



2018 FINANCIAL STATEMENTS

**MISSION
VALLEY
BANCORP**



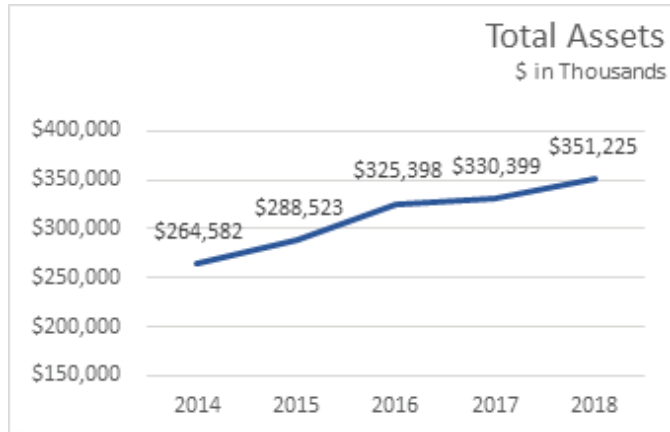


To our Shareholders, Clients & Friends,

2018 was yet another strong year for Mission Valley. Our Team's dedication to unwavering service excellence drove total assets, deposits, net loans, as well as net interest income to new highs.

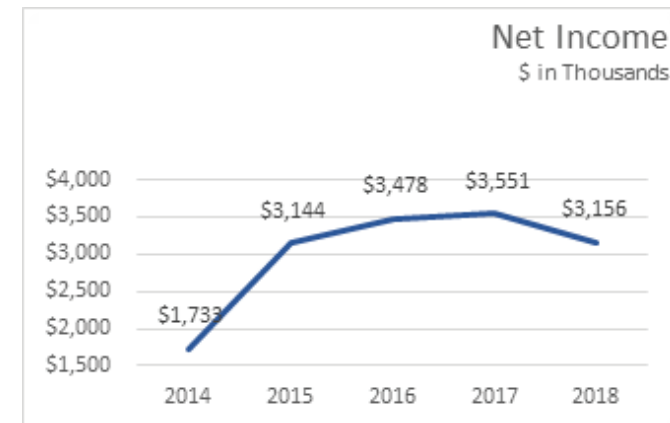
Over the course of the year we achieved solid and balanced growth –

- Total assets rose to \$351 million at December 31, 2018 from \$330 million reported at yearend 2017.
- Total deposits closed 2018 at \$297 million from \$280 million reported as of December 31, 2017.
- Net Loans increased to \$239 million as of December 31, 2018 as compared to \$210 million at yearend 2017.
- And total interest income surpassed \$15.4 million as of December 31, 2018 as compared to \$14.2 million as of yearend 2017.



Despite a onetime expense related to a single credit relationship which resulted in a \$1.2 million lower of cost or market write-down taken against sale of loans during the third quarter of 2018, net earnings reached \$3.156 million as of December 31, 2018. While this represents an 11.12% decrease from the \$3.551 million reported at yearend 2017, a solid year none-the-less.

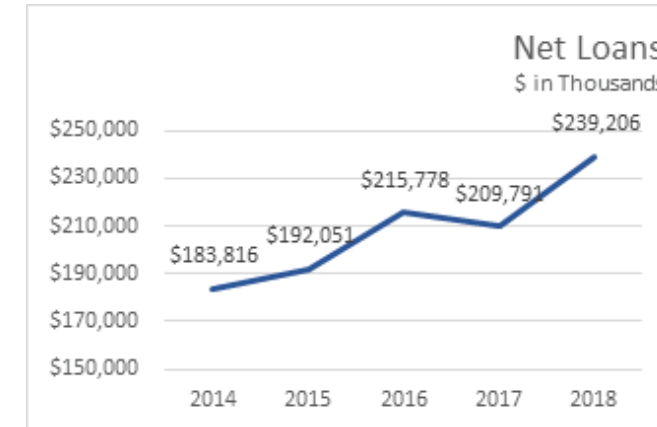
We began the year with a Federal Reserve benchmark rate range between 1.25 percent and 1.5 percent, twelve months and four rate adjustments later, we closed the year with the central bank's benchmark rate between 2.25 percent to 2.5 percent. The ripple effects of a rising rate environment reach from Wall Street to Main Street. With each rate increase, markets, consumers and businesses react. At Mission Valley, loan demand remained relatively constant. New loans funded outpaced payoffs, supporting an increase of \$1.5 million in loans and loans held for sale. Loan quality remains strong with Classified Assets to Tier 1 Capital at 14.53%.



Deposit interest expense increased slightly, 1.7% year over year, reporting \$359,000 as of December 31, 2018 as compared to \$353,000 at yearend 2017. Other interest expense ended the year up 54%, reflective of the first full year since Mission Valley fully redeemed its \$10.3 million Community Development Capital Investment (CDCI) (formerly TARP/CPP) to the Treasury in advance of its contractually scheduled rate increase to 9% from the initial rate of 2% and subsequently issued \$10.3 million of private debt (notes payable) with a 60-month term and average interest rate of 5.19%. As a result, other interest expense increased by \$400,000 to \$802,000 for the year. The net result being a 54% increase in total interest expense to \$1,161,000 for the year ended December 31, 2018 as compared to \$755,000 for the year ended 2017.

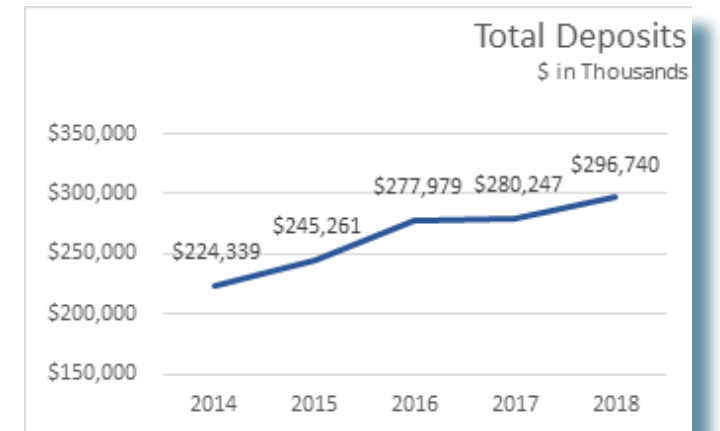
During 2018 Mission Valley also made great strides toward our long term strategy of strengthening our infrastructure as well as the depth of our management team. In October of 2018 we opened our new South Bay Loan Production Office. Strategically located in the heart of Torrance and staffed with a skilled team of Business Bankers, this new location affords Mission Valley the opportunity to broaden our footprint and thus our impact throughout the communities we serve. Additionally, we were fortunate to attract and secure several sought after banking professionals – Jeffrey Watson,

Chief Operating Officer; Daniel Epstein, Executive Vice President and Chief Credit Officer; Jennifer Burrue, Senior Vice President and Enterprise Risk Manager and Petra Hatzesberger, Vice President of Human Resources. Each of these talented bankers bring with them a wealth of knowledge and their individual expertise will play crucial roles as the Bank continues to grow and navigate the financial industry's increasingly competitive environment.



As we enter into 2019 – both our balance sheet and capital position are strong. For the period ended December 31, 2018, both Mission Valley Bancorp and Mission Valley Bank's capital ratios continue to exceed regulatory requirements with Mission Valley Bancorp reporting a Total Leverage ratio of 12.1%, Common Equity Tier 1 Capital ratio of 11.8%, Tier 1 Capital ratio of 13.9% and a Total Capital ratio of 15.2%. Mission Valley Bank reported a Total Leverage ratio of 14.4%, Common Equity Tier 1 Capital ratio of 16.7%, Tier 1 Capital ratio of 16.7% and a Total Capital ratio of 17.9%. Regulatory requirements for a "Well Capitalized" bank are 5%, 6.5%, 8% and 10%, respectively.

Throughout the year Mission Valley earned a number of accolades. Early in the year the OTC Markets Group announced that Mission Valley Bancorp was ranked #5 out of the "Best 50 2018 OTCQX" (an annual ranking wherein the OTCQX ranks the top 50 U.S. and international companies on the OTCQX marketplace based on one-year share price performance). In addition, Mission Valley's performance continued to be recognized by the financial industry's most respected rating firms. Bauer Financial, Veribanc and BankRate.com, all of whom continue to rank Mission Valley's soundness and financial strength with their highest ratings. Our Executive Management Team was named the 2018 Team of the Year at the SFVBJ Women's Council Awards and in August, Paula Bahamon, Vice President and Business Banker, was honored as one of the Valley's Most Trusted Advisors – Business Banking. This honor marks the eighth consecutive year that a Mission Valley Banker has received this award.



As we enter into 2019 we are starting strong. We have a sound, diversified balance sheet, a solid capital base to carry us forward and a tremendous team dedicated to our success and to the success of our clients and shareholders. Mission Valley Bancorp is well positioned to maintain our course of steady and controlled growth throughout 2019 and beyond. On behalf of everyone at Mission Valley, please accept our sincere appreciation for your continued confidence and support.

Sincerely,

Earle S. Wasserman
Chairman of the Board
Mission Valley Bancorp
Mission Valley Bank

Tamara Gurney
President & CEO
Mission Valley Bancorp
Mission Valley Bank



2018 Awards, Recognitions & Industry Accolades

OTCQX ranked Mission Valley Bancorp as #5 among the “Best 50 – OTCQX – 2018”
www.otcmarkets.com

The Findley Reports named Mission Valley Bank among the **2018 Premier Performing Banks**
www.Findley-Reports.com

BankRate.Com rated Mission Valley Bank as a **5 Star Financial Institution**
 Exhibiting Superior Condition and Earning a **Full 5 Star Rating for Safety & Soundness**
www.BankRate.com

Bauer Financial, Inc. named Mission Valley Bank **5-Star Superior** and ranking the Bank among the
Strongest Financial Institutions in the Nation
www.BauerFinancial.com

Veribanc ranked Mission Valley Bank as a **Green Three Star “Blue Ribbon Bank”**
 with the **Commendation of Excellence**
www.Veribanc.com

Mission Valley Bank’s Paula Bahamon (Vice President / Business Banking)
 named one of the **Valley’s Most Trusted Advisors – Business Banking Award** by the
San Fernando Valley Business Journal marking Mission Valley Bank’s
 8th Consecutive Year receiving this honor
www.SFVBJ.com

Mission Valley Bank’s Executive Team named as **2018 Team of the Year**
 at the **San Fernando Valley Business Journal’s Women’s Council Awards**
www.SFVBJ.com

During 2018, the **Los Angeles Business Journal**
 recognized Mission Valley Bank among the following:

- Top Ranked Banks**
- Largest Ranked Banks**
- Top Public Companies**
- www.LABJ.com



2018 FINANCIAL STATEMENTS

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Report of Independent Auditors

The Board of Directors and Shareholders
Mission Valley Bancorp

Report on Financial Statements

We have audited the accompanying consolidated financial statements of Mission Valley Bancorp and its subsidiary, which comprise the consolidated statements of financial condition as of December 31, 2018 and 2017, and the related consolidated statements of income, comprehensive income, changes in shareholders' equity, and cash flows for the years then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

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

Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Mission Valley Bancorp and its subsidiary as of December 31, 2018 and 2017, and the results of their operations and cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Moss Adams LLP

Los Angeles, California
March 28, 2019

Mission Valley Bancorp Consolidated Statements of Financial Condition (In Thousands, Except Share Data)

	December 31,	
	2018	2017
ASSETS		
Cash and due from banks	\$ 20,575	\$ 18,850
Federal funds sold	53,760	35,790
Total cash and cash equivalents	74,335	54,640
Interest bearing deposits in other banks	4,294	2,725
Investment securities:		
Available-for-sale, at fair value	12,080	14,805
Held-to-maturity, at amortized cost	17	79
Loans held for sale	4,697	32,584
Loans, net	239,206	209,791
Premises and equipment, net	286	269
Deferred tax asset, net	876	389
Bank owned life insurance	10,024	9,754
Restricted equity securities	1,889	1,874
Accrued interest receivable	836	900
Other assets	2,685	2,589
Total assets	\$ 351,225	\$ 330,399
LIABILITIES AND SHAREHOLDERS' EQUITY		
Liabilities		
Deposits:		
Non-interest bearing demand	\$ 188,552	\$ 170,922
Interest-bearing demand	64,201	70,239
Savings	18,495	20,421
Time deposits under \$250,000	8,812	7,804
Time deposits \$250,000 and over	16,680	10,861
Total deposits	296,740	280,247
Junior subordinated deferrable interest debentures	6,186	6,186
Notes payable	10,336	10,336
Accrued interest payable and other liabilities	4,695	3,214
Total liabilities	317,957	299,983
Commitments and contingencies - Note 13		
Shareholders' Equity		
Preferred stock - 10,000,000 shares authorized; zero shares issued and outstanding	-	-
Common stock - 10,000,000 shares authorized; no par value; 3,208,365 shares issued and outstanding	12,747	12,747
Additional paid in capital	1,400	1,199
Retained earnings	19,754	16,598
Accumulated other comprehensive loss	(633)	(128)
Total shareholders' equity	33,268	30,416
Total liabilities and shareholders' equity	\$ 351,225	\$ 330,399

See accompanying notes.

Mission Valley Bancorp
Consolidated Statements of Income
(In Thousands, Except Per Share Data)

	Years Ended December 31,	
	2018	2017
INTEREST INCOME		
Interest and fees on loans	\$ 13,994	\$ 13,298
Interest on investment securities	262	296
Other interest income	1,162	576
Total interest income	15,418	14,170
INTEREST EXPENSE		
Interest on deposits	359	353
Interest on borrowings	802	402
Total interest expense	1,161	755
NET INTEREST INCOME	14,257	13,415
PROVISION FOR LOAN LOSSES	609	237
NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES	13,648	13,178
NON-INTEREST INCOME		
Service charges and other income	1,740	1,789
(Loss) Gain on sale of loans	(386)	871
Net merchant income	548	741
Increase in cash surrender value of bank owned life insurance	271	245
Other income	511	442
Total non-interest income	2,684	4,088
NON-INTEREST EXPENSES		
Salaries, wages and employee benefits	7,539	6,435
Legal, professional, and consulting	950	1,003
Furniture and equipment	876	812
Data processing	623	615
Occupancy and equipment expenses	531	559
Advertising	208	198
Insurance	159	159
Other operating expenses	1,395	1,497
Total non-interest expenses	12,281	11,278
NET INCOME BEFORE PROVISION FOR INCOME TAXES	4,051	5,988
Provision for income taxes	895	2,437
NET INCOME	3,156	3,551
Preferred stock dividends	-	(159)
NET INCOME AVAILABLE TO COMMON SHAREHOLDERS	\$ 3,156	\$ 3,392
Earnings per share available to common shareholders - basic and diluted	\$ 0.98	\$ 1.07

See accompanying notes.

