1st CAPITAL BANK

ANNUAL REPORT 2016

CELEBRATING OUR TENTH YEAR

PROVIDING THE BUILDING BLOCKS FOR A STRONG FINANCIAL COMMUNITY

TO OUR SHAREHOLDERS AND CLIENTS

We proudly celebrate the 10th anniversary of the founding of 1st Capital Bank this year. In April 2007, local business leaders joined together, with the shared vision that local businesses throughout Monterey County needed and would be best served by a local community bank to meet their growing credit needs. The timing of 1st Capital Bank's opening was auspicious as California and the entire nation were heading into the most severe economic contraction since the Great Depression. However, with steady leadership and oversight provided by the Board of Directors and conservative management, 1st Capital Bank avoided many of the pitfalls and troubled situations encountered by most of our California-based peers. We have enjoyed steady growth in loans, deposits, and shareholders' equity since our founding in 2007, with assets now approaching $550 million, and we continue to build the foundation required for us to continue to pursue this excellent growth trajectory. Most importantly, we continue to strive to become "the first choice in community banking" providing the building blocks for a strong financial future for the Central Coast!

2016 HIGHLIGHTS

1st Capital Bank posted record results again in 2016. Total assets increased to a record $549.9 million at year-end, 7% above the $513.9 million level at year-end 2015. Net income exceeded $3 million for the first time, ending the year at $3.07 million, or $0.70 per share (diluted), a 29% increase over 2015 earnings of $2.38 million and earnings per share of $0.55 (diluted), which included $249 thousand in after-tax nonrecurring income. The increase in net income is particularly attributable to the increased momentum of our core loan portfolio, which improved asset yields, as well as the ongoing benefits of a low-cost deposit base.

The Board of Directors was pleased to once again declare a 5% stock dividend, paid during December, 2016. This stock dividend expresses the Board's optimism regarding the continued favorable prospects of the Bank, as well as overall economic conditions in our primary banking market along the Central Coast.

During 2016, total loans outstanding increased to $405.3 million, a 7.6% increase over the prior year's level of $376.7 million. The loan portfolio mix has evolved favorably as loans in our core banking market increased more than 12% during 2016. We experienced solid performance in all three of our regions, Monterey, Salinas, and San Luis Obispo, and notably booked several new high profile businesses in our Monterey/Santa Cruz region during the year. Under the leadership of Chief Lending Officer Jon Ditlevsen, our relationship banking approach to lending was very successful during 2016, and we begin 2017 with a very strong backlog of new business opportunities in all three regions. Indeed, our loan balances in the San Luis Obispo market, which we entered in June 2015, have now reached a level sufficient to generate a positive return on our investment, which has been accomplished less than two years since the opening of the branch.

Funding this loan growth is our outstanding deposit base. Total deposits increased 6.9% during 2016, from $468.4 million at year-end 2015 to $500.6 million at year-end 2016. Significantly, noninterest-bearing deposits increased 17% during the year to $239.8 million, which is an exceptional 47% of total deposits. The advantage of this low-cost funding is anticipated to be more apparent during 2017, as we enter a cyclical rising interest-rate environment.

Complementing the improving operating performance, management continues to invest in new product development and more centralized and scalable operations. We have doubled the amount of multifamily loans in our loan portfolio over the past eighteen months. Additionally, we have increased our focus on government-guaranteed lending during 2016. Our Small Business Administration Lending Chief, Rob Skeen, has relocated to San Luis Obispo, assuming the role of Regional President and continuing to lead our government-guaranteed lending efforts, particularly in this historically attractive market for SBA lending activities, thanks to the number of young businesses sprouting up around Cal Poly University. Roger Gilbert joined our team as Vice President to continue and expand our momentum in government-guaranteed lending in Monterey and Salinas, and we are encouraged by the increased activity in this lending segment. Finally, under the leadership of Chief Administrative Officer Robin Seelye, we have commenced banking money service businesses in our primary markets. Robin and her experienced team are selective in opening these more cash-intensive businesses; however, we believe that servicing some of these clients is an important aspect of being a full service community bank.

More than twenty employees in our operations support and lending support functions relocated to a new, more convenient facility adjacent to our Salinas branch, which we anticipate will result in lower employee turnover, more efficiencies, and better cross-training of our employees. We introduced a new and improved website, which is more informative and interactive, generating more interest and "touches" by our clients and prospects, and a new mobile banking application was added to help customers better track debit card usage and identify card fraud.

2017 OUTLOOK

The outlook for the local and national economy remains positive for 2017, which, combined with increasing momentum in our core banking markets, makes us optimistic that we can continue to create shareholder value in 2017. Key initiatives include i) increasing our market share throughout Monterey County and surrounding areas, ii) capitalizing upon new opportunities presented to us by recent bank mergers, iii) increasing our "share of wallet" with our existing customers, iv) introducing additional traditional community banking products, and v) increasing fee income for the services we provide.

1st Capital Bank retains its excellent financial strength to support management's growth objectives as traditional performance metrics including capital adequacy, liquidity, and credit quality remain strong.

We are excited to be introducing new consumer lending products during 2017. Erin King joined us in King City and is leading our entry into this promising new segment. Single-family mortgage lending debuted in February 2017, already generating new referral fees for the Bank. Home equity lines of credit are on schedule to be introduced to the local market during spring 2017. Early reactions from clients and our own relationship managers make us optimistic that this product will be well received. Finally, we plan to roll out a new construction loan program during the latter half of 2017.

As announced last summer, we will be relocating our corporate headquarters to Salinas by early May. The move is crucial for 1st Capital Bank to become a more visible presence in the local community, and we are proud to become a part of the revitalization of downtown Salinas. We are confident it will generate significant new business opportunities for the Bank during 2017 and beyond.

BENEFITTING OUR COMMUNITIES

Our Board of Directors has been determined since the Bank's founding that we can make a true difference in the quality of life along the Central Coast, and management took time this past year to revisit our original Vision and Mission Statement. We discovered that we are committed to the purpose of the Bank and the vision of the founding shareholders. We altered it slightly but firmly believe the fundamental reason for existence of 1st Capital Bank is:

To invest in long-term relationships that enhance the financial health and wellbeing of our communities.

Of course, accepting local deposits, protecting the safety and security of our customers' deposits, and lending those monies out locally are the central activities of community banking. But in addition, we make a positive contribution to the quality of life in our communities by supporting the many deserving local not-for-profits. During 2016, we were pleased to contribute more than $100,000 to this vital sector. Our funds and resources supported youth outreach, arts and music, education, and low-income households - which we recognize as vital to the wellbeing of our community.

Our support extended further during 2016, as our employees have been encouraged to volunteer for organizations that are personally meaningful to them; we provide up to forty paid hours per year for them to volunteer for the organization of their choice. Our employees responded by volunteering more than 1000 hours during 2016 to local charities, including more han 800 hours in leadership roles. Their work is noticed and appreciated by us and by everyone in the community.

EXPRESSING OUR APPRECIATION

Starting from scratch ten years ago, 1st Capital Bank has grown to nearly $550 million in assets. The foundation is strong, and our management team is excited to seize upon the opportunities present in today's marketplace. We have enjoyed the support of our directors, shareholders, employees, and clients for our growth and success. It is very appropriate also to express our appreciation for the hard work and dedication exhibited by our original Chief Executive Officers the late Fred Rowden and board members Susan Freeland, Dan Hightower and Greg Thelen who have been with us since the start.Their original vision for 1st Capital Bank provided the building blocks for today's management team to continue to develop what we firmly believe is "the first choice in community banking" along the Central Coast.

Sincerely,

Thomas E. Meyer, President and Chief Executive Officer	Kurt J. Gollnick, Chairman of the Board

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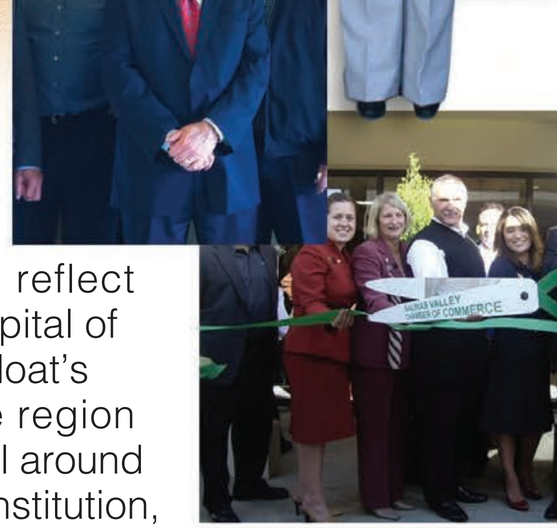

"Thus, using our rich history, the bank was named 1st Capital Bank."

...The newly formed board of directors and management wanted a name that would reflect the history and stability of Monterey, the first capital of Spain's California. In July 1846, Commodore Sloat's flagship raised the American flag, claiming the region for the United States. In 1849, delegates from all around California met in Monterey to create a State Constitution, and California entered the Union in 1850. Thus, using our rich history, the bank was named 1st Capital Bank.

NG A LEGACY

1st Capital Bank was founded in 2007 by a group of local men and women who recognized a need. With a clear vision and a deep commitment they began a new journey in community banking. With this vision, the founders were inspired to create a bank dedicated to improving the financial health of Monterey County and provide the building blocks for a sound financial marketplace... to give back through the bank's focus on lending, and provide unparalleled professional service to the local communities.

The Bank opened its doors on April 16, 2007 with branches in Salinas and Monterey and an administration office in Monterey at Ryan Ranch. The Salinas branch was opened in its current location at 1097 South Main Street in Salinas and was expanded a year later to occupy the entirety of the building. The Monterey branch was first opened in the historic Estrada Adobe (established in 1836) on Tyler Street and has subsequently moved to our beautiful new Bonafacio Place location.

Now, we proudly celebrate a true milestone, our 10th anniversary. We congratulate and thank those who have brought us on this momentous and successful journey and we sincerely hope you join us in our enthusiasm as we continue toward the future.

FINANCIAL HIGHLIGHTS

(amounts in thousands, except per share amounts)

	2014	2015	2016
For the Year:			
Net interest income before provision for loan losses	$13,198	$15,045	$16,986
Provision for loan losses	$575	$565	$295
Bank-owned life insurance benefits	$0	$249	$0
Other operating income	$302	$361	$431
Noninterest expenses	$9,758	$11,265	$12,062
Net income	$1,960	$2,381	$3,068
Diluted Earnings per Share	$0.47	$0.55	$0.70
Average Balances for the Year:			
Gross loans	$295,467	$352,971	$390,544
Interest-earning assets	$426,780	$479,758	$530,722
Interest-bearing liabilities	$241,967	$272,019	$288,971
Deposits	$391,560	$439,381	$488,593
At Year End:			
Total assets	$464,863	$513,950	$549,927
Net loans	$321,176	$370,790	$399,039
Demand deposits	$181,939	$204,624	$239,799
Total deposits	$422,753	$468,389	$500,621
Stockholders' equity	$41,181	$44,489	$47,645
Financial Ratios:			
Net interest margin	3.09%	3.14%	3.20%
Efficiency ratio	71.42%	71.96%	69.25%
Noninterest expenses to average assets	2.25%	2.32%	2.25%
Allowance for loan losses to gross loans	1.63%	1.57%	1.55%
Nonaccrual loans to gross loans	0.24%	0.46%	0.03%
Net loan charge-offs (recoveries) to average gross loans	-0.02%	-0.01%	-0.01%
Nonperforming assets to total assets	0.17%	0.34%	0.03%
Tier 1 leverage ratio	9.01%	8.82%	8.89%
Common equity Tier 1 risk-based capital	N/A	13.24%	12.99%
Total risk-based capital	14.91%	14.49%	14.25%
Return on average assets	0.45%	0.49%	0.57%
Return on average equity	4.96%	5.51%	6.61%

Crowe Horwath.

Crowe Horwath LLP
Independent Member Crowe Horwath International

INDEPENDENT AUDITOR'S REPORT

To the Shareholders and Board of Directors
1st Capital Bank
Monterey, California

Report on the Financial Statements

We have audited the accompanying financial statements of 1st Capital Bank, which comprise the balance sheets as of December 31, 2016 and 2015, and the related statements of income, comprehensive income, changes in stockholders' equity, and cash flows for each of the years in the three year period ended December 31, 2016, 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 control 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 audit 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 1st Capital Bank as of December 31, 2016 and 2015, and the results of its operations and its cash flows for each of the years in the three year period ended December 31, 2016 in accordance with accounting principles generally accepted in the United States of America.

