Communities First Financial Corporation

2016

ANNUAL REPORT

Communities First Financial Corporation

Message from the Chairman of the Board and President & CEO

Since the beginning, our goal at Communities First Financial Corporation and Fresno First Bank has been a commitment to building client relationships and creating value for our shareholders. In 2016, we continued with that goal in mind and had a year of consistent, solid growth.

Fresno First Bank is the bank of choice for many individuals and businesses throughout the valley that see the value in our services and accomplishments, and appreciate our dedication to building beneficial, long-lasting client relationships.

In 2016, we also continued to create our culture of shared employee ownership within the Bank. Our focus has brought us success across the board and during the year total assets grew 23%, to $363.5 million; total deposits grew 24%, to $332.3 million; total loans increased 21%, to $227.7 million, and total after-tax profit increased 21%, to $3.1 million.

In our quest to always bring the best products and service options to our customers, the Bank launched several new partnerships. Communities First Financial partnered with BodeTree, a cloud-based business management program; and Breakaway Funding, a next generation crowd-funding company, putting the Company on the forefront of financial service providers in California.

Also in 2016, the Company continued to invest in the community to ensure that we are making an impact not just in the business community but also with the people who support those local businesses. The staff made a commitment to the Community Food Bank and we are proud to say that we were able to make a sizeable impact through funds we raised and the actual hours our staff dedicated to the Community Food Bank throughout the year. We also continued to expand our relationship with Fresno State University through financial support in the school's foundations; summer internships for students and by hosting company sponsored tailgates during the football season.

We believe that our dedication in developing relationships with our clients and our community, and our company culture will help us maintain the momentum as we move forward. We are grateful for our shareholders who have demonstrated their confidence in us and we recognize the importance of delivering on our promises.

Dave Price
Chairman of the Board

Steve Miller
President & CEO

Communities First Financial Corporation

Mission Statement

The mission of Fresno First Bank is to become the Bank of choice for business owners, professionals, entrepreneurs and individuals that value a high touch approach, or "relationship" approach to their banking needs. We will accomplish this by:

- Developing an ownership culture that fosters a working environment which encourages professional and financial growth and entrepreneurial freedom.
- Committing to exceed customer service expectations for quality, responsiveness and professional excellence.
- Generating a superior return for our shareholders while investing in the communities we serve.

Values Statement

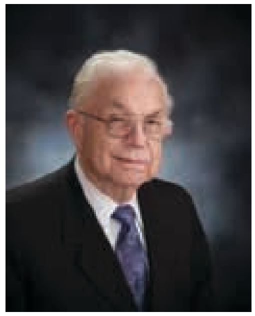
Fresno First Bank will be the Bank of choice for successful businesses and individuals who value superior service and a relationship approach to their banking and financing needs. Our group of experienced professional bankers will help clients navigate through complex financial choices which will ultimately assist in stimulating economic growth in our community. Our commitment to an ownership culture will foster an exceptional work environment that generates a fair return for our shareholders.

Core Values

We Value:

- The highest standard of ethical behavior and professional integrity.
- An owner-orientated working environment dedicated to teamwork that encourages respect and dignity, while recognizing and rewarding innovation and exceptional performance.
- Proactive, solutions-orientated recommendations that consistently exceed client expectations.
- The loyalty of our client relationships gained by knowing, understanding and placing their needs first.

Communities First Financial Corporation and Fresno First Bank's Board of Directors



David Price, Chairman of the Board
President & CEO of David Price & Associates

Jack Holt, President
Holt Lumber Co.

Sheila Frowsing, President
Kamps Insurance Agency

Robert Kubo, Orthodontist
Kubo Orthodontics

Lorrie Lorenz, Principal
Lorenz & Associates

Jared Martin, Realtor
Keller/Williams

Steve Miller, President & CEO
Fresno First Bank

Mark Saleh, President
Saleh & Company

Joel Slonski
Joel Slonski, CPA

Al Smith, President
Al Smith & Partners

Dan Suchy
Retired Physician

Employee Owners

Brandon Anaya, Customer Service Rep.
Vik Aulakh, Commercial Loan Officer
Lisa Bassill, AVP/ Personal Banker
Tobi Burnes, Loan Documentation Clerk
Debbie Cameron, VP/Corporate Secretary
Steven Campos, Merchant Services Officer
Steve Canfield, EVP/Chief Financial Officer
Lanny Chan, VP/Personal Banker
Craig DeShields, SVP/Senior Loan Officer
Ken Dodderer, SVP/Agri-Business Manager
Laura Drake, Customer Service Rep.
Pat Durkin, VP/SBA Loan Officer
Regina Elisarraraz, Customer Service Rep.
Kristina Fabbian, Marketing Coordinator
Michael Fanucchi, SVP/SBA Dept. Manager
Catherine Fitzgerald, VP/Merchant Services
Melissa Gamez, Accounting Assistant
Evangelina Gonzalez, SVP/Operations
Julie Henvit, AVP/Operations Officer
Richard Huynh, Credit Analyst
David Kraechan, SVP/Commercial Loan Officer
Lillian Lucero, SBA Loan Officer
Ryan McAbee, VP, Compliance Officer
Steve Miller, President & CEO
Jim O'Brien, Business Development Officer
Michael Ossanna, VP/Commercial Loan Officer
Ramesh Padmanabhan, VP/Strategy & Implementation
Teresa Palsgaard, VP/Relationship Manager
Elizabeth Parsons, SBA Processor
Susan Perry, Business Banking Officer
Jennifer Peterson, VP, Customer Service Manager
Lee Reed, EVP/Chief Credit Officer
Margaret Rodriguez, Loan Assistant
Rosa Rodriguez, Branch Sales Officer
Nick Sanchez, New Accounts Officer
Ruth Setencich, Business Banking Officer
Alice Shevenell, VP/Loan Services Manager
Raj Solanki, Data Analytics
Noel Terriquez, Commercial Loan Analyst
Jessica Vasquez, Customer Service Rep.
Bradley Wakefield, Documentation Specialist
Nick Ward, Portfolio Manager
Melanie Welch, SBA Loan Processor

Marketing Highlights

Fresno First Financial Management Tool Powered by BodeTree

Last year Fresno First Bank launched a new financial management tool that will make managing your business finances easier than ever before. By giving you easy access to all your business accounts in one place, BodeTree helps you monitor cash flow, uncover trends, and plan for the future of your business in minutes.

Hybrid Crowdfunding Partnership with Breakaway Funding

In 2016, the Bank partnered with Breakaway Funding to provide a hybrid crowdfunding loan program to create greater access to traditional bank financing for growing companies in our surrounding communities.

Companies who raise a minimum of 10% equity capital from “their community” may be eligible for additional bank financing through our SBA 7a or SBA 504 programs.

Fresno First Bank is Central California’s #1 SBA Community Bank Lender

Fresno First Bank has been declared the top Community Bank SBA Lender for the 15 county Fresno District for the fourth consecutive year. The Bank approved 37 SBA 7(a) loans totaling $16.7 million and participated in numerous SBA 504 loan approvals during the year which will yield approximately $15.6 million in additional loans to small businesses in Central California.

“The credit for this recognition goes to our team. Their dedication and hard work has allowed us to keep the top community bank lender spot in the Fresno District,” said Michael Fanucchi, our Senior Vice President. “As a Preferred SBA lender, we are committed to the SBA Program,” said Fanucchi. “Our experienced team works with a broad base of loans, including franchises and changes of ownership.”

Fresno State University Football Tailgates

Fresno First Bank is a proud supporter of the Fresno State Athletic program. The Bank has a picnic space and hosts a tailgate for each home game featuring food vendors that are clients of the bank.

Community Involvement

Fresno Community Food Bank

Fresno First Bank team members adopted the Community Food Bank as our charity of choice in 2016. We participated in several events ranging from food drives to warehouse work days. The Bank raised over $25,000, enough to provide 175,000 meals to the hungry in our local area.




In addition to the Fresno Community Food Bank, Fresno First Bank supported a variety of community partners in 2016 with monetary donations, volunteer hours, and training and education. Some of these partners include the American Heart Association, United Cerebral Palsy, Hope Now for Youth, Exceptional Parents Unlimited, the Bulldog Foundation and Hope Animal Foundation. Our team members truly put community first.

Fresno First Bank team members supporting Breast Cancer Awareness Day

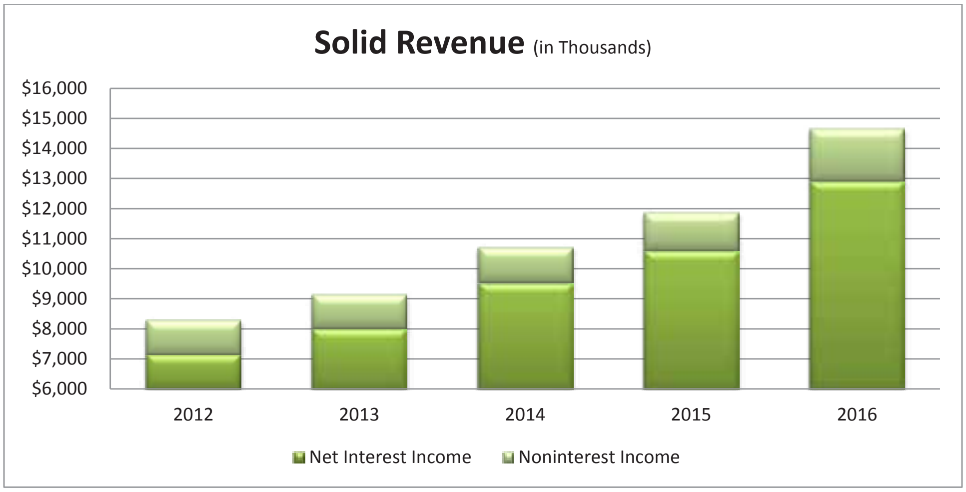
Education and Training

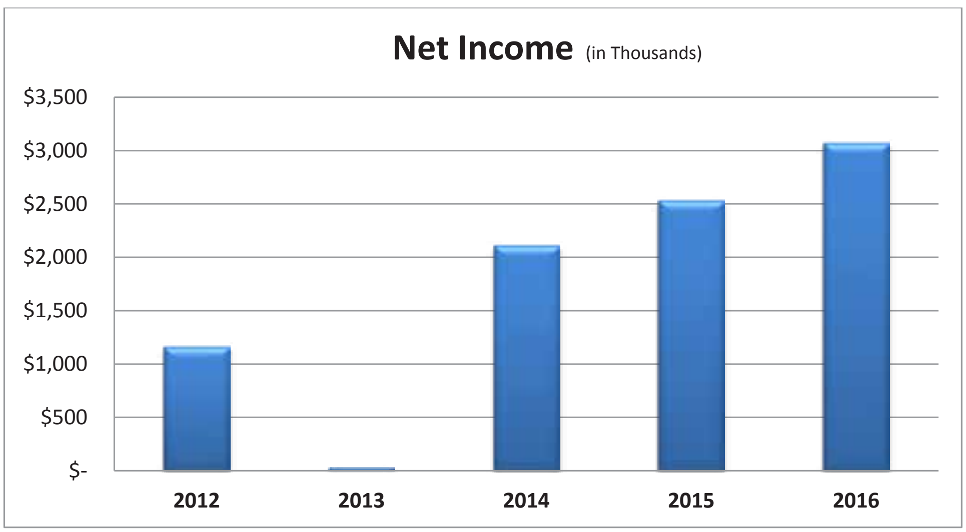
Fresno First Bank also partnered with Fresno State University to provide internships, scholarships and with team member participation on the Board of the University's Craig School of Business.

