FEDERAL DEPOSIT INSURANCE CORPORATION
Washington, D.C. 20429

FORM 10-K

[X] Annual Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934.
For the Fiscal Year Ended December 31, 2018
[ ] Transition Report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for the transition period from ___ to ___.

FDIC Certificate Number 32203

Summit State Bank
(Exact name of registrant as specified in its charter)

California	94-2878925
(State of incorporation)	(I.R.S. Employee Identification No.)

500 Bicentennial Way, Santa Rosa, California 95403
(Address of principal executive offices)
(707) 568-6000
(registrant's telephone number, including area code)

Securities registered pursuant to Section 12(b) of the Act:
Common Stock, no par value, registered on the NASDAQ Stock Market, LLC
Securities registered pursuant to Section 12(g) of the Act:
None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes [ ] No [X]
Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or 15(d) of the Exchange Act. Yes [ ] No [X]
Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months and (2) has been subject to such filing requirements for the past 90 days. Yes [X] No [ ]
Indicate by check mark whether the registrant has submitted electronically, if any, every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit such files). Yes ☐ No ☒
Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. [ ]
Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company, or emerging growth company. See the definitions of "large accelerated filer," "accelerated filer," "smaller reporting company," an "emerging growth company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer ☐	Accelerated filer ☒
Non-accelerated filer ☐	Smaller reporting company ☒
Emerging growth company ☐	

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act. ☐

Indicate by check mark if the registrant is a shell company (as defined), in Rule 12b(2) of the Exchange Act. Yes [ ] No [X]
The aggregate market value of the Common Stock held by nonaffiliates was approximately $77,195,000 (based upon the closing price of shares of the registrant's Common Stock, no par value, as reported by the NASDAQ Stock Market, LLC on June 30, 2018). The number of shares outstanding of the registrant's common stock (no par value) at the close of business March 18, 2019 was 6,066,475.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the registrant's Proxy Statement for the 2019 Annual Meeting of Shareholders to be filed within 120 days of the fiscal year ended December 31, 2018 are incorporated by reference into Part III.

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SUMMIT STATE BANK

ANNUAL REPORT ON FORM 10-K

PART I

DISCLOSURE REGARDING FORWARD-LOOKING STATEMENTS

This report contains certain statements that are forward-looking within the meaning of the Private Securities Litigation Reform Act of 1995. These statements are not guarantees of future performance and involve certain risks, uncertainties and assumptions that are difficult to predict. Actual outcomes and results may differ materially from those expressed in, or implied by, our forward-looking statements. Words such as "expects," "anticipates," "believes," "estimates" and other similar expressions or future or conditional verbs such as "will," "should," "would" and "could" are intended to identify such forward-looking statements. Readers of this annual report of Summit State Bank (also referred to as we, us or our) should not rely solely on the forward-looking statements and should consider all uncertainties and risks throughout the report.

Forward-looking statements, by their nature, are subject to risks, uncertainties and assumptions. Our future results and shareholder values may differ significantly from those expressed in these forward-looking statements. You are cautioned not to put undue reliance on any forward-looking statement. The statements are representative only as of the date they are made, and we undertake no obligation to update any forward-looking statement. However, your attention is directed to any further disclosures made on related subjects in any subsequent reports we may file with the Federal Deposit Insurance Corporation ("FDIC"), including on Forms 10-K, 10-Q and 8-K.

ITEM 1. BUSINESS

INFORMATION ABOUT SUMMIT STATE BANK

General

Summit State Bank (the "Bank") is a state-chartered commercial bank operating a traditional community banking business within our primary service area of Sonoma County in California, however, we consider loans primarily from Marin, Napa and San Francisco counties. We operate through five Sonoma County depository offices located in Santa Rosa, Rohnert Park, Healdsburg and Petaluma. The Bank also has a loan production office in Roseville, California.

The Bank was incorporated on December 20, 1982 and commenced operations as a California state-chartered savings and loan in 1982. On January 15, 1999, the Bank received authority to convert its charter to a California state-chartered commercial bank. On July 13, 2006, the Bank completed an underwritten initial public offering and listed its stock on the Nasdaq Global Market under the symbol SSBI. The Bank's deposits are insured by the FDIC in accordance with the Federal Deposit Insurance Act and the related regulations of the FDIC.

We provide a broad array of financial services to small to medium-sized businesses and their owners and employees, entrepreneurs, high net worth families, foundations, estates and individual consumers. We believe that our principal competitive advantages are personal service, flexibility and responsiveness to customer needs. Our lending activities are primarily focused on commercial real estate, construction, and business loans to our targeted clientele.

We emphasize relationship banking and we believe we offer our customers many of the management capabilities of a large financial institution, together with the resourcefulness and superior customer service of a community bank. Through our branches and the use of technology, we offer a broad array of deposit products and services for both commercial and consumer customers, including electronic banking, cash management services and electronic bill payment. We provide a comprehensive set of loan products, such as commercial loans and leases, lines of credit, commercial real estate loans, Small Business Administration, or SBA, loans, residential mortgage loans, home equity lines of credit and construction loans. We believe that local decision-making ensures that our lending process is fast, efficient, and focused on maintaining our high credit quality and underwriting standards.

The Bank's only subsidiary is ALTO Service Corporation, which is a wholly owned subsidiary, incorporated in California. Its purpose is to act as trustee on the Bank's deeds of trust and perform reconveyances. The assets of ALTO Service Corporation consist exclusively of cash on deposit with the Bank. It has no employees and its operations and balance sheet are not material to the Bank's consolidated operating income or financial condition.

Services and Financial Products

Deposit Products

The Bank offers a wide range of deposit accounts designed to attract commercial businesses, professionals, and residents in the Bank's primary service area. These accounts include personal and business checking accounts, money market accounts, time certificates of deposit, sweep accounts and specialized deposit accounts, including professional accounts, small business "packaged" accounts, and tiered accounts designed to attract larger deposits, and Keogh and IRA accounts.

Lending Products

The Bank also offers a full complement of lending products designed to meet the specialized needs of its customers, including commercial and industrial lines of credit and term loans, credit lines to individuals, equipment loans, real estate and construction loans, small business loans of which a portion may be guaranteed by the SBA, and business lines of credit. The Bank has the designation of "Preferred Lender" by the SBA, which allows for expedited loan approval and funding. The Bank offers loans in amounts which exceed the Bank's lending limits through participation arrangements with correspondent banks. On a selective basis, the Bank also offers loans for accounts receivable and inventory financing, loans to agriculture-related businesses, and equipment and expansion financing programs.

Brokered Deposits and Reciprocal Deposits

The Bank will accept brokered deposits when the Bank determines that brokered deposits would be advantageous over other time deposits accepted through the Bank's branch system. The Bank is a member of a network (Promontory Interfinancial Network) offering a time deposit product called CDARS and demand deposit product called ICS. When a customer places a large deposit with the Bank as a network member, the Bank can place the funds into certificates of deposit or demand accounts issued by other banks in the network in increments of less than $250,000, so that both principal and interest are eligible for complete FDIC protection. Other banks do the same thing with their customer funds. The network banks exchange deposits on a dollar-for-dollar basis, bringing the full amount of the original deposit back to the originating bank. Because the originating bank comes out "whole," it can make the full amount of deposits received available for community lending purposes or other initiatives of its choosing. Deposits placed using CDARS and ICS meet the pass-through insurance coverage guidelines established by the FDIC and the depositor can obtain up to $25 million in FDIC insurance coverage. The deposits received by the Bank from other network members in exchange for the Bank's customers' deposits placed in the program are not considered as brokered deposits for FFIEC Call Report purposes. Deposit funding raised through the CDARS products can vary significantly between financial reporting periods. CDARS, ICS and other brokered deposits totaled $47,725,000 or 10% of deposits at December 31, 2018, and $69,907,000 or 13% of deposits at December 31, 2017.

State of California Approved Depository

The Bank is an approved depository for the deposit of funds of the State of California. These time deposits are placed with the Bank by the Treasurer of the State of California with maturities of three to six months, and are collateralized by investment securities, mortgage loans or letters of credit issued by the Federal Home Loan Bank ("FHLB"). These deposits totaled $48,500,000 or 10% of deposits at December 31, 2018 and $48,500,000 or 9% of deposits at December 31, 2017.

Internet and Telephone Banking Services

The Bank offers a computerized internet banking system, accessible on the Internet at the Bank's website www.summitstatebank.com, that enables its customers to view account information, access cash management services (including the initiation of automated clearinghouse payments), make transfers between accounts, pay bills, make loan payments, pre-schedule deposit transfers and request loan draws, and view both the front and back of cleared deposit items. The Bank also offers telephone banking services that enable customers to obtain account information, make transfers between accounts, make stop payments, check cleared items, and pre-schedule deposit transfers and loan payments. The Bank has an "app" for cellular phones that allows check image deposits, account inquiries and account transfers.

Other Services

Other services which the Bank offers include banking by appointment, online banking services, direct payroll and social security deposits, letters of credit, access to national automated teller machine networks, courier services, safe deposit boxes, night depository facilities, notary services, travelers checks, lockbox, and banking by mail.

Management evaluates the Bank's services on an ongoing basis, and adds or discontinues services based upon customer needs, competitive factors, and the financial and other capabilities of the Bank. Future services may also be significantly influenced by improvements and developments in technology and evolving state and federal regulations.

