Communities First Financial Corporation

2018
ANNUAL REPORT

Annual Meeting of Shareholders
Fresno First Bank
Wednesday, May 15, 2019 7:30 a.m.
7690 N. Palm Ave.
Fresno, CA 93711

Corporate Office:

Communities First Financial Corp.
7690 N. Palm Avenue, Suite 101
Fresno, CA 93711
559.439.0200

Transfer Agent:

Continental Stock Transfer & Trust Co.
1 State Street Plaza 30th Floor
New York, NY 10004
212.509.4000

Independent Auditors:

Crowe, LLP
400 Capitol Mall, Suite 1400
Sacramento, CA 95814
916.441.1000

Legal Counsel:

Stuart & Moore
641 Higuera Street, Suite 302
San Luis Obispo, CA 93401
805.545.8590

Stock Facilitators:

Michael Natzic – D A Davidson & Co.
800.288.2811

Steven Levenson –Western Financial Corporation
619.234.3235

Michael Sammon - Fig Partners, LLC
312.242.0433

Mission Statement

We safeguard, invest, and move capital.

Vision Statement

We believe people deserve the opportunity
to achieve their aspirations and personal success.

Core Values

Teamwork:

- We value our diverse strengths, hold ourselves and each other accountable, and have each other's back.

Relationship:

- We build trust by being respectful and transparent with each other and our clients.

Authentic:

- We are honest, humble and have the courage to be vulnerable.

Commitment:

- We are resourceful, responsive and strive for excellence with pride of ownership.

"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

To Our Shareholders:

This has been a busy year at Fresno First Bank. Everyone has worked hard to build a high-performing bank with strong financial results, including progress on several strategic initiatives that will strengthen our foundation and add value to the Bank. In 2018, we had record earnings of $6.25 million or $2.14 per diluted share. Our asset growth was strong, ending the year at $467.2 million, reflecting a 15% growth rate over 2017. The strength of our Bank is our core deposit franchise. At year's end, over 60% of our deposits were in non-interest-bearing checking accounts, which is one of the best ratios in the country. In 2018, our financial performance was rewarded with the recognition of Communities First Financial Corporation (CFST) as one of the OTCQX Top 50 Stocks based on overall performance. As an ESOP company, our entire team takes great pride in our ownership culture and our ability to drive shareholder value.

As we grow, we continue to work on several strategic initiatives. Last year, we successfully opened a loan production office in Los Angeles, immediately improving our loan growth. In addition, we hired a new Head of SBA/Government Guaranteed lending to help expand this business line beyond the Central Valley, while maintaining our position as the largest community bank SBA lender by volume in the Central Valley.

Our business model is based on blending a high-touch relationship focus with technological solutions that create efficiencies for our customers and the Bank. With that in mind, in 2019 we are upgrading our core operating system to provide a "Best in Class" user experience, while also establishing a platform that enables the Bank to efficiently continue scaling up our business. In the end, however, our most important asset is still our people. Through investment in our people and innovative employee initiatives, we continue to attract and retain the best talent in the market.

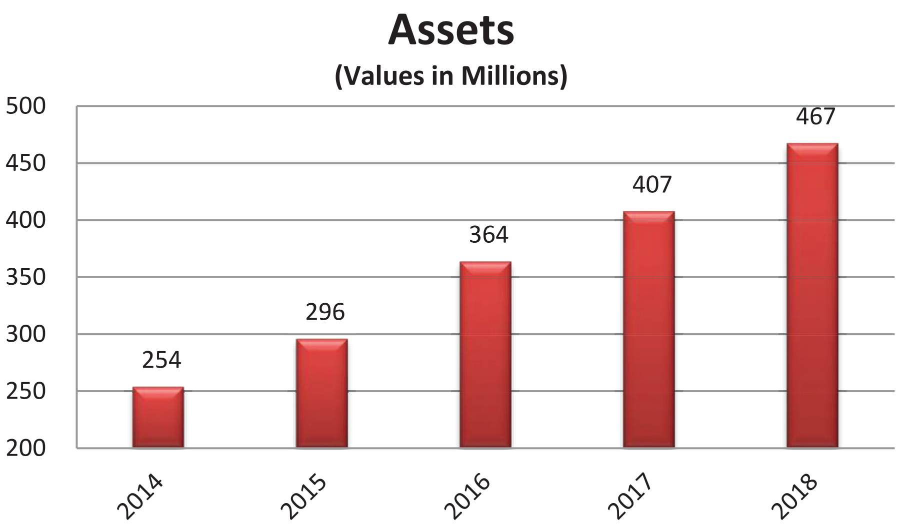
The Bank continues to be dedicated to our local communities, which is seen directly in our lending activities, our charitable giving, and our personal support of local community initiatives.

As shareholders ourselves, the entire team is proud of our financial results in 2018. We look forward to an exciting year ahead and as we build shareholder value, we appreciate and thank you for your continued support!

Mark D. Saleh, Chairman of the Board
(559) 905-1104

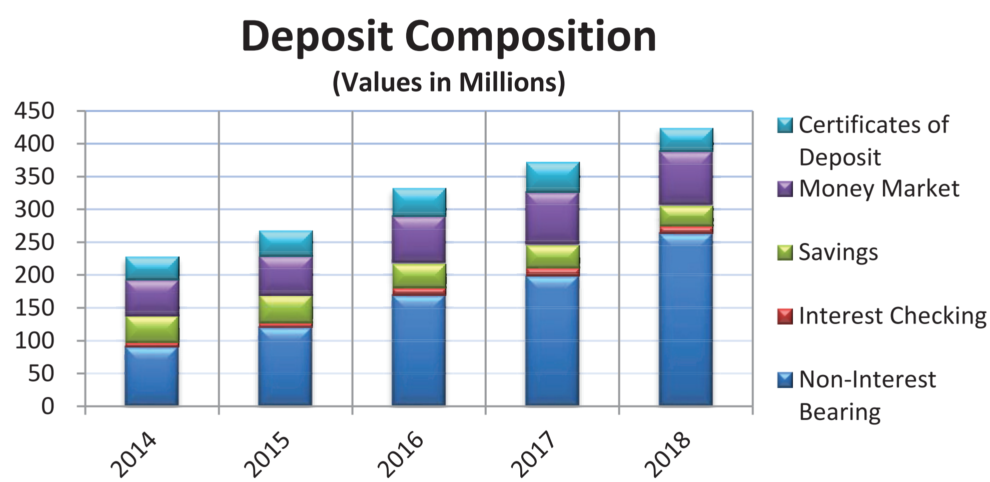
Steve Miller, President & CEO,
(818) 318-9716

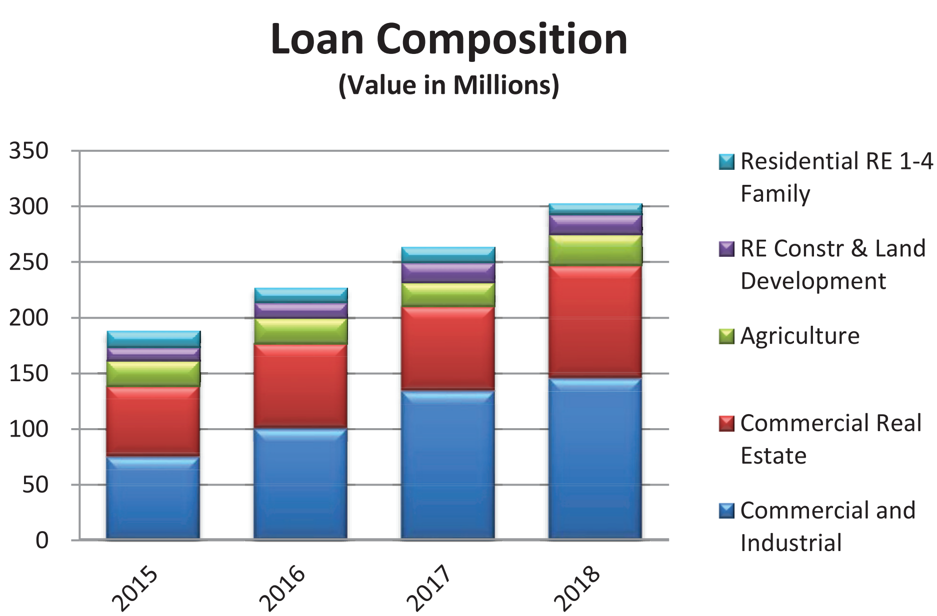
Financial Highlights



Total Assets
Asset growth remained strong ending the year at $467.15 million, reflecting a 15% growth rate over 2017.