We also provided training, education and assistance to members of the Fresno Area Hispanic Foundation and Fresno SCORE. Our President, Steve Miller is on the Advisory Board of Fresno SCORE.

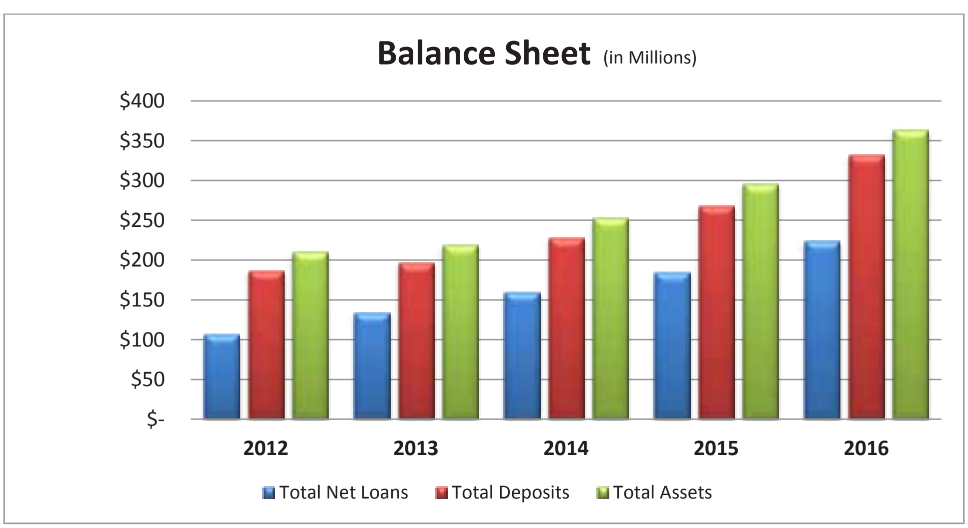
Financial Highlights

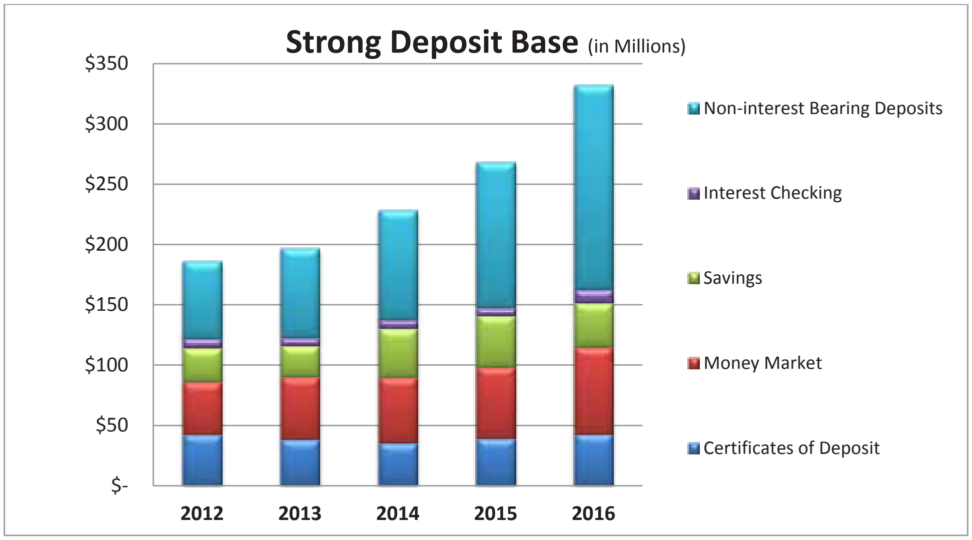
The following graphs represent the solid growth Fresno First Bank has experienced during the past five years.

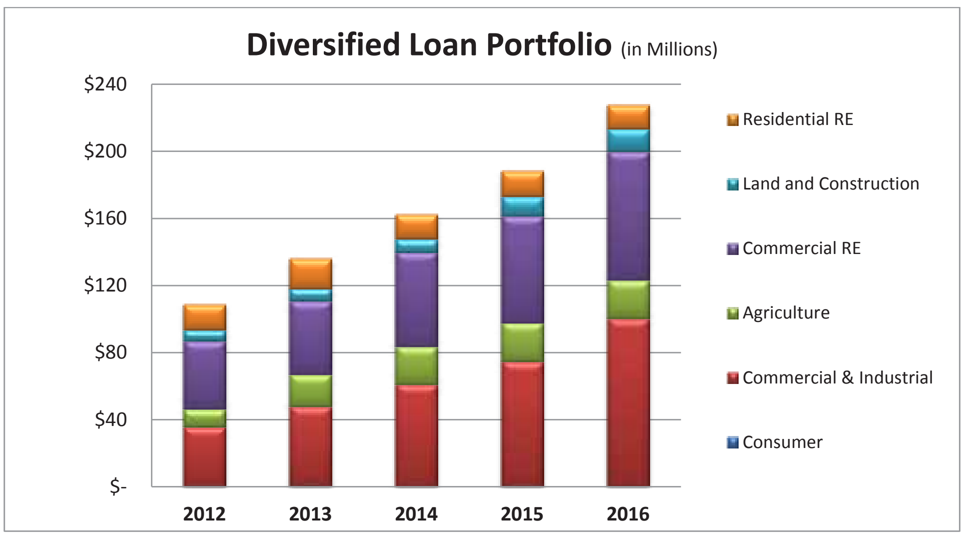


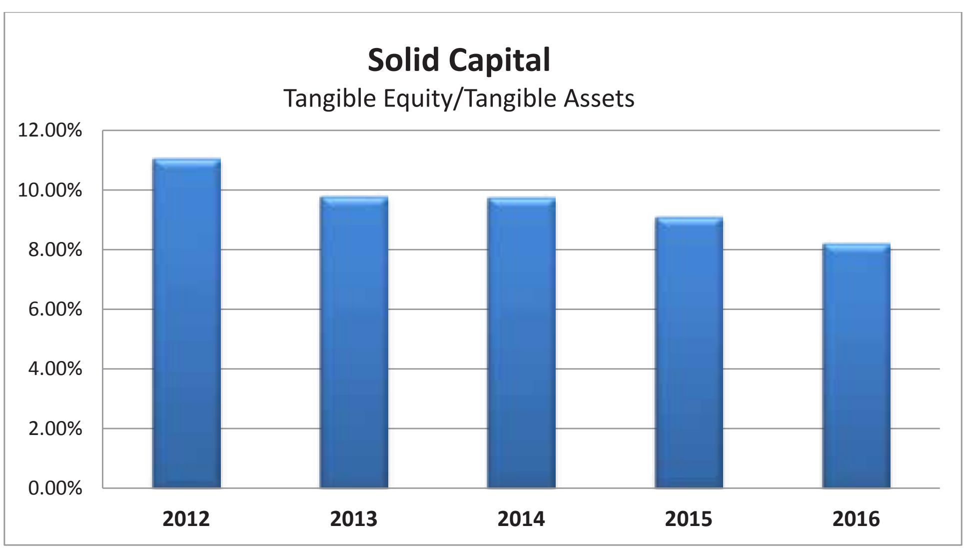


2013 provision for loan losses was $3.275 million




Strong Deposit Base (in Millions)
$350
$300
$250
$200
$150
$100
$50
$-
2012
2013
2014
2015
2016
Non-interest Bearing Deposits
Interest Checking
Savings
Money Market
Certificates of Deposit


Diversified Loan Portfolio (in Millions)
$240
$200
$160
$120
$80
$40
$-
2012
2013
2014
2015
2016
Residential RE
Land and Construction
Commercial RE
Agriculture
Commercial & Industrial
Consumer


Solid Capital
Tangible Equity/Tangible Assets
12.00%
10.00%
8.00%
6.00%
4.00%
2.00%
0.00%
2012
2013
2014
2015
2016

Communities First Financial Corporation

"We strive to be the best company our employees ever work for, the best bank our customers ever do business with, and the best investment our shareholders ever make!"

-CFST Employee/Owner

COMMUNITIES FIRST FINANCIAL CORPORATION

CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2016 and 2015

COMMUNITIES FIRST FINANCIAL CORPORATION

CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2016 and 2015

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Crowe Horwath LLP
Independent Member Crowe Horwath International

INDEPENDENT AUDITOR'S REPORT

To the Shareholders and
Board of Directors
Communities First Financial Corporation
Fresno, California

Report on the Financial Statements

We have audited the accompanying consolidated financial statements of Communities First Financial Corporation which comprise the consolidated balance sheets as of December 31, 2016 and 2015, and the related consolidated statements of income, comprehensive income, changes in shareholders' equity, and cash flows for the years then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Communities First Financial Corporation as of December 31, 2016 and 2015, and the results of its operations and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Crowe Horwath LLP

Crowe Horwath LLP

Sacramento, California
March 28, 2017

COMMUNITIES FIRST FINANCIAL CORPORATION
CONSOLIDATED BALANCE SHEETS
For the Years Ended December 31, 2016 and 2015

	2016	2015
ASSETS		
Cash and due from banks	$ 6,879,474	$ 11,805,379
Federal funds sold	52,604,573	14,099,481
Interest-bearing deposits in banks	2,908,171	6,000,000
Total cash and cash equivalents	62,392,218	31,904,860
Certificates of deposit	5,199,000	5,695,000
Securities available-for-sale	66,291,965	68,775,094
Loans, net	224,355,335	184,839,048
Correspondent bank stock, at cost	1,918,206	1,649,175
Premises and equipment	167,730	167,564
Interest receivable and other assets	3,208,776	3,007,170
Total assets	$ 363,533,230	$ 296,037,911
LIABILITIES AND SHAREHOLDERS' EQUITY		
Deposits	$ 332,330,704	$ 268,111,310
Interest payable and other liabilities	1,272,597	948,761
Total liabilities	333,603,301	269,060,071
Commitments and contingencies (Notes 4 and 11)		
Common stock - 5,000,000 shares authorized, no par value; 2,732,043 and 2,698,417 shares issued and outstanding in 2016 and 2015, respectively	25,943,065	25,882,391
Additional paid-in capital	1,111,062	1,033,984
Retained earnings / (Accumulated deficit)	2,774,616	(300,493)
Accumulated other comprehensive income	101,186	361,958
Total shareholders' equity	29,929,929	26,977,840
Total liabilities and shareholders' equity	$ 363,533,230	$ 296,037,911

See accompanying notes to the financial statements.