Mission Valley Bancorp
Consolidated Statements of Comprehensive Income
(In Thousands)

	Years Ended December 31,	
	2018	2017
NET INCOME	\$ 3,156	\$ 3,551
Other comprehensive loss:		
Net change in unrealized losses on cash flow hedge	(395)	-
Change in unrealized losses on available for sale securities, net of taxes of \$10 and \$1 in 2018 and 2017, respectively	(110)	(2)
Other comprehensive loss	(505)	(2)
TOTAL COMPREHENSIVE INCOME	\$ 2,651	\$ 3,549

See accompanying notes.

Mission Valley Bancorp
Consolidated Statements of Changes in Shareholders' Equity
(In Thousands, Except Share Data)

	Preferred Stock		Common Stock		Additional Paid in Capital	Retained Earnings	Accumulated Other Comprehensive Loss	Total Shareholders' Equity
	Number of Shares	Amount	Number of Shares	Amount				
BALANCE, December 31, 2016	10,336	\$ 10,336	3,154,865	\$ 12,747	\$ 1,115	\$ 13,527	\$ (126)	\$ 37,599
Dividends on preferred stock	-	-	-	-	-	(159)	-	(159)
Retirement of preferred stock	(10,336)	(10,336)	-	-	-	-	-	(10,336)
Share-based compensation expense	-	-	-	-	84	-	-	84
Issuance of stock awards	-	-	53,500	-	-	-	-	-
Dividends on common stock	-	-	-	-	-	(321)	-	(321)
Total comprehensive income	-	-	-	-	-	3,551	(2)	3,549
BALANCE, December 31, 2017	-	-	3,208,365	12,747	1,199	16,598	(128)	30,416
Share-based compensation expense	-	-	-	-	64	-	-	64
Issuance of stock awards	-	-	-	-	137	-	-	137
Total comprehensive income	-	-	-	-	-	3,156	(505)	2,651
BALANCE, December 31, 2018	-	\$ -	3,208,365	\$ 12,747	\$ 1,400	\$ 19,754	\$ (633)	\$ 33,268

See accompanying notes.

Mission Valley Bancorp
Consolidated Statements of Cash Flows
(In Thousands)

	Years Ended December 31,	
	2018	2017
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income	\$ 3,156	\$ 3,551
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization of premises and equipment	112	149
Provision for loan losses	609	237
Amortization of deferred loan fees, costs, and premium, net	1,715	1,025
Origination of loans held for sale	(1,300)	(18,672)
Proceeds from sale of loans held for sale	21,430	18,499
Loss (Gain) on sale of loans held for sale	386	(871)
Accretion and amortization on investments	61	53
Shared-based compensation expense	201	84
Deferred taxes	487	285
Increase in cash surrender value of bank owned life insurance	(271)	(3,197)
Net change in:		
Accrued interest receivable and other assets	(994)	(857)
Accrued interest payable and other liabilities	1,085	(420)
Net cash provided by (used in) operating activities	26,677	(134)
CASH FLOWS FROM INVESTING ACTIVITIES		
Changes in interest bearing deposits in other banks, net	(1,569)	3,760
Purchases of available-for-sale investments	-	(3,401)
Proceeds from repayments, sales, and maturities of available-for-sale investments	2,544	3,698
Proceeds from prepayments and maturities of held-to-maturity investments	62	166
Net purchases of restricted equity securities	(15)	(214)
Net increase in loans	(24,368)	(3,200)
Purchases of premises and equipment	(129)	(134)
Net cash (used in) provided by investing activities	(23,475)	675
CASH FLOWS FROM FINANCING ACTIVITIES		
Net increase (decrease) in time deposits	6,827	(15,119)
Increase in notes payable	-	10,336
Retirement of preferred stock	-	(10,336)
Net increase in other deposits	9,666	17,387
Dividends paid on preferred stock	-	(159)
Dividends on common stock	-	(321)
Net cash provided by financing activities	16,493	1,788
Change in Cash and Cash Equivalents	19,695	2,329
Cash and cash equivalents, beginning of year	54,640	52,311
Cash and cash equivalents, end of year	\$ 74,335	\$ 54,640
Supplemental Disclosures of Cash Flow Information		
Interest paid	\$ 1,170	\$ 716
Taxes paid	1,109	3,331
Supplemental Disclosures of Noncash Investing and Financing Activities		
Change in unrealized gain and losses on investments available-for-sale	120	3
Transfers of loans receivable held for sale to loans receivable held for investment	6,601	\$ 6,162

See accompanying notes.

Note 1 – Summary of Significant Accounting Policies

Nature of operations – Mission Valley Bank (the “Bank”) was formed during 2001 and on May 24, 2005, the shareholders of the Bank approved the exchange of common stock in Mission Valley Bank for common stock of a newly formed holding company, Mission Valley Bancorp (the “Company”). The transaction was consummated on August 20, 2005. The Bank is the Company’s only subsidiary and it is wholly owned by the Company. The Company provides a full range of banking services to individual and corporate customers through the Bank. The Bank has two branches located in Sun Valley and Santa Clarita, California. The Company has been authorized by the Federal Reserve Bank of San Francisco to engage in lending activities separate from the Bank, but to date has not done so.

Mission Valley Bank is a state chartered depository institution subject to regulation and examination by the California Department of Business Oversight (DBO) and Federal Deposit Insurance Corporation (FDIC).

Basis of presentation and consolidation – The accompanying consolidated financial statements are prepared in accordance with accounting principles generally accepted in the United States of America (GAAP) and general practices within the banking industry. The consolidated financial statements include the accounts of the Company and its wholly-owned subsidiary, Mission Valley Bank. All significant intercompany balances and transactions have been eliminated in consolidation.

In 2005, the Company issued \$6,186,000 of junior subordinated deferrable interest debentures through Mission Valley Statutory Trust I. The Company follows GAAP that determines when variable interest entities should be consolidated and determined that the Mission Valley Statutory Trust I should not be consolidated. As a result, the consolidated statements of financial condition include \$6,186,000 as junior subordinated deferrable interest debentures. Also included in other assets in the consolidated statements of financial condition is \$186,000 of investments in Mission Valley Statutory Trust I, which is reported using the cost method.

Use of estimates – The preparation of consolidated financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the consolidated statements of financial condition and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Material estimates that are particularly susceptible to significant change in the near term relate to the determination of the allowance for loan losses, valuation of investment securities, valuation of deferred tax assets and share-based compensation.

Concentrations of credit risk – Assets and liabilities that subject the Company to concentrations of credit risk consist of interest-bearing deposits at other banks, investments available-for-sale, loans and deposits. Most of the Company’s customers are located within Los Angeles County and surrounding areas. For the years ended December 31, 2018 and 2017, the Company did not have any significant concentrations in its business with any one customer.

Note 1 – Summary of Significant Accounting Policies (continued)

As of December 31, 2018 and 2017, the Company has cash deposits at other financial institutions in excess of the FDIC insured limits. The Company places these deposits with major financial institutions and monitors the financial condition of these institutions. Management believes the risk of loss associated with such deposits to be minimal.

The Company's loan portfolio consists primarily of loans to borrowers within Southern California. Although the Company has a diversified loan portfolio, a substantial part of the debtors' ability to honor their contracts is dependent upon the economic conditions in this region. Real estate secured loans represented approximately 62% and 56% of total gross loans held for investment at December 31, 2018 and 2017. Management has taken this factor into account in the determination of the allowance for loan losses.

Cash and cash equivalents – For purposes of reporting cash and cash equivalents in the consolidated statements of financial condition and the consolidated statements of cash flows, cash and cash equivalents include cash, due from banks and federal funds sold, all of which have original maturities of ninety days or less.

Banking regulations require that banks maintain a percentage of their deposits as reserves in cash or on deposit with the Federal Reserve Bank. The Company was in compliance with its reserve requirements as of December 31, 2018 and 2017.

Interest-bearing deposits in other banks – Interest-bearing deposits in other banks are purchased with an original maturity date greater than ninety days and are carried at amortized cost. Interest-bearing deposits in other banks include certificates of deposits in major financial institutions located throughout the United States of America.

Investment securities – In accordance with generally accepted accounting principles, the Company is required to designate its readily marketable investments securities as “held-to-maturity”, “available-for-sale”, or “trading”. The Company did not designate any of its investments as trading securities. Debt securities are classified as held to maturity if the Company has both the intent and ability to hold those securities to maturity regardless of changes in market conditions, liquidity needs or changes in general economic conditions. These securities are carried at cost adjusted for amortization of premium and accretion of discount, computed by the effective interest method over their contractual lives. Debt securities classified as available-for-sale are reported at fair value, with unrealized gains and losses excluded from earnings and reported as a separate component of shareholders' equity as an item of other comprehensive income. Investment transactions are recorded on the trade settlement date. Gains and losses realized on disposition of investment securities are recognized at the time of sale based upon the specific identification method. Premiums and discounts are recognized in interest income using the interest method over the period to maturity.

Note 1 – Summary of Significant Accounting Policies (continued)

Interest income from the investment securities portfolio is accrued as earned including the accretion of discounts and the amortization of premiums based on the original cost of each security owned. Discounts and premiums are accreted and amortized on a method that approximates the effective interest method to the maturity date of the security with the exception of the mortgage backed securities. Discounts and premiums on mortgage-backed securities are accreted and amortized to the expected maturity date of the investment security. Realized gains or losses on the sale of investment and mortgage-backed securities are reported in the consolidated statement of operations as of the trade date and determined using the amortized cost of the specific security sold. Declines in the fair value of individual securities below their cost that are deemed other than temporary result in write-downs of the individual securities to their fair value.

Management performs regular impairment analyses on the securities portfolio in accordance with Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) guidance related to the consideration of impairment related to certain debt and equity securities. If it is probable that the Company will be unable to collect all amounts due according to the contractual terms of the debt security not impaired at acquisition, an other-than-temporary impairment is considered to have occurred. When an other-than-temporary impairment (OTTI) occurs, the cost basis of the security is written down to its fair value (as the new cost basis) and the write-down is accounted for as a realized loss if it is credit related. In assessing whether impairment represents OTTI, the Company must consider whether it intends to sell a security or if it is likely that they would be required to sell the security before recovery of the amortized cost basis of the investment, which may be maturity. For debt securities, if the Company intends to sell the security or it is likely that a sale of the security may be required before recovering the cost basis, the entire impairment loss would be charged to results of operations as an OTTI. If the Company does not intend to sell the security and it is not likely the sale of the security is required by the Company, and the Company does not expect to recover the entire amortized cost basis of the security, only the portion of the impairment loss representing credit losses would be charged to results of operations. The credit loss on a security is measured as the difference between the amortized cost basis and the present value of the cash flows to be expected to be collected. Projected cash flows are discounted by the original or current effective interest rate depending on the nature of the security being measured for potential OTTI. The remaining impairment related to other factors, the difference between the present value of the cash flows to be expected to be collected and fair value, is recognized as a charge to other comprehensive income (OCI).

Note 1 – Summary of Significant Accounting Policies (continued)

Loans – Loans receivable that management has the intent and ability to hold for the foreseeable future or until maturity or payoff are reported at their outstanding unpaid principal balances reduced by any charge-offs or specific valuation amounts and net of any deferred fees or costs on originated loans, or unamortized premiums or discounts on purchased loans. Interest income on loans is calculated by the simple-interest method on daily balances of the principal amount outstanding. Loan origination fees and origination costs are capitalized and recognized as an adjustment to yield over the life of the related loan using the effective interest method. The accrual of interest on loans is discontinued at the time the loan becomes ninety-days delinquent unless the credit is well secured and in process of collection. In some cases, loans can be placed on nonaccrual status or charged-off at an earlier date if collection of principal or interest is considered doubtful. Subsequent collections of interest are applied to unpaid balances or included in interest income based upon management's assessment of the likelihood that principal will be collected.

When loans are placed on nonaccrual status, all interest previously accrued but not collected is reversed against current period interest income. Income on nonaccrual loans is subsequently recognized only to the extent that cash is received and the loan's principal balance is deemed collectible. Interest accruals are resumed on such loans only when they are brought current with respect to interest and principal and when, in the judgment of management, the loans are estimated to be fully collectible as to all principal and interest.

A loan is considered impaired when it is probable that the Company will not be able to collect all principal and interest amounts due according to the loan's contractual terms based upon available information and events. Factors considered by management in determining impairment include payment status, collateral value, and the probability of collecting scheduled principal and interest payments when due. The amount of the valuation allowance for impaired loans is determined by comparing the recorded investment in each loan with its value measured by one of three methods: (i) the estimated present value of total expected future cash flows, discounted at the loan's effective interest rate; (ii) the loan's observable market price, if available from a secondary market; or (iii) by the fair value of the underlying collateral if the loan is collateral dependent.

If the measure of impairment for an impaired loan is less than the related recorded investment, the shortfall is charged off or a specific valuation allowance (impairment allowance) is established as a component of the allowance for loan losses through a charge to the provision for loan losses. Subsequent permitted adjustments to the impairment allowance are made through a corresponding charge or credit to the provision for loan losses.

Note 1 – Summary of Significant Accounting Policies (continued)

Loans are reported as restructured when the Company grants concession(s) to a borrower experiencing financial difficulties that it would not otherwise consider. Examples of such concession include forgiveness of principal or accrued interest, extending the maturity date(s), or providing a lower interest rate than would be normally available for a transaction of similar risk. As a result of these concessions, restructured loans are impaired as the Company will not collect all amounts due, both principal and interest, in accordance with the terms of the original loan agreement. Impairment allowances on non-collateral dependent restructured loans are measured by comparing the present value of expected future cash flows on the restructured loans discounted at the interest rate of the original loan agreement to the loan's carrying value. These impairment allowances are recognized as a specific component to be provided for in the allowance for loan losses.