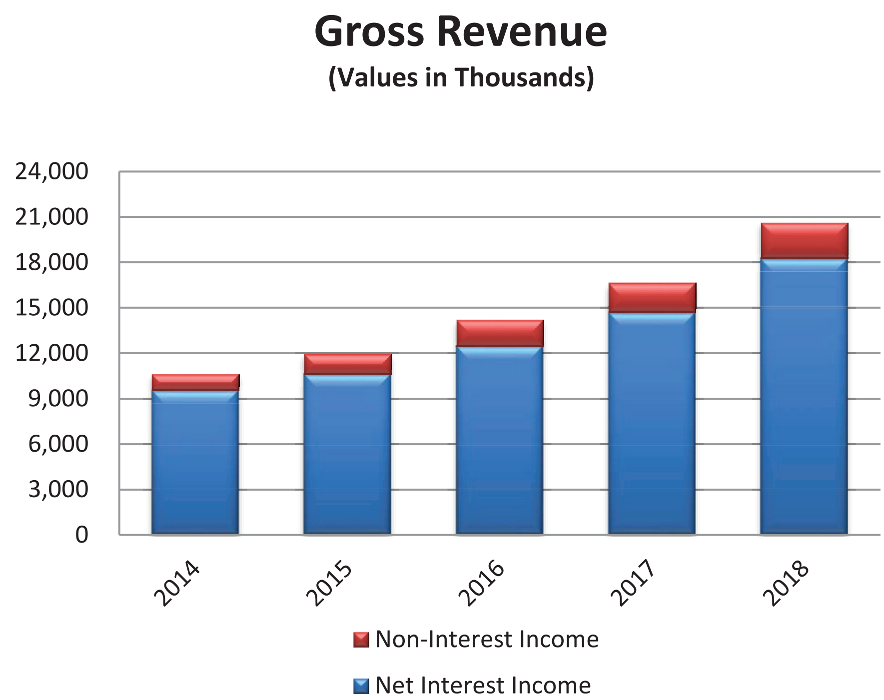
Total Deposits
Our core deposit portfolio is the strength of our franchise. Total deposits have grown significantly with noninterest bearing deposits accounting for 62% of our entire deposit base at year end.

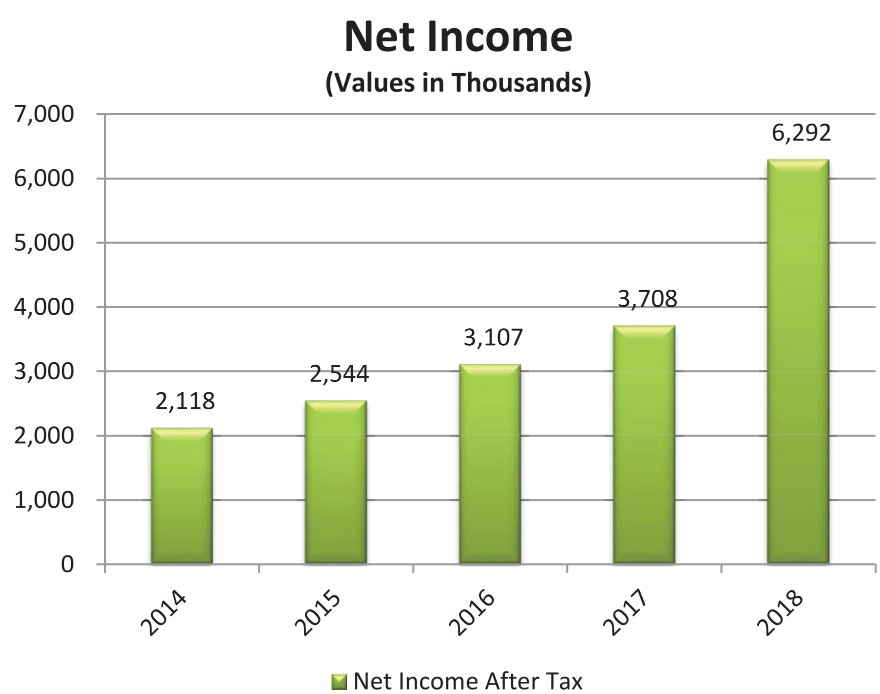




Total Loans
Our loan portfolio is well diversified. The total loan portfolio increased 15% to $303.41 million in 2018.

Gross Revenue
Our earnings begin with the top line revenue we generate and our primary source is the net interest income from loans and investments. We had an exceptional year with gross revenue increasing 24%.





Net Income
Net income after tax is our bottom line number. In 2018, net income was an impressive $6.25 million or $2.14 per diluted share a 67% increase over 2017.

2018 Community Involvement

Fresno First Bank prides itself on helping our community. From sponsorships to volunteer days, we enjoy giving back. Here are the major organizations we supported this year.

Central California Food Bank

The Central California Food Bank is dedicated to ending hunger in Central California. They provide food to more than 220 agencies in Fresno, Madera, Kings, Kern and Tulare Counties and serve over 280,000 people each month totaling over 38 million pounds.

Central Valley Veterans

Central Valley Veterans answer the immediate needs of local valley veterans, active duty service members and their families. CVV is an all volunteer organization! Their mission is to honor any United States Veterans with support and guidance to improve the quality of life.

Central Valley SCORE

SCORE, America's premier source of free and confidential small business advice for entrepreneurs and small businesses, is a nonprofit resource partner with the U.S. Small Business Administration (SBA). We have over 300 SCORE offices across the country offering free business mentoring and low- or no-cost workshops.

CSU Fresno

Fresno State has roots dating back to 1911, when the doors of the Fresno State Normal School opened to 150 hopeful students. Today, the student population is more than 25,000 and the University has garnered national attention for its rise in college rankings.

Valley Innovators

Fresno First Bank is the exclusive financial services partner of Valley Innovators. Steve Miller, the founding Chairman, and Steve Canfield, Board member, are part of the Valley Innovators leadership team. Valley Innovators provides entrepreneurs with the opportunity to obtain education, network, and pitch their business for cash prizes while receiving marketing exposure. Unlike most incubators and accelerators that host pitch contests, Valley Innovators won't require an equity stake from founders in order to win the prize money.

2018 Team Highlights

From tailgates to retirement parties, community service to team building. Fresno First Bank had a lot to celebrate in 2018.

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COMMUNITIES FIRST FINANCIAL CORPORATION

CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2018 and 2017

COMMUNITIES FIRST FINANCIAL CORPORATION

CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2018 and 2017

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Crowe LLP
Independent Member Crowe Global

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, 2018 and 2017, and the related consolidated statements of income, comprehensive income, changes in shareholders' equity, and cash flows for each of the years in the three-year period ended December 31, 2018, 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 audits 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 consolidated financial statements referred to above present fairly, in all material respects, the financial position of Communities First Financial Corporation as of December 31, 2018 and 2017, and the results of its operations and its cash flows for each of the years in the three-year period ended December 31, 2018 in accordance with accounting principles generally accepted in the United States of America.

