REPORT OF INDEPENDENT AUDITORS
AND FINANCIAL STATEMENTS FOR

MOUNTAIN PACIFIC BANK

December 31, 2017 and 2016

MOSSADAMS

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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.

Report of Independent Auditors

To the Board of Directors and Stockholders
Mountain Pacific Bank

Report on the Financial Statements

We have audited the accompanying financial statements of Mountain Pacific Bank (the Bank), which comprise the balance sheets as of December 31, 2017 and 2016, and the related statements of income, comprehensive income, changes in stockholders' equity, and cash flows for the years then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these 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 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 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 financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the 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 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 financial statements.

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

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Mountain Pacific Bank as of December 31, 2017 and 2016, and the results of its operations and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Moss Adams LLP

Everett, Washington
February 27, 2018

ASSETS

	December 31, 2017	December 31, 2016
Cash and due from banks	$ 4,145,191	$ 4,570,028
Federal funds sold and excess balance account - Federal Reserve Bank	10,702,000	14,789,000
Total cash and cash equivalents	14,847,191	19,359,028
Interest-bearing deposits in banks	-	2,000,000
Investment securities available-for-sale	12,538,856	12,543,358
Loans held-for-sale	885,000	-
Loans	242,297,995	191,469,441
Less allowance for loan losses	3,603,778	2,974,275
Total loans, net	238,694,217	188,495,166
Premises and equipment, net	11,145,815	449,373
Accrued interest receivable	788,072	814,698
Federal Home Loan Bank (FHLB) stock and Pacific Coast Bankers’ Bank (PCBB) stock, at cost	897,600	503,200
Other real estate owned (OREO), net	4,462,433	4,930,275
Deferred tax asset, net	1,855,000	3,350,000
Other assets	983,013	479,845
Total assets	$ 287,097,197	$ 232,924,943

LIABILITIES AND STOCKHOLDERS’ EQUITY

	2017	2016
Deposits		
Noninterest-bearing	$ 41,249,215	$ 35,096,445
Interest-bearing	206,276,767	169,209,948
Total deposits	247,525,982	204,306,393
FHLB advances	10,701,139	2,000,000
Accrued interest payable	160,045	85,390
Other liabilities	1,348,205	921,229
Total liabilities	259,735,371	207,313,012
Stockholders’ equity		
Common stock, $1 par value, 10,000,000 shares authorized; 6,244,636 and 6,231,451 issued and outstanding at December 31, 2017 and 2016, respectively	6,244,636	6,231,451
Additional paid-in capital	27,100,103	26,927,921
Accumulated deficit	(5,824,393)	(7,404,393)
Accumulated other comprehensive loss, net of tax	(158,520)	(143,048)
Total stockholders’ equity	27,361,826	25,611,931
Total liabilities and stockholder’s equity	$ 287,097,197	$ 232,924,943

Mountain Pacific Bank
Statements of Income

	Years Ended December 31, 2017	2016
INTEREST AND DIVIDEND INCOME		
Loans, including fees	$ 11,022,558	$ 8,588,871
Federal funds sold and excess balance account - Federal Reserve Bank and interest-bearing deposits in banks	99,070	41,878
Investment securities	284,319	190,595
Dividends from FHLB and PCBB	14,625	19,517
Total interest and dividend income	11,420,572	8,840,861
INTEREST EXPENSE		
Deposits	1,508,393	874,645
FHLB advances and other borrowings	78,280	29,225
Total interest expense	1,586,673	903,870
Net interest income	9,833,899	7,936,991
PROVISION FOR LOAN LOSSES	625,000	400,000
Net interest income after provision for loan losses	9,208,899	7,536,991
NONINTEREST INCOME		
Service fees	547,536	382,731
Rental income	301,661	-
(Loss) gain on sale of investment securities available-for-sale	(1,729)	27,624
Gain on sale of loans	2,007,965	54,436
Total noninterest income	2,855,433	464,791
NONINTEREST EXPENSES		
Salaries and employee benefits	4,344,799	3,710,667
Occupancy and equipment	810,280	933,182
Data processing	494,629	430,695
Advertising and business development	263,541	248,745
Professional fees and state taxes	503,040	446,886
Regulatory assessments	191,753	225,450
Other real estate owned, net	155,582	155,560
Other	1,255,708	480,597
Total noninterest expenses	8,019,332	6,631,782
NET INCOME BEFORE PROVISION FOR FEDERAL INCOME TAXES	4,045,000	1,370,000
PROVISION FOR FEDERAL INCOME TAXES	2,490,000	530,000
NET INCOME	$ 1,555,000	$ 840,000

See accompanying notes.

