28.5% and 20.7% for the three months ended September 30, 2020 and 2019, and 27.3% and 22.5% for the nine months ended September 30, 2020 and 2019, respectively.

Our average cost of funds was 0.35% and 1.33% during the three months ended September 30, 2020 and 2019, respectively, and 0.55% and 1.28% during the nine months ended September 30, 2020 and 2019, respectively. The decrease in cost of funds was driven by a reduction in deposit rates consistent with the lower interest rate environment.

Money market deposit accounts as of September 30, 2020 were \$805.6 million, an increase of \$190.1 million, or 30.9%, compared to \$615.6 million as of December 31, 2019. Total time deposits as of September 30, 2020 were \$177.4 million, an increase of \$42.5 million, or 31.5%, from December 31, 2019. Negotiable order of withdrawal, or NOW accounts, increased \$9.8 million, or 10.6%, to \$101.7 million from December 31, 2019 to September 30, 2020.

The following table represents the amount of certificates of deposit by time remaining until maturity as of September 30, 2020:

<i>(Dollars in thousands)</i>	<b>As of September 30, 2020</b>				
	<b>Maturity Within:</b>				
	<b>Three Months or Less</b>	<b>Three to Six Months</b>	<b>Six to 12 Months</b>	<b>After 12 Months</b>	<b>Total</b>
Time, \$250,000 and over	\$ 11,038	\$ 6,649	\$ 14,882	\$ 34,926	\$ 67,495
Other	31,520	19,118	40,981	18,277	109,896
<b>Total</b>	<b>\$ 42,558</b>	<b>\$ 25,767</b>	<b>\$ 55,863</b>	<b>\$ 53,203</b>	<b>\$ 177,391</b>

**Borrowings**

We have short-term and long-term borrowing sources available to supplement deposits and meet our liquidity needs. As of September 30, 2020 and December 31, 2019, borrowings totaled \$236.5 million and \$16.6 million, respectively.

During the nine months ended September 30, 2020, the Company completed the issuance and sale of subordinated notes totaling \$8.0 million. The increase in other borrowings is primarily attributed to participation in the Paycheck Protection Program Loan Facility from the Federal Reserve with a period end balance of \$204.1 million. Borrowing from this facility is expected to match fund the balances of PPP loans. The table below presents balances of each of the borrowing facilities as of the dates indicated:

<i>(Dollars in thousands)</i>	<b>September 30,</b>	<b>December 31,</b>
	<b>2020</b>	<b>2019</b>
<b>Borrowings</b>		
FHLB Topeka borrowings	\$ 18,000	\$ 10,000
Federal Reserve borrowings	204,075	—
Subordinated notes	14,447	6,560
	<b>\$ 236,522</b>	<b>\$ 16,560</b>

We have a blanket pledge and security agreement with the FHLB Topeka that requires certain loans and securities be pledged as collateral for any outstanding borrowings under the agreement. The collateral pledged as of September 30, 2020 and December 31, 2019 amounted to \$612.1 million and \$515.5 million, respectively. Based on this collateral and the Company's holdings of FHLB Topeka stock, the Company was eligible to borrow an additional \$401.9 million at September 30, 2020.

<i>(Dollars in thousands)</i>	<b>As of and for the</b>
	<b>Nine Months Ended</b>
	<b>September 30,</b>
	<b>2020</b>
<b>Short-term borrowings:</b>	
Maximum outstanding at any month-end during the period	\$ 28,000
Balance outstanding at end of period	18,000
Average outstanding during the period	\$ 15,923
Average interest rate during the period	0.90 %
Average interest rate at the end of the period	0.18 %

As of September 30, 2020 and December 31, 2019, we had three unsecured federal funds lines of credit with up to \$10.0 million, \$19.0 million, and \$25.0 million, respectively, available to us under such federal funds lines.

As of December 31, 2019, we had a Restated Revolving Credit Note with a correspondent lending partner and the borrowing capacity associated with this facility was \$5.0 million. As of June 30, 2020, the Restated Revolving Credit Note was renewed under a new Business Loan Agreement and associated Promissory Note. As of September 30, 2020, the Promissory Note had a borrowing capacity under this facility of \$5.0 million.