Crowe LLP

Crowe LLP

Sacramento, California
March 28, 2019

COMMUNITIES FIRST FINANCIAL CORPORATION
CONSOLIDATED BALANCE SHEETS
For the Years Ended December 31, 2018 and 2017

	2018	2017
ASSETS		
Cash and due from banks	$ 10,699,827	$ 5,731,158
Federal funds sold	26,437,000	43,765,000
Interest-bearing deposits in banks	5,244,561	5,240,000
Total cash and cash equivalents	42,381,388	54,736,158
Certificates of deposit	10,906,000	5,199,000
Securities available-for-sale	83,856,984	72,663,649
Securities held-to-maturity (fair value 2018 - $12,203,541)	12,091,875	-
Loans held for sale	4,080,500	-
Loans, net of allowance	299,502,561	260,609,698
SBIC investments and correspondent bank stock, at cost	2,434,241	2,235,785
Cash surrender value of life insurance	7,780,366	8,072,190
Premises and equipment, net	285,946	269,960
Interest receivable and other assets	3,888,975	3,631,262
Total assets	$ 467,208,836	$ 407,417,702
LIABILITIES AND SHAREHOLDERS' EQUITY		
Deposits	$ 424,345,524	$ 371,400,535
Interest payable and other liabilities	2,148,928	1,444,352
Total liabilities	426,494,452	372,844,887
Commitments and contingencies (Notes 4 and 11)		
Shareholders' equity:		
Common stock - 5,000,000 shares authorized, no par value; 2,858,172 and 2,837,313 shares issued and outstanding in 2018 and 2017, respectively	28,453,102	28,035,076
Retained earnings	12,707,859	6,458,314
Accumulated other comprehensive (loss) income	(446,577)	79,425
Total shareholders' equity	40,714,384	34,572,815
Total liabilities and shareholders' equity	$ 467,208,836	$ 407,417,702

See accompanying notes to the consolidated financial statements.

COMMUNITIES FIRST FINANCIAL CORPORATION
CONSOLIDATED STATEMENTS OF INCOME
For the Years Ended December 31, 2018, 2017, and 2016

	2018	2017	2016
Interest Income:			
Loans, including fees	$ 15,661,655	$ 13,109,730	$ 11,220,145
Taxable investment securities	2,117,868	1,383,957	1,126,766
Tax-exempt investment securities	70,062	166,226	224,902
Federal funds sold and other	1,025,266	527,848	362,454
Total interest income	18,874,851	15,187,761	12,934,267
Interest Expense			
Savings deposits, NOW, and money market accounts	316,709	235,118	225,882
Time deposits	313,336	241,517	230,797
Other borrowings	8	4	1,242
Total interest expense	630,053	476,639	457,921
Net interest income	18,244,798	14,711,122	12,476,346
Provision for loan losses	950,000	825,000	1,266,000
Net interest income after provision for loan losses	17,294,798	13,886,122	11,210,346
Non-interest income:			
Service charges on deposits	1,127,468	975,772	845,866
(Loss) gain on sale of investment securities	(14,137)	119,412	7,569
Gain on sale of loans	106,067	465,104	669,053
Income from life insurance	904,006	72,190	-
Other	279,256	294,590	211,125
Total non-interest income	2,402,660	1,927,068	1,733,613
Non-interest expenses:			
Salaries and employee benefits	6,390,733	5,384,920	4,606,768
Occupancy and equipment expenses	773,906	664,325	515,668
Regulatory assessments	292,769	281,600	202,900
Data processing fees	1,137,148	661,744	558,765
Professional fees	547,619	467,937	434,913
Marketing and business promotion	877,635	458,050	315,649
Director fees and stock-based compensation	228,297	387,838	274,623
Other expenses	1,019,796	866,470	912,684
Total non-interest expenses	11,267,903	9,172,884	7,821,970
Income before income taxes	8,429,555	6,640,306	5,121,989
Provision for income taxes	2,180,010	2,956,608	2,046,880
Net income	$ 6,249,545	$ 3,683,698	$ 3,075,109
Net income per share - basic	$ 2.19	$ 1.31	$ 1.13
Net income per share - diluted	$ 2.14	$ 1.28	$ 1.12

See accompanying notes to the consolidated financial statements.

COMMUNITIES FIRST FINANCIAL CORPORATION
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
For the Years Ended December 31, 2018, 2017, and 2016

	2018	2017	2016
Net income	$ 6,249,545	$ 3,683,698	$ 3,075,109
Other comprehensive income (loss):			
Available-for-sale securities:			
Unrealized holding (losses) gains during the year	(760,874)	60,666	(434,418)
Reclassification adjustment for losses (gains) realized in net income	14,137	(119,412)	(7,569)
Net unrealized losses	(746,737)	(58,746)	(441,987)
Income tax benefit	220,735	36,985	181,215
Other comprehensive loss	(526,002)	(21,761)	(260,772)
Total comprehensive income	$ 5,723,543	$ 3,661,937	$ 2,814,337

See accompanying notes to the consolidated financial statements.

COMMUNITIES FIRST FINANCIAL CORPORATION
CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY
For the years ended December 31, 2018, 2017, and 2016

	Common Stock Shares	Common Stock Amount	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total Shareholders' Equity
Balances, January 1, 2016	2,698,417	$ 26,916,375	$ (300,493)	$ 361,958	$ 26,977,840
Stock based compensation	-	137,752	-	-	137,752
Exercise of stock options	7,126	-	-	-	-
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	$ 27,054,127	$ 2,774,616	$ 101,186	$ 29,929,929
Issuance of common stock	43,800	521,220	-	-	521,220
Stock based compensation	-	383,920	-	-	383,920
Exercise of stock options	20,300	75,809	-	-	75,809
Net issuance of restricted stock awards	41,170	-	-	-	-
Net income	-	-	3,683,698	-	3,683,698
Other comprehensive loss	-	-	-	(21,761)	(21,761)
Balances, December 31, 2017	2,837,313	$ 28,035,076	$ 6,458,314	$ 79,425	$ 34,572,815
Stock based compensation	-	418,026	-	-	418,026
Exercise of stock options	151	-	-	-	-
Net Issuance of restricted stock awards	20,708	-	-	-	-
Net income	-	-	6,249,545	-	6,249,545
Other comprehensive loss	-	-	-	(526,002)	(526,002)
Balances, December 31, 2018	2,858,172	$ 28,453,102	$12,707,859	$ (446,577)	$ 40,714,384

See accompanying notes to the consolidated financial statements.

COMMUNITIES FIRST FINANCIAL CORPORATION
CONSOLIDATED STATEMENTS OF CASH FLOWS
For the Years Ended December 31, 2018, 2017, and 2016

	2018	2017	2016
Cash flows from operating activities			
Net income	$ 6,249,545	$ 3,683,698	$ 3,075,109
Adjustments to reconcile net income to net cash From operating activities:			
Depreciation of premises and equipment	158,140	113,773	95,526
Amortization and accretion on securities available for sale, net	691,825	752,232	777,223
Amortization and accretion on securities held to maturity, net	1,509	-	-
Provision for loan losses	950,000	825,000	1,266,000
Loss (gain) on sale of investment securities	14,137	(119,412)	(7,569)
Gain on sale of loans held for sale	(106,067)	(465,104)	(669,053)
Proceeds from sale of loans held for sale	-	5,297,089	8,977,095
Originations of loans held for sale	(4,080,500)	(4,831,985)	(8,308,042)
Stock based compensation expense	418,026	383,920	137,752
Increase in value of life insurance	(221,418)	(72,190)	-
Increase in interest receivable	(344,458)	(369,778)	(437,459)
Increase (decrease) in interest payable and other liabilities	704,577	171,755	(370,605)
Decrease (increase) in other assets	413,573	(44,884)	930,295
Net cash provided by operating activities	4,848,889	5,324,114	5,466,272
Cash flow from investing activities			
Purchase of certificates of deposit	(9,165,000)	(748,000)	(250,000)
Proceeds from maturities of certificates of deposit	492,000	748,000	746,000
Proceeds from sales of certificates of deposit	2,966,000	-	-
Purchase of available-for-sale securities	(30,584,088)	(24,260,786)	(9,050,487)
Proceeds from maturities of available-for-sale securities	17,183,027	9,514,210	10,503,189
Proceeds from sale of available-for-sale securities	755,000	7,720,311	-
Purchase of held-to-maturity securities	(12,122,261)	-	-
Proceeds from maturities of held-to-maturity securities	28,877	-	-
Net increase in loans	(39,842,863)	(37,079,363)	(40,782,287)
Purchase of SBIC investments and correspondent bank stock	(198,456)	(325,403)	(269,031)
Purchase of company owned life insurance	-	(8,000,000)	-
Proceeds from company owned life insurance	513,242	-	-
Purchases of premises and equipment	(174,126)	(216,003)	(95,692)
Net cash used in investing activities	(70,148,648)	(52,647,034)	(39,198,308)
Cash flows from financing activities			
Net increase in demand deposits and savings accounts	61,949,710	36,809,014	60,701,815
Net (decrease) increase in time deposits	(9,004,721)	2,260,817	3,517,579
Net proceeds from exercise of stock options	-	75,809	-
Cash proceeds from issuance of common stock	-	521,220	-
Net cash provided by financing activities	52,944,989	39,666,860	64,219,394
Net change in cash and cash equivalents	(12,354,770)	(7,656,060)	30,487,358
Cash and cash equivalents, beginning of year	54,736,158	62,392,218	31,904,860
Cash and cash equivalents, end of year	$ 42,381,388	$ 54,736,158	$ 62,392,218

(Continued)

Supplemental disclosures of cash flow information:						
Interest paid	$	622,485	$	447,646	$	450,866
Taxes paid	$	2,130,000	$	2,430,000	$	1,670,000

See accompanying notes to the consolidated 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. In September 2018 the Bank opened a loan production office in Torrance, 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 for recognition and disclosure through March 28, 2019, 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, 2018, and 2017, 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, 2018 and 2017.