Allowance for loan losses – The provision for loan losses charged to results of operations is an amount sufficient to bring the allowance for loan losses to an estimated balance considered adequate to absorb probable losses inherent in the portfolio at the date of the consolidated financial statements. Loan losses are charged against the allowance when management believes the uncollectability of a loan balance is confirmed. Subsequent recoveries, if any, are credited to the allowance.

The allowance for loan losses is evaluated on a regular basis by management and is based upon management's periodic review of the collectability of the loans that considers historical experience, the nature and volume of the loan portfolio, adverse situations that may affect the borrower's ability to repay, estimated value of any underlying collateral, and prevailing economic conditions. The evaluation is inherently subjective as it requires estimates that are susceptible to significant revision as more information becomes available. The allowance consists of specific, general, and unallocated components. The specific component relates to loans that are classified as impaired. The general component covers non-impaired loans and is based on historical loss experience adjusted for qualitative factors. An unallocated component is maintained to cover uncertainties that could affect management's estimate of probable losses. The unallocated component of the allowance reflects the margin of imprecision inherent in the underlying assumptions used in the methodologies for estimating specific and general losses in the portfolio.

In addition, bank regulatory authorities, as part of their periodic examination of the Company, may require additional charges to the provision for loan and lease losses in future periods if warranted as a result of their review. A significant decline in real estate market values may require an increase in the allowance for loan and lease losses. The prolonged U.S. recession, the housing market downturn, and declining real estate values in our markets have negatively impacted aspects of the Company's residential development, commercial real estate, commercial construction and commercial loan portfolios. A continued deterioration in the Company's markets may adversely affect its loan portfolio and may lead to additional charges to the provision for loan losses.

Note 1 – Summary of Significant Accounting Policies (continued)

Loans held for sale and non-guaranteed portion of SBA loans – The portions of U.S. Small Business Administration (SBA) loans that are guaranteed by the SBA are classified by management as loans held for sale since the Company intends to sell these loans. Loans held for sale are recorded at the lower of aggregate cost or estimated fair value. The fair value of SBA loans held for sale is based primarily on prices that secondary markets are currently offering for loans with similar characteristics. Net unrealized losses, if any, are recognized through a valuation allowance through a charge to income. The carrying value of SBA loans held for sale is net of premiums as well as deferred origination fees and costs. Premiums and net origination fees and costs are deferred and included in the basis of the loans in calculating gains and losses upon sale. SBA loans are generally secured by the borrowing entities' assets such as accounts receivable, property and equipment, and other business assets. The Company generally recognizes gains or losses on these loan sales based on the difference between the sales proceeds received and the allocated carrying value of the loans sold (which can include deferred premiums and net origination fees and costs). The non-guaranteed portion of SBA loans is not typically sold by the Company and is classified as held for investment.

Servicing assets – In connection with the Company's SBA lending activities, the Company recognizes servicing assets when servicing rights are retained. The Company initially recognizes and measures at fair value servicing rights obtained from SBA loan sales. The Company subsequently measures these servicing assets by using the amortization method, which amortizes servicing assets in proportion to, and over the period of, estimated net servicing income. The amortization of the servicing assets is analyzed periodically and is adjusted to reflect changes in prepayment rates and other estimates. The servicing asset is included in other assets on the consolidated statements of financial condition and the related amortization is net against other non-operating income in the consolidated statements of income.

Premises and equipment – Premises and equipment are reported at cost less accumulated depreciation and amortization. Depreciation is computed using the straight-line method over the estimated useful lives, which typically range from three to seven years for furniture and equipment. Leasehold improvements are amortized over the shorter of the remaining lease term and the subsequent option period that is likely to be exercised or the estimated useful lives of the leasehold improvements.

Expenditures for betterments or major repairs are capitalized and those for ordinary repairs and maintenance are charged to results of operations as incurred. Gains and losses on dispositions are included in current results of operations.

The Company reviews long-lived assets for impairment whenever events or changes in circumstances indicate that the carrying amounts of such assets may not be recoverable. If the sum of the expected future cash flows is less than the stated amount of the asset, an impairment loss is recognized for the difference between the fair value of the asset and its carrying amount.

Note 1 – Summary of Significant Accounting Policies (continued)

Other real estate owned – Assets acquired in settlement of loans are recorded at fair value less estimated disposal costs. Any excess of the carrying amount of the loan over the fair value of the asset is charged against the allowance for loan losses at the time of transfer. Subsequent to the transfer, any losses on disposition or write-downs as a result of declines in market value of specific assets are charged against current results of operations. Real estate acquired through foreclosure sale, deed-in-lieu of foreclosure, and bank property for which banking use is no longer contemplated are classified as other real estate owned on the consolidated statements of financial condition. Operating income and expenses incurred on these properties are reflected in current earnings within non-interest expense. There were no other real estate owned properties that were acquired during the years ended 2018 and 2017.

Derivative financial instruments and hedging activities – The Company enters into derivative transactions principally to protect against the risk of adverse price or interest rate movements on the future cash flows of certain assets. ASC Topic 815, Derivatives and Hedging (“ASC 815”), establishes accounting and reporting standards requiring that every derivative instrument be recorded in the Consolidated Statements of Financial Condition as either an asset or liability measured at its fair value. The accounting for changes in the fair value of a derivative instrument depends on whether it has been designated and qualifies as part of a hedging relationship and on the type of hedging relationship. On the date the derivative contract is entered into, the Company designates the derivative as a fair value hedge, a cash flow hedge, or a non-designated derivative. The Company’s derivative contract is designated as a cash flow hedge.

Cash flow hedges are accounted for by recording the changes in the fair value of the effective portion of the derivative instrument in other comprehensive income (loss) and are recognized in the Consolidated Statements of Operations when the hedged item affects earnings.

The Company formally documents the relationship between a derivative instrument and a hedged asset or liability, as well as its risk management objective and strategy for undertaking various hedge transactions.

The Company also formally assesses, both at the hedge’s inception and on an ongoing basis, whether the derivatives that are used in the hedging transactions are highly effective in offsetting changes in fair values or cash flows of hedged items.

Note 1 – Summary of Significant Accounting Policies (continued)

Income taxes – The Company uses the asset and liability method to account for income taxes. The objective of the asset and liability method is to establish deferred tax assets and liabilities for the temporary differences between the financial reporting basis and the income tax basis of the Company’s assets and liabilities at enacted tax rates expected to be in effect when such amounts are realized or settled. Changes in enacted tax rates result in a revaluation of deferred tax assets and liabilities through the income tax provision in the period that the tax rate changes are enacted.

The Company’s annual tax rate is based on its income, statutory tax rates, and tax planning opportunities available in which it operates. Tax laws are complex and subject to different interpretations by the taxpayer and respective governmental taxing authorities. Significant judgment is required in determining tax expense and in evaluating tax positions, including evaluating uncertainties. Accounting for income taxes prescribes a recognition threshold and a measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return.

Benefits from tax positions are recognized in the financial statements only when it is more likely than not that the tax position will be sustained upon examination by the appropriate taxing authority that would have full knowledge of all relevant information. A tax position that meets the more-likely-than-not recognition threshold is measured at the largest amount of benefit that is greater than fifty percent likely of being realized upon ultimate settlement. The Company reviews its tax positions periodically and adjusts the balances as new information becomes available. It is the Company’s policy to recognize interest and penalties associated with uncertain tax positions as components of other operating expenses in the income statement.

Deferred income tax assets represent amounts available to reduce income taxes payable on taxable income in future years. Such assets arise because of temporary differences between the financial reporting and tax bases of assets and liabilities, as well as from net operating loss and tax credit carry forwards. The Company evaluates the recoverability of these future tax deductions by assessing the adequacy of future expected taxable income from all sources, including reversal of taxable temporary differences, forecasted operating earnings, and available tax planning strategies. These sources of income inherently rely heavily on estimates. The Company uses historical experience and short and long-range business forecasts to provide insight. Deferred tax assets could be reduced in the near term if estimates of taxable income are significantly reduced or available tax planning strategies are no longer viable.

Bank owned life insurance – The Company invests in Bank Owned Life Insurance (BOLI). BOLI involves the purchasing of life insurance by the Company on a chosen group of employees. The Company is the owner and beneficiary of these policies. BOLI is recorded as an asset at cash surrender value. Increases in the cash value of these policies, as well as insurance proceeds received, are recorded in other non-interest income and are not subject to income tax.

Note 1 – Summary of Significant Accounting Policies (continued)

Restricted equity securities – At December 31, 2018 and 2017, the Company held \$1,358,000 and \$1,343,000, respectively, of shares of Federal Home Loan Bank (FHLB). The Company evaluates its investment in FHLB stock for impairment on a periodic basis. The FHLB has been in compliance with all of its regulatory capital requirements at the end of 2018 and 2017. The Company has not recorded an impairment on its investment of FHLB stock during 2018 and 2017.

The Company also invests in the stock of Pacific Coast Bankers Bank (PCBB) in connection with its correspondent banking arrangement with PCBB. At December 31, 2018 and 2017, the Company held approximately \$531,000, par value, of PCBB stock. PCBB stock is restricted as to purchase, sale, and redemption.

The investments in FHLB stock, and PCBB stock are carried as cost method investments as of December 31, 2018 and 2017.

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

Share-based compensation – The Company accounts for stock option awards whereby the compensation cost relating to share-based payment transactions be recognized in the statements of operations based upon the grant-date fair value of the stock options granted by the Company. The effect of stock-based accounting rules is to require entities to measure the cost of employee services received in exchange for stock options and to recognize the cost over the period the employee is required to provide services for the award. The fair value of stock options is measured using a Black-Sholes pricing model.

The Company's 2017 Stock Option and Restricted Stock Grant Plan provides for granting of restricted stock units for the benefit of certain members of the board of directors, executives, and key employees of the Company and its affiliates. Restricted stock grants are subject to performance-based vesting as well as other approved vesting conditions. Compensation expense is recognized over the service period to the extent restricted stock units are expected to vest.

Advertising costs – Advertising costs of \$208,000 and \$198,000 for the years ended December 31, 2018 and 2017, respectively, were expensed as incurred.

Comprehensive income – Comprehensive income consists of net income and other comprehensive income (loss). Other comprehensive income (loss) consists of unrealized gains and losses on securities available-for-sale which is also recognized as a separate component of consolidated shareholders' equity.

Note 1 – Summary of Significant Accounting Policies (continued)

Common stock – The Company has authorized 10 million shares of common stock. Each share entitles the holder to one vote. There are no dividend or liquidation preferences, participation rights, call prices or dates, conversion prices or rates, sinking fund requirements, or unusual voting rights associated with these shares.

Preferred stock – The Company has authorized 10 million shares of preferred stock. Refer to Note 17 – U.S. Treasury Capital Purchase Program, Community Development Capital Initiative Program and Mandatory Convertible Cumulative Preferred Stock for details pertaining to preferred stock issued.

Earnings per share (EPS) – Earnings per share amounts have been computed using the weighted average number of shares outstanding of common stock for the purposes of computing basic EPS. There were no common stock equivalents outstanding that would have a dilutive impact on EPS at December 31, 2018 or 2017. Basic EPS is computed by dividing net income available to common shareholders by the weighted average number of common shares outstanding for the period. Basic EPS excludes the dilutive effect that could occur if any securities or other contracts to issue common stock were exercised or converted into or resulted in the issuance of common stock. Diluted EPS reflects the potential dilution that could occur if securities or other contracts to issue common stock, such as stock options, result in the issuance of common stock which shares in the earnings available to common shareholders of the Company. The Company's restricted stock awards outstanding are not eligible to be issued or to receive dividends until fully vested. No awards were fully vested at year end December 31, 2018, and therefore, there is no dilutive effect on EPS. The treasury stock method is applied to determine the dilutive effect of stock options in computing dilutive earnings per share. Basic EPS is calculated as follows:

	2018	2017
<i>(In thousands, except per share data)</i>		
BASIC EARNINGS PER SHARE		
Net income	\$ 3,156	\$ 3,551
Dividends paid on preferred stock	-	(159)
Net income available to common shareholders	<u>3,156</u>	<u>3,392</u>
Weighted average common shares outstanding	<u>3,208</u>	<u>3,179</u>
Earnings per share available to common shareholders - basic	<u>\$ 0.98</u>	<u>\$ 1.07</u>

Note 1 – Summary of Significant Accounting Policies (continued)

Fair value measurements – FASB ASC 820, *Fair Value Measurements and Disclosures*, defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. FASB ASC 820 establishes a three-level hierarchy for disclosure of assets and liabilities recorded at fair value. The classification of assets and liabilities within the hierarchy is based on whether the inputs to the valuation methodology used for measurement are observable or unobservable. Observable inputs reflect market-derived or market-based information obtained from independent sources, while unobservable inputs reflect our estimates about market data. In general, fair values determined by Level 1 inputs utilize quoted prices for identical assets or liabilities traded in active markets that the Company has the ability to access. Fair values determined by Level 2 inputs utilize 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 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. 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. The Company's assessment of the significance of a particular input to the fair value measurement in its entirety requires judgment and considers factors specific to the asset or liability.

Recently issued accounting pronouncements – In February 2016, the FASB issued ASU No. 2016-02, *Leases (Topic 842)*. The new guidance requires a lessee to recognize in the statement of financial position a liability to make lease payments and a right-of-use asset representing its right to use the underlying asset for the lease term. The guidance separates leases into finance and operating categories, both of which are required to be recognized as an asset and liability on the financial statements. The asset and liability are initially measured at the present value of the lease payments, in the statement of financial position for both finance and operating leases. For finance leases, lessees are to recognize interest on the lease liability separate from amortization of the right-of-use asset in the statement of comprehensive income, and classify repayments of the principal portion of the lease liability within financing activities and payments of interest on the lease liability and variable lease payments within operating activities in the statement of cash flows. For operating leases, lessees are to recognize a single lease cost, calculated so that the cost of the lease is allocated over the lease term on a generally straight-line basis, and all cash payments are to be classified within operating activities in the statement of cash flows. The amendments of this Update are effective for fiscal years beginning after December 15, 2018, for public business entities. The Company is currently evaluating the impact this ASU will have on the Company's financial statements. The Company leases three buildings and offices under non-cancelable operating leases, the majority of which will be subject to this ASU. While the Company has not quantified the impact to its balance sheet, it does expect the adoption of this ASU will result in a gross-up in its balance sheet as a result of recording a right-of-use asset and lease liability for these leases.

