# 1st Capital Bank

2017 Annual Report

## TO OUR SHAREHOLDERS AND CLIENTS

2017 was a year to remember! In addition to commemorating the 10th anniversary of the founding of 1st Capital Bank, we celebrated our corporate relocation to Salinas City Center with a ribbon-cutting ceremony held on May 18th. We were pleased to introduce new consumer lending products, including home equity lines of credit and the brokering of single family mortgage loans in 2017. The initial launch was well received by our customer base.

Our consistent focus on growing our core lines of business continued to bear fruit in 2017, as interest earned on our loan portfolio grew 9.7% to $20.6 million, and non-interest income increased 168% to $1.2 million, driving growth in pre-tax income of 20.6% from $5.1 million in 2016 to $6.1 million in 2017. Simultaneously, interest expense declined 11.6% to $620 thousand, reflecting the continued growth in non-interest bearing demand deposits, which totaled 45.6% of our deposit base at year end. We believe this success in growing our core commercial and industrial and commercial real estate loan portfolios, funded by a low-cost deposit base, positions us well for continued success as we enter 2018.

## 2017 HIGHLIGHTS

Total assets increased to a record $580 million at year end, 5.5% above the $550 million at year-end 2016. Net income decreased 7.3% to $2.8 million, or $.60 per share (diluted) compared to 2016 earnings of $3.1 million and earnings per share of $0.67 (diluted).

With the signing into law of the Tax Cuts and Jobs Act of 2017, generally accepted accounting principles ("GAAP") require deferred tax assets and liabilities on corporate balance sheets be revalued to reflect the value of the future tax benefits associated with temporary differences between GAAP and Federal income tax accounting. The reduction in the top marginal tax rate to 21% replaced the former 35% top marginal rate. As a result of this reduction in marginal rates, the Bank made an adjustment to the value of its net deferred tax assets, causing additional income tax expense of $913 thousand, or $0.19 per diluted share during the fourth quarter of 2017. While the adjustment to the value of net deferred tax assets negatively affected 2017 results, the benefits of the lower corporate income tax rate will be beneficial to 1st Capital Bank in 2018 and beyond.

Pre-tax income for 2017 rose significantly to $6.1 million, 20.6% above 2016's pre-tax income of $5.1 million. Contributing to the growth in pre-tax income was 1) the nearly 12% growth in the higher yielding commercial and industrial and commercial real estate loan portfolios during 2017, 2) the ongoing benefits of a low cost deposit base, and 3) a 110% increase in noninterest income compared to 2016.

The Board of Directors once again declared a 5% stock dividend, paid December 15, 2017. The stock dividend demonstrates the Board's continued optimism regarding favorable growth prospects within our primary marketplace along the Central Coast.

During 2017, total loans outstanding increased to $428 million, a 5.6% increase over the prior year's total of $405 million. The growth was concentrated with a nearly 12% growth in our core lending areas. Commercial and industrial loans increased 14.2% to $52 million as of December 31, 2017. Commercial real estate loans grew 19.1% to $173 million as of December 31, 2017; over the same period the lower yielding single family residential portfolio, consisting primarily of purchased loans, decreased 4.7 % to $115 million. New core loan commitments exceeded $102 million, a more than 20% increase above 2016 levels. Our seasoned relationship bankers enjoyed a strong finish to 2017 and enter 2018 with an excellent pipeline of new opportunities with both new prospects and existing customers. Management remains optimistic about new relationship lending opportunities in all its primary markets along the Central Coast in 2018.

Funding this loan growth during 2017 was our outstanding deposit base. Total deposits increased $25 million, or 5.1%, from $501 million at year end 2016, to $526 million as of December 31, 2017. The Bank's cost of funds actually declined during 2017 to 0.12% from 0.14% during 2016. The primary driver of our continued low cost of funds was an increase in non-interest bearing deposits which comprised 49.7% of total deposits.

The improving loan mix and, to a lesser extent, a significant increase in the yield in the Bank's investment portfolio triggered a strong increase in the Bank's net interest margin from 3.20% in 2016 to 3.50% in 2018. The Bank's net interest margin reached 3.68% for the fourth quarter, demonstrating the continued favorable shift in the loan portfolio as well as the benefit of gradually increasing interest rates.

We are pleased to report that annual non-interest income increased 110% from $551 thousand in 2016 to $1.2 million earned in 2017. The doubling of fee income was generated across a variety of sources including account analysis fees, lockbox service charges and mortgage brokerage fees. Additionally the Bank increased its investment in Bank-owned term life insurance ("BOLI") policies by $5.0 million during the fourth quarter of 2016 from $2.4 million to $7.4 million. Service charge income increased 73.7% to $243 thousand in 2017, gains on sale of loans increased 174% to $266 thousand, and BOLI income increased 168% to $221 thousand in 2017.

Loan growth has been accomplished during the past few years without sacrificing credit standards. Past due loans constitute a mere 0.06% of the total loan portfolio at year end 2017, while nonperforming assets total 0.04% of total assets. Our relationship managers, led by EVP & Chief Lending Officer Jon Ditlevsen, work closely and collaboratively with our Credit Administration Department to identify and structure credit facilities that meet the needs of our customer base.

## *2018 OUTLOOK*

The outlook for our local economy continues to be positive for 2018. We note the growing optimism of small business owners and investors now, and the recent changes in the corporate income tax rate have increased confidence levels. However, we are closely monitoring economic conditions as growing fiscal deficits as well as local labor shortages are beginning to cause the inflation rate to increase from historically low levels.

Management strives to create additional shareholder value by capitalizing upon new opportunities presented to us by recent bank merger activity, increasing our "share of wallet" with existing customers, and continuing our momentum in increasing fee income from the services we provide. Responding to customer demand, we are adding construction lending to our product suite during 2018. Additionally, we will be upgrading our online banking and cash management platforms to meet our clients' banking needs, whether they be business or personal, in-branch or on-line.

Our Board of Directors remains convinced of the opportunity and the need for a true community bank that can enhance the financial health and wellbeing of our communities along the Central Coast. We appreciate the support of you, our shareholders, in supporting our mission.

Sincerely,

Thomas E. Meyer
President and
Chief Executive Officer

Kurt J. Gollnick
Chairman of the Board

# FINANCIAL HIGHLIGHTS

*(amounts in thousands, except per share amounts)*

| | 2015 | 2016 | 2017 |
|---|---|---|---|
| **For the Year:** | | | |
| Net interest income before provision for loan losses | $ 15,045 | $ 16,986 | $ 19,042 |
| Provision for loan losses | $ 565 | $ 295 | $ 175 |
| Bank-owned life insurance benefits | $ 249 | $ -- | $ -- |
| Other operating income | $ 361 | $ 431 | $ 1,156 |
| Non-interest expenses | $ 11,265 | $ 12,062 | $ 14,018 |
| Income before provision for income taxes | $ 3,825 | $ 5,060 | $ 6,105 |
| Net income | $ 2,381 | $ 3,068 | $ 2,845 |
| | | | |
| Diluted Earnings per Share | $ 0.53 | $ 0.67 | $ 0.60 |
| | | | |
| **Average Balances for the Year:** | | | |
| Gross loans | $352,971 | $390,544 | $415,893 |
| Interest-earning assets | $479,758 | $530,722 | $547,622 |
| Interest-bearing liabilities | $272,019 | $288,971 | $278,266 |
| Deposits | $439,381 | $488,593 | $509,206 |
| | | | |
| **At Year End:** | | | |
| Total assets | $513,950 | $549,927 | $580,231 |
| Net loans | $370,790 | $399,039 | $421,555 |
| Demand deposits | $204,624 | $239,799 | $261,706 |
| Total deposits | $468,389 | $500,621 | $526,076 |
| Stockholders’ equity | $ 44,489 | $ 47,645 | $ 51,992 |
| Market capitalization | $ 46,726 | $ 51,121 | $ 72,126 |
| | | | |
| **Financial Ratios:** | | | |
| Net interest margin | 3.14% | 3.20% | 3.50% |
| Efficiency ratio | 71.96% | 69.25% | 69.06% |
| Non-interest expenses to average assets | 2.32% | 2.25% | 2.49% |
| Allowance for loan losses to gross loans | 1.57% | 1.55% | 1.49% |
| Non-accrual loans to gross loans | 0.46% | 0.03% | 0.06% |
| Net loan charge-offs (recoveries) to average gross loans | -0.01% | -0.01% | 0.02% |
| Non-performing assets to total assets | 0.34% | 0.03% | 0.04% |
| Tier 1 leverage ratio | 8.82% | 8.89% | 9.14% |
| Common equity Tier 1 risk-based capital | 3.24% | 12.99% | 12.91% |
| Total risk-based capital | 14.49% | 14.25% | 14.16% |
| Return on average assets | 0.49% | 0.57% | 0.51% |
| Return on average equity | 5.51% | 6.61% | 5.65% |

Crowe Horwath.