	Years Ended December 31, 2017	2016
NET INCOME	$ 1,555,000	$ 840,000
OTHER COMPREHENSIVE INCOME		
Unrealized gain (loss) on securities		
Unrealized holding gain (loss)	11,998	(187,164)
Tax (expense) benefit on unrealized holding gain and loss	(4,199)	65,354
Reclassification adjustments for realized (gains) losses on sales	2,660	(27,624)
Tax expense (benefit) for realized gains and losses on sales	(931)	9,646
Other comprehensive income (loss)	9,528	(139,788)
COMPREHENSIVE INCOME	$ 1,564,528	$ 700,212

Mountain Pacific Bank
Statements of Changes in Stockholders' Equity

	Common Stock Shares	Common Stock Amount	Additional Paid-In Capital	Accumulated Deficit	Accumulated Other Comprehensive Income (Loss)	Total Stockholders' Equity
BALANCE, December 31, 2015	6,212,541	$ 6,212,541	$ 26,794,351	$ (8,244,393)	$ (3,260)	$ 24,759,239
Net income	-	-	-	840,000	-	840,000
Other comprehensive loss, net	-	-	-	-	(139,788)	(139,788)
Stock awards vested	6,630	6,630	(6,630)	-	-	-
Stock options exercised	11,780	11,780	23,741	-	-	35,521
Stock warrants exercised	500	500	4,500	-	-	5,000
Stock-based compensation expense	-	-	111,959	-	-	111,959
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

See accompanying notes.

	Years Ended December 31, 2017	2016
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income	$ 1,555,000	$ 840,000
Adjustments to reconcile net income to net cash flows from operating activities		
Provision for loan losses	625,000	400,000
Stock-based compensation expense including stock in lieu of compensation	171,102	111,959
Depreciation and amortization	400,106	294,737
Amortization on investment securities	73,476	87,774
Loss (gain) on sale of investment securities	1,729	(27,624)
Gain on sale of loans	(2,007,965)	(54,436)
Proceeds from sale of loans	22,351,747	554,023
Originations of loans held-for-sale	(19,458,782)	-
Deferred federal income taxes	1,489,870	250,000
Changes in operating assets and liabilities		
Accrued interest receivable	26,626	(226,874)
Other assets	(513,038)	(52,433)
Accrued interest payable	74,655	14,075
Other liabilities	426,976	321,620
Net cash from operating activities	5,216,502	2,512,821
CASH FLOWS FROM INVESTING ACTIVITIES		
Net change in interest-bearing deposits in banks	2,000,000	1,000,000
Net change in loans made to customers	(52,594,051)	(39,350,121)
Purchases of investment securities available-for-sale	(2,037,188)	(8,158,528)
Proceeds from principal paydowns of mortgage-backed securities	1,602,854	1,634,046
Proceeds from sale of investments available-for-sale	388,159	593,571
Proceeds from maturities and calls of investments available-for-sale	-	1,998,675
Proceeds from maturities and calls of investments held to maturity	-	999,745
Proceeds from sales of other real estate owned	505,578	539,110
Capitalized costs for other real estate owned	(37,736)	(128,965)
(Purchase) redemption of FHLB stock	(394,400)	73,400
Additions to premises and equipment, net	(11,096,548)	(85,664)
Net cash used in investing activities	(61,663,332)	(40,884,731)
CASH FLOWS FROM FINANCING ACTIVITIES		
Net increase in noninterest-bearing deposits	6,152,770	4,008,094
Net increase in interest-bearing deposits	37,066,819	36,449,439
Proceeds from exercise of stock options	14,265	35,521
Proceeds from exercise of stock warrants	-	5,000
Advances (repayment) of FHLB borrowings	8,701,139	(3,000,000)
Net cash from financing activities	51,934,993	37,498,054
NET CHANGE IN CASH AND CASH EQUIVALENTS	(4,511,837)	(873,856)
CASH AND CASH EQUIVALENTS, beginning of year	19,359,028	20,232,884
CASH AND CASH EQUIVALENTS, end of year	$ 14,847,191	$ 19,359,028
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION		
Cash paid during the period for interest	$ 1,512,018	$ 889,795
Cash paid during the period for federal income taxes	$ 690,000	$ 260,000
SUPPLEMENTAL DISCLOSURE OF NONCASH ITEMS		
Unrealized gain (loss) on securities available-for-sale	$ 24,528	$ (214,788)

See accompanying notes.