Note 1 – Summary of Significant Accounting Policies (continued)

In June 2016, FASB issued ASU No. 2016-13, *Measurement of Credit Losses on Financial Instruments*. Current GAAP requires an "incurred loss" methodology for recognizing credit losses that delays recognition until it is probable a loss has been incurred. The main objective of this ASU is to provide financial statement users with more decision-useful information about the expected credit losses on financial instruments and other commitments to extend credit held by a reporting entity at each reporting date. The amendments in this ASU replace the incurred loss impairment methodology in current GAAP with a methodology that reflects expected credit losses and requires consideration of a broader range of reasonable and supportable information to inform credit loss estimates. The amendments in this ASU require a financial asset (or group of financial assets) measured at amortized cost basis to be presented at the net amount expected to be collected. The allowance for credit losses is a valuation account that is deducted from the amortized cost basis of the financial asset(s) to present the net carrying value at the amount expected to be collected on the financial asset. The measurement of expected credit losses will be based on relevant information about past events, including historical experience, current conditions, and reasonable and supportable forecasts that affect the collectability of the reported amount. The amendments in this ASU broaden the information that an entity must consider in developing its expected credit loss estimate for assets measured either collectively or individually. The use of forecasted information incorporates more timely information in the estimate of expected credit loss, which will be more useful to users of the financial statements. The amendments in this ASU will be effective for fiscal years beginning after December 15, 2019, including interim periods within those fiscal years. The Company is still evaluating the effects this ASU will have on the Company's Consolidated Financial Statements. While the Company has not quantified the impact of this ASU, it does expect changing from the current incurred loss model to an expected loss model will result in an earlier recognition of losses.

Adoption of New Accounting Standards: On January 1, 2018, the Company adopted ASU 2014-09 *Revenue from Contracts with Customers* and all subsequent amendments to the ASU (collectively, "ASC 606"), which (i) creates a single framework for recognizing revenue from contracts with customers that fall within its scope and (ii) revises when it is appropriate to recognize a gain (loss) from the transfer of nonfinancial assets, such as other real estate owned (OREO). To determine revenue recognition for arrangements that an entity determines are within the scope of Topic 606, the Company performs the following five steps: (i) identify the contract(s) with a customer; (ii) identify the performance obligations in the contract; (iii) determine the transaction price; (iv) allocate the transaction price to the performance obligations in the contract; and (v) recognize revenue when (or as) the Company satisfies a performance obligation. The majority of the Company's revenues come from interest income and other sources, including loans, leases, securities, and derivatives, that are outside the scope of ASC 606. The Company's services that fall within the scope of ASC 606 are presented within Non-Interest Income and are recognized as revenue as the Company satisfies its obligation to the customer. Services within the scope of ASC 606 include Deposit service charges, debit and ATM interchange income, brokerage revenue, merchant fee income, credit card and interchange income, and gain (loss) on other real estate owned, net. Refer to Note 18 Revenue from Contracts with Customers for further discussion on the Company's accounting policies for revenue sources within the scope of ASC 606.

Note 1 – Summary of Significant Accounting Policies (continued)

The Company adopted ASC 606 using the modified retrospective method applied to all contracts not completed as of January 1, 2018. Results for reporting periods beginning after January 1, 2018, are presented under ASC 606 while prior period amounts continue to be reported in accordance with legacy GAAP. The adoption of ASC 606 did not result in a material change to the accounting for any of the in-scope revenue streams; as such, no cumulative effect adjustment was recorded.

In January 2016, the FASB issued ASU No. 2016-01, *Financial Instruments – Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities*. The new guidance is intended to improve the recognition and measurement of financial instruments. This ASU 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. In addition, the amendment requires public business entities to use the exit price notion when measuring the fair value of financial instruments for disclosure purposes and requires separate presentation of financial assets and financial liabilities by measurement category and form of financial asset (i.e., securities or loans and receivables) on the balance sheet or the accompanying notes to the financial statements. This ASU also eliminates the requirement for public business entities to disclose the method(s) and significant assumptions used to estimate the fair value that is required to be disclosed for financial instruments measured at amortized cost on the balance sheet. The amendment also requires a reporting organization to present separately in other comprehensive income the portion of the total change in the fair value of a liability resulting from a change in the instrument specific credit risk (also referred to as “own credit”) when the organization has elected to measure the liability at fair value in accordance with the fair value option for financial instruments. ASU No. 2016-01 is effective for financial statements issued for fiscal years beginning after December 15, 2017, and interim periods within those fiscal years. Early adoption is permitted for certain provisions. The adoption of this ASU did not have a material impact on the Company’s consolidated financial statements.

In March 2016, the FASB issued ASU 2016-09, *Compensation – Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting*. ASU 2016-09 includes provisions intended to simplify various aspects related to how share-based payments are accounted for and presented in the financial statements. The areas for simplification include income tax consequences, forfeitures, classification of awards as either equity or liabilities and classification on the statement of cash flows. ASU 2016-09 is effective for fiscal years in annual periods beginning after December 15, 2016, and interim periods within those fiscal year’s annual periods. The adoption of ASU 2016-09 did not have a material impact on the consolidated financial statements.

Reclassification – Certain amounts from the prior year footnotes have been reclassified, in order to conform to the current year presentation. There was no impact on net income or retained earnings.

Note 2 – Investment Securities

The carrying amounts of securities and their estimated fair values at December 31, 2018 and 2017 were as follows:

	December 31, 2018			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
<i>(In thousands)</i>				
<u>Available-for-Sale</u>				
Mortgage and asset-backed securities	\$ 11,231	\$ 1	\$ (304)	\$ 10,928
Municipal investments	388	-	(1)	387
Other	800	-	(35)	765
	<u>\$ 12,419</u>	<u>\$ 1</u>	<u>\$ (340)</u>	<u>\$ 12,080</u>

	December 31, 2018			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
<i>(In thousands)</i>				
<u>Held-to-Maturity</u>				
Mortgage and asset-backed securities	\$ 17	\$ -	\$ -	\$ 17
	<u>\$ 17</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 17</u>

	December 31, 2017			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
<i>(In thousands)</i>				
<u>Available-for-Sale</u>				
Mortgage and asset-backed securities	\$ 13,832	\$ 3	\$ (208)	\$ 13,627
Municipal investments	392	4	-	396
Other	800	-	(18)	782
	<u>\$ 15,024</u>	<u>\$ 7</u>	<u>\$ (226)</u>	<u>\$ 14,805</u>

	December 31, 2017			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
<i>(In thousands)</i>				
<u>Held-to-Maturity</u>				
Mortgage and asset-backed securities	\$ 79	\$ -	\$ -	\$ 79
	<u>\$ 79</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 79</u>

Mission Valley Bancorp
Notes to Consolidated Financial Statements

Note 2 – Investment Securities (continued)

Information pertaining to investment securities with gross unrealized losses at December 31, 2018 and 2017, aggregated by investment category and length of time that individual securities have been in continuous loss position is as follows:

	2018					
	Less Than 12 Months		12 months or longer		Total	
	Estimated Fair Value	Gross Unrealized Losses	Estimated Fair Value	Gross Unrealized Losses	Estimated Fair Value	Gross Unrealized Losses
<i>(In thousands)</i>						
<u>Available-for-Sale</u>						
Mortgage and asset-backed securities	\$ 617	\$ (4)	\$ 10,652	\$ (301)	\$ 11,269	\$ (305)
Other	-	-	765	(35)	765	(35)
	<u>\$ 617</u>	<u>\$ (4)</u>	<u>\$ 11,417</u>	<u>\$ (336)</u>	<u>\$ 12,034</u>	<u>\$ (340)</u>
	2017					
	Less Than 12 Months		12 months or longer		Total	
	Estimated Fair Value	Unrealized Losses	Estimated Fair Value	Gross Unrealized Losses	Estimated Fair Value	Gross Unrealized Losses
<i>(In thousands)</i>						
<u>Available-for-Sale</u>						
Mortgage and asset-backed securities	\$ 6,738	\$ (68)	\$ 6,532	\$ (140)	\$ 13,270	\$ (208)
Other	-	-	782	(18)	782	(18)
	<u>\$ 6,738</u>	<u>\$ (68)</u>	<u>\$ 7,314</u>	<u>\$ (158)</u>	<u>\$ 14,052</u>	<u>\$ (226)</u>

There were twenty-three and twenty-five available-for-sale and one and four held-to-maturity securities in an unrealized loss position for the years ended December 31, 2018 and 2017, respectively. There were twenty-one available for sale securities in an unrealized loss position for twelve months or more for the year ended December 31, 2018. There were eight available for sale securities in an unrealized loss position for twelve months or more for the year ended December 31, 2017.

Management evaluates securities for OTTI at least on a quarterly basis, and more frequently when economic or market concerns warrant such evaluation. Consideration is given to (1) the length of time and the extent to which the fair value has been less than cost, (2) the financial condition and near-term prospects of the issuer, and (3) the intent and ability of the Company to retain its investment in the issuer for a period of time sufficient to allow for any anticipated recovery in fair value, which may be maturity. In analyzing an issuer's financial condition, management considers whether the securities are issued by the federal government or its agencies, whether downgrades by bond rating agencies have occurred, and the results of reviews of the issuer's financial condition. The Company does not have any securities that were considered to be other than temporarily impaired in 2018 or 2017.

Mission Valley Bancorp
Notes to Consolidated Financial Statements

Note 2 – Investment Securities (continued)

The amortized cost and estimated fair values of investment securities at December 31, 2018 and 2017, by contractual maturity, are shown below. Expected and actual maturities may differ from contractual maturities because issuers or borrowers may have the right to call or prepay obligations with or without prepayment penalties.

	December 31, 2018		December 31, 2017	
	Amortized Cost	Estimated Fair Value	Amortized Cost	Estimated Fair Value
	<i>(In thousands)</i>			
<u>Available-for-Sale</u>				
Due in one year or less	\$ -	\$ -	\$ 23	\$ 23
Due from one to five years	938	934	415	412
Due in more than five years	11,481	11,146	14,586	14,370
	<u>\$ 12,419</u>	<u>\$ 12,080</u>	<u>\$ 15,024</u>	<u>\$ 14,805</u>
	Held-to-Maturity			
	December 31, 2018		December 31, 2017	
	Amortized Cost	Estimated Fair Value	Amortized Cost	Estimated Fair Value
<i>(In thousands)</i>				
<u>Held-to-Maturity</u>				
Due in one year or less	\$ -	\$ -	\$ 33	\$ 33
Due from one to five years	17	17	46	46
	<u>\$ 17</u>	<u>\$ 17</u>	<u>\$ 79</u>	<u>\$ 79</u>

There were no sales of available-for-sale securities for the year ended December 31, 2018 or 2017.

Note 3 – Loans and Allowance for Loan Losses

The composition of the Company's loan portfolio at December 31, 2018 and 2017, was as follows:

<i>(In thousands)</i>	2018	2017
Real estate loans	\$ 151,567	\$ 120,369
Commercial loans	38,067	38,859
Consumer loans	2,486	2,918
SBA loans	35,485	31,691
Accounts Receivable loans	15,809	19,110
Leasing	65	121
Advanced Restaurant Financing	-	823
Overdrafts	29	285
Gross loans	<u>243,508</u>	<u>214,176</u>
Less:		
Allowance for loan losses	3,791	3,532
Discount on retained loans	1,678	1,635
Deferred loan costs, net	<u>(1,167)</u>	<u>(782)</u>
Net loans	<u>\$ 239,206</u>	<u>\$ 209,791</u>

The adequacy of the allowance for loan losses is determined by the Company's management based upon evaluation and review of credit quality of the loan portfolio, consideration of historical loss experience, relevant internal and external factors that affect the collection of a loan, and other pertinent factors. The allowance for loan loss analysis is a formula methodology based upon assigning a risk rating to each loan upon loan origination and is periodically reassessed and validated during the term of the loan through the Company's credit review processes. The Company's risk rating methodology assigns risk ratings ranging from 1 to 9 where a higher rating represents a higher risk.

Additionally, the Company's management utilizes qualitative adjustments to the allowance for loan loss analysis in order to systematically quantify the credit risk impact of other trends and changes within the loan portfolio. The qualitative factors consider the following nine factors, which are patterned after the guidelines provided under the Federal Financial Institutions Examination Council Interagency Policy Statement on the Allowance for Loan and Lease Losses issued in 2006:

- Changes in lending policies and procedures, including changes in underwriting standards and collection, charge-off, and recovery practices not considered elsewhere in estimating credit losses;
- Changes in international, national, regional, and local economic and business conditions and developments that affect the collectability of the portfolio, including the condition of various market segments;

Note 3 – Loans and Allowance for Loan Losses (continued)

- Changes in the nature and volume of the portfolio and in the terms of loans;
- Changes in the experience and ability of lending management and other relevant staff;
- Changes in the volume and severity of past due loans, the volume of nonaccrual loans, and the volume and severity of adversely classified or graded loans;
- Changes in the quality of the institution's loan review system;
- Changes in the value of underlying collateral for collateral-dependent loans;
- The existence and effect of any concentrations of credit, and changes in the level of such concentrations; and
- The effect of other external factors such as competition and legal and regulatory requirements on the level of estimated credit losses in the institutions' existing portfolio.

The Company also establishes specific loss allowances for loans where management has identified potential credit risk conditions or circumstances related to a specific individual credit. The specific allowance amounts are determined by a method prescribed by FASB ASC 310-10-35-22, *Measurement of Impairment*. The loans identified as impaired will be accounted for in accordance with one of the three acceptable valuations as follows: (1) the present value of future cash flows discounted at the loan's effective interest rate; (2) the loan's observable market price; or (3) the fair value of the collateral, if the loan is collateral dependent. For the collateral dependent impaired loans, the Company obtains an appraisal to determine the amount of impairment at the date that the loan becomes impaired. If third party market data indicates that the value of collateral property values has declined since the most recent valuation date, the value of the property is adjusted downward to reflect current market conditions. If the fair value of the collateral, less cost to sell, is less than the recorded amount of the loan, the Company either recognizes impairment by creating or adjusting an existing valuation allowance with a corresponding charge to the provision for loan losses or charge-off the impaired balance on collateral dependent loans if it is determined that such loss amount represents a confirmed loss.

