REPORT OF INDEPENDENT AUDITORS
AND CONSOLIDATED FINANCIAL STATEMENTS

MOUNTAIN PACIFIC BANCORP, INC. AND SUBSIDIARY

December 31, 2018 and 2017

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NOTE: This annual report serves as Mountain Pacific Bank’s annual disclosure statement under the requirements of the Federal Deposit Insurance Corporation (FDIC). This statement has not been reviewed or confirmed for accuracy or relevance by the FDIC.

MOSSADAMS

Report of Independent Auditors

To the Board of Directors and Stockholders
Mountain Pacific Bancorp, Inc. and Subsidiary

Report on the Financial Statements

We have audited the accompanying consolidated financial statements of Mountain Pacific Bancorp, Inc. and Subsidiary (the Company) which comprise the consolidated balance sheets as of December 31, 2018 and 2017, and the related consolidated statements of income, comprehensive income (loss), changes in stockholders' equity, and cash flows for the years then ended, and the related notes to the consolidated 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 controls 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 audits 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 Mountain Pacific Bancorp, Inc. as of December 31, 2018 and 2017, and the results of their operations and their cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Moss Adams LLP

Everett, Washington
February 26, 2019

Mountain Pacific Bancorp, Inc. and Subsidiary
Consolidated Balance Sheets

ASSETS

	December 31, 2018	December 31, 2017
Cash and due from banks	$ 3,995,532	$ 4,145,191
Federal funds sold and excess balance account - Federal Reserve Bank	4,814,000	10,702,000
Total cash and cash equivalents	8,809,532	14,847,191
Interest-bearing deposits in banks	27,475,538	-
Investment securities available-for-sale	16,243,980	12,538,856
Investment securities held-to-maturity	1,006,711	-
Loans held-for-sale	-	885,000
Loans	260,305,678	242,297,995
Less allowance for loan losses	3,858,683	3,603,778
Total loans, net	256,446,995	238,694,217
Premises and equipment, net	10,870,561	11,145,815
Accrued interest receivable	1,027,695	788,072
Federal Home Loan Bank (FHLB) stock and Pacific Coast Bankers' Bank (PCBB) stock, at cost	829,300	897,600
Other real estate owned (OREO), net	3,280,186	4,462,433
Deferred tax asset, net	1,820,000	1,855,000
Other assets	1,367,589	983,013
Total assets	$ 329,178,087	$ 287,097,197

LIABILITIES AND STOCKHOLDERS' EQUITY

	2018	2017
Deposits		
Noninterest-bearing	47,703,889	$ 41,249,215
Interest-bearing	233,033,597	206,276,767
Total deposits	280,737,486	247,525,982
Borrowings	7,368,357	10,701,139
Subordinated debt	7,500,000	-
Accrued interest payable	334,104	160,045
Other liabilities	1,634,545	1,348,205
Total liabilities	297,574,492	259,735,371
Stockholders' equity		
Common stock, $1 par value, 10,000,000 shares authorized; 6,275,236 and 6,244,636 issued and outstanding at December 31, 2018 and 2017, respectively	6,275,236	6,244,636
Additional paid-in capital	27,350,752	27,100,103
Accumulated deficit	(1,684,393)	(5,824,393)
Accumulated other comprehensive loss, net of tax	(338,000)	(158,520)
Total stockholders' equity	31,603,595	27,361,826
Total liabilities and stockholder's equity	$ 329,178,087	$ 287,097,197

Mountain Pacific Bancorp, Inc. and Subsidiary
Consolidated Statements of Income

	Years Ended December 31, 2018	2017
INTEREST AND DIVIDEND INCOME		
Loans, including fees	$ 13,607,876	$ 11,022,558
Federal funds sold and excess balance account - Federal Reserve Bank and interest-bearing deposits in banks	908,285	99,070
Investment securities	346,157	284,319
Dividends from FHLB and PCBB	34,423	14,625
Total interest and dividend income	14,896,741	11,420,572
INTEREST EXPENSE		
Deposits	2,795,595	1,508,393
Borrowings	156,438	78,280
Subordinated debt	25,544	-
Total interest expense	2,977,577	1,586,673
Net interest income	11,919,164	9,833,899
PROVISION FOR LOAN LOSSES	625,000	625,000
Net interest income after provision for loan losses	11,294,164	9,208,899
NONINTEREST INCOME		
Service fees	837,723	547,536
Rental income	489,579	301,661
Loss on sale of investment securities available-for-sale	-	(1,729)
Gain on sale of loans	2,198,986	2,007,965
Total noninterest income	3,526,288	2,855,433
NONINTEREST EXPENSES		
Salaries and employee benefits	4,795,446	4,344,799
Occupancy and equipment	834,257	810,280
Data processing	530,145	494,629
Advertising and business development	275,739	263,541
Professional fees and state taxes	618,757	503,040
Regulatory assessments	281,600	191,753
Other real estate owned, net	547,808	155,582
Other	1,646,700	1,255,708
Total noninterest expenses	9,530,452	8,019,332
NET INCOME BEFORE PROVISION FOR FEDERAL INCOME TAXES	5,290,000	4,045,000
PROVISION FOR FEDERAL INCOME TAXES	1,150,000	2,490,000
NET INCOME	$ 4,140,000	$ 1,555,000

See accompanying notes.

Consolidated Statements of Comprehensive Income (Loss)

	Years Ended December 31,	
	2018	2017
NET INCOME	$ 4,140,000	$ 1,555,000
OTHER COMPREHENSIVE INCOME		
Unrealized (loss) gain on securities		
Unrealized holding (loss) gain	(234,480)	11,998
Tax benefit (expense) on unrealized holding gain and loss	55,000	(4,199)
Reclassification adjustments for realized losses (gains) on sales	-	2,660
Tax benefit for realized gains and losses on sales	-	(931)
Other comprehensive (loss) income	(179,480)	9,528
COMPREHENSIVE INCOME	$ 3,960,520	$ 1,564,528

See accompanying notes.

Mountain Pacific Bancorp, Inc. and Subsidiary
Consolidated Statements of Changes in Stockholders' Equity

	Common Stock		Additional Paid-In	Accumulated	Accumulated Other Comprehensive	Total Stockholders'
	Shares	Amount	Capital	Deficit	Income (Loss)	Equity
BALANCE, December 31, 2016	6,231,451	$ 6,231,451	$ 26,927,921	$ (7,404,393)	$ (143,048)	$ 25,611,931
Net income	-	-	-	1,555,000	-	1,555,000
Other comprehensive income, net	-	-	-	-	9,528	9,528
Stock awards vested	8,835	8,835	(8,835)	-	-	-
Stock options exercised	4,350	4,350	9,915	-	-	14,265
Stock-based compensation expense	-	-	171,102	-	-	171,102
Reclassification from tax reform	-	-	-	25,000	(25,000)	-
BALANCE, December 31, 2017	6,244,636	6,244,636	27,100,103	(5,824,393)	(158,520)	27,361,826
Net income	-	-	-	4,140,000	-	4,140,000
Other comprehensive loss, net	-	-	-	-	(179,480)	(179,480)
Stock awards vested	12,700	12,700	(12,700)	-	-	-
Stock options exercised	17,900	17,900	40,278	-	-	58,178
Stock-based compensation expense	-	-	223,071	-	-	223,071
BALANCE, December 31, 2018	6,275,236	$ 6,275,236	$ 27,350,752	$ (1,684,393)	$ (338,000)	$ 31,603,595

See accompanying notes.