Our borrowing facilities include various financial and other covenants, including, but not limited to, a requirement that the Bank maintains regulatory capital that is deemed "well capitalized" by federal banking agencies. As of September 30, 2020 and December 31, 2019, the Company was in compliance with the covenant requirements.

*Liquidity and Capital Resources*

Liquidity resources primarily include interest-bearing and noninterest-bearing deposits which primarily contribute to our ability to raise funds to support asset growth, acquisitions, and meet deposit withdrawals and other payment obligations. Access to purchased funds primarily include the ability to borrow from FHLB Topeka and from correspondent banks.

The following table illustrates, during the periods presented, the composition of our funding sources and the average assets in which those funds are invested as a percentage of average total assets for the period indicated.

	Average Percentage for the Three Month Period Ended September 30, 2020	Average Percentage for the Nine Month Period Ending September 30, 2020
<b>Sources of Funds:</b>		
Deposits:		
Noninterest-bearing	22.35 %	22.52 %
Interest-bearing	55.97	60.14
FHLB and Federal Reserve borrowings	11.90	6.39
Subordinated notes	0.77	0.79
Other liabilities	1.21	1.31
Shareholders' equity	7.80	8.85
Total	<u>100 %</u>	<u>100 %</u>
<b>Uses of Funds:</b>		
Total loans	77.74 %	79.75 %
Available-for-sale securities	2.17	3.09
Mortgage loans held for sale	5.07	4.31
Interest-bearing deposits in other financial institutions	9.57	6.94
Noninterest-earning assets	5.45	5.91
Total	<u>100 %</u>	<u>100 %</u>
Average noninterest-bearing deposits to total average deposits	28.54 %	27.25 %
Average loans to total average deposits	100.00	97.19
Average interest-bearing deposits to total average deposits	71.46 %	72.75 %

Our primary source of funds is interest-bearing and noninterest-bearing deposits, and our primary use of funds is loans. We do not expect a change in the primary source or use of our funds in the foreseeable future.

*Capital Resources*

Total shareholders' equity increased \$21.9 million, or 17.2%, from December 31, 2019 to \$149.6 million at September 30, 2020. The increase is primarily due to an increase in net income.

On June 14, 2019, the Company announced that its Board of Directors had authorized a share repurchase program under which the Company may repurchase up to 300,000 shares of its common stock and that the Board of Governors of the Federal Reserve System advised the Company that it had no objection to the Company's stock repurchase program. The repurchase program authorized the Company to purchase its common stock from time to time in privately negotiated transactions, in the open market, including pursuant to any trading plan that may be adopted in accordance with Rule 10b5-1 plan promulgated by the Securities and Exchange Commissions, or otherwise in a manner that complies with applicable federal securities laws. During the year ended December 31, 2019, the Company repurchased 43,698 shares at an average price of \$16.51. During the nine months ended September 30, 2020, the Company repurchased 22,679 shares at an average price of \$16.50. No shares were repurchased during the three months ended September 30, 2020 as the repurchase program expired in June 2020. Management is currently evaluating various capital planning strategies which may include implementing a share repurchase program.

We are subject to various regulatory capital adequacy requirements at a consolidated level and the bank level. These requirements are administered by 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 our consolidated financial statements. Under capital adequacy guidelines and, additionally for banks, the regulatory framework for prompt corrective action, we must meet specific capital guidelines that involve quantitative measures of our assets, liabilities, and certain off-balance sheet items as calculated under regulatory accounting practices.

Capital levels are viewed as important indicators of an institution’s financial soundness by banking regulators. Generally, FDIC-insured depository institutions and their holding companies are required to maintain minimum capital relative to the amount and types of assets they hold. As of September 30, 2020 and December 31, 2019, our holding company and Bank were in compliance with all applicable regulatory capital requirements, and the Bank was classified as “well capitalized,” for purposes of the prompt corrective action regulations. As we continue to grow our operations and maintain capital requirements, our regulatory capital levels may decrease depending on our level of earnings. During the nine months ended September 30, 2020 the Company made a \$10.0 million capital injection into the Bank as a result of the growth due to the acquisition. We continue to monitor growth and control our capital activities in order to remain in compliance with all applicable regulatory capital standards.