Management believes that the allowance for loan losses was adequate as of December 31, 2018 and 2017. There is, however, no assurance that future loan losses will not exceed the levels provided for in the allowance for loan losses and could possibly result in additional charges to the provision for loan losses.

Mission Valley Bancorp
Notes to Consolidated Financial Statements

Note 3 – Loans and Allowance for Loan Losses (continued)

The following tables present by portfolio segment, the activity in the allowance for loan losses for the years ended December 31, 2018 and 2017. The following also presents by loan type, the balance and activity for the allowance for loan losses disaggregated on the basis of the Company's impairment measurement method and the related recorded investment in loans and leases as of and for the years December 31, 2018 and 2017. Recorded investment is defined as the unpaid principal balance, adjusted for deferred fees/costs, premiums, discounts, accrued interest, and may also reflect a previous write-down of the investment. However, for reporting purposes recorded investments for the Company approximates unpaid principal balance as the other components are not deemed material.

Allowance for Loan Losses						
As of and For the Year Ended December 31, 2018						
	Beginning Balance	Provision for Loan Losses charged to Expense	Charge-offs	Recoveries on Loans Previously Charged-off	Ending Balance	Ending Balance Individually Evaluated for Impairment
<i>(In thousands)</i>						
Real Estate loans	\$ 1,403	\$ 831	\$ -	\$ -	\$ 2,234	\$ 2
Commercial loans	358	172	(96)	94	528	47
Consumer loans	25	10	-	-	35	-
SBA loans	536	319	(338)	-	517	-
Accounts Receivable loans	1,123	(651)	-	-	472	-
Leasing	1	-	-	-	1	-
Advance Restaurant Financing loans	8	-	-	-	-	-
Overdrafts	43	(29)	(10)	-	4	-
Unallocated	35	(35)	-	-	-	-
Total	<u>\$ 3,532</u>	<u>\$ 609</u>	<u>\$ (444)</u>	<u>\$ 94</u>	<u>\$ 3,791</u>	<u>\$ 49</u>

Allowance for Loan Losses						
As of and For the Year Ended December 31, 2017						
	Beginning Balance	Recapture of Loan Losses charged to Expense	Charge-offs	Recoveries on Loans Previously Charged-off	Ending Balance	Ending Balance Individually Evaluated for Impairment
<i>(In thousands)</i>						
Real Estate loans	\$ 1,552	\$ (149)	\$ -	\$ -	\$ 1,403	\$ 6
Commercial loans	395	76	(127)	14	358	-
Consumer loans	25	-	-	-	25	-
SBA loans	446	240	(150)	-	536	-
Accounts Receivable loans	934	189	-	-	1,123	-
Leasing	20	(35)	-	16	1	-
Advance Restaurant Financing	48	(40)	-	-	8	-
Overdrafts	9	39	(5)	-	43	-
Unallocated	118	(83)	-	-	35	-
Total	<u>\$ 3,547</u>	<u>\$ 237</u>	<u>\$ (282)</u>	<u>\$ 30</u>	<u>\$ 3,532</u>	<u>\$ 6</u>

Mission Valley Bancorp
Notes to Consolidated Financial Statements

Note 3 – Loans and Allowance for Loan Losses (continued)

Recorded Investment in Loans			
As of December 31, 2018			
	Ending Balance Individually Evaluated for Impairment	Ending Balance Collectively Evaluated for Impairment	Ending Balance
<i>(In thousands)</i>			
Real Estate	\$ 434	\$ 151,133	\$ 151,567
Commercial	1,359	36,708	38,067
Consumer	-	2,486	2,486
SBA	821	34,664	35,485
Accounts Receivable	-	15,809	15,809
Leasing	-	65	65
Advance Restaurant Financing	-	-	-
Overdrafts	-	29	29
Total	<u>\$ 2,614</u>	<u>\$ 240,894</u>	<u>\$ 243,508</u>

Recorded Investment in Loans			
As of December 31, 2017			
	Ending Balance Individually Evaluated for Impairment	Ending Balance Collectively Evaluated for Impairment	Ending Balance
<i>(In thousands)</i>			
Real Estate	\$ 1,262	\$ 119,107	\$ 120,369
Commercial	97	38,762	38,859
Consumer	-	2,918	2,918
SBA	1,043	30,648	31,691
Accounts Receivable	302	18,808	19,110
Leasing	-	121	121
Advance Restaurant Financing	-	823	823
Overdrafts	-	285	285
Total	<u>\$ 2,704</u>	<u>\$ 211,472</u>	<u>\$ 214,176</u>

Note 3 – Loans and Allowance for Loan Losses (continued)

As previously noted, the Company uses several credit quality indicators to manage credit risk in an ongoing manner. The Company's primary credit quality indicators are to use an internal credit risk rating system that categorizes loans and leases into pass, special mention, or classified categories. Credit risk ratings are applied individually to all loans that have significant or unique credit characteristics that benefit from a case-by-case evaluation. The following are the definitions of the Company's credit quality indicators:

- **Pass/Watch:** Loans in all classes that comprise the commercial and consumer portfolio segments that are not adversely rated, are contractually current as to principal and interest, and are otherwise in compliance with the contractual terms of the loan or lease agreement. Management believes that there is a low likelihood of loss related to those loans that are considered pass.
- **Special Mention:** Loans classified as special mention have a potential weakness that deserves management's close attention. If left uncorrected, these potential weaknesses may result in deterioration of the repayment prospects for the loan or of the Company's credit position at some future date.
- **Substandard:** Loans classified as substandard are inadequately protected by the current net worth and paying capacity of the obligor or of the collateral pledged, if any. Loans so classified have a well-defined weakness or weaknesses that jeopardize the repayment of the debt. They are characterized by the distinct possibility that the Company will sustain some loss if the deficiencies are not corrected.
- **Doubtful/Loss:** Loans classified as doubtful have all the weaknesses inherent in those classified as substandard, with the added characteristic that the weaknesses make collection or repayment in full, on the basis of currently existing facts, conditions, and values, highly questionable and improbable. The possibility of loss is extremely high, but because of certain important and reasonably specific pending factors, which may work towards strengthening of the asset, classification as a loss (and immediate charge-off) is deferred until more exact status may be determined. In certain circumstances, a doubtful rating will be temporary, while the Company is awaiting an updated collateral valuation. In these cases, once the collateral is valued and appropriate margin applied, the remaining un-collateralized portion will be charged off. The remaining balance, properly margined, may then be upgraded to Substandard, however, must remain on nonaccrual. A loss rating is assigned to loans considered un-collectible and of such little value that the continuance as an active Company asset is not warranted. This rating does not mean that the loan has no recovery or salvage value, but rather that the loan should be charged off now, even though partial or full recovery may be possible in the future.

Note 3 – Loans and Allowance for Loan Losses (continued)

The following tables present by portfolio segment and by credit quality indicator, the recorded investment in the Company's loans as of December 31, 2018 and 2017:

Internal Risk Rating by Loan Class For the Year Ended December 31, 2018					
<i>(In thousands)</i>	Pass/Watch	Special Mention	Substandard	Doubtful/Loss	Total
Real estate loans	\$ 150,410	\$ 394	\$ 763	\$ -	\$ 151,567
Commercial loans	36,433	-	1,634	-	38,067
Consumer loans	2,486	-	-	-	2,486
SBA loans	31,587	2,423	903	572	35,485
Accounts Receivable loans	13,437	-	2,372	-	15,809
Leasing	65	-	-	-	65
Advanced Restaurant Financing	-	-	-	-	-
Overdrafts	29	-	-	-	29
Total	\$ 234,447	\$ 2,817	\$ 5,672	\$ 572	\$ 243,508

Internal Risk Rating by Loan Class For the Year Ended December 31, 2017					
<i>(In thousands)</i>	Pass/Watch	Special Mention	Substandard	Doubtful/Loss	Total
Real estate loans	\$ 119,107	\$ 409	\$ 853	\$ -	\$ 120,369
Commercial loans	35,735	3,028	96	-	38,859
Consumer loans	2,918	-	-	-	2,918
SBA loans	23,061	6,161	2,419	50	31,691
Accounts Receivable loans	14,231	4,573	306	-	19,110
Leasing	121	-	-	-	121
Advanced Restaurant Financing	823	-	-	-	823
Overdrafts	285	-	-	-	285
Total	\$ 196,281	\$ 14,171	\$ 3,674	\$ 50	\$ 214,176

Mission Valley Bancorp
Notes to Consolidated Financial Statements

Note 3 – Loans and Allowance for Loan Losses (continued)

The following tables present by portfolio segment, an aging analysis and the recorded investment in loans and leases past due as of December 31, 2018 and 2017:

Aging Analysis of Past Due Loans As of December 31, 2018						
	30-59 Days Past Due	60-89 Days Past Due	Greater Than 90 Days	Total Past Due	Current	Total Loans Receivable
<i>(In thousands)</i>						
Real Estate	\$ -	\$ -	\$ -	\$ -	\$ 151,567	\$ 151,567
Commercial	-	-	-	-	38,067	38,067
Consumer	-	-	-	-	2,486	2,486
SBA	50	-	-	50	35,435	35,485
Accounts Receivable	-	-	-	-	15,809	15,809
Leasing	-	-	-	-	65	65
Advanced Restaurant Financing	-	-	-	-	-	-
Overdrafts	-	-	-	-	29	29
Total	\$ 50	\$ -	\$ -	\$ 50	\$ 243,458	\$ 243,508

Aging Analysis of Past Due Loans As of December 31, 2017						
	30-59 Days Past Due	60-89 Days Past Due	Greater Than 90 Days	Total Past Due	Current	Total Loans Receivable
<i>(In thousands)</i>						
Real Estate	\$ -	\$ -	\$ -	\$ -	\$ 120,369	\$ 120,369
Commercial	-	-	-	-	38,859	38,859
Consumer	-	-	-	-	2,918	2,918
SBA	293	-	-	293	31,398	31,691
Accounts Receivable	-	-	-	-	19,110	19,110
Leasing	-	-	-	-	121	121
Advanced Restaurant Financing	-	-	-	-	823	823
Overdrafts	-	-	-	-	285	285
Total	\$ 293	\$ -	\$ -	\$ 293	\$ 213,883	\$ 214,176

There were no loans that were greater than ninety days past due and still accruing interest at December 31, 2018 and 2017. The recorded investment in loans and leases on nonaccrual status as of December 31, 2018, consisted of \$376,000 in real estate loans, and \$1,494,000 in SBA loans. The recorded investment in loans and leases on nonaccrual status as of December 31, 2017, consisted of \$412,000 in real estate loans, \$96,000 in commercial loans, and \$317,000 in SBA loans.

Mission Valley Bancorp
Notes to Consolidated Financial Statements

Note 3 – Loans and Allowance for Loan Losses (continued)

The following tables present information related to impaired loans as of and for the years ended December 31, 2018 and 2017. There were no impaired loans that were fully reserved with an allowance for loan loss for the years ended December 31, 2018 and December 31, 2017:

Impaired Loans For the Year Ended December 31, 2018					
<i>(In thousands)</i>	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized
With no related allowance recorded:					
Real estate	\$ 376	\$ 376	\$ -	\$ 567	\$ 22
Commercial	-	-	-	48	-
SBA	821	821	-	932	128
Consumer	-	-	-	-	-
Accounts Receivable	-	-	-	151	-
With an allowance recorded:					
Real estate	\$ 58	\$ 58	\$ 2	\$ 281	\$ 8
Commercial	1,359	1,359	47	679	35
SBA	-	-	-	-	-
Consumer	-	-	-	-	-
Accounts Receivable	-	-	-	-	-
Total:					
Real estate	\$ 434	\$ 434	\$ 2	\$ 848	\$ 30
Commercial	1,359	1,359	47	727	35
SBA	821	821	-	932	128
Consumer	-	-	-	-	-
Accounts Receivable	-	-	-	151	-

Note 3 – Loans and Allowance for Loan Losses (continued)

(In thousands)	Impaired Loans For the Year Ended December 31, 2017				
	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized
With no related allowance recorded:					
Real estate	\$ 757	\$ 757	\$ -	\$ 819	\$ 47
Commercial	97	97	-	350	27
SBA	1,043	1,043	-	1,064	128
Consumer	-	-	-	-	-
Accounts Receivable	302	302	-	-	-
With an allowance recorded:					
Real estate	\$ 505	\$ 505	\$ 6	\$ 864	\$ 48
Commercial	-	-	-	-	-
SBA	-	-	-	-	-
Consumer	-	-	-	-	-
Accounts Receivable	-	-	-	-	-
Total:					
Real estate	\$ 1,262	\$ 1,262	\$ 6	\$ 1,683	\$ 95
Commercial	97	97	-	350	27
SBA	1,043	1,043	-	1,064	128
Consumer	-	-	-	-	-
Accounts Receivable	302	302	-	-	-

Troubled Debt Restructurings

The Company offers a variety of modifications to borrowers. The modification categories offered can generally be described in the following categories:

Rate modification – A modification in which the interest rate is changed.

Term modification – A modification in which the maturity date, timing of payments, or frequency of payments is changed.

Interest only modification – A modification in which the loan is converted to interest only payments for a period of time.

Payment modification – A modification in which the dollar amount of the payment is changed, other than an interest only modification described above.

Combination modification – Any other type of modification, including the use of multiple categories above.

Note 3 – Loans and Allowance for Loan Losses (continued)

As of December 31, 2018, there was one restructured loan in the amount of \$376,000 with no allocated allowance included within the impaired loan balance as of December 31, 2018.

As of December 31, 2017, there was one restructured loan in the amount of \$96,000 with no allocated allowance included within the impaired loan balance as of December 31, 2017.

There were no newly restructured loans that met the definition of a troubled debt restructuring during the years ended December 31, 2018 and 2017, respectively.

Loans Held for Sale

Loans held for sale totaled \$4,697,000 and 32,584,000 at December 31, 2018 and 2017, respectively. Loans held for sale for the secondary market are carried at lower of aggregate cost or fair market value. Net unrealized losses, if any, are recorded as a valuation allowance and is charge against earnings through gain/loss on sale of loans. Loans designated as held for sale consist primarily of SBA loans.