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: Held-to-maturity securities consist of U.S. agency securities and mortgage-backed securities not classified as trading securities or available-for-sale securities. These securities are carried at amortized cost when management has the positive intent and ability to hold them to maturity. Available-for-sale securities consist of U.S. agency securities, obligations of states and political subdivisions, 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 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, 2018, 2017, and 2016 salaries and employee benefits expense totaling $152,784, $143,711, and $125,208, 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, 2018 and 2017 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)

SBIC Investments and 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 Company held stock in the FHLB totaling $1,434,600 and $1,200,000 at December 31, 2018 and 2017, 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, 2018 and 2017. Correspondent bank stock accounts on the consolidated balance sheet include The Independent Bankers Bank (TIB) stock of $225,147 and $228,137 and Pacific Coast Bankers' Bank (PCBB) stock of $400,000 and $400,000 at December 31, 2018 and 2017, respectively. TIB and PCBB stock are carried at cost and were not considered impaired as of December 31, 2018 and 2017. The Company has made certain investments in Small Business Development Corporations (SBICs). SBIC investments on the consolidated balance sheet include the Caltius Fund V of $74,494 and $197,648 and the Central Valley Fund III of $300,000 and $210,000 at December 31, 2018 and 2017, respectively. These investments are carried at cost and were not considered impaired as of December 31, 2018 and 2017.

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 $352,449, $244,235, and $184,438 for the years ended December 31, 2018, 2017, and 2016, 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 are reported at the lower of cost or fair value. Cost generally approximates market value, given the short duration of these assets. Net unrealized losses, if any, are recorded as a valuation allowance and charged to earnings.

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.

(Continued)

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

In accordance with accounting standards, the Company has assessed its tax positions and has concluded there are no unrecognized tax benefits at December 31, 2018 and 2017. The Company recognizes interest accrued and penalties related to unrecognized tax benefits in tax expense. During the years ended December 31, 2018 and 2017, 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 2014.

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

Fair Value Measurement: 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.

Financial Instruments: 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.

Earnings per Share (EPS): 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.

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.

(Continued)

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

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. Servicing rights are included in other assets on the consolidated balance sheets.

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, 2018 and 2017 were $147,773 and $190,403, respectively. No impairment charges were recorded for the years ended December 31, 2018 or 2017 related to servicing assets.

Reclassifications: Certain reclassifications have been made to the prior year consolidated financial statements to conform to the classifications used in 2018. Reclassifications had no effect on prior year net income or shareholders' equity.

Adoption of New Accounting Standards:

FASB Accounting Standards Update (ASU) 2014-09 - *Revenue from Contracts with Customers (Topic 606): Revenue from Contracts with Customers* was issued in May 2014. This ASU is the result of a joint project initiated by the FASB and the International Accounting Standards Board (IASB) to clarify the principles for recognizing revenue, and to develop common revenue standards and disclosure requirements that would: (1) remove inconsistencies and weaknesses in revenue requirements; (2) provide a more robust framework for addressing revenue issues; (3) improve comparability of revenue recognition practices across entities, industries, jurisdictions, and capital markets; (4) provide more useful information to users of financial statements through improved disclosures; and (5) simplify the preparation of financial statements by reducing the number of requirements to which an entity must refer. The guidance affects any entity that either enters into contracts with customers to transfer goods or services or enters into contracts for the transfer of nonfinancial assets. The core principle is that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. The guidance provides steps to follow to achieve the core principle. An entity should disclose sufficient information to enable users of financial statements to understand the nature, amount, timing and uncertainty of revenue and cash flows arising from contracts with customers. Qualitative and quantitative information is required with regard to contracts with customers, significant judgments and changes in judgments, and assets recognized from the costs to obtain or fulfill a contract. This ASU is effective for annual reporting periods beginning after December 15, 2017, including interim periods therein, with early adoption permitted for reporting periods beginning after December

(Continued)

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

15, 2016. The Company adopted ASU 2014-09 on January 1, 2018 utilizing the modified retrospective approach. Since the guidance does not apply to revenue associated with financial instruments such as loans and investments, which are accounted for under other provisions of GAAP, there was no impact to interest income, our largest component of income. The adoption of this ASU did not have a material impact on the Company's consolidated financial position, cash flows or results of operations. No cumulative adjustment was required upon adoption.

The Company performed an overall assessment of revenue streams potentially affected by the ASU, including certain deposit related fees and interchange fees, to determine the potential impact of this guidance on our consolidated financial statements. Approximately 90% of our revenue, including all of our net interest income and a portion of our noninterest income, is out of scope of the guidance. The contracts that are in scope of the guidance are primarily related to service charges and fees on deposit accounts, debit card fees, ATM processing fees, and other service charges, commissions and fees. We have completed analyzing the individual contracts in scope and determined our revenue recognition practices within the scope of the ASU as described below did not change in any material regard upon adoption of the ASU.

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

Merchant and Debit Card Fees: The Company earns interchange fees from cardholder transactions conducted through the payment networks. Interchange fees from cardholder transactions represent a percentage of the underlying transaction value and are recognized daily, concurrently with the transaction processing services provided to the cardholder.

FASB Accounting Standards Update (ASU) 2016-01 - *Financial Instruments - Overall (Subtopic 825-10)*: *Recognition and Measurement of Financial Assets and Financial Liabilities,* was issued January 2016. The main provisions of the update are to eliminate the available-for-sale classification of accounting for equity securities and to adjust the fair value disclosures for financial instruments carried at amortized costs such that the disclosed fair values represent an exit price as opposed to an entry price. The provisions of this update will require that equity securities be carried at fair market value on the balance sheet and any periodic changes in value will be adjustments to the income statement. A practical expedient is provided for equity securities without a readily determinable fair value, such that these securities can be carried at cost less any impairment. ASU No. 2016-01 was effective for fiscal years beginning after December 15, 2017, including interim periods within those fiscal years. The Company adopted this ASU on January 1, 2018 and the impact upon adoption was not material to the Company's consolidated financial position, cash flows or results of operations. No cumulative adjustment was required upon adoption.