	Years Ended December 31, 2018	2017
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income	$ 4,140,000	$ 1,555,000
Adjustments to reconcile net income to net cash flows from operating activities		
Provision for loan losses	625,000	625,000
Stock-based compensation expense including stock in lieu of compensation	223,071	171,102
Depreciation and amortization	354,562	400,106
Amortization on investment securities	62,289	73,476
Loss on sale of investment securities available for sale	-	1,729
Gain on sale of loans	(2,198,986)	(2,007,965)
Proceeds from sale of loans	40,045,005	22,351,747
Originations of loans held-for-sale	(36,961,019)	(19,458,782)
Loss on disposals of premises and equipment	3,954	-
Deferred federal income taxes	90,000	1,489,870
Changes in operating assets and liabilities		
Accrued interest receivable	(239,623)	26,626
Other assets	(384,576)	(513,038)
Accrued interest payable	174,059	74,655
Other liabilities	286,340	426,976
Net cash from operating activities	6,220,076	5,216,502
CASH FLOWS FROM INVESTING ACTIVITIES		
Net change in interest-bearing deposits in banks	(27,475,538)	2,000,000
Net change in loans made to customers	(18,377,778)	(52,594,051)
Purchases of investment securities available-for-sale	(5,564,686)	(2,037,188)
Proceeds from principal paydowns of mortgage-backed securities	1,562,854	1,602,854
Proceeds from sale of investments available-for-sale	-	388,159
Purchases of investment securities held-to-maturity	(1,006,772)	-
Proceeds from sales of other real estate owned	1,284,044	505,578
Capitalized costs for other real estate owned	(101,797)	(37,736)
Redemption (purchase) of FHLB stock	68,300	(394,400)
Additions to premises and equipment, net	(83,262)	(11,096,548)
Net cash used in investing activities	(49,694,635)	(61,663,332)
CASH FLOWS FROM FINANCING ACTIVITIES		
Net increase in noninterest-bearing deposits	6,454,674	6,152,770
Net increase in interest-bearing deposits	26,756,830	37,066,819
Proceeds from exercise of stock options	58,178	14,265
(Repayment) advances of FHLB borrowings	(3,332,782)	8,701,139
Issuance of subordinated debt	7,500,000	-
Net cash from financing activities	37,436,900	51,934,993
NET CHANGE IN CASH AND CASH EQUIVALENTS	(6,037,659)	(4,511,837)
CASH AND CASH EQUIVALENTS, beginning of year	14,847,191	19,359,028
CASH AND CASH EQUIVALENTS, end of year	$ 8,809,532	$ 14,847,191
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION		
Cash paid during the period for interest	$ 2,803,518	$ 1,512,018
Cash paid during the period for federal income taxes	$ 1,005,910	$ 690,000
SUPPLEMENTAL DISCLOSURE OF NONCASH ITEMS		
Unrealized (loss) gain on securities available-for-sale	$ (234,480)	$ 24,528

Note 1 – Organization and Summary of Significant Accounting Policies

Nature of operations – Mountain Pacific Bancorp, Inc., a bank holding company, was issued a certificate of incorporation in the state of Washington on April 12, 2018. On June 9, 2018, the Federal Reserve Board granted authority to Mountain Pacific Bancorp, Inc. to become a bank holding company through a reorganization of the ownership interests of Mountain Pacific Bank. Washington Department of Financial Institutions Divisions of Banks approved the articles of share exchange and plan of share exchange, and issued a certificate of reorganization on June 29, 2018.

Mountain Pacific Bancorp, Inc. (The Company), whose principal activity is the ownership and management of its wholly owned subsidiary, Mountain Pacific Bank (the Bank). The Bank provides a full range of banking services to individual and corporate customers through its headquarters in Everett, Washington, and full-service branches in Lynnwood, Washington, and the Ballard neighborhood of Seattle, Washington. The Bank's primary deposit products are checking and term certificate accounts, and its primary lending products are commercial loans and commercial real estate loans. The Bank is subject to significant competition from other financial institutions.

MPB Directors Buildout LLC (the Related Entity) was formed during 2010, and is a related party entity that, at December 31, 2018 and 2017, has common controlling ownership with the Bank through one of its directors. The Related Entity was formed to enter into project-specific buildouts of certain Bank-owned lots without providing further risk to the Bank. The Bank has no direct ownership in the Related Entity. There was no activity or amounts outstanding for the years ended December 31, 2018 or 2017.

At periodic intervals, various banking regulatory agencies routinely examine the Company's consolidated financial statements as part of their legally prescribed oversight of the banking system. Based on these examinations, the regulators can direct the Company's consolidated financial statements to be adjusted in accordance with their findings.

Principles of consolidation – The consolidated financial statements include the accounts and transactions of the Company and the Bank. All significant intercompany accounts and transactions have been eliminated in consolidation.

Financial statement presentation and use of estimates – The consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America and reporting practices applicable to the banking industry. In preparing the consolidated financial statements, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities as of the date of the balance sheets, and revenues and expenses for the period. Actual results could differ from estimated amounts. Material estimates that are particularly susceptible to significant change relate to the determination of the allowance for loan losses, the valuation of impaired loans, other real estate owned, fair value of financial instruments, and deferred tax assets.

Subsequent events – Subsequent events are events or transactions that occur after the balance sheet date but before consolidated financial statements are issued. The Company recognizes in the consolidated financial statements the effects of all subsequent events that provide additional evidence about conditions that existed at the date of the balance sheet, including the estimates inherent in the process of preparing the consolidated financial statements. The Company's consolidated financial statements do not recognize subsequent events that provide evidence about conditions that did not exist at the date of the balance sheet but arose after the balance sheet date and before the consolidated financial statements are available to be issued. The Company has evaluated subsequent events through February 26, 2019, which is the date the consolidated financial statements are issued. On February 19, 2019, the Company received approval from the FDIC and DFI to establish a branch and mobile branch in Burlington, Washington. The Company will lease office space, and the branch is expected to open in the second quarter of 2019.

Cash and cash equivalents – For purposes of reporting cash flows, cash and cash equivalents include cash on hand, noninterest-bearing amounts due from banks, federal funds sold, and the excess balance account at the Federal Reserve Bank (FRB), all with original maturities of three months or less. Generally, federal funds are purchased and sold for one-day periods. The amounts on deposit fluctuate and, at times, may exceed the insured limit by the Federal Deposit Insurance Corporation (FDIC), which potentially subjects the Company to credit risk. Investments in federal funds sold are made with correspondent banks as approved by the Board of Directors.

Note 1 – Organization and Summary of Significant Accounting Policies (continued)

Interest-bearing deposits in banks – Interest-bearing deposits in banks mature within one year and are carried at cost. The amounts on deposit fluctuate and, at times, may exceed the insured limit by the FDIC, which potentially subjects the Company to credit risk.

Investment securities – Investment securities are classified into one of three categories: (1) held-to-maturity, (2) available-for-sale, or (3) trading. There were no trading securities at December 31, 2018 or 2017. Investment securities are categorized as held-to-maturity when management has the positive intent and ability to hold those securities to maturity. Securities that are held-to-maturity are stated at cost and adjusted for amortization of premiums and accretion of discounts, which are recognized as adjustments to interest income. Interest income includes amortization of premiums and discounts. Premiums and discounts are recognized in interest income using the interest method over the period to maturity.

Investment securities categorized as available-for-sale are generally held for investment purposes (to maturity), although unanticipated future events may result in the sale of some securities. Available-for-sale securities are recorded at estimated fair value, with the net unrealized gain or loss reported as "accumulated other comprehensive gain (loss)" within the statements of changes in stockholders' equity. Realized gains or losses on dispositions are based on the net proceeds and the adjusted carrying amount of securities sold, using the specific identification method, and are included in earnings.

Investment securities are reviewed on an ongoing basis for the presence of other-than-temporary impairment (OTTI) or permanent impairment, taking into consideration current market conditions; fair value in relationship to cost; extent and nature of the change in fair value; issuer rating changes and trends; whether management intends to sell a security or if it is likely that management will be required to sell the security before recovery of the amortized cost basis of the investment, which may be maturity; and other factors. For debt securities, if management intends to sell the security or it is likely that management will be required to sell the security before recovering its cost basis, the entire impairment loss would be recognized in earnings as an OTTI. If management does not intend to sell the security and it is not likely that management will be required to sell the security, but management does not expect to recover the entire amortized cost basis of the security, only the portion of the impairment loss representing credit losses would be recognized in earnings. The credit loss on a security is measured as the difference between the amortized cost basis and the present value of the cash flows expected to be collected. Projected cash flows are discounted by the original or current effective interest rate depending on the nature of the security being measured for potential OTTI. The remaining impairment related to all other factors, i.e., the difference between the present value of the cash flows expected to be collected and fair value, is recognized as a charge to other comprehensive income (loss). Impairment losses related to all other factors are presented as separate categories within other comprehensive income (loss).

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

The accrual of interest on loans is discontinued at the time the loan is 90 days delinquent unless the credit is well secured and in process of collection. Past due status is based on contractual terms of the loan. In all cases, loans are placed on nonaccrual or charged off at an earlier date if collection of principal or interest is considered doubtful.

All interest accrued but not collected for loans that are placed on nonaccrual or charged off is reversed against interest income. The interest on these loans is accounted for on the cash basis or cost-recovery method until qualifying for return to accrual. Loans are returned to accrual status when all the principal and interest amounts contractually due are brought current and future payments are reasonably ensured.

Note 1 – Organization and Summary of Significant Accounting Policies (continued)

Significant concentrations of credit risk – Most of the Company's business activity is with customers located within Snohomish and King Counties, Washington. The Bank originates commercial, real estate, construction, and consumer loans. Generally, loans are secured by accounts receivable, inventory, deposit accounts, personal property, or real estate. Rights to collateral vary and are legally documented to the extent practicable. Local economic conditions may affect borrowers' ability to meet the stated repayment terms. Approximately 79% of the Bank's loan portfolio is secured by real estate (Note 3). The Bank does not have any significant concentrations to one customer.