The valuation allowance on loans held for sale was \$1,344,000 and \$324,000 at December 31, 2018 and 2017, respectively. The increase in valuation allowance at December 31, 2018 was primarily attributable to one commercial real estate 2nd trust deed loan in the amount of \$1,022,000. A valuation allowance was established as the loan migrated to nonaccrual status and was subsequently placed into liquidation. The full amount of the loan was written down as a result of an appraisal indicating a lack of sufficient collateral value.

SBA loans are generally sold with servicing rights retained. The carrying value of SBA loans sold is reduce by the proportional amount of deferred costs, if any, when applicable. Gains and losses on sale of SBA loans are based on the difference between the selling price and the carrying value of the related loans sold.

Note 4 – Premises and Equipment

Premises and equipment as of December 31, 2018 and 2017, are summarized as follows:

(In thousands)	2018	2017
Building improvements	\$ 1,508	\$ 1,478
Furniture, fixtures, and equipment	2,498	2,502
	4,006	3,980
Less accumulated depreciation and amortization	(3,720)	(3,711)
	\$ 286	\$ 269

Depreciation and amortization expense for the years ended December 31, 2018 and 2017, amounted to \$112,000 and \$149,000, respectively.

Mission Valley Bancorp
Notes to Consolidated Financial Statements

Note 5 – Servicing Assets

Activity for servicing assets and the related changes in fair value for the years ended December 31, 2018 and 2017, is as follows:

<i>(In thousands)</i>	2018	2017
Beginning balance	\$ 1,455	\$ 1,179
Additions, net	178	313
Changes in fair value	(191)	(37)
Ending balance	<u>\$ 1,442</u>	<u>\$ 1,455</u>

Loans serviced for others, consisting solely of SBA loans, are not included in the Consolidated Statements of Financial Condition. The unpaid principal balances of these loans serviced for others were \$110,468,000 and \$119,879,000, as of December 31, 2018 and 2017, respectively. Net servicing fees totaled \$226,000 and \$398,000 for the years ended December 31, 2018 and 2017, respectively.

Note 6 – Deposits

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

<i>(In thousands)</i>	Time Deposits under \$250,000	Time Deposits \$250,000 and Over
Matures during year ending December 31,		
2019	\$ 7,184	\$ 15,892
2020	1,046	788
2021	406	-
2022	90	-
2023	86	-
	<u>\$ 8,812</u>	<u>\$ 16,680</u>

Note 7 – Borrowings

During 2017, the Company issued a series of unsecured term notes totaling \$1,750,000 and entered into an unsecured loan agreement in the amount of \$8,586,000 in connection with retiring \$10,336,000 of mandatory convertible cumulative preferred stock associated with the Community Development Capital Initiative Program. See Note 17.

On May 1, 2017, the Company entered into three unsecured term notes for \$1,750,000 with a maturity date of May 1, 2022, bearing interest at a rate of 5.00% with interest only paid semi-annually and principal due at maturity. At December 31, 2018 and 2017, the outstanding balance of these notes was \$1,750,000 and interest paid on these notes was \$88,000 and \$59,000 for the years ended December 31, 2018 and 2017, respectively.

Mission Valley Bancorp
Notes to Consolidated Financial Statements

Note 7 – Borrowings (continued)

On August 1, 2017, the Company entered into an unsecured note agreement for \$8,586,000 with a maturity date of August 14, 2022, and bears interest at a rate of 5.23%. At December 31, 2018 and 2017, the outstanding balance on this note is \$8,586,000 and interest paid was \$455,000 and \$173,000 for the years ended December 31, 2018 and 2017, respectively.

The following is a summary of principal maturities for the next five years and thereafter:

<u>Fiscal Years</u>	
2019	\$ 643,950
2020	858,600
2021	858,600
2022	7,974,850
2023	-
Total	<u>\$ 10,336,000</u>

The Company has a line of credit available from the FHLB, which is secured by pledged loans. Borrowings may include overnight advances as well as loans with terms of up to 30 years. There were no outstanding borrowings at December 31, 2018 and 2017. The Company had \$82,693,000 and \$81,456,000 of borrowing capacity from the FHLB at December 31, 2018 and 2017, respectively, based upon loans and securities available to be pledged. The Company had \$3,115,000 and \$4,544,000 of borrowing capacity from the Federal Reserve Bank of San Francisco (FRB) as of December 31, 2018 and 2017, respectively, based upon loans available to be pledged.

The Company has an unsecured revolving line of credit with PCB B providing for federal fund purchases up to \$8,200,000, \$8,000,000 with Zions Bank, and up to \$5,000,000 with Union Bank. Borrowings are payable on demand and interest on outstanding borrowings accrues at rates negotiated at the time of the borrowing. As of December 31, 2018 and 2017, the Company did not have an outstanding balance against these lines of credits.

Note 8 – Junior Subordinated Deferrable Interest Debentures

The Mission Valley Statutory Trust I (the "Trust") was formed by the Company for the sole purpose of issuing trust preferred securities fully and unconditionally guaranteed by the Company. For financial reporting purposes, the Trust is not consolidated and the fixed rate junior subordinated deferrable interest debentures held by the Trust, issued and guaranteed by the Company, are reflected in borrowings within the Company's consolidated statements of financial condition.

Note 8 – Junior Subordinated Deferrable Interest Debentures (continued)

On September 16, 2005, the Trust issued \$6,000,000 fixed rate Capital Trust Pass-Through Securities (TRUPS) with a liquidation value of \$1,000 per security for gross proceeds of \$6,000,000. The entire proceeds of the issuance were invested by the Trust in \$6,186,000 of junior subordinated deferrable interest debentures issued by the Company with identical maturity, repricing, and payment terms as the TRUPS. These debentures represent the sole assets of the Trust and mature on December 15, 2035, and bore interest at 5.97% through September 15, 2010 and variable rate equal to LIBOR plus 1.50% from September 15, 2010 through maturity. Interest payments are due on a quarterly basis. The interest is deferrable, at the Company's option for a period of up to twenty consecutive quarterly periods, but in any event not beyond September 16, 2035.

Note 9 – Derivative Instrument and Hedge Activity

During the year ended December 31, 2018, the Company entered into an interest rate swap agreement with a counterparty to manage interest rate risk associated with its variable rate borrowings on the TRUPS. The interest rate swap is designated as a cash flow hedge with the aggregate fair value of the swap recorded in other assets or other liabilities with changes in fair value of the hedge accounted for within the statement of comprehensive income, net of taxes, to the extent effective. The amount included in accumulated other comprehensive income would be reclassified to current interest incurred from the hedged variable rate borrowings on the TRUPS when it affects earnings. The Company assesses the effectiveness of the hedging relationship by comparing the changes in fair value of the derivative hedging instrument with the changes in fair value of the designated hedged transaction. The Company expects the hedge to remain highly effective during the remaining terms of the swap and did not recognize any hedge ineffectiveness in current earnings during the year ended December 31, 2018. The notional amount of the swap agreement is \$6,000,000 with a variable interest rate of 3-month LIBOR plus 1.50% maturing on December 15, 2035. The fixed rate paid on the instrument was 4.77% at December 31, 2018. The fair value of the swap is approximately \$395,000 and is recorded in accrued interest payable and other liabilities at December 31, 2018. The Company did not record any ineffectiveness on the cash flow hedge within the consolidated statements of income for the year ended December 31, 2018.

Note 10 – Income Taxes

The provision for income taxes for years ended December 31, 2018 and 2017 consisted of the following:

<i>(In thousands)</i>	2018	2017
Current		
Federal	\$ 787	\$ 1,544
State	560	608
	<u>1,347</u>	<u>2,152</u>
Deferred		
Federal	(206)	254
State	(246)	31
	<u>(452)</u>	<u>285</u>
	<u>\$ 895</u>	<u>\$ 2,437</u>

Note 10 – Income Taxes (continued)

A reconciliation of the Company's effective tax rate with the statutory Federal income tax rate for years ended December 31, 2018 and 2017, is as follows:

<i>(In thousands)</i>	2018		2017	
Statutory Federal income tax rate	\$ 851	21.0 %	\$ 2,036	34.0 %
State franchise tax, net of federal benefit	295	7.3	428	7.2
Rate change impact	-	-	242	4.0
Stock compensation	19	0.5	(190)	(3.2)
Tax exempt interest	(16)	(2.0)	(6)	(1.2)
BOLI	(80)	(0.4)	(72)	(0.1)
Other	(174)	(4.3)	(1)	(3.2)
	<u>\$ 895</u>	<u>22.1 %</u>	<u>\$ 2,437</u>	<u>37.5 %</u>

The Company recorded a \$242,000 charge for the revaluation of its deferred tax asset in 2017 as a result of the lowering of the corporate tax rate for federal tax purposes from 34% to 21%. There were no such charges during 2018.

The following is a summary of the components of the net deferred tax asset at December 31, 2018 and 2017:

<i>(In thousands)</i>	2018	2017
Deferred tax assets:		
Allowance for loan losses	\$ 612	\$ 432
State tax	118	128
Unrealized loss on investment securities	100	65
Non-accrual interest	30	15
Deferred compensation	808	526
Other, net	-	-
Total deferred tax assets	<u>1,668</u>	<u>1,166</u>
Deferred tax liabilities:		
Loan origination costs	(601)	(606)
Depreciation and amortization	(68)	(80)
Certain prepaid assets	(123)	(91)
Total deferred tax liabilities	<u>(792)</u>	<u>(777)</u>
Net deferred tax asset	<u>\$ 876</u>	<u>\$ 389</u>

Note 10 – Income Taxes (continued)

Management believes, based upon the Company's historical performance and future projections, it is more likely than not the deferred tax asset will be realized in the normal course of operations and has determined that no valuation allowance is necessary as of December 31, 2018 and 2017, respectively.

The Company recognizes the tax benefit from uncertain tax positions only if it is more likely than not that the tax positions will be sustained on examination by the tax authorities, based on the technical merits of the position. The tax benefit is measured based on the largest benefit that has a greater than 50% likelihood of being realized upon ultimate settlement.

The Company recognizes interest and penalties related to income tax matters in other operating expenses in the statements of operations. The Company does not anticipate that the amount of unrecognized tax benefits will significantly increase or decrease in the next twelve months. There were no interest and penalties accrued for the years ended December 31, 2018 and 2017. The Company files income tax returns in the U.S. federal jurisdiction and in California.

Note 11 – Employee Benefit Plans

The Company has established a 401(k) Plan for the benefit of eligible employees, whereby each employee being at least twenty-one years of age may become a participant at specified intervals. Employees may contribute up to 50% of their annual compensation to the 401(k) Plan each year subject to certain limits based on federal tax laws. The Company may elect to make some level of matching contributions to the Plan at the discretion of the Board of Directors. Matching contributions of \$135,000 and \$131,000 were made for the years ended December 31, 2018 and 2017, respectively.

The Company sponsors a supplemental executive retirement plan (SERP) which is a nonqualified unfunded pension plan covering a select group of executives. The plan provides a retirement benefit payable in the form of a life annuity to the participants, which is based on a specified dollar amount as stated in the agreements. The accrued postretirement benefit balance was \$2,230,000 and \$1,778,000 at December 31, 2018 and 2017, respectively, and is reported in accrued interest payable and other liabilities within the consolidated statements of financial condition. The postretirement benefit expense reported within salaries, wages and employee benefits in the consolidated statements of income was \$594,000 and \$263,000 for the years ended December 31, 2018 and 2017, respectively.

Note 12 – Share-Based Compensation

The Company approved the 2017 Omnibus Stock Equity Plan (the "Plan"), voted into effect by the majority of shares represented at its May 23, 2017 Annual Shareholders' Meeting and set to expire March 28, 2027. Under the Plan, Directors and key employees receive long-term incentives ("Awards") in the form of incentive and nonqualified stock options and restricted stock. The Plan is administered by the Board of Directors, or a Committee to be appointed by the Board, who will select the directors and key executives to receive options or awards, the form of those awards, the number of shares or dollar targets, and all terms and conditions. The Plan provides for terms with respect to accelerated vesting should a change in control occur.

Stock options expire no later than ten years from the date of grant. Stock Options granted to an Optionee who owns stock representing more than ten percent of the voting power of all classes of stock of the Company, shall expire not more than five years from the date of grant.

During 2018, 49,250 incentive stock options were granted at a weighted average price of \$15.90. No stock options were granted during 2017. No stock options were exercised during 2018 and 2017. As of December 31, 2018, there was \$225,000 of total unrecognized compensation cost related to nonvested stock options granted under the plan. The cost is expected to be recognized over a weighted-average remaining period of 2.3 years. The aggregate intrinsic value of the options exercisable plus options expected to vest in the future years is \$0 based on a stock price of \$14.00 per share for the year ended December 31, 2018.

The fair value of each option grant was estimated on the date of grant using the Black-Scholes option-pricing model using the assumptions shown in the following table. The expected volatility was based on the volatility of the Company's stock price over a period commensurate with the expected term of the option. The Company uses historical data on option exercises to determine the expected term within the valuation model.

The risk-free rate for the expected term of the option is based upon the U.S. Treasury yield curve at the time of option grant. The assumptions used to estimate the fair value of stock options granted for the year ended December 31, 2018, were the following: 1) Risk free interest rate – 2.96%, 2) Weighted-average expected life – 6 years, and 3) Volatility – 32.2%.

The maximum number of shares available for all Awards under the 2018 Plan is up to 600,000 shares of the Bank's common stock. No more than 250,000 shares may be issued pursuant to Awards of restricted stock, and no more than 500,000 shares may be issued pursuant to Awards of incentive stock options; provided, however, that in no event may the total of all the restricted stock awards, incentive stock options and nonqualified stock options granted under the 2018 Plan exceed 600,000.

Note 12 – Share-Based Compensation (continued)

At December 31, 2018, there were 25,000 unvested restricted stock awards under the prior 2006 equity plan. During the year ended December 31, 2018, 16,750 restricted stock awards were issued at a price of \$15.95 per share. Restricted stock awards are ineligible to received stock dividends during the period in which they are unvested. As of December 31, 2018, there was \$13,000 of total unrecognized compensation cost related to nonvested restricted stock awards granted under the plan. The cost is expected to be recognized over a weighted-average remaining period of 0.2 years. During the year ended December 31, 2017, no restricted stock awards were issued.