Crowe Horwath LLP

Crowe Horwath LLP

Sacramento, California
March 20, 2017

1ST CAPITAL BANK

BALANCE SHEETS
DECEMBER 31, 2016 and 2015
(Dollars in Thousands)

	December 31, 2016	December 31, 2015
ASSETS:		
Cash and due from banks	$ 2,754	$ 3,334
Due from Federal Reserve Bank	50,884	42,857
Total cash and cash equivalents	53,638	46,191
Interest-bearing deposits in other financial institutions	2,490	2,241
Securities available for sale, at fair value	77,870	84,203
Loans receivable held for investment (net of allowance for loan losses of $6,267 at December 31, 2016 and $5,920 at December 31, 2015)	399,039	370,790
Cash surrender value of bank-owned life insurance	7,433	2,350
Deferred tax assets, net	3,437	2,547
Federal Home Loan Bank stock, at cost	2,939	2,593
Premises and equipment, net	1,477	1,612
Accrued interest and dividends receivable	1,277	1,119
Other assets	327	304
TOTAL ASSETS	$ 549,927	$ 513,950
LIABILITIES AND STOCKHOLDERS' EQUITY:		
LIABILITIES:		
Noninterest-bearing deposits	$ 239,799	$ 204,624
Interest-bearing deposits	260,822	263,765
Total deposits	500,621	468,389
Accrued interest payable	22	28
Other liabilities	1,639	1,044
Total liabilities	502,282	469,461
Commitments and contingencies (Note 11)		
STOCKHOLDERS' EQUITY:		
Preferred stock, no par value, 10,000,000 shares authorized; no shares issued or outstanding at December 31, 2016 and 2015	--	--
Common stock, no par value, 20,000,000 shares authorized; 4,350,721 shares issued and outstanding at December 31, 2016; 4,064,485 shares issued and outstanding at December 31, 2015	45,510	42,386
Retained earnings	2,601	1,887
Accumulated other comprehensive income (loss), net of taxes	(466)	216
Total stockholders' equity	47,645	44,489
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	$ 549,927	$ 513,950

See Notes to Financial Statements

1ST CAPITAL BANK

STATEMENTS OF INCOME
FOR THE YEARS ENDED DECEMBER 31, 2016, 2015, and 2014
(Dollars in Thousands, Except Share and Per Share Amounts)

	2016	2015	2014
INTEREST AND DIVIDEND INCOME:			
Loans receivable	$ 16,279	$ 14,732	$ 12,921
Taxable securities available for sale	753	601	627
Tax-exempt securities available for sale	43	16	53
Federal Home Loan Bank stock	347	278	137
Interest-bearing deposits in other financial institutions	43	33	42
Interest-bearing balances due from Federal Reserve Bank	223	50	39
Total interest and dividend income	17,688	15,710	13,819
INTEREST EXPENSE:			
Deposits	702	661	619
Borrowings	--	4	2
Total interest expense	702	665	621
NET INTEREST INCOME BEFORE PROVISION FOR LOAN LOSSES	16,986	15,045	13,198
PROVISION FOR LOAN LOSSES	295	565	575
NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES	16,691	14,480	12,623
NON-INTEREST INCOME:			
Service charges and fees	140	123	122
Bank-owned life insurance dividend income	82	60	78
Gain on sale of loans	97	100	19
Gain on sale of investment securities	10	--	162
Bank-owned life insurance benefits	--	249	--
Other income	102	78	83
Total non-interest income	431	610	464
NON-INTEREST EXPENSE:			
Compensation and employee benefits	7,488	6,890	5,858
Occupancy	919	841	764
Item and data processing	602	596	564
Professional services	537	532	529
Equipment and furniture	476	459	333
Marketing and business development	184	220	196
Other non-interest expense	1,856	1,727	1,514
Total non-interest expense	12,062	11,265	9,758

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1ST CAPITAL BANK

STATEMENTS OF INCOME (Continued)
FOR THE YEARS ENDED DECEMBER 31, 2016, 2015, and 2014
(Dollars in Thousands, Except Share and Per Share Amounts)

	2016	2015	2014
INCOME BEFORE PROVISION FOR INCOME TAXES	5,060	3,825	3,329
PROVISION FOR INCOME TAXES	1,992	1,444	1,369
NET INCOME	$ 3,068	$ 2,381	$ 1,960
BASIC EARNINGS PER SHARE	$ 0.71	$ 0.56	$ 0.48
Weighted average shares used in basic earnings per share calculation	4,314,335	4,226,917	4,097,475
DILUTED EARNINGS PER SHARE	$ 0.70	$ 0.55	$ 0.47
Weighted average shares used in diluted earnings per share calculation	4,363,723	4,296,133	4,162,552

See Notes to Financial Statements

1ST CAPITAL BANK

STATEMENTS OF COMPREHENSIVE INCOME
FOR THE YEARS ENDED DECEMBER 31, 2016, 2015, and 2014
(Dollars in Thousands)

	2016	2015	2014
NET INCOME	$ 3,068	$ 2,381	$ 1,960
Other comprehensive income (loss):			
Unrealized gains (losses) on securities available for sale:			
Unrealized holding (losses) gains	(1,159)	(66)	665
Less: Reclassification for net gain included in net income	(10)	--	(162)
Other comprehensive (loss) income, before tax	(1,169)	(66)	503
Tax effect	487	26	(206)
Total other comprehensive (loss) income, net of tax	(682)	(40)	297
COMPREHENSIVE INCOME	$ 2,386	$ 2,341	$ 2,257

See Notes to Financial Statements

1ST CAPITAL BANK

STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY
FOR THE YEARS ENDED DECEMBER 31, 2016, 2015, and 2014
(Dollars in Thousands)

	Common Stock		Retained	Accumulated Other Comprehensive Income	Total Stockholders'
	Shares	Amount	Earnings	(Loss)	Equity
Balance at January 1, 2014	3,497,190	$ 36,009	$ 1,774	$ (41)	$ 37,742
Stock options exercised	69,304	653			653
Vested restricted stock awards issued	35,895				
Restricted share compensation expense		502			502
Stock option compensation expense		29			29
5% stock dividend	176,797	1,997	(1,997)		--
Cash paid in lieu of fractional shares	(147)		(2)		(2)
Net income			1,960		1,960
Net change in unrealized gain on securities available for sale, net of tax				297	297
Balance at December 31, 2014	3,779,039	39,190	1,735	256	41,181
Stock options exercised & tax benefit	48,641	469			469
Vested restricted stock awards issued	45,014	8			8
Restricted share compensation expense		493			493
5% stock dividend	192,180	2,226	(2,226)		--
Cash paid in lieu of fractional shares	(389)		(3)		(3)
Net income			2,381		2,381
Net change in unrealized gain (loss) on securities available for sale, net of tax				(40)	(40)
Balance at December 31, 2015	4,064,485	$ 42,386	$ 1,887	$ 216	$ 44,489

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1ST CAPITAL BANK

STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY
FOR THE YEARS ENDED DECEMBER 31, 2016, 2015, and 2014
(Dollars in Thousands)

	Common Stock		Retained	Accumulated Other Comprehensive Income	Total Stockholders'
	Shares	Amount	Earnings	(Loss)	Equity
Balance at December 31, 2015	4,064,485	$ 42,386	$ 1,887	$ 216	$ 44,489
Stock options exercised	42,299	376			376
Vested restricted stock awards issued	37,692	8			8
Restricted share compensation expense		389			389
5% stock dividend	206,487	2,351	(2,351)		--
Cash paid in lieu of fractional shares	(242)		(3)		(3)
Net income			3,068		3,068
Net change in unrealized gain (loss) on securities available for sale, net of tax				(682)	(682)
Balance at December 31, 2016	4,350,721	$ 45,510	$ 2,601	$ (466)	$ 47,645

1ST CAPITAL BANK

STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED DECEMBER 31, 2016, 2015, and 2014
(Dollars in Thousands)

	2016	2015	2014
OPERATING ACTIVITIES:			
Net income	$ 3,068	$ 2,381	$ 1,960
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation and amortization of premises and equipment	445	400	306
Amortization of security premiums, net of accretion of discounts	336	70	359
(Increase) decrease in deferred loan fees, costs, premiums, and discounts, net	210	(444)	83
Provision for loan losses	295	565	575
Gain on sale of investment securities	(10)	--	(162)
Gain on sale of loans	(97)	(100)	(19)
Origination of loans held for sale	(1,271)	(1,684)	(514)
Proceeds from sale of loans held for sale	1,392	1,816	545
Increase in loan servicing rights	(6)	(17)	(5)
Increase in discount on retained interests in loans	(43)	(32)	(12)
Loss on disposal of premises and equipment	--	9	6
Compensation expense related to stock compensation plans	389	493	531
Increase in accrued interest and dividends receivable	(159)	(164)	(64)
Change in deferred income taxes	(412)	(335)	(213)
Change in valuation allowance on deferred tax assets	(100)	--	--
Bank-owned life insurance dividend income	(82)	(60)	(78)
Decrease in other assets	90	265	185
Increase (decrease) in accrued interest payable	(6)	1	(11)
Increase (decrease) in other liabilities	596	142	(6)
Net cash provided by operating activities	4,635	3,306	3,466
INVESTING ACTIVITIES:			
Net increase in loans receivable held for investment	(28,734)	(49,736)	(70,994)
Purchases of securities available for sale	(30,437)	(14,322)	(31,685)
Principal repayments on securities available for sale	18,713	24,790	31,469
Proceeds from sales of securities available for sale	11,704	--	7,678
Proceeds from calls of securities available for sale	4,868	2,000	--
Purchases of premises and equipment	(311)	(598)	(250)
Purchases of Federal Home Loan Bank stock	(347)	(586)	(513)
(Increase) decrease in interest-bearing deposits in other financial institutions, net	(249)	747	1,594
Purchase of bank-owned life insurance	(5,000)	--	--
Proceeds from surrender of bank-owned life insurance	--	--	1,177
Proceeds from death benefits on bank-owned life insurance	--	259	--
Net cash used in investing activities	(29,793)	(37,446)	(61,524)

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1ST CAPITAL BANK

STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED DECEMBER 31, 2016, 2015, and 2014
(Dollars in Thousands)

	2016	2015	2014
FINANCING ACTIVITIES:			
Net increase in transaction and savings deposits	48,310	47,389	70,486
Net (decrease) increase in certificates of deposit	(16,078)	(1,753)	3,891
Cash paid in lieu of fractional shares	(3)	(3)	(2)
Cash proceeds from exercise of stock options	376	446	653
Net cash provided by financing activities	32,605	46,079	75,028
NET INCREASE (DECREASE) INCREASE IN CASH AND CASH EQUIVALENTS	7,447	11,939	16,970
CASH & CASH EQUIVALENTS AT BEGINNING OF YEAR	46,191	34,252	17,282
CASH & CASH EQUIVALENTS AT END OF YEAR	$ 53,638	$ 46,191	$ 34,252
SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION:			
Cash paid during the period for:			
Interest expense	$ 709	$ 664	$ 632
Income taxes	$ 2,415	$ 1,420	$ 1,333

See Notes to Financial Statements

1. BASIS OF PRESENTATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Organization and Nature of Operations

1st Capital Bank (the "Bank") opened for business on April 16, 2007. The Bank is a California state-chartered non-Federal Reserve member bank, and is subject to regulation by the California Department of Business Oversight (the "DBO") and the Federal Deposit Insurance Corporation (the "FDIC"). The Bank primarily markets to businesses, professionals, real estate investors, family commercial entities, and individuals located along the Central Coast region of California. The Bank's primary business is attracting checking, money market, savings, and certificate of deposit accounts through its branch facilities, courier service, remote branch deposit, and various electronic means, and investing such deposits and other available funds into loans, including real estate mortgages, commercial business loans, and construction loans. In addition, the Bank invests in securities and may utilize various sources of wholesale borrowings. The Bank also provides a range of fee-based services, including an array of cash management services. The Bank operates full-service branch offices in Monterey, Salinas, King City, and San Luis Obispo – all located in Monterey County or San Luis Obispo County, California. The Bank supplements its physical locations with a wide range of financial service delivery options including remote check scanning, remote branch deposit, on-line banking, telephone banking, courier service, electronic bill payment, remote ACH origination, mobile banking, and remote wire request. The Bank's corporate offices are located at 5 Harris Court, Building N, Suite 3, Monterey, California 93940. The Bank's website is www.1stCapital.bank. The main telephone number is 831.264.4000, and the main facsimile number is 831.264.4001.

The deposits in the Bank are insured by the FDIC up to applicable legal limits.

The accounting and reporting policies of the Bank conform with accounting principles generally accepted in the United States of America ("GAAP") and prevailing practices within the banking industry.

Summary of Significant Accounting Policies

Subsequent Events – We have reviewed all events occurring from December 31, 2016 through March 20, 2017, the date the financial statements were available to be issued, and determined that there were no reportable subsequent events.

Stock Dividend – On October 27, 2016, the Bank's Board of Directors declared a 5.00% stock dividend, which was distributed on December 15, 2016 to shareholders of record as of November 23, 2016. All per-share information has been retroactively adjusted to reflect the stock dividend.

Use of Estimates –The preparation of the financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, and contingent assets and liabilities as of the balance sheet date and revenues and expenses for the reporting period. Actual results could differ from those estimates.

Cash and Cash Equivalents – Cash and cash equivalents include cash on hand, amounts due from banks, federal funds sold, interest-bearing transaction deposits in other financial institutions, securities purchased under agreements to resell with original maturities of three months or less, and certificates of deposit with original maturities of three months or less. Generally, federal funds are sold on an overnight basis. For purposes of the Statements of Cash Flows, net cash flows are reported for client loans held for investment, client deposit accounts, securities purchased under agreement to resell, and certificates of deposit with original maturities greater than three months. At December 31, 2016, the Bank maintained "due from" noninterest-bearing account balances at its correspondent banks (excluding the Federal Reserve Bank of San Francisco, or "FRB", and excluding the Federal Home Loan Bank of San Francisco, or "FHLB") of $1.2 million, all but $698 thousand of which was fully FDIC insured. The Bank earns interest on its deposit balances maintained at the FRB and FHLB.

Restrictions on Cash – Cash on hand or on deposit with the Federal Reserve Bank was used to meet regulatory reserve requirements of $15.2 million and $11.8 million at December 31, 2016 and 2015, respectively.

Securities Available for Sale – Securities to be held for indefinite periods of time, including securities that management intends to use as part of its asset / liability management strategy that may be sold in response to changes in interest rates, loan prepayments, or other factors, are classified as available for sale. Securities available for sale are carried at fair value. Gains or losses on the sale of securities are determined using the specific identification method. Premiums and discounts are recognized in interest income using the interest method over the period to contractual maturity, except for securities with early call provisions, in which case premiums are recognized in interest income using the interest method over the period to the first call date and discounts are recognized in interest income using the interest method over the period to the contractual maturity date. For mortgage-backed securities and collateralized mortgage obligations, the amortization or accretion is based on the estimated lives of the securities. The lives of these securities can fluctuate based on the amount of prepayments received on the underlying collateral of the securities. Unrealized holding gains or losses, net of tax, for securities available for sale are reported within accumulated other comprehensive income, which is a separate component of stockholders' equity, until realized.

Management determines the appropriate classification of its securities at the time of purchase and may only change the classification in certain limited circumstances. All transfers between classifications are accounted for at fair value. At December 31, 2016 and 2015, the Bank did not have any securities classified as held to maturity or trading. During the years ended December 31, 2016, 2015, and 2014, there were no transfers of securities between classifications.

An investment security is impaired when its carrying value is greater than its fair value. Investment securities that are impaired are evaluated on at least a quarterly basis and more frequently when economic or market conditions warrant such an evaluation to determine whether such a decline in their fair value is other than temporary. Management utilizes criteria such as the magnitude and duration of the decline and the intent and ability of the Bank to retain its investment in the securities for a period of time sufficient to allow for an anticipated recovery in fair value, in addition to the reasons underlying the decline, to determine whether the loss in value is other than temporary. The term "other than temporary" is not intended to indicate that the decline is permanent, but indicates that the prospects for a near-term recovery of value are not necessarily favorable, or that there is a lack of evidence to support a realizable value equal to or greater than the carrying value of the investment. Once a decline in value is determined to be other than temporary, and management does not intend to sell the security or it is more likely than not that the Bank will not be required to sell the security before recovery, only the portion of the impairment loss representing credit exposure is recognized as a charge to earnings, with the balance recognized as a charge to other comprehensive income. If management intends to sell the security or it is more likely than not that the Bank will be required to sell the security before recovering its forecasted cost, the entire impairment loss is recognized as a charge to earnings.