Sources of Business

In marketing its services, the Bank capitalizes on its identity as a local, community bank, with officers, directors and shareholders who have business and personal ties to the community. Small to medium-sized businesses are targeted, as well as nonprofit charities.

The Bank competes with other financial institutions in its service area through localized promotional activities, personalized service, and personal contact with potential customers by executive officers, directors, employees and shareholders. Promotional activities include media advertising, community advisory groups and officer participation in community business and civic groups. Officers and directors are active members of the community who call personally on their business contacts and acquaintances in the Sonoma County area to become customers.

Competition

The banking business in California generally, and in the Bank's service area in particular, is highly competitive with respect to both loans and deposits and is dominated by a relatively small number of major banks that have offices operating over wide geographic areas. The Bank competes for deposits and loans with these banks as well as with savings and loan associations, credit unions, mortgage companies, money market funds, stock brokerage firms, insurance companies, and other traditional and non-traditional financial institutions.

Major financial institutions with offices in the service area include Bank of America, Wells Fargo Bank, and JP Morgan Chase. Regional and independent financial institutions with offices in our service area include, among others, Redwood Credit Union, Luther Burbank Savings, Poppy Bank, Exchange Bank, and Westamerica Bank.

The major banks and some of the other institutions have the ability to finance extensive advertising campaigns and to shift their resources to regions or activities of greater potential profitability. Many of the competing banks and other institutions offer diversified financial services which may not be directly offered by the Bank. The major banks also have substantially more capital and higher lending limits.

The Bank competes for customers' funds with governmental and private entities issuing debt or equity securities or other forms of investments which may offer different or higher yields than those available through bank deposits.

Existing and future state and federal legislation could significantly affect the Bank's cost of doing business, its range of permissible activities, and the competitive balance among major, regional and independent banks, and other financial institutions. Management cannot predict the impact these matters may have on commercial banking in general or on the business of the Bank in particular.

To compete with the financial institutions operating in the Bank's service area, the Bank relies upon its independent status to provide flexibility and personalized service to its customers. The Bank emphasizes personal contacts with potential customers by Executive Officers, Directors and employees, develops local promotional activities, and seeks to develop specialized or streamlined services for customers. To the extent customers desire loans in excess of its lending limits or services not offered by the Bank, the Bank attempts to assist customers in obtaining such loans or other services through participations with other banks or assistance from correspondent banks.

Our Address, Telephone Number and Internet Website

Our principal executive offices are located at 500 Bicentennial Way, Santa Rosa, California 95403, and our telephone number is (707) 568-6000. Information about us is available at www.summitstatebank.com. The information on our website is not incorporated by reference into and does not form a part of this report.

REGULATION AND SUPERVISION

Overview

Described below are the material elements of selected laws and regulations applicable to the Bank. The descriptions are not intended to be complete and are qualified in their entirety by reference to the full text of the statutes and regulations described. Changes in applicable laws or regulations, and in their interpretation and application by regulatory agencies and other governmental authorities, cannot be predicted, but may have a material effect on our business, results of operations or financial condition of the business, or results of operations or financial condition of our subsidiaries.

The Bank is extensively regulated by federal and state authorities. As a California state-chartered commercial bank, the Bank is regulated, supervised and examined by the California Department of Business Oversight's Division of Financial Institutions ("DBO") and the FDIC, which is the Bank's primary federal regulator. The regulations of the DBO and the FDIC govern most aspects of the Bank's business relating to dividends, investments, loans, borrowings, capital requirements, certain check-clearing activities, branching, mergers and acquisitions, reserves against deposits, the issuance of securities and numerous other areas. Although the Bank is not a member bank of the Federal Reserve System, it is subject to certain regulations of the Board of Governors of the Federal Reserve System (the "Federal Reserve Board"), such as those dealing with check clearing activities (Regulation CC), and establishment of reserves against deposits (Regulation D). The Bank is also subject to the requirements and restrictions of various consumer laws and regulations, as well as applicable provisions of California law, insofar as they do not conflict with and are not preempted by federal banking laws. Supervision, legal action and examination of the Bank by the regulatory agencies are generally intended to protect depositors and are not intended for the protection of shareholders.

The Bank's deposits are insured by the FDIC to the fullest extent permissible by law. As an insurer of deposits, the FDIC issues regulations, conducts examinations, requires the filing of reports and generally supervises the operations of all institutions to which it provides deposit insurance. The approval of the FDIC is required for certain transactions in which the Bank may engage, including any merger or consolidation by us, the acquisition of another bank, a change in control over us, or the establishment or relocation of any of our branch offices. In reviewing applications seeking approval of such transactions, the FDIC may consider, among other things, the competitive effect and public benefits of the transactions, the capital position and financial and managerial resources and future prospects of the organizations involved in the transaction, the applicant's performance record under the Community Reinvestment Act (see "Community Reinvestment Act and Fair Lending Laws" below) and the effectiveness of the organizations involved in the transaction in combating money laundering activities. The FDIC also has the power to prohibit these and other transactions even if FDIC approval is not required and could do so if the Bank has otherwise failed to comply with all laws and regulations applicable to it. The FDIC may pursue an enforcement action against a bank for unsafe and unsound practices in conducting its business, or for violations of any law, rule or regulation, any consent order with any agency, any condition imposed in writing by the agency, or any written agreement with the agency. Enforcement actions may include the imposition of a conservator or receiver, cease-and-desist orders and written agreements, the termination of insurance of deposits, the imposition of civil money penalties and removal and prohibition orders against institution-affiliated parties.

Statutes, regulations and policies affecting the banking industry are frequently under review by the U.S. Congress and state legislatures, and by the federal and state agencies charged with supervisory and examination authority over banking institutions. Changes in the banking and financial services industry can be expected to occur in the future. Changes in the statutes, regulations or policies that affect the Bank cannot be predicted and may have a material effect on the Bank's business and earnings. In addition, the regulatory agencies that have jurisdiction over the Bank have broad discretion in exercising their supervisory powers and may affect the conduct of our business or impose additional regulatory burdens.

California Law

California law governs the licensing and regulation of California commercial banks, including organizational and capital requirements, fiduciary powers, investment authority, branch offices and electronic terminals, declaration of dividends, changes of control and mergers, interstate branching and banking, debt offerings, borrowing limits, limits on loans to one obligor, liquidation, sale of shares or options in the Bank to its directors, officers, employees and others, the purchase by the Bank of its own shares, and the issuance of capital notes or debentures. The DBO is charged with our supervision and regulation.

With certain limited exceptions, unsecured loans to one person generally may not exceed 15% of the sum of a bank's capital stock, allowance for loan losses and capital notes and debentures, and both secured and unsecured loans to one person (excluding certain secured lending and letters of credit) at any given time generally may not exceed 25% of the sum of a bank's capital stock, allowance for loan losses and capital notes and debentures. Except for limitations on the amount of loans to a single borrower, loans secured by real or personal property may be made to any person without regard to the location or nature of the collateral. The Bank is required to invest its funds in accordance with limitations under California law and may only make investments that are permissible investments for banks, subject to any limitations under any other applicable law.

Under California law, the amount a bank generally may borrow may not exceed its shareholders' equity without the consent of the DBO, except for borrowings from the Federal Home Loan Bank and the Federal Reserve Bank. In addition to remedies available to the FDIC, the Commissioner of the DBO may take possession of a bank if certain conditions exist such as insufficient shareholders' equity, unsafe or unauthorized operations, or violations of law.

The laws of the State of California affect the Bank's business and operations. The California Financial Code provides that if the DBO believes that a bank is violating its articles of incorporation or state law, or is engaging in unsafe or injurious business practices, the DBO can order that bank to comply with the law or to cease the unsafe or injurious practices and has authority to impose civil money penalties. The DBO has the power to suspend or remove bank officers, directors and employees who violate any law or regulation relating to the business of the bank or breach any fiduciary duty to the bank, engage in any unsafe and unsound practices related to the business of the bank, or are charged with or convicted of a felony involving dishonesty or breach of trust. The DBO also has authority to take possession of and to liquidate a bank, to appoint a conservator for a bank and to appoint the FDIC as receiver for a bank.

Dodd-Frank Wall Street Reform and Consumer Protection Act

The Dodd-Frank Act, which was enacted in July 2010, significantly restructured the financial regulatory system in the United States. Provisions of the Dodd-Frank Act that have had or may have a material effect on the Bank's business include, among others, repealing the federal prohibitions on the payment of interest on demand deposits, thereby permitting depository institutions to pay interest on corporate transaction and other accounts, imposing additional underwriting standards on mortgages and restricting so-called "high-cost mortgages," and making permanent the $250,000 limit for federal deposit insurance. The Dodd-Frank Act also centralized responsibility for consumer financial protection by creating a new agency, the Consumer Financial Protection Bureau ("CFPB"), responsible for implementing, examining and enforcing compliance with federal consumer financial protection laws. Many aspects of the Dodd-Frank Act are the subject of rulemakings.

The existing and future rulemakings issued under the Dodd-Frank Act have resulted, and may continue to result, in a significant cost of compliance. The changes resulting from the Dodd-Frank Act may impact the profitability of our business activities, require changes to certain of our business practices, impose upon us more stringent capital, liquidity and leverage requirements or otherwise materially and adversely affect us.