COMMUNITIES FIRST FINANCIAL CORPORATION
CONSOLIDATED STATEMENTS OF INCOME
For the Years Ended December 31, 2016 and 2015

	2016	2015
Interest Income:		
Interest and fees on loan	$ 11,220,145	$ 9,493,697
Interest on investment securities	1,351,668	1,333,246
Interest on federal funds sold and other	362,454	213,759
Total interest income	12,934,267	11,040,702
Interest Expense		
Interest on savings deposits, NOW, and money market accounts	225,882	210,236
Interest on time deposits	230,797	211,399
Interest on other borrowings	1,242	389
Total interest expense	457,921	422,024
Net interest income	12,476,346	10,618,678
Provision for loan losses	1,266,000	270,000
Net interest income after provision for loan losses	11,210,346	10,348,678
Non-interest income:		
Service charges on deposits	845,866	706,191
Gain on sale of investment securities	7,569	68,285
Gain on sale of loans held-for-sale	669,053	389,293
Other operating income	211,125	162,738
Total non-interest income	1,733,613	1,326,507
Non-interest expenses:		
Salaries and employee benefits	4,606,768	4,182,271
Occupancy and equipment expenses	515,668	595,494
Regulatory assessments	202,900	182,000
Data processing fees	558,764	532,661
Professional fees	434,913	428,462
Marketing and business promotion	315,649	386,762
Director fees and stock-based compensation	274,623	247,996
Other expenses	912,685	984,094
Total non-interest expenses	7,821,970	7,539,740
Income before income taxes	5,121,989	4,135,445
Provision for income taxes	2,046,880	1,596,282
Net income	$ 3,075,109	$ 2,539,163
Preferred stock dividends	$ -	$302,965
Net income available to common shareholders	$ 3,075,109	$ 2,236,198
Net income per share - basic	$1.13	$1.01
Net income per share - diluted	$1.12	$0.93

See accompanying notes to the financial statements.

COMMUNITIES FIRST FINANCIAL CORPORATION
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
For the Years Ended December 31, 2016 and 2015

	2016	2015
Net income	$ 3,075,109	$ 2,539,163
Available-for-sale securities:		
Unrealized holding losses during the year	(434,418)	(2,954)
Reclassification adjustment for gains realized in net income	(7,569)	(68,285)
Net unrealized losses	(441,987)	(71,239)
Income tax benefit	181,215	29,208
Other comprehensive loss	(260,772)	(42,031)
Total comprehensive income	$ 2,814,337	$ 2,497,132

See accompanying notes to the financial statements.

COMMUNITIES FIRST FINANCIAL CORPORATION
CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY
For the years ended December 31, 2016 and 2015

	Preferred Stock		Common Stock		Additional	Accumulated	Accumulated Other Comprehensive	
	Shares	Amount	Shares	Amount	Paid-in Capital	Deficit	Income (Loss)	Total
Balances, January 1, 2015	60,593	$ 5,676,907	1,967,502	$ 19,521,640	$ 1,660,404	$ (2,536,308)	$ 403,989	$ 24,726,632
Stock based compensation	-	-	-	-	40,549	-	-	40,549
Exercise of stock options	-	-	47,906	683,844	(666,969)	-	-	16,875
Issuance of restricted stock awards	-	-	15,000	-	-	-	-	-
Conversion of preferred stock	(60,593)	(5,676,907)	668,009	5,676,907	-	(383)	-	(383)
Dividend paid on Series A preferred stocks	-	-	-	-	-	(302,965)	-	(302,965)
Net income	-	-	-	-	-	2,539,163	-	2,539,163
Other comprehensive loss	-	-	-	-	-	-	(42,031)	(42,031)
Balances, December 31, 2015	-	-	2,698,417	25,882,391	1,033,984	(300,493)	361,958	26,977,840
Stock based compensation	-	-	-	-	137,752	-	-	137,752
Exercise of stock options	-	-	7,126	60,674	(60,674)	-	-	-
Net issuance of restricted stock awards	-	-	26,500	-		-	-	-
Net income	-	-	-	-	-	3,075,109	-	3,075,109
Other comprehensive loss	-	-	-	-	-	-	(260,772)	(260,772)
Balances, December 31, 2016	-	$ -	2,732,043	$ 25,943,065	$ 1,111,062	$ 2,774,616	$ 101,186	$ 29,929,929

See accompanying notes to the financial statements.

COMMUNITIES FIRST FINANCIAL CORPORATION
CONSOLIDATED STATEMENTS OF CASH FLOWS
For the Years Ended December 31, 2016 and 2015

	2016	2015
Cash flows from operating activities		
Net income	$ 3,075,109	$ 2,539,163
Adjustments to reconcile net income to net cash from operating activities:		
Depreciation and amortization of premises and equipment	95,526	210,268
Amortization and accretion of premiums and discounts on securities available for sale, net	777,223	620,635
Provision for loan losses	1,266,000	270,000
Gain on sale of investment securities	(7,569)	(68,285)
Gain on sale of loans held for sale	(669,053)	(389,293)
Proceeds from sale of loans held for sale	8,977,095	7,543,070
Originations of loans held for sale	(8,308,042)	(7,153,777)
Stock based compensation	137,752	40,549
Decrease (increase) in deferred taxes	169,000	(108,000)
Increase (decrease) in interest payable and other liabilities	(370,605)	194,349
Decrease (increase) in interest receivable and other assets	323,836	(406,919)
Net cash from operating activities	5,466,272	3,291,760
Cash flow from investing activities		
Purchase of certificates of deposit	(250,000)	(1,739,000)
Proceeds from maturities of certificates of deposit	746,000	1,244,457
Purchase of available-for-sale securities	(9,050,487)	(24,120,133)
Proceeds from maturities of available-for-sale securities	10,503,189	18,139,949
Proceeds from sale of available-for-sale securities	-	2,364,599
Net increase in loans	(40,782,287)	(25,728,607)
Purchase of correspondent bank stock	(269,031)	(53,565)
Purchases of premises and equipment	(95,692)	(50,379)
Net cash from investing activities	(39,198,308)	(29,942,679)
Cash flows from financing activities		
Net increase in demand deposits and savings accounts	60,701,815	36,336,947
Net increase in time deposits	3,517,579	3,930,277
Cash paid in lieu of fractional shares	-	(383)
Payment of dividends on Series A preferred stocks	-	(302,965)
Common stock issued	-	16,875
Net cash from financing activities	64,219,394	39,980,751
Net increase in cash and cash equivalents	30,487,358	13,329,832
Cash and cash equivalents, beginning of year	31,904,860	18,575,028
Cash and cash equivalents, end of year	$ 62,392,218	$ 31,904,860
Supplemental disclosures of cash flow information:		
Interest paid	$ 450,866	$ 405,412
Taxes paid	$ 1,670,000	$ 1,930,000
Non-cash financing activities:		
Conversion of preferred stock	$ -	$ 5,676,907

See accompanying notes to the financial statements.

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The accounting and reporting policies of Communities First Financial Corporation (the Company) conform to accounting principles generally accepted in the United States of America and general practices within the banking industry. A summary of the significant accounting policies applied in the preparation of the accompanying consolidated financial statements is as follows:

Nature of Operations: On November 7, 2014 (the Effective Date), a bank holding company reorganization was completed whereby Communities First Financial Corporation became the parent holding company of Fresno First Bank (the Bank). On the Effective Date, each of the Bank's outstanding shares of common stock converted into an equal number of shares of common stock of Communities First Financial Corporation, and the Bank became its wholly-owned subsidiary. The Company's administrative headquarters is based in Fresno, California.

The Bank is incorporated in the state of California and organized as a single operating segment that operates one full-service office in Fresno, California. The Bank's primary source of revenue is providing loans to customers, who are predominately small and middle-market businesses and individuals.

Subsequent Events: The Company has evaluated the effects of subsequent events that have occurred after the period ending December 31, 2016 and through March 28, 2017, which is the date the consolidated financial statements were available to be issued.

Consolidation: The consolidated financial statements include the accounts of Communities First Financial Corporation and its wholly owned subsidiary, Fresno First Bank. Intercompany accounts and transactions have been eliminated in consolidation.

Use of Estimates: In preparing consolidated financial statements in conformity with generally accepted accounting principles, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities, and the disclosure of contingent assets and liabilities at the date of the consolidated financial statements, and revenues and expenses during the reported year. Actual results could differ from those estimates.

Concentrations of Credit Risk: Assets and liabilities that subject the Company to concentrations of credit risk consist of cash balances at other banks, loans, and deposits. Most of the Company's customers are located within Fresno County and the surrounding areas. The Company's primary lending products are discussed in Note 3 to the consolidated financial statements. The Company did not have any significant concentrations in its business with any one customer or industry. The Company obtains what it believes to be sufficient collateral to secure potential losses on loans. The extent and value of collateral varies based on the details underlying each loan agreement.

As of December 31, 2016 and 2015, the Company has cash deposits at other financial institutions in excess of FDIC insured limits. However, as the Company places these deposits with major financial institutions and monitors the financial condition of these institutions, management believes the risk of loss to be minimal. Banking regulations require that banks maintain a percentage of their deposits as reserves in cash or on deposit with the Federal Reserve Bank. The Company complied with the reserve requirements as of December 31, 2016 and 2015.

Cash and Cash Equivalents: For purposes of reporting cash flows, cash equivalents include cash, due from banks, interest-bearing deposits in financial institutions with maturities of 90 days or less, and federal funds sold. Generally, federal funds are sold for one-day periods and interest-bearing deposits are for periods of 90 days or less.

(Continued)

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Securities Available-For-Sale: Available-for-sale securities consist of U.S. Treasury securities, U.S. agency securities, obligations of states and political subdivisions, obligations of U.S. corporations, mortgage-backed securities, and other securities not classified as trading securities or held-to-maturity securities. These securities are carried at estimated fair value with unrealized holding gains and losses, net of tax, reported as a separate component of accumulated other comprehensive income, until realized. Gains and losses on the sale of available-for-sale securities are determined using the specific identification method. The amortization of premiums and accretion of discounts are recognized as adjustments to interest income using the interest method over the period to call or maturity.

Investments with fair values that are less than amortized cost are considered impaired. Impairment may result from either a decline in the financial condition of the issuing entity or, in the case of fixed interest rate investments, from rising interest rates. At each financial statement date, management assesses each investment to determine if impaired investments are temporarily impaired or if the impairment is other than temporary. This assessment includes a determination of whether the Company intends to sell the security, or if it is more likely than not that the Company will be required to sell the security before recovery of its amortized cost basis less any current-period credit losses. For debt securities that are considered other than temporarily impaired and that the Company does not intend to sell and will not be required to sell prior to recovery of the amortized cost basis, the amount of impairment is separated into the amount that is credit related (credit loss component) and the amount due to all other factors.