Loans Held for Sale – Loans held for sale are carried at the lower of aggregate net cost, including qualified deferred fees and costs, or fair value, grouped by category. Unrealized losses by category are recognized via a charge against earnings. Realized gains and losses on loans held for sale are accounted for under the specific identification method. Qualified deferred loan origination fees and costs are not amortized during the period the loans are held for sale. Transfers of loans held for sale to the held-for-investment portfolio are recorded at the lower of cost or estimated market value on the transfer date. The Bank did not have any loans held for sale at December 31, 2016 or 2015.

Loans Receivable Held for Investment – Loans receivable held for investment are those loans that management has the intent and ability to hold for the foreseeable future or until maturity or payoff. Loans receivable held for investment are stated at unpaid principal balances less undisbursed loan funds, unearned discounts, deferred loan origination fees, and allowances for loan losses, plus deferred direct loan origination costs and unamortized premiums.

Interest Income on Loans – Interest income on loans is accrued and credited to income as it is earned. However, interest generally is not accrued on loans over 90 days contractually delinquent. In addition, interest is not accrued on loans that are less than 90 days contractually delinquent, but where management has identified concern over future collection. Accrued interest income is reversed when a loan is placed on non-accrual status. Discounts, premiums, deferred loan origination fees and deferred direct loan origination costs are amortized into interest income over the contractual lives of the related loans using the interest method, except when a loan is in non-accrual status. When a loan is paid off or is sold, any unamortized balance of any related premiums, discounts, loan origination fees, and direct loan origination costs is recognized in income. Payments received on non-accrual loans may be allocated between principal and interest or may be recorded entirely as reductions in principal based upon management's opinion of the ultimate risk of loss on the individual loan. Loans are returned to accrual status when all of the principal and interest amounts contractually due are brought current and future payments are reasonably assured.

Sales of Loans – The Bank accounts for the transfer of financial assets based on the financial assets it controls and liabilities it has incurred, derecognizes financial assets when control has been surrendered, and derecognizes liabilities when extinguished. Gains or losses resulting from sales of loans are recorded at the time of sale and are determined by the difference between: (i) the net sales proceeds plus the estimated fair value of any interests retained in the loans, and (ii) the carrying value of the assets sold. The difference between the adjusted carrying value of the interests retained and the face amount of the interests retained is amortized to operations over the estimated remaining life of the associated loans using the interest method. The fair value of any interests retained is periodically evaluated, with any shortfall in estimated fair value versus carrying amount being charged against operations. The Bank serviced loans for others in the amount of $2.7 million and $2.3 million at December 31, 2016 and 2015, respectively.

Troubled Debt Restructurings – A loan is considered a troubled debt restructuring ("TDR") when the Bank, for economic or legal reasons related to the borrower's financial difficulties, provides the borrower certain concessions that it would not normally consider. The concessions are provided with the objective of maximizing the recovery of the Bank's investment. A troubled debt restructuring includes situations in which the Bank accepts a note (secured or unsecured) from a third party in payment of its receivable from the borrower, other assets in payment of the loan, an equity interest in the borrower or its assets in lieu of the Bank's receivable under which the value received is less than the face amount of the debt, or a modification of the terms of the debt including, but not limited to: (i) a reduction in the stated interest rate to a below-market rate; (ii) an extension of maturity at an interest rate or other terms below market; (iii) a reduction in the face amount of the debt; and / or (iv) a reduction in the accrued interest receivable. Restructured workout loans typically present an elevated level of credit risk as the borrowers are not able to perform according to the original contractual terms. Loans that are reported as TDRs are considered impaired and are measured for impairment as described below. The Bank had loans considered to be troubled debt restructurings of $326 thousand and $1.7 million at December 31, 2016 and 2015, respectively.

Impaired Loans – The Bank considers a loan to be impaired when it is deemed probable by management that the Bank will be unable to collect all contractual interest and contractual principal payments in accordance with the terms of the original loan agreement. In evaluating whether a loan is considered impaired, insignificant delays or shortfalls in payments in the absence of other facts and circumstances would not alone lead to the conclusion that a loan is impaired. Factors considered in determining impairment include payment status, collateral value, and the probability of collecting scheduled principal and interest payments when due.

The Bank includes among impaired loans all loans that: (i) are contractually delinquent 90 days or more; (ii) meet the definition of a troubled debt restructuring; (iii) are classified in part or in whole as either doubtful or loss; and (iv) have been placed on non-accrual status. The Bank may also classify other loans as impaired based upon their specific circumstances. Loans identified as impaired are evaluated and have a specific loss allowance applied to adjust the loan to fair value, or the impaired amount is charged off.

The Bank accounts for impaired loans, except those loans that are accounted for at market value or at the lower of cost or market value, at the present value of the expected future cash flows discounted at the loan's effective interest rate at the date of initial impairment, or, as a practical expedient, at the loan's observable market price or fair value of the collateral if the loan is collateral dependent. The Bank evaluates the collectability of both contractual interest and contractual principal when assessing the need for a loss accrual for impaired loans. Payments received on impaired non-accrual loans may be allocated between principal and interest or may be recorded entirely as a reduction in principal based upon management's opinion of the ultimate risk of loss on the individual loan. Interest income on other impaired loans is recognized on an accrual basis. The Bank had $7.9 million of impaired loans as of December 31, 2016 and $9.3 million of impaired loans as of December 31, 2015.

The Bank may acquire loans through business combinations or purchases for which differences may exist between the contractual cash flows and the cash flows expected to be collected when due, at least in part due to credit quality. When the Bank acquires such loans, the yield that may be accreted is limited to the excess of the expected cash flows at acquisition over the Bank's initial investment in the loan. The excess of contractual cash flows over cash flows expected to be collected may not be recognized as an adjustment to yield, loss, or a valuation allowance. Subsequent increases in cash flows expected to be collected are recognized prospectively through adjustment of the loan's yield over its remaining life. Decreases in cash flows expected to be collected are recognized as impairments. The Bank does not "carry over" or create a valuation allowance in the initial accounting for loans acquired under these circumstances. The Bank did not have any loans accounted for under these policies as of December 31, 2016 and 2015.

Allowance for Loan Losses – The Bank maintains an allowance for loan losses (the "allowance"), which is a valuation allowance, to absorb probable incurred credit losses. The allowance is based on ongoing assessments of the probable estimated losses. Loans are charged against the allowance when management believes the principal to not be recoverable. The allowance is increased by the provision for loan losses. The provision for loan losses is charged against current period earnings. The allowance is decreased by the amount of charge-offs, net of recoveries. While allocations of the allowance for loan losses may be made for specific loans, the entire allowance for loan losses is available for any loan that should be charged off.

The Bank's methodology for assessing the appropriateness of the allowance consists of several key elements, which include the formula (or general) allowance, specific allowances, and the unallocated allowance.

The determination of the general allowance for loans that are collectively evaluated for impairment is based on historical loss experience adjusted for current factors. The historical loss experience is determined by portfolio segment and is based on the actual loss history experienced by the Bank, its peers, or a combination thereof for a period of twenty-eight consecutive quarters prior to the most current year end. This actual loss experience is supplemented with other economic factors based on the risks present for each portfolio segment. These economic factors include consideration of the following: levels of and trends in delinquencies and impaired loans; levels of and trends in charge-offs and recoveries; trends in volume and terms of loans; effects of any changes in risk selection and underwriting standards; other changes in lending policies, procedures, and practices; experience, ability, and depth of lending management and other relevant staff; national and local economic trends and conditions; industry conditions; and effects of changes in credit concentrations.

These loss factors are inherently subjective and are driven by the repayment risk associated with each portfolio segment described below.

Construction, land, and lot – Construction, land, and lot loans generally possess a higher inherent risk of loss than other real estate portfolio segments. A major risk arises from the necessity to complete projects within specified costs and timelines. Trends in the construction industry significantly impact the credit quality of these loans, as demand drives construction activity. In addition, trends in real estate values significantly impact the credit quality of these loans, as property values determine the economic viability of construction projects.

Multifamily and commercial and industrial real estate – Multifamily and commercial and industrial real estate mortgage loans generally possess a higher inherent risk of loss than other real estate portfolio segments, except construction, land, and lot loans. Adverse economic developments or an overbuilt market affect multifamily and commercial and industrial real estate projects and may result in troubled loans. Trends in vacancy rates of multifamily and commercial properties affect the credit quality of these loans. High vacancy rates reduce operating revenues and the ability for properties to produce sufficient cash flow to service debt obligations.

Commercial and industrial – Commercial and industrial loans generally possess a lower inherent risk of loss than real estate portfolio segments because these loans generally are underwritten to existing cash flows of operating businesses. Debt coverage is provided by business cash flows, and economic trends evidenced by unemployment rates and other key economic indicators are closely correlated to the credit quality of these loans.

Agricultural – Loans secured by crop production and livestock are especially vulnerable to two risk factors that are largely outside the control of the Bank and borrowers: commodity prices and weather conditions.

Single-family residential real estate and home equity lines of credit – The degree of risk in residential real estate lending depends primarily on the loan amount in relation to collateral value, the interest rate, and the borrower's ability to repay in an orderly fashion. These loans generally possess a lower inherent risk of loss than other real estate portfolio segments. Economic trends evidenced by unemployment rates and other key economic indicators are closely correlated to the credit quality of these loans. Weak economic trends indicate that the borrowers' capacity to repay their obligations may be deteriorating.

Other – These loans are typically various types of loans to not-for-profit organizations and other miscellaneous categories of loans and as such are vulnerable to risk factors that are largely outside the control of the Bank.

The Bank assigns risk ratings to all loans and periodically performs detailed reviews of all loans over a certain dollar threshold to identify credit risks and to assess the overall collectability of the portfolio. These risk ratings are also subject to examination by independent specialists engaged by the Bank and the Bank's regulators. During these internal reviews, management monitors and analyzes the financial condition of borrowers and guarantors, trends in the industries in which borrowers operate, and the fair value of collateral securing these loans. These credit quality indicators are used to assign a risk rating to each individual loan.

Specific allowances are established for loans that are deemed impaired if the fair value of the loan or the collateral or the present value of expected future cash flows is estimated to be less than the Bank’s investment in the loan. In developing specific valuation allowances, the Bank considers: (i) the estimated cash payments expected to be received by the Bank; (ii) the estimated net sales proceeds from the loan or its collateral; (iii) cost of refurbishment; (iv) certain operating income and expenses; and (v) the costs of acquiring, holding, and disposing of the collateral. The Bank charges off a portion of an impaired loan against the specific allowance when that portion is not considered recoverable.

The unallocated allowance is maintained to cover uncertainties that could affect management's estimate of probable losses. The unallocated allowance reflects the margin of imprecision inherent in the underlying assumptions used in the methodologies for estimating general and specific losses in the credit portfolio. The Bank maintained a $156 thousand unallocated allowance at December 31, 2016 and a $153 thousand unallocated allowance at December 31, 2015.

While management uses currently available information to determine the allowance for loan losses, additions to or recoveries from the allowance may be necessary based upon a number of factors including, but not limited to, changes in economic conditions and credit quality trends, particularly in the real estate market, borrower financial status, the regulatory environment, real estate values, and loan portfolio size and composition. Many of these factors are beyond the Bank’s control and, accordingly, periodic provisions for loan losses may vary from time to time. In addition, various regulatory agencies, as an integral part of the examination process, periodically review the Bank’s allowance for loan losses. Such regulatory agencies may develop judgments different from those of management and may require the Bank to recognize additional provisions. The Bank’s Board of Directors reviews and approves the adequacy of the allowance for loan losses at least quarterly.

Loan Commitments and Related Financial Instruments – Financial instruments include off-balance sheet credit instruments, such as commitments to make loans and commercial letters of credit, issued to meet client financing needs. The face amount for these items represents the exposure to loss, before considering client collateral or ability to repay. Such financial instruments are recorded when they are funded.

Allowance for Off-Balance Sheet Credit Exposures **–** The Bank also maintains a separate allowance for off-balance sheet commitments. Management estimates anticipated losses using historical data and utilization assumptions. The allowance for off-balance sheet commitments is included in other liabilities on the Balance Sheets. The allowance for off-balance sheet commitments was $119 thousand at December 31, 2016 and $148 thousand at December 31, 2015.

Premises and Equipment **–** Premises and equipment are stated at cost, less accumulated depreciation and amortization. The Bank depreciates or amortizes furniture and equipment on a straight-line basis over the estimated useful lives of the various assets (generally three to seven years) and amortizes leasehold improvements over the shorter of the asset’s useful life or the remaining term of the lease including option periods the Bank has the right, capacity, and intent to exercise. Gains and losses on disposition of premises and equipment are accounted for under the specific identification method. The cost of repairs and maintenance is charged to earnings as incurred, whereas expenditures that improve or extend the service lives of assets are capitalized.

Leased equipment meeting certain capital lease criteria is capitalized, and the present value of the related lease payments is recorded as a liability. Amortization of capital leases is computed using a straight-line method over the shorter of the estimated and useful life of the equipment or the initial lease term. The Bank did not have any capital leases as of December 31, 2016 and 2015.

Certain operating leases contain scheduled and specified rent increases and incentives in the form of tenant improvement allowances or credits. The scheduled rent increases are recognized on a straight-line basis over the lease term as adjustments in the amount of rental expense recognized each period. Lease incentives are capitalized at the inception of the lease and amortized on a straight-line basis over the lease term. Amounts accrued in excess of amounts paid related to the scheduled rent increases and the unamortized deferred rent credits associated with tenant improvement allowances are included in other liabilities on the Balance Sheets.

Bank-Owned Life Insurance –The Bank has purchased life insurance policies on certain key executives. Bank-owned life insurance is recorded at the amount that can be realized under the insurance contract at the balance sheet date, which is the cash surrender value adjusted for other charges or other amounts due that are probable at settlement.

Servicing Rights – When whole loans, the government agency-guaranteed portion of loans, or loan participations are sold with servicing retained, servicing rights are initially recorded at fair value with the income statement effect recorded in gains or losses on the sale of loans. Fair value is based on a valuation model that calculates the present value of estimated net servicing income.

Under the fair value measurement method, the Bank measures servicing rights at fair value at each reporting date and reports changes in the fair value of servicing assets in earnings in the period in which changes occur. The Bank maintained servicing rights of $31 thousand and $25 thousand at December 31, 2016 and 2015, respectively.