Crowe Horwath LLP
Independent Member Crowe Horwath International

INDEPENDENT AUDITOR'S REPORT

To the Shareholders and Board of Directors
1st Capital Bank
Salinas, 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, 2017 and 2016, 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, 2017, 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, 2017 and 2016, and the results of its operations and its cash flows for each of the years in the three-year period ended December 31, 2017 in accordance with accounting principles generally accepted in the United States of America.

Crowe Horwath LLP

Crowe Horwath LLP

Sacramento, California
March 14, 2018

**1ST CAPITAL BANK**

**BALANCE SHEETS**
**DECEMBER 31, 2017 and 2016**
**(Dollars in Thousands)**

| | December 31, 2017 | December 31, 2016 |
|---|---|---|
| **ASSETS:** | | |
| Cash and due from banks | $ 7,726 | $ 2,754 |
| Due from Federal Reserve Bank | 56,250 | 50,884 |
| Total cash and cash equivalents | 63,976 | 53,638 |
| Interest-bearing deposits in other financial institutions | 1,743 | 2,490 |
| Securities available for sale, at fair value | 74,927 | 77,870 |
| Loans receivable held for investment (net of allowance for loan losses of $6,378 at December 31, 2017 and $6,267 at December 31, 2016) | 421,555 | 399,039 |
| Cash surrender value of bank-owned life insurance | 7,654 | 7,433 |
| Federal Home Loan Bank stock, at cost | 3,163 | 2,939 |
| Deferred tax assets, net | 2,420 | 3,437 |
| Premises and equipment, net | 2,308 | 1,477 |
| Accrued interest and dividends receivable | 1,493 | 1,277 |
| Other assets | 992 | 327 |
| TOTAL ASSETS | $ 580,231 | $ 549,927 |
| **LIABILITIES AND STOCKHOLDERS' EQUITY:** | | |
| LIABILITIES: | | |
| Noninterest-bearing deposits | $ 261,706 | $ 239,799 |
| Interest-bearing deposits | 264,370 | 260,822 |
| Total deposits | 526,076 | 500,621 |
| Accrued interest payable | 18 | 22 |
| Other liabilities | 2,145 | 1,639 |
| Total liabilities | 528,239 | 502,282 |
| 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, 2017 and 2016 | -- | -- |
| Common stock, no par value, 20,000,000 shares authorized; 4,686,521 shares issued and outstanding at December 31, 2017; 4,350,721 shares issued and outstanding at December 31, 2016 | 50,110 | 45,510 |
| Retained earnings | 2,061 | 2,601 |
| Accumulated other comprehensive loss, net of taxes | (179) | (466) |
| Total stockholders' equity | 51,992 | 47,645 |
| TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY | $ 580,231 | $ 549,927 |

See Notes to Financial Statements

**1ST CAPITAL BANK**

**STATEMENTS OF INCOME**
**FOR THE YEARS ENDED DECEMBER 31, 2017, 2016, and 2015**
**(Dollars in Thousands)**

| | 2017 | 2016 | 2015 |
|---|---|---|---|
| INTEREST AND DIVIDEND INCOME: | | | |
| Loans receivable | $ 17,860 | $ 16,279 | $ 14,732 |
| Taxable securities available for sale | 980 | 753 | 601 |
| Tax-exempt securities available for sale | 151 | 43 | 16 |
| Federal Home Loan Bank stock | 235 | 347 | 278 |
| Interest-bearing deposits in other financial institutions | 204 | 43 | 33 |
| Interest-bearing balances due from Federal Reserve Bank | 332 | 223 | 50 |
| Total interest and dividend income | 19,762 | 17,688 | 15,710 |
| INTEREST EXPENSE: | | | |
| Deposits | 620 | 702 | 661 |
| Borrowings | -- | -- | 4 |
| Total interest expense | 620 | 702 | 665 |
| NET INTEREST INCOME BEFORE PROVISION FOR LOAN LOSSES | 19,142 | 16,986 | 15,045 |
| PROVISION FOR LOAN LOSSES | 175 | 295 | 565 |
| NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES | 18,967 | 16,691 | 14,480 |
| NON-INTEREST INCOME: | | | |
| Service charges and fees | 243 | 140 | 123 |
| Bank-owned life insurance dividend income | 221 | 82 | 60 |
| Gain on sale of loans | 266 | 97 | 100 |
| Gain on sale of investment securities | -- | 10 | -- |
| Bank-owned life insurance benefits | -- | -- | 249 |
| Other income | 426 | 102 | 78 |
| Total non-interest income | 1,156 | 431 | 610 |
| NON-INTEREST EXPENSE: | | | |
| Compensation and employee benefits | 8,712 | 7,488 | 6,890 |
| Occupancy | 1,057 | 919 | 841 |
| Item and data processing | 600 | 602 | 596 |
| Professional services | 722 | 537 | 532 |
| Equipment and furniture | 485 | 476 | 459 |
| Marketing and business development | 229 | 184 | 220 |
| Other non-interest expense | 2,213 | 1,856 | 1,727 |
| Total non-interest expense | 14,018 | 12,062 | 11,265 |

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**1ST CAPITAL BANK**

**STATEMENTS OF INCOME (Continued)**
**FOR THE YEARS ENDED DECEMBER 31, 2017, 2016, and 2015**
**(Dollars in Thousands)**

| | 2017 | 2016 | 2015 |
|---|---|---|---|
| INCOME BEFORE PROVISION FOR INCOME TAXES | 6,105 | 5,060 | 3,825 |
| PROVISION FOR INCOME TAXES | 3,260 | 1,992 | 1,444 |
| NET INCOME | $ 2,845 | $ 3,068 | $ 2,381 |
| BASIC EARNINGS PER SHARE | $ 0.61 | $ 0.68 | $ 0.54 |
| Weighted average shares used in basic earnings per share calculation | 4,637,570 | 4,530,052 | 4,438,263 |
| DILUTED EARNINGS PER SHARE | $ 0.60 | $ 0.67 | $ 0.53 |
| Weighted average shares used in diluted earnings per share calculation | 4,709,507 | 4,581,909 | 4,510,940 |

See Notes to Financial Statements

**1ST CAPITAL BANK**

**STATEMENTS OF COMPREHENSIVE INCOME**
**FOR THE YEARS ENDED DECEMBER 31, 2017, 2016, and 2015**
**(Dollars in Thousands)**

| | 2017 | 2016 | 2015 |
|---|---|---|---|
| NET INCOME | $ 2,845 | $ 3,068 | $ 2,381 |
| Other comprehensive income (loss): | | | |
| Unrealized gains (losses) on securities available for sale: | | | |
| Unrealized holding gains (losses) | 542 | (1,159) | (66) |
| Less: Reclassification for net gain included in net income | -- | (10) | -- |
| Other comprehensive income (loss), before tax | 542 | (1,169) | (66) |
| Tax effect | 223 | 487 | 26 |
| Total other comprehensive income (loss), net of tax | 319 | (682) | (40) |
| COMPREHENSIVE INCOME | $ 3,164 | $ 2,386 | $ 2,341 |