<u>Newly Issued Not Yet Effective Accounting Standards:</u>

FASB Accounting Standards Update (ASU) 2016-02 - *Leases - Overall (Subtopic 845),* was issued February 2016. ASU 2016-02 will, among other things, require lessees to recognize a lease liability, which is a lessee's obligation to make lease payments arising from a lease, measured on a discounted basis; and a right-of-use asset, which is an asset that represents the lessee's right to use, or control the use of, a specified asset for the lease term. ASU 2016-02 does not significantly change lease accounting requirements applicable to

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NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

lessors; however, certain changes were made to align, where necessary, lessor accounting with the lessee accounting model and ASC *Topic 606, "Revenue from Contracts with Customers*." ASU 2016-02 will be effective for us on January 1, 2019 and initially required transition using a modified retrospective approach for leases existing at, or entered into after, the beginning of the earliest comparative period presented in the financial statements. In July 2018, the FASB issued ASU 2018-11, "Leases (Topic 842) - Targeted Improvements," which, among other things, provides an additional transition method that would allow entities to not apply the guidance in ASU 2016-02 in the comparative periods presented in the financial statements and instead recognize a cumulative-effect adjustment to the opening balance of retained earnings in the period of adoption. In December 2018, the FASB also issued ASU 2018-20, "Leases (Topic 842) - Narrow-Scope *Improvements for Lessors,"* which provides for certain policy elections and changes lessor accounting for sales and similar taxes and certain lessor costs. As of January 1, 2019, the Company adopted ASU 2016-02 and recorded a right-of-use asset and a corresponding lease liability, however the amounts were not material. We elected to apply certain practical expedients provided under ASU 2016-02 whereby we will not reassess (i) whether any expired or existing contracts are or contain leases, (ii) the lease classification for any expired or existing leases and (iii) initial direct costs for any existing leases. We also do not expect to apply the recognition requirements of ASU 2016-02 to any short-term leases (as defined by related accounting guidance). We expect to account for lease and non-lease components separately because such amounts are readily determinable under our lease contracts and because we expect this election will result in a lower impact on our balance sheet.

FASB Accounting Standards Update (ASU) 2016-13 - *Measurement of Credit Losses on Financial Instruments (Subtopic 326)*: *Financial Instruments - Credit Losses,* commonly referred to as "CECL," was issued June 2016. The provisions of the update eliminate the probable initial recognition threshold under current GAAP which requires reserves to be based on an incurred loss methodology. Under CECL, reserves required for financial assets measured at amortized cost will reflect an organization's estimate of all expected credit losses over the contractual term of the financial asset and thereby require the use of reasonable and supportable forecasts to estimate future credit losses. Because CECL encompasses all financial assets carried at amortized cost, the requirement that reserves be established based on an organization's reasonable and supportable estimate of expected credit losses extends to held to maturity ("HTM") debt securities. Under the provisions of the update, credit losses recognized on available for sale ("AFS") debt securities will be presented as an allowance as opposed to a write-down. In addition, CECL will modify the accounting for purchased loans, with credit deterioration since origination, so that reserves are established at the date of acquisition for purchased loans. Under current GAAP a purchased loan's contractual balance is adjusted to fair value through a credit discount and no reserve is recorded on the purchased loan upon acquisition. Since under CECL reserves will be established for purchased loans at the time of acquisition, the accounting for purchased loans is made more comparable to the accounting for originated loans. Finally, increased disclosure requirements under CECL require organizations to present the currently required credit quality disclosures disaggregated by the year of origination or vintage. The FASB expects that the evaluation of underwriting standards and credit quality trends by financial statement users will be enhanced with the additional vintage disclosures. The Company is required to adopt ASU 2016-13 on January 1, 2021.

The Company has formed an internal task force that is responsible for oversight of the Company's implementation strategy for compliance with provisions of the new standard. The Company has also established a project management governance process to manage the implementation across affected disciplines. An external provider specializing in community bank loss driver and CECL reserving model design as well as other related consulting services has been retained, and we have begun to evaluate potential CECL modeling alternatives. As part of this process, the Company has determined potential loan pool segmentation and sub-segmentation under CECL, as well as begun to evaluate the key economic loss drivers for each segment. While the Company is currently unable to reasonably estimate the impact of adopting this new guidance, management expects the impact of adoption will be significantly influenced by

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

the composition and quality of the Company's loans and investment securities as well as the economic conditions as of the date of adoption. The Company also anticipates significant changes to the processes and procedures for calculating the reserve for credit losses and continues to evaluate the potential impact on our consolidated financial statements.

NOTE 2 – INVESTMENT SECURITIES

The amortized cost and estimated fair values of securities are as follows:

	2018			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Available-for-sale:				
U.S. government and agency securities	$ 50,145,139	$ 184,843	$ (490,536)	$ 49,839,446
Mortgage-backed securities	26,776,144	54,964	(327,426)	26,503,682
State and municipal agencies	7,569,683	47,598	(103,425)	7,513,856
	$ 84,490,966	$ 287,405	$ (921,387)	$ 83,856,984

	2018			
	Amortized Cost	Gross Unrecognized Gains	Gross Unrecognized Losses	Estimated Fair Value
Held-to-Maturity:				
U.S. government and agency securities	$ 922,437	$ 5,203	$ -	$ 927,640
Mortgage-backed securities	11,169,438	113,333	(6,870)	11,275,901
	$ 12,091,875	$ 118,536	$ (6,870)	$ 12,203,541

	2017			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Available-for-sale:				
U.S. government and agency securities	$ 42,017,880	$ 397,002	$ (214,712)	$ 42,200,170
Mortgage-backed securities	21,994,134	34,591	(131,101)	21,897,624
State and municipal agencies	8,538,880	93,567	(66,592)	8,565,855
	$ 72,550,894	$ 525,160	$ (412,405)	$ 72,663,649

There were no held-to-maturity investment securities as of December 31, 2017.

(Continued)

NOTE 2 – INVESTMENT SECURITIES (Continued)

The amortized cost and estimated fair value of all investment securities as of December 31, 2018 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
Available-for-sale		
Within One Year	$ -	$ -
One to Five Years	1,892,987	1,884,597
Five to Ten Years	3,433,860	3,376,743
Beyond Ten Years	2,242,836	2,252,516
U.S. government and agency securities	50,145,139	49,839,446
Mortgage-backed securities	26,776,144	26,503,682
	$ 84,490,966	$ 83,856,984

	Amortized	Estimated Fair Value
Held-to-maturity		
U.S. government and agency securities	$ 922,437	$ 927,640
Mortgage-backed securities	11,169,438	11,275,901
	$ 12,091,875	$ 12,203,541

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	
2018	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
Available-for-sale						
U.S. government and agency securities	$ 17,437,705	$ (373,987)	$ 16,036,259	$ (116,549)	$ 33,473,964	$ (490,536)
Mortgage backed securities	10,901,696	(247,441)	8,357,598	(79,985)	19,259,294	(327,426)
State and municipal agencies	2,946,329	(92,884)	1,589,515	(10,541)	4,535,844	(103,425)
	$ 31,285,730	$ (714,312)	$ 25,983,372	$ (207,075)	$ 57,269,102	$ (921,387)

	12 months or more		less than 12 Months		Total	
2018	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
Held-to-maturity						
U.S. government and agency securities	$ -	$ -	$ -	$ -	$ -	$ -
Mortgage backed securities	-	-	3,554,902	(6,870)	3,554,902	(6,870)
	$ -	$ -	$ 3,554,902	$ (6,870)	$ 3,554,902	$ (6,870)

(Continued)

NOTE 2 – INVESTMENT SECURITIES (Continued)

	12 months or more		less than 12 Months		Total	
2017	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
Available-for-sale						
U.S. government and agency securities	$ 1,728,232	$ (17,896)	$ 19,747,080	$ (196,816)	$ 21,475,312	$ (214,712)
Mortgage backed securities	2,289,158	(60,640)	11,294,326	(70,461)	13,583,484	(131,101)
State and municipal agencies	2,591,021	(56,704)	1,251,194	(9,888)	3,842,215	(66,592)
	$ 6,608,411	$ (135,240)	$ 32,292,600	$ (277,165)	$ 38,901,011	$ (412,405)

Certain investment securities shown in the previous table currently have fair values less than amortized cost and therefore contain unrealized losses. The Company 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 Company 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, 2018 and 2017 and has determined that no securities are other than temporarily impaired.

The Company does not have the intent to sell the investments that are impaired, and it is more likely than not that the Company will not be required to sell those investments before recovery of the amortized cost basis. The Company 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, 2018, there were 55 investment securities with a value of $31,285,730 that were in a loss position for more than 12 months. The Company 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.

The proceeds from sales and calls of investment securities and the associated gains and losses are listed below:

	2018	2017	2016
Proceeds	$ 755,000	$ 7,720,311	$ -
Gross gains	-	137,849	7,569
Gross losses	14,137	18,437	-

Investment securities carried at approximately $8,708,000 and $13,590,000 at December 31, 2018 and 2017, respectively, were pledged to secure public deposits or other purposes as permitted or required by law.