Allowance for loan losses – The allowance for loan losses is established as losses are estimated to have occurred through a provision for loan losses charged to earnings. Loan losses are charged against the allowance when management believes the uncollectibility of a loan balance is confirmed. Subsequent recoveries, if any, are credited to the allowance.

The allowance for credit losses is maintained at a level sufficient to provide for probable loan losses based on evaluating known and inherent risks in the loan portfolio and is evaluated on a regular basis by management. The allowance is provided based upon management's continuing analysis of the pertinent factors underlying the quality of the loan portfolio. These factors include changes in the size and composition of the loan portfolio, delinquency levels, actual loan loss experience, current economic conditions, and detailed analysis of individual loans for which full collectability may not be ensured. The detailed analysis includes techniques to estimate the fair value of loan collateral and the existence of potential alternative sources of repayment. The allowance consists of specific, general, and unallocated components. The specific component relates to loans that are classified as impaired. For such loans classified as impaired, an allowance is established when the discounted cash flows (or collateral value or observable market price) of the impaired loan is lower than the carrying value of that loan. The general component covers nonimpaired loans and is based on historical loss experience adjusted for qualitative factors. 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 appropriateness of the allowance for loan losses is estimated based upon these factors and trends identified by management at the time the consolidated financial statements are prepared. This evaluation is inherently subjective, as it requires estimates that are susceptible to significant revision as more information becomes available.

A loan is considered impaired when, based on current information and events, it is probable that the Bank will be unable to collect the scheduled payments of principal or interest when due according to the contractual terms of the loan agreement. Factors considered by management in determining impairment include payment status, collateral value, and the probability of collecting scheduled principal and interest payments when due. Loans that experience insignificant payment delays and payment shortfalls generally are not classified as impaired. Management determines the significance of payment delays and payment shortfalls on a case-by-case basis, taking into consideration all of the circumstances surrounding the loan and the borrower, including the length of the delay, the reasons for the delay, the borrower's prior payment record, and the amount of the shortfall in relation to the principal and interest owed. Impairment is measured by either the present value of expected future cash flows discounted at the loan's effective interest rate, the loan's obtainable market price, or the fair value of the collateral, if the loan is collateral-dependent. For such loans that are also classified as impaired, an allowance is established when the discounted cash flows (or collateral value or observable market price) of the impaired loan are lower than the carrying value of that loan. Large groups of smaller-balance loans are excluded from this analysis and collectively evaluated for impairment.

A troubled debt restructuring is a loan to a borrower that is experiencing financial difficulty that has been modified from its original terms and conditions in such a way that the Bank is granting the borrower a concession of some kind. The Bank has granted a variety of concessions to borrowers in the form of loan modifications. These loans are included in the impaired loan disclosures.

Note 1 – Organization and Summary of Significant Accounting Policies (continued)

Transfers of financial assets – Transfers of an entire financial asset, a group of entire financial assets, or participating interest in an entire financial asset 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 Bank, (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 Bank does not maintain effective control over the transferred assets through an agreement to repurchase them before their maturity.

Loan sales recognition – The Bank originates loans through the Small Business Administration (SBA) and sometimes sells the guaranteed portion. Loans held for sale consist of the guaranteed portion of SBA loans the Bank intends to sell after origination and are reflected at the lower of aggregate cost of fair value. The Bank retains the servicing on the sold guaranteed portion of SBA loans. The Bank receives a fee for servicing the loan. The Bank recognizes a sale on loans if the transferred portion (or portions) and any portion that continues to be held by the transferor are participating interests.

To determine the gain or loss on sale of loans, the Bank's investment in the loan is allocated among the retained portion of the loan, the servicing retained, and the sold portion of the loan, based on the relative fair market value of each portion. The gain or loss on the sold portion of the loan is based on the difference between the sale proceeds and the allocated investment in the sold portion of the loan. A discount is recorded against the carrying value of the retained portion of the loan to offset the fair value allocation of said retained portion.

SBA servicing assets – The Bank accounts for SBA servicing rights as separately recognized servicing rights and initially measures them at fair value. Fair value is based on market prices for comparable servicing contracts, when available, or alternatively, is based on a valuation model that calculates the present value of estimated future net servicing income. The Bank subsequently measures each SBA servicing asset using the amortization method. Under the amortization method, servicing assets are amortized into noninterest income in proportion to, and over the period of, estimated net servicing income. The amortized assets are assessed for impairment or increased obligation, at the loan level, based on the fair value at each reporting date. As of December 31, 2018 and 2017, SBA servicing assets are included in other assets on the consolidated balance sheets.

Federal Home Loan Bank (FHLB) stock – As a member of the FHLB system, the Bank is required to maintain a minimum investment level in FHLB stock based on specific percentages of the Bank's outstanding loans, total assets, or FHLB advances. This security is classified at cost, classified as a restricted security, and periodically evaluated for impairment based on ultimate recovery of par value. Both cash and stock dividends are reported as income. Management determined there was no impairment at December 31, 2018 and 2017. The Bank had $639,300 and $707,600 of FHLB stock at December 31, 2018 and 2017, respectively.

Pacific Coast Bankers' Bank (PCBB) stock – PCBB stock represents an investment by the Bank in the capital stock of PCBB of $190,000 at both December 31, 2018 and 2017, and is carried at cost, classified as a restricted security, and periodically evaluated for impairment. Both cash and stock dividends are reported as income.

Premises and equipment – Premises and equipment, including leasehold improvements, are stated at cost less accumulated depreciation or amortization, which is computed on the straight-line method over the estimated useful lives of the related assets, which range from 3 to 39 years. Assets are reviewed for impairment when events indicate their carrying value may not be recoverable. If management determines impairment exists, the asset is reduced with an offsetting charge to expense.

Note 1 – Organization and Summary of Significant Accounting Policies (continued)

Other real estate owned – Assets acquired through, or in lieu of, loan foreclosure are held-for-sale and are initially recorded at the lower of cost or estimated fair value at the date of foreclosure. Losses arising from the acquisition of property, in full or partial satisfaction of loans, are charged to the allowance for loan losses. Subsequent to foreclosure, valuations are periodically performed by management and the assets are carried at the lower of carrying amount or fair value less cost to sell. Revenue and expenses from operations and changes in the valuation allowance are included in net expenses from other real estate owned on the statements of income.

Income taxes – The provision for income tax is recorded under the liability method. 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. Deferred taxes result from temporary differences in the recognition of certain income and expense amounts between the Company's consolidated financial statements and its tax return. Deferred tax assets are reduced by a valuation allowance if, based on the weight of evidence available, it is more likely than not that some portion or all of a deferred tax asset will not be realized.

Financial instruments – In the ordinary course of business, the Company enters into off-balance-sheet financial instruments consisting of commitments to extend credit, commercial letters of credit, standby letters of credit, and financial guarantees. Such financial instruments are recorded in the consolidated financial statements when they are funded or related fees are incurred or received.

Advertising costs – The Bank expenses advertising costs as they are incurred. Total advertising expense was $116,561 and $128,128 for the years ended December 31, 2018 and 2017, respectively.

Restricted assets – FRB regulations generally require maintenance of certain minimum reserve balances on deposit with the FRB or another institution in a pass-through relationship. The amounts of such balances are generally based on asset size and other factors. Such requirements were $1,360,000 and $724,000 at December 31, 2018 and 2017, respectively.

Comprehensive income (loss) – Accounting principles generally require that recognized revenue, expenses, gains, and losses be included in net income. Certain changes in assets and liabilities, such as unrealized gains and losses on available-for-sale investments, are reported as a separate component of the stockholders' equity section of the balance sheets. Accumulated other comprehensive loss consists of only one component: unrealized gains or losses on investment securities available-for-sale.

Stock-based compensation plan – Compensation cost is recognized for stock options and restricted stock awards issued to employees, based on the fair value of these awards at the date of grant. A Black-Scholes model is utilized to estimate the fair value of stock options, while the market price of the Company's common stock at the grant date is used for restricted stock awards.

Compensation cost is recognized over the required service period, generally defined as the vesting period. For awards with graded vesting, compensation cost is recognized on a straight-line basis over the requisite service period for the entire award. The Company's accounting policy is to recognize forfeitures as they occur.

Fair value measurements – Fair values of financial instruments are estimated using relevant market information and other assumptions as disclosed in a separate note. Fair value estimates involve uncertainties and matters of significant judgment regarding interest rates, credit risk, prepayments, and other factors, especially in the absence of broad markets for particular items. Changes in assumptions or in market conditions could significantly affect these estimates.

Reclassifications – Certain reclassifications have been made to the prior-year financial statements in order to be in accordance with the current-year presentation with no effect on net income or total stockholder's equity.