See Notes to Financial Statements

**1ST CAPITAL BANK**

**STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY**
**FOR THE YEARS ENDED DECEMBER 31, 2017, 2016, and 2015**
**(Dollars in Thousands)**

| | Common Stock | | Retained | Accumulated Other Comprehensive Income | Total Stockholders' |
|---|---|---|---|---|---|
| | **Shares** | **Amount** | **Earnings** | **(Loss)** | **Equity** |
| Balance at January 1, 2015 | 3,779,039 | $ 39,190 | $ 1,735 | $ 256 | $ 41,181 |
| Stock options exercised | 48,641 | 469 | | | 469 |
| Vested restricted stock awards issued | 45,014 | 8 | | | 8 |
| Restricted share compensation expense | | 493 | | | 493 |
| 5% stock dividend | 191,791 | 2,226 | (2,226) | | -- |
| Cash paid in lieu of fractional shares | | | (3) | | (3) |
| Net income | | | 2,381 | | 2,381 |
| Net change in unrealized 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 |
| Stock options exercised & tax benefit | 42,299 | 376 | | | 376 |
| Vested restricted stock awards issued | 37,692 | 8 | | | 8 |
| Restricted share compensation expense | | 389 | | | 389 |
| 5% stock dividend | 206,245 | 2,351 | (2,351) | | -- |
| Cash paid in lieu of fractional shares | | | (3) | | (3) |
| Net income | | | 3,068 | | 3,068 |
| Net change in unrealized 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 |

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**1ST CAPITAL BANK**

**STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY**
**FOR THE YEARS ENDED DECEMBER 31, 2017, 2016, and 2015**
**(Dollars in Thousands)**

| | Common Stock | | | Accumulated Other Comprehensive Income | Total Stockholders' |
|---|---|---|---|---|---|
| | Shares | Amount | Retained Earnings | (Loss) | Equity |
| Balance at December 31, 2016 | 4,350,721 | $ 45,510 | $ 2,601 | $ (466) | $ 47,645 |
| Stock options exercised | 64,596 | 552 | | | 552 |
| Vested restricted stock awards issued | 48,427 | -- | | | -- |
| Restricted share compensation expense | | 635 | | | 635 |
| 5% stock dividend | 222,777 | 3,413 | (3,413) | | -- |
| Cash paid in lieu of fractional shares | | | (4) | | (4) |
| Net income | | | 2,845 | | 2,845 |
| Reclassification of stranded tax effects | | | 32 | (32) | -- |
| Net change in unrealized gain on securities available for sale, net of tax | | | | 319 | 319 |
| Balance at December 31, 2017 | 4,686,521 | $ 50,110 | $ 2,061 | $ (179) | $ 51,992 |

**1ST CAPITAL BANK**

**STATEMENTS OF CASH FLOWS**
**FOR THE YEARS ENDED DECEMBER 31, 2017, 2016, and 2015**
**(Dollars in Thousands)**

| | 2017 | 2016 | 2015 |
|---|---|---|---|
| OPERATING ACTIVITIES: | | | |
| Net income | $ 2,845 | $ 3,068 | $ 2,381 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | | |
| Depreciation and amortization of premises and equipment | 542 | 445 | 400 |
| Amortization of security premiums, net of accretion of discounts | 454 | 336 | 70 |
| Decrease (increase) in deferred loan fees, costs, premiums, and discounts, net | 553 | 210 | (444) |
| Provision for loan losses | 175 | 295 | 565 |
| Gain on sale of investment securities | -- | (10) | -- |
| Gain on sale of loans | (266) | (97) | (100) |
| Origination of loans sold | (3,808) | (1,271) | (1,684) |
| Proceeds from sale of loans | 4,136 | 1,392 | 1,816 |
| Increase in loan servicing rights | (38) | (6) | (17) |
| Increase in discount on retained interests in loans | (123) | (43) | (32) |
| (Gain) loss on disposal of premises and equipment | (1) | -- | 9 |
| Compensation expense related to stock compensation plans | 636 | 389 | 493 |
| Increase in accrued interest and dividends receivable | (216) | (159) | (164) |
| Provision for deferred income taxes | 711 | (412) | (335) |
| Change in reserve for uncertain tax positions | (70) | (100) | -- |
| Bank-owned life insurance dividend income | (221) | (82) | (60) |
| (Increase) decrease in other assets | (478) | 90 | 265 |
| (Decrease) increase in accrued interest payable | (3) | (6) | 1 |
| Increase in other liabilities | 505 | 596 | 142 |
| Net cash provided by operating activities | 5,333 | 4,635 | 3,306 |
| INVESTING ACTIVITIES: | | | |
| Net increase in loans receivable held for investment | (23,183) | (28,734) | (49,736) |
| Purchases of securities available for sale | (12,764) | (30,437) | (14,322) |
| Principal repayments on securities available for sale | 15,797 | 18,713 | 24,790 |
| Proceeds from sales of securities available for sale | -- | 11,704 | -- |
| Proceeds from calls of securities available for sale | -- | 4,868 | 2,000 |
| Purchases of premises and equipment | (1,376) | (311) | (598) |
| Proceeds from the sale of premises and equipment | 5 | -- | -- |
| Purchases of Federal Home Loan Bank stock | (224) | (347) | (586) |
| Decrease (increase) in interest-bearing deposits in other financial institutions, net | 747 | (249) | 747 |
| Purchase of bank-owned life insurance | -- | (5,000) | -- |
| Proceeds from death benefits on bank-owned life insurance | -- | -- | 259 |
| Net cash used in investing activities | (20,998) | (29,793) | (37,446) |

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**1ST CAPITAL BANK**

**STATEMENTS OF CASH FLOWS**
**FOR THE YEARS ENDED DECEMBER 31, 2017, 2016, and 2015**
**(Dollars in Thousands)**

| | 2017 | 2016 | 2015 |
|---|---|---|---|
| FINANCING ACTIVITIES: | | | |
| Net increase in transaction and savings deposits | 26,369 | 48,310 | 47,389 |
| Net decrease in certificates of deposit | (914) | (16,078) | (1,753) |
| Cash paid in lieu of fractional shares | (4) | (3) | (3) |
| Cash proceeds from exercise of stock options | 552 | 376 | 446 |
| Net cash provided by financing activities | 26,003 | 32,605 | 46,079 |
| NET INCREASE IN CASH AND CASH EQUIVALENTS | 10,338 | 7,447 | 11,939 |
| CASH & CASH EQUIVALENTS AT BEGINNING OF YEAR | 53,638 | 46,191 | 34,252 |
| CASH & CASH EQUIVALENTS AT END OF YEAR | $ 63,976 | $ 53,638 | $ 46,191 |
| SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION: | | | |
| Cash paid during the period for: | | | |
| Interest expense | $ 624 | $ 709 | $ 664 |
| Income taxes | $ 3,062 | $ 2,415 | $ 1,420 |

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 150 Main Street, Suite 150, Salinas, CA 93901. 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 –*** Management has reviewed all events occurring from December 31, 2017 through March 14, 2018, the date the financial statements were available to be issued, and determined that there were no reportable subsequent events.

***Stock Dividend*** – On October 26, 2017, the Bank's Board of Directors declared a 5.00% stock dividend, which was distributed on December 15, 2017 to shareholders of record as of November 22, 2017. All share and per-share information disclosed in the notes to the financial statements 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, 2017, 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 $4.8 million, of which $4.2 million was not 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 $16.7 million and $15.2 million at December 31, 2017 and 2016, 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, 2017 and 2016, the Bank did not have any securities classified as held to maturity or trading. During the years ended December 31, 2017, 2016, and 2015, 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, 2017 or 2016.

***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 costs, 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 to operations. The Bank serviced loans for others in the amount of $5.6 million and $2.7 million at December 31, 2017 and 2016, 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 $311 thousand and $326 thousand at December 31, 2017 and 2016, 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 $5.2 million of impaired loans as of December 31, 2017 and $8.0 million of impaired loans as of December 31, 2016.

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, and are classified as purchased credit impaired. 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, 2017 and 2016.

***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 thirty-two 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 and land, including farmland*** – Construction and land, including farmland 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.

***Residential 1 to 4 unit 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 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.