At year-end 2018 and 2017, there were no holdings of securities of any one issuer, other than the U.S. Government and its agencies, in an amount greater than 10% of shareholders' equity.

NOTE 3 – LOANS

Major classifications of loans are as follows:

	2018	2017
Commercial and industrial	$ 145,503,208	$ 133,928,596
Commercial real estate	101,666,857	76,306,248
Land and construction	17,794,333	18,115,171
Residential real estate	10,349,961	14,224,548
Agriculture	28,080,467	21,285,130
Consumer	15,273	9,904
	303,410,099	263,869,597
Allowance for loan losses	(4,048,891)	(3,363,452)
Deferred loan fees and costs, net	141,353	103,553
Loans, net of allowance	$ 299,502,561	$ 260,609,698

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

All of the Company'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 enterprises for working capital, equipment purchases, acquisition, partner/management buyout, growth and expansion, and any other permissible purposes. The Company's management examines current and projected cash flow to determine the ability of the borrower to repay its obligations as agreed. Commercial loans are primarily made based on the identified cash flow of the borrower and secondarily on the underlying collateral provided by the borrower. The cash flow 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.

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 Company's commercial real estate portfolio are diverse in terms of type and industries operating within the properties. This diversity helps reduce the Company'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.

(Continued)

NOTE 3 – LOANS (Continued)

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 primarily made to individuals and business enterprises 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 Company’s agricultural portfolio are diverse in terms of type of crop. This diversity helps reduce the Company’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 Company 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 Company’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 Company’s policies and procedures.

(Continued)

NOTE 3 – LOANS (Continued)

Information related to impaired loans as of the year ended consisted of the following:

December 31, 2018	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	$ 129,471	$ -	$ 423,621	$ -	$ 2,505,465	$ -	$ 3,058,557
With specific allowance recorded	-	-	-	-	-	-	-
Total recorded investment In impaired loans	$ 129,471	$ -	$ 423,621	$ -	$ 2,505,465	$ -	$ 3,058,557
Unpaid principal balance of impaired loans:							
With no specific allowance recorded	$ 129,471	$ -	$ 423,621	$ -	$ 2,505,465	$ -	$ 3,058,557
With specific allowance recorded	-	-	-	-	-	-	-
Total unpaid principal balance of impaired loans	$ 129,471	$ -	$ 423,621	$ -	$ 2,505,465	$ -	$ 3,058,557
Specific allowance	$ -	$ -	$ -	$ -	$ -	$ -	$ -
Average recorded investment in impaired loans during the year	$ 48,507	$ -	$ 423,621	$ -	$ 2,505,465	$ -	$ 2,977,593
Interest income recognized on impaired loans during the year	$ 50,051	$ -	$ -	$ -	$ 822	$ -	$ 50,873

December 31, 2017	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	$ -	$ -	$ 422,758	$ -	$ 2,506,941	$ -	$ 2,929,699
With specific allowance recorded	-	-	-	-	-	-	-
Total recorded investment In impaired loans	$ -	$ -	$ 422,758	$ -	$ 2,506,941	$ -	$ 2,929,699
Unpaid principal balance of impaired loans:							
With no specific allowance recorded	$ -	$ -	$ 422,758	$ -	$ 2,506,941	$ -	$ 2,929,699
With specific allowance recorded	-	-	-	-	-	-	-
Total unpaid principal balance of impaired loans	$ -	$ -	$ 422,758	$ -	$ 2,506,941	$ -	$ 2,929,699
Specific allowance	$ -	$ -	$ -	$ -	$ -	$ -	$ -
Average recorded investment in impaired loans during the year	$ 15,330	$ -	$ -	$ -	$ 1,880,211	$ -	$ 1,895,541
Interest income recognized on impaired loans during the year	$ 854	$ -	$ 11,905	$ -	$ 12,274	$ -	$ 25,033

(Continued)

NOTE 3 – LOANS (Continued)

December 31, 2016	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	$ -	$ -	$ -	$ -	$ -	$ -	$ -

The Company 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 Company'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 Company's credit position at some future date. Special Mention assets are not adversely classified and do not expose the Company 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 Company will sustain some loss if the deficiencies are not corrected.

NOTE 3 – LOANS (Continued)

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.

The following table summarizes the loan portfolio by credit quality and product and/or collateral type as of December 31, 2018:

	Pass	Special Mention	Substandard	Doubtful	Total
Grade:					
Commercial & industrial	$ 144,403,368	$ 321,020	$ 778,820	$ -	$ 145,503,208
Commercial real estate	101,666,857	-	-	-	101,666,857
Land & construction	17,371,575	-	422,758	-	17,794,333
Residential real estate	10,349,961	-	-	-	10,349,961
Agriculture	23,823,514	1,752,311	2,504,642	-	28,080,467
Consumer	15,273	-	-	-	15,273
Total	$ 297,630,548	$ 2,073,331	$ 3,706,220	$ -	$ 303,410,099

The following table summarizes the loan portfolio by credit quality and product and/or collateral type as of December 31, 2017:

	Pass	Special Mention	Substandard	Doubtful	Total
Grade:					
Commercial & industrial	$ 133,928,596	$ -	$ -	$ -	$ 133,928,596
Commercial real estate	76,306,248	-	-	-	76,306,248
Land & construction	17,692,413	-	422,758	-	18,115,171
Residential real estate	14,224,548	-	-	-	14,224,548
Agriculture	18,778,189	-	2,506,941	-	21,285,130
Consumer	9,904	-	-	-	9,904
Total	$ 260,939,898	$ -	$ $2,929,699	$ -	$ 263,869,597

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

	2018	2017
Commercial and industrial	$ 292,670	$ -
Commercial real estate	-	-
Land and construction	422,758	422,758
Residential real estate	-	-
Agriculture	2,504,642	2,506,941
Consumer	-	-
	$ 3,220,070	$ 2,929,699

NOTE 3 – LOANS (Continued)

The following table is an aging analysis of loans, segregated by class of loans, as of December 31, 2018:

	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	$ 278,636	$ 129,472	$ 163,198	$ 571,306	$ 144,931,902	$ 145,503,208	$ -
Commercial Real Estate	118,082	-	-	118,082	101,548,775	101,666,857	-
Land & Construction	-	-	422,758	422,758	17,371,575	17,794,333	-
Residential Real Estate	-	-	-	-	10,349,961	10,349,961	-
Agriculture	-	-	2,504,642	2,504,642	25,575,825	28,080,467	-
Consumer	-	-	-	-	15,273	15,273	-
Total	$ 396,718	$ 129,472	$ 3,090,598	$ 3,616,788	$ 299,793,311	$ 303,410,099	$ -

The following table is an aging analysis of loans, segregated by class of loans, as of December 31, 2017:

	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	$ -	$ -	$ -	$ -	$ 133,928,596	$ 133,928,596	$ -
Commercial Real Estate	-	-	-	-	76,306,248	76,306,248	-
Land & Construction	-	-	422,758	422,758	17,692,413	18,115,171	-
Residential Real Estate	-	-	-	-	14,224,548	14,224,548	-
Agriculture	-	-	2,506,941	2,506,941	18,778,189	21,285,130	-
Consumer	-	-	-	-	9,904	9,904	-
Total	$ -	$ -	$ 2,929,699	$ 2,929,699	$ 260,939,898	$ 263,869,597	$ -

There were no loans modified and considered troubled debt restructurings during 2018 or 2017.