Note 1 – Organization and Summary of Significant Accounting Policies

Nature of operations – Mountain Pacific 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, 2017 and 2016, 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, 2017 or 2016.

At periodic intervals, the state of Washington and the Federal Deposit Insurance Corporation (FDIC) routinely examine the Bank's financial statements as part of their legally prescribed oversight of the banking system. Based on these examinations, the regulators can direct the Bank's financial statements to be adjusted in accordance with their findings.

Financial statement presentation and use of estimates – The 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 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, and deferred tax assets.

Subsequent events – Subsequent events are events or transactions that occur after the balance sheet date but before financial statements are issued. The Bank recognizes in the 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 financial statements. The Bank's 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 financial statements are available to be issued. The Bank has evaluated subsequent events through February 27, 2018, which is the date the financial statements are issued.

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 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 Bank to credit risk. Investments in federal funds sold are made with major banks as approved by the board of directors.

Interest-bearing deposits in banks – Interest-bearing deposits in banks include interest-bearing deposits and certificates of deposit in federally insured financial institutions located throughout the United States and territories. The amounts on deposit fluctuate and, at times, may exceed the insured limit by the FDIC, which potentially subjects the Bank 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. The Bank had no trading securities at December 31, 2017 or 2016. Investment securities are categorized as held-to-maturity when the Bank 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.

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

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 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 the Bank 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 the Bank 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 the Bank 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).

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, 2017 and 2016. The Bank had $707,600 and $313,200 of FHLB stock at December 31, 2017 and 2016, 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, 2017 and 2016, and is carried at cost, classified as a restricted security, and periodically evaluated for impairment. Both cash and stock dividends are reported as income.

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 Bank'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 78% 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 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 for which the Bank, for reasons related to the borrower's financial difficulties, grants a concession to the borrower that the Bank would not otherwise consider. The loan terms that have been modified or restructured due to the borrower's financial difficulty include, but are not limited to, a reduction in the stated interest rate; an extension of the maturity; an interest rate below market; a reduction in the face amount of the debt; a reduction in the accrued interest; or extension, deferral, renewal, or rewrite of the original loan terms.

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, 2017 and 2016, SBA servicing assets totaled $502,810 and $68,147, included in other assets on the balance sheets, from servicing $23,392,759 and $3,733,390 in loans, respectively.

Premises and equipment – Premises and equipment 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.

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.

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

Income taxes – The Bank records its provision for income tax 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 Bank's 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 Bank 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 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 $161,328 and $162,505 for the years ended December 31, 2017 and 2016, 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 $724,000 and $406,000 at December 31, 2017 and 2016, respectively.

Comprehensive income – 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 Bank'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 Bank's accounting policy is to recognize compensation cost net of estimated forfeitures.

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 conform to 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, 2017	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
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 cert	1,495,008	3,010	(21,940)	1,476,078
	$ 12,732,376	$ 14,750	$ (208,270)	$ 12,538,856
December 31, 2016				
Available-for-sale securities				
Obligations of U.S. agencies	$ 3,234,810	$ 80	$ (79,610)	$ 3,155,280
Agency mortgage-backed securities	5,777,295	1,834	(105,936)	5,673,193
Agency collateralized mortgage obligations	2,205,120	-	(27,548)	2,177,572
Corporate bonds	999,471	15,029	-	1,014,500
SBA participation cert	544,710	-	(21,897)	522,813
	$ 12,761,406	$ 16,943	$ (234,991)	$ 12,543,358

The amortized cost and estimated fair value of investment securities at December 31, 2017, 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	
	Amortized Cost	Estimated Fair Value
1 to 5 years	$ 1,548,492	$ 1,518,232
More than 5 years	11,183,884	11,020,624
	$ 12,732,376	$ 12,538,856

There were no investment securities pledged at December 31, 2017 or 2016.