The credit loss component is recognized in earnings and is calculated as the difference between the security's amortized cost basis and the present value of its expected future cash flows. The remaining difference between the security's fair value and the present value of the future expected cash flows is deemed to be due to factors that are not credit related and is recognized in other comprehensive income.

Loans: Loans are reported at the principal amount outstanding, net of deferred loan fees and costs and the allowance for loan losses. Unearned discounts on installment loans are recognized as income over the terms of the loans. Interest on other loans is calculated by using the simple interest method on the daily balance of the principal amount outstanding.

Loan fees, net of certain direct costs of origination, are deferred and amortized over the contractual term of the loan as an adjustment to the interest yield. During the years ended December 31, 2016 and 2015, salaries and employee benefits expense totaling $125,208 and 75,215, respectively, were deferred as loan origination costs.

Loans on which the accrual of interest has been discontinued are designated as non-accrual loans. Accrual of interest on loans is discontinued either when reasonable doubt exists as to the full and timely collection of interest or principal or when a loan becomes contractually past due by 90 days or more with respect to interest or principal. When a loan is placed on non-accrual status, all interest previously accrued, but not collected, is reversed against current period interest income. Income on such loans is then recognized only to the extent that cash is received and where the future collection of principal is probable. Interest accruals are resumed on such loans only when they are brought fully current with respect to interest and principal and when, in the judgment of management, the loans are estimated to be fully collectible as to both principal and interest.

(Continued)

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Allowance for loan losses: The allowance for loan losses is established through a provision for loan losses charged to operations. Loan losses are charged against the allowance for loan losses when management believes that the collectability of the principal is unlikely. Subsequent recoveries of previously charged off amounts, if any, are credited to the allowance.

Management employs a systematic methodology for determining the allowance for loan losses. On a regular basis, management reviews the credit quality of the loan portfolio and considers problem and delinquent loans, existing general economic conditions affecting the key lending areas of the Company, credit quality trends, collateral values, loan volumes and concentrations, seasoning of the loan portfolio, specific industry conditions, recent loss experience, duration of the current business cycle, bank regulatory examination results, and findings of the Company's internal credit examiners. The allowance for loan losses at December 31, 2016 and 2015 reflects management's estimate of probable incurred losses in the portfolio. This evaluation is inherently subjective as it requires estimates that are susceptible to significant revision as more information becomes available.

The allowance consists of specific, general, and unallocated components. The specific component relates to loans that are classified as impaired. Impaired loans, as defined, are measured based on the present value of expected future cash flows discounted at the loan's effective interest rate or the fair value of the collateral if the loan is collateral dependent. The general component relates to non-impaired loans and is based on historical loss experience and loss history experienced by the Company's peers when the Company did not have losses in a particular loan class, adjusted for qualitative factors impacting the loan portfolio. An unallocated component is maintained to cover uncertainties that could affect management's estimate of probable losses. The unallocated component of the allowance reflects the margin of imprecision inherent in the underlying assumptions used in the methodologies for estimating specific and general losses in the portfolio.

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

Troubled Debt Restructuring: In situations where, for economic or legal reasons related to a borrower's financial difficulties, the Company grants a concession to the borrower that it would not otherwise consider, the related loan is classified as a troubled debt restructuring. The Company measures any loss on the troubled debt restructuring in accordance with the guidance concerning impaired loans set forth above. Additionally, loans modified in troubled debt restructurings are generally placed on non-accrual status at the time of restructuring. These loans are returned to accrual status after the borrower demonstrates performance with the modified terms for a sustained period of time (generally six months) and has the capacity to continue to perform in accordance with the modified terms of the restructured debt.

(Continued)

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Correspondent Bank Stock: The Company is a member of the Federal Home Loan Bank (FHLB) system. Members are required to own a certain amount of stock based on the level of borrowings and other factors, and may invest in additional amounts. The Bank held stock in the FHLB totaling $1,128,100 and $1,024,400 at December 31, 2016 and 2015, respectively. FHLB stock is carried at cost, classified as a restricted security, and periodically evaluated for impairment based on the ultimate recovery of par value. Both cash and stock dividends are reported as income. FHLB stock was not considered impaired as of December 31, 2016 and 2015. The remaining balance in the correspondent bank stock account on the consolidated balance sheet includes The Independent Bankers Bank (TIB) stock of $228,137 and $224,775 and Pacific Coast Bankers' Bank (PCBB) stock of $400,000 and $400,000 at December 31, 2016 and 2015, respectively. TIB and PCBB stock are carried at cost and were not considered impaired as of December 31, 2016 and 2015.

Premises and Equipment: Premises and equipment are carried at cost less accumulated depreciation and amortization. Depreciation is computed using the straight-line method over the estimated useful lives, which range from three to seven years for computer equipment, equipment, furniture, and fixtures. Leasehold improvements are amortized using the straight-line method over the estimated useful lives of the improvements or the remaining lease term, whichever is shorter. Expenditures for betterments or major repairs are capitalized and those for ordinary repairs and maintenance are charged to operations as incurred.

Advertising Costs: The Company expenses the costs of advertising in the year incurred. Advertising expense was $184,438 and $278,562 for the years ended December 31, 2016 and 2015, respectively.

Other Real Estate Owned: Real estate acquired by foreclosure or deed in lieu of foreclosure is recorded at fair value at the date of foreclosure, establishing a new cost basis by a charge to the allowance for loan losses, if necessary. Fair value is based on current appraisals less estimated selling costs. Any subsequent write-downs are charged against operating expenses and recognized as a valuation allowance. Operating expenses of such properties, net of related income, and gains and losses on their disposition are included in other operating expenses.

Loans Held For Sale: Loans held for sale include mortgage loans and are reported at the lower of cost or market value. Cost generally approximates market value, given the short duration of these assets. Gains or losses on the sale of loans that are held for sale are recognized at the time of the sale, subject to the expiration of any warranty or recourse provisions, and determined by the difference between net sale proceeds and the net book value of the loans, plus the estimated fair value of any retained mortgage servicing rights, less the estimated discount associated with the unguaranteed portion of the sold loan that is retained. As of December 31, 2016 and 2015 there were no loans held for sale.

Income Taxes: The Company uses the asset and liability method to account for income taxes. Under such method, deferred tax assets and liabilities are recognized for the future tax consequences of differences between the consolidated financial statement carrying amounts of existing assets and liabilities and their respective tax basis (temporary differences). Deferred tax assets and liabilities are reflected at currently enacted income tax rates applicable to the period in which the deferred tax assets or liabilities are expected to be realized or settled. As changes in tax laws or rates are enacted, deferred tax assets and liabilities are adjusted through the provision for income taxes in the period of enactment.

A valuation allowance against net deferred tax assets is established to the extent that it is more likely than not that the benefits associated with the deferred tax assets will not be fully realized.

In accordance with accounting standards, the Company has assessed its tax positions and has concluded there are no unrecognized tax benefits at December 31, 2016 and 2015.

(Continued)

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

The Company recognizes interest accrued and penalties related to unrecognized tax benefits in tax expense. During the years ended December 31, 2016 and 2015, the Company recognized no interest and penalties.

The Company files a consolidated tax return in the U.S. federal jurisdiction and with the state of California and has a tax sharing agreement with the Bank. The Company is subject to U.S. federal and state income tax examinations by tax authorities for years beginning 2011.

<u>Comprehensive Income</u>: Changes in unrealized gains and losses on available-for-sale securities are the only component of accumulated other comprehensive income for the Company.

<u>Fair Value Measurement</u>: Fair value is the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. Current accounting guidance establishes a fair value hierarchy, which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. The guidance describes three levels of inputs that may be used to measure fair value:

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 a liability.

See Note 14 for more information and disclosures relating to the Company's fair value measurements.

<u>Financial Instruments</u>: In the ordinary course of business, the Company has entered into off-balance sheet financial instruments consisting of commitments to extend credit, commercial letters of credit, and standby letters of credit as described in Note 11. Such financial instruments are recorded in the consolidated financial statements when they are funded or related fees are incurred or received.

<u>Earnings Per Share (EPS)</u>: Basic EPS excludes dilution and is computed by dividing income available to common stockholders by the weighted-average number of common shares outstanding for the period. Diluted EPS reflects the potential dilution that could occur if securities or other contracts to issue common stock, such as stock options, were exercised or converted into common stock or resulted in the issuance of common stock that then shared in the earnings of the entity. The treasury stock method is applied to determine the dilutive effect of stock options when computing diluted earnings per share. The dilutive effect of convertible preferred stock is calculated using the "if-converted method." Under the if-converted method, securities are assumed to be converted at the beginning of the period, and the resulting common shares are included in the denominator of the diluted EPS calculation for the entire period being presented. Dividends on convertible securities are added back to the numerator for purposes of the if-converted calculation.

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Stock-Based Compensation: The Company recognizes the cost of employee services received in exchange for awards of stock options, or other equity instruments, based on the grant-date fair value of those awards. This cost is recognized over the period that an employee is required to provide services in exchange for the award, generally the vesting period. See Note 12 for additional information on the Company's stock option plan.

Transfers of Financial Assets: Transfers of financial assets are accounted for as sales when control over the assets has been surrendered. Control over transferred assets is deemed to be surrendered when: (1) the assets have been isolated from the Company, (2) the transferee obtains the right (free of conditions that constrain it from taking advantage of that right) to pledge or exchange the transferred assets, and (3) the Company does not maintain effective control over the transferred assets through an agreement to repurchase them before their maturity.

Servicing Rights: The Company sells or transfers loans, including the guaranteed portion of various government agencies' loans (with servicing retained) for cash proceeds equal to the principal amount of loans, as adjusted to yield interest to the investor based upon the current market rates. The Company records an asset representing the right to service a loan for others when it sells a loan and retains the servicing rights. The carrying value of the loan is allocated between the loan and the servicing rights, based on their relative fair values. The fair value of servicing rights is estimated by discounting estimated future cash flows from servicing using discount rates that approximate current market rates and estimated prepayment rates.

The servicing rights are initially measured at fair value and amortized in proportion to and over the period of the estimated net servicing income assuming prepayments. Additionally, management assesses the servicing rights for impairment as of each financial reporting date. For purposes of evaluating and measuring impairment, servicing rights are based on a discounted cash flow methodology, current prepayment speeds, and market discount rates. Any impairment is measured as the amount by which the carrying value of servicing rights for a stratum exceeds its fair value. The carrying value of servicing rights at December 31, 2016 and 2015 were $211,112 and $209,615, respectively. No impairment charges were recorded for the years ended December 31, 2016 or 2015 related to servicing assets.

Reclassifications: Certain reclassifications have been made to the 2015 consolidated financial statements to conform to the classifications used in 2016.