(Continued)

NOTE 3 – LOANS (Continued)

The following table summarizes the Company's allowance for loan losses for the year ended December 31, 2018 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	$ 1,825,936	$ 450,949	$ 187,656	$ 92,828	$ 31,122	$ 54	$ 774,907	$ 3,363,452
Charge-offs	(271,561)	-	-	-	-	-	-	(271,561)
Recoveries	-	-	-	-	-	7,000	-	7,000
Provision	1,130,510	411,068	(58,594)	(54,524)	57,402	(6,984)	(528,878)	950,000
Ending balance	$ 2,684,885	$ 862,017	$ 129,062	$ 38,304	$ 88,524	$ 70	$ 246,029	$ 4,048,891
Period-end amount allocated to:								
Loans individually evaluated for impairment	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -
Loans collectively evaluated for impairment	2,684,885	862,017	129,062	38,304	88,524	70	246,029	4,048,891
Ending Balance	$ 2,684,885	$ 862,017	$ 129,062	$ 38,304	$ 88,524	$ 70	$ 246,029	$ 4,048,891
Loans:								
Individually evaluated for impairment	$ 129,471	$ -	$ 423,621	$ -	$ 2,505,465	$ -	$ -	$ 3,058,557
Collectively evaluated for impairment	145,373,737	101,666,857	17,370,712	10,349,961	25,575,002	15,273	-	300,351,542
Ending balance	$145,503,208	$101,666,857	$ 17,794,333	$ 10,349,961	$ 28,080,467	$ 15,273	$ -	$303,410,099

(Continued)

NOTE 3 – LOANS (Continued)

The following table summarizes the Company's allowance for loan losses for the year ended December 31, 2017 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	$ 1,881,520	$ 457,384	$ 229,849	$ 70,510	$ 116,855	$ 70	$ 124,035	$ 2,880,223
Charge-offs	(368,038)	-	-	-	-	-	-	(368,038)
Recoveries	26,267	-	-	-	-	-	-	26,267
Provision	286,187	(6,435)	(42,193)	22,318	(85,733)	(16)	650,872	825,000
Ending balance	$ 1,825,936	$ 450,949	$ 187,656	$ 92,828	$ 31,122	$ 54	$ 774,907	$ 3,363,452
Period-end amount allocated to:								
Loans individually evaluated for impairment	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -
Loans collectively evaluated for impairment	1,825,936	450,949	187,656	92,828	31,122	54	774,907	3,363,452
Ending Balance	$ 1,825,936	$ 450,949	$ 187,656	$ 92,828	$ 31,122	$ 54	$ 774,907	$ 3,363,452
Loans:								
Individually evaluated for impairment	$ -	$ -	$ 422,758	$ -	$ 2,506,941	$ -	$ -	$ 2,929,699
Collectively evaluated for impairment	133,928,596	76,306,248	17,692,413	14,224,548	18,778,189	9,904	-	260,939,898
Ending balance	$133,928,596	$ 76,306,248	$ 18,115,171	$ 14,224,548	$ 21,285,130	$ 9,904	$ -	$263,869,597

(Continued)

NOTE 3 – LOANS (Continued)

The following table summarizes the Company'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	$ 325,866	$ -	$ -	$ -	$ -	$ -	$ -	$ 325,866
Collectively evaluated for impairment	100,163,030	76,560,970	14,086,527	13,643,268	22,869,834	12,791	-	227,336,420
Ending balance	$100,488,896	$ 76,560,970	$ 14,086,527	$ 13,643,268	$ 22,869,834	$ 12,791	$ -	$227,662,286

(Continued)

NOTE 4 – PREMISES AND EQUIPMENT

A summary of premises and equipment is as follows:

	2018	2017
Leasehold improvements	$ 949,481	$ 949,481
Furniture, fixtures, and equipment	748,424	691,168
Computer equipment	602,590	461,120
	2,300,495	2,101,769
Less accumulated depreciation	(2,014,549)	(1,831,809)
	$ 285,946	$ 269,960

In January 2016 the Company exercised the first of two potential five-year lease extensions for its main banking and administrative offices. The Company 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 Company 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 commenced in March 2017 and will expire in 2021. In August 2018 the Company entered into a new lease for a loan production office in Torrance, California. The lease term is for three years and commenced in September 2018 and will expire in 2021.

Depreciation expense amount to $158,140, $113,773, and $95,526 for the years ending December 31, 2018, 2017, and 2016, respectively.

At December 31, 2018, the future lease rental payable under non-cancellable operating lease commitments for the Company's offices were as follows:

2019	$ 475,341
2020	488,954
2021	90,126
2022	-
2023	-
Thereafter	-
	$ 1,054,421

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 $506,030, $427,293, and $333,726 for the years ended December 31, 2018, 2017, and 2016, respectively.

(Continued)

NOTE 5 – DEPOSITS

Customer deposits were as follows:

	2018	2017
Non-interest-bearing demand	$ 263,817,752	$ 198,918,372
Savings, NOW, and money market accounts	124,434,441	127,384,112
Time deposits under $250,000	22,269,747	28,468,051
Time deposits $250,000 and over	13,823,584	16,630,000
	$ 424,345,524	$ 371,400,535

At December 31, 2018, the scheduled maturities of time deposits are as follows:

2019	$ 29,297,158
2020	4,365,930
2021	1,626,107
2022	376,241
2023	427,895
Thereafter	-
	$ 36,093,331

NOTE 6 – BORROWING ARRANGEMENTS

The Company may borrow up to $22,000,000 overnight on an unsecured basis from three correspondent banks. The Company may also borrow up to approximately $117,000,000 from the Federal Home Loan Bank of San Francisco, subject to providing collateral and fulfilling other conditions of the credit facility. The Company has pledged investment securities of approximately $7,680,000 for the credit facility at Federal Home Loan Bank of San Francisco. The Company 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 2018, and 2017, 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, 2018, 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, 2018, 2017, and 2016 contributions to the ESOP were $310,000, $343,014, and $237,252, respectively. The ESOP held 136,176 and 146,769 shares of common stock as of December 31, 2018 and 2017, respectively and there were no unearned shares of common stock held by the ESOP at December 31, 2018 and 2017.

NOTE 7 – EMPLOYEE BENEFITS (Continued)

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, 2018, 2017, and 2016.

The Board of Directors approved a salary continuation plan for certain executives during 2017. Under the Plan the Company is obligated to provide executives with annual benefits after retirement. The estimated present value of these future benefits is accrued from the effective date of the plan and is expensed over the years of service. The expense recognized under this plan was $284,120 and $89,911 for the years ended December 31, 2018 and 2017, respectively. Accrued compensation payable under the salary continuations plan totaled $374,031 and $89,911 at December 31, 2018 and 2017 and is included in interest payable and other liabilities on the Company's balance sheet.

NOTE 8 – INCOME TAXES

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

	2018	2017	2016
Current			
Federal	$ 1,659,081	$ 1,862,165	$ 1,386,395
State	914,424	730,961	491,485
	2,573,505	2,593,126	1,877,880
Deferred			
Federal	(258,603)	65,373	112,116
State	(134,892)	(32,603)	56,884
Remeasurement of deferred tax assets and deferred tax liabilities at reduced federal corporate tax rate	-	330,712	-
	(393,495)	363,482	169,000
Provision	$ 2,180,010	$ 2,956,608	$ 2,046,880

On December 22, 2017, H.R.1, commonly known as the Tax Cuts and Jobs Act of 2017 (the "Act") was signed into law. Among other things, the Act reduces our corporate federal tax rate from 34% to 21% effective January 1, 2018. As a result, we are required to re-measure, through income tax expense, our deferred tax assets and liabilities using the enacted rate at which we expect them to be recovered or settled. The re-measurement of our net deferred tax asset resulted in additional income tax expense of $330,712 for the year ended December 31, 2017.

(Continued)

NOTE 8 – INCOME TAXES (Continued)

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:

	2018	2017
Deferred tax assets:		
Pre-operating expenses	$ 24,587	$ 36,882
Depreciation	121,635	132,856
Allowance for loan losses	819,645	538,790
Stock-based compensation	95,128	61,019
Deferred compensation	110,577	26,581
State tax deferral	195,717	156,645
Unrealized losses on available-for-sale securities	187,428	-
Non-accrual loan interest	-	44,676
Other	128,287	72,542
	1,683,004	1,069,991
Deferred tax liabilities:		
Unrealized gains on available-for-sale securities	-	(33,334)
Lease financing receivable	(151,159)	(131,067)
Other	(92,724)	(80,726)
	(243,883)	(245,127)
Net deferred income tax asset	$ 1,439,121	$ 824,864

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, 2017, 2016, and 2015 are open to audit by the federal authorities and income tax returns for the years ended December 31, 2017, 2016, 2015, and 2014, are open to audit by state authorities. As of December 31, 2018, the Company does not have any unrecognized tax benefits. The Company does not expect unrecognized tax benefits to significantly increase or decrease within the next 12 months.