Federal Home Loan Bank Stock – As a member of the Federal Home Loan Bank System, the Bank is required to maintain an investment in the capital stock of the Federal Home Loan Bank of San Francisco (“FHLB”) based upon the size and profile of its balance sheet and the level of its FHLB advances. The Bank’s investment in FHLB stock is carried at cost, is classified as a restricted security, and is periodically evaluated for impairment based upon ultimate recovery of par value. Both cash and stock dividends are reported as income. The Bank’s investment in FHLB stock was $2.9 million and $2.6 million at December 31, 2016 and 2015, respectively.

Income Taxes – Income tax expense is the total of the current year income tax due or refundable plus the change in deferred tax assets and liabilities. The Bank accounts for income taxes under the asset and liability method. Under this method, deferred tax assets and deferred tax liabilities are recognized for future tax consequences attributable to temporary differences between the financial statement carrying amounts of certain existing assets and liabilities, and their respective bases for Federal income and California franchise taxes. Deferred tax assets and liabilities are calculated by applying current effective tax rates against future deductible or taxable amounts. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in earnings in the period that includes the enactment date. Future tax benefits attributable to temporary differences are recognized to the extent the realization of such benefits is more likely than not.

Accounting for Uncertainty in Income Taxes – The Bank considers all tax positions recognized in its financial statements for the likelihood of realization. When tax returns are filed, it is highly likely that some positions taken would be sustained upon examination by the taxing authorities, while others are subject to uncertainty about the merits of the position taken or the amount of the position that ultimately would be sustained. The benefit of a tax position is recognized in the financial statements in the period during which, based upon all available evidence, management believes it is more likely than not that the position will be sustained upon examination, including the resolution of appeals or litigation processes, if any. Tax positions taken are not offset or aggregated with other positions. Tax positions that meet the more-likely-than-not recognition threshold are measured as the largest amount of tax benefit that is more than 50 percent likely of being realized upon settlement with the applicable taxing authority. The portion of the benefits associated with tax positions taken that exceeds the amount measured as described above, if any, is reflected as a liability for unrecognized tax benefits in the accompanying Balance Sheets along with any associated interest and penalties that would be payable to the taxing authorities upon examination. Interest expense and penalties associated with unrecognized tax benefits, if any, are classified as income tax expense in the Statements of Income. The Bank maintained a reserve for uncertain tax positions of $143 thousand and $243 thousand at December 31, 2016 and 2015, respectively.

Earnings Per Share – Basic earnings per share excludes dilution and is computed by dividing net income available to common shareholders by the weighted average number of common shares outstanding during the period. Diluted earnings per share reflects the potential dilution that could occur if contracts to issue common stock or securities convertible into common stock were exercised or converted, which currently consist of shares issuable upon the exercise of stock options and the vesting of outstanding restricted stock awards. Dilution resulting from the Bank's Equity Incentive Plan is calculated using the treasury stock method. Earnings and dividends per share are restated for all stock splits and stock dividends through the date of issuance of the financial statements.

Comprehensive Income – Comprehensive income includes net income and other comprehensive income. The Bank's only source of other comprehensive income is derived from unrealized gains and losses on securities available for sale. Reclassification adjustments result from gains or losses on securities that were realized and included in net income of the current period that also had been included in other comprehensive income as unrealized holding gains or losses in the period in which they arose. Such adjustments are excluded from current period comprehensive income in order to avoid double counting.

Derivative Instruments and Hedging Activities – The Bank did not enter into any freestanding derivative contracts, did not conduct any hedging activities, and did not identify any embedded derivatives requiring bifurcation and separate valuation during 2016 or 2015.

Fair Value of Financial Instruments – Fair values of financial instruments are estimated using relevant market information and other assumptions, as more fully disclosed in Note 2. 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.

Loss Contingencies – Loss contingencies, including claims and legal actions arising in the ordinary course of business, are recorded as liabilities when the likelihood of loss is probable and an amount or range of loss can be reasonably estimated. Management does not believe there now are such matters that will have a material effect on the financial statements.

Concentrations of Credit Risk – Most the Bank's business activity is with clients located within Monterey and San Luis Obispo Counties. Therefore, the Bank's exposure to credit risk is significantly affected by changes in the economy, business conditions, and real estate values in the Monterey and San Luis Obispo County areas.

Segment Disclosure – The Bank operates a single line of business (financial services) with no client accounting for more than 10% of its revenue and manages its operations under a unified management and reporting structure. Therefore, no additional segment disclosures are provided.

Share-Based Payments – The Bank has one share-based compensation plan, the 1st Capital Bank 2016 Equity Incentive Plan (the "Plan"), which has been approved by its shareholders and permits the grant of stock options and restricted stock awards for up to 640,400 shares of the Bank's common stock. The Plan is designed to attract and retain employees and directors. The amount, frequency, and terms of share-based awards may vary based on competitive practices, the Bank's operating results, and government regulations. New shares are issued upon option exercise or vesting of restricted stock awards. In addition, the Plan requires that the exercise price of options may not be less than the fair market value of the stock at the date the option is granted, and that the exercise price must be paid in full at the time the option is exercised.

Share-based compensation expense is recorded for all stock options and restricted stock awards that are expected ultimately to vest as the requisite service is rendered based on the grant date fair value of the awards.

Management estimates the fair value of each stock option award as of the date of grant using a Black-Scholes-Merton option pricing formula. Expected volatilities are based on historical volatilities of the Bank's common stock over a preceding period commensurate with the expected term of the options. The Bank uses historical data to estimate option exercise and post-vesting termination behavior. The expected term of options granted is based on this historical data and represents the period of time that options granted are expected to be outstanding, which takes into account that the options are not transferable. The risk-free interest rate for the expected term of the option is based on the U.S. Treasury yield curve in effect at the time of grant. Expected dividend yield was not considered in the option pricing formula since the Bank has no plans to pay cash dividends. In addition to these assumptions, management makes estimates regarding pre-vesting forfeitures that will affect total compensation expense recognized under the Plan.

Restricted share awards are grants of shares of the Bank's common stock that are subject to forfeiture until specific conditions or goals are met. Conditions may be based on continuing employment or service and / or achieving specified performance goals. During the period of restriction, Plan participants holding restricted share awards have no voting or cash dividend rights. The restrictions lapse in accordance with a schedule or with other conditions determined by the Board of Directors as reflected in each award agreement. The restricted stock awards are considered fixed awards as the number of shares and fair value is known at the date of grant. The fair value for restricted stock awards is determined by the market price of the Bank's common stock on the date of grant.

The Bank recognizes the share-based compensation expense over the vesting period of each award of restricted shares based upon the fair value of the common stock at the date of grant and considering the probability of the performance criteria being achieved. Plan participants have the opportunity to elect tax information reporting of the award of restricted shares within thirty days of grant under Internal Revenue Code Section 83(b). To the extent Plan participants make such elections, the Bank recognizes the expense for tax purposes more quickly than for book purposes, thereby generating a deferred tax liability.

Upon the exercise of each vested stock option and vesting of each restricted share award, the Bank issues the associated common shares from its inventory of authorized common shares. All outstanding stock options and restricted stock awards under the Plan immediately vest in the event of a change in control of the Bank. The shares associated with any stock options that are forfeited or expire unexercised and restricted share awards that fail to vest become available for re-issuance under the Plan.

Adoption of New Financial Accounting Standards

ASU 2016-02, Leases – In February 2016, the Financial Accounting Standards Board ("FASB") amended existing guidance that requires lessees recognize the following for all leases (with the exception of short-term leases) at the commencement date: (1) a lease liability, which is a lessee's obligation to make lease payments arising from a lease, measured on a discounted basis; and (2) a right-of use asset, which is an asset that represents the lessee's right to use, or control the use of, a specified asset for the lease term. Under the new guidance, lessor accounting is largely unchanged. Certain targeted improvements were made to align, where necessary, lessor accounting with the lessee accounting model and Topic 606, Revenue from Contracts with Customers. These amendments are effective for public business entities for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years (i.e., January 1, 2019, for a calendar year entity).

Lessees (for capital and operating leases) and lessors (for sales-type, direct financing and operating leases) must apply a modified retrospective transition approach for leases existing at, or entered into after, the beginning of the earliest comparative period presented in the financial statements. The modified retrospective approach would not require any transition accounting for leases that expired before the earliest comparative period presented. Lessees and lessors may not apply a full retrospective transition approach. The adoption of this standard is not expected to have a material effect on the Company's operating results or financial condition.

ASU 2016-13, Financial Instruments – Credit Losses – In June 2016, the FASB issued guidance to replace the incurred loss model with an expected loss model, which is referred to as the current expected credit loss ("CECL") model. The CECL model is applicable to the measurement of credit losses on financial assets measured at amortized cost, including loan receivables, held-to maturity debt securities, and reinsurance receivables. It also applies to off-balance sheet credit exposures not accounted for as insurance (loan commitments, standby letters of credit, financial guarantees, and other similar instruments) and net investments in leases recognized by a lessor.

Transition:

- For debt securities with other-than temporary impairment ("OTTI"), the guidance will be applied prospectively.
- Existing purchased credit impaired ("PCI") assets will be grandfathered and classified as purchased credit deteriorated ("PCD") asserts at the date of adoption. The asset will be grossed up for the allowance for expected credit losses for all PCD assets at the date of adoption and will continue to recognize the noncredit discount in interest income based on the yield of such assets as of the adoption date. Subsequent changes in expected credit losses will be recorded through the allowance.
- For all other assets within the scope of CECL, a cumulative-effect adjustment will be recognized in retained earnings as of the beginning of the first reporting period in which the guidance is effective.

These amendments are effective as follows:

- For public business entities (“PBE”) that meet the definition of a Securities and Exchange Commission (“SEC”) filer, the standard will be effective for fiscal years beginning after December 15, 2019, including interim periods in those fiscal years. For calendar year-end SEC filers, it is effective for March 31, 2020 Interim Financial Statements.
- For PBEs that do not meet the definition of an SEC filer (the Bank’s current status), the standard will be effective for fiscal years beginning after December 15, 2020, including interim periods within those fiscal years. For calendar year-end PBEs that are not SEC filers, it is effective for March 31, 2021 Interim Financial Statements.
- For all other entities, the standard will be effective for fiscal years beginning after December 15, 2020, and interim periods within the fiscal years beginning after December 15, 2021. For calendar year-end entities that are not PBEs, it is effective for December 31, 2021 Annual Financial Statements.
- All entities may early adopt for fiscal years beginning after December 15, 2018, including interim periods in those fiscal years, which means that calendar year-end entities may adopt as early as the March 31, 2019, interim financial statements.

As of this time, management has not fully modeled and analyzed the historical data necessary to make a clear determination as to the materiality of the impact on either financial condition or future operations based upon the implementation of the CECL methodology of required reserves or recognition of future credit losses. Management does believe there is a potential material impact to both capital and operations based upon this new framework for both reserving and recognizing future credit losses.

ASU 2016-09, Improvements to Employee Share-Based Payment Accounting – In March 2016, the FASB issued guidance intended to simplify various aspects related to how share-based payments are accounted for and presented in the financial statements. Some of the key provisions of this new ASU include: (1) companies will no longer record excess tax benefits and certain tax deficiencies in additional paid-in capital ("APIC"). Instead, they will record all excess tax benefits and tax deficiencies as income tax expense or benefit in the income statement, and APIC pools will be eliminated. The guidance also eliminates the requirement that excess tax benefits be realized before companies can recognize them. In addition, the guidance requires companies to present excess tax benefits as an operating activity on the statement of cash flows rather than as a financing activity; (2) increase the amount an employer can withhold to cover income taxes on awards and still qualify for the exception to liability classification for shares used to satisfy the employer's statutory income tax withholding obligation. The new guidance will also require an employer to classify the cash paid to a tax authority when shares are withheld to satisfy its statutory income tax withholding obligation as a financing activity on its statement of cash flows (current guidance did not specify how these cash flows should be classified); and (3) permit companies to make an accounting policy election for the impact of forfeitures on the recognition of expense for share-based payment awards. Forfeitures can be estimated, as required today, or recognized when they occur. ASU No. 2016-09 is effective for interim and annual reporting periods beginning after December 15, 2016. Early adoption was permitted, but all of the guidance must be adopted in the same period. The Bank has evaluated the provisions of ASU No. 2016-09 to determine the potential impact of the new standard and has determined that it is not expected to have a material impact on the Bank's financial position, results of operations or cash flows.

2. FAIR VALUE

Fair value is the exchange price that would be received for an asset or paid to transfer a liability (exit price) in the principal or most advantageous market for an asset or liability in an orderly transaction between market participants on the measurement date. Assets and liabilities measured at fair value are grouped into three levels, based on the markets in which the assets and liabilities are traded and the reliability of the assumptions used to determine fair value.

Level 1

In general, fair values determined by Level 1 inputs utilize quoted prices (unadjusted) for identical assets or liabilities in active markets that the Bank has the ability to access as of the measurement date.

Level 2

Fair values determined by Level 2 inputs utilize significant inputs other than quoted prices included in Level 1 that are observable for the asset or liability, either directly or indirectly. Level 2 inputs include quoted prices for similar assets and liabilities in active markets, and inputs other than quoted prices that are observable for the asset or liability, such as interest rates and yield curves that are observable at commonly quoted intervals. Level 2 inputs also include quoted prices in markets that are not active and other inputs that are observable or that can be corroborated by observable market data.

Level 3

Level 3 inputs are unobservable inputs for the asset or liability, and include situations where there is little, if any, market activity for the asset or liability. Level 3 inputs often reflect the Bank's own assumptions about the assumptions that market participants would use in pricing an asset or liability.

In certain cases, the inputs used to measure fair value may fall into different levels of the fair value hierarchy. In such cases, the level in the fair value hierarchy within which the fair value measurement in its entirety falls has been determined based on the lowest level input that is significant to the fair value measurement in its entirety.

Management monitors the availability of observable market data to assess the appropriate classification of financial instruments within the fair value hierarchy. Changes in economic conditions or model-based valuation techniques may require the transfer of financial instruments from one fair value level to another. In such instances, the transfer is reported at the beginning of the reporting period.

Management evaluates the significance of transfers between levels based upon the nature of the financial instrument and size of the transfer relative to total assets, total liabilities, or total earnings.

The Bank utilized the following methods and significant assumptions to estimate fair value:

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

Impaired Loans – The fair value of impaired loans is based upon the fair value of the collateral, generally obtained through property appraisals, for collateral dependent loans; and for other impaired loans estimated using a discounted cash flow model. These appraisals may utilize a single valuation approach or a combination of approaches including comparable sales and the income approach. Adjustments are routinely made in the appraisal process by the independent appraisers to adjust for differences between the comparable sales and income data available. Such adjustments are usually significant and typically result in a Level 3 classification of the inputs for determining fair value. Impaired loans are evaluated on at least a quarterly basis for additional impairment and adjusted accordingly.