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, 2017	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value
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 cert	-	-	(21,940)	490,045
	$ (9,040)	$ 908,173	$ (199,230)	$ 9,633,120
December 31, 2016				
Available-for-sale securities				
Obligations of U.S. agencies	$ (79,610)	$ 2,155,200	$ -	$ -
Agency mortgage-backed securities	(64,705)	2,919,181	(41,231)	2,525,826
Agency collateralized mortgage obligations	(4,327)	1,037,821	(23,221)	1,139,751
SBA participation cert	(21,897)	522,813	-	-
	$ (170,539)	$ 6,635,015	$ (64,452)	$ 3,665,577

There were sixteen and fifteen securities in an unrealized loss position at December 31, 2017 and 2016, 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 Bank does not consider these securities to be other than temporarily impaired at December 31, 2017 or 2016.

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. There were three securities sold for gross realized gains of $27,624 and none for losses in 2016.

Note 3 – Loans

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

	2017	2016
Residential 1-4 family	$ 20,541,301	$ 14,818,260
Residential multi-family	5,547,882	6,604,440
Residential construction, 1-4 family and multifamily	9,733,503	10,044,770
Home equity loans and lines of credit	3,442,056	1,685,920
C & I loans	25,881,475	26,892,441
Agriculture*	25,997,655	23,729,982
CRE land/development and construction	20,552,009	7,763,099
CRE income property - owner-occupied (OOC)	50,015,441	52,306,041
CRE income property - nonowner-occupied (NOC)	80,219,297	46,948,800
Consumer	1,057,442	1,239,053
Total Loans	242,988,061	192,032,806
Less deferred loan fees, net	(690,066)	(563,365)
Less allowance for loan losses	(3,603,778)	(2,974,275)
Total loans, net	$ 238,694,217	$ (2,974,275)

*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 and FRB. Loans totaling $38,217,841 and $48,327,718 were pledged to the FHLB at December 31, 2017 and 2016, respectively. There were $0 loans pledged to the FRB at December 31, 2017 and 2016. (Note 7).

Past due loans – Loans are considered past due if the required principal and interest payments have not been received as of the date such payments were due.

The following table presents past due loans, net of partial loan charge-offs, by type as of December 31, 2017 and 2016:

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

Note 3 – Loans (continued)

2016	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	$ 393,066	$ -	$ 378,626	$ 771,692	$ 14,046,568	$ 14,818,260
Residential multi-family	-	-	-	-	6,604,440	6,604,440
Residential construction, 1-4 family and multifamily	-	-	-	-	10,044,770	10,044,770
Home equity loans and lines of credit	-	-	-	-	1,685,920	1,685,920
C & I loans	-	-	-	-	26,892,441	26,892,441
Agriculture	-	-	-	-	23,729,982	23,729,982
CRE land/development and construction	-	-	-	-	7,763,099	7,763,099
CRE income property - OOC	-	-	-	-	52,306,041	52,306,041
CRE income property - NOC	-	-	-	-	46,948,800	46,948,800
Consumer	-	-	-	-	1,239,053	1,239,053
	$ 393,066	$ -	$ 378,626	$ 771,692	$ 191,261,114	$ 192,032,806

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

	2017	2016
Residential 1-4 family	$ 344,545	$ 378,626
Agriculture	1,271,365	-
	$ 1,615,910	$ 378,626

There were no loans 90 days past due and still accruing at December 31, 2017 or 2016.

Note 3 – Loans (continued)

The following table presents loans individually evaluated for impairment by class of loans as of December 31, 2017 and 2016:

2017	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	$ 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
2016					
With allowance recorded					
C & I loans	$ 112,298	$ 112,298	$ 25,747	$ 123,320	$ 7,788
With no allowance recorded					
Agriculture	3,685,433	3,685,433	-	3,891,523	198,925
Residential 1-4 family	378,626	378,626	-	392,073	-
	4,064,059	4,064,059	-	4,283,596	198,925
Total	$ 4,176,357	$ 4,176,357	$ 25,747	$ 4,406,916	$ 206,713

Note 3 – Loans (continued)

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, 2017 and 2016:

	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

	Allowance for Loan Losses			Loans Receivable		
2016	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	$ 204,791	$ -	$ 204,791	$ 14,818,260	$ 378,626	$ 14,439,634
Residential multi-family	65,973	-	65,973	6,604,440	-	6,604,440
Residential construction, 1-4 family and multifamily	261,648	-	261,648	10,044,770	-	10,044,770
Home equity loans and lines of credit	26,059	-	26,059	1,685,920	-	1,685,920
C & I loans	450,937	25,747	425,190	26,892,441	112,298	26,780,143
Agriculture	396,118	-	396,118	23,729,982	3,685,433	20,044,549
CRE land/development and construction	73,576	-	73,576	7,763,099	-	7,763,099
CRE income property - OOC	751,853	-	751,853	52,306,041	-	52,306,041
CRE income property - NOC	707,696	-	707,696	46,948,800	-	46,948,800
Consumer	35,624	-	35,624	1,239,053	-	1,239,053
	$ 2,974,275	$ 25,747	$ 2,948,528	$ 192,032,806	$ 4,176,357	$ 187,856,449