NOTE 9 – RELATED PARTY TRANSACTIONS

The Company has granted loans to certain directors and their related interests with which they are associated. The balance of these loans outstanding was approximately $836,000 and $638,000 at December 31, 2018 and 2017, respectively.

Deposits from certain directors, officers, and their related interests with which they are associated, held by the Company at December 31, 2018 and 2017, amounted to approximately $5,597,000 and $4,451,000, respectively.

(Continued)

NOTE 10 – EARNINGS PER SHARE (EPS)

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

	2018	2017	2016
Basic earnings per share:			
Net income available to common shareholders	$ 6,249,545	$ 3,683,698	$ 3,075,109
Weighted average common shares outstanding	2,855,761	2,816,454	2,728,600
Basic earnings per share	$ 2.19	$ 1.31	$ 1.13
Diluted earnings per share:			
Net income available to common shareholders, diluted	$ 6,249,545	$ 3,683,698	$ 3,075,109
Weighted average common shares outstanding	2,855,761	2,816,454	2,728,600
Effect of dilutive stock options	64,975	55,079	23,643
Adjusted weighted average common shares outstanding, diluted	2,920,736	2,871,533	2,752,243
Diluted earnings per share	$ 2.14	$ 1.28	$ 1.12

At December 31, 2018, 2017 and 2016, there were 58,903, 52,957, and 99,246 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.

NOTE 11– COMMITMENTS

In the ordinary course of business, the Company 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 Company'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 Company uses the same credit policies in making commitments as it does for loans reflected in the consolidated financial statements.

(Continued)

NOTE 11 – COMMITMENTS (Continued)

As of December 31, 2018, and 2017, the Company had the following outstanding financial commitments whose contractual amount represents credit risk:

	2018	2017
Commitments to extend credit	$ 77,433,577	$ 61,180,483
Letters of credit	1,005,658	1,577,000
	$ 78,439,235	$ 62,757,483

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 Company evaluates each client's credit worthiness on a case-by-case basis. The amount of collateral obtained, if deemed necessary by the Company, is based on management's credit evaluation of the customer. The majority of the Company's commitments to extend credit and standby letters of credit are secured by real estate.

NOTE 12 – STOCK-BASED COMPENSATION

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 $418,026, $383,920, and $137,752 in 2018, 2017, and 2016, respectively.

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.

NOTE 12 – STOCK-BASED COMPENSATION (Continued)

A summary of the status of stock options that have been granted by the Company as of December 31, 2018, 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	108,036	$ 8.95	4.1 years	$ 1,144,695
Granted	-	$ -		
Exercised	(151)	$ 10.45		
Forfeited, expired, or returned to Plan through cashless exercise	(349)	$ 10.45		
Outstanding at end of year	107,536	$ 8.95	3.1 years	$ 1,166,281
Options exercisable	107,536	$ 8.95	3.1 years	$ 1,166,281

As of December 31, 2018, there was no unrecognized compensation cost related to the outstanding stock options.

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.

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

Non-vested at January 1, 2018	53,843	$ 12.29
Granted	25,175	20.00
Vested	(27,390)	12.13
Forfeited	(4,467)	20.55
Non-vested at December 31, 2018	47,161	$ 16.22

As of December 31, 2018, there was approximately $480,878 of total unrecognized compensation cost related to the outstanding restricted stock grants that will be recognized over a weighted average period of 1.5 years.

(Continued)

NOTE 13 – SHAREHOLDERS' EQUITY

Regulatory Capital:

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, 2015 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 0.000% for 2015 to 2.500% by 2019. The capital conservation buffer for 2017 was 1.250% and for 2018 is 1.875%. The net unrealized gain or loss on available for sale securities is not included in computing regulatory capital. Management believes as of December 31, 2018, 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 2018 and 2017, 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.

Actual and required capital amounts and ratios, excluding the capital conservation buffer, 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, 2018:						
Common Equity Tier I Capital (to Risk-Weighted Assets)	$ 40,918	15.3%	$ 12,000	>4.5%	$ 17,333	>6.5%
Total Capital (to Risk-Weighted Assets)	$ 44,260	16.6%	$ 21,333	>8.0%	$ 26,667	>10.0%
Tier I Capital (to Risk-Weighted Assets)	$ 40,918	15.3%	$ 16,000	>6.0%	$ 21,333	>8.0%
Tier I Capital (to Average Assets)	$ 40,918	8.7%	$ 18,732	>4.0%	$ 23,415	>5.0%
December 31, 2017:						
Common Equity Tier I Capital (to Risk-Weighted Assets)	$ 34,210	15.6%	$ 9,838	>4.5%	$ 14,211	>6.5%
Total Capital (to Risk-Weighted Assets)	$ 36,952	16.9%	$ 17,490	>8.0%	$ 21,863	>10.0%
Tier I Capital (to Risk-Weighted Assets)	$ 34,210	15.6%	$ 13,118	>6.0%	$ 17,490	>8.0%
Tier I Capital (to Average Assets)	$ 34,210	8.6%	$ 15,912	>4.0%	$ 19,890	>5.0%

(Continued)

NOTE 13 – SHAREHOLDERS' EQUITY (Continued)

Dividends:

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.

Common Stock:

On February 24, 2017, the Company issued 43,800 shares of its common stock totaling $521,220 as the Company's ESOP contribution for the years of 2016 and 2017.

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 Company 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 Company 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, 2018 and 2017.

(Continued)

NOTE 14 – FAIR VALUE (Continued)

The following table summarizes the Company's assets that were measured at fair value on a recurring basis at December 31, 2018:

Description of Assets	December 31, 2018	Quoted Prices in Active Markets For Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Securities available-for-sale				
U.S. government and agency securities	$ 49,839,446	$ -	$ 49,839,446	$ -
Mortgage-backed securities	26,503,682	-	26,503,682	-
State and municipal agencies	7,513,856	-	7,513,856	-
Total	$ 83,856,984	$ -	$ 83,856,984	$ -

The following table summarizes the Company's assets that were measured at fair value on a recurring and non-recurring basis at December 31, 2017:

Description of Assets	December 31, 2017	Quoted Prices in Active Markets For Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Securities available-for-sale				
U.S. government and agency securities	$ 42,200,170	$ -	$ 42,200,170	$ -
Mortgage-backed securities	21,897,624	-	21,897,624	-
State and municipal agencies	8,565,855	-	8,565,855	-
Total	$ 72,663,649	$ -	$ 72,663,649	$ -

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.

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.

(Continued)

NOTE 14 – FAIR VALUE (Continued)

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 and SBIC investments approximates carrying value. The estimated fair values of financial instruments disclosed below as of December 31, 2018 follow the guidance in ASU 2016-01 which prescribes an "exit price" approach in estimating and disclosing fair value of financial instruments incorporating discounts for credit, liquidity, and marketability factors. The fair values shown as of December 31, 2017 use an "entry price" approach.

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):

	2018			2017		
	Carrying Amount	Estimated Fair Value	Fair Value Hierarchy	Carrying Amount	Estimated Fair Value	Fair Value Hierarchy
Financial assets:						
Cash and cash equivalents	$ 42,381	$ 42,381	Level 1	$ 54,736	$ 54,736	Level 1
Certificates of deposit	10,906	11,173	Level 2	5,199	5,316	Level 2
Securities available-for-sale	83,857	83,857	Level 2	72,664	72,664	Level 2
Securities held-to-maturity	12,092	12,204	Level 2	-	-	Level 2
Loans held for sale	4,081	4,081	Level 3	-	-	Level 3
Loans, net	299,503	295,939	Level 3	260,610	258,519	Level 3
SBIC investments	374	374	Level 2	408	408	Level 2
Correspondent bank stock	2,060	N/A	N/A	1,828	N/A	N/A
Interest receivable	1,939	1,939	Level 2	1,595	1,595	Level 2
Financial liabilities:						
Deposits	424,346	387,220	Level 2	371,401	343,415	Level 2
Interest payable	25	25	Level 2	18	18	Level 2

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