Other Real Estate Owned – Non-recurring adjustments to certain multifamily, commercial, residential, and agricultural real estate properties classified as other real estate owned are measured at fair value, less estimated costs to sell. Fair values are based on recent real estate appraisals. These appraisals may use a single valuation approach or a combination of approaches including comparable sales and the income approach. Adjustments are routinely made in the appraisal process by the independent appraisers to adjust for differences between the comparable sales and income data available. Such adjustments are usually significant and typically result in a Level 3 classification of the inputs for determining fair value.

Loan Servicing Rights – On a quarterly basis, loan servicing rights are evaluated for impairment based upon the fair value of the rights as compared to the carrying amount. If the carrying amount of an individual tranche exceeds fair value, impairment is recorded on that tranche so that the servicing asset is carried at fair value. Fair value is determined at a tranche level based on a valuation model that calculates the present value of estimated future net servicing income based upon various assumptions (Level 3).

The following table presents information about the Bank's assets and liabilities measured at fair value on a recurring basis as of December 31, 2016 and 2015. They indicate the hierarchy of valuation techniques utilized by the Bank to determine the fair value of these assets and liabilities.

		Fair Value Measurements on a Recurring Basis at December 31, 2016, Using		
(Dollars in Thousands)	Fair Value 12/31/2016	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Variable-rate US Agency securities:				
Residential MBS	$ 560	$ --	$ 560	$ --
Residential CMO	48,284	--	48,284	--
Commercial CMO	513	--	513	--
Subtotal	49,357	--	49,357	--
Fixed-rate US Agency securities:				
Residential MBS	24,932	--	24,932	--
Commercial MBS	399	--	399	--
Subtotal	25,331	--	25,331	--
Fixed-rate obligations of states and political subdivisions	3,182	--	3,182	--
Total	$ 77,870	$ --	$ 77,870	$ --

		Fair Value Measurements on a Recurring Basis at December 31, 2015, Using		
(Dollars in Thousands)	Fair Value 12/31/2015	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Variable-rate US Agency securities:				
Residential MBS	$ 2,244	$ --	$ 2,244	$ --
Commercial MBS	14,983	--	14,983	--
Residential CMO	63,831	--	63,831	--
Commercial CMO	677	--	677	--
Subtotal	81,735	--	81,735	--
Fixed-rate US Agency securities:				
Residential MBS	1,546	--	1,546	--
Commercial MBS	451	--	451	--
Subtotal	1,997	--	1,997	--
Fixed-rate obligations of states and political subdivisions	471	--	471	--
Total	$ 84,203	$ --	$ 84,203	$ --

There were no changes in the valuation techniques used during 2016. During the years ended December 31, 2016 and 2015, there were no transfers in or out of Levels 1, 2, or 3.

The Bank may be required, from time to time, to measure certain assets at fair value on a non-recurring basis. These include assets that are measured at the lower of cost or market value that were recognized at fair value which was below cost at the reporting date.

Assets and liabilities measured at fair value on a non-recurring basis are summarized below:

(Dollars in Thousands)	Fair Value 12/31/2016	Fair Value Measurements on a Non-Recurring Basis at December 31, 2016, Using			
		Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total Losses
Loan servicing rights	$ 31	$ --	$ --	$ 31	$ --

(Dollars in Thousands)	Fair Value 12/31/2015	Fair Value Measurements on a Non-Recurring Basis at December 31, 2015, Using			
		Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total Losses
Loan servicing rights	$ 25	$ --	$ --	$ 25	$ --

The carrying amounts and estimated fair values of the Bank's financial instruments are as follows:

(Dollars in Thousands)	Carrying Amount	Fair Value Measurements at December 31, 2016			
		Level 1	Level 2	Level 3	Total
Financial Assets					
Cash and cash equivalents	$ 53,638	$ 53,638	$ --	$ --	$ 53,638
Time deposits at other financial institutions	2,490	--	2,492	--	2,492
Securities available for sale	77,870	--	77,870	--	77,870
Loans receivable held for investment, net	399,039	--	--	399,093	399,093
Federal Home Loan Bank stock	2,939	--	--	--	NA
Accrued interest receivable[1]	1,229	--	120	1,109	1,229
Loan servicing rights	31	--	--	31	31
Financial Liabilities					
Transaction and savings deposits	$ 487,577	$ 487,577	$ --	$ --	$ 487,557
Certificates of deposit	13,044	--	13,003	--	13,003
Accrued interest payable	22	7	15	--	22

	Carrying Amount	Fair Value Measurements at December 31, 2015			
		Level 1	Level 2	Level 3	Total
Financial Assets					
Cash and cash equivalents	$ 46,191	$ 46,161	$ --	$ --	$ 46,191
Time deposits at other financial institutions	2,241	--	2,251	--	2,251
Securities available for sale	84,203	--	84,203	--	84,203
Loans receivable held for investment, net	370,790	--	--	372,129	372,129
Federal Home Loan Bank stock	2,593	--	--	--	NA
Accrued interest receivable[1]	1,077	--	48	1,027	1,077
Loan servicing rights	25	--	--	25	25
Financial Liabilities					
Transaction and savings deposits	$ 439,268	$ 439,268	$ --	$ --	$ 439,268
Certificates of deposit	29,121	--	29,071	--	29,071
Accrued interest payable	28	7	21	--	28

1 = Excludes accrued dividends on FHLB stock.

The estimated fair value amounts have been determined by the Bank, at a specific point in time, using available market information and appropriate valuation methodologies. However, considerable judgment is required to interpret market data to develop the estimates of fair value. Accordingly, the estimates presented herein are not necessarily indicative of the amounts the Bank could realize in a current market exchange.

The fair value estimates presented herein are based upon pertinent information available to management as of December 31, 2016 and 2015. The fair value amounts have not been comprehensively reevaluated since the reporting date. Therefore, current estimates of fair value and the amounts realizable in current secondary market transactions may differ significantly from the amounts presented herein.

The estimated fair value amounts do not reflect any premium or discount that might be realized by offering the Bank's entire holdings of a particular financial instrument for sale at one time. The estimated fair value amounts do not attempt to estimate the value of anticipated future business related to the financial instruments. In addition, the tax ramifications related to the realization of unrealized gains and losses can have a potential effect on fair value estimated and have not been considered in any of the estimates.

Because no active market exists for a significant portion of the Bank's financial instruments, fair value estimates are based on judgments regarding current economic conditions, risk characteristics of various financial instruments, and other factors. These estimates are subjective in nature and involve uncertainties and matters of significant judgment, and therefore cannot be determined with precision. The use of different assumptions and / or estimation methodologies could have a material effect on the estimated fair value amounts.

The following methods and assumptions, not previously presented, were utilized by the Bank in computing the estimated fair values:

Cash and Cash Equivalents - Current carrying amounts approximate estimated fair value, resulting in a Level 1 classification.

Loans Receivable Held for Investment - The fair value of loans, excluding loans held for sale, is estimated as follows: For variable rate loans that reprice frequently and with no significant change in credit risk, fair values are based on carrying values resulting in a Level 3 classification. Fair values for other loans are estimated using discounted cash flow analyses, using interest rates currently being offered for other loans with similar terms to borrowers of similar credit quality resulting in a Level 3 classification. Impaired loans are valued at the lower of cost or fair value as described previously. The methods utilized to estimate the fair value of loans do not necessarily represent an exit price.

FHLB Stock – It is not practical to determine the fair value of FHLB stock due to restrictions placed on its transferability.

Accrued Interest Receivable – Current carrying amounts approximate fair value, with the balances distributed according to the Level classification of the associated asset.

Transaction and Savings Deposit Accounts – The estimated fair value of checking, savings, and money market deposit accounts is the amount payable on demand at the reporting date, represented by the carrying value, resulting in a Level 1 classification.

Certificates of Deposit - Fair value has been estimated by discounting the contractual cash flows using current market rates for similar time deposits with comparable remaining terms, resulting in a Level 2 classification.

Accrued Interest Payable – Current carrying amounts approximate fair value, with balances distributed according to the Level classification of the associated liability.

Off-Balance Sheet Instruments – Off-balance sheet commitments to extend credit are primarily for adjustable-rate loans. The fair values of commitments are estimated based on fees currently charged to enter into similar agreements. These fees were not significant as of December 31, 2016 and 2015 and therefore have not been included in the above table.

3. SECURITIES AVAILABLE FOR SALE

The amortized cost and estimated fair value of securities available for sale are presented below. The Bank's securities portfolio comprises collateralized mortgage obligations ("CMO"), mortgage-backed securities ("MBS"), and loan pools issued by the Federal National Mortgage Association ("FNMA"), the Federal Home Loan Mortgage Corporation ("FHLMC"), and the Government National Mortgage Association ("GNMA"), collectively, ("US Agencies"). All of the Bank's securities at December 31, 2016 and 2015 were publicly traded.

(Dollars in Thousands)	December 31, 2016			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Variable-rate US Agency securities:				
Residential CMO	$ 48,360	$ 81	$ (157)	$ 48,284
Commercial CMO	515	--	(2)	513
Residential MBS	531	29	--	560
Subtotal	49,406	110	(159)	49,357
Fixed-rate US Agency securities:				
Residential MBS	25,502	15	(585)	24,932
Commercial MBS	403	--	(4)	399
Subtotal	25,905	15	(589)	25,331
Fixed-rate obligations of states and political subdivisions	3,350	2	(170)	3,182
Total securities available for sale	$ 78,661	$ 127	$ (918)	$ 77,870

Net unrealized losses on available-for-sale investment securities totaling $791 thousand were recorded, net of $325 thousand of tax assets, as accumulated other comprehensive income within stockholders' equity at December 31, 2016.

(Dollars in Thousands)	December 31, 2015			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Variable-rate US Agency securities:				
Residential CMO	$ 63,619	$ 262	$ (50)	$ 63,831
Commercial CMO	674	4	(1)	677
Residential MBS	2,163	81	--	2,244
Commercial MBS	14,982	45	(44)	14,983
Subtotal	81,438	392	(95)	81,735
Fixed-rate US Agency securities:				
Residential MBS	1,490	56	--	1,546
Commercial MBS	446	5	--	451
Subtotal	1,936	61	--	1,997
Fixed-rate obligations of states and political subdivisions	461	10	--	471
Total securities available for sale	$ 83,835	$ 463	$ (95)	$ 84,203

Net unrealized gains on available-for-sale investment securities totaling $368 thousand were recorded, net of $152 thousand of tax liabilities, as accumulated other comprehensive income within stockholders' equity at December 31, 2015.

Securities with unrealized losses at December 31, 2016 are summarized and classified according to the duration of the loss period as follows.

(Dollars in Thousands)	Less than 12 Months Fair Value	Less than 12 Months Unrealized Losses	12 Months or Longer Fair Value	12 Months or Longer Unrealized Losses	Total Fair Value	Total Unrealized Losses
Variable-rate Agency securities:						
Residential CMO	$ 23,114	$ (81)	$ 9,430	$ (76)	$ 32,544	$ (157)
Commercial CMO	513	(2)	--	--	513	(2)
Subtotal	$ 23,627	$ (83)	$ 9,430	$ (76)	$ 33,057	$ (159)
Fixed-rate Agency securities:						
Residential MBS	24,177	(585)	--	--	24,177	(585)
Commercial MBS	399	(4)	--	--	399	(4)
Subtotal	$ 24,576	$ (589)	$ --	$ --	$ 24,576	$ (589)
Fixed-rate obligations of states and political subdivisions	2,720	(170)	--	--	2,720	(170)
Total temporarily impaired securities	$ 50,923	$ (842)	$ 9,430	$ (76)	$ 60,353	$ (918)

Securities with unrealized losses at December 31, 2015 are summarized and classified according to the duration of the loss period as follows.

(Dollars in Thousands)	Less than 12 Months Fair Value	Less than 12 Months Unrealized Losses	12 Months or Longer Fair Value	12 Months or Longer Unrealized Losses	Total Fair Value	Total Unrealized Losses
Variable-rate Agency securities:						
Commercial MBS	$ --	$ --	$ 4,685	$ (44)	$ 4,685	$ (44)
Residential CMO	11,172	(46)	2,419	(4)	13,591	(50)
Commercial CMO	--	--	1,271	(1)	1,271	(1)
Subtotal	$ 11,172	$ (46)	$ 8,375	$ (49)	$ 19,547	$ (95)
Total temporarily impaired securities	$ 11,172	$ (46)	$ 8,375	$ (49)	$ 19,547	$ (95)

At December 31, 2016, the Bank held 68 securities, of which:

- One was a fixed-rate US Agency commercial MBS security in a loss position that had been in a loss position for less than twelve months.
- Nineteen were variable-rate US Agency residential CMO securities in a loss position that had been in a loss position for less than twelve months, and five had been in a loss position for more than twelve months.
- Seven were fixed-rate US Agency residential MBS securities in a loss position that had been in a loss position for less than twelve months.
- One was a variable-rate US Agency commercial CMO security in a loss position that had been in a loss position for less than twelve months.
- Nine were fixed rate obligations of states and political subdivisions in a loss position that had been in a loss position for less than twelve months

The unrealized losses on the Bank's securities at December 31, 2016 were caused by interest rate fluctuations. In the case of the U.S. Agency securities, the contractual cash flows of these investments are guaranteed by an agency of the U.S. government. It is expected that the securities will not be settled at a price less than the amortized cost of the Bank's investment. Because the decline in market value is attributable to changes in interest rates and not credit quality, and because the Bank has the ability and intent to hold those investments until a recovery of fair value, which may be maturity, the Bank does not consider these investments to be other-than-temporarily impaired at December 31, 2016.

The following table shows the amortized cost and estimated fair value of the Bank's securities available for sale by category and by year of contractual maturity. Actual maturities may differ from contractual maturities due to principal prepayments, priority of principal allocation within collateralized mortgage obligations, or rights of issuers to call obligations prior to maturity.

	December 31, 2016	
(Dollars in Thousands)	Amortized Cost	Fair Value
Variable-rate US Agency securities:		
Residential CMO		
Due beyond ten years	$ 48,360	$ 48,284
Commercial CMO		
Due in one to five years	515	513
Residential MBS		
Due beyond ten years	531	560
Fixed-rate US Agency securities:		
Residential MBS		
Due in one to five years	465	479
Due in five to ten years	2,534	2,433
Due beyond ten years	22,503	22,020
Commercial MBS		
Due in five to ten years	403	399
Fixed-rate obligations of states and political subdivisions:		
Due beyond five years	1,158	1,095
Due beyond ten years	2,192	2,087
Total	$ 78,661	$ 77,870

At December 31, 2016 and 2015, there were no holdings of securities of any one issuer, other than US Agencies, in an amount greater than 10.0% of shareholders' equity.