The following table presents our regulatory capital ratios for the dates noted.

<i>(Dollars in thousands)</i>	September 30, 2020		December 31, 2019	
	Amount	Ratio	Amount	Ratio
<b>Tier 1 capital to risk-weighted assets</b>				
Bank	\$ 127,441	10.28 %	\$ 99,461	10.67 %
Consolidated Company	122,987	9.88	105,821	11.31
<b>Common Equity Tier 1(CET1) to risk-weighted assets</b>				
Bank	127,441	10.28	99,461	10.67
Consolidated Company	122,987	9.88	105,821	11.31
<b>Total capital to risk-weighted assets</b>				
Bank	139,647	11.26	107,509	11.53
Consolidated Company	149,753	12.03	120,429	12.87
<b>Tier 1 capital to average assets</b>				
Bank	127,441	7.81	99,461	8.09
Consolidated Company	\$ 122,987	7.52 %	\$ 105,821	8.58 %

*Contractual Obligations and Off-Balance Sheet Arrangements*

We enter into credit-related financial instruments with off-balance sheet risk in the normal course of business to meet the financing needs of our clients. These financial instruments include commitments to extend credit. Such commitments involve, to varying degrees, elements of credit and interest rate risk in excess of the amount recognized in the consolidated balance sheets. Commitments may expire without being utilized. Our exposure to loan loss is represented by the contractual amount of these commitments, although material losses are not anticipated. We follow the same credit policies in making commitments as we do for on-balance sheet instruments.

The following table presents future contractual obligations to make future payments with respect to borrowings for the periods indicated (amounts in thousands):

	As of September 30, 2020				
	1 Year or Less	More than 1 Year but Less than 3 Years	More than 3 Years but Less than 5 Years	5 Years or More	Total
FHLB Topeka and Federal Reserve Subordinated notes	\$ 3,000	\$ 219,075	\$ —	\$ —	\$ 222,075
Time deposits	42,324	114,748	18,627	1,692 <sup>(1)</sup>	177,391
Minimum lease payments	3,082	5,390	4,204	26	12,702
<b>Total</b>	<b>\$ 48,406</b>	<b>\$ 339,213</b>	<b>\$ 22,831</b>	<b>\$ 16,165</b>	<b>\$ 426,615</b>

(1) Reflects contractual maturity dates of December 31, 2026 and March 31, 2030.

The following table presents financial instruments whose contract amounts represent credit risk, as of the periods indicated.

	September 30,		December 31,	
	2020		2019	
	Fixed Rate	Variable Rate	Fixed Rate	Variable Rate
Unused lines of credit	\$ 74,726	\$ 327,326	\$ 32,896	\$ 290,653
Standby letters of credit	1,754	17,324	1,759	24,197
Commitments to make loans to sell	419,035	—	47,354	—
Commitments to make loans	\$ 23,496	\$ 33,691	\$ —	\$ —

We may enter into contracts for services in the conduct of ordinary business operations, which may require payment for services to be provided in the future and may contain penalty clauses for early termination of the contracts. We do not believe these off-balance sheet arrangements have or are reasonably likely to have a material effect on our financial condition, revenues or expenses, results of operations, liquidity, capital expenditures, or capital resources. However, there can be no assurance that such arrangements will not have an effect on future operations.

*Critical Accounting Policies*

Our accounting policies and procedures are described in Note 1 - Organization and Summary of Significant Accounting Policies in the accompanying Notes to the Condensed Consolidated Financial Statements as well as the Company's Annual Report on Form 10-K for the year ended December 31, 2019 as filed with the SEC.

**Item 3. Quantitative and Qualitative Disclosures about Market Risk**

*Interest Rate Sensitivity and Market Risk*

Market risk is the risk of loss in a financial instrument arising from adverse changes in market prices and rates, foreign currency exchange rates, commodity prices and equity prices. Our market risk arises primarily from interest rate risk inherent in lending, investing and deposit taking activities. To that end, management actively monitors and manages interest rate risk exposure. We do not have any market risk sensitive instruments entered into for trading purposes.