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 $63 thousand unallocated allowance at December 31, 2017 and a $156 thousand unallocated allowance at December 31, 2016.

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 $155 thousand at December 31, 2017 and $119 thousand at December 31, 2016.

***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, 2017 and 2016.

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.

The Bank has elected the fair value option for servicing rights. 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 $69 thousand and $31 thousand at December 31, 2017 and 2016, 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 $3.2 million and $2.9 million at December 31, 2017 and 2016, 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 marginal 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 $73 thousand and $143 thousand at December 31, 2017 and 2016, 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 2017 or 2016.

***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 706,041 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.

***New Financial Accounting Standards***

**ASU 2014-09, Revenue from Contracts with Customers (Topic 606)** – In May 2014, the Financial Accounting Standards Board ("FASB") amended existing guidance related to revenue from contracts with customers. This amendment supersedes and replaces nearly all existing revenue recognition guidance, including industry-specific guidance, establishes a new control-based revenue recognition model, changes the basis for deciding when revenue is recognized over time or at a point in time, provides new and more detailed guidance on specific topics and expands and improves disclosures about revenue. In addition, this amendment specifies the accounting for some costs to obtain or fulfill a contract with a customer.

These amendments are effective for public business entities for annual reporting periods beginning after December 15, 2017, including interim periods within that reporting period. Early application is permitted only as of annual reporting periods beginning after December 15, 2016, including interim reporting periods within that period. The Bank did not early adopt this accounting standard, but adopted it effective January 1, 2018.

The amendments allow for one of two transition methods: full retrospective or modified retrospective. The full retrospective approach requires application to all periods presented. The modified retrospective transition requires application to uncompleted contracts at the date of adoption. Periods prior to the date of adoption are not retrospectively revised, but a cumulative effect is recognized at the date of initial application on uncompleted contracts.

The Bank is finalizing its assessment and has identified the revenue line items within the scope of this new guidance. The Bank does not expect the new standard to result in a material change for revenue because the majority of the Bank's financial instruments are not within the scope of Topic 606. Revenue streams within Other Noninterest Income the Bank is evaluating includes Service Charges on deposit accounts, for which the revenue recognition methods are not expected to change significantly, but for which disclosures will be impacted in the Bank's 2018 financial statements.

**ASU 2016-01, Financial Instruments – Overall (Subtopic 825-10) – Recognition and Measurement of Financial Assets and Financial Liabilities** – In January 2016, the FASB amended existing guidance that requires equity investments (except those accounted for under the equity method of accounting, or those that result in consolidation of the investee) to be measured at fair value with changes in fair value recognized in net income. It requires public business entities ("PBEs") to use the exit price notion when measuring the fair value of financial instruments for disclosure purposes. It requires separate presentation of financial assets and financial liabilities by measurement category and form of financial asset (i.e., securities or loans and receivables). It eliminates the requirement for PBEs to disclose the method(s) and significant assumptions used to estimate fair value that is required to be disclosed for financial instruments measured at amortized cost.

These amendments are effective for PBEs for fiscal years beginning after December 15, 2017, including interim periods within those fiscal periods.

The adoption of this standard is not expected to have a material effect on the Bank's operating results or financial condition. The adoption of this guidance is not expected to have a material impact on the financial statements; however, it will impact the fair value discloses included in footnote 2.

**ASU 2016-02, Leases** – In February 2016, the 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 Bank'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.

For PBEs 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. 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 March 31, 2019 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 such as the Bank, it is effective for March 31, 2021 interim financial statements.

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") assets 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.

The Bank has formed a CECL committee that is assessing data and system needs in order to evaluate the impact of adopting the new guidance. Management expects to recognize a one-time cumulative effect adjustment to the allowance for loan losses as of the beginning of the first reporting period in which the new standard is effective. The Bank expects the adoption will result in a material increase to the allowance for loan losses balance. At this time, the impact is being evaluated.

**ASU 2016-09, Improvements to Employee Share-Based Payment Accounting** – In March 2016, the FASB issued guidance intended to simplify the accounting for share-based payment award transactions, including: (a) income tax consequences; (b) classification of awards as either equity or liabilities; (c) classification on the statement of cash flows; and (d) policy election to estimate the number of awards that are expected to vest (current GAAP) or account for forfeitures when they occur. The amendments are effective for public companies for annual periods beginning after December 15, 2016, and interim periods within those annual periods.

Amendments related to the timing of when excess tax benefits are recognized, minimum statutory withholding requirements, forfeitures, and intrinsic value should be applied using a modified retrospective transition method by means of a cumulative effect adjustment to equity as of the beginning of the period in which the guidance is adopted.

An entity may elect to apply the amendments related to the presentation of excess tax benefits on the statement of cash flows using either a prospective transition method or a retrospective transition method.

The Bank adopted this standard as of January 1, 2017 on a prospective basis with respect to amendments to the statement of cash flows. The Bank elected to account for forfeitures of equity awards as they occur. The adoption of this standard did not have a material effect on the Bank's operating results or financial condition.

**ASU 2017-09, Compensation – Stock Compensation (Topic 718): Scope of Modification Accounting** – In May 2017, the FASB provided guidance about which changes to the terms or conditions of a share-based payment award require an entity to apply modification accounting in Topic 718. An entity should account for the effects of a modification unless the following are met:

- The fair value (or calculated or intrinsic value, if such an alternative measure is used) of the modified award is the same as the fair value (or calculated value or intrinsic value, if such an alternative measure is used) of the original award immediately before the original award is modified. If the modification does not affect any of the inputs to the valuation technique that the entity uses to value the award, the entity is not required to estimate the value immediately before the original award is modified.
- The vesting conditions of the modified award are the same as the vesting conditions of the original award immediately before the original award is modified.
- The classification of the modified award as an equity instrument or a liability instrument is the same as the classification of the original award immediately before the original award is modified.

The amendments in this Update are effective for all entities for annual periods, and interim periods within those annual periods, beginning after December 15, 2017. Early adoption is permitted, including adoption in any interim period, for reporting periods for which financial statement have not yet been issued.
The amendments should be applied prospectively to an award modified on or after the adoption date. The adoption of this standard is not expected to have a material effect on the Bank's operating results or financial condition.

## 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).

***Loan Servicing Rights*** – On an annual basis, loan servicing rights are adjusted to 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, 2017 and 2016. 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, 2017, Using** | | |
|---|---|---|---|---|
| (Dollars in Thousands) | **Fair Value 12/31/2017** | **Quoted Prices in Active Markets for Identical Assets (Level 1)** | **Significant Other Observable Inputs (Level 2)** | **Significant Unobservable Inputs (Level 3)** |
| Securities Available for Sale: | | | | |
| Variable-rate US Agency securities: | | | | |
| Residential MBS | $ 492 | $ -- | $ 492 | $ -- |
| Residential CMO | 37,257 | -- | 37,257 | -- |
| Commercial CMO | 303 | -- | 303 | -- |
| Subtotal | 38,052 | -- | 38,052 | -- |
| Fixed-rate US Agency securities: | | | | |
| Residential MBS | 23,299 | -- | 23,299 | -- |
| Commercial MBS | 358 | -- | 358 | -- |
| Subtotal | 23,657 | -- | 23,657 | -- |
| Fixed-rate obligations of states and political subdivisions | 13,218 | -- | 13,218 | -- |
| Total securities available for sale | $ 74,927 | $ -- | $ 74,927 | $ -- |
| Loan servicing rights | $ 69 | $ -- | $ -- | $ 69 |

| (Dollars in Thousands) | Fair Value 12/31/2016 | Fair Value Measurements on a 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) |
|---|---|---|---|---|
| Securities Available for Sale: | | | | |
| 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 securities available for sale | $ 77,870 | $ -- | $ 77,870 | $ -- |
| Loan servicing rights | $ 31 | $ -- | $ -- | $ 31 |

There were no changes in the valuation techniques used during 2017. During the years ended December 31, 2017 and 2015, there were no transfers in or out of Levels 1, 2, or 3.