The Bank from time to time pledges securities to the Federal Home Loan Bank as collateral for advances, to the State of California as collateral for certain deposits, to public entities as collateral for certain deposits, to the Federal Reserve Bank as collateral for borrowings, and to other financial institutions or securities dealers as collateral for borrowings. The following table details the amortized cost and estimated fair value of securities pledged for various purposes:

(Dollars in Thousands)	December 31, 2016	
	Amortized Cost	Fair Value
Pledged to the State of California	$ 9,724	$ 9,716
Pledged to public entities	16,815	16,763
	$ 26,539	$ 26,479

(Dollars in Thousands)	December 31, 2015	
	Amortized Cost	Fair Value
Pledged to the State of California	$ 22,304	$ 22,438
Pledged to public entities	24,140	24,191
	$ 46,444	$ 46,629

4. LOANS RECEIVABLE HELD FOR INVESTMENT

Loans receivable held for investment, net, are summarized as follows:

(Dollars in Thousands)	December 31,	
	2016	2015
Investor commercial real estate	$ 94,018	$ 83,532
Owner-occupied commercial real estate	50,887	56,046
Multifamily	53,338	36,862
Subtotal	198,243	176,440
Residential one to four units	120,983	124,741
Construction and land (including farmland)	18,993	17,498
Home equity lines of credit	11,609	8,594
Commercial and industrial	50,334	44,278
Other loans	5,144	5,159
Total loans receivable held for investment	405,306	376,710
Allowance for loan losses	(6,267)	(5,920)
Total loans receivable held for investment, net	$ 399,039	$ 370,790

The amounts above are shown net of unamortized purchase premiums and discounts, deferred loan fees, and deferred direct origination costs. These items increased the above reported totals by $875 thousand and $1.04 million at December 31, 2016 and 2015, respectively.

The Bank did not have any loans past due 90 days or more and still on accrual status at December 31, 2016 or 2015. The Bank had no loans 30 or more days past due at December 31, 2016 or 2015.

The Bank had loans on non-accrual status totaling $139 thousand and $1.7 million at December 31, 2016 and 2015, respectively. Interest foregone on non-accrual loans totaled zero in 2016 and $7 thousand in 2015.

At December 31, 2016 and 2015, the Bank had a recorded investment in troubled debt restructurings of $326 thousand and $1.7 million, respectively. The Bank allocated $134 thousand and zero specific allowances for those loans as of December 31, 2016 and 2015, respectively. The Bank had not committed to lend additional amounts associated with loans that were classified as troubled debt restructurings as of December 31, 2016 and 2015.

There were no loans modified as troubled debt restructurings during the years ended December 31, 2016 or 2015.

The terms of certain other loans were modified during the year ended December 31, 2016 but did not meet the definition of a troubled debt restructuring. The modification of these loans involved either a modification of the terms of a loan to borrowers who were not experiencing financial difficulties or a delay in a payment that was considered to be insignificant (defined by the Bank to be 90 days or less). In order to determine whether a borrower is experiencing financial difficulty, an evaluation is performed of the probability that the borrower will be in payment default on any of its debt in the foreseeable future without the modification. This evaluation is performed under the Bank's internal credit policy.

During the years ended December 31, 2016 and 2015, no troubled debt restructurings have subsequently defaulted.

Compensation expenses totaling $470 thousand, $441 thousand, and $485 thousand were deferred as direct loan origination costs during the years ended December 31, 2016, 2015, and 2014, respectively.

The Bank from time to time pledges certain loans to the Federal Home Loan Bank of San Francisco (“FHLB”) and the Federal Reserve Bank (“FRB”) as collateral for borrowings. The FHLB currently has a blanket lien on a majority of the Bank’s loans, but accepts a subordinated security position for certain loans pledged to the FRB as specified under an inter-creditor agreement. The Bank had loans totaling $404 million pledged to either the FHLB or FRB as of December 31, 2016. The Bank had loans totaling $375 million pledged to either the FHLB or FRB as of December 31, 2015. Loans generally are made on the basis of a secure repayment source, which is based on a detailed cash flow analysis; however, collateral is generally a secondary source of repayment for loan qualification.

5. ALLOWANCE FOR LOAN LOSSES

The following table presents the activity in the allowance for loan losses by portfolio segment for the year ending December 31, 2016.

(Dollars in Thousands) Allowance for Loan Losses	Multifamily and Commercial & Industrial Real Estate	Residential 1 to 4 Units	Construction and Land (Including Farmland)	Home Equity Lines of Credit	Commercial and Industrial	Other	Unallocated	Total
Balance, beginning of period	$ 2,789	$ 1,118	$ 310	$ 120	$ 1,063	$ 367	$ 153	$ 5,920
Provision for loan losses	(984)	509	188	107	674	(202)	3	295
Charge-offs	--	--	--	--	(14)	--	--	(14)
Recoveries	--	--	--	--	66	--	--	66
Balance, end of period	$ 1,805	$ 1,627	$ 498	$ 227	$ 1,789	$ 165	$ 156	$ 6,267

The following table presents the activity in the allowance for loan losses by portfolio segment for the year ending December 31, 2015.

(Dollars in Thousands) Allowance for Loan Losses	Multifamily and Commercial & Industrial Real Estate	Residential 1 to 4 Units	Construction and Land (Including Farmland)	Home Equity Lines of Credit	Commercial and Industrial	Other	Unallocated	Total
Balance, beginning of period	$ 2,591	$ 728	$ 287	$ 117	$ 990	$ 380	$ 232	$ 5,325
Provision for loan losses	198	390	23	3	42	(12)	(79)	565
Charge-offs	--	--	--	--	(21)	(1)	--	(22)
Recoveries	--	--	--	--	52	--	--	52
Balance, end of period	$ 2,789	$ 1.118	$ 310	$ 120	$ 1,063	$ 367	$ 153	$ 5,920

The following table presents the activity in the allowance for loan losses by portfolio segment for the year ending December 31, 2014.

(Dollars in Thousands) Allowance for Loan Losses	Multifamily and Commercial & Industrial Real Estate	Resi-dential 1 to 4 Units	Construction and Land (Including Farmland)	Home Equity Lines of Credit	Commercial and Industrial	Other	Unallocated	Total
Balance, beginning of period	$ 2,161	$ 432	$ 272	$ 127	$ 1,414	$ 145	$ 140	$ 4,691
Provision for loan losses	430	296	15	(10)	(472)	224	92	575
Charge-offs	--	--	--	--	--	--	--	--
Recoveries	--	--	--	--	48	11	--	59
Balance, end of period	$ 2,591	$ 728	$ 287	$ 117	$ 990	$ 380	$ 232	$ 5,325

The following table shows the allocation of the allowance for loan losses and the recorded investment in loans at December 31, 2016 and 2015 by portfolio segment and by impairment methodology. The Bank had $156 thousand unallocated allowance for loan losses at December 31, 2016 and $153 thousand unallocated allowance for loan losses at December 31, 2015.

(Dollars in Thousands)	Multifamily and Commercial & Industrial Real Estate	Residential 1 to 4 Units	Construction and Land (Including Farmland)	Home Equity Lines of Credit	Commercial and Industrial	Other	Unallocated	Total
December 31, 2016								
Allowance for Loan Losses								
Individually evaluated for impairment	$ 134	$ --	$ --	$ --	$ 9	$ --	$ --	$ 143
Collectively evaluated for impairment	1,671	1,627	498	227	1,780	165	156	6,124
Total	$ 1,805	$ 1,627	$ 498	$ 227	$ 1,789	$ 165	$ 156	$ 6,267
Loans								
Individually evaluated for impairment	$ 2,002	$ --	$ 5,821	$ --	$ 157	$ --	$ --	$ 7,980
Collectively evaluated for impairment	196,241	120,983	13,172	11,609	50,177	5,144	--	397,326
Total	$ 198,243	$ 120,983	$ 18,993	$ 11,609	$ 50,334	$ 5,144	$ --	$ 405,306

(Dollars in Thousands) December 31, 2015	Multifamily and Commercial & Industrial Real Estate	Residential 1 to 4 Units	Construction and Land (Including Farmland)	Home Equity Lines of Credit	Commercial and Industrial	Other	Unallocated	Total
Allowance for Loan Losses								
Individually evaluated for impairment	$ --	$ --	$ --	$ --	$ 36	$ 10	$ --	$ 46
Collectively evaluated for impairment	2,789	1,118	310	120	1,027	357	153	5,874
Total	$ 2,789	$ 1,118	$ 310	$ 120	$ 1,063	$ 367	$ 153	$ 5,920
Loans								
Individually evaluated for impairment	$ 1,485	$ --	$ 1,526	$ --	$ 6,360	$ 10	$ --	$ 9,381
Collectively evaluated for impairment	174,955	124,741	15,972	8,594	37,918	5,149	--	367,329
Total	$ 176,440	$ 124,741	$ 17,498	$ 8,594	$ 44,278	$ 5,159	$ --	$ 376,710

The following table presents information related to impaired loans by portfolio segment as of and for the years ended December 31, 2016, 2015 and 2014:

(Dollars in Thousands) **December 31, 2016**	Unpaid Principal Balance	Recorded Investment	Allowance for Loan Losses Allocated	Average Recorded Investment	Interest Income Recognized	Cash Basis Interest Recognized
With no related allowance recorded						
Multifamily and commercial and industrial real estate	$ 1,799	$ 1,797	$ --	$ 1,849	$ 92	$ 92
Residential one to four units	--	--	--	--	--	--
Construction / land (including farmland)	5,828	5,821	--	5,886	300	300
Home equity lines of credit	--	--	--	--	--	--
Commercial and industrial	126	139	--	142	--	--
Other	--	--	--	--	--	--
Subtotal	7,753	7,757	--	7,877	392	392
With an allowance recorded						
Multifamily and commercial and industrial real estate	204	205	134	206	11	11
Residential one to four units	--	--	--	--	--	--
Construction / land (including farmland)	--	--	--	--	--	--
Home equity lines of credit	--	--	--	--	--	--
Commercial and industrial	17	18	9	39	--	--
Other	--	--	--	--	--	--
Subtotal	221	223	143	245	11	11
Total	$ 7,974	$ 7,980	$ 143	$ 8,122	$ 403	$ 403

	Unpaid Principal Balance	Recorded Investment	Allowance for Loan Losses Allocated	Average Recorded Investment	Interest Income Recognized	Cash Basis Interest Recognized
December 31, 2015						
With no related allowance recorded						
Multifamily and commercial and industrial real estate	$ 1,488	$ 1,485	$ --	$ 1,528	$ 71	$ 71
Residential one to four units	--	--	--	--	--	--
Construction / land (including farmland)	1,525	1,526	--	1,570	--	--
Home equity lines of credit	--	--	--	--	--	--
Commercial and industrial	6,292	6,287	--	5,669	254	254
Other	--	--	--	--	--	--
Subtotal	9,305	9,298	--	8,767	325	325
With an allowance recorded						
Multifamily and commercial and industrial real estate	--	--	--	--	--	--
Residential one to four units	--	--	--	--	--	--
Construction / land (including farmland)	--	--	--	--	--	--
Home equity lines of credit	--	--	--	--	--	--
Commercial and industrial	72	73	36	91	--	--
Other	10	10	10	3	--	--
Subtotal	82	83	46	94	--	--
Total	$ 9,387	$ 9,381	$ 46	$ 8,861	$ 325	$ 325
December 31, 2014						
With no related allowance recorded						
Multifamily and commercial and industrial real estate	$ 1,568	$ 1,568	$ --	$ 2,006	$ 66	$ 66
Residential one to four units	--	--	--	--	--	--
Construction / land (including farmland)	2,650	2,650	--	2,776	93	93
Home equity lines of credit	--	--	--	--	--	--
Commercial and industrial	2,268	2,268	--	6,067	123	123
Other	1,375	1,375	--	1,391	17	17
Subtotal	7,861	7,861	--	12,240	299	299
With an allowance recorded						
Multifamily and commercial and industrial real estate	433	433	1	440	19	19
Residential one to four units	--	--	--	--	--	--
Construction / land (including farmland)	--	--	--	--	--	--
Home equity lines of credit	--	--	--	--	--	--
Commercial and industrial	328	328	273	355	20	20
Other	10	10	10	3	--	--
Subtotal	771	771	284	798	39	39
Total	$ 8,632	$ 8,632	$ 284	$ 13,038	$ 338	$ 338

The recorded investment in loans includes the unamortized or unaccreted balance of deferred loan origination costs, fees, points, purchase premiums, and purchase discounts, net.

Credit Quality Indicators

The Bank determines a separate allowance for each portfolio segment (loan type). These portfolio segments include:

- Multifamily and commercial and industrial real estate
- Residential one to four units
- Construction and land (including farmland)
- Home equity lines of credit
- Commercial and industrial
- Other

The allowance for loan losses attributable to each portfolio segment, which includes both loans individually evaluated for impairment and loans that are collectively evaluated for impairment, are combined to determine the Bank's overall allowance, which is included on the balance sheet and available for all loss exposures.

The Bank assigns a risk rating to all loans and periodically performs detailed reviews of all such loans over a certain threshold to identify credit risks and to assess the overall collectability of the portfolio. These risk ratings are also subject to examination by independent specialists engaged by the Bank and by the Bank's regulators. During the Bank's internal reviews, management monitors and analyzes the financial condition of borrowers and guarantors, trends in the industries in which borrowers operate, and the fair values of collateral securing these loans. These credit quality indicators are used to assign a risk rating to each individual loan. The risk ratings do not differ by portfolio segment, and can be grouped into five major categories, defined as follows:

Pass – A pass loan is a strong credit with no existing or known potential weaknesses deserving of management's close attention. A Watch loan is a pass graded loan where management has identified the need to monitor the status of the loan on a more frequent basis than would be typical for the type of loan.

Special Mention – A special mention loan has potential weaknesses that deserve management's close attention. If left uncorrected, these potential weaknesses may result in deterioration of the repayment prospects for the loan or in the Bank's credit position at some future date. Special Mention loans are not adversely classified and do not expose the Bank to sufficient risk to warrant adverse classification.

Substandard – A substandard loan is not adequately protected by the current sound worth and paying capacity of the borrower or the value of the collateral pledged, if any. Loans classified as substandard have a well defined weakness or weaknesses that jeopardize the liquidation of the debt. Well defined weaknesses include a project's lack of marketability, inadequate cash flow or collateral support, failure to complete construction on time, or the project's failure to fulfill economic expectations. They are characterized by the distinct possibility that the Bank will sustain some loss if the deficiencies are not corrected.