Note 2 – Investment Securities

Amortized cost and estimated fair values of investment securities are summarized as follows:

December 31, 2018	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Available-for-sale securities				
Obligations of U.S. agencies	$ 5,000,000	$ 1,000	$ (86,000)	$ 4,915,000
Agency mortgage-backed securities	6,401,170	-	(160,000)	6,241,170
Agency collateralized mortgage obligations	2,908,621	-	(41,000)	2,867,621
Corporate bonds	1,000,000	-	(98,000)	902,000
SBA participation certificates	1,362,189	-	(44,000)	1,318,189
	$ 16,671,980	$ 1,000	$ (429,000)	$ 16,243,980
Held to maturity securities				
Municipal bonds	$ 1,006,711	$ 21,678	$ -	$ 1,028,389
December 31, 2017				
Available-for-sale securities				
Obligations of U.S. agencies	$ 3,000,000	$ -	$ (82,610)	$ 2,917,390
Agency mortgage-backed securities	5,399,359	-	(70,260)	5,329,099
Agency collateralized mortgage obligations	1,838,219	-	(33,460)	1,804,759
Corporate bonds	999,790	11,740	-	1,011,530
SBA participation certificates	1,495,008	3,010	(21,940)	1,476,078
	$ 12,732,376	$ 14,750	$ (208,270)	$ 12,538,856

The amortized cost and estimated fair value of investment securities at December 31, 2018, by contractual or expected maturity, are shown below. Expected maturities will differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

	Available-for-Sale		Held to Maturity	
	Amortized Cost	Estimated Fair Value	Amortized Cost	Estimated Fair Value
1 to 5 years	$ 5,630,637	$ 5,489,637	$ -	$ -
More than 5 years	11,041,343	10,754,343	1,006,711	1,028,389
	$ 16,671,980	$ 16,243,980	$ 1,006,711	$ 1,028,389

There were no investment securities pledged at December 31, 2018 or 2017.

Note 2 – Investment Securities (continued)

Information pertaining to investment securities with gross unrealized losses aggregated by investment category and length of time that individual securities have been in a continuous loss position is as follows at December 31:

	Less Than 12 Months		Greater Than 12 Months	
December 31, 2018	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value
Available-for-sale securities				
Obligations of U.S. agencies	$ -	$ -	$ (86,000)	$ 2,914,000
Agency mortgage-backed securities	-	-	(160,000)	5,277,479
Agency collateralized mortgage obligations	-	-	(41,000)	1,482,903
Corporate bonds	(98,000)	902,000	-	-
SBA participation certificates	(18,000)	871,550	(26,000)	446,639
	$ (116,000)	$ 1,773,550	$ (313,000)	$ 10,121,021
December 31, 2017				
Available-for-sale securities				
Obligations of U.S. agencies	$ -	$ -	$ (82,610)	$ 2,917,390
Agency mortgage-backed securities	(9,040)	908,173	(61,220)	4,420,926
Agency collateralized mortgage obligations	-	-	(33,460)	1,804,759
SBA participation certificates	-	-	(21,940)	490,045
	$ (9,040)	$ 908,173	$ (199,230)	$ 9,633,120

There were 19 and 16 securities in an unrealized loss position at December 31, 2018 and 2017, respectively. Unrealized losses have not been recognized into income because management does not intend to sell and does not expect it will be required to sell the investments. The unrealized loss is largely due to changes in market conditions and interest rates, rather than credit quality. The fair value is expected to recover as the underlying securities in the portfolio approach maturity date and market conditions improve. The Company does not consider these securities to be other than temporarily impaired at December 31, 2018 or 2017.

There were no securities sold during 2018. There was one security sold for a gross realized gain of $1,670 and one security sold for a gross realized loss of $3,399 in 2017.

Note 3 – Loans

The major classifications of loans at December 31 are summarized as follows:

	2018	2017
Residential 1-4 family	$ 22,075,589	$ 20,541,301
Residential multi-family	4,441,006	5,547,882
Residential construction, 1-4 family and multifamily	11,966,638	9,733,503
Home equity loans and lines of credit	3,767,479	3,442,056
Commercial & Industrial loans (C&I)	32,364,096	25,881,475
Agriculture*	19,880,167	25,997,655
Commercial real estate (CRE)		
Land/development and construction	29,032,830	20,552,009
Income property - owner-occupied (OOC)	67,164,104	50,015,441
Income property - nonowner-occupied (NOC)	69,334,433	80,219,297
Consumer	985,616	1,057,442
Total Loans	261,011,958	242,988,061
Less deferred loan fees, net	(706,280)	(690,066)
Less allowance for loan losses	(3,858,683)	(3,603,778)
Total loans, net	$ 256,446,995	$ 238,694,217

*Balances included in Agriculture primarily consist of maritime loans.

The Bank pledged certain commercial, multi-family, and 1-4 family residential loans as collateral for purposes of borrowings with the FHLB. Loans totaling $40,041,754 and $38,217,841 were pledged to the FHLB at December 31, 2018 and 2017, respectively (Note 8).

Past due loans – The following table presents past due loans, net of partial loan charge-offs, by type as of December 31, 2018 and 2017:

2018	30 - 59 Days Past Due	60 - 89 Days Past Due	90 Days or More Past Due	Total Past Due	Current	Total Loans
Residential 1-4 family	$ -	$ -	$ 320,371	$ 320,371	$ 21,755,218	$ 22,075,589
Residential multi-family	-	-	-	-	4,441,006	4,441,006
Residential construction, 1-4 family and multifamily	-	-	-	-	11,966,638	11,966,638
Home equity loans and lines of credit	-	-	-	-	3,767,479	3,767,479
C & I loans	-	-	-	-	32,364,096	32,364,096
Agriculture	-	-	457,029	457,029	19,423,138	19,880,167
CRE land/development and construction	-	-	-	-	29,032,830	29,032,830
CRE income property - OOC	-	-	-	-	67,164,104	67,164,104
CRE income property - NOC	-	-	-	-	69,334,433	69,334,433
Consumer	-	-	-	-	985,616	985,616
	$ -	$ -	$ 777,400	$ 777,400	$ 260,234,558	$ 261,011,958

Note 3 – Loans (continued)

2017	30 - 59 Days Past Due	60 - 89 Days Past Due	90 Days or More Past Due	Total Past Due	Current	Total Loans
Residential 1-4 family	$ -	$ -	$ 344,545	$ 344,545	$ 20,196,756	$ 20,541,301
Residential multi-family	-	-	-	-	5,547,882	5,547,882
Residential construction, 1-4 family and multifamily	-	-	-	-	9,733,503	9,733,503
Home equity loans and lines of credit	-	-	-	-	3,442,056	3,442,056
C & I loans	-	-	-	-	25,881,475	25,881,475
Agriculture	1,271,365	-	-	1,271,365	24,726,290	25,997,655
CRE land/development and construction	-	-	-	-	20,552,009	20,552,009
CRE income property - OOC	-	-	-	-	50,015,441	50,015,441
CRE income property - NOC	-	-	-	-	80,219,297	80,219,297
Consumer	-	-	-	-	1,057,442	1,057,442
	$ 1,271,365	$ -	$ 344,545	$ 1,615,910	$ 241,372,151	$ 242,988,061

The following table presents the recorded investment in nonaccrual loans at December 31:

	2018	2017
Residential 1-4 family	$ 320,371	$ 344,545
Agriculture	457,029	1,271,365
	$ 777,400	$ 1,615,910

There were no loans 90 days past due and still accruing interest at December 31, 2018 or 2017.

The following table presents loans individually evaluated for impairment by class of loans as of December 31, 2018 and 2017:

2018	Recorded Investments (Loan Balance Less Charge-off)	Unpaid Principal Balance	Related Allowance	Average Investment in Impaired Loans	Interest Income Recognized
With allowance recorded					
C & I loans	$ 62,904	$ 62,904	$ 21	$ 74,119	$ 5,855
With no allowance recorded					
Agriculture	557,029	950,701	-	1,257,683	4,663
Residential 1-4 family	320,371	320,371	-	331,260	-
	877,400	1,271,072	-	1,588,943	4,663
Total	$ 940,304	$ 1,333,976	$ 21	$ 1,663,062	$ 10,518

Note 3 – Loans (continued)

	Recorded Investments (Loan Balance Less Charge-off)	Unpaid Principal Balance	Related Allowance	Average Investment in Impaired Loans	Interest Income Recognized
2017					
With allowance recorded					
C & I loans	$ 87,132	$ 87,132	$ 21,306	$ 98,795	$ 6,658
Agriculture	1,271,365	1,271,365	4,556	1,271,365	68,272
	1,358,497	1,358,497	25,862	1,370,160	74,930
With no allowance recorded					
Agriculture	1,551,382	1,551,382	-	2,104,056	111,566
Residential 1-4 family	344,545	344,545	-	359,711	-
	1,895,927	1,895,927	-	2,463,767	111,566
Total	$ 3,254,424	$ 3,254,424	$ 25,862	$ 3,833,927	$ 186,496