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, 2017: Level 1 | Level 2 | Level 3 | Total |
|---|---|---|---|---|---|
| **Financial Assets** | | | | | |
| Cash and cash equivalents | $ 63,976 | $ 63,976 | $ -- | $ -- | $ 63,976 |
| Time deposits at other financial institutions | 1,743 | -- | 1,744 | -- | 1,744 |
| Securities available for sale | 74,927 | -- | 74,927 | -- | 74,927 |
| Loans receivable held for investment, net | 421,555 | -- | -- | 424,877 | 424,877 |
| Federal Home Loan Bank stock | 3,163 | -- | -- | -- | NA |
| Accrued interest receivable[1] | 1,438 | -- | 231 | 1,208 | 1,439 |
| Loan servicing rights | 69 | -- | -- | 69 | 69 |
| **Financial Liabilities** | | | | | |
| Transaction and savings deposits | $ 513,946 | $ 513,946 | $ -- | $ -- | $ 513,946 |
| Certificates of deposit | 12,130 | -- | 12,036 | -- | 12,036 |
| Accrued interest payable | 18 | 5 | 13 | -- | 18 |

| | 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 |

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 may be measured at the fair value of collateral less estimated costs to sell, however, there were no such loans at December 31, 2017 and 2016. 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, 2017 and 2016 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").

| (Dollars in Thousands) | **December 31, 2017** | | | |
|---|---|---|---|---|
| | **Amortized Cost** | **Gross Unrealized Gains** | **Gross Unrealized Losses** | **Fair Value** |
| Variable-rate US Agency securities: | | | | |
| Residential CMO | $ 37,155 | $ 123 | $ (21) | $ 37,257 |
| Commercial CMO | 303 | -- | -- | 303 |
| Residential MBS | 470 | 22 | -- | 492 |
| Subtotal | 37,927 | 145 | (21) | 38,052 |
| Fixed-rate US Agency securities: | | | | |
| Residential MBS | 23,704 | 6 | (411) | 23,299 |
| Commercial MBS | 358 | -- | -- | 358 |
| Subtotal | 24,062 | 6 | (411) | 23,657 |
| Fixed-rate obligations of states and political subdivisions | 13,186 | 112 | (80) | 13,218 |
| Total securities available for sale | $ 75,176 | $ 263 | $ (512) | $ 74,927 |

Net unrealized losses on available-for-sale investment securities totaling $249 thousand were recorded, net of $93 thousand of tax assets, as accumulated other comprehensive income within stockholders' equity at December 31, 2017.

| (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 loss within stockholders' equity at December 31, 2016.

Securities with unrealized losses at December 31, 2017 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 | $ 693 | $ (1) | $ 12,233 | $ (20) | $ 12,926 | $ (21) |
| Fixed-rate Agency securities: Residential MBS | $ 1,164 | $ (3) | $ 20,736 | $ (408) | $ 21,900 | $ (411) |
| Fixed-rate obligations of states and political subdivisions | 3,942 | (15) | 2,785 | (65) | 6,727 | (80) |
| Total temporarily impaired securities | $ 5,799 | $ (19) | $ 35,754 | $ (493) | $ 41,553 | $ (512) |

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) |

At December 31, 2017, the Bank held 85 securities, of which:

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

The unrealized losses on the Bank's securities at December 31, 2017 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, 2017.

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.

| (Dollars in Thousands) | December 31, 2017 Amortized Cost | December 31, 2017 Fair Value |
|---|---|---|
| Variable-rate US Agency securities: | | |
| Residential CMO | | |
| Due beyond ten years | $ 37,155 | $ 37,257 |
| Commercial CMO | | |
| Due in one to five years | 303 | 303 |
| Residential MBS | | |
| Due beyond ten years | 470 | 492 |
| Fixed-rate US Agency securities: | | |
| Residential MBS | | |
| Due within one year | 1,180 | 1,177 |
| Due in one to five years | 201 | 205 |
| Due in five to ten years | 2,658 | 2,575 |
| Due beyond ten years | 19,665 | 19,342 |
| Commercial MBS | | |
| Due in five to ten years | 358 | 358 |
| Fixed-rate obligations of states and political subdivisions: | | |
| Due in one to five years | 692 | 717 |
| Due beyond five years | 1,192 | 1,163 |
| Due beyond ten years | 11,302 | 11,338 |
| Total | $ 75,176 | $ 74,927 |

At December 31, 2017 and 2016, there were no holdings of securities of any one issuer, other than US Agencies, in an amount greater than 10.0% of stockholders' 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, 2017 Amortized Cost | December 31, 2017 Fair Value |
|---|---|---|
| Pledged to the State of California | $ 1,370 | $ 1,397 |
| Pledged to public entities | 25,496 | 25,395 |
| | $ 26,866 | $ 26,792 |

| (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 |

## 4. LOANS RECEIVABLE HELD FOR INVESTMENT

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

| (Dollars in Thousands) | December 31, | |
|---|---|---|
| | 2017 | 2016 |
| Investor commercial real estate | $ 105,196 | $ 94,018 |
| Owner-occupied commercial real estate | 67,326 | 50,887 |
| Multifamily | 51,982 | 53,338 |
| Subtotal | 224,504 | 198,243 |
| Residential one to four units | 115,339 | 120,983 |
| Construction and land (including farmland) | 16,301 | 18,993 |
| Home equity lines of credit | 8,832 | 11,609 |
| Commercial and industrial | 57,412 | 50,334 |
| Other loans | 5,545 | 5,144 |
| Total loans receivable held for investment | 427,933 | 405,306 |
| Allowance for loan losses | (6,378) | (6,267) |
| Total loans receivable held for investment, net | $ 421,555 | $ 399,039 |

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 $445 thousand and $875 thousand at December 31, 2017 and 2016, respectively.

The Bank did not have any loans past due 90 days or more and still on accrual status at December 31, 2017 or 2016. The Bank had no loans 30 or more days past due at December 31, 2017 or 2016.

The Bank had loans on non-accrual status totaling $255 thousand and $139 thousand at December 31, 2017 and 2016, respectively. Interest foregone on non-accrual loans totaled zero in 2017 and 2016.

At December 31, 2017 and 2016, the Bank had a recorded investment in troubled debt restructurings of $311 thousand and $326 thousand, respectively. The Bank allocated $113 thousand and $134 thousand allowances for those loans as of December 31, 2017 and 2016, respectively. The Bank had not committed to lend additional amounts associated with loans that were classified as troubled debt restructurings as of December 31, 2017 and 2016.

There were no loans modified as troubled debt restructurings during the years ended December 31, 2017, 2016 and 2015.

The terms of certain other loans were modified during the year ended December 31, 2017 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, 2017, 2016 and 2015, no troubled debt restructurings have subsequently defaulted.

Compensation expenses totaling $421 thousand, $470 thousand, and $441 thousand were deferred as direct loan origination costs during the years ended December 31, 2017, 2016, and 2015, 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 $427 million pledged to either the FHLB or FRB as of December 31, 2017. The Bank had loans totaling $404 million pledged to either the FHLB or FRB as of December 31, 2016. 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, 2017.

| (Dollars in Thousands)<br>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 | $ 1,805 | $ 1,627 | $ 498 | $ 227 | $ 1,789 | $ 165 | $ 156 | $ 6,267 |
| Provision for loan losses | 429 | (315) | (296) | 176 | 259 | 15 | (93) | 175 |
| Charge-offs | -- | -- | -- | -- | (112) | -- | -- | (112) |
| Recoveries | -- | -- | -- | -- | 48 | -- | -- | 48 |
| Balance, end of period | $ 2,234 | $ 1,312 | $ 202 | $ 403 | $ 1,984 | $ 180 | $ 63 | $ 6,378 |

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)<br>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 | 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 | $ 2,591 | $ 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 shows the allocation of the allowance for loan losses and the recorded investment in loans at December 31, 2017 and 2016 by portfolio segment and by impairment methodology. The Bank had $63 thousand unallocated allowance for loan losses at December 31, 2017 and $156 thousand unallocated allowance for loan losses at December 31, 2016.