(Continued)

NOTE 2 – INVESTMENT SECURITIES

The amortized cost and estimated fair values of securities available-for-sale are as follows:

	2016			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Available-for-sale:				
U.S. government and agency securities	$ 26,734,673	$ 316,034	$ (61,966)	$ 26,988,741
Mortgage-backed securities	24,589,003	85,338	(230,683)	24,443,658
State and municipal agencies	14,796,788	192,351	(129,573)	14,859,566
	$ 66,120,464	$ 593,723	$ (422,222)	$ 66,291,965

	2015			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Available-for-sale:				
U.S. government and agency securities	$ 31,047,522	$ 353,945	$ (70,535)	$ 31,330,932
Mortgage-backed securities	23,751,827	127,853	(77,180)	23,802,500
State and municipal agencies	13,362,258	286,933	(7,529)	13,641,663
	$ 68,161,607	$ 768,731	$ (155,244)	$ 68,775,094

The amortized cost and estimated fair value of all investment securities as of December 31, 2016 by contractual maturities are shown below. Expected maturities may differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

	Amortized	Estimated Fair Value
Within One Year	$ 602,568	$ 602,984
One to Five Years	17,469,785	17,599,995
Five to Ten Years	16,729,709	16,500,138
Beyond Ten Years	31,318,402	31,588,848
	$ 66,120,464	$ 66,291,965

(Continued)

NOTE 2 – INVESTMENT SECURITIES (Continued)

The gross unrealized loss and related estimated fair value of investment securities that have been in a continuous loss position for less than twelve months and over twelve months are as follows:

	12 months or more		less than 12 Months		Total	
2016	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
U.S. government and agency securities	$ 3,182,873	$ (22,234)	$ 6,999,060	$ (39,731)	$ 10,181,933	$ (61,965)
Mortgage backed securities	966,765	(28,822)	13,625,902	(201,861)	14,592,667	(230,683)
State and municipal agencies	-	-	5,558,961	(129,574)	5,558,961	(129,574)
	$ 4,149,638	$ (51,056)	$ 26,183,923	$ (371,166)	$ 30,333,561	$ (422,222)

	12 months or more		less than 12 Months		Total	
2015	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
U.S. government and agency securities	$ 2,441,973	$ (20,078)	$ 6,519,084	$ (50,457)	$ 8,961,057	$ (70,535)
Mortgage-backed securities	961,182	(32,368)	23,802,500	(44,812)	24,763,682	(77,180)
State and municipal agencies	-	-	1,389,235	(7,529)	1,389,235	(7,529)
	$ 3,403,155	$ (52,446)	$ 31,710,819	$ (102,798)	$ 35,113,974	$ (155,244)

Certain investment securities shown in the previous table currently have fair values less than amortized cost and therefore contain unrealized losses. The Bank considers a number of factors including, but not limited to: (a) the length of time and the extent to which the fair value has been less than the amortized cost, (b) the financial condition and near-term prospects of the issuer, (c) the intent and ability of the Bank to retain its investment for a period of time sufficient to allow for an anticipated recovery in value, (d) whether the debtor is current on interest and principal payments, and (e) general market conditions and the industry-or sector-specific outlook. Management has evaluated all securities at December 31, 2016 and 2015 and has determined that no securities are other than temporarily impaired.

The Bank does not have the intent to sell the investments that are impaired, and it is more likely than not that the Bank will not be required to sell those investments before recovery of the amortized cost basis. The Bank has evaluated these securities and has determined that the decline in value is temporary and is related to the change in market interest rates since purchase. The decline in value is not related to any issuer or industry-specific event. These temporary unrealized losses relate principally to current interest rates for similar types of securities. In analyzing an issuer's financial condition, management considers whether the securities are issued by the federal government or its agencies, whether downgrades by bond rating agencies have occurred, and the results of reviews of the issuer's financial condition. At December 31, 2016, there were 12 investment securities with a value of $4,150,000 that were in a loss position for more than 12 months. At December 31, 2015, there were 11 investment securities with a value of $3,403,000 that were in a loss position for more than 12 months. The Bank anticipates full recovery of amortized cost with respect to these securities at maturity or sooner in the event of a more favorable market interest rate environment.

(Continued)

NOTE 2 – INVESTMENT SECURITIES (Continued)

Proceeds from the sales of investment securities totaled $0 and $2,364,599 during the years ended December 31, 2016 and 2015, respectively. Gross realized gains totaled $7,569 and $78,808 during 2016 and 2015, respectively. Gross realized losses totaled $0 and $10,523 during 2016 and 2015, respectively.

Investment securities carried at approximately $15,031,000 and $16,632,000 at December 31, 2016 and 2015, respectively, were pledged to secure public deposits or other purposes as permitted or required by law.

NOTE 3 – LOANS

Major classifications of loans are as follows:

	2016	2015
Commercial and industrial	$ 100,488,896	$ 74,910,256
Commercial real estate	76,560,970	63,534,864
Land and construction	14,086,527	11,823,378
Residential real estate	13,643,268	15,069,169
Agriculture	22,869,834	23,232,211
Consumer	12,791	37,611
	227,662,286	188,607,489
Allowance for loan losses	(2,880,223)	(3,556,390)
Deferred loan fees and costs, net	(426,728)	(212,051)
	$ 224,355,335	$ 184,839,048

The Bank's loan portfolio consists primarily of loans to borrowers within Fresno County, California.

All of the Bank's loans are underwritten by evaluating the borrower's character, cash flow, collateral, and credit worthiness and, for commercial and business loans, managerial and operational experience. Underwriting standards are designed to promote relationship banking rather than transactional banking.

Commercial and industrial loans are primarily made to commercial and business entities for working capital, equipment purchases, growth and expansion, and any other permissible purposes. The Bank's management examines current and projected cash flows to determine the ability of the borrower to repay its obligations as agreed. Commercial loans are primarily made based on the identified cash flows of the borrower and secondarily on the underlying collateral provided by the borrower. The cash flows of borrowers, however, may not be as expected and the collateral securing these loans may fluctuate in value. Most commercial loans are secured by the assets being financed or other business assets such as equipment, accounts receivable, or inventory and may incorporate personal guarantees or personal assets as collateral; however, some loans may be made on an unsecured basis.

(Continued)

NOTE 3 – LOANS (Continued)

Commercial real estate loans are primarily made to owner-users of the property or investors with current tenants in the property. Commercial real estate loans are subject to underwriting standards and processes similar to commercial loans. These loans are viewed primarily as cash flow loans and secondarily as loans secured by real estate. Commercial real estate lending typically involves higher loan principal amounts and the repayment of these loans is generally largely dependent on the successful operation of the property securing the loan or the business conducted on the property securing the loan. Commercial real estate loans may be more adversely affected by conditions in the real estate markets or in the general economy. The properties securing the Bank's commercial real estate portfolio are diverse in terms of type and industries operating within the properties. This diversity helps reduce the Bank's exposure to adverse economic events that affect any single market or industry. Management monitors and evaluates commercial real estate loans based on collateral type, geography, industry, and risk grade criteria.

Land and construction loans are primarily made to borrowers who are using the property for their own purposes. Land loans are made with amortizing repayment terms to borrowers with proven, historic cash flow sufficient to repay the loan. Collateral values are based on the current "as is" market value of the property. Construction loans are made based on the borrower's historic and projected cash flow. Risk arises from the necessity to complete projects within specified cost and time limits. Trends in the construction industry may also impact the credit quality of these loans, as demand drives construction activity. In addition, trends in real estate values significantly impact the credit quality of these loans, as property values determine the economic viability of future construction projects.

Residential real estate loans are made to individuals for the purchase or refinance of residential 1-to-4 family properties for investment purposes. Residential real estate loans are underwritten similar to commercial and industrial and commercial real loans. Residential real estate loans may be more adversely affected by conditions in the real estate markets or in the general economy.

Agricultural loans are primarily made to producers of agricultural products. Agricultural loans are subject to underwriting standards and processes similar to commercial loans. These loans are viewed primarily as cash flow loans and secondarily as loans secured by real estate and/or agricultural commodities. Agricultural real estate lending typically involves higher loan principal amounts and the repayment of these loans is generally largely dependent on the successful operation of the property securing the loan or the business conducted on the property securing the loan. Agricultural crop loans may be more adversely affected by conditions in the weather or in the general economy. The properties securing the Bank's agricultural portfolio are diverse in terms of type of crop. This diversity helps reduce the Bank's exposure to adverse economic events that affect any single commodity. Management monitors and evaluates agricultural real estate loans based on collateral, crop type, geography, and risk grade criteria.

The Bank utilizes an independent third party loan review consultant to review and validate the credit risk program on a periodic basis. Results of these reviews are presented to management and the Bank's Board of Directors. The loan review process complements and reinforces the risk identification and assessment decisions made by lenders and credit personnel, as well as the Bank's policies and procedures

(Continued)

NOTE 3 – LOANS (Continued)

Information related to impaired loans as of December 31, 2016 and for the year ended consisted of the following:

	Commercial and Industrial	Commercial Real Estate	Land and Construction	Residential Real Estate	Agriculture	Consumer	Total
Recorded investment in impaired loans:							
With no specific allowance recorded	$ -	$ -	$ -	$ -	$ -	$ -	$ -
With specific allowance recorded	325,660	-	-	-	-	-	325,660
Total recorded investment In impaired loans	$ 325,660	$ -	$ -	$ -	$ -	$ -	$ 325,660
Unpaid principal balance of impaired loans:							
With no specific allowance recorded	$ -	$ -	$ -	$ -	$ -	$ -	$ -
With specific allowance recorded	325,660	-	-	-	-	-	325,660
Total unpaid principal balance of impaired loans	$ 325,660	$ -	$ -	$ -	$ -	$ -	$ 325,660
Specific allowance	$ 15,227	$ -	$ -	$ -	$ -	$ -	$ 15,227
Average recorded investment in impaired loans during the year	$ 540,877	$ -	$ -	$ -	$ -	$ -	$ 540,877
Interest income recognized on impaired loans during the year	$ -	$ -	$ -	$ -	$ -	$ -	$ -

Information related to impaired loans as of December 31, 2015 and for the year ended consisted of the following:

	Commercial and Industrial	Commercial Real Estate	Land and Construction	Residential Real Estate	Agriculture	Consumer	Total
Recorded investment in impaired loans:							
With no specific allowance recorded	$ 1,081,923	$ -	$ -	$ -	$ -	$ -	$ 1,081,923
With a specific allowance recorded	1,278,630	-	-	-	-	-	1,278,630
Total recorded investment in impaired loans	$ 2,360,553	$ -	$ -	$ -	$ -	$ -	$ 2,360,553
Unpaid principal balance of impaired loans:							
With no specific allowance recorded	$ 1,081,923	$ -	$ -	$ -	$ -	$ -	$ 1,081,923
With a specific allowance recorded	1,278,630	-	-	-	-	-	1,278,630
Total unpaid principal balance of impaired loans	$ 2,360,553	$ -	$ -	$ -	$	$ -	$ 2,360,553
Specific allowance	$ 1,278,630	$ -	$	$ -	$ -	$ -	$ 1,278,630
Average recorded investment in impaired loans during the year	$ 1,794,910	$ 392,112	$ -	$ -	$ -	$ -	$ 2,187,022
Interest income recognized on impaired loans during the year	$ -	$ 14,626	$ -	$ 1	$ -	$ -	$ 14,627

(Continued)

NOTE 3 – LOANS (Continued)

The Bank has established a loan risk rating system to measure and monitor the quality of the loan portfolio. All loans are assigned a risk rating from the inception of the loan until the loan is paid off. The primary loan grades are as follows:

Loans rated Pass – These are loans to borrowers with satisfactory financial support, repayment capacity, and credit strength. Borrowers in this category demonstrate fundamentally sound financial positions, repayment capacity, credit history, and management expertise. Loans in this category must have an identifiable and stable source of repayment and meet the Bank's policy regarding debt service coverage ratios. These borrowers are capable of sustaining normal economic, market, or operational setbacks without significant financial impacts. Financial ratios and trends are acceptable. Negative external industry factors are generally not present. The loan may be secured, unsecured, or supported by non-real estate collateral for which the value is more difficult to determine and/or marketability is more uncertain. These loans carry a normal degree of risk. The borrowers have the capacity to perform according to terms; any deviation from historic performance is limited and temporary.