The following table presents the balance in the allowance for loan losses and the recorded investment in loans by class and based on impairment method as of December 31, 2018 and 2017:

	Allowance for Loan Losses			Loans Receivable		
2018	Ending Balance	Ending Balance Individually Evaluated for Impairment	Ending Balance Collectively Evaluated for Impairment	Ending Balance	Ending Balance Individually Evaluated for Impairment	Ending Balance Collectively Evaluated for Impairment
Residential 1-4 family	$ 282,725	$ -	$ 282,725	$ 22,075,589	$ 320,371	$ 21,755,218
Residential multi-family	91,079	-	91,079	4,441,006	-	4,441,006
Residential construction, 1-4 family and multifamily	361,219	-	361,219	11,966,638	-	11,966,638
Home equity loans and lines of credit	35,976	-	35,976	3,767,479	-	3,767,479
C & I loans	649,310	21	649,289	32,364,096	62,904	32,301,192
Agriculture	270,535	-	270,535	19,880,167	557,029	19,323,138
CRE land/development and construction	120,753	-	120,753	29,032,830	-	29,032,830
CRE income property - OOC	1,037,974	-	1,037,974	67,164,104	-	67,164,104
CRE income property - NOC	977,014	-	977,014	69,334,433	-	69,334,433
Consumer	32,098	-	32,098	985,616	-	985,616
	$ 3,858,683	$ 21	$ 3,858,662	$ 261,011,958	$ 940,304	$ 260,071,654

Note 3 – Loans (continued)

	Allowance for Loan Losses			Loans Receivable		
2017	Ending Balance	Ending Balance Individually Evaluated for Impairment	Ending Balance Collectively Evaluated for Impairment	Ending Balance	Ending Balance Individually Evaluated for Impairment	Ending Balance Collectively Evaluated for Impairment
Residential 1-4 family	$ 240,939	$ -	$ 240,939	$ 20,541,301	$ 344,545	$ 20,196,756
Residential multi-family	77,618	-	77,618	5,547,882	-	5,547,882
Residential construction, 1-4 family and multifamily	307,832	-	307,832	9,733,503	-	9,733,503
Home equity loans and lines of credit	30,659	-	30,659	3,442,056	-	3,442,056
C & I loans	544,822	21,306	523,516	25,881,475	87,132	25,794,343
Agriculture	566,039	4,556	561,483	25,997,655	2,822,747	23,174,908
CRE land/development and construction	91,336	-	91,336	20,552,009	-	20,552,009
CRE income property - OOC	884,565	-	884,565	50,015,441	-	50,015,441
CRE income property - NOC	832,614	-	832,614	80,219,297	-	80,219,297
Consumer	27,354	-	27,354	1,057,442	-	1,057,442
	$ 3,603,778	$ 25,862	$ 3,577,916	$ 242,988,061	$ 3,254,424	$ 239,733,637

The following table presents the activity in the allowance for loan losses and impairment method by segment for the years ended December 31, 2018 and 2017:

2018	Beginning Balance	Provision for Loan Losses	Charge-offs	Recoveries	Ending Balance
Residential 1-4 family	$ 240,939	$ 41,786	$ -	$ -	$ 282,725
Residential multi-family	77,618	13,461	-	-	91,079
Residential construction,					-
1-4 family and multifamily	307,832	53,387	-	-	361,219
Home equity loans and lines					-
of credit	30,659	5,317	-	-	35,976
C & I loans	544,822	94,488	-	10,000	649,310
Agriculture	566,039	98,168	(393,672)	-	270,535
CRE land/development					-
and construction	91,336	15,840	-	13,577	120,753
CRE income property - OOC	884,565	153,409	-	-	1,037,974
CRE income property - NOC	832,614	144,400	-	-	977,014
Consumer	27,354	4,744	-	-	32,098
	$ 3,603,778	$ 625,000	$ (393,672)	$ 23,577	$ 3,858,683

Note 3 – Loans (continued)

2017	Beginning Balance	Provision for Loan Losses	Charge-offs	Recoveries	Ending Balance
Residential 1-4 family	$ 204,791	$ 36,148	$ -	$ -	$ 240,939
Residential multi-family	65,973	11,645	-	-	77,618
Residential construction, 1-4 family and multifamily	261,648	46,184	-	-	307,832
Home equity loans and lines of credit	26,059	4,600	-	-	30,659
C & I loans	450,937	79,597	-	14,288	544,822
Agriculture	396,118	169,921	-	-	566,039
CRE land/development and construction	73,576	12,987	-	4,773	91,336
CRE income property - OOC	751,853	132,712	-	-	884,565
CRE income property - NOC	707,696	124,918	-	-	832,614
Consumer	35,624	6,288	(14,558)	-	27,354
	$ 2,974,275	$ 625,000	$ (14,558)	$ 19,061	$ 3,603,778

Credit quality indicator – Federal regulations provide for the classification of lower quality loans and other assets, such as debt and equity securities, as substandard, doubtful, or loss. An asset is considered substandard if it is inadequately protected by the current net worth and pay capacity of the borrower or of any collateral pledged. Substandard assets include those characterized by the distinct possibility that the Company will sustain some loss if the deficiencies are not corrected. Assets classified as doubtful have all the weaknesses inherent in those classified substandard, with the added characteristic that the weaknesses present make collection or liquidation in full highly questionable and improbable on the basis of currently existing facts, conditions, and values. Assets classified as loss are those considered uncollectible and of such little value that their continuance as assets without the establishment of a specific loss reserve is not warranted.

Risk ratings are assigned to each loan. These numeric ratings range in value from 1 to 10 and are based on the following criteria:

1. Ratings of 1-5 indicate low to minimal credit risk (pass).

2. Rating of 6 indicates an average to above average credit risk with adequate repayment capacity when prolonged periods of adversity do not exist (watch).

3. Rating of 7 indicates potential weaknesses and higher credit risk requiring greater attention by Bank personnel and management to help prevent further deterioration (special mention).

4. Rating of 8 indicates a loss is possible if loan weaknesses are not corrected (substandard).

5. Rating of 9 indicates loss is highly probable; however, the amount of the loss has not yet been determined (doubtful).

6. Rating of 10 indicates the loan is uncollectible and, when identified, is charged off (loss).

Note 3 – Loans (continued)

Periodically, all loans are reviewed to assess the ability of the borrowers to service all interest and principal obligations and, as a result, the risk rating may be adjusted accordingly. Risk ratings should be reviewed and updated whenever appropriate, with more periodic reviews as the risk and dollar value of loss on the loan increases. In the event that full collection of principal and interest is not reasonably ensured, the loan is appropriately downgraded and, if warranted, placed on nonaccrual status even though the loan may be current as to principal and interest payments. Additionally, impairment analysis is used to assess whether a loan warrants specific reserves or a write-down of the loan.

The following table represents the internally assigned grade as of December 31 by type of loans:

2018	Pass/Watch	Special Mention	Substandard	Doubtful	Loss	Total
Residential 1-4 family	$ 21,172,379	$ 582,839	$ 320,371	$ -	$ -	$ 22,075,589
Residential multi-family	4,441,006	-		-	-	4,441,006
Residential construction, 1-4 family and multifamily	11,966,638	-		-	-	11,966,638
Home equity loans and lines of credit	3,712,534	54,945	-	-	-	3,767,479
C & I loans	30,486,167	-	1,877,929	-	-	32,364,096
Agriculture	19,323,138	-	557,029	-	-	19,880,167
CRE land/development and construction	29,032,830	-	-	-	-	29,032,830
CRE income property - OOC	64,722,868	1,111,897	1,329,339	-	-	67,164,104
CRE income property - NOC	69,334,433	-	-	-	-	69,334,433
Consumer	959,165	26,451	-	-	-	985,616
	$ 255,151,158	$ 1,776,132	$ 4,084,668	$ -	$ -	$ 261,011,958
2017						
Residential 1-4 family	$ 19,601,940	$ 594,816	$ 344,545	$ -	$ -	$ 20,541,301
Residential multi-family	5,547,882	-		-	-	5,547,882
Residential construction, 1-4 family and multifamily	9,733,503	-		-	-	9,733,503
Home equity loans and lines of credit	3,442,056	-	-	-	-	3,442,056
C & I loans	23,785,418	2,008,925	87,132	-	-	25,881,475
Agriculture	23,174,908	-	2,822,747	-	-	25,997,655
CRE land/development and construction	17,556,466	2,995,543	-	-	-	20,552,009
CRE income property - OOC	47,366,682	2,648,759	-	-	-	50,015,441
CRE income property - NOC	80,219,297	-	-	-	-	80,219,297
Consumer	994,044	63,398	-	-	-	1,057,442
	$ 231,422,196	$ 8,311,441	$ 3,254,424	$ -	$ -	$ 242,988,061

Loans classified as troubled debt restructurings (TDRs) totaled $572,755 and $2,844,530 at December 31, 2018 and 2017, respectively.