| (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, 2017 | | | | | | | | |
| **Allowance for Loan Losses** | | | | | | | | |
| Individually evaluated for impairment | $ 113 | $ -- | $ -- | $ -- | $ 83 | $ -- | $ -- | $ 196 |
| Collectively evaluated for impairment | 2,121 | 1,312 | 202 | 403 | 1,901 | 180 | 63 | 6,182 |
| Total | $ 2,234 | $ 1,312 | $ 202 | $ 403 | $ 1,984 | $ 180 | $ 63 | $ 6,378 |
| **Loans** | | | | | | | | |
| Individually evaluated for impairment | $ 1,888 | $ -- | $ 2,726 | $ -- | $ 586 | $ -- | $ -- | $ 5,200 |
| Collectively evaluated for impairment | 222,616 | 115,339 | 13,575 | 8,832 | 56,826 | 5,545 | -- | 422,733 |
| Total | $ 224,504 | $ 115,339 | $ 16,301 | $ 8,832 | $ 57,412 | $ 5,545 | $ -- | $ 427,933 |

| (Dollars in Thousands) December 31, 2016 | 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 | $ 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 |

The following table presents information related to impaired loans by portfolio segment as of and for the years ended December 31, 2017, 2016 and 2015:

| (Dollars in Thousands) **December 31, 2017** | 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 | $ 1,687 | $ 1,687 | $ -- | $ 1,739 | $ 86 | $ 86 |
| Residential one to four units | -- | -- | -- | -- | -- | -- |
| Construction / land (including farmland) | 2,733 | 2,726 | -- | 4,019 | 235 | 235 |
| Home equity lines of credit | -- | -- | -- | -- | -- | -- |
| Commercial and industrial | 308 | 255 | -- | 310 | -- | -- |
| Other | -- | -- | -- | -- | -- | -- |
| Subtotal | 4,728 | 4,668 | -- | 6,068 | 321 | 321 |
| With an allowance recorded | | | | | | |
| Multifamily and commercial and industrial real estate | 200 | 201 | 113 | 202 | 4 | 4 |
| Residential one to four units | -- | -- | -- | -- | -- | -- |
| Construction / land (including farmland) | -- | -- | -- | -- | -- | -- |
| Home equity lines of credit | -- | -- | -- | -- | -- | -- |
| Commercial and industrial | 330 | 331 | 83 | 366 | 27 | 27 |
| Other | -- | -- | -- | -- | -- | -- |
| Subtotal | 530 | 532 | 196 | 568 | 31 | 31 |
| Total | $ 5,258 | $ 5,200 | $ 196 | $ 6,636 | $ 352 | $ 352 |

| (Dollars in Thousands) | Unpaid Principal Balance | Recorded Investment | Allowance for Loan Losses Allocated | Average Recorded Investment | Interest Income Recognized | Cash Basis Interest Recognized |
|---|---|---|---|---|---|---|
| **December 31, 2016** | | | | | | |
| 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 |
| **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 |

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

The following table presents the loan portfolio by portfolio segment allocated by internal risk ratings at December 31, 2017 and 2016:

| (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 | Total |
|---|---|---|---|---|---|---|---|
| | Credit Exposure Credit Risk Profile by Internally Assigned Grade | | | | | | |
| **December 31, 2017** | | | | | | | |
| Rating: | | | | | | | |
| Pass / Watch | $ 221,262 | $ 114,392 | $ 13,568 | $ 8,832 | $ 51,766 | $ 5,545 | $ 415,365 |
| Special Mention | -- | 947 | -- | -- | 2,808 | -- | 3,755 |
| Substandard | 3,242 | -- | 2,733 | -- | 2,838 | -- | 8,813 |
| Total | $ 224,504 | $ 115,339 | $ 16,301 | $ 8,832 | $ 57,412 | $ 5,545 | $ 427,933 |
| **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 |

## 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, 2017, the Bank owned 31,629 shares of $100 par value FHLB capital stock. As of December 31, 2016, the Bank owned 29,394 shares of $100 par value FHLB capital stock. The amount of capital stock owned at December 31, 2017 meets the most recent formula determination.

## 7. PREMISES AND EQUIPMENT

Premises and equipment consisted of the following:

| (Dollars in Thousands) | December 31, 2017 | December 31, 2016 |
|---|---|---|
| Furniture and equipment | $ 2,862 | $ 2,668 |
| Leasehold improvements | 2,293 | 1,345 |
| Total, at cost | 5,155 | 4,013 |
| Accumulated depreciation and amortization | (2,847) | (2,536) |
| Premises and equipment, net | $ 2,308 | $ 1,477 |

Depreciation and amortization expense related to the Bank's leasehold improvements, furniture, and equipment was $542 thousand, $445 thousand, and $400 thousand for the years ended December 31, 2017, 2016, and 2015, respectively.

## 8. DEPOSITS

Deposits are summarized as follows:

| (Dollars in Thousands) | December 31, 2017 Balance | December 31, 2017 Weighted Average Rate | December 31, 2016 Balance | December 31, 2016 Weighted Average Rate |
|---|---|---|---|---|
| Noninterest-bearing demand deposits | $ 261,706 | -- | $ 239,799 | -- |
| Interest-bearing checking | 35,082 | 0.04% | 33,889 | 0.04% |
| Savings | 110,059 | 0.22% | 100,600 | 0.29% |
| Money market | 107,100 | 0.25% | 113,289 | 0.25% |
| Certificates of deposit, less than $100,000 | 3,239 | 0.22% | 3,541 | 0.22% |
| Certificates of deposit, $100,000 to $250,000 | 4,865 | 0.25% | 5,467 | 0.25% |
| Certificates of deposit, $250,000 or more | 4,026 | 0.19% | 4,036 | 0.19% |
| | $ 526,076 | 0.13% | $ 500,621 | 0.13% |

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

| (Dollars in Thousands) | December 31, 2017 Balance Less than $100,000 | Balance $100,000 to $250,000 | Balance $250,000 or More | Total |
|---|---|---|---|---|
| Three months or less | $ 980 | $ 694 | $ 1,542 | $ 3,216 |
| Over three through six months | 767 | 1,553 | 566 | 2,886 |
| Over six through twelve months | 969 | 2,167 | 1,602 | 4,738 |
| Over twelve months through two years | 523 | 451 | 316 | 1,290 |
| | $ 3,239 | $ 4,865 | $ 4,026 | $ 12,130 |

The ten largest depositors at December 31, 2017 maintained balances of $118.2 million, representing 22% of total deposits. The ten largest depositors at December 31, 2016 maintained balances of $113.5 million, representing 23% of total deposits. No client represented 5.0% or more of the Bank's deposits at December 31, 2017, and one client represented 5.0% or more of the Bank's deposits at December 31, 2016.

Interest expense on deposits for the years ended December 31, 2017, 2016, and 2015 is summarized as follows:

| (Dollars in Thousands) | 2017 | 2016 | 2015 |
|---|---|---|---|
| Interest-bearing checking | $ 16 | $ 13 | $ 11 |
| Savings | 259 | 297 | 280 |
| Money market | 309 | 352 | 318 |
| Certificates of deposit, less than $100,000 | 7 | 8 | 10 |
| Certificates of deposit, $100,000 to $250,000 | 10 | 18 | 22 |
| Certificates of deposit, $250,000 or more | 19 | 14 | 20 |
| | $ 620 | $ 702 | $ 661 |

## 9. INCOME TAXES

Income tax expense for the years ended December 31, 2017, 2016, and 2015 consisted of the following:

| (Dollars in Thousands) | 2017 | 2016 | 2015 |
|---|---|---|---|
| Current: | | | |
| Federal | $ 1,894 | $ 1,877 | $ 1,337 |
| State | 655 | 527 | 442 |
| Total | 2,549 | 2,404 | 1,779 |
| Deferred: | | | |
| Federal | (173) | (326) | (247) |
| Effect of change in Federal tax rate | 923 | -- | -- |
| State | (39) | (86) | (88) |
| Total | 711 | (412) | (335) |
| Provision for income taxes | $ 3,260 | $ 1,992 | $ 1,444 |