Management uses various asset/liability strategies to manage the re-pricing characteristics of our assets and liabilities designed to ensure that exposure to interest rate fluctuations is limited within established guidelines of acceptable levels of risk-taking.

The Board of Directors monitors interest rate risk by analyzing the potential impact on the net economic value of equity and net interest income from potential changes in interest rates, and considers the impact of alternative strategies or changes in balance sheet structure. We manage our balance sheet in part to maintain the potential impact on economic value of equity and net interest income within acceptable ranges despite changes in interest rates.

Our exposure to interest rate risk is reviewed at least quarterly by the Board of Directors. Interest rate risk exposure is measured using interest rate sensitivity analysis to determine the change in net interest income and economic value of equity in the event of hypothetical changes in interest rates. If potential changes to net economic value of equity and net interest income resulting from hypothetical interest rate changes are not within the limits established by our Board of Directors, the Board of Directors may direct management to adjust the asset and liability mix to bring interest rate risk within board-approved limits.

The following tables summarize the sensitivity in net interest income and fair value of equity over the periods indicated, using a parallel ramp scenario.

	As of September 30, 2020		As of December 31, 2019	
	Percent Change in Net Interest Income	Percent Change in Fair Value of Equity	Percent Change in Net Interest Income	Percent Change in Fair Value of Equity
<b>Change in Interest Rates (Basis Points)</b>				
300	8.59 %	22.79 %	(5.76)%	(9.33)%
200	5.26	18.45	(2.97)	(3.45)
100	2.40	11.16	(1.18)	(0.13)
Base	—	—	—	—
-100	(2.45)%	(27.69)%	(0.16)%	(9.99)%

The model simulations as of September 30, 2020 imply that our balance sheet is more asset sensitive compared to our balance sheet as of December 31, 2019.



Although the simulation model is useful in identifying potential exposure to interest rate changes, actual results for net interest income and economic value of equity may differ. There are a variety of factors that can impact the outcomes such as timing and magnitude of interest rate changes, asset and liability mix, pre-payment speeds, deposit beta assumptions, and decay rates that differ from our projections. Additionally, the results do not account for actions implemented to manage our interest rate risk exposure.

#### *Impact of Inflation*

Our Condensed Consolidated Financial Statements and related notes included within this Form 10-Q have been prepared in accordance with GAAP, which requires the measurement of financial position and operating results in terms of historical dollars, without considering changes in the relative value of money over time due to inflation or recession.

Our assets and liabilities are substantially monetary in nature. Therefore, changes in interest rates can significantly impact on our performance beyond the general effects of inflation. Interest rates do not necessarily move in the same direction or magnitude as prices of general goods and services, while other operating expenses can be correlated with the impact of general levels of inflation.

#### **Item 4. Controls and Procedures**

##### *Evaluation of Disclosure Controls and Procedures*

As of the end of the period covered by this Form 10-Q, the Company carried out an evaluation, under the supervision and with the participation of its management, including its Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of its disclosure controls and procedures. In designing and evaluating the disclosure controls and procedures, management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives, and management was required to apply judgment in evaluating its controls and procedures. Based on this evaluation, the Company's Chief Executive Officer and Chief Financial Officer concluded that the Company's disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended, or the "Exchange Act") were effective as of the end of the period covered by this report.

##### *Internal Control over Financial Reporting*

There were no changes in the Company's internal control over financial reporting (as such term is defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) that occurred during the three months ended September 30, 2020 that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

## **PART II. OTHER INFORMATION**

#### **Item 1. Legal Proceedings**

The Company, from time to time, is involved in various legal actions arising in the normal course of business. While the ultimate outcome of any such proceedings cannot be predicted with certainty, it is the opinion of management, after consulting with our legal counsel, that no proceedings exist, either individually or in the aggregate, which, if determined adversely to the Company, would have a material effect on the Company's consolidated financial statements. See Note 9 - Commitments and Contingencies in the Notes to Condensed Consolidated Financial Statements.