In an Executive Order signed on February 3, 2017, the President of the United States directed the Secretary of the Treasury, in consultation with federal financial regulators, to assess the rules promulgated under the Dodd-Frank Act since 2010 with a view to producing a plan to revise them as necessary. As such, the new U.S. presidential administration and Congress could lead to increased regulatory uncertainty for our industry and for us. It is unknown at this time to what extent new legislation will be passed into law, what pending or new regulatory proposals will be adopted, or if existing legislation or regulations will be repealed. It is also unknown what the effect of such passage, adoption or repeal would have, either positively or negatively, on our industry or on us. If legislation or regulations are implemented or repealed, it may be time-consuming and expensive for us to alter our internal operations in order to comply with such changes.

The Regulatory Relief Act

The Economic Growth, Regulatory Relief, and Consumer Protection Act (the "Regulatory Relief Act") was signed into law in May 2018. The Regulatory Relief Act amends parts of the Dodd-Frank Act, as well as other laws that involve regulation of the financial industry. While the Regulatory Relief Act keeps in place fundamental aspects of the Dodd-Frank Act's regulatory framework, the Regulatory Relief Act includes a number of provisions that are favorable to banks with total assets of less than $10 billion, such as the Bank, and also makes changes to consumer mortgage and credit reporting regulations and to the authorities of the agencies that regulate the financial industry. A number of the provisions included in the Regulatory Relief Act require the federal banking agencies to engage in rulemaking to implement the necessary changes.

The following is a brief summary of select provisions of the Regulatory Relief Act.

- *Simplified Capital Requirements for Community Banks*. The Regulatory Relief Act simplifies capital calculations by requiring regulators to create a community bank leverage ratio of tangible equity/average assets between 8% and 10%. Depository institutions that maintain a higher ratio would automatically be deemed to be well capitalized and in compliance with capital and leverage requirements, although regulators retain the flexibility to determine that a depository institution may not qualify for the community bank leverage ratio test based on the institution's risk profile. On November 21, 2018, the federal banking agencies issued a notice of proposed rulemaking seeking comment on a proposal that would create an alternative, voluntary, capital framework for qualifying institutions that will deem an institution to be well capitalized so long as the institution maintains a leverage ratio of at least 9% and adequately capitalized so long as the institution maintains a leverage ratio of at least 7.5%. Under the proposed rule, banks with less than $10 billion in assets would be able to elect the community bank leverage ratio framework if they meet the 9 percent ratio and if they hold 25 or less percent of assets in off-balance sheet exposures, 5 percent or less of assets in total trading assets and liabilities, 25 percent or less in mortgage servicing assets and 25 percent or less in temporary difference deferred tax assets. The proposal provides details about the calculation of the community bank leverage ratio, the election process and how the agencies would handle situations when banks' leverage ratios deteriorate and when prompt corrective action is required. A qualifying community banking organization that has chosen the alternative framework would not be required to calculate the existing risk-based and leverage capital requirements and would also be considered to have met the capital ratio requirements to be well capitalized for the agencies' prompt corrective action rules, provided it has a community bank leverage ratio greater than 9 percent.

- *Revised Capital Requirements for High Volatility Commercial Real Estate Loans*. The Regulatory Relief Act also provides that federal banking regulators may not impose higher capital standards on High Volatility Commercial Real Estate (HVCRE) exposures unless they are for acquisition, development or construction (ADC), and clarifies ADC status. The Regulatory Relief Act expands the exclusions from the current definition of an HVCRE exposure by (1) excluding loans for (a) the acquisition or refinancing of existing income-producing real property if the cash flow of the property is sufficient to support the debt service and expenses of the property and (b) for improvements to existing income-producing real property if the cash flow of the property is sufficient to support the debt service and expenses of the property and (2) by counting paid development expenses and contributed real property or improvements towards the borrower's contributed capital. This new two-prong test provides lenders with the flexibility to terminate the HVCRE ADC designation and release the borrower's additional capital without the need for refinancing. The Regulatory Relief Act also makes it clear that lenders have discretion to determinate when and if the two-prong test has been satisfied based on their own underwriting criteria.

- *Exception for Certain Reciprocal Deposits from Treatment as Brokered Deposits*. The Regulatory Relief Act amends the Federal Deposit Insurance Act to exclude reciprocal deposits of an insured depository institution from limitations on brokered deposits. A well-managed and well-capitalized depository institution may now hold reciprocal deposits in an amount that does not exceed the lesser of $5 billion or 20% of the depository institution’s total liabilities without those reciprocal deposits being treated as brokered deposits. Reciprocal deposits are defined in the Regulatory Relief Act as deposits that a bank receives through a deposit placement network with the same maturity (if any) and in the same aggregate amount as deposits (other than deposits obtained through a deposit broker) placed by the bank in another network bank. The amendment will also have the effect of lowering deposit insurance premiums for well-capitalized banks that use deposit placement networks.

- *Increase in Asset Threshold for Qualifying for an 18-Month Examination Cycle*. For well-managed, well-capitalized banks, the Regulatory Relief Act increases the asset threshold for institutions qualifying for an 18-month on-site examination cycle, from the current 12-month on-site examination cycle, from $1 billion to $3 billion in total consolidated assets.

- *Short Form Call Reports*. The Regulatory Relief Act requires the federal banking agencies to promulgate regulations allowing an insured depository institution with less than $5 billion in total consolidated assets (and that satisfies such other criteria as determined to be appropriate by the agencies) to submit a short-form call report for its first and third quarters of a calendar year.

- *Consumer Protection Enhancements*. The Regulatory Relief Act improves consumer access to mortgage credit by, among other things, (i) exempting banks with less than $10 billion in assets from the ability-to-repay requirements for certain qualified residential mortgage loans; (ii) removing the requirement to obtain appraisals for certain transactions valued at less than $400,000 in rural areas; (iii) exempting banks and credit unions that originate fewer than 500 open-end and 500 closed-end mortgages from expanded Home Mortgage Disclosure Act data disclosures mandated by the Dodd-Frank Act; (iv) amending the SAFE Mortgage Licensing Act by providing registered mortgage loan originators in good standing with 120 days of transitional authority to originate loans when moving from a federal depository institution to a non-depository institution or across state lines; (v) requiring the CFPB to clarify how TILA-RESPA Integrated Disclosure applies to mortgage assumption transactions and construction-to-permanent home loans as well as outline certain liabilities related to model disclosure use, (vi) adding certain protections for consumers, including veterans and active duty military personnel, expanded credit freezes and creation of an identity theft protection database.

Capital Adequacy Guidelines

Federal bank regulatory agencies have adopted risk-based capital guidelines intended to provide a measure of capital adequacy that reflects the degree of risk associated with a financial institution’s operations. The capital standards require the maintenance of common equity Tier 1 capital, Tier 1 capital and total capital to risk-weighted assets, and a leverage ratio of total assets to Tier 1 capital. Common equity Tier 1 capital is generally defined as common stockholders’ equity and retained earnings. Tier 1 capital is generally defined as common equity Tier 1 and additional Tier 1 capital. Additional Tier 1 capital includes certain noncumulative perpetual preferred stock and related surplus and minority interests in equity accounts of consolidated subsidiaries. Total capital includes Tier 1 capital (common equity Tier 1 capital plus additional Tier 1 capital) and Tier 2 capital. Tier 2 capital is comprised of capital instruments and related surplus, meeting specified requirements, and may include cumulative preferred stock and long-term perpetual preferred stock, mandatory convertible securities, intermediate preferred stock and subordinated debt. Also included in Tier 2 capital is the allowance for loan and lease losses limited to a maximum of 1.25% of risk-weighted assets and, for institutions that have exercised an opt-out election regarding the treatment of Accumulated Other Comprehensive Income (“AOCI”), up to 45% of pre-tax net unrealized gains on available-for-sale securities with readily determinable fair market values. Institutions that have not exercised the AOCI opt-out must incorporate AOCI, including unrealized gains and losses on available-for-sale-securities, into common equity tier 1 capital. The Bank exercised its opt-out election during the first quarter of calendar 2015. Calculation of all types of regulatory capital is subject to deductions and adjustments specified in the regulations.

The guidelines make regulatory capital requirements sensitive to the differences in risk profiles among banking institutions, take off-balance-sheet items into account when assessing capital adequacy, and minimize disincentives to holding liquid low-risk assets.

The guidelines require the Bank to maintain a minimum common equity Tier 1 capital ratio of 4.5%, a Tier 1 capital ratio of 6%, a total capital ratio of 8%, and a Tier 1 leverage ratio of 4%. The guidelines also establish a "capital conservation buffer" of 2.5% above the regulatory minimum capital requirements, which must consist entirely of common equity Tier 1 capital. Phase in of the capital conservation buffer began in January 2016 at 0.625% of risk-weighted assets and increases by that amount each year until fully implemented on January 1, 2019. The capital conservation buffer is designed to absorb losses during periods of economic stress. Banking institutions that fail to maintain the capital conservation buffer will face constraints on dividends, equity repurchases and compensation based on the amount of the shortfall. The above capital ratios are minimum requirements. In practice, banks are expected to operate with more than the minimum capital and the FDIC may establish greater minimum capital requirements for specific institutions.