Doubtful – Loans classified doubtful have all the weaknesses inherent in those classified as substandard with the added characteristic that the weaknesses make collection or liquidation in full, on the basis of currently known facts, conditions, and values, highly questionable and improbable.

Loss – Loans classified loss are considered uncollectible and are charged off immediately.

The following table presents the loan portfolio by portfolio segment allocated by internal risk ratings at December 31, 2016 and 2015:

(Dollars in Thousands)	Credit Exposure Credit Risk Profile by Internally Assigned Grade						
	Multifamily and Commercial & Industrial Real Estate	Residential 1 to 4 Units	Construction and Land (Including Farmland)	Home Equity Lines of Credit	Commercial and Industrial	Other	Total
December 31, 2016							
Rating:							
Pass / Watch	$ 195,260	$ 120,983	$ 9,055	$ 11,024	$ 49,014	$ 5,144	$ 390,480
Special Mention	786	--	4,117	585	768	--	6,256
Substandard	2,197	--	5,821	--	552	--	8,570
Total	$ 198,243	$ 120,983	$ 18,993	$ 11,609	$ 50,334	$ 5,144	$ 405,306
December 31, 2015							
Rating:							
Pass / Watch	$ 171,672	$ 124,741	$ 10,025	$ 8,594	$ 41,753	$ 5,149	$ 361,934
Special Mention	3,283	--	--	--	1,763	--	5,046
Substandard	1,485	--	7,473	--	762	10	9,730
Total	$ 176,440	$ 124,741	$ 17,498	$ 8,594	$ 44,278	$ 5,159	$ 376,710

6. FEDERAL HOME LOAN BANK STOCK

As a member of the Federal Home Loan Bank of San Francisco ("FHLB"), the Bank is required to own capital stock in an amount specified by a formula promulgated by the FHLB. As of December 31, 2016, the Bank owned 29,394 shares of $100 par value FHLB capital stock. As of December 31, 2015, the Bank owned 25,926 shares of $100 par value FHLB capital stock. The amount of capital stock owned at December 31, 2016 meets the most recent formula determination.

7. PREMISES AND EQUIPMENT

Premises and equipment consisted of the following:

(Dollars in Thousands)	December 31, 2016	December 31, 2015
Furniture and equipment	$ 2,668	$ 2,357
Leasehold improvements	1,345	1,345
Total, at cost	4,013	3,702
Accumulated depreciation and amortization	(2,536)	(2,090)
Premises and equipment, net	$ 1,477	$ 1,612

Depreciation and amortization expense related to the Bank's leasehold improvements, furniture, and equipment was $445 thousand, $400 thousand, and $306 thousand for the years ended December 31, 2016, 2015, and 2014, respectively.

8. DEPOSITS

Deposits are summarized as follows:

(Dollars in Thousands)	December 31, 2016 Balance	December 31, 2016 Weighted Average Rate	December 31, 2015 Balance	December 31, 2015 Weighted Average Rate
Noninterest-bearing demand deposits	$ 239,799	--	$ 204,624	--
Interest-bearing checking	33,889	0.04%	29,838	0.04%
Savings	100,600	0.29%	94,315	0.29%
Money market	113,289	0.25%	110,491	0.25%
Certificates of deposit, less than $100,000	3,541	0.22%	3,970	0.22%
Certificates of deposit, $100,000 to $250,000	5,467	0.25%	7,597	0.25%
Certificates of deposit, $250,000 or more	4,036	0.19%	17,554	0.19%
	$ 500,621	0.13%	$ 468,389	0.13%

The following table sets forth the maturity distribution of certificates of deposit:

(Dollars in Thousands)	December 31, 2016 Balance Less than $100,000	Balance $100,000 to $250,000	Balance $250,000 or More	Total
Three months or less	$ 1,079	$ 1,280	$ 1,567	$ 3,926
Over three through six months	1,110	1,698	868	3,676
Over six through twelve months	1,011	2,151	1,347	4,509
Over twelve months through two years	341	338	254	933
	$ 3,541	$ 5,467	$ 4,036	$ 13,044

The ten largest depositors at December 31, 2016 maintained balances of $113.5 million, representing 23% of total deposits. The ten largest depositors at December 31, 2015 maintained balances of $125.7 million, representing 27% of total deposits. One client represented 5.0% or more of the Bank's deposits at December 31, 2016, and December 31, 2015.

Interest expense on deposits for the years ended December 31, 2016, 2015, and 2014 is summarized as follows:

(Dollars in Thousands)	2016	2015	2014
Interest-bearing checking	$ 13	$ 11	$ 27
Savings	297	280	243
Money market	352	318	291
Certificates of deposit, less than $100,000	8	10	13
Certificates of deposit, $100,000 to $250,000	18	22	24
Certificates of deposit, $250,000 or more	14	20	21
	$ 702	$ 661	$ 619

9. INCOME TAXES

Income tax expense for the years ended December 31, 2016, 2015, and 2014 consisted of the following:

(Dollars in Thousands)	2016	2015	2014
Current:			
Federal	$ 1,877	$ 1,337	$ 1,203
State	527	442	379
Total	2,404	1,779	1,582
Deferred:			
Federal	(326)	(247)	(194)
State	(86)	(88)	(19)
Total	(412)	(335)	(213)
Provision for income taxes	$ 1,992	$ 1,444	$ 1,369

Effective tax rates differ from the Federal statutory tax rate of 34.00% applied to income before income taxes due to the following:

	2016	2015	2014
Federal statutory tax rate	34.0%	34.0%	34.0%
State income taxes (net of Federal income tax benefit)	5.8%	6.1%	7.2%
Bank-owned life insurance death benefits	0.0%	(2.2%)	0.0%
Bank-owned life insurance dividend income and benefits	(0.6%)	(0.5%)	(0.7%)
Interest on Federally tax-exempt securities	(0.3%)	(0.1%)	(0.5%)
Other	0.5%	0.5%	1.1%
Effective tax rate	39.4%	37.8%	41.1%

Deferred income taxes reflect the net tax effects of temporary differences between the carrying amount of assets and liabilities for financial reporting purposes and the amount used for income tax purposes. The tax effects of temporary differences that gave rise to significant portions of the deferred tax assets and liabilities are as follows:

(Dollars in Thousands)	December 31, 2016	December 31, 2015
Deferred tax assets:		
Allowance for loan losses	$ 2,504	$ 2,361
Accrued expenses	438	244
Unrealized loss on securities available for sale	326	--
Deferred loan fees, points, and discounts	295	306
State franchise tax	203	155
Organization costs	156	185
Deferred compensation	127	92
Equity-based compensation	48	56
Total gross deferred tax assets	4,096	3,399
Deferred tax liabilities:		
Deferred loan origination costs and premiums	(574)	(518)
Prepaid expenses	(53)	(77)
Premises and equipment accumulated depreciation	(18)	(97)
Other deferred tax liabilities	(14)	(8)
Unrealized gain on securities available for sale	--	(152)
Total gross deferred tax liabilities	(659)	(852)
Net deferred tax assets	$ 3,437	$ 2,547

The Bank has identified certain unrecognized tax benefits. A reconciliation of the beginning and ending amounts of unrecognized tax benefits for the years ended December 31, 2016 and 2015 is as follows:

(Dollars in Thousands)	2016	2015
Beginning balance	$ 243	$ 237
Additions based on tax positions related to the current year	--	--
Additions for tax positions of prior years	--	6
Reductions for tax positions of prior years	--	--
Reductions due to the statute of limitations	(100)	--
Settlements and payments	--	--
Ending balance	$ 143	$ 243

All of the unrecognized tax benefits are associated with tax years 2012 through 2014. These benefits, if recognized, would favorably affect the effective income tax rate in future periods. The Bank does not expect the total amount of unrecognized tax benefits to significantly increase or decrease in the next twelve months.

The Bank files income tax returns in the United States and California jurisdictions. Federal tax returns for 2013 through 2016 are currently open for examination. State tax returns for 2012 through 2016 are currently open for examination.

The Bank is currently under examination by the California Franchise Tax Board regarding certain deductions taken in 2012. The impact of any adjustment is not expected to be material to the Bank's financial position or results of operations.

10. BORROWINGS

The Bank is a member of the Federal Home Loan Bank of San Francisco ("FHLB"). As of December 31, 2016 and 2015, the Bank had $91.9 million and $68.6 million in untapped borrowing capacity, respectively, available through the FHLB under which overnight and term advances were available. These advances are secured by assets including the Bank's ownership interest in the capital stock of the FHLB and various types of qualifying whole loans. The Bank had no advances outstanding as of December 31, 2016 or 2015.

The Bank had $25.0 million in unsecured and uncommitted federal funds lines of credit from its correspondent banks as of December 31, 2016 and 2015. There were no borrowings outstanding under these federal funds lines of credit at December 31, 2016 or 2015.

The Bank is approved for discount window access from the Federal Reserve Bank of San Francisco ("FRB"). At December 31, 2016, the Bank had available discount window borrowing capacity of $20.5 million. At December 31, 2015, the Bank had an available discount window borrowing capacity of $16.9 million. As of December 31, 2016 and 2015, there were no discount window borrowings outstanding.

Refer to Note 4 regarding loans pledged to secure various potential future borrowings.

11. COMMITMENTS AND CONTINGENCIES

The Bank is subject to certain legal proceedings arising in the normal course of business. In the opinion of management, the outcomes of such proceedings should not have a material adverse effect on the Bank's financial position or results of operations.

The Bank is involved in various income tax settlement negotiations with the California Franchise Tax Board and in connection with them has unrecorded tax benefits totaling $143 and $243 thousand as of December 31, 2016 and 2015, respectively, as disclosed in Note 9.

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. These financial instruments include letters of credit, commitments to originate fixed- and variable-rate loans, lines of credit, and construction loans in process, and involve, to varying degrees, elements of interest-rate risk and credit risk in excess of the amount recognized in the balance sheets. The Bank uses the same credit policies in making commitments to originate loans and lines of credit as it does for on-balance sheet instruments.

Commitments to fund loans are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commitments generally have expiration dates or other termination clauses. In addition, external market forces may affect the probability of commitments being exercised; therefore, total commitments outstanding do not necessarily represent future cash requirements.

At December 31, 2016 and 2015, the Bank had commitments outstanding to make the following funds available under various types of loans:

(Dollars in Thousands) **Credit Category**	**December 31, 2016 Available Credit Commitments**	**December 31, 2015 Available Credit Commitments**
Commercial and industrial	$ 49,806	$ 51,238
Home equity lines of credit	5,855	6,674
Construction and land (including farmland)	1,532	110
Other	1,348	8,034
Multifamily and commercial and industrial real estate	1,000	4,330
	$ 59,541	$ 70,386

The Bank may issue letters of credit to facilitate international trade ("commercial letters of credit"), guarantee certain payments by customers ("financial standby letters of credit"), and guarantee the performance of a customer to a third party ("performance standby letters of credit"). The Bank had financial standby letters of credit of $236 thousand and $333 thousand outstanding at December 31, 2016 and 2015, respectively

The Bank leases its facilities under non-cancelable operating leases for varying periods extending through December 31, 2023. A majority of the leases provide for the payment of taxes, insurance, maintenance, and certain other operating costs associated with the leased premises in addition to the monthly rental payments. Many of the leases contain escalation clauses and extension provisions that could extend certain leases through 2031.

The following table presents future minimum rental payments under non-cancelable operating leases as of December 31, 2016:

(Dollars in Thousands)	**Net Minimum Rental Commitments**
2017	$ 633
2018	442
2019	441
2020	454
2021	467
Thereafter	515
Total	$ 2,952

The Bank accounts for the leases on its facilities under the "level yield" method, whereby the average cost over the contracted lease period is recognized each month. Rent expense, including operating costs reimbursed to landlords, totaling $540 thousand, $516 thousand, and $472 thousand was recognized in occupancy expense in the Statements of Income for the years ended December 31, 2016, 2015, and 2014, respectively.

12. REGULATORY CAPITAL REQUIREMENTS AND OTHER REGULATORY MATTERS

Banks and bank holding companies are subject to regulatory capital requirements administered by federal banking agencies. Capital adequacy guidelines and, additionally for banks, prompt corrective action regulations, involve quantitative measures of assets, liabilities, and certain off-balance-sheet items calculated under regulatory practices. Capital amounts and classifications are also subject to qualitative judgments by regulators. Failure to meet capital requirements can initiate regulatory action. The final rules implementing Basel committee on Banking Supervision's capital guidelines for U.S. banks (Basel III rules) became effective for the 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 2016 is 0.625%. The net unrealized gain or loss on available for sale securities is not included in computing regulatory capital, as the Bank made this election effective January 1, 2015. Management believes as of December 31, 2016, the Bank meets all capital adequacy requirements to which it is subject.

Prompt corrective action regulations provide five classifications: well capitalized, adequately capitalized, undercapitalized, significantly undercapitalized, and critically undercapitalized, although these terms are not used to represent overall financial condition. As of December 31, 2016 and 2015, the most recent regulatory notifications categorized the Bank as "well capitalized" under the regulatory framework for prompt correction action. There are no conditions or events since that notification that management believes have changed the Bank's category.

The actual regulatory capital amounts and ratios of the Bank as of December 31, 2016 and 2015 are presented in the following table.

(Dollars in Thousands)	Actual		Minimum for Capital Adequacy Purposes		To Be Considered Well Capitalized under PCA Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
As of December 31, 2016						
Tier 1 Capital to Average Total Assets (Leverage)	$ 48,093	8.89%	$ 21,632	4.00%	$ 27,040	5.00%
Common Equity Tier 1 to Risk Weighted Assets	$ 48,093	12.99%	$ 16,649	4.50%	$ 24,049	6.50%
Tier 1 Capital to Risk Weighted Assets	$ 48,093	12.99%	$ 22,199	6.00%	$ 29,599	8.00%
Total Capital to Risk Weighted Assets	$ 52,740	14.25%	$ 29,599	8.00%	$ 36,999	10.00%
As of December 31, 2015						
Tier 1 Capital to Average Total Assets (Leverage)	$ 44,258	8.82%	$ 20,075	4.00%	$ 25,093	5.00%
Common Equity Tier 1 to Risk Weighted Assets	$ 44,258	13.24%	$ 15,045	4.50%	$ 21,732	6.50%
Tier 1 Capital to Risk Weighted Assets	$ 44,258	13.24%	$ 20,061	6.00%	$ 26,747	8.00%
Total Capital to Risk Weighted Assets	$ 48,461	14.49%	$ 26,747	8.00%	$ 33,434	10.00%

Under California banking laws, cash dividends declared by the Bank may not, without prior regulatory approval, exceed the lesser of: (i) the retained earnings of the Bank, or (ii) the net income of the Bank for its last three fiscal years, less the amount of any distributions made by the Bank to the shareholders of the Bank during such period. At December 31, 2016, the Bank had $2.6 million available for cash dividends under these restrictions.