Loans rated Special Mention – These are loans that have potential weaknesses that deserve management's close attention. If left uncorrected, these potential weaknesses may result in deterioration of the repayment prospects for the asset or in the Bank's credit position at some future date. Special Mention assets are not adversely classified and do not expose the Bank to sufficient risk to warrant adverse classification. These loans exhibit a more weakened condition than Pass loans, but not to the degree where they would be considered substandard. These loans show definite signs of deterioration or weakness, and the likelihood of correction is somewhat questionable. Weaknesses might include significant earnings decline, collection of accounts receivable is slowing, delayed accounts payable, greater dependency on line usage, and covenants not being met and/or waived for short periods.

Loans rated Substandard – These are loans that are inadequately protected by the current sound worth and paying capacity of the borrower or by the collateral pledged, if any. These loans have a well-defined weakness or weaknesses that jeopardize the liquidation of the loan. They are characterized by the distinct possibility that the Bank will sustain some loss if the deficiencies are not corrected.

Loans rated Doubtful – These are loans that have all the weaknesses inherent in a loan classified as Substandard with the added characteristic that the weaknesses make the collection or liquidation in full, on the basis of currently known facts, conditions and values, highly questionable, and improbable. These loans have a high probability of loss due to significant deterioration in financial condition of the borrower and collateral value pledged, if any. The borrower is unable to demonstrate the ability to strengthen their financial condition within a reasonable time; therefore, close supervision is required and the loan is placed on non-accrual. The risk of loss is measured by an impairment analysis; any loss exposure determined through this analysis is to be charged off.

(Continued)

NOTE 3 – LOANS (Continued)

The following table summarizes the loan portfolio by credit quality and product and/or collateral type as of December 31, 2016:

	Pass	Special Mention	Substandard	Doubtful	Total
Grade:					
Commercial & industrial	$ 100,042,403	$ -	$151,493	$295,000	$100,488,896
Commercial real estate	76,560,970	-	-	-	76,560,970
Land & construction	13,798,468	288,059	-	-	14,086,527
Residential real estate	13,350,771	-	292,497	-	13,643,268
Agriculture	19,499,618	3,370,216	-	-	22,869,834
Consumer	12,791	-	-	-	12,791
Total	$ 223,265,021	$ 3,658,275	$ 443,990	$ 295,000	$227,662,286

The following table summarizes the loan portfolio by credit quality and product and/or collateral type as of December 31, 2015:

	Pass	Special Mention	Substandard	Doubtful	Total
Grade:					
Commercial and industrial	$ 72,207,229	$ -	$ 342,474	$ 2,360,553	$ 74,910,256
Commercial real estate	63,534,864	-	-	-	63,534,864
Land and construction	11,823,378	-	-	-	11,823,378
Residential real estate	14,775,364	-	293,804	-	15,069,169
Agriculture	23,232,211	-	-	-	23,232,211
Consumer	37,613	-	-	-	37,613
Total	$ 185,610,658	$ -	$ 636,279	$ 2,360,553	$ 188,607,489

Year-end non-accrual loans, segregated by class, are as follows:

	2016	2015
Commercial and industrial	$ 295,000	$ 2,360,553
Commercial real estate	-	-
Land and construction	-	-
Residential real estate	-	-
Agriculture	-	-
Consumer	-	-
	$ 295,000	$ 2,360,553

(Continued)

NOTE 3 – LOANS (Continued)

The following table is an aging analysis of loans, segregated by class of loans, as of December 31, 2016:

	30-59 Days Past Due	60-89 Days Past Due	Greater Than 90 Days	Total Past Due	Current	Total Loans	Recorded Investment> 90 Days and Accruing
Commercial & Industrial	$ -	$ -	$ 295,000	$ 295,000	$ 100,193,896	$ 100,488,896	$ -
Commercial Real Estate	-	-	-	-	76,560,970	76,560,970	-
Land & Construction	-	-	-	-	14,086,527	14,086,527	-
Residential Real Estate	-	-	-	-	13,643,268	13,643,268	-
Agriculture	-	-	-	-	22,869,834	22,869,834	-
Consumer	-	-	-	-	12,791	12,791	-
Total	$ -	$ -	$ 295,000	$ 295,000	$ 227,367,286	$ 227,662,286	$ -

The following table is an aging analysis of loans, segregated by class of loans, as of December 31, 2015:

	30-59 Days Past Due	60-89 Days Past Due	Greater Than 90 Days	Total Past Due	Current	Total Loans	Recorded Investment> 90 Days and Accruing
Commercial and industrial	$ -	$ -	$ 2,360,553	$ 2,360,553	$ 72,549,703	$ 74,910,256	$ -
Commercial real estate	-	-	-	-	63,534,864	63,534,864	-
Land and construction	-	-	-	-	11,823,378	11,823,378	-
Residential real estate	-	-	-	-	15,069,169	15,069,169	-
Agriculture	-	-	-	-	23,232,211	23,232,211	-
Consumer	-	-	-	-	37,613	37,613	-
Total	$ -	$ -	$ 2,360,553	$ 2,360,553	$ 188,607,489	$ 188,607,489	$ -

The following table shows the loans, segregated by class that were modified and considered troubled debt restructurings during 2016:

	2016		
	Number of Contracts	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment
Commercial and industrial	1	$ 30,983	$ 30,983
Commercial real estate	-	-	-
Land and construction	-	-	-
Residential real estate	-	-	-
Agriculture	-	-	-
Consumer	-	-	-
Total	1	$ 30,983	$ 30,983

The troubled debt restructuring described above increased the allowance for loan losses by approximately $1,190,000. During 2015, there were no loans that were modified and considered troubled debt restructurings. During 2016 there were no troubled debt restructurings for which there was a payment default within twelve months following the modification date.

The Bank has not committed to lend any additional amounts to customers with outstanding loans that are classified as troubled debt restructurings.

(Continued)

NOTE 3 – LOANS (Continued)

The following table summarizes the Bank's allowance for loan losses for the year ended December 31, 2016 by loan product and collateral type:

	Commercial and Industrial	Commercial Real Estate	Land and Construction	Residential Real Estate	Agriculture	Consumer	Unallocated	Total
Allowance for loan losses:								
Beginning balance	$ 2,419,315	$ 338,650	$ 239,097	$ 89,282	$ 149,327	$ 322	$ 320,397	$ 3,556,390
Charge-offs	(1,961,105)	-	-	-	-	(2,200)	-	(1,963,305)
Recoveries	21,138	-	-	-	-	-	-	21,138
Provision	1,402,172	118,734	(9,248)	(18,772)	(32,472)	1,948	(196,362)	1,266,000
Ending balance	$ 1,881,520	$ 457,384	$ 229,849	$ 70,510	$ 116,855	$ 70	$ 124,035	$ 2,880,223
Period-end amount allocated to:								
Loans individually evaluated for impairment	$ 15,433	$ -	$ -	$ -	$ -	$ -	$ -	$ 15,433
Loans collectively evaluated for impairment	1,866,087	457,384	229,849	70,510	116,855	70	124,035	2,864,790
Ending Balance	$ 1,881,520	$ 457,384	$ 229,849	$ 70,510	$ 116,855	$ 70	$ 124,035	$ 2,880,223
Loans:								
Individually evaluated for impairment	$ 325,660	$ -	$ -	$ -	$ -	$ -	$ -	$ 325,660
Collectively evaluated for impairment	100,163,236	76,560,970	14,086,527	1 3,643,268	22,869,834	12,791	-	227,336,626
Ending balance	$100,488,896	$ 76,560,970	$ 14,086,527	$ 13,643,268	$ 22,869,834	$ 12,791	$ -	$227,662,286

(Continued)

NOTE 3 – LOANS (Continued)

The following table summarizes the Bank's allowance for loan losses for the year ended December 31, 2015 by loan product and collateral type:

	Commercial and Industrial	Commercial Real Estate	Land and Construction	Residential Real Estate	Agriculture	Consumer	Unallocated	Total
Allowance for loan losses:								
Beginning balance	$ 1,534,337	$ 784,357	$ 93,730	$ 133,240	$ 168,870	$ 244	$ 328,084	$ 3,042,862
Charge-offs	(66,156)	-	-	-	-	-	-	(66,156)
Recoveries	242,158	-	-	67,526	-	-	-	309,684
Provision	708,976	(445,707)	145,367	(111,484)	(19,543)	78	(7,687)	270,000
Ending balance	$ 2,419,316	$ 338,650	$ 239,097	$ 89,282	$ 149,327	$ 322	$ 320,397	$ 3,556,390
Period-end amount allocated to:								
Loans individually evaluated for impairment	$ 1,278,630	$ -	$ -	$ -	$ -	$ -	$ -	$ 1,278,630
Loans collectively evaluated for impairment	1,140,685	338,650	239,097	89,282	149,327	322	320,397	2,277,760
Ending balance	$ 2,419,315	$ 338,650	$ 239,097	$ 89,282	$ 149,327	$ 322	$ 320,397	$ 3,556,390
Loans:								
Individually evaluated for impairment	$ 2,360,553	$ -	$ -	$ -	$ -	$ -	$ -	$ 2,360,553
Collectively evaluated for impairment	72,549,703	63,534,864	11,823,378	15,069,169	23,232,211	37,613	-	186,246,936
Ending balance	$ 74,910,256	$ 63,534,864	$ 11,823,378	$ 15,069,169	$ 23,232,211	$ 37,613	$ -	$188,607,489

(Continued)

NOTE 4 – PREMISES AND EQUIPMENT

A summary of premises and equipment is as follows:

	2016	2015
Leasehold improvements	$ 1,220,352	$ 1,217,831
Furniture, fixtures, and equipment	598,887	585,392
Computer equipment	863,059	780,861
	2,682,298	2,584,085
Less accumulated depreciation and amortization	(2,514,568)	(2,416,521)
	$ 167,730	$ 167,564

In January 2016 the Bank exercised the first of two potential five-year lease extensions for its main banking and administrative offices. The Bank is responsible for common area maintenance, taxes, and insurance to the extent they exceed the base year amounts. The current lease extension expires on January 31, 2021. In August 2016 the Bank entered into a new lease for additional office space in a building adjacent to the main office. The lease term is for four years and will commence in March 2017 and will expire in 2021.