Prompt Corrective Action

Federal banking agencies, including the FDIC, have adopted regulations implementing a system of prompt corrective action under the Federal Deposit Insurance Corporation Improvement Act. Under the prompt corrective action provisions and implementing regulations, every institution is classified into one of five categories, depending on its total risk-based capital ratio, its common equity Tier 1 ratio, its Tier 1 risk-based capital ratio, its leverage ratio, and subjective factors. The categories are "well capitalized," "adequately capitalized," "undercapitalized," "significantly undercapitalized" and "critically undercapitalized." To be considered well capitalized for purposes of the prompt corrective action rules, a bank must maintain total risk-based capital of 10.0% or greater, Tier 1 risk-based capital of 8.0% or greater, common equity Tier 1 capital of 6.5% or greater, and a leverage ratio of 5.0% or greater. An institution with a capital level that might qualify for well capitalized or adequately capitalized status may nevertheless be treated as though it were in the next lower capital category if its primary federal banking supervisory authority determines that an unsafe or unsound condition or practice warrants that treatment.

A financial institution's operations can be significantly affected by the financial institution's capital classification under the prompt corrective action rules. For example, an institution that is not well capitalized generally is prohibited from accepting brokered deposits and offering interest rates on deposits higher than the prevailing rate in its market without advance regulatory approval, which can have an adverse effect on the bank's liquidity. At each successively lower capital category, an insured depository institution is subject to additional restrictions. Undercapitalized institutions are required to take specified actions to increase their capital or otherwise decrease the risks to the federal deposit insurance funds. Bank regulatory agencies generally are required to appoint a receiver or conservator shortly after an institution becomes critically undercapitalized (with tangible equity to total assets of 2% or less).

As of December 31, 2018, the Bank was well-capitalized and had a common equity Tier 1 capital ratio of 10.5%, a total risk-based capital ratio of 11.6%, a Tier-1 risk-based capital ratio of 10.5%, and a leverage ratio of 9.9%.

In addition to measures taken under the prompt corrective action provisions, commercial banking organizations may be subject to potential enforcement actions by the federal banking agencies for unsafe or unsound practices in conducting their businesses or for violations of any law, rule, regulation, condition imposed in writing by the agency or written agreement with the agency. Enforcement actions may include the issuance of formal and informal agreements, the issuance of a cease-and-desist order that can be judicially enforced, the issuance of directives to increase capital, the imposition of civil money penalties, the issuance of removal and prohibition orders against institution-affiliated parties, the termination of insurance of deposits, the imposition of a conservator or receiver, and the enforcement of such actions through injunctions or restraining orders based upon a judicial determination that the agency would be harmed if such equitable relief was not granted.

Standards for Safety and Soundness

Federal law requires each federal banking agency to prescribe certain standards for all insured depository institutions. These standards relate to, among other things, internal controls, information systems and audit systems, loan documentation, credit underwriting, interest rate risk exposure, asset growth, compensation, and other operational and managerial standards as the agency deems appropriate. Interagency guidelines set forth the safety and soundness standards that the federal banking agencies use to identify and address problems at insured depository institutions before capital becomes impaired. If the appropriate federal banking agency determines that an institution fails to meet any standard prescribed by the guidelines, the agency may require the institution to submit to the agency an acceptable plan to achieve compliance with the standard. If an institution fails to meet these standards, the appropriate federal banking agency may require the institution to implement an acceptable compliance plan. Failure to implement such a plan can result in further enforcement action, including the issuance of a "cease and desist" order or the imposition of civil money penalties.

Deposit Insurance Premiums

The Deposit Insurance Fund of the FDIC insures deposits at insured depository institutions such as the Bank. Deposit accounts in the Bank are insured by the FDIC generally up to a maximum of $250,000 based upon the ownership rights and capacities in which deposit accounts are maintained at the Bank.

The FDIC has developed a risk-based assessment system providing that the assessment rate for an insured depository institution varies according to the level of risk incurred in its activities. Institutions are classified into one of four risk categories. The FDIC is able to assess higher rates to institutions with a significant reliance on secured liabilities or a significant reliance on brokered deposits but, for well-managed and well-capitalized institutions, only when accompanied by rapid asset growth.

Assessments are based on the average consolidated total assets less tangible equity capital of a financial institution. Assessment rates range from 2.5 to 9 basis points on the broader assessment base for banks in the lowest risk category ("well capitalized" and CAMELS 1 or 2) and up to 30 to 45 basis points for banks in the highest risk category.

Effective July 1, 2016, the FDIC changed the way established small banks are assessed for deposit insurance. The FDIC eliminated the risk categories for banks, such as the Bank, that have been FDIC insured for at least five years and have less than $10 billion in total assets, and assessments are now based on financial measures and supervisory ratings derived from statistical modeling estimating the probability of failure within three years. In conjunction with the Deposit Insurance Fund reserve ratio achieving 1.15%, the assessment range (inclusive of possible adjustments) for established small banks with CAMELS 1 or 2 ratings has been reduced to 1.5 to 16 basis points and the maximum assessment rate for established small banks with CAMELS 3 through 5 ratings is 30 basis points.

As of September 30, 2018, the Deposit Insurance Fund reserve ratio exceeded the required minimum of 1.35% set by the Dodd-Frank Act. Small banks, such as the Bank, with total assets less than $10 billion, will receive credits to offset the portion of their assessments that helped to raise the Deposit Insurance Fund reserve ratio from 1.15 percent to 1.35 percent. The total amount of small bank credits was approximately $765 million at December 31, 2018 according to the FDIC's Fourth Quarter 2018 Quarterly Banking Profile. When the Deposit Insurance Fund reserve ratio is at or above 1.38%, the FDIC has stated that it will automatically apply credits to reduce a small bank's regular assessment up to the entire amount of the assessment. Small banks are expected to receive these credits later in 2019.

The FDIC has authority to increase insurance assessments. Any significant increases would have an adverse effect on the operating expenses and results of operations of the Bank. Management cannot predict what assessment rates will be in the future.

Insurance of deposits may be terminated by the FDIC upon a finding that an institution has engaged in unsafe or unsound practices, is in an unsafe or unsound condition to continue operations or has violated any applicable law, regulation, rule, order or condition imposed by the FDIC. The Bank does not currently know of any practice, condition or violation that may lead to termination of its deposit insurance.

Brokered Deposit Restrictions

Well-capitalized institutions are not subject to limitations on brokered deposits, while an adequately capitalized institution is able to accept, renew or roll over brokered deposits only with a waiver from the FDIC and subject to certain restrictions on the yield paid on such deposits. Undercapitalized institutions are generally not permitted to accept, renew, or roll over brokered deposits.

Limitations on Dividends

Under California law, the holders of the Bank's common stock are entitled to receive dividends out of funds legally available for the payment of dividends when and as declared by the Board of Directors, provided the conditions described below are satisfied.

The payment of cash dividends by the Bank depends on various factors, including the earnings and capital requirements of the Bank and other financial conditions. California law provides that, as a state-licensed bank, the Bank may not make a cash distribution to its shareholders in excess of the lesser of the following: (a) the Bank's retained earnings or (b) the Bank's net income for its last three fiscal years, less the amount of any distributions made by the Bank to its shareholders during that period. However, a bank such as the Bank, with the prior approval of the DBO, may make a distribution to its shareholders of an amount not to exceed the greatest of (1) the Bank's retained earnings, (2) the Bank's net income for its last fiscal year, or (3) the Bank's net income for the current fiscal year. If the DBO determines that the shareholders' equity of the Bank is inadequate or that the making of a distribution by the Bank would be unsafe or unsound, the DBO may order the Bank to refrain from making a proposed distribution.

The FDIC and the DBO have authority to prohibit a bank from engaging in business practices that are considered to be unsafe or unsound. Depending upon the financial condition of the Bank and upon other factors, the FDIC or the DBO could assert that payments of dividends or other payments by the Bank might be an unsafe or unsound practice.

Reserve Requirements

The Bank is subject to the uniform reserve requirements of the Federal Reserve Board's Regulation D, which applies to all depository institutions with transaction accounts or non-personal time deposits. During 2018, amounts in transaction accounts above $16 million and up to $122.3 million were required to have reserves held against them in the ratio of 3% of such amounts. Amounts above $122.3 million required reserves of $3,189,000 plus 10% of the amount in excess of $122.3 million. The Federal Reserve Board changes its reserve requirements on an annual basis and the Bank is subject to new requirements for 2019. The Bank was in compliance with its reserve requirements at December 31, 2018 and is in compliance with its current reserve requirements.

Transactions with Related Parties and Insiders

Transactions between banks and their related parties or affiliates are limited by Sections 23A and 23B of the Federal Reserve Act. An affiliate of a bank is any company or entity that controls, is controlled by or is under common control with the bank. In a holding company context, the parent bank holding company and any companies which are controlled by such parent holding company are affiliates of the bank.