Note 3 – Loans (continued)

There were no newly restructured TDR loans during 2018 and no TDR's that defaulted within 12 months of the modification date. There were no newly restructured TDR loans during 2017 and one TDR loan of $1,271,228 that defaulted within 12 months of the modification date.

The Bank had no commitments to extend additional credit to borrowers owing loans whose terms have been modified in troubled debt restructurings.

Note 4 – Land, Buildings, Leaseholds, and Equipment

Land, Buildings, Leaseholds, and Equipment at December 31 are classified as follows:

	2018	2017
Land and buildings	$ 11,050,000	$ 11,050,000
Leasehold improvements	1,732,638	1,681,564
Furniture, fixtures, and office equipment	1,183,902	1,282,308
	13,966,540	14,013,872
Accumulated depreciation and amortization	(3,095,979)	(2,868,057)
	$ 10,870,561	$ 11,145,815

The Bank leased its office, administrative, and loan operations space at standard market rates from a related party LLC, of which two directors are members. During 2017, the Bank purchased from an LLC, whose members are related parties, the current main branch building, and two floors of an adjacent building in Everett, Washington, for $11,050,000, for the purposes of continued operations and leasing income. Upon completion of the purchase, the related leases owed by the Bank were dissolved.

Total amounts paid to related parties for Everett lease space were $0 and $87,626 for the years ended December 31, 2018 and 2017, respectively (Note 12).

The Company has a lease agreement with an unaffiliated party for the Ballard Branch location. The lease is a three-year lease ending August 2021 and contains one renewal option for three years.

The Company also has a lease agreement with an unaffiliated party for the Lynnwood office. The lease is a five-year lease ending January 2023 and contains one renewal option for five years.

All lease agreements require the Company to pay its pro rata share of building operating expenses. The minimum annual lease payments through the lease term for the years ending December 31 are as follows:

2019	$ 193,905
2020	200,172
2021	193,582
2022	173,640
Thereafter	14,505
	$ 775,804

Rental expense charged to operations was $219,771 and $202,012 for the years ended December 31, 2018 and 2017, respectively.

Note 4 – Land, Buildings, Leaseholds, and Equipment (continued)

A portion of the Company's owned premises are leased to unaffiliated third parties. Minimum rental receipts under sublease agreements for future years ending December 31 are as follows:

2019	$ 442,540
2020	427,337
2021	379,829
2022	215,537
Thereafter	162,403
	$ 1,627,646

Note 5 – Other Real Estate Owned

The following table presents other real estate owned as of December 31:

	2018	2017
Beginning balance	$ 4,462,433	$ 4,930,275
Capitalized improvements	101,797	37,736
Sales	(1,284,044)	(505,578)
Ending balance	$ 3,280,186	$ 4,462,433

Other real estate owned as of December 31, 2018, consists of developed and raw land and a single-family residence.

Note 6 – Servicing Asset

Loans serviced totaled $47,922,945 and $23,392,759 at December 31, 2018 and 2017, respectively. The fair value of servicing assets held at December 31, 2018 and 2017, were $1,074,769 and $502,810, respectively.

Changes in the balance of the servicing asset were as follows for the years ended December 31:

	2018	2017
Balance, beginning of year	$ 502,810	$ 68,147
Additions	655,069	490,878
Amortization	(219,694)	(56,215)
Balance, end of year	$ 938,184	$ 502,810

Note 6 – Servicing Asset (continued)

The projected amortized expense of the servicing asset is an estimate. The amortization expense for future periods was calculated by applying the same quantitative factors, such as servicing asset prepayment assumptions that were used to determine amortization expense for 2018. These factors are inherently subject to significant fluctuations, primarily due to the effect that changes in interest rates have on loan prepayment experience. Accordingly, any projection of servicing asset amortization in future periods is limited by the conditions that existed at the time the calculations were performed and may not be indicative of actual amortization expense that will be recorded in future periods. The constant prepayment rate as of December 31, 2018, is 12.23%. The discount rate as of December 31, 2018, is 11.47%.

At December 31, 2018, the expected weighted-average life of the Bank's servicing asset was 6.45 years. Projected amortization expense at December 31, 2018, is estimated to be as follows:

2019	$ 253,447
2020	213,045
2021	172,644
2022	132,243
2023	92,050
Thereafter	74,755
Carrying value of servicing asset	$ 938,184

The following represents servicing fees earned in connection with the servicing asset and is included in the accompanying consolidated financial statements as a component of noninterest income for the years ended December 31:

	2018	2017
Servicing fees	$ 308,949	$ 91,960

Late fees associated with the servicing asset are immaterial for the years ended December 31, 2018 and 2017.

Note 7 – Deposits

Deposits as of December 31 consisted of the following:

	2018	2017
Demand accounts		
Noninterest-bearing	$ 47,703,889	$ 41,249,215
Interest-bearing	28,924,231	26,015,933
Savings accounts	4,055,960	3,566,323
Money market accounts	97,046,783	105,338,071
Certificates of deposit	103,006,623	71,356,440
	$ 280,737,486	$ 247,525,982

Note 7 – Deposits (continued)

At December 31, 2018, scheduled maturities of certificates of deposit are as follows:

2019	$ 58,052,081
2020	28,035,324
2021	15,921,677
2022	249,105
2023	748,436
	$ 103,006,623

Certificates of deposit that met or exceeded the $250,000 federally insured limit were $37,399,809 and $11,438,809 at December 31, 2018 and 2017, respectively.

Note 8 – Credit Arrangements

Borrowings

The Company has line-of-credit agreements with separate unaffiliated banks totaling $14,400,000, subject to certain collateral requirements. These two lines provide for lending at the corresponding bank's federal fund rates. There were no borrowings outstanding on either of these lines at December 31, 2018 and 2017.

The Bank is a member of the FHLB of Des Moines and, as such, has a committed credit line of up to 35% of total eligible assets, subject to certain collateral requirements. Borrowings generally provide for interest at the then-current published rates. At December 31, 2018 and 2017, loans pledged to the FHLB equated to a borrowing capacity after indebtedness of $20,857,491 and $16,824,591, respectively. At December 31, 2018 and 2017, the Bank had $7,368,357 and $10,701,139 of borrowings, respectively, outstanding with the FHLB, with fixed rates ranging from 1.32% to 3.02% under these agreements. The borrowings have a weighted-average interest rate of 2.93% and 1.41% as of December 31, 2018 and 2017, respectively. Current borrowings are collateralized by pledged loans (Note 3).

The contractual maturities of FHLB advances at December 31, 2018, are as follows:

2019	$ 1,918,504
2020	449,853
2021	-
2022	-
2023	5,000,000
	$ 7,368,357

Subordinated debt

On December 21, 2018, (the Closing Date), Mountain Pacific Bancorp, Inc. issued 12 unsecured subordinated term notes (the Subordinated Notes) in the aggregate principal amount of $7,500,000 due December 31, 2025 (maturity date), pursuant to Subordinated Loan Agreements with various investors, two of which are Directors of the Company. The Subordinated Notes bear interest at an annual interest rate of 6.50%, payable by the Company quarterly in arrears beginning March 31, June 30, September 30, and December 31, of each year, commencing on the first such date following the Closing Date and on the maturity date. Debt issuance costs were not significant.

The Subordinated Notes will mature on December 31, 2025, but may be prepaid at the Company's option and with regulatory approval at any time on or after five years after the Closing Date or at any time upon certain events, such as a change in the regulatory capital treatment of the Subordinated Notes or the interest on the Subordinated Notes no longer being deductible by the Company for United States federal income tax purposes. The Company contributed $5,000,000 of the proceeds from the Subordinated Notes as additional capital to the Bank in the fourth quarter of 2018 and used the balance to fund general working capital and operating expenses.

Note 9 – Federal Income Taxes

The components of the federal income tax expense are as follows at December 31:

	2018	2017
Current	$ 1,060,000	$ 1,000,130
Deferred	90,000	1,489,870
	$ 1,150,000	$ 2,490,000

The following are the significant components of the Company's deferred tax assets and liabilities at December 31:

	2018	2017
Deferred tax asset		
Allowance for loan losses	$ 524,128	$ 392,878
Net operating loss carryforward	1,163,067	1,245,829
Organization expenditures	17,314	17,822
OREO valuation adjustments	125,756	284,841
Nonaccrual interest	49,558	25,758
Unrealized losses on securities	89,880	40,639
SBA loan discount	211,132	-
Other	81,368	(22,013)
Subtotal	2,262,203	1,985,754
Deferred tax liabilities		
Deferred loan costs	106,808	92,458
SBA servicing asset	197,019	105,590
Property and equipment depreciation	138,376	(67,294)
Subtotal	442,203	130,754
Net deferred tax asset	$ 1,820,000	$ 1,855,000

Pursuant to Sections 382 and 383 of the Internal Revenue Code, annual use of net operating loss and credit carryforwards may be limited in the event a cumulative change in ownership of more than 50% occurs within a three-year period. The Bank determined such an ownership change occurred as of December 12, 2011, as a result of the exercise of stock warrants. This ownership change results in annual limitations on the use of net operating loss carryforwards and limits the Bank's ability to fully utilize its deferred tax assets. The Bank's net operating loss deferred tax asset has been reduced to account for Section 382 limitations.