At December 31, 2016, the future lease rental payable under non-cancellable operating lease commitments for the Bank's main and administrative offices were as follows:

2017	$ $428,210
2018	449,418
2019	458,278
2020	468,209
2021	39,087
Thereafter	-
	$ 1,843,202

The minimum rental payments shown above are given for the existing lease obligations and are not a forecast of future rental expense. Total rental expense was approximately $333,726 and $308,248 for the years ended December 31, 2016 and 2015 respectively.

NOTE 5 – DEPOSITS

Customer deposits were as follows:

	2016	2015
Non-interest-bearing demand	$ 169,538,554	$ 120,303,379
Savings, NOW, and money market accounts	119,954,916	108,488,276
Time deposits under $250,000	24,611,921	23,721,883
Time deposits $250,000 and over	18,225,313	15,597,772
	$ 332,330,704	$ 268,111,310

(Continued)

NOTE 5 – DEPOSITS (Continued)

At December 31, 2016, the scheduled maturities of time deposits are as follows:

2017	$ 36,480,075
2018	4,234,508
2019	490,890
2020	563,611
2021	1,068,151
Thereafter	-
	$ 42,837,234

NOTE 6 – BORROWING ARRANGEMENTS

The Bank may borrow up to $22,000,000 overnight on an unsecured basis from three correspondent banks. The Bank may also borrow up to approximately $90,000,000 from the Federal Home Loan Bank of San Francisco, subject to providing collateral and fulfilling other conditions of the credit facility. The Bank has pledged investment securities of approximately $15,031,000 for the credit facility at Federal Home Loan Bank of San Francisco. The Bank may also borrow from the Federal Reserve Bank of San Francisco, subject to fulfilling other conditions of the credit facility and providing collateral. As of December 2016 and 2015, no amounts were outstanding under these arrangements.

The Company has a line of credit with TIB under which it can borrow up to $7,500,000 for general corporate purposes. The line is secured by a pledge of the underlying stock the Company holds of Fresno First Bank. As of December 31, 2016, there was no amount outstanding under this arrangement.

NOTE 7 – EMPLOYEE BENEFITS

The Company sponsors an employee stock ownership plan (ESOP) for eligible employees. Eligibility begins after an employee has attained the age of 21 and completed one year of service, as defined in the ESOP documents. Under the ESOP, the Company contributes a discretionary amount to the ESOP for the purchase of the Company's stock, to be held in trust for each participant to be distributed later in accordance with the ESOP. For the years ended December 31, 2016 and 2015, contributions to the ESOP were $237,252 and $185,560, respectively. The ESOP held 103,069 and 111,413 shares of common stock as of December 31, 2016 and 2015, respectively and there were no unearned shares of common stock held by the ESOP at December 31, 2016 and 2015.

The Company sponsors a 401(k) plan for the benefit of its employees. The Company can match employee contributions and make additional contributions annually as determined by the Board of Directors. The Company made no contributions for the years ended December 31, 2016 and 2015.

(Continued)

NOTE 8 – INCOME TAXES

The provision for income taxes for the years ended December 31 consists of the following:

	2016	2015
Current		
Federal	$ 1,387,000	$ 1,433,000
State	491,000	337,000
	1,878,000	1,770,000
Deferred		
Federal	112,000	(240,000)
State	57,000	132,000
	169,000	(108,000)
Reversal of valuation allowance	-	(66,000)
Provision	$ 2,047,000	$ 1,596,000

Deferred taxes are a result of differences between income tax accounting and generally accepted accounting principles with respect to income and expense recognition.

The following is a summary of the components of the net deferred tax asset accounts included in interest receivable and other assets in the accompanying consolidated balance sheets at December 31:

	2016	2015
Deferred tax assets:		
Pre-operating expenses	$ 68,000	$ 86,000
Depreciation differences	301,000	319,000
Allowance for loan losses due to tax limitations	539,000	771,000
Stock-based compensation	35,000	42,000
State tax deferral	167,000	109,000
Non-accrual loan interest	58,000	45,000
Other	173,000	133,000
	1,341,000	1,505,000
Deferred tax liabilities:		
Unrealized gains on available-for-sale securities	(70,000)	(252,000)
Other	(121,000)	(116,000)
	(191,000)	(368,000)
Net deferred income tax asset	$ 1,150,000	$ 1,137,000

The Company is subject to federal income tax and franchise tax of the state of California. Income tax returns for the years ended December 31, 2015, 2014, and 2013 are open to audit by the federal authorities and income tax returns for the years ended December 31, 2015, 2014, 2013, and 2012, are open to audit by state authorities. Unrecognized tax benefits are not expected to significantly increase or decrease within the next 12 months.

(Continued)

NOTE 9 – RELATED PARTY TRANSACTIONS

The Bank has granted loans to certain directors and their related interests with which they are associated. The balance of these loans outstanding was approximately $514,000 and $492,000 at December 31, 2016 and 2015, respectively.

Deposits from certain directors, officers, and their related interests with which they are associated, held by the Bank at December 31, 2016 and 2015, amounted to approximately $5,049,000 and $3,621,000, respectively.

NOTE 10 – EARNINGS PER SHARE (EPS)

Earnings per share for the years ended December 31 were computed as follows:

	2016	2015
Basic earnings per share:		
Net income	$ 3,075,109	$ 2,539,163
Dividends paid on Series A preferred stock	-	(302,965)
Net income available to common shareholders	$ 3,075,109	$ 2,236,198
Weighted average common shares outstanding	2,728,600	2,209,321
Basic earnings per share	$ 1.13	$ 1.01
Diluted earnings per share:		
Net income available to common shareholders	$ 3,075,109	$ 2,236,198
Preferred stock dividends on convertible Series A preferred stock	-	302,965
Net income available to common shareholders, diluted	$ 3,075,109	$ 2,539,163
Weighted average common shares outstanding	2,728,600	2,209,321
Effect of dilutive stock options and restricted stock	23,643	69,649
Dilutive effect of Series A convertible preferred stock	-	445,359
Adjusted weighted average common shares outstanding, diluted	2,752,243	2,724,329
Diluted earnings per share	$ 1.12	$ 0.93

At December 31, 2016 and 2015, there were 99,246 and 217,314 stock options respectively that could potentially dilute earnings per share in the future that were not included in the computation of diluted earnings per share.

(Continued)

NOTE 11– COMMITMENTS

In the ordinary course of business, the Bank enters into financial commitments to meet the financing needs of its customers. These financial commitments include commitments to extend credit and standby letters of credit. Those instruments involve, to varying degrees, elements of credit and interest rate risk not recognized in the Company's consolidated financial statements.

The Bank's exposure to loan loss in the event of non-performance on commitments to extend credit and standby letters of credit is represented by the contractual amount of those instruments. The Bank uses the same credit policies in making commitments as it does for loans reflected in the consolidated financial statements.

As of December 31, 2016 and 2015, the Bank had the following outstanding financial commitments whose contractual amount represents credit risk:

	2016	2015
Commitments to extend credit	$ 66,616,000	$ 50,160,000
Letters of credit	3,392,000	1,240,000
	$ 70,008,000	$ 51,400,000

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Since many of the commitments are expected to expire without being drawn upon, the total amounts do not necessarily represent future cash requirements. The Bank evaluates each client's credit worthiness on a case-by-case basis. The amount of collateral obtained, if deemed necessary by the Bank, is based on management's credit evaluation of the customer. The majority of the Bank's commitments to extend credit and standby letters of credit are secured by real estate.

NOTE 12 – STOCK OPTION PLAN

The Company's 2005 Equity Based Compensation Plan (the Plan) was approved by its shareholders in February 2006. Under the terms of the Plan, officers and key employees may be granted both non-qualified, incentive stock options and restricted stock awards, and directors, who are not also an officer or employee, may only be granted non-qualified stock options and restricted stock awards. The Plan provides for a maximum number of shares that may be awarded to eligible employees and directors not to exceed 495,000 shares. In July 2012, the shareholders approved an additional 183,000 shares to be added to the Plan increasing the total to 678,000 shares. In July 2015 the Shareholders approved the 2015 Equity Based Compensation Plan to replace the 2005 plan which was due to expire at the end of 10 years. Upon approval, the remaining unallocated shares in the 2005 Plan were transferred into the 2015 Plan for future grants. No new shares were added to the 2015 Plan beyond those already approved under the 2005 plan. There are 774,782 shares authorized under the Plan. The total number of shares authorized has been retroactively adjusted for the effect of stock dividends. Stock options are granted at a price not less than 100% of the fair market value of the stock on the date of grant. Stock options expire no later than ten years from the date of the grant and all equity-based awards generally vest over three years. The Plan provides for accelerated vesting if there is a change of control, as defined in the Plan. The Company recognized stock based compensation cost of $137,752 and $40,549 in 2016 and 2015, respectively. The Company did not recognize tax expense related to stock-based compensation for either year ended December 31, 2016 and 2015.

(Continued)

NOTE 12 – STOCK OPTION PLAN (Continued)

The following table shows weighted average assumptions used in valuing stock options granted for the year ended December 31, 2015. There were no stock options granted in 2016.

	2015
Expected volatility	18.10%
Expected term	6.5 years
Expected dividends	None
Risk free rate	1.64%
Grant date fair value	$ 1.62

Since the Company has a limited amount of historical stock activity, the expected volatility is based on the historical volatility of similar banks that have a longer trading history. The expected term represents the estimated average period of time that the options remain outstanding. Since the Company does not have sufficient historical data on the exercise of stock options, the expected term is based on the “simplified” method that measures the expected term as the average of the vesting period and the contractual term. The risk free rate of return reflects the grant date interest rate offered for U.S. Treasury bonds over the expected term of the options.