Generally, Section 23A of the Federal Reserve Act and the Federal Reserve Board's Regulation W limit the extent to which a bank or its subsidiaries may engage in "covered transactions" with any one affiliate to an amount equal to 10.0% of such bank's capital stock and surplus, and contain an aggregate limit on all such transactions with all affiliates to an amount equal to 20.0% of such bank's capital stock and surplus. The term ''covered transaction'' includes the making of loans, purchase of assets, issuance of guarantees and other similar transactions. In addition, loans or other extensions of credit by the bank to an affiliate are required to be collateralized in accordance with regulatory requirements and the bank's transactions with affiliates must be consistent with safe and sound banking practices and may not involve the purchase by the bank of any low-quality asset. Section 23B applies to covered transactions as well as certain other transactions and requires that all such transactions be on terms substantially the same, or at least as favorable, to the institution or subsidiary as those provided to non-affiliates.

Section 22(h) of the Federal Reserve Act and the Federal Reserve Board's Regulation O govern extensions of credit made by a bank to its directors, executive officers, and principal stockholders (''insiders''). Among other things, these provisions require that extensions of credit to insiders be made on terms that are substantially the same as, and follow credit underwriting procedures that are not less stringent than, those prevailing for comparable transactions with unaffiliated persons and that do not involve more than the normal risk of repayment or present other unfavorable features. Further, such extensions may not exceed certain limitations on the amount of credit extended to such persons, individually and in the aggregate, which limits are based, in part, on the amount of the Bank's capital. Extensions of credit in excess of certain limits must also be approved by the board of directors.

Customer Privacy

Federal law currently contains extensive customer privacy protection provisions. Under these provisions, a financial institution must provide to its customers, at the inception of the customer relationship and annually thereafter, the institution's policies and procedures regarding the handling of customers' nonpublic personal financial information. These provisions also provide that, except for certain limited exceptions, a financial institution may not provide such personal information to unaffiliated third parties unless the institution discloses to the customer that such information may be so provided and the customer is given the opportunity to opt out of such disclosure. Further, under the "Interagency Guidelines Establishing Information Security Standards," banks must implement a comprehensive information security program that includes administrative, technical, and physical safeguards to ensure the security and confidentiality of customer information. Federal law makes it a criminal offense, except in limited circumstances, to obtain or attempt to obtain customer information of a financial nature by fraudulent or deceptive means.

Cybersecurity

Statements by federal regulators regarding cybersecurity indicate that financial institutions should design multiple layers of security controls to establish lines of defense and to ensure that their risk management processes also address the risk posed by compromised client credentials, including security measures to reliably authenticate clients accessing Internet-based services of the financial institution. Financial institution management is also expected to maintain sufficient business continuity planning processes to ensure the rapid recovery, resumption and maintenance of the institution's operations after a cyber-attack involving destructive malware. A financial institution is expected to develop appropriate processes to enable recovery of data and business operations and address rebuilding network capabilities and restoring data if the institution or its critical service providers fall victim to this type of cyber-attack. If the Bank fails to observe regulatory guidance regarding appropriate cybersecurity safeguards, we could be subject to various regulatory sanctions, including financial penalties.

In the ordinary course of business, the Bank relies on electronic communications and information systems to conduct its operations and to store sensitive data. The Bank employs an in-depth, layered, defensive approach that incorporates security processes and technology to manage and maintain cybersecurity controls. We employ a variety of preventative and detective tools to monitor, block, and provide alerts regarding suspicious activity, as well as to report on any suspected advanced persistent threats. Notwithstanding the strength of the Bank's defensive measures, the threat from cyber-attacks is severe, attacks are sophisticated and increasing in volume, and attackers respond rapidly to changes in defensive measures. While to date we have not experienced a significant compromise, significant data loss or any material financial losses related to cybersecurity attacks, our systems and those of our clients and third-party service providers are under constant threat and it is possible that we could experience a significant event in the future. Risks and exposures related to cybersecurity attacks are expected to remain high for the foreseeable future due to the rapidly evolving nature and sophistication of these threats, as well as due to the expanding use of Internet banking, mobile banking and other technology-based products and services by the Bank and its clients.

Community Reinvestment Act and Fair Lending Laws

Under the Community Reinvestment Act of 1977 ("CRA"), the FDIC is required to assess the record of all financial institutions regulated by it to determine if such institutions are meeting the credit needs of the community (including low and moderate-income neighborhoods) which they serve. CRA performance evaluations are based on a four-tiered rating system: Outstanding, Satisfactory, Needs to Improve and Substantial Noncompliance. CRA performance evaluations are considered in evaluating applications for such things as mergers, acquisitions and applications to open branches. The Bank has a CRA rating of "Satisfactory".

In addition, the Equal Credit Opportunity Act and the Fair Housing Act prohibit lenders from discriminating in their lending practices on the basis of characteristics specified in those statutes. The failure to comply with the Equal Credit Opportunity Act and the Fair Housing Act could result in enforcement actions by the FDIC, the Department of Housing and Urban Development, and the Department of Justice, and in private civil actions by borrowers.

Anti-Money Laundering and OFAC

Under federal law, financial institutions must maintain anti-money laundering programs that include established internal policies, procedures and controls; a designated compliance officer; an ongoing employee training program; and testing of the program by an independent audit function. Financial institutions are also prohibited from entering into specified financial transactions and account relationships and must meet enhanced standards for due diligence and customer identification in their dealings with foreign financial institutions and foreign customers. Financial institutions must take reasonable steps to conduct enhanced scrutiny of account relationships to guard against money laundering and to report any suspicious transactions, and law enforcement authorities have been granted increased access to financial information maintained by financial institutions. Bank regulators routinely examine institutions for compliance with these obligations, and they must consider an institution's compliance in connection with the regulatory review of applications, including applications for banking mergers and acquisitions. The regulatory authorities have imposed "cease and desist" orders and civil money penalty sanctions against institutions found to be violating these obligations.

The Office of Foreign Assets Control ("OFAC") is responsible for helping to ensure that U.S. entities do not engage in transactions with certain prohibited parties, as defined by various Executive Orders and Acts of Congress. OFAC sends bank regulatory agencies lists of persons and organizations suspected of aiding, harboring or engaging in terrorist acts or narcotics trafficking, known as Specially Designated Nationals and Blocked Persons. If the Bank finds a name on any transaction, account or wire transfer that is on an OFAC list, the Bank must freeze such account, file a suspicious activity report and notify the appropriate authorities.

Programs to Mitigate Identity Theft

In November 2007, federal banking agencies together with the NCUA and FTC adopted regulations under the Fair and Accurate Credit Transactions Act of 2003 to require financial institutions and other creditors to develop and implement a written identity theft prevention program to detect, prevent and mitigate identity theft in connection with certain new and existing accounts. Covered accounts generally include consumer accounts and other accounts that present a reasonably foreseeable risk of identity theft. Each institution's program must include policies and procedures designed to: (i) identify indicators, or "red flags," of possible risk of identity theft; (ii) detect the occurrence of red flags; (iii) respond appropriately to red flags that are detected; and (iv) ensure that the program is updated periodically as appropriate to address changing circumstances. The regulations include guidelines that each institution must consider and, to the extent appropriate, include in its program.

Consumer Protection Laws

The Bank is subject to a number of federal and state laws designed to protect borrowers and promote lending to various sectors of the economy. These laws include the Equal Credit Opportunity Act, the Fair Housing Act, the Fair Credit Reporting Act, the Fair and Accurate Credit Transactions Act, the Truth in Lending Act, the Home Mortgage Disclosure Act, and the Real Estate Settlement Procedures Act, and various state law counterparts. Further, the Dodd-Frank Act established the CFPB, which has the responsibility for making rules and regulations under the federal consumer protection laws relating to financial products and services. The CFPB also has a broad mandate to prohibit unfair or deceptive acts and practices and is specifically empowered to require certain disclosures to consumers and draft model disclosure forms. Failure to comply with consumer protection laws and regulations can subject financial institutions to enforcement actions, fines and other penalties. The FDIC will examine the Bank for compliance with CFPB rules and will enforce CFPB rules with respect to the Bank.

Federal and State Securities Laws

The Bank's common stock is registered with the FDIC under section 12(i) of the Securities Exchange Act of 1934 (the "Exchange Act"). As such, we are subject to the information, proxy solicitation, insider trading restrictions and other requirements of the Exchange Act. Further, if the

Bank wishes to sell common stock or other securities to raise capital in the future, it will be subject to the anti-fraud and other applicable provisions of state and federal securities laws.

Although the Bank is exempt from the registration requirements of the federal Securities Act of 1933, and as such is not required to file a prospectus with the SEC, the FDIC, or any other federal agency before commencing the sale of its stock, California does not exempt bank stock offerings from securities registration and qualification requirements. A California-chartered bank generally must obtain a permit from the DBO to sell its stock. The DBO will generally approve the application if the DBO determines that the stock offering is fair, just, and equitable. The permit required to sell stock applies to private placement transactions and public offerings conducted by California-chartered banks.

Legislation and Proposed Changes

From time to time, legislation is enacted which has the effect of increasing the cost of doing business, limiting or expanding permissible activities or affecting the competitive balance between banks and other financial institutions. Proposals to change the laws and regulations governing the operations and taxation of banks, bank holding companies and other financial institutions are frequently made in Congress, in the California legislature and before various bank regulatory agencies. Typically, the intent of this type of legislation is to strengthen the banking industry. No prediction can be made as to the likelihood of any major changes or the impact that new laws or regulations might have on the Bank.

Employees

As of December 31, 2018, the Bank employed a total of 89 employees in various capacities, all located in California. The Bank's employees are not represented by any union or covered by any collective bargaining agreement. The Bank considers its relationships with its employees to be good.