The Bank has federal net operating loss carryforwards of approximately $6.0 million at December 31, 2018, before the consideration of any Section 382 limits. Federal net operating loss carryforwards, to the extent not used, will begin to expire in 2029.

Note 9 – Federal Income Taxes (continued)

At December 31, 2018, the Bank had unamortized preopening expenditures of approximately $61,000 (for tax reporting purposes) that can be used to offset future federal income taxes. These expenditures are amortizing at a rate of approximately $24,000 per year.

At December 31, 2018 and 2017, the Company had no unrecognized tax benefits. 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 income tax returns in the U.S. federal jurisdiction.

Note 10 – Employee Benefits

The Company has a 401(k) defined contribution plan (the 401k Plan) for those employees who meet the eligibility requirements set forth in the 401(k) Plan. Eligible employees can contribute up to 100% of compensation subject to certain limits based on federal tax laws. The 401(k) Plan also allows for discretionary employer matching contributions equal to 100% up to the first 3%, and 50% up to the next 2% of compensation. Matching contributions vest immediately. The Company's contribution for the years ended December 31, 2018 and 2017, was $136,566 and $132,767, respectively.

Note 11 – Stockholders' Equity

Regulatory capital – The Bank and the bank holding company are subject to various regulatory capital requirements administered by the federal banking agencies. Failure to meet minimum capital requirements can initiate certain mandatory—and possibly additional discretionary—actions by regulators that, if undertaken, could have a direct material effect on the Company's consolidated financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Bank must meet specific capital guidelines that involve quantitative measures of assets, liabilities, and certain off-balance-sheet items, as calculated under regulatory accounting practices. Capital amounts and classifications are also subject to qualitative judgments by the regulators about components, risk weightings, and other factors.

Quantitative measures established by regulation to ensure capital adequacy require the Bank to maintain minimum amounts and ratios (set forth in the following table) of total, common equity Tier I, and Tier I capital (as defined in the regulations) to risk-weighted assets (as defined), and of Tier I (as defined) capital to average assets (as defined). As of December 31, 2018, management believes that the Company and the Bank meet all capital adequacy requirements to which it is subject.

To be categorized as adequately capitalized, the Bank must maintain minimum total risk-based, common equity Tier I risk-based, Tier I risk-based, and Tier I leverage ratios, as set forth in the table. The institution is well capitalized under the prompt corrective action provisions.

As of December 31, 2018, the most recent notification from the FDIC categorized the Bank as well capitalized under the regulatory framework for prompt corrective action. To be categorized as well capitalized, an institution must maintain minimum total risk-based, common equity Tier I risk-based, Tier I risk-based, and Tier I leverage ratios, as set forth in the following table. There are no conditions or events since the notification that management believes have changed the Bank's category. The Company's consolidated assets are less than $1 billion at the beginning of the year, therefore consolidated ratios are not required to be disclosed.

Note 11 – Stockholders' Equity (continued)

The Bank's actual capital amounts and ratios as of December 31 are also presented in the table.

	Actual		For Capital Adequacy Purposes		For Capital Adequacy with Capital Buffer		To Be Well Capitalized Under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio	Amount	Ratio
As of December 31, 2018								
Total capital (to risk-weighted assets)	$ 39,539,000	13.55%	$ 23,347,677 ≥	8.00%	$ 28,819,891 ≥	9.88%	$ 29,184,597 ≥	10.00%
Tier I capital (to risk-weighted assets)	35,887,000	12.30%	17,510,836 ≥	6.00%	22,982,951 ≥	7.88%	23,347,782 ≥	8.00%
Common equity Tier 1 capital (to risk-weighted assets)	35,887,000	12.30%	13,133,127 ≥	4.50%	18,605,246 ≥	6.38%	18,970,073 ≥	6.50%
Tier I capital (to average assets)	35,887,000	10.82%	13,267,036 ≥	4.00%	N/A		16,583,795 ≥	5.00%
As of December 31, 2017								
Total capital (to risk-weighted assets)	$ 28,853,000	10.88%	$ 21,222,658 ≥	8.00%	$ 24,538,678 ≥	9.25%	$ 26,528,323 ≥	10.00%
Tier I capital (to risk-weighted assets)	25,527,000	9.62%	15,916,904 ≥	6.00%	19,233,018 ≥	7.25%	21,222,539 ≥	8.00%
Common equity Tier 1 capital (to risk-weighted assets)	25,527,000	9.62%	11,937,678 ≥	4.50%	15,253,773 ≥	5.75%	17,243,313 ≥	6.50%
Tier I capital (to average assets)	25,527,000	9.04%	11,299,007 ≥	4.00%	N/A		14,123,759 ≥	5.00%

The final rules implementing Basel Committee on Banking Supervision's capital guidelines for U.S. banks (Basel III rules) became effective for the Bank 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 Bank must hold a capital conservation buffer above the adequately capitalized risk-based capital ratios. The capital conservation buffer is being phased in from 0.0% for 2015 to 2.50% by 2019. The capital conservation buffer for 2018 is 1.875%. The net unrealized gain or loss on available-for-sale securities is not included in computing regulatory capital.

Note 12 – Stock-Based Compensation Plan

The Company has one stock-based compensation plan, which is described below. The total compensation cost for restricted stock and stock options that has been charged against income for the plan was $223,071 and $171,103 in 2018 and 2017. There was no compensation cost capitalized and no income tax benefits realized on these stock-based compensation arrangements in 2018 or 2017.

Stock option plan – In 2017, stockholders approved an equity incentive plan (the Plan) to promote the best interest of the Company by providing an incentive to those key employees who contribute to its success. The Plan permits the grant of incentive stock options for employees, nonqualified stock options for directors, and restricted stock grants for directors. The maximum amount of common stock that may be issued under the Plan is 1,000,000 shares, of which there are 100,000 shares available for restricted stock grants. As of December 31, 2018, 585,000 shares remained available to grant out of the Plan of which 67,750 are available for restricted stock grants. The Plan will expire in 2027.

Incentive stock and nonqualified stock option awards are generally granted with an exercise price equal to the market price of the Company's stock at the date of grant; those option awards generally vest and become exercisable in incremental percentages from one to five years of continuous service from the grant date, and expire after 10 years. Certain option and share awards provide for accelerated vesting upon death of the optionee or if there is a change in control (as defined in the Plan).

Note 12 – Stock-Based Compensation Plan (continued)

Restricted stock grants vest ratably over three to five years from the date of grant. The fair value equals their value on the date of grant. The fair value of each option award is estimated on the date of grant using the Black-Scholes-Merton valuation model that uses the assumptions noted in the following table. Expected volatilities are based on historical volatility of the Company's stock and other factors. The expected term of options granted was evaluated by a calculation that factored in the contractual term and vesting period, and considered different employee segments. The risk-free interest rate for periods within the contractual life of the option is based on the U.S. Treasury yield curve in effect at the time of grant.

	2018	2017
Risk-free interest rate	2.27-2.38%	2.46%
Dividend yield rate	0.00%	0.00%
Expected volatility	18-19%	28%
Expected term (in years)	5.8-6.6 years	6.5 years

A summary of incentive and nonqualified stock option activity is presented below:

	Granted Options for Common Stock	Weighted-Average Exercise Price of Shares Under Plan	Weighted-Average Remaining Contractual Term (Years)
Outstanding at December 31, 2017	640,770	$ 3.36	
Granted	210,000	4.48	
Exercised	(17,900)	3.25	
Forfeited	(21,000)	4.11	
Outstanding at December 31, 2018	811,870	$ 3.64	6.72
Options exercisable at December 31, 2018	370,470	$ 3.20	4.27

The weighted-average grant-date fair value of options granted was $1.10 and $1.26 for each of the years ended December 31, 2018 and 2017, respectively. As of December 31, 2018, there was $364,062 of total unrecognized compensation cost related to incentive and nonqualified stock options granted under the Plan. That cost is expected to be recognized over a weighted-average period of 1.96 years. There were no tax benefits realized from the exercise of options in 2018 or 2017.