Without admitting or denying the SEC's findings, FWCM agreed on July 16, 2020 to settle claims that FWCM failed reasonably to supervise its investment adviser representatives who purchased securities sold in reliance on Rule 144A under the Securities Act of 1933, as amended (the "Securities Act"), for advisory clients when the clients were not qualified institutional buyers in a Rule 144A transaction, and to adopt and implement written policies and procedures reasonably designed to prevent violations of the Investment Advisers Act of 1940 and the rules thereunder by the adviser and its supervised persons. FWCM paid a previously accrued fine of \$0.2 million to the SEC, and replaced the FWCM President and FWCM compliance team in place at that time.

## Item 1A. Risk Factors

There has been no material change in the risk factors previously disclosed under Item 1A of the Company in its 2019 Annual Report on Form 10-K filed with the SEC, on March 12, 2020 with the exception of the risk factor identified in the first quarter of 2020, which is set forth below:

***The COVID-19 pandemic has adversely impacted our business and financial results, and the ultimate impact will depend on future developments, which are highly uncertain and cannot be predicted, including the scope and duration of the pandemic and actions taken by governmental authorities in response to the pandemic.***

The COVID-19 pandemic is creating extensive disruptions to the global economy and to the lives of individuals throughout the world. Governments, businesses, and the public are taking unprecedented actions to contain the spread of COVID-19 and to mitigate its effects, including quarantines, travel bans, shelter-in-place orders, closures of businesses and schools, fiscal stimulus, and legislation designed to deliver monetary aid and other relief. While the scope, duration, and full effects of COVID-19 are rapidly evolving and not fully known, the pandemic and related efforts to contain it have disrupted global economic activity, adversely affected the functioning of financial markets, impacted interest rates, increased economic and market uncertainty, and disrupted trade and supply chains. If these effects continue for a prolonged period or result in sustained economic stress or recession, many of the risk factors identified in our Form 10-K could be exacerbated and such effects could have a material adverse impact on us in a number of ways related to credit, collateral, customer demand, funding, operations, interest rate risk, and human capital, as described in more detail below.

- ***Credit Risk.*** Our risks of timely loan repayment and the value of collateral supporting the loans are affected by the strength of our borrower's financial condition and business. Concern about the spread of COVID-19 has caused and is likely to continue to cause business shutdowns, limitations on commercial activity and financial transactions, suspensions on evictions, labor shortages, supply chain interruptions, increased unemployment and commercial property vacancy rates, reduced profitability and ability for property owners to make mortgage payments, and overall economic and financial market instability, all of which may cause our customers to be unable to make scheduled loan payments. If the effects of COVID-19 result in widespread and sustained repayment shortfalls on loans in our portfolio or defaults by counterparties, we could incur significant delinquencies, foreclosures and credit losses, particularly if the available collateral is insufficient to cover our exposure. The future effects of COVID-19 on economic activity could negatively affect the collateral values associated with our existing loans, the ability to liquidate the real estate collateral securing our residential and commercial real estate loans, our ability to maintain loan origination volume and to obtain additional financing, the future demand for or profitability of our lending and services, and the financial condition and credit risk of our customers. Further, in the event of delinquencies, regulatory changes and policies designed to protect borrowers may slow or prevent us from or, in some cases, our business decisions may result in, a delay in our taking certain remediation actions, such as foreclosure. In addition, we have unfunded commitments to extend credit to customers, which are generally not drawn upon. During a challenging economic environment, such as the ongoing pandemic, our customers are more dependent on our credit commitments and increased borrowings under these commitments could adversely impact our liquidity. Furthermore, in an effort to support our communities during the pandemic, we participated in the PPP under the CARES Act whereby loans to small businesses were made and those loans are subject to the regulatory requirements that would require forbearance of loan payments for a specified time or that would limit our ability to pursue all available remedies in the event of a loan default. If the borrower under the PPP loan fails to qualify for loan forgiveness, we are at the heightened risk of holding these loans at unfavorable interest rates as compared to the loans to customers that we would have otherwise extended credit.
- ***Strategic Risk.*** Our success may be affected by a variety of external factors that may affect the price or marketability of our products and services, including disruptions in the capital markets, changes in interest rates that may increase our funding costs, reduced demand for our financial products due to economic conditions and the various response of governmental and nongovernmental authorities. In recent weeks, the COVID-19 pandemic has significantly increased economic and demand uncertainty and has led to disruption and volatility in the global capital markets, which increases the cost of capital and adversely impacts access to capital. Furthermore, many of the governmental actions have been directed toward curtailing household and business activity to contain COVID-19. These actions have been rapidly expanding in scope and intensity. For example, in many of our markets, local governments have acted to temporarily close or restrict the operations of most businesses. In particular, we have recently experienced a decline in our origination of loans. The future effects of