Note 3 – Loans (continued)

The following table presents the activity in the allowance for loan losses and impairment method by segment for the years ended December 31, 2017 and 2016:

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
2016					
Residential 1-4 family	$ 168,752	$ 66,039	$ (30,000)	$ -	$ 204,791
Residential multi-family	73,759	(7,786)	-	-	65,973
Residential construction,					
1-4 family and multifamily	242,283	19,365	-	-	261,648
Home equity loans and lines					
of credit	31,067	(5,008)	-	-	26,059
C & I loans	334,772	92,994	-	23,171	450,937
Agriculture	477,591	(81,473)	-	-	396,118
CRE land/development					
and construction	28,717	18,824	-	26,035	73,576
CRE income property - OOC	611,551	140,302	-	-	751,853
CRE income property - NOC	575,635	132,061	-	-	707,696
Consumer	10,942	24,682	-	-	35,624
	$ 2,555,069	$ 400,000	$ (30,000)	$ 49,206	$ 2,974,275

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 Bank 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.

The extension of credit in the form of loans to individuals and businesses is one of the Bank’s principal commerce activities. The Bank’s policies and applicable laws and regulations require risk analysis, as well as ongoing portfolio and credit management. The Bank manages its credit risk through lending limit constraints, credit review, approval policies, and ongoing internal monitoring. The Bank also manages credit risk through diversification of the loan portfolio by type of loan, type of industry, type of borrower, and by limiting the aggregation of debt to a single borrower.

Note 3 – Loans (continued)

In analyzing the Bank's existing portfolio, 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).

Periodically, the Bank reviews all loans 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, the Bank assesses whether an impairment of 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:

2017	Pass/Watch	Special Mention	Substandard	Doubtful	Loss	Total
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

Note 3 – Loans (continued)

2016	Pass/Watch	Special Mention	Substandard	Doubtful	Loss	Total
Residential 1-4 family	$ 14,152,681	$ 286,953	$ 378,626	$ -	$ -	$ 14,818,260
Residential multi-family	6,604,440	-	-	-	-	6,604,440
Residential construction, 1-4 family and multifamily	10,044,770	-	-	-	-	10,044,770
Home equity loans and lines of credit	1,552,098	133,822	-	-	-	1,685,920
C & I loans	24,638,869	2,225,498	28,074	-	-	26,892,441
Agriculture	18,729,969	371,866	4,628,147	-	-	23,729,982
CRE land/development and construction	7,763,099	-	-	-	-	7,763,099
CRE income property - OOC	49,728,358	2,577,683	-	-	-	52,306,041
CRE income property - NOC	44,058,353	2,890,447	-	-	-	46,948,800
Consumer	1,208,505	30,548	-	-	-	1,239,053
	$ 178,481,142	$ 8,516,817	$ 5,034,847	$ -	$ -	$ 192,032,806

Loans classified as troubled debt restructurings (TDRs) totaled $2,844,530 and $3,713,507 at December 31, 2017 and 2016, respectively. These loans are included in the impaired loan disclosures. 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.

There were no newly restructured TDR loans during 2017. The following table presents newly restructured TDR loans by class that occurred during the year ended December 31, 2016 by type of concession granted:

2016	Number of Contracts	Payment Modification	Combination Modification	Total Modifications
Pre and post-modification outstanding recorded investment				
Agriculture	2	$ 1,684,228	$ 1,271,365	$ 2,955,593

During the year ended December 31, 2017, there was one TDR loan of $1,271,228 that defaulted within 12 months of the modification date.

There were no loans that were modified within the prior 12 months that subsequently defaulted during the year ended December 31, 2016.

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

Bank leaseholds and equipment at December 31 are classified as follows:

	2017	2016
Land and buildings	$ 11,050,000	$ -
Leasehold improvements	1,681,564	1,672,694
Furniture, fixtures, and office equipment	1,282,308	1,244,630
	14,013,872	2,917,324
Accumulated depreciation and amortization	(2,868,057)	(2,467,951)
	$ 11,145,815	$ 449,373

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 the related party LLC, the current main branch building and two floors of the 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 $87,626 and $294,815 for the years ended December 31, 2017 and 2016, respectively (Note 12).