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

| | 2017 | 2016 | 2015 |
|---|---|---|---|
| Federal statutory tax rate | 34.0% | 34.0% | 34.0% |
| State income taxes (net of Federal income tax benefit) | 6.6% | 5.8% | 6.1% |
| Bank-owned life insurance death benefits | 0.0% | 0.0% | (2.2%) |
| Bank-owned life insurance dividend income and benefits | (1.2%) | (0.6%) | (0.5%) |
| Interest on Federally tax-exempt securities | (0.8%) | (0.3%) | (0.1%) |
| Effect of change in Federal tax rate | 15.1% | -- | -- |
| Other | (0.3%) | 0.5% | 0.5% |
| Effective tax rate | 53.4% | 39.4% | 37.8% |

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, 2017 | December 31, 2016 |
|---|---|---|
| Deferred tax assets: | | |
| Allowance for loan losses | $ 1,836 | $ 2,504 |
| Accrued expenses | 373 | 438 |
| Deferred loan fees, points, and discounts | 287 | 295 |
| State franchise tax | 145 | 203 |
| Unrealized loss on securities available for sale | 104 | 326 |
| Deferred compensation | 105 | 127 |
| Organization costs | 91 | 156 |
| Equity-based compensation | 70 | 47 |
| Total gross deferred tax assets | 3,011 | 4,096 |
| Deferred tax liabilities: | | |
| Deferred loan origination costs and premiums | (477) | (574) |
| Prepaid expenses | (82) | (53) |
| Premises and equipment accumulated depreciation | (13) | (18) |
| Other deferred tax liabilities | (19) | (14) |
| Total gross deferred tax liabilities | (591) | (659) |
| Net deferred tax assets | $ 2,420 | $ 3,437 |

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, 2017 and 2016 is as follows:

| (Dollars in Thousands) | 2017 | 2016 |
|---|---|---|
| Beginning balance | $ 143 | $ 243 |
| Additions based on tax positions related to the current year | -- | -- |
| Additions for tax positions of prior years | -- | -- |
| Reductions for tax positions of prior years | -- | -- |
| Reductions due to the statute of limitations | -- | (100) |
| Settlements and payments | (70) | -- |
| Ending balance | $ 73 | $ 143 |

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 2014 through 2017 are currently open for examination. State tax returns for 2013 through 2017 are currently open for examination.

The Bank is currently under examination by the California Franchise Tax Board regarding certain deductions taken in 2013. The impact of any adjustment is not expected to be material to the Bank's financial position or results of operations.

The Tax Cuts and Jobs Act signed into law on December 22, 2017 reduces the corporate tax rate, effective January 1, 2018, from a graduated set of rates with a maximum 35 percent tax rate to a flat 21 percent tax rate. Accounting Standards Codification Topic 740 requires remeasurement of all deferred income tax assets and liabilities for temporary differences and net operating loss carryforwards from the 35 percent tax rate to the new corporate tax rate of 21 percent. The cumulative adjustment was recognized in income tax expense from continuing operations as a discrete item for the year ended December 31, 2017, the period in which the law was enacted.

## 10. BORROWINGS

The Bank is a member of the Federal Home Loan Bank of San Francisco ("FHLB"). As of December 31, 2017 and 2016, the Bank had $85.7 million and $91.9 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, 2017 or 2016.

The Bank had $25.0 million in unsecured and uncommitted federal funds lines of credit from its correspondent banks as of December 31, 2017 and 2016. There were no borrowings outstanding under these federal funds lines of credit at December 31, 2017 or 2016.

The Bank is approved for discount window access from the Federal Reserve Bank of San Francisco ("FRB"). At December 31, 2017, the Bank had available discount window borrowing capacity of $10.3 million. At December 31, 2016, the Bank had an available discount window borrowing capacity of $20.5 million. As of December 31, 2017 and 2016, 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 $73 thousand and $143 thousand as of December 31, 2017 and 2016, 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, 2017 and 2016, the Bank had commitments outstanding to make the following funds available under various types of loans:

| (Dollars in Thousands)<br><br>**Credit Category** | **December 31, 2017 Available Credit Commitments** | **December 31, 2016 Available Credit Commitments** |
|---|---|---|
| Commercial and industrial | $ 61,308 | $ 49,806 |
| Multifamily and commercial and industrial real estate | 6,536 | 1,000 |
| Home equity lines of credit | 5,550 | 5,855 |
| Construction and land (including farmland) | 1,585 | 1,532 |
| Other | 1,346 | 1,348 |
| | $ 76,325 | $ 59,541 |

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 $291 thousand and $236 thousand outstanding at December 31, 2017 and 2016, respectively

The Bank leases its facilities under non-cancelable operating leases for varying periods extending through April 30, 2024. 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, 2017:

| (Dollars in Thousands) | **Net Minimum Rental Commitments** |
|---|---|
| 2018 | $ 584 |
| 2019 | 441 |
| 2020 | 453 |
| 2021 | 466 |
| 2022 | 253 |
| Thereafter | 274 |
| Total | $ 2,471 |

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 $564 thousand, $540 thousand, and $516 thousand was recognized in occupancy expense in the Statements of Income for the years ended December 31, 2017, 2016, and 2015, 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 2017 was 1.250% and the capital conservation buffer for 2016 was 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, 2017, 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, 2017 and 2016, 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, 2017 and 2016 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, 2017** | | | | | | |
| Tier 1 Capital to Average Total Assets (Leverage) | $ 52,097 | 9.14% | $ 22,802 | 4.00% | $ 28,503 | 5.00% |
| Common Equity Tier 1 to Risk Weighted Assets | $ 52,097 | 12.91% | $ 18,166 | 4.50% | $ 26,240 | 6.50% |
| Tier 1 Capital to Risk Weighted Assets | $ 52,097 | 12.91% | $ 24,221 | 6.00% | $ 32,295 | 8.00% |
| Total Capital to Risk Weighted Assets | $ 57,161 | 14.16% | $ 32,295 | 8.00% | $ 40,369 | 10.00% |
| **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% |

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, 2017, the Bank had $2 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 706,041 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 Equity Incentive 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, 2017, 2016, and 2015, and changes and related expense during the years ended December 31, 2016, 2015, and 2014, has been adjusted to reflect the 2017 issuance of a 5% stock dividend and is as follows:

*Restricted Share Awards*

| (In Whole Shares; Dollars in Thousands Except Per Share Amounts) | 2017 Shares | 2017 Weighted Average Grant Date Fair Value | 2016 Shares | 2016 Weighted Average Grant Date Fair Value | 2015 Shares | 2015 Weighted Average Grant Date Fair Value |
|---|---|---|---|---|---|---|
| Awards outstanding at the beginning of the period | 129,753 | $ 10.34 | 150,394 | $ 9.93 | 157,935 | $ 9.46 |
| Award activity during the period: | | | | | | |
| Time-based awards granted | 104,667 | $ 13.28 | 53,236 | $ 10.36 | 61,605 | $ 10.12 |
| Time-based awards forfeited | (9,006) | $ 10.86 | (33,006) | $ 10.33 | (18,638) | $ 9.92 |
| Time-based awards vested | (50,857) | $ 10.98 | (40,871) | $ 10.45 | (50,508) | $ 9.87 |
| Awards outstanding at the end of the period | 174,555 | $ 9.24 | 129,753 | $ 10.34 | 150,394 | $ 9.93 |
| Restricted share award compensation expense | $ 635 | | $ 389 | | $ 493 | |

*Stock Options*

| (In Whole Shares; Dollars in Thousands Except Per Share Amounts) | 2017 Shares | 2017 Weighted Average Exercise Price | 2016 Shares | 2016 Weighted Average Exercise Price | 2015 Shares | 2015 Weighted Average Exercise Price |
|---|---|---|---|---|---|---|
| Options outstanding at the beginning of the period | 117,855 | $ 8.57 | 164,547 | $ 8.43 | 222,380 | $ 8.53 |
| Option activity during the period: | | | | | | |
| Options exercised | (67,826) | $ 8.14 | (46,564) | $ 8.08 | (56,310) | $ 7.94 |
| Options forfeited | (3,101) | $ 8.07 | (128) | $ 6.21 | (1,523) | $ 7.69 |
| Options outstanding at the end of the period | 46,928 | $ 9.22 | 117,855 | $ 8.57 | 164,547 | $ 8.43 |
| Options vested and exercisable | 46,928 | $ 9.22 | 117,855 | $ 8.57 | 164,547 | $ 8.43 |
| Stock option compensation expense | $ -- | | $ -- | | $ -- | |

Additional information regarding stock options outstanding at December 31, 2017 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 | 46,928 | $ 9.22 | 3.69 years | $ 290 |
| Stock options exercisable | 46,928 | $ 9.22 | 3.69 years | $ 290 |
| Stock options vested or expected to vest | 46,928 | $ 9.22 | 3.69 years | $ 290 |

The Bank did not award any stock option grants for the years ended December 31, 2017, 2016, and 2015.