COVID-19 on economic activity could negatively affect the future banking products we provide including the ability to sell mortgage loan that we originate with the intent to sell.

- *Operational Risk.* Current and future restrictions on our workforce's access to our facilities could limit our ability to meet customer servicing expectations and have a material adverse effect on our operations. We rely on business processes and profit center activity that largely depend on people, technology, and the use of complex systems and models to manage our business, including access to information technology systems and models as well as information, applications, payment systems and other services provided by third parties. In response to COVID-19, we have modified our business practices with a majority of our employees working remotely from their homes to have our operations uninterrupted as much as possible. Further, technology in employees' homes may not be as robust as in our offices and could cause the networks, information systems, applications, and other tools available to employees to be more limited or less reliable than in our offices, the continuation of these work-from-home measures introduces additional operational risk, especially including increased cybersecurity risk. These cyber risks include greater phishing, malware, and other cybersecurity attacks, vulnerability to disruptions of our information technology infrastructure and telecommunications systems for remote operations, increased risk of unauthorized dissemination of confidential information, limited ability to restore the systems in the event of a systems failure or interruption, great risk of a security breach resulting in destruction or misuse of valuable information, and potential impairment of our ability to perform critical functions, including wiring funds, all of which could expose us to risks of data or financial loss, litigation and liability and could seriously disrupt our operations and the operations of any impacted customers.

Moreover, we rely on many third parties in our business operations, including appraisers of real property collateral, vendors that supply essential services such as loan servicers, providers of financial information, systems and analytical tools and providers of electronic payment and settlement systems, and local and federal government agencies, offices, and courthouses. In light of the developing measures responding to the pandemic, many of these entities have limited the availability and access of their services. For example, loan origination could be delayed due to the limited availability of real estate appraisers for the collateral. Loan closings could be delayed related to reductions in available staff in recording offices or the closing of courthouses in certain counties, which slows the process for title work, mortgage and UCC filings in those counties. If the third party service providers continue to have limited capacities for a prolonged period or if additional limitations or potential disruptions in these services materialize, it may negatively affect our operations.

- *Interest Rate Risk.* Our net interest income, lending activities, deposits, hedging activities, and profitability could be negatively affected by volatility in interest rates caused by uncertainties stemming from COVID-19. In March 2020, the Federal Reserve lowered the target range for the federal funds rate to a range from 0 to 0.25 percent, citing concerns about the impact of COVID-19 on markets and stress in the energy sector. A prolonged period of extremely volatile and unstable market conditions would likely increase our funding costs and negatively affect market risk mitigation strategies. Higher income volatility from changes in interest rates and spreads to benchmark indices could cause a loss of future net interest income and a decrease in current fair market values of our assets. Fluctuations in interest rates will impact both the level of income and expense recorded on most of our assets and liabilities and the market value of all interest-earning assets and interest-bearing liabilities, other than those which have a short-term to maturity, which in turn could have a material adverse effect on our net income, operating results, or financial condition.
- *Trust and Investment Management Risk.* Recent market volatility associated with the pandemic and the decline in oil and gas prices has adversely impacted the value of our assets under management. We derive a significant amount of our revenues primarily from investment management fees based on assets under management. As such, fluctuations in the equity and debt markets can have a direct impact upon our net earnings. A sustained decline in the value of the assets that we manage or otherwise administer or service for others, could have an adverse effect on related fee income and demand for our services.