At December 31, 2018, there were 16,750 unvested restricted stock awards under the 2017 equity plan. Restricted stock awards are ineligible to received stock dividends during the period in which they are unvested. As of December 31, 2018, there was \$208,000 of total unrecognized compensation cost related to nonvested restricted stock awards granted under the plan. The cost is expected to be recognized over a weighted-average remaining period of 2.5 years.

Note 13 – Commitments and Contingencies

The Company is a party to financial instruments with off-balance-sheet risk in the normal course of business to meet the financing needs of its customers. These financial instruments include commitments to extend credit. These instruments involve, to varying degrees, elements of credit risk in excess of the amount recognized on the statements of financial condition. To mitigate this risk posed by these off-balance sheet exposures, the Company has established an off-balance sheet reserve totaling \$25,000 and \$55,000 as of December 31, 2018 and 2017, respectively, included in accrued interest payable and other liabilities on the statements of financial condition.

The Company's exposure to credit loss in the event of nonperformance by the other party to the financial instrument for commitments to extend credit and standby letters of credit is represented by the contractual amount of those instruments. Standby letters of credit are conditional commitments issued by the Company to guarantee the performance of a customer to a third party. Those guarantees are preliminarily issued to support public and private borrowing arrangements, including commercial paper, bond financing, and similar transactions. All standby letters of credit issued by the Company expire within one year of issuance.

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Since many of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. The Company evaluates each customer's credit worthiness on a case-by-case basis. The amount of collateral obtained, if deemed necessary by the Company upon extension of credit, is based on management's credit evaluation.

Note 13 – Commitments and Contingencies (continued)

Collateral held varies but may include receivables, inventory, property, plant, and equipment, residential properties, and income-producing commercial properties.

A summary of the contractual or notional amounts of the Company's significant off-balance sheet financial instruments as of December 31, 2018 and 2017, is as follows:

	2018	2017
<i>(In thousands)</i>		
Commitments to extend credit	\$ 28,329	\$ 27,234
Standby letters of credit	1,224	1,581
	<u>\$ 29,553</u>	<u>\$ 28,815</u>

Litigation – In the ordinary course of business, the Company becomes involved in litigation. Management believes, based upon opinions of legal counsel, that the disposition of all suits pending against the Company will not have a material adverse effect on its financial position or results of operations.

Lease commitments – The Company currently leases its administrative offices and branches. The Company leases office locations and equipment which have been classified as noncancelable operating leases. These lease agreements call for various monthly payments expiring at dates through the year 2020. Rental expense for the years ended December 31, 2018 and 2017, amounted to \$334,000 and \$366,000, respectively.

The following table shows future minimum payments under operating leases with terms in excess of one year as of December 31, 2018:

<u>Year Ending December 31,</u>	
<i>(In thousands)</i>	
2019	\$ 445
2020	393
2021	294
2022	297
2023	180
Thereafter	-
	<u>\$ 1,609</u>

Note 14 – Transactions with Related Parties

In the ordinary course of business, the Company enters into transactions with certain directors, officers, and shareholders and certain affiliates of the Company.

Note 14 – Transactions with Related Parties (continued)

As part of its normal banking activities, the Company has extended credit to and received deposits from certain members of its Board of Directors, major shareholders, officers as well as entities with which these individuals are associated. These related parties had deposits at the Company totaling approximately \$31,986,000 and \$38,230,000 at December 31, 2018 and 2017, respectively. There were no related party loans at December 31, 2018 and 2017. Management believes these transactions were made in the ordinary course of business on substantially the same terms and conditions, including interest rates and collateral requirements, as comparable loans and deposits with other customers, and the loans did not involve more than normal credit risk or present other unfavorable features.

Note 15 – Fair Value of Financial Instruments

Fair value measurements within the Accounting Standards Codification defines fair value, establishes a framework for measuring fair value under GAAP, and expands disclosures about fair value measurement. Fair value measurements apply to all financial assets and liabilities that are being measured and reported at fair value on a recurring and non-recurring basis.

The fair value of a financial instrument is the amount at which the asset or obligation could be exchanged in a current transaction between willing parties, other than in a forced or liquidation sale. Fair value estimates are made at a specific point in time based on relevant market information and information about the financial instrument. These estimates do not reflect any premium or discount that could result from offering for sale at one time the entire holdings of a particular financial instrument. Because no market value exists for a significant portion of the financial instruments, fair value estimates are based on judgments regarding future expected loss experience, current economic conditions, risk characteristics of various financial instruments, and other factors. These estimates are subjective in nature, involve uncertainties and matters of judgment and, therefore, cannot be determined with precision. Changes in assumptions could significantly affect the estimates.

A three-level hierarchy is used for disclosure of assets and liabilities recorded at fair value. The classification of assets and liabilities within the hierarchy is based on whether the inputs to the valuation methodology used for measurement are observable or unobservable. Observable inputs reflect market-derived or market-based information obtained from independent sources, while unobservable inputs reflect our estimates about market data.

Note 15 – Fair Value of Financial Instruments (continued)

In general, fair values determined by level 1 inputs utilize quoted prices (unadjusted) for identical instruments that are highly liquid, observable and actively traded in over-the-counter markets. Fair values determined by level 2 inputs utilize 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 instruments in active markets, quoted prices for identical or similar instruments in markets that are not active and model-derived valuations whose inputs are observable and can be corroborated by market data. Level 3 inputs are unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities. 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. The Company's assessment of the significance of a particular input to the fair value measurement in its entirety requires judgment and considers factors specific to the asset or liability.

The following tables present information about the Company's assets and liabilities measured at fair value on a recurring and non-recurring basis as of December 31, 2018 and 2017, and indicates the fair value hierarchy of the valuation techniques utilized by the Company to determine such fair value. In general, fair values determined by Level 1 inputs utilize quoted prices (unadjusted) for identical instruments that are highly liquid, observable and actively traded in over-the-counter markets.

	December 31, 2018			
	Total	Level 1	Level 2	Level 3
<i>(In thousands)</i>				
<u>Recurring items:</u>				
Financial assets				
Securities available-for-sale				
Mortgage backed securities	\$ 10,928	\$ -	\$ 10,928	\$ -
Corporate bonds	-	-	-	-
Municipal investments	387	-	387	-
Other	765	765	-	-
Servicing assets	1,442	-	-	1,442
Financial liabilities				
Derivative liability	395	-	-	395
<u>Nonrecurring items:</u>				
Impaired loans	2,614	-	-	2,614

Note 15 – Fair Value of Financial Instruments (continued)

(In thousands)	December 31, 2017			
	Total	Level 1	Level 2	Level 3
Recurring items:				
Financial assets				
Securities available-for-sale				
Mortgage backed securities	\$ 13,627	\$ -	\$ 13,672	\$ -
Corporate bonds	-	-	-	-
Municipal investments	396	-	396	-
Other	782	782	-	-
Servicing assets	1,455	-	-	1,455
Nonrecurring items:				
Impaired loans	2,704	-	-	2,704

The following table presents additional information about the unobservable inputs used in the fair value measurements on recurring basis that were categorized within Level 3 of the fair value hierarchy as of December 31, 2018:

Financial Instrument	Valuation Technique	Unobservable Inputs	Range of Inputs	Weighted Average Input	Impact to Valuation from an Increased or Higher Input Value
Servicing assets	Discounted cash flow	Prepayment speeds	7.54% - 17.21%	14.40%	Decrease
		Discount rate	11.37% - 22.85%	13.49%	Decrease
		Expected weighted average on loan	4.25% - 7.75%	5.02 years	Increase

Securities available for sale – The table above presents the balance of securities available-for-sale, which is measured at fair value on a recurring basis. An independent third party performs market valuations of the Company’s securities available-for-sale. The fair values are determined by using several sources for valuing securities. The techniques include pricing models that vary based on the type of asset being valued and incorporate available trade, bid, and other market information. Market valuation sources include observable market inputs and are therefore considered Level 2 inputs for purposes of determining the fair values.

Servicing assets – Fair value is based on a loan-by-loan basis taking into consideration the original term to maturity, the current age of the loan and the remaining term to maturity. The valuation methodology utilized for the servicing assets begins with generating future cash flows for each servicing asset, based on their unique characteristics and market-based assumptions for prepayment speeds. The present value of the future cash flows are then calculated utilizing market-based discount rate assumptions.

Derivative instruments – Interest rate swaps are valued by a third party, using models that primarily use market observable inputs, such as yield curves, and are validated by comparison with valuations provided by the respective counterparties. Derivative financial instruments are included in other assets and other liabilities in the Consolidated Statements of Financial Condition.

Note 15 – Fair Value of Financial Instruments (continued)

Impaired loans and other real estate owned – The loan balance shown in the table above represents all of the Company’s impaired loans for which impairment was recognized during the period. These loans are measured at fair value on a non-recurring basis. Impaired loans that are collateral-dependent are measured based on the fair value of their collateral while non collateral-dependent loans are measured on a discounted cash flow basis. The fair value of each loan’s collateral is generally based on estimated market prices from an independently prepared appraisal, which is then adjusted for the cost related to liquidating such collateral. The estimated fair value of other real estate owned is based on the appraised values or other information for the estimated fair values of such assets. We generally use an 8-10% discount for selling costs which is applied to all properties, regardless of size. Appraised values may be adjusted to reflect changes in market conditions that have occurred subsequent to the appraisal date, or for revised estimates regarding the timing or cost of the property sale. These adjustments are based on qualitative judgments made by management on a case-by-case basis. There have been no significant changes in the valuation techniques during the period ended December 31, 2018.

The following tables present information about the level in the fair value hierarchy for the Company’s assets and liabilities that are not measured at fair value as of December 31, 2018 and 2017. The valuation of loans receivable held for investment was impacted by the adoption of ASU 2016-01. In accordance with ASU 2016-01, the fair value of loans held for investment is estimated using discounted cash flow analyses. The discount rates used to determine fair value use interest rate spreads that reflect factors such as liquidity, credit, and nonperformance risk of the loans. Loans are considered a Level 3 classification.

Transfers between levels of the fair value hierarchy are recognized on the actual date of the events or circumstances that caused the transfer, which generally corresponds to the Company’s quarterly valuation process. During the years ended December 31, 2018 and 2017, there were no transfers between levels of the fair value hierarchy.

Mission Valley Bancorp
Notes to Consolidated Financial Statements

Note 15 – Fair Value of Financial Instruments (continued)

(In thousands)	2018				
	Carrying Value	Estimated Fair Value	Fair Value Measurements Using		
			Level 1	Level 2	Level 3
Financial Assets					
Cash and cash equivalents	\$ 74,335	\$ 74,335	\$ 74,335	\$ -	\$ -
Interest bearing deposit in other banks	4,294	4,294	-	4,294	-
Investment securities, held-to-maturity	17	17	-	17	-
Loans, net	239,206	235,191	-	-	235,191
Loans, held for sale	4,697	4,697	-	4,697	-
Bank owned life insurance	10,024	10,024	10,024	-	-
Restricted equity securities	1,889	1,889	1,889	-	-
Accrued interest receivable	836	836	836	-	-
Financial Liabilities					
Deposits	\$ 296,740	\$ 274,762	\$ -	\$ -	\$ 274,762
Subordinated debentures	6,186	4,933	-	-	4,933
Notes payable	10,336	-	-	-	10,065
Accrued interest payable	4	4	4	-	-
(In thousands)	2017				
	Carrying Value	Estimated Fair Value	Fair Value Measurements Using		
			Level 1	Level 2	Level 3
Financial Assets					
Cash and cash equivalents	\$ 54,640	\$ 54,640	\$ 54,640	\$ -	\$ -
Interest bearing deposit in other banks	2,725	2,706	-	2,706	-
Investment securities, held-to-maturity	79	79	-	79	-
Loans, net	209,791	213,990	-	-	213,990
Loans, held for sale	32,584	32,584	-	32,584	-
Bank owned life insurance	9,754	9,754	9,754	-	-
Restricted equity securities	1,874	1,874	1,874	-	-
Accrued interest receivable	900	900	900	-	-
Financial Liabilities					
Deposits	\$ 280,247	\$ 262,258	\$ -	\$ -	\$ 262,258
Subordinated debentures	6,186	4,241	-	-	4,241
Notes payable	10,336	9,970	-	-	9,970
Accrued interest payable	5	5	5	-	-

Mission Valley Bancorp
Notes to Consolidated Financial Statements

Note 16 – Regulatory Matters

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

Quantitative measures established by regulation to ensure capital adequacy require the Company and the Bank to maintain minimum amounts and ratios (set forth in the following table) of Tier 1 capital (as defined in the regulations) to total average assets (as defined), and minimum ratios of Tier 1, common equity Tier 1 and total capital (as defined) to risk-weighted assets (as defined). Management believes, as of December 31, 2018 and 2017, that the Company and the Bank meets all capital requirements to which it is subject.

The Bank has been notified by its regulator that, as of its most recent regulatory examination, the Bank is regarded as "well capitalized" under the regulatory framework for prompt corrective action. Such determination has been made based on the Bank's Tier 1, common equity Tier 1, total capital and leverage ratios. There have been no conditions or events since this notification that management believes would change the Bank's categorization as well capitalized under the ratios listed below.