The Bank has a lease agreement with an unaffiliated party for the Ballard Branch location that began in September 2015. The lease is a three-year lease ending August 2018 and contains two renewal options for three years each.

The Bank also has a lease agreement with an unaffiliated party for the Lynnwood office. The lease is a 10-year lease ending January 2018, and contains an option to renew for two 5-year terms at rates to be mutually determined at that time. In January 2018, the Bank renewed the lease and is set to mature in January 2023. There is one option left to extend the lease as of January 2018.

All lease agreements require the Bank 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:

2018	$ 187,423
2019	193,905
2020	200,172
2021	193,582
Thereafter	173,640
	$ 948,722

Rental expense charged to operations was $202,012 and $487,194 for the years ended December 31, 2017 and 2016, respectively.

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

The owned adjacent floors of the Everett building are partially leased to unaffiliated third parties. Minimum rental receipts under sublease agreement for future years ending December 31 are as follows:

2018	$ 451,785
2019	442,540
2020	427,337
2021	379,829
Thereafter	377,941
	$ 2,079,432

Note 5 – Other Real Estate Owned

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

	2017	2016
Beginning balance	$ 4,930,275	$ 5,340,420
Capitalized improvements	37,736	128,965
Sales	(505,578)	(539,110)
Ending balance	$ 4,462,433	$ 4,930,275

Other real estate owned as of December 31, 2017, consists of land and a single-family residence.

Note 6 – Deposits

Deposits as of December 31 consisted of the following:

	2017	2016
Demand accounts		
Noninterest-bearing	$ 41,249,215	$ 35,096,445
Interest-bearing	26,015,933	21,390,070
Savings accounts	3,566,323	4,836,411
Money market accounts	105,338,071	89,435,166
Certificates of deposit	71,356,440	53,548,301
	$ 247,525,982	$ 204,306,393

At December 31, 2017, scheduled maturities of certificates of deposit are as follows:

2018	$ 41,913,188
2019	26,298,150
2020	1,927,125
2021	967,218
2022	250,759
	$ 71,356,440

The Bank had $11,438,809 and $7,330,119 of certificates of deposit that met or exceeded the $250,000 federally insured limit at December 31, 2017 and 2016, respectively.

Note 7 – Credit Arrangements

The Bank has line-of-credit agreements with separate unaffiliated banks totaling $2,000,000 and $10,000,000, 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, 2017 and 2016.

The Bank is a member of the FHLB of Des Moines and, as such, has a committed credit line of up to 20% of total eligible assets, subject to certain collateral requirements. Borrowings generally provide for interest at the then-current published rates. At December 31, 2017 and 2016, loans pledged to the FHLB equated to a borrowing capacity of $16,824,591 and $33,232,836, respectively. At December 31, 2017 and 2016, the Bank had $10,701,139 and $2,000,000 of borrowings, respectively, outstanding with the FHLB, with fixed rates ranging from 1.22% to 1.58% under these agreements. The borrowings have a weighted-average interest rate of 1.41% and 0.84% as of December 31, 2017 and 2016, respectively. Current borrowings are collateralized by pledged loans (Note 3).

The contractual maturities of FHLB advances at December 31, 2017, are as follows:

2018	$ 6,000,000
2019	3,919,594
2020	781,545
	$ 10,701,139

Note 8 – Federal Income Taxes

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

	2017	2016
Current	$ 1,000,130	$ 280,000
Deferred	1,489,870	250,000
	$ 2,490,000	$ 530,000

The Bank's 2017 results included the impact of the enactment of the Tax Cuts and Jobs Act, which was signed into law on December 22, 2017. The law includes significant changes to the U.S. corporate tax system, including a Federal corporate rate reduction from 34% to 21%. In 2017, the Bank applied the newly enacted corporate federal income tax rate of 21%, resulting in approximately a $1,185,000 increase in tax expense. The final impact of the tax rate change may differ due to changes in assumptions made by the Bank or actions the Bank may take as a result of tax reform.