ITEM 1A. RISK FACTORS

The risks and uncertainties described below are not the only ones facing us. Additional risks and uncertainties that management is not aware of or focused on or that management currently deems immaterial may also impair our business operations. This report is qualified in its entirety by these risk factors.

Economic or Market Risks

The Bank's Business May Be Adversely Affected by General Economic Conditions Including Conditions in California.

The banking business is affected by general economic and political conditions, both domestic and international, and by governmental monetary and fiscal policies. Conditions such as inflation, recession, unemployment, volatile interest rates, money supply, scarce natural resources, weather, natural disasters such as earthquakes, international disorders, and other factors beyond the Bank's control may adversely affect the profitability of the Bank.

A substantial majority of the Bank's assets and deposits are generated in Northern California. Local economic conditions in this area can have a significant impact on the demand for our products and services, the ability of borrowers to pay interest on and repay the principal of our loans, and the value of the collateral securing these loans. Adverse changes in economic conditions in the Northern California market may negatively affect our business, results of operations or financial condition.

The Bank Is Highly Dependent on Real Estate and Events that Negatively Impact the Real Estate Market Could Hurt Our Business.

A significant portion of our loan portfolio is dependent on real estate. At December 31, 2018, real estate served as the principal source of collateral with respect to approximately 91% of our loan portfolio. A future decline in the value of the real estate securing our loans and real estate owned by us could adversely impact our financial condition. In addition, acts of nature, including earthquakes, brush fires and floods, which may cause uninsured damage and other loss of value to real estate that secures these loans, may also negatively impact our financial condition. This is particularly significant in light of the fact that substantially all of the real estate that makes up the collateral of our real estate-secured loans is located in Northern California, where earthquakes and brush fires are common.

Lending and Other Operating Risks

Our Allowance for Loan Losses May Prove to Be Insufficient to Absorb Losses in Our Loan Portfolio.

Lending money is a substantial part of our business. Every loan carries a certain risk that it will not be repaid in accordance with its terms or that any underlying collateral will not be sufficient to assure repayment. This risk is affected by, among other things:

- cash flow of the borrower and/or the project being financed;
- the changes and uncertainties as to the future value of the collateral, in the case of a collateralized loan;
- the credit experience of a particular borrower;
- changes in economic and industry conditions; and
- the duration of the loan.

The Bank maintains an allowance for loan losses, a reserve established through a provision for loan losses charged to expense, which the Bank believes is appropriate to provide for probable losses in its loan portfolio. The amount of this allowance is determined by Bank management through a periodic review and consideration of several factors, including, but not limited to:

- our general reserve, based on our historical default and loss experience as well as current macroeconomic factors; and
- our specific reserve, based on our evaluation of non-performing loans and their underlying collateral.

The determination of the appropriate level of the allowance for loan losses inherently involves a high degree of subjectivity and requires us to make significant estimates of current credit risks and future trends, all of which may undergo material changes. Continuing deterioration in economic conditions affecting borrowers, new information regarding existing loans, identification of additional problem loans and other factors, both within and outside of our control, may require an increase in the allowance for loan losses. In addition, bank regulatory agencies periodically review our allowance for loan losses and may require an increase in the provision for possible loan losses or the recognition of further loan charge-offs, based on judgments different than those of management. In addition, if charge-offs in future periods exceed the allowance for loan losses, we may need additional provisions to replenish the allowance for loan losses. Any increases in the allowance for loan losses will result in a decrease in net income and, most likely, capital, and may have a material negative effect on our financial condition and results of operations.

A new accounting standard may require us to increase our allowance for loan losses and may have a material adverse effect on our financial condition and results of operations.

The Financial Accounting Standards Board ("FASB") has adopted a new accounting standard that will be effective for the Bank's fiscal year, and interim periods within the fiscal year, beginning January 1, 2020. This standard, referred to as Current Expected Credit Loss, or CECL, will require financial institutions to determine periodic estimates of lifetime expected credit losses on loans, and recognize the expected credit losses as allowances for loan losses. This will change the current method of providing allowances for loan losses that are probable, which may require us to increase our allowance for loan losses, and to greatly increase the types of data we will need to collect and review to determine the appropriate level of the allowance for loan losses. Any change in the allowance for loan losses at the time of adoption will be an adjustment to retained earnings and would change the Bank's capital levels. A banking organization that experiences a reduction in retained earnings as of the CECL adoption date may elect to phase in the day-one regulatory capital impact of adopting CECL over a three-year transition period. Any increase in our allowance for loan losses or expenses incurred to determine the appropriate level of the allowance for loan losses may have a material adverse effect on our financial condition and results of operations. Upon adoption of the CECL, credit loss allowances may increase, which would decrease retained earnings and thereby affect common equity tier 1 capital for regulatory capital purposes. CECL implementation poses operational risk, including the failure to properly transition internal processes or systems, which could lead to call report errors, financial misstatements, or operational losses. Successful implementation may require adjustments to existing data elements and credit loss methods.

Regulatory requirements affecting our loans secured by commercial real estate could limit our ability to leverage our capital and adversely affect our growth and profitability.

Rising commercial real estate lending concentrations may expose institutions like us to unanticipated earnings and capital volatility in the event of adverse changes in the commercial real estate market. In addition, institutions that are exposed to significant commercial real estate concentration risk may be subject to increased regulatory scrutiny. The federal banking agencies have issued guidance for institutions that are deemed to have concentrations in commercial real estate lending. Pursuant to the supervisory criteria contained in the guidance for identifying institutions with a potential commercial real estate concentration risk, institutions that have (i) total reported loans for construction, land development, and other land which represent 100% or more of an institution's total risk-based capital; or (ii) total commercial real estate loans which represent 300% or more of the institution's total risk-based capital and an increase in the outstanding balance of the institution's commercial real estate loan portfolio of 50% or more during the prior 36 months, are identified as having potential commercial real estate concentration risk. As of December 31, 2018, our loans for construction, land development and other land represented 37% of our total risk-based capital. The Bank's non-owner occupied commercial real estate concentration at December 31, 2018 was 258% of the Bank's capital. Management has implemented and continues to maintain heightened portfolio monitoring and reporting, and enhanced underwriting criteria with respect to its commercial real estate portfolio. Nevertheless, our level of commercial real estate lending could limit our growth or require us to obtain additional capital and could have a material adverse effect on our business, financial condition and results of operations.

Our Business is Subject to Liquidity Risk and Changes in Our Source of Funds May Affect Our Performance and Financial Condition.

Our ability to make loans is directly related to our ability to secure funding. In addition to local deposits, the Bank receives funding from FHLB advances, brokered deposits and State of California time deposits, when such alternatives are attractive compared to the cost of attracting additional local deposits. These alternative sources of funds, along with local time deposits, are sensitive to interest rates and can affect the cost of funds and net interest margin. Liquidity risk arises from the inability to meet obligations when they come due or to manage the unplanned decreases or changes in funding sources. Although we believe we can continue to successfully pursue a local deposit funding strategy, if there are significant fluctuations in local deposit balances or if one of the alternative sources of funds becomes unavailable, we may experience an adverse effect on our financial condition and results of operations.

Changes in interest rates may reduce our net income.

The income of the Bank depends to a great extent on the difference between the interest rates earned on its loans, securities and other interest-earning assets and the interest rates paid on its deposits and other interest-bearing liabilities. These rates are highly sensitive to many factors that are beyond the Bank's control, including general economic conditions and the policies of various governmental and regulatory agencies, in particular the Federal Reserve Board. A change in interest rates could have a material adverse effect on the Bank's results of operations, financial condition and prospects by reducing the spread between income realized on interest earning assets and interest paid on interest bearing liabilities. Generally, the value of fixed-rate securities fluctuates inversely with changes in interest rates. Therefore, an increase in interest rates could cause the fair value of the Bank's securities investments to decrease. See "Quantitative and Qualitative Disclosures About Market Risk" on page 53.

We Are Exposed to Risk of Environmental and Other Liabilities with Respect to Properties to Which We Take Title.

In the course of our business, we may foreclose and take title to real estate, and could be subject to environmental or other liabilities with respect to these properties. The Bank may be held liable to a governmental entity or to third persons for property damage, personal injury, investigation and clean-up costs incurred by these parties in connection with environmental contamination, or the Bank may be required to investigate or clean up hazardous or toxic substances, or chemical releases at a property. The costs associated with investigation or remediation activities could be substantial. In addition, in the event the Bank becomes the owner or former owner of a contaminated site, the Bank may be subject to common law claims by third parties based on damages and costs resulting from environmental contamination emanating from the property. If the Bank ever becomes subject to significant environmental liabilities, our business, financial condition, liquidity and results of operations could be materially and adversely affected.