The Company's and the Bank's actual and required capital amounts and ratios are (dollars in thousands):

(Dollars in thousands)	Mission Valley Bancorp					
			Amount of Capital Required			
	Actual		Minimum Capital Requirement		Minimum To Be Well-Capitalized Under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
As of December 31, 2018						
Total Capital Ratio	\$ 43,444	15.20%	\$ 22,872	8.00%	\$ 28,591	10.00%
Tier 1 Capital Ratio	39,867	13.90%	17,154	6.00%	22,872	8.00%
Tier 1 Leverage Ratio	39,867	12.10%	13,223	4.00%	16,528	5.00%
Common Equity Tier 1 Capital Ratio	33,268	11.80%	12,866	4.50%	18,584	6.50%
As of December 31, 2017						
Total Capital Ratio	\$ 39,718	15.60%	\$ 20,394	8.00%	\$ 25,493	10.00%
Tier 1 Capital Ratio	36,527	14.30%	15,296	6.00%	20,394	8.00%
Tier 1 Leverage ratio	36,527	11.20%	13,025	4.00%	16,282	5.00%
Common Equity Tier 1 Capital Ratio	30,527	12.00%	11,472	4.50%	16,570	6.50%

Mission Valley Bancorp
Notes to Consolidated Financial Statements

Note 16 – Regulatory Matters (continued)

	Mission Valley Bank					
	Amount of Capital Required					
	Actual		Minimum Capital Requirement		Minimum To Be Well-Capitalized Under Prompt Corrective Action Provisions	
(Dollars in thousands)	Amount	Ratio	Amount	Ratio	Amount	Ratio
As of December 31, 2018						
Total Capital Ratio	\$ 51,116	17.89%	\$ 22,863	8.00%	\$ 25,579	10.00%
Tier 1 Capital Ratio	47,541	16.64%	17,147	6.00%	22,863	8.00%
Tier 1 Leverage Ratio	47,541	14.43%	13,180	4.00%	16,475	5.00%
Common Equity Tier 1 Capital Ratio	47,541	16.64%	12,860	4.50%	18,576	6.50%
As of December 31, 2017						
Total Capital Ratio	\$ 48,401	19.09%	\$ 20,289	8.00%	\$ 25,361	10.00%
Tier 1 Capital Ratio	45,226	17.83%	15,217	6.00%	20,289	8.00%
Tier 1 Leverage ratio	45,226	13.93%	12,988	4.00%	16,235	5.00%
Common Equity Tier 1 Capital Ratio	45,226	17.83%	11,413	4.50%	16,485	6.50%

The Bank is required to establish and phase-in a “conservation buffer,” consisting of a common equity Tier 1 capital amount equal to 2.5% of risk-weighted assets by 2019. As of December 31, 2018, the “conservation buffer” amount was 1.875%. An institution that does not meet the conservation buffer requirement will be subject to restrictions on certain activities including payment of dividends, stock repurchases, and discretionary bonuses to executive officers. The phase-in began in 2016 and increases until fully phased-in by 2019.

The difference in Common Equity Tier 1 Capital Ratio between Mission Valley Bancorp and Mission Valley Bank is due to the TRUPS securities disclosed in Note 8.

Note 17 – U.S. Treasury Capital Purchase Program, Community Development Capital Initiative Program and Mandatory Convertible Cumulative Preferred Stock

During 2009, the Company was a participant in the U.S. Treasury Capital Purchase Program (CPP), under which the Company issued preferred stock shares to the Treasury for an aggregate purchase price of \$5,500,000. On August 20, 2010, Mission Valley Bancorp completed an exchange of its CPP capital into the Community Development Capital Initiative (CDCI) program. Under both programs the Company is subject to certain restrictions and requirements, such as restrictions on repurchases of preferred stock shares and payment of dividends, requirements relating to executive compensation, and corporate governance practices.

Mission Valley Bancorp was able to participate in the CDCI program because the bank was recognized as a Community Development Financial Institution (CDFI) since 2006. The CDFI Fund was created for the purpose of promoting economic revitalization and community development through investment in, and assistance to, community development financial institutions (CDFIs).

Mission Valley Bancorp
Notes to Consolidated Financial Statements

Note 17 – U.S. Treasury Capital Purchase Program, Community Development Capital Initiative Program and Mandatory Convertible Cumulative Preferred Stock (continued)

As a result, 5,500 shares of Series A, 5% fixed rate, non-voting, non-cumulative perpetual preferred shares were exchanged for 5,500 shares of Series C, 2% fixed rate, non-voting, noncumulative perpetual preferred shares. This was a noncash transaction in 2010.

On September 24, 2010, Mission Valley Bancorp received an additional \$4,836,000 in capital via the CDCI program. As a result, 4,836 shares of Series D, 2% fixed rate non-voting non-cumulative perpetual preferred shares were issued for an aggregate issue price of \$4,836,000. Series C and D preferred shares qualify as Tier 1 capital.

During the third quarter of 2017, the Company fully redeemed its \$10,336,000 Community Development Capital Investment (CDCI) (Formerly TARP/CPP) to the Treasury using proceeds from a private debt issuance in anticipation of the scheduled CDCI rate increase to 9% in 2018. See Note 7.

The series C and D had a dividend rate of 2% per annum for eight years escalating to 9% for an additional five years. Series C and D had quarterly dividend payments payable on each February 15, May 15, August 15, and November 15. During 2017, the Company declared and paid dividends on Series C and D in the cumulative amount of \$159,000.

Note 18 – Revenue from Contracts with Customers

As noted in Note 1, the Company adopted the provisions of ASU No. 2014-09, *Revenue from Contracts with Customers (Topic 606)*, on January 1, 2018 and all subsequent ASUs that modified Topic 606. Results for reporting periods beginning after December 31, 2017, are presented under Topic 606, while prior period amounts have not been adjusted and continue to be reported in accordance with Topic 605.

All of the Company's revenue from contracts with customers in the scope of ASC 606 is recognized in Non-Interest Income. Gains/losses on the sale of other real estate owned are included in non-interest expense and are generally recognized when the performance obligation is completed. This is typically at delivery of control over the property to the buyer at time of each real estate closing. There was no gain/loss activity related to other real estate owned during 2018.

The following table presents the Company's sources of Non-Interest Income for the twelve months ended December 31:

(In thousands)	2018	2017
NON-INTEREST INCOME		
Service charges and other income	1,740	1,789
(Loss) Gain on sale of loans	(386)	871
Net merchant income	548	741
Increase in cash surrender value of bank owned life insurance (1)	271	245
Other income (1)	511	442
Total non-interest income	2,684	4,088

Note 18 – Revenue from Contracts with Customers (continued)

Deposit service charges

The Company earns fees from its deposit customers for account maintenance, transaction-based activity and overdraft services. Account maintenance fees consist primarily of account fees and analyzed account fees charged on deposit accounts on a monthly basis. The performance obligation is satisfied and the fees are recognized on a monthly basis as the service period is completed. Transaction-based fees on deposit accounts are charged to deposit customers for specific services provided to the customer, such as non-sufficient funds fees, overdraft fees, and wire fees. The performance obligation is completed as the transaction occurs and the fees are recognized at the time each specific service is provided to the customer.

Debit and ATM interchange fee income and expenses

Debit and ATM interchange income represent fees earned when a debit card issued by the Company is used. The Company earns interchange fees from debit cardholder transactions through the Visa payment network. Interchange fees from cardholder transactions represent a percentage of the underlying transaction value and are recognized daily, concurrently with the transaction processing services provided to the cardholder. The performance obligation is satisfied and the fees are earned when the cost of the transaction is charged to the cardholders' debit card. Certain expenses directly associated with the credit and debit card are recorded on a net basis with the interchange income.

Merchant fee income

Merchant fee income represents fees earned by the Company for card payment services provided to its merchant customers. The Company has a contract with a third party to provide card payment services to merchants that contract for those services. The third party provider passes the payments made by the merchants through to the Company. The Company, in turn, pays the third party provider for the services it provides to the merchants. These payments to the third party provider are recorded as expenses as a net reduction against fee income. In addition, a portion of the payment received represents interchange fees which are passed through to the card issuing bank. Income is primarily earned based on the dollar volume and number of transactions processed. The performance obligation is satisfied and the related fee is earned when each payment is accepted by the processing network.

Credit card and interchange income and expenses

Credit card interchange income represent fees earned when a credit card issued by the Company is used. Similar to the debit card interchange, the Company earns an interchange fee for each transaction made with the Company's branded credit cards. The performance obligation is satisfied and the fees are earned when the cost of the transaction is charged to the cardholders' credit card. Certain expenses and rebates directly related to the credit card interchange contract are recorded net to the interchange income.

Note 18 – Revenue from Contracts with Customers (continued)

Gain/loss on other real estate owned, net

The Company records a gain or loss from the sale of other real estate owned when control of the property transfers to the buyer, which generally occurs at the time of an executed deed of trust. When the Company finances the sale of other real estate owned to the buyer, the Company assesses whether the buyer is committed to perform their obligations under the contract and whether collectability of the transaction price is probable. Once these criteria are met, the other real estate owned asset is derecognized and the gain or loss on sale is recorded upon the transfer of control of the property to the buyer. In determining the gain or loss on sale, The Company adjusts the transaction price and related gain or loss on sale if a significant financing component is present.

Note 19 – Subsequent Events

On January 29, 2019, the Board of Directors of Mission Valley Bank authorized a \$2,000,000 dividend upstream to Mission Valley Bancorp to fund its operations. Additionally, on January 29, 2019, the Board of Directors of Mission Valley Bancorp authorized a \$0.10 per share common stock dividend to shareholders of record on February 14, 2019, payable on February 28, 2019.

The Company recognizes in the consolidated financial statements the effect of all subsequent events (transactions or events that occur after the balance sheet date but before the consolidated financial statements are issued) that provide additional evidence about conditions that existed at the date of the balance sheet, including the estimates inherent in the process of preparing the consolidated financial statements. The Company's consolidated financial statements do not recognize subsequent events that provide evidence about conditions that did not exist at the date of the balance sheet but arose after the balance sheet date and before consolidated financial statements are available to be issued. The Company has evaluated subsequent events through March 28, 2019, which is the date the consolidated financial statements were available to be issued.

Board of Directors

Tamara Gurney

President, CEO & Director of
Mission Valley Bancorp & Bank

Kathleen Kellogg

Director of Mission Valley Bancorp & Bank
Ms. Kellogg is an experienced banking executive and director.

John Miller

Director of Mission Valley Bancorp & Bank
Mr. Miller is an Executive Officer & Co-Founder of Lexicon Bank in organization, as well as an investment advisory professional and community bank consultant.

Jerold B. Neuman, ESQ

Director of Mission Valley Bancorp
Mr. Neuman is a partner with the law firm of DLA Piper, LLP.

Ara Oghoorian, CFA, CFP®, CPA

Director of Mission Valley Bancorp & Bank
Mr. Oghoorian is the Founder & President of ACap Asset Management, Inc.

John Parker

Director of Mission Valley Bancorp & Bank
Mr. Parker is the Executive Officer and Co-Founder of Parker Brown Inc.

Eric Sato, CPA

Director of Mission Valley Bancorp & Bank
Mr. Sato is a Partner in the Certified Public Accounting firm of Edwards, Sato & Yang CPAs.

Earle S. Wasserman

Director and Chairman of the Board of
Mission Valley Bancorp & Bank
Mr. Wasserman is the Chairman of the Hallmark Group.

The Patrick Visciglia Spirit Award



Mission Valley Bank's Spirit Award was established in memoriam of one of our original founders & directors, Patrick Visciglia.

Each year, the entire staff is asked to nominate the individual that they believe most closely emulates Pat Visciglia's dedication, passion and commitment to the Bank, fellow staff members and clients.

The 2018 recipient of the Patrick Visciglia Spirit Award is Maria Gonzalez – Vice President, Central Operations Manager. This is Maria's second consecutive year to receive this well-deserved honor by her peers.

Senior Management

Tamara Gurney

President
Chief Executive Officer

Diane Auten

Executive Vice President
Chief Financial Officer

Jennifer Burruel

Senior Vice President
Enterprise Risk Manager

Jill Clements

Senior Vice President
Deputy Chief Credit Officer

Daniel Epstein

Executive Vice President
Chief Credit Officer

Roy Fisher

Senior Vice President
Operations Administrator

Linda Rousseau

Executive Vice President
Chief Administrative Officer

Jahun Smith

Senior Vice President
Regional Sales Manager

Jeffrey Watson

Chief Operating Officer

Administrative Officers

Cindy Albers

Vice President, CRCM
BSA Officer

Arturo Andrade

Vice President
Core Systems Manager

Paula Bahamon

Vice President
Business Banking Officer

Carrie Burrell

Vice President, CFMP
Marketing Manager

Daniel Cable

Vice President
Merchant Services Manager

Maria Gonzalez

Vice President
Central Operations Manager

Petra Hatzesberger

Vice President
Human Resource Manager

Omar Khairzada

Vice President
SBA Business Development Officer

Sandy Konish

Vice President
Core Systems Manager

Diane McAuley

Vice President
Credit Administration

Yolanda Ortiz

Vice President
Compliance & Risk Manager

Sally Reichhardt

Assistant Vice President
Quality Control Manager

Ryan Roques

Vice President
SBA Business Development Officer

Frank Wong

Vice President
Controller

Sun Valley Corporate Office

Tony Rodriguez

Vice President
Operations Manager

Lola Forbis

Vice President
Relationship Manager

Santa Clarita Valley Business Banking Center

Steve Nuñez

Vice President
Relationship Manager

Welmer Jurado

Vice President
Relationship Manager

Laura Soto

Assistant Vice President
Operations Manager

South Bay Loan Production Office

Thomas Fiebig

Vice President
Manager

Manny Serrano

Vice President
Business Development Officer

Jose Troncoso

Vice President
Business Development Officer

Investor Information

Common Stock:

Effective July 23, 2014, Mission Valley Bancorp's stock began trading on the OTCQX market under the symbol "MVLV". As of December 31, 2018 there were approximately 161 shareholders of record and 3,208,365 shares of common.

Stock Information:

D. A. Davidson & Co.
Michael Natzic, Senior Vice President
Kathy E. Ehlers, Associate Vice President
909 584-4500 / 800 288-2811

Stock Transfer Agent:

Shareholders with inquiries regarding accounts, lost stock certificates or changes of address, may contact Lisa Mora, Corporate Secretary of Mission Valley Bancorp at (818) 394-2300 during regular business hours or Computershare at (800) 962-4284 24 hours a day.

Written correspondence may be sent to:

Computershare
Post Office Box 30170
College Station, Texas 77842-3170



MISSION VALLEY BANCORP
2018 FINANCIAL STATEMENTS

Corporate Offices & Sun Valley Branch Office
9116 Sunland Boulevard | Sun Valley, CA 91352
(818) 394-2300

Centre Pointe Branch & Business Banking Office
26415 Carl Boyer Drive | Santa Clarita, CA 91350
(661) 253-9500

South Bay Loan Production Office
21515 Hawthorne Boulevard, Suite 420
Torrance, CA 90503
(310) 432-0290