Note 8 – Federal Income Taxes (continued)

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

	2017	2016
Deferred tax asset		
Allowance for loan losses	$ 392,878	$ 423,589
Net operating loss carryforward	1,245,829	2,172,016
Organization expenditures	17,822	37,098
OREO valuation adjustments	284,841	680,122
Nonaccrual interest	25,758	10,438
Property and equipment depreciation	67,294	77,947
Unrealized losses on securities	40,639	76,108
Other	-	16,942
Subtotal	2,075,061	3,494,260
Deferred tax liabilities		
Deferred loan costs	92,458	121,090
SBA servicing asset	105,590	23,170
Other	22,013	-
Subtotal	220,061	144,260
Net deferred tax asset	$ 1,855,000	$ 3,350,000

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 by $95,000 to account for Section 382 limitations.

The Bank has federal net operating loss carryforwards of approximately $6,387,000 at December 31, 2017, before the consideration of any Section 382 limits. Federal net operating loss carryforwards, to the extent not used, will begin to expire in 2029.

At December 31, 2017, the Bank had unamortized preopening expenditures of approximately $85,000 (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, 2017 and 2016, the Bank had no unrecognized tax benefits. The Bank recognizes interest accrued and penalties related to unrecognized tax benefits in tax expense. During the years ended December 31, 2017 and 2016, the Bank recognized no interest and penalties. The Bank files income tax returns in the U.S. federal jurisdiction. With few exceptions, the Bank is no longer subject to U.S. federal income tax examinations by tax authorities for years before 2014.

Note 9 – Employee Benefits

The Bank 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 Bank's contribution for the years ended December 31, 2017 and 2016, was $132,767 and $85,819, respectively.

Note 10 – Stockholders' Equity

Regulatory capital – The Bank is 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 Bank's 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 the Bank's assets, liabilities, and certain off-balance-sheet items, as calculated under regulatory accounting practices. The Bank's 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, 2017, management believes that the Bank meets 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, 2017, 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.

Note 10 – 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, 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%
As of December 31, 2016								
Total capital								
(to risk-weighted assets)	$ 26,213,000	12.40%	$16,911,613	≥ 8.00%	$ 18,276,806	≥ 8.63%	$ 21,139,516	≥ 10.00%
Tier I capital								
(to risk-weighted assets)	23,548,000	11.10%	12,728,649	≥ 6.00%	14,038,706	≥ 6.63%	16,971,532	≥ 8.00%
Common equity Tier 1 capital								
(to risk-weighted assets)	23,548,000	11.10%	9,546,486	≥ 4.50%	10,860,131	≥ 5.13%	13,789,369	≥ 6.50%
Tier I capital (to average assets)	23,548,000	10.60%	8,886,038	≥ 4.00%	N/A		11,107,547	≥ 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 2017 is 1.25%. The net unrealized gain or loss on available-for-sale securities is not included in computing regulatory capital. Management believes as of December 31, 2017, the Bank meets all capital adequacy requirements to which they are subject.

Note 11 – Stock-Based Compensation Plan

The Bank 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 operations for the plan was $171,103 in 2017 and $111,959 in 2016. There was no compensation cost capitalized and no income tax benefits realized on these stock-based compensation arrangements in 2017 or 2016.

Stock option plan – In 2017, stockholders approved an equity incentive plan (the Plan) to promote the best interest of the Bank 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, 2017, 786,000 shares remained available to grant out of the Plan. 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 Bank'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 11 – 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

Bank'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.

	2017	2016
Risk-free interest rate	2.46%	1.90%-2.06%
Dividend yield rate	0.00%	0.00%
Expected volatility	28%	35%
Expected term (in years)	6.5 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, 2016	457,620	$ 3.18	
Granted	203,000	3.64	
Exercised	(4,350)	3.28	
Forfeited	(15,500)	3.40	
Outstanding at December 31, 2017	640,770	$ 3.36	6.27
Options exercisable at December 31, 2017	274,770	$ 3.07	4.11

The weighted-average grant-date fair value of options granted was $1.26 and $1.31 for each of the years ended December 31, 2017 and 2016. As of December 31, 2017, there was $276,372 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 1.78 years. There were no tax benefits realized from the exercise of options in 2017 or 2016.

Note 11 – 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, 2016	15,535	$ 3.27
Granted	16,000	3.78
Vested	(8,835)	3.23
Forfeited	-	-
Nonvested at December 31, 2017	22,700	$ 3.64

As of December 31, 2017, there was $49,945 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 1.41 years.