A summary of the status of stock options that have been granted by the Company as of December 31, 2016, and changes during the year ending thereon, is presented below:

	Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term	Aggregate Intrinsic Value
Outstanding at beginning of year	275,713	$ 9.89		
Granted	-	$ -		
Exercised	7,126	$ 8.51		
Forfeited, expired, or returned to Plan through cashless exercise	128,747	$ 11.07		
Outstanding at end of year	139,840	$ 8.88	4.3 years	$ 366,312
Options exercisable	135,006	$ 8.84	4.2 years	$ 358,785

Included in the stock options exercised during 2016, there were 4,981 shares that represent cashless stock option exercises and 2,145 shares which represent exercises where previously owned shares were tendered in lieu of cash. As of December 31, 2016, there was approximately $5,241 of total unrecognized compensation cost related to the outstanding stock options that will be recognized over a weighted average period of 1.0 years.

Share Award Plan: The Equity Compensation Plan provides for the issuance of restricted shares to directors and officers. Compensation expense is recognized over the vesting period of the awards based on the fair value of the stock at the issue date. The fair value of the stock was determined based on the closing price listed for the Company’s stock on the date of grant.

(Continued)

NOTE 12 – STOCK OPTION PLAN (Continued)

A summary of changes in the Company's non-vested restricted share grants for the year follows:

Nonvested Shares	Shares	Weighted Average Grant Date Fair Value
Nonvested at December 31, 2015	15,000	$ 10.25
Granted	26,600	10.15
Vested	4,999	10.25
Forfeited	1,000	10.15
Nonvested at December 31, 2016	35,601	$ 10.18

As of December 31, 2016, there was approximately $288,218 of total unrecognized compensation cost related to the outstanding restricted stock grants that will be recognized over a weighted average period of 2.1 years.

NOTE 13 – REGULATORY MATTERS

Banks are subject to regulatory capital requirements administered by federal banking agencies. Capital adequacy guidelines and prompt corrective action regulations, involve quantitative measures of assets, liabilities, and certain off-balance-sheet items calculated under regulatory accounting practices. Capital amounts and classifications are also subject to qualitative judgments by regulators. Failure to meet capital requirements can initiate regulatory action. The final rules implementing Basel Committee on Banking Supervision's capital guidelines for U.S. banks (Basel III rules) became effective for the Company on January 1, 2016 with full compliance with all of the requirements being phased in over a multi-year schedule, and fully phased in by January 1, 2019. Under the Basel III rules, the Company must hold a capital conservation buffer above the adequately capitalized risk-based ratios. The capital conservation buffer is being phased in from 0.0% for 2015 to 2.5% by 2019. The capital conservation buffer for 2016 is 0.625%. The net unrealized gain or loss on available for sale securities is not included in computing regulatory capital. Management believes as of December 31, 2016, the Company and Bank meet all capital adequacy requirements to which they are subject.

Prompt corrective action regulations provide five classifications: well capitalized, adequately capitalized, undercapitalized, significantly undercapitalized, and critically undercapitalized, although these terms are not used to represent overall financial condition. If adequately capitalized, regulatory approval is required to accept brokered deposits. If undercapitalized, capital distributions are limited, as is asset growth and expansion, and capital restoration plans are required. At year-end 2016 and 2015, the most recent regulatory notifications categorized the Bank as well capitalized under the regulatory framework for prompt corrective action. There are no conditions or events since that notification that management believes have changed the institution's category.

(Continued)

NOTE 13 – REGULATORY MATTERS (Continued)

Actual and required capital amounts and ratios are presented below (dollar amounts in thousands):

	Actual		For Capital Adequacy Purposes		To be Well-Capitalized Under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
December 31, 2016:						
Common Equity Tier I Capital (to Risk-Weighted Assets)	$ 29,597	14.8%	$ 8,981	>4.5%	$ 12,972	>6.5%
Total Capital (to Risk-Weighted Assets)	$ 32,097	16.1%	$ 15,966	>8.0%	$ 19,958	>10.0%
Tier I Capital (to Risk-Weighted Assets)	$ 29,597	14.8%	$ 11,975	>6.0%	$ 15,966	>8.0%
Tier I Capital (to Average Assets)	$ 29,597	8.4%	$ 14,014	>4.0%	$ 17,517	>5.0%
December 31, 2015:						
Common Equity Tier I Capital (to Risk-Weighted Assets)	$ 26,353	15.4%	$ 7,706	>4.5%	$ 11,130	>6.5%
Total Capital (to Risk-Weighted Assets)	$ 28,511	16.7%	$ 13,699	>8.0%	$ 17,124	>10.0%
Tier I Capital (to Risk-Weighted Assets)	$ 26,353	15.4%	$ 10,274	>6.0%	$ 13,699	>8.0%
Tier I Capital (to Average Assets)	$ 26,353	8.8%	$ 12,006	>4.0%	$ 15,007	>5.0%

The California Financial Code provides that a bank may not make a cash distribution to its shareholders in excess of the lessor of the bank's undivided profits or the bank's net income for its last three fiscal years less any distributions made to shareholders during the same period without the approval in advance of the Commissioner of the California Department of Business Oversight.

NOTE 14 – FAIR VALUE

The following is a description of valuation methodologies used for assets and liabilities recorded at fair value:

Securities – The fair values of securities available-for-sale are determined matrix pricing, which is a mathematical technique used widely in the industry to value debt securities without relying exclusively on quoted prices for specific securities, but rather by relying on the securities' relationship to other benchmark securities (Level 2).

Loans Held For Sale – The Bank does not record loans held for sale at fair value on a recurring basis. Loans held for sale are carried at the lower of cost or fair value. The fair value of loans held for sale is based on what secondary markets are currently offering for portfolios with similar characteristics (Level 2).

Collateral-Dependent Impaired Loans – The Bank does not record loans at fair value on a recurring basis. However, from time to time, fair value adjustments are recorded on these loans to reflect: (1) partial write-downs, through charge offs or specific reserve allowances, that are based on the current appraised or market-quoted value of the underlying collateral, or (2) the full charge off of the loan carrying value. In some cases, the properties for which market quotes or appraisal values have been obtained are located in areas where comparable sales data is limited, outdated, or unavailable. Fair value estimates for collateral-dependent impaired loans are obtained from real estate brokers or other third-party consultants. Adjustments are routinely made in the appraisal process by the appraisers to adjust for differences between the comparable sales and income data available. There were no collateral-dependent impaired loans measured at fair value at December 31, 2016 and 2015.

(Continued)

NOTE 14 – FAIR VALUE (Continued)

The following table summarizes the Company's assets that were measured at fair value on a recurring and non-recurring basis at December 31, 2016:

Description of Assets	December 31, 2016	Quoted Prices in Active Markets For Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs
Securities available-for-sale (recurring)				
U.S. government and agency securities	$ 26,988,741	$ -	$ 26,988,741	$ -
Mortgage-backed securities	24,443,658	-	24,443,658	-
State and municipal agencies	14,859,566	-	14,859,566	-
Total	$ 66,291,965	$ -	$ 66,291,965	$ -

The following table summarizes the Company's assets that were measured at fair value on a recurring and non-recurring basis at December 31, 2015:

Description of Assets	December 31, 2015	Quoted Prices in Active Markets For Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs
Securities available-for-sale (recurring)				
U.S. government and agency securities	$ 31,330,932	$ -	$ 31,330,932	$ -
Mortgage-backed securities	23,802,500	-	23,802,500	-
State and municipal agencies	13,641,663	-	13,641,663	-
Total	$ 68,775,094	$ -	$ 68,775,094	$ -

The fair value of a financial instrument is the amount at which the asset or obligation could be exchanged in a current transaction between willing parties, other than in a forced or liquidation sale. Fair value estimates are made at a specific point in time based on relevant market information and information about the financial instrument. These estimates do not reflect any premium or discount that could result from offering for sale at one time the entire holdings of a particular financial instrument. Because no market value exists for a significant portion of the financial instruments, fair value estimates are based on judgments regarding future expected loss experience, current economic conditions, risk characteristics of various financial instruments, and other factors. These estimates are subjective in nature, involve uncertainties and matters of judgment and, therefore, cannot be determined with precision. Changes in assumptions could significantly affect the estimates.

(Continued)

NOTE 14 – FAIR VALUE (Continued)

Fair value estimates are based on financial instruments both on and off the balance sheet without attempting to estimate the value of anticipated future business and the value of assets and liabilities that are not considered financial instruments. Additionally, tax consequences related to the realization of the unrealized gains and losses can have a potential effect on fair value estimates and have not been considered in many of the estimates.

The following methods and assumptions were used by the Company in estimating fair values of financial instruments:

Financial Assets – The carrying amounts of cash, short-term investments due from customers on acceptances, and bank acceptances outstanding are considered to approximate fair value. Short-term investments include federal funds sold, securities purchased under agreements to resell, and interest bearing deposits with banks. The fair values of securities available for sale are generally based on matric pricing, which is a mathematical technique used widely in the industry to value debt securities without relying exclusively on quoted prices for specific securities, but rather by relying on the securities' relationship to other benchmark securities. The fair value of variable loans that reprice frequently and that have experienced no significant change in credit risk is based on carrying values. The fair values for all other loans are estimated using discounted cash flow analyses and interest rates currently being offered for loans with similar terms to borrowers with similar credit quality. Loans are generally expected to be held to maturity and any unrealized gains or losses are not expected to be realized. Fair value for correspondent bank stock is not practical to determine due to restrictions on transferability. Fair value for interest receivable approximates its carrying value.

Financial Liabilities – The carrying amounts of deposit liabilities payable on demand, commercial paper, and other borrowed funds are considered to approximate fair value. For fixed maturity deposits, fair value is estimated by discounting estimated future cash flows using currently offered rates for deposits of similar remaining maturities. The fair value of interest payable approximates its carrying amount.

Off-Balance Sheet Financial Instruments – The fair value of commitments to extend credit and standby letters of credit is estimated using the fees currently charged to enter into similar agreements, taking into account the remaining terms of the agreements and the credit standing of the counterparties. The fair value of the commitments is not material.

The carrying amounts and estimated fair value of financial instruments not carried at fair value at December 31 are summarized as follows (in thousands):

	2016			2015		
	Carrying Amount	Estimated Fair Value	Fair Value Hierarchy	Carrying Amount	Estimated Fair Value	Fair Value Hierarchy
Financial assets:						
Cash and cash equivalents	$ 62,392	$ 62,392	Level 1	$ 31,905	$ 31,905	Level 1
Certificates of deposit	5,199	5,199	Level 1	5,695	5,695	Level 1
Loans, net	224,355	224,041	Level 3	184,839	183,988	Level 3
Loans held for sale	-	-		-	-	
Correspondent bank stock	1,918	N/A	N/A	1,649	N/A	N/A
Interest receivable	1,410	1,410	Level 2	1,168	1,168	Level 2
Financial liabilities:						
Deposits	332,331	313,789	Level 2	268,111	255,356	Level 2
Interest payable	25	25	Level 2	41	41	Level 2

COMMUNITIES FIRST FINANCIAL CORPORATION

Annual Meeting of Shareholders

Tuesday, May 16, 2017 at 5:30 pm
Fort Washington Country Club
10272 N. Millbrook
Fresno, CA 93730

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