The following stock option exercise information is for the years ended December 31, 2017, 2016, and 2015:

| (Dollars in Thousands) | 2017 | 2016 | 2015 |
|---|---|---|---|
| Intrinsic value of stock options exercised | $ 619 | $ 145 | $ 103 |
| Cash received from stock option exercises | $ 552 | $ 376 | $ 469 |
| Tax benefit realized from stock option exercises | $ 56 | $ 107 | $ 98 |

The tax benefit associated with the stock option exercises during 2017, 2016, and 2015 reduced the associated deferred tax asset.

As of December 31, 2017, there was $1.75 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 2.7 years. The total fair value of restricted share awards vested in 2017, 2016, and 2015 was $782 thousand, $480 thousand, and $577 thousand, respectively.

At December 31, 2017, the intrinsic value of the 174,555 outstanding unvested restricted share awards was $2.69 million, based upon a market price of $15.39 per share. At December 31, 2016, the intrinsic value of the 129,753 outstanding unvested restricted share awards was $1.52 million, based upon a market price of $11.75 per share. At December 31, 2015, the intrinsic value of the 150,394 outstanding unvested restricted share awards was $1.72 million, based upon a market price of $11.42 per share.

As of December 31, 2017, there was no unrecognized compensation cost related to stock options granted under the Plan.

At December 31, 2017, total shares available for future issuance under the Plan were 241,585. Total shares available for issuance under the plan were 357,420 and 292,516 at December 31, 2016 and 2015, 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.

An analysis of the activity of these loans for the years ended December 31, 2017 and 2016 is as follows:

| (Dollars in Thousands) | 2017 | 2016 |
|---|---|---|
| Principal outstanding, beginning of period | $ 4,182 | $ 6,582 |
| New term loans and advances | 8,961 | 1,751 |
| Repayments | (9,453) | (4,151) |
| Principal outstanding, end of period | $ 3,690 | $ 4,182 |
| Credit commitments, end of period | $ 9,835 | $ 10,304 |

Deposits from principal officers, directors, and their affiliates at December 31, 2017 and 2016 were $7.4 million and $4.2 million, respectively.

During the years ended December 31, 2017, 2016, and 2015, the Bank did not purchase any goods or services from related parties, other than normal employee and director compensation and benefits and $49 thousand and $59 thousand paid in 2017 and 2016, respectively, for branch architectural services to the architectural firm for which a member of the Bank's board of directors is a principal.

## 15. OTHER NON-INTEREST EXPENSE

Other non-interest expense for the years ended December 31, 2017, 2016, and 2015 consisted of the following:

| (Dollars in Thousands) | 2017 | 2016 | 2015 |
|---|---|---|---|
| Customer expenses | $ 324 | $ 72 | $ 60 |
| Director expenses, including share-based compensation | 288 | 264 | 211 |
| Regulatory dues and assessments | 287 | 396 | 358 |
| Telecommunications | 268 | 247 | 233 |
| Licensing and software expenses | 195 | 201 | 151 |
| Professional education | 128 | 119 | 144 |
| Messenger service | 116 | 128 | 109 |
| Stationery and supplies | 103 | 100 | 98 |
| Operational expenses | 101 | 65 | 56 |
| Provision for unfunded loan commitments | 36 | (29) | 31 |
| Other expenses | 367 | 293 | 276 |
| | $ 2,213 | $ 1,856 | $ 1,727 |

## 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 $186 thousand, $165 thousand, and $154 thousand during the years ended December 31, 2017, 2016, and 2015, 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 $11 thousand and $9 thousand for the years ended December 31, 2017 and 2016, respectively. The Bank's total liability under the Plan was $354 thousand and $309 thousand at December 31, 2017 and 2016, respectively.

## 18. EARNINGS PER SHARE

The factors used in the earnings per share computation follow.

| (Dollars in Thousands Except Per Share Amounts) | 2017 | 2016 | 2015 |
|---|---|---|---|
| **Basic Earnings Per Share** | | | |
| Net income | $ 2,845 | $ 3,068 | $ 2,381 |
| Weighted average common shares outstanding | 4,637,570 | 4,530,052 | 4,438,263 |
| Basic earnings per common share | $ 0.61 | $ 0.68 | $ 0.54 |
| **Diluted Earnings Per Share** | | | |
| Net income | $ 2,845 | $ 3,068 | $ 2,381 |
| Weighted average common shares outstanding for basic earnings per common share | 4,637,570 | 4,530,052 | 4,438,263 |
| Add: Dilutive effects from equity compensation | 71,937 | 51,857 | 72,677 |
| Shares for diluted earnings per share | 4,709,507 | 4,581,909 | 4,510,940 |
| Diluted earnings per common share | $ 0.60 | $ 0.67 | $ 0.53 |

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 2017, 2016 and 2015.

## *DIRECTORS:*

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

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

Susan C. Freeland, J.D.
*Broker Associate*
*Carmel Realty Company*

Francis Giudici
*President*
*L.A. Hearne Company*

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*

## *EXECUTIVE OFFICERS:*

Thomas E. Meyer
President
Chief Executive Officer

Michael J. Winiarski
Executive Vice President
Chief Financial Officer

Jon D. Ditlevsen
Executive Vice President
Chief Lending Officer

Dale R. Diederick
Executive Vice President
Chief Credit Officer

Robin A. Seelye
Executive Vice President
Chief Administrative Officer

## *LOCATIONS:*

Corporate Offices
Salinas City Center Branch
150 Main Street, Suite 150
Salinas, California 93901
831.264.4000

Monterey Branch
300 Bonifacio Place
Monterey, California 93940
831.264.4070

Salinas Branch
1097 South Main Street
Salinas, California 93901
831.540.4080

King City Branch
432 Broadway Street
King City, California 93930
831.385.8900

San Luis Obispo Branch
142 Cross Street, Suite 130
San Luis Obispo, California 93401
805.592.2030

Investor Relations
Thomas E. Meyer
President, Chief Executive Officer
1st Capital Bank
831.264.4057
Tom.Meyer@1stcapitalbank.com

Corporate Counsel
Glenn T. Dodd
Dodd Mason George, LLP
408.452.1476
www.doddmason.com

Certified Public Accountants
Crowe Horwath, LLP
400 Capitol Mall, Suite 1400
Sacramento, California 95814
916.441.1000
www.crowehorwath.com

Stock Transfer Agent
Computershare
211 Quality Circle, Suite 210
College Station, Texas 77845
800.962.4284
www.computershare.com

1ST CAPITAL BANK

CORPORATE OFFICES
SALINAS CITY CENTER BRANCH
150 MAIN STREET, SUITE 150
SALINAS, CA 93901

SALINAS BRANCH
1097 S. MAIN STREET
SALINAS, CA 93901

MONTEREY BRANCH
300 BONIFACIO PLACE
MONTEREY, CA 93940

KING CITY BRANCH
432 BROADWAY
KING CITY, CA 93930

SAN LUIS OBISPO BRANCH
142 CROSS STREET, SUITE 130
SAN LUIS OBISPO, CA 93401

WWW.1STCAPITAL.BANK • 831.264.4000
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