We Are Exposed to Adverse, Regulatory, Reputation and Litigation Risk with Respect to California's Marijuana Laws

The California Adult Use of Marijuana Act authorizes adults 21 and over to possess, privately use, and give away up to one ounce of cannabis, and to cultivate no more than six plants for personal use at their residence. It also legalizes the commercial sale, distribution and production of cannabis for adult use at state-licensed facilities beginning January 1, 2018, under terms spelled out in the Medical and Adult Use of Cannabis Regulation and Safety Act approved by the legislature in 2017. Local city and county governments can restrict or ban cannabis businesses in their jurisdiction. Marijuana remains illegal under the federal Controlled Substances Act and banks are prohibited from knowingly providing banking services to enterprises that are illegal under federal law. However, in 2013, the U.S. Department of Justice issued the "Cole Memorandum," which directed federal prosecutors to focus prosecutorial priorities away from state-legal marijuana activity unless certain heightened risk factors were present. Further, in 2014, the Financial Crimes Enforcement Network or FinCEN issued guidance to banks on how to comply with the due diligence and reporting requirements in the Bank Secrecy Act when providing banking services to marijuana businesses.

On January 4, 2018, the U.S. Attorney General announced the rescission of the Cole Memorandum and announced that federal prosecutors retain the discretion to prosecute violations of the Controlled Substances Act, including state-legal recreational marijuana activity, in accordance with principles that govern all federal prosecutions. The Bank does not offer banking services to marijuana-related enterprises. However, in the course of our business, we may foreclose and take title to real estate that is used in a marijuana business, or may inadvertently offer loan or deposit services to customers who engage in that business if the customer misrepresents or hides its involvement in the cannabis industry. In the event the Bank unknowingly provides banking services to a marijuana-related business, or holds funds used in a marijuana business, or is seen as participating in an illegal enterprise, the Bank may be subject to additional risk, including through litigation, regulatory enforcement actions, collateral asset seizure, and reputation risk.

Our Growth or Future Losses May Require Us to Raise Additional Capital in the Future, but That Capital May Not Be Available When It Is Needed or the Cost of That Capital May Be Very High.

Under applicable government regulations, the Bank is permitted to make unsecured loans to any single borrower or group of related borrowers in an amount that will not exceed 15% of its shareholders' equity, plus the allowance for loan losses, capital notes and debentures, and secured loans in an amount that, when combined with unsecured loans made to the same borrower or group of related borrowers, will not exceed 25% of its shareholders' equity, plus the allowance for loan losses, capital notes and debentures ("Lending Limits"). Such Lending Limits make it more difficult for the Bank to attract borrowers who have lending requirements in excess of those Lending Limits and, as a result, the future success of the Bank depends on, among other things, its ability to increase capital (and thereby the amount of the loans it will be able to make to borrowers) by selling additional common stock, preferred stock or subordinated debt. The Bank has no plans at this time to sell any such securities (except upon issuance of options to directors and employees under its stock option plan). However, if the need to do so should arise, either because of the Bank's desire to make larger loans to accommodate customers or to meet regulatory capital requirements as a result of growth or losses, there is no assurance that the Bank's efforts to raise such additional capital will be successful or that the sale of additional shares will not dilute the ownership of current investors. Any dilution of current investors could be substantial. The Bank seeks the participation of other banks and lending institutions, as co-lenders with it, for loans that exceed the Bank's Lending Limits; however, there can be no assurance that other lending institutions will be interested in doing so.

The Accuracy of the Bank's Judgments and Estimates about Financial and Accounting Matters Will Impact Operating Results and Financial Condition.

The Bank makes certain estimates and judgments in preparing its financial statements. The quality and accuracy of those estimates and judgments will have an impact on the Bank's operating results and financial condition. Three items that are subject to material estimates and judgments include the consideration of other than temporary impairment of investment securities, the recorded goodwill asset of $4,119,000 and the allowance for loan losses of $6,029,000 as of December 31, 2018. Although management supports its estimates and judgments by employing third party reviews there are no assurances that regulatory reviews may result in a different conclusion or future events may occur that impact the recorded values resulting in material fluctuations of financial results. See "Management's Discussion and Analysis of Financial Condition and Results of Operations – Critical Accounting Policies and Estimates" beginning on page 34.

Failure to Successfully Execute Our Strategy Could Adversely Affect Our Performance.

Along with the other factors listed herein, our financial performance and profitability depends on our ability to execute our corporate growth strategy. Continued growth may present operating and other problems that could adversely affect our business, financial condition and results of operations. Accordingly, there can be no assurance that the Bank will be able to execute its growth strategy or maintain the level of profitability that it has recently experienced.

Changes in Tax Laws Could Have an Adverse Effect on Us, Our Industry, Our Customers, The Value of Collateral Securing Our Loans and Demand for Our Loans.

Federal tax reform legislation enacted by Congress in December 2017 contains a number of provisions that could have an impact on the banking industry, borrowers and the market for single-family residential and multifamily residential real estate. Among the changes are: a lower cap on the amount of mortgage interest that a borrower may deduct on single-family residential mortgages; the lower mortgage interest cap will be spread among all of the borrower's residential mortgages, which may result in elimination or lowering of the mortgage interest deduction on a second home; limitations on deductibility of business interest expense; limitations on the deductibility of state and local income and property taxes. Such changes could have an adverse effect on the market for and valuation of single-family residential properties and multifamily residential properties, and on the demand for such loans in the future. If home ownership or multifamily residential property ownership becomes less attractive, demand for our loans would decrease. The value of the properties securing loans in our portfolio may be adversely impacted as a result of the changing economics of home ownership and multifamily residential ownership, which could require an increase in our provision for loan losses, which would reduce our profitability and could materially adversely affect our business, financial condition and results of operations.

We Are Dependent on Our Management Team and Key Employees, and If We Are Not Able to Retain Them, Our Business Operations Could Be Materially Adversely Affected.

Our success depends, in large part, on our management team and key employees. Our management team has significant industry experience. Our future success also depends on our continuing ability to attract, develop, motivate and retain key employees. Qualified individuals are in high demand, and we may incur significant costs to attract and retain them. Because the market for qualified individuals is highly competitive, we may not be able to attract and retain qualified officers or candidates. The loss of any of our management team or our key employees could materially adversely affect our ability to execute our business strategy, and we may not be able to find adequate replacements on a timely basis, or at all. We cannot ensure that we will be able to retain the services of any members of our management team or other key employees. Though we have change-in-control agreements in place with certain members of our management team they may still elect to leave at any time. Failure to attract and retain a qualified management team and qualified key employees could have a material adverse effect on our business, financial condition and results of operations.

Our operations could be interrupted if our third-party service providers experience difficulty, terminate their services or fail to comply with banking regulations.

We depend to a significant extent on a number of relationships with third-party service providers. Specifically, we receive core systems processing, essential web hosting and other internet systems, deposit processing and other processing services from third-party service providers. If these third-party service providers experience difficulties or terminate their services and we are unable to replace them with other service providers, our operations could be interrupted. If an interruption were to continue for a significant period of time, our business, financial condition and results of operations could be adversely affected, perhaps materially. Even if we are able to replace them, it may be at a higher cost to us, which could adversely affect our business, financial condition and results of operations.

We have a continuing need for technological change, and we may not have the resources to effectively implement new technology or we may experience operational challenges when implementing new technology.

The financial services industry is undergoing rapid technological changes with frequent introductions of new technology-driven products and services. In addition to better serving customers, the effective use of technology increases efficiency and enables financial institutions to reduce costs. Our future success will depend in part upon our ability to address the needs of our customers by using technology to provide products and services that will satisfy customer demands for convenience as well as to create additional efficiencies in our operations as we continue to grow and expand our market area. We may experience operational challenges as we implement these new technology enhancements, or seek to implement them across all of our offices and business units, which could result in us not fully realizing the anticipated benefits from such new technology or require us to incur significant costs to remedy any such challenges in a timely manner.

Many of our larger competitors have substantially greater resources to invest in technological improvements. As a result, they may be able to offer additional or superior products to those that we will be able to offer, which would put us at a competitive disadvantage. Accordingly, a risk exists that we will not be able to effectively implement new technology-driven products and services or be successful in marketing such products and services to our customers.

The Bank's Information Systems May Experience an Interruption or Breach in Security.

The Bank relies heavily on communications and information systems to conduct its business. Any failure, interruption or breach in security of these systems could result in failures or disruptions in the Bank's customer relationship management and systems. There can be no assurance that any such failures, interruptions or security breaches will not occur or, if they do occur, that they will be adequately corrected by the Bank. The occurrence of any such failures, interruptions or security breaches could damage the Bank's reputation, result in a loss of customer business, subject the Bank to additional regulatory scrutiny, or expose the Bank to litigation and possible financial liability, any of which could have a material adverse effect on the Bank's financial condition and results of operations.

The Bank May Be Adversely Affected by Disruptions to Our Network and Computer Systems or To Those of Our Service Providers as A Result of Denial-Of-Service or Other Cyber Attacks.

We may experience disruptions or failures in our computer systems and network infrastructure or in those of our service providers as a result of denial-of-service or other cyber attacks in the future. We have developed and continue to invest in, systems and processes that are designed to detect and prevent security breaches and cyber attacks. Due to the increasing sophistication of such attacks, we may not be able to prevent denial-of-service or other cyber attacks that could compromise our normal business operations, compromise the normal business operations of our customers, or result in the unauthorized use of customers' confidential and proprietary information. The occurrence of any failure, interruption or security breach of network and computer systems resulting from denial-of-service or other cyber attacks could damage our reputation, result in a loss of customer business, subject us to additional regulatory scrutiny, or expose us to civil litigation and possible financial liability, any of which could adversely affect our business, results of operations or financial condition.