Because there have been no comparable recent global pandemics that resulted in similar global impact, we do not yet know the full extent of COVID-19's effects on our business, operations, or the global economy as a whole. Any future development will be highly uncertain and cannot be predicted, including the scope and duration of the pandemic, the effectiveness of our work from home arrangements and third party providers' ability to support our operation, any actions taken by governmental authorities and other third parties in response to the pandemic. The uncertain future development

of this crisis could materially and adversely affect our business, operations, operating results, financial condition, liquidity or capital levels.

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

Not applicable.

**Item 3. Defaults upon Senior Securities**

Not applicable.

**Item 4. Mine Safety Disclosures**

Not applicable.

**Item 5. Other Information**

Not applicable.

**Item 6. Exhibits**

Exhibit No.	Description
31.1*	<a href="#">Certification of Chief Executive Officer pursuant to Rule 13a-14(a) of the Exchange Act, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.</a>
31.2*	<a href="#">Certification of Chief Financial Officer pursuant to Rule 13a-14(a) of the Exchange Act, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.</a>
32.1**	<a href="#">Certification of Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.</a>
32.2**	<a href="#">Certification of Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.</a>
101.INS*	Inline XBRL Instance 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 (formatted as inline XBRL and contained in Exhibit 101)

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\* Filed herewith.

\*\* These exhibits are furnished herewith and shall not be deemed “filed” for purposes of Section 18 of the Exchange Act, or otherwise subject to the liability of that section, and shall not be deemed to be incorporated by reference into any filing under the Securities Act or the Exchange Act.

**SIGNATURES**

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

**First Western Financial, Inc.**

November 5, 2020  
Date

By: /s/ Scott C. Wylie  
Scott C. Wylie  
Chairman, Chief Executive Officer and President

November 5, 2020  
Date

By: /s/ Julie A. Courkamp  
Julie A. Courkamp  
Chief Financial Officer and Treasurer

**Certification of Chief Executive Officer  
Pursuant to Rules 13a-14(a) and 15d-14(a) of the Securities Exchange Act of 1934  
and Section 302 of the Sarbanes-Oxley Act of 2002**

I, Scott C. Wylie, certify that:

1. I have reviewed this quarterly report on Form 10-Q of First Western Financial, Inc.:
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) 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) [Paragraph omitted in accordance with Exchange Act Rule 13a-14(a)];
  - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - (d) Disclosed in this Report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
  - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: November 5, 2020

/s/ Scott C. Wylie

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Scott C. Wylie

Chairman, Chief Executive Officer and President  
(Principal Executive Officer)

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**Certification of Chief Financial Officer  
Pursuant to Rules 13a-14(a) and 15d-14(a) of the Securities Exchange Act of 1934  
and Section 302 of the Sarbanes-Oxley Act of 2002**

I, Julie A. Courkamp, certify that:

1. I have reviewed this quarterly report on Form 10-Q of First Western Financial, Inc.:
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) 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) [Paragraph omitted in accordance with Exchange Act Rule 13a-14(a)];
  - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - (d) Disclosed in this Report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
  - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: November 5, 2020

/s/ Julie A. Courkamp  
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Julie A. Courkamp  
Chief Financial Officer and Treasurer  
(Principal Financial Officer)

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

In connection with this report of First Western Financial, Inc. (the "Company") on Form 10-Q for the period ended September 30, 2020, as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Scott C. Wylie, Chairman, Chief Executive Officer and President of the Company, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that, to the best of my knowledge:

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

FIRST WESTERN FINANCIAL, INC.

Date: November 5, 2020

/s/ Scott C. Wylie  
Scott C. Wylie  
Chairman, Chief Executive Officer and President

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

In connection with this report of First Western Financial, Inc. (the "Company") on Form 10-Q for the period ended September 30, 2020, as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Julie A. Courkamp, Chief Financial Officer and Treasurer of the Company, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that, to the best of my knowledge:

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

FIRST WESTERN FINANCIAL, INC.

Date: November 5, 2020

/s/ Julie A. Courkamp  
Julie A. Courkamp  
Chief Financial Officer and Treasurer

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