Note 12 – 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 collectibility 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:

	2017	2016
Beginning balance	$ 4,590,646	$ 3,935,140
New loans	2,634,248	856,708
Repayments	(255,716)	(201,202)
Transfers out	-	-
Ending balance	$ 6,969,178	$ 4,590,646
Deposits	$ 15,636,106	$ 11,994,292

During 2016 and 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.

Note 13 – Commitments and Contingencies

The Bank 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 Bank's involvement in particular classes of financial instruments.

The Bank'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 Bank's experience has been that approximately 81% of loan commitments are drawn upon by customers. The Bank 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 Bank, as a matter of policy, does not extend credit in excess of 20% of Tier I capital, or $5.0 million, to any single borrower or group of related borrowers.

Standby letters of credit and financial guarantees written are conditional commitments issued by the Bank 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 Bank maintains various levels of collateral supporting those commitments for which collateral is deemed necessary.

The Bank has not been required to perform on any financial guarantees. The Bank has not incurred any losses on its commitments in 2017 or 2016.

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

	2017	2016
Commitments to extend credit	$ 42,709,885	$ 46,272,503
Standby letters of credit	$ 228,548	$ 302,791

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 Bank's financial statements. As of December 31, 2017, the Bank was a defendant in an ongoing lawsuit with a trial date set for fourth quarter 2018. The Bank has denied the allegations and is defending the lawsuit. No contingencies have been recorded at December 31, 2017, as the outcome is unknown.

Note 14 – 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 Bank's principal market. The Bank 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 Bank'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 Bank'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 14 – 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 Bank's assets and liabilities measured at fair value on a recurring basis:

	Level 1	Level 2	Level 3	Total
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 cert		1,476,078		1,476,078
2016				
Obligations of U.S. agencies	$ -	$ 3,155,280	$ -	$ 3,155,280
Agency mortgage-backed securities	-	5,673,193	-	5,673,193
Agency collateralized mortgage obligations	-	2,177,572	-	2,177,572
Corporate bonds	-	1,014,500	-	1,014,500
SBA participation cert		522,813		522,813

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 Bank's assets measured at fair value on a nonrecurring basis:

	Level 1	Level 2	Level 3	Total
December 31, 2017				
Impaired loans	$ -	$ -	$ 1,267,287	$ 1,267,287
Other real estate owned	-	-	4,462,433	4,462,433
December 31, 2016				
Impaired loans	$ -	$ -	$ 2,328	$ 2,328
Other real estate owned	-	-	4,930,275	4,930,275

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 14 – 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, 2017 and 2016, along with the valuation techniques used, are shown in the following table:

	Fair Value at December 31, 2017	Valuation Technique	Unobservable Input	Range[1]
Impaired loans	$ 1,267,287	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.

	Fair Value at December 31, 2016	Valuation Technique	Unobservable Input	Range[1]
Impaired loans	$ 2,328	Market comparable	Adjustment to appraisal value	0% - 10%
OREO	4,930,275	Market comparable	Adjustment to appraisal value	0% - 10%

[1] Discount for selling costs.

The fair value estimates below are subjective in nature and involve uncertainties and matters of significant judgment; therefore, they are not necessarily indicative of the amounts the Bank could realize in a current market exchange. The Bank has not included certain material items in its disclosure, such as the value of the long-term relationships with the Bank's lending and deposit clients, since this is an intangible and not a financial instrument. Additionally, the estimates do not include any tax ramifications. There may be inherent weaknesses in any calculation technique and changes in the underlying assumptions used, including discount rates and estimates of future cash flows that could materially affect the results. For all of these reasons, the aggregation of the fair value calculations presented herein do not represent, and should not be construed to represent, the underlying value of the Bank.

	2017		2016	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
Financial assets				
Cash and cash equivalents	$ 14,847,191	$ 14,847,191	$ 19,359,028	$ 19,359,028
Interest-bearing deposits in banks	-	-	2,000,000	2,000,000
Investment securities available-for-sale	12,538,856	12,538,856	12,543,358	12,543,358
FHLB and PCBB stock	897,600	897,600	503,200	503,200
Loans	242,297,995	190,903,955	191,469,441	190,903,955
Accrued interest receivable	788,072	788,072	814,698	814,698
Financial liabilities				
Deposits	247,525,982	199,553,627	204,306,393	199,553,627
FHLB advances	10,701,139	1,992,000	2,000,000	1,992,000
Other borrowings	-	-	-	-
Accrued interest payable	160,045	160,045	85,390	85,390