13. SHARE-BASED PAYMENTS

The Board of Directors approved the 1st Capital Bank 2016 Equity Incentive Plan ("Plan") on June 8, 2016. The Plan replaced the 2007 Equity Incentive Plan. The Plan permits the grant of stock options and restricted share awards for up to 640,400 shares of the Bank's common stock. The Plan will expire on June 8, 2026. No more options or restricted shares may be issued from the 2007 Equity Incentive Plan, but shares may be issued for exercises of outstanding options and for the vesting of restricted shares previously granted from the 2007 Plan. Stock options may be incentive stock options or nonqualified stock options. Stock option exercise periods may be up to ten years, while the vesting schedule for stock options is based upon each specific option award. Restricted share awards may be time-based, performance-based, or both. Time-based restricted share awards generally vest pro-rata in arrears on each annual anniversary of the award date and become fully vested over the applicable time period as determined by the Board of Directors, typically five years. Vesting of performance-based restricted share awards is dependent upon achievement of criteria established by the Board of Directors for each award.

The Bank accrues share-based compensation expense for stock options and restricted share awards over the vesting period based upon the fair value of the equity award at the date of grant and considering the probability of the performance criteria being achieved.

A summary of the status of the restricted share awards and stock options outstanding under the Plan as of December 31, 2016, 2015, and 2014, and changes and related expense during the years ended December 31, 2015, 2014, and 2013, has been adjusted to reflect the 2016 issuance of a 5% stock dividend and is as follows:

Restricted Share Awards

(In Whole Shares; Dollars in Thousands Except Per Share Amounts)	2016 Shares	2016 Weighted Average Grant Date Fair Value	2015 Shares	2015 Weighted Average Grant Date Fair Value	2014 Shares	2014 Weighted Average Grant Date Fair Value
Awards outstanding at the beginning of the period	143,232	$ 10.43	150,414	$ 9.93	90,295	$ 9.80
Award activity during the period:						
Time-based awards granted	50,701	$ 10.88	58,671	$ 10.63	102,025	$ 9.99
Time-based awards forfeited	(31,434)	$ 10.85	(17,750)	$ 10.42	(2,315)	$ 9.72
Time-based awards vested	(38,925)	$ 10.97	(48,103)	$ 10.36	(39,591)	$ 9.77
Awards outstanding at the end of the period	123,574	$ 10.86	143,232	$ 10.43	150,414	$ 9.93
Restricted share award compensation expense	$ 389		$ 493		$ 502	

Stock Options

(In Whole Shares; Dollars in Thousands Except Per Share Amounts)	2016 Shares	2016 Weighted Average Exercise Price	2015 Shares	2015 Weighted Average Exercise Price	2014 Shares	2014 Weighted Average Exercise Price
Options outstanding at the beginning of the period	156,711	$ 8.85	211,790	$ 8.96	295,150	$ 8.53
Option activity during the period:						
Options exercised	(44,347)	$ 8.48	(53,629)	$ 8.34	(75,526)	$ 8.30
Options forfeited	(122)	$ 6.52	(1,450)	$ 8.07	(4,833)	$ 9.95
Options outstanding at the end of the period	112,242	$ 9.00	156,711	$ 8.85	211,790	$ 8.96
Options vested and exercisable	112,242	$ 9.00	156,711	$ 8.85	209,114	$ 8.71
Stock option compensation expense	$ --		$ --		$ 29	

Additional information regarding stock options outstanding at December 31, 2016 includes the following:

(In Whole Shares; Dollars in Thousands Except Per Share Amounts)	Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term	Aggregate Intrinsic Value
Stock options outstanding	112,242	$ 9.00	2.20 years	$ 309
Stock options exercisable	112,242	$ 9.00	2.20 years	$ 309
Stock options vested or expected to vest	112,242	$ 9.00	2.20 years	$ 309

The Bank did not award any stock option grants for the years ended December 31, 2016, 2015, and 2014.

The following stock option exercise information is for the years ended December 31, 2016, 2015, and 2014:

(Dollars in Thousands)	2016	2015	2014
Intrinsic value of stock options exercised	$ 145	$ 103	$ 337
Cash received from stock option exercises	$ 376	$ 469	$ 653
Tax benefit realized from stock option exercises	$ 107	$ 98	$ 60

The tax benefit associated with the stock option exercises during 2016, 2015, and 2014 reduced the associated deferred tax asset.

As of December 31, 2016, there was $1.08 million of total unrecognized compensation cost related to outstanding, unvested restricted shares awards granted under the Plan. This cost is expected to be recognized over the weighted average remaining period of approximately 3.3 years. The total fair value of restricted share awards vested in 2016, 2015, and 2014 was $427 thousand, $520 thousand, and $415 thousand, respectively.

At December 31, 2016, the intrinsic value of the 123,574 outstanding unvested restricted share awards was $1.45 million, based upon a market price of $11.75 per share. At December 31, 2015, the intrinsic value of the 143,232 outstanding unvested restricted share awards was $1.5 million, based upon a market price of $11.42 per share. At December 31, 2014, the intrinsic value of the 150,414 outstanding unvested restricted share awards was $1.5 million, based upon a market price of $10.28 per share.

As of December 31, 2016, there was no unrecognized compensation cost related to stock options granted under the Plan.

Total shares available for future issuance under the Plan were 340,400, 278,587, and 318,246 at December 31, 2016, 2015, and 2014, respectively.

14. RELATED PARTY TRANSACTIONS

During the normal course of business, the Bank enters into transactions with related parties, including directors, executive officers, and their affiliates. These transactions occur at substantially the same rates and terms as those prevailing at the time for comparable transactions with unrelated parties, and do not involve more than normal risk or unfavorable terms for the Bank.

An analysis of the activity of these loans for the years ended December 31, 2016 and 2015 is as follows:

(Dollars in Thousands)	2016	2015
Credit commitments, beginning of period	$ 12,582	$ 13,136
New term loans and lines of credit	200	--
Repayments	(2,478)	(554)
Credit commitments, end of period	$ 10,304	$ 12,582
Outstanding balances, end of period	$ 4,182	$ 6,582

Deposits from principal officers, directors, and their affiliates at December 31, 2016 and 2015 were $4.2 million and $5.4 million, respectively.

During the years ended December 31, 2016, 2015, and 2014, the Bank did not purchase any goods or services from related parties, other than normal employee and director compensation and benefits and $59 thousand and $2 thousand paid in 2016 and 2015, respectively, for branch architectural services to the architectural firm for which Director Henry Ruhnke is a principal.

15. OTHER NON-INTEREST EXPENSE

Other non-interest expense for the years ended December 31, 2016, 2015, and 2014 consisted of the following:

(Dollars in Thousands)	2016	2015	2014
Regulatory dues and assessments	$ 396	$ 358	$ 324
Director expenses, including share-based compensation	264	211	239
Telecommunications	247	233	129
Licensing and software expenses	201	151	127
Messenger service	128	109	102
Professional education	119	144	114
Stationery and supplies	100	98	107
Customer expenses	72	60	73
Operational expenses	65	56	62
Provision for unfunded loan commitments	(29)	31	(3)
Other expenses	293	276	240
	$ 1,856	$ 1,727	$ 1,514

16. 401(k) RETIREMENT PLAN

The Bank maintains the 1st Capital Bank 401(k) Profit Sharing Plan and Trust ("Plan") to enable employees to save for retirement under a tax-advantaged plan and to furnish employees the opportunity to directly manage their retirement assets through a variety of investment options. The Plan allows eligible employees to elect to contribute up to 92.00% of their eligible compensation to the Plan, subject to the annual contribution limit established by the Internal Revenue Service applicable to each employee. During 2014, the Bank commenced 100% matching of the employee Plan contributions up to 1.00% of their eligible compensation, and then 50% matching of the employee Plan contributions above 1.00% and up to 6.00% of their eligible compensation. In addition, all Bank matching contributions immediately became fully vested effective with the transition of the Plan to a safe harbor classification.

The Bank recorded matching contribution expenses under the Plan of $165 thousand, $154 thousand, and $130 thousand during the years ended December 31, 2016, 2015, and 2014, respectively.

17. NONQUALIFIED DEFERRED COMPENSATION PLAN

The Bank established the 1st Capital Bank Nonqualified Deferred Compensation Plan ("Plan") effective December 1, 2012. The Plan is a defined contribution program. Participants in the Plan are general unsecured creditors of the Bank. The Plan was established for the purpose of providing the executive officers and certain other highly compensated employees an opportunity to defer compensation. Participants in the Plan may elect to defer annually any bonus or incentive compensation and any amount of base salary in excess of $3,000 per month. At the time of election to defer compensation, the participants must also elect a distribution date and a distribution method. Participants may elect to receive amounts payable in a lump sum or in annual installments over a designated period not to exceed ten years. The Bank pays the administrative costs of the Plan, but does not make contributions to the Plan aside from interest credited. The Plan requires the Bank to pay interest on the deferred balances at a rate equal to The Wall Street Journal Prime Rate on November 1 of the preceding year, set annually for each calendar year, subject to a floor of 0.00%. Participants were first eligible to contribute to the Plan on January 1, 2013. The Bank recorded interest expense on deferred compensation of $9 thousand and $5 thousand for the years ended December 31, 2016 and 2015, respectively. The Bank's total liability under the Plan was $309 thousand and $224 thousand at December 31, 2016 and 2015, respectively.

18. EARNINGS PER SHARE

The factors used in the earnings per share computation follow.

(Dollars in Thousands Except Per Share Amounts)	2016	2015	2014
Basic Earnings Per Share			
Net income	$ 3,068	$ 2,381	$ 1,960
Weighted average common shares outstanding	4,314,335	4,226,917	4,097,475
Basic earnings per common share	$ 0.71	$ 0.56	$ 0.48
Diluted Earnings Per Share			
Net income	$ 3,068	$ 2,381	$ 1,960
Weighted average common shares outstanding for basic earnings per common share	4,314,335	4,226,917	4,097,475
Add: Dilutive effects from equity compensation	49,388	69,216	65,076
Shares for diluted earnings per share	4,363,723	4,296,133	4,162,552
Diluted earnings per common share	$ 0.70	$ 0.55	$ 0.47

Anti-dilutive shares are shares of common stock issuable as a result of the vesting of restricted share awards or the exercise of stock options for which the assumed proceeds per share from the exercise price (in the case of stock options), excess tax benefits, and future associated compensation expense are greater than the average market price for the Bank's common stock for the reporting period. Anti-dilutive shares are not included in the computation of diluted earnings per share due to their anti-dilutive effect. The weighted average anti-dilutive shares totaled zero for both 2016 and 2015, and 29,538 for 2014.

CELEBRATING OUR TENTH YEAR

PROVIDING THE BUILDING BLOCKS FOR A STRONG FINANCIAL COMMUNITY

LOCATIONS

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Monterey Banking Office
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Monterey, CA 93940
831.264.4070

Salinas Banking Office
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Salinas, CA 93901
831.540.4080

King City Banking Office
432 Broadway Street
King City, CA 93930
831.385.8900

San Luis Obispo Banking Office
142 Cross Street, Suite 130
San Luis Obispo, CA 93401
805.592.2030

www.1stcapital.bank

Stock

1st Capital Bank's common stock trades in the OTC Pink marketplace under the symbol FISB.

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OUR MANAGERS

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Michael J. Winiarski
Executive VP, Chief Financial Officer

Jon D. Ditlevsen
Executive VP, Chief Lending Officer

Robin A. Seelye
Executive VP, Chief Administrative Officer

Steven Martin
Regional President

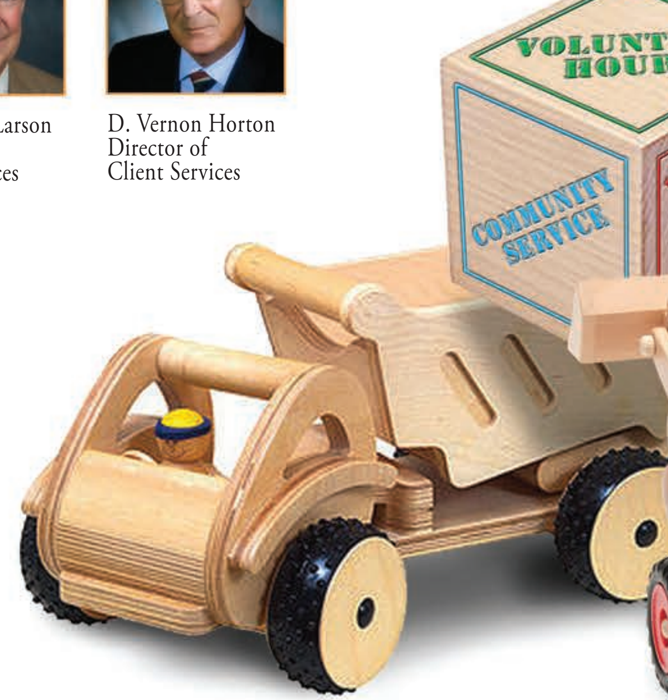
Stuart M. Tripp
Regional President

Robert E. Skeen
Regional President

Dale R. Diederick
Executive VP, Chief Credit Officer

Clayton C. Larson
Director of Client Services

D. Vernon Horton
Director of Client Services



We're proud of the 1st Capital team helping provide the building blocks for the communities in which we live.

AND DIRECTORS

Kurt J. Gollnick
Chairman of the Board
Chief Operating Officer
Scheid Vineyards, Inc.

Daniel R. Hightower, MD
Vice Chairman of the Board
Physician, Diagnostic and Interventional Radiology
Community Hospital of the Monterey Peninsula

Susan C. Freeland, JD
Broker Associate
Carmel Realty Company

Francis Giudici
President
L.A. Hearne Company

Thomas E. Meyer
President, Chief Executive Officer

Henry P. Ruhnke, Jr.
Architect, Principal
Wald, Ruhnke & Dost Architects

Gregory T. Thelen
Certified Public Accountant

F. Warren Wayland
Co-Founder and Certified Public Accountant
Hayashi Wayland

A dedication to community service is a big part of the corporate culture at 1st Capital Bank. Our team of Officers, Directors and Staff dedicate countless volunteer hours and support as a way of saying thank you to the communities in which we live. Our employees work directly with local nonprofits to help make a difference in the neighborhoods we serve.

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