Note 12 – Stock-Based Compensation Plan (continued)

Restricted stock grants – The fair value of restricted stock grants is determined based on the last trade price or most recent stock valuation on the grant date. A summary of nonvested restricted stock grants activity is presented below:

	Shares	Weighted-Average Grant-Date Fair Value
Nonvested at December 31, 2017	22,700	$ 3.64
Granted	20,000	4.48
Vested	(12,700)	3.58
Forfeited	(3,750)	4.22
Nonvested at December 31, 2018	26,250	$ 4.22

As of December 31, 2018, there was $70,498 of total unrecognized compensation cost related to restricted stock granted under the Plan. That cost is expected to be recognized over a weighted-average period of approximately 1.38 years.

Note 13 – Related Party Transactions

Certain directors, executive officers, and principal stockholders are Bank customers and have had banking transactions with the Bank. All loans and commitments included in such transactions were made in compliance with applicable laws on substantially the same terms (including interest rates and collateral) as those prevailing at the time for comparable transactions with other persons and do not involve more than the normal risk of collectability or present any other unfavorable features. The following summarizes these transactions with directors, executive officers, principal stockholders, and companies with which they are associated at December 31:

	2018	2017
Beginning balance	$ 6,991,737	$ 4,590,646
New loans	1,151,991	2,656,807
Repayments	(1,330,054)	(255,716)
Ending balance	$ 6,813,674	$ 6,991,737
Deposits	$ 13,055,436	$ 15,636,106

During 2017, the Bank leased office space from a related party LLC, of which two directors are members (Note 4). As of December 31, 2017, no related party leases remained.

Two directors were investors in the Company's subordinated debt offering in 2018. Rates and terms are consistent for all investors.

Note 14 – Commitments and Contingencies

The Company is a party to financial instruments with off-balance-sheet risk in the normal course of business to meet the financing needs of its customers and to reduce its own exposure to fluctuations in interest rates. These financial instruments include commitments to extend credit, standby letters of credit, and financial guarantees. Those instruments involve, to varying degrees, elements of credit and interest rate risk in excess of the amount recognized in the balance sheets. The contract or notional amounts of those instruments reflect the extent of the Company's involvement in particular classes of financial instruments.

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

Commitments to extend credit and financial guarantees – Commitments to extend credit are agreements to lend to a customer, as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Because many of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. The Company's experience has been that approximately 81% of loan commitments are drawn upon by customers. The Company evaluates customers' creditworthiness on a case-by-case basis and follows the Bank's normal credit policies. The amount of collateral obtained, if it is deemed necessary by the Bank upon extension of credit, is based on management's credit evaluation of the counterparty. Collateral held varies but may include accounts receivable, inventory, property, plant and equipment, income-producing commercial properties, and other real estate.

The distribution of commitments to extend credit approximates the distribution of loans outstanding. Commercial and standby letters of credit were granted primarily to commercial borrowers. The Company, as a matter of policy, does not extend credit in excess of 20% of Tier I capital, or approximately $7.9 million, to any single borrower or group of related borrowers.

Standby letters of credit and financial guarantees written are conditional commitments issued by the Company to guarantee the performance of a customer to a third party. Those guarantees are primarily issued to support public and private borrowing arrangements, including commercial paper, bond financing, and similar transactions. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loan facilities to customers. The Company maintains various levels of collateral supporting those commitments for which collateral is deemed necessary.

The Company has not been required to perform on any financial guarantees. The Company has not incurred any losses on its commitments in 2018 or 2017.

A summary of the notional amounts of the Company's financial instruments with off-balance-sheet risk at December 31 follows:

	2018	2017
Commitments to extend credit	$ 50,488,510	$ 42,709,885
Standby letters of credit	$ 160,000	$ 228,548

Legal contingencies – Various legal claims also arise from time to time in the normal course of business that, in the opinion of management, will have no material effect on the Company's consolidated financial statements.

Note 15 – Fair Value of Financial Instruments

Fair value is the price to sell an asset or transfer a liability in an orderly transaction between market participants in the Company's principal market. The Company has established and documented its process for determining the fair values of its assets and liabilities, where applicable. Fair value is based on quoted market prices, when available, for identical or similar assets or liabilities. In the absence of quoted market prices, management determines the fair value of the Company's assets and liabilities using valuation models or third-party pricing services, both of which rely on market-based parameters when available, such as interest rate yield curves, option volatilities and credit spreads, or unobservable inputs. Unobservable inputs may be based on management's judgment, assumptions, and estimates related to credit quality, liquidity, interest rates, and other relevant inputs.

Valuation adjustments, such as those pertaining to counterparty and the Company's own credit quality and liquidity, may be necessary to ensure that assets and liabilities are recorded at fair value. Credit valuation adjustments are made when market pricing is not indicative of the counterparty's credit quality.

Any changes to valuation methodologies are reviewed by management to ensure that they are relevant and justified. Valuation methodologies are refined as more market-based data becomes available.

There are three levels of inputs that may be used to measure fair values:

Level 1 – Quoted prices (unadjusted) in active markets for identical assets or liabilities.

Level 2 – Either (i) quoted prices for similar assets or liabilities; (ii) observable inputs, such as interest rates or yield curves; or (iii) inputs derived principally from or corroborated by observable market data.

Level 3 – Unobservable inputs.

The hierarchy gives the highest ranking to Level 1 inputs and the lowest ranking to Level 3 inputs. The level in the fair value hierarchy within which the fair value measurement in its entirety falls is determined based on the lowest level input that is significant to the overall fair value measurement.

Qualitative disclosures of valuation techniques

Investment securities – Where quoted prices are available in an active market, securities are classified as Level 1. Level 1 instruments include highly liquid government bonds, securities issued by the U.S. Treasury, and exchange-traded equity securities. If quoted prices are not available, management determines fair value using pricing models, quoted prices of similar securities, or discounted cash flows. Such instruments are classified as Level 2. In certain cases, where there is limited activity in the market for a particular instrument, assumptions must be made to determine its fair value. Such instruments are classified as Level 3.

Note 15 – Fair Value of Financial Instruments (continued)

Assets measured at fair value on a recurring basis – Assets are considered to be fair valued on a recurring basis if fair value is measured regularly (i.e., daily, weekly, monthly, or quarterly). The following table shows the Company's assets and liabilities measured at fair value on a recurring basis:

	Level 1	Level 2	Level 3	Total
2018				
Obligations of U.S. agencies	$ -	$ 4,915,000	$ -	$ 4,915,000
Agency mortgage-backed securities	-	6,241,170	-	6,241,170
Agency collateralized mortgage obligations	-	2,867,621	-	2,867,621
Corporate bonds	-	902,000	-	902,000
SBA participation certificates		1,318,189		1,318,189
2017				
Obligations of U.S. agencies	$ -	$ 2,917,390	$ -	$ 2,917,390
Agency mortgage-backed securities	-	5,329,099	-	5,329,099
Agency collateralized mortgage obligations	-	1,804,759	-	1,804,759
Corporate bonds	-	1,011,530	-	1,011,530
SBA participation certificates		1,476,078		1,476,078

Assets measured at fair value on a nonrecurring basis – Assets are considered to be fair valued on a nonrecurring basis if the fair value measurement of the instrument does not necessarily result in a change in the amount recorded on the balance sheets. Generally, nonrecurring valuation is the result of the application of other accounting pronouncements that require assets or liabilities to be assessed for impairment or recorded at the lower of cost or fair value. The following table presents the Company's assets measured at fair value on a nonrecurring basis:

	Level 1	Level 2	Level 3	Total
December 31, 2018				
Impaired loans	$ -	$ -	$ 940,304	$ 940,304
Other real estate owned	-	-	3,280,186	3,280,186
December 31, 2017				
Impaired loans	$ -	$ -	$ 3,254,424	$ 3,254,424
Other real estate owned	-	-	4,462,433	4,462,433

Valuations of impaired loans are periodically performed by management, and the fair value of the loans is carried at the fair value of the underlying collateral less cost to foreclose, sell, and carry the collateral. Fair value of the underlying collateral is determined by an appraisal performed by a qualified independent appraiser. Other real estate owned is valued in a similar manner as impaired loans.

Note 15 – Fair Value of Financial Instruments (continued)

Quantitative information about Level 3 fair value measurements – The range and weighted average of the significant unobservable inputs used to fair value Level 3 nonrecurring assets during the years ending December 31, 2018 and 2017, along with the valuation techniques used, are shown in the following table:

	Fair Value at December 31, 2018	Valuation Technique	Unobservable Input	Range[1]
Impaired loans	$ 940,304	Market comparable	Adjustment to appraisal value	0% - 10% (5%)
OREO	3,280,186	Market comparable	Adjustment to appraisal value	0% - 10%

[1] Discount for selling costs.

	Fair Value at December 31, 2017	Valuation Technique	Unobservable Input	Range[1]
Impaired loans	$ 3,254,424	Market comparable	Adjustment to appraisal value	0% - 10%
OREO	4,462,433	Market comparable	Adjustment to appraisal value	0% - 10%

[1] Discount for selling costs.