The Bank's Controls and Procedures May Fail or Be Circumvented.

Management regularly reviews and updates the Bank's internal control over financial reporting, disclosure controls and procedures, and corporate governance policies and procedures. Any system of controls and procedures, however well designed and operated, is based in part on certain assumptions and can provide only reasonable, not absolute, assurances that the objectives of the system are met. Any failure or circumvention of the Bank's controls and procedures or failure to comply with regulations related to controls and procedures could have a material adverse effect on the Bank's business, results of operations and financial condition.

Regulatory Risks

The Bank's Business is Subject to Extensive Government Regulation and Legislation.

The Bank is subject to extensive state and federal regulation, supervision and legislation, and the laws that govern the Bank and its operations are subject to change from time to time. Applicable laws and regulations provide for the regular examination and supervision of institutions; affect the cost of funds through reserve requirements and assessments on deposits; limit or prohibit the payment of interest on demand deposits; limit the kinds of investments a bank or bank holding company can make and the kinds of activities in which it can engage; and grant the regulatory agencies broad enforcement authority in case of violations. The laws and regulations increase the cost of doing business and have an adverse impact on the ability of the Bank to compete efficiently with other financial services providers that are not similarly regulated. There can be no assurance that future regulation or legislation will not impose additional requirements and restrictions on the Bank in a manner that will adversely affect its results of operations, financial condition and prospects. See "Information About Summit State Bank – Competition and Regulation and Supervision" on pages 4 through 21.

Changes in laws and regulations and the cost of compliance with new laws and regulations may adversely affect our operations and our income.

We are subject to extensive regulation, supervision and examination by the DBO and the FDIC. These regulatory authorities have extensive discretion in connection with their supervisory and enforcement activities, including the ability to impose restrictions on a bank's operations, reclassify assets, determine the adequacy of a bank's allowance for loan losses and determine the level of deposit insurance premiums assessed. Because our business is highly regulated, the laws and applicable regulations are subject to frequent change. Any change in these regulations and oversight, whether in the form of regulatory policy, new regulations or legislation or additional deposit insurance premiums could have a material impact on our operations.

The potential exists for additional federal or state laws and regulations, or changes in policy, affecting lending and funding practices and liquidity standards. Moreover, bank regulatory agencies have been active in responding to concerns and trends identified in examinations, and have issued many formal enforcement orders requiring capital ratios in excess of regulatory requirements. Bank regulatory agencies, such as the FDIC, DBO, Federal Reserve Board and CFPB, directly or indirectly govern the activities in which we may engage, primarily for the protection of depositors and consumers, and not for the protection or benefit of potential investors. In addition, new laws and regulations may increase our costs of regulatory compliance and of doing business, and otherwise affect our operations. New laws and regulations may significantly affect the markets in which we do business, the markets for and value of our loans and investments, the fees we can charge and our ongoing operations, costs and profitability.

The Bank's Ability to Declare Future Dividends Is Subject to Certain Limitations.

The Bank's ability to pay dividends is limited by law, regulation and the financial condition of the Bank. There can be no assurance that the Bank will continue to pay dividends at the rate and frequency at which it has done so in the past or that any dividends will be declared and paid in the future at all. See "Regulation and Supervision - Limitations on Dividends" on page 16.

We face a risk of noncompliance and enforcement action with the Bank Secrecy Act and other anti-money laundering statutes and regulations.

The Bank Secrecy Act of 1970, the Uniting and Strengthening America by Providing Appropriate Tools to Intercept and Obstruct Terrorism Act of 2001, or the USA PATRIOT Act, or Patriot Act, and other laws and regulations require financial institutions, among other duties, to institute and maintain an effective anti-money laundering program and to file reports such as suspicious activity reports and currency transaction reports. We are required to comply with these and other anti-money laundering requirements. Our federal and state banking regulators, the Financial Crimes Enforcement Network, or FinCEN, and other government agencies are authorized to impose significant civil money penalties for violations of anti-money laundering requirements. We are also subject to increased scrutiny of compliance with the regulations issued and enforced by the Office of Foreign Assets Control, or OFAC. If our program is deemed deficient, we could be subject to liability, including fines, civil money penalties and other regulatory actions, which may include restrictions on our business operations and our ability to pay dividends, restrictions on mergers and acquisitions activity, restrictions on expansion, and restrictions on entering new business lines. Failure to maintain and implement adequate programs to combat money laundering and terrorist financing could also have significant reputational consequences for us. Any of these circumstances could have a material adverse effect on our business, financial condition or results of operations.

Competitive Risks

The Bank's Business Is Highly Competitive.

In California generally, and in the Bank's service area specifically, major banks and regional banks dominate the commercial banking market. By virtue of their larger capital bases, such institutions have substantially greater financial, marketing and operational resources than the Bank and offer diversified services that might not be directly offered by the Bank. The Bank competes with these larger commercial banks and other financial institutions, such as savings and loan associations and credit unions, which offer services traditionally offered only by banks. In addition, the Bank competes with other institutions such as money market funds, brokerage firms, commercial finance companies, leasing companies, and even retail stores seeking to penetrate the financial services market. No assurance can be given, however, that the Bank's efforts to compete with other banks and financial institutions will continue to be successful. In addition, the costs of providing a high level of personal service could adversely affect the Bank's operating results. See "Information About Summit State Bank - Competition" on page 7.

The Bank Depends on Loan Originations to Grow Its Business.

The Bank's success depends on, among other things, its ability to originate loans. Real estate valuations in the Bank's market area have escalated in recent years and may not be sustained. The Bank's competitors may offer better terms or better service, or respond to changing capital and other regulatory requirements better than the Bank is able to do. Some of the Bank's competitors make loans on terms that the Bank is not willing to match. Success in competing for loans depends on such factors as:

- Quality of service to borrowers, especially the time it takes to process loans;
- Economic factors, such as interest rates;
- Terms of the loans offered, such as rate adjustment provisions, adjustment caps, loan maturities, loan-to-value ratios and loan fees; and
- Size of the loan.

Our Share Price May Be Volatile.

A limited trading market exists for our common shares which could lead to price volatility. Your ability to sell our common shares depends upon the existence of an active trading market for our common shares. While our stock is quoted on the NASDAQ Global Market, there is low trading volume in our common stock. As a result, you may be unable to sell or purchase our common shares at the volume, price and time you desire. The limited trading market for our common shares may cause fluctuations in the market value of our common shares to be exaggerated, leading to price volatility in excess of that which would occur in a more active trading market. In addition, even if a more active market of our common stock develops, we cannot assure you that such a market will continue.

ITEM 1B. UNRESOLVED STAFF COMMENTS

None.

ITEM 2. PROPERTIES

The Bank owns its head office building located at 500 Bicentennial Way, Santa Rosa, California. The building has approximately 31,000 square feet of usable space. The Bank occupies approximately 20,000 square feet as its headquarters. The remaining 11,000 square feet are currently leased to 2 tenants, with lease terms maturing from 2021 to 2022. The Bank also leases spaces for branch offices in three shopping centers and one commercial building. These leases expire at various dates from 2020 through 2024 and include renewal and termination options and rental adjustment provisions. The Bank leases commercial space for an operations center and a space for a loan production office with lease expirations of 2022 and 2021.

ITEM 3. LEGAL PROCEEDINGS

The nature of our business causes us to be involved in legal proceedings from time to time. As of the date of this report, the Bank is not a party to any litigation where management anticipates that the outcome will have a material effect on the consolidated financial position or results of operations.

ITEM 4. MINE SAFETY DISCLOSURES

Not applicable.

PART II

ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

The Bank's common stock trades on the NASDAQ under the symbol "SSBI." There were 150 common stock shareholders of record at December 31, 2018. There were no issuer purchases of equity securities for the three-month period ended December 31, 2018.

ITEM 6. SELECTED FINANCIAL DATA

Selected Financial Data

(in thousands except per share data)	Year Ended December 31 2018	2017	2016	2015	2014
Income statement data:					
Interest income	$ 25,572	$ 20,713	$ 19,907	$ 18,573	$ 17,933
Net interest income before provision for (reversal of) loan losses	21,622	18,572	18,673	17,637	16,917
Provision for (reversal of) loan losses	530	520	-	(800)	(1,400)
Total non-interest income	2,309	1,715	2,021	2,645	1,995
Total non-interest expense	15,357	13,845	12,245	10,823	10,982
Income before provision for income taxes	8,044	5,922	8,449	10,259	9,330
Provision for income taxes	2,217	2,630	3,482	4,229	3,845
Net income	$ 5,827	$ 3,292	$ 4,967	$ 6,030	$ 5,485
Preferred dividend	-	-	-	92	138
Net income available to common shareholders	$ 5,827	$ 3,292	$ 4,967	$ 5,938	$ 5,347
Selected balance sheet data:					
Assets	$ 622,104	$ 610,864	$ 513,704	$ 513,365	$ 459,675
Loans, net	504,549	437,594	354,638	343,217	279,798
Earning assets	609,956	599,619	502,121	501,192	444,550
Deposits	501,189	533,513	384,251	397,246	355,259
Federal Home Loan Bank advances	56,800	15,000	68,900	55,800	35,000
Shareholders' equity	61,520	59,677	58,622	57,325	67,580
Balance sheet data - average					
Assets	$ 586,978	$ 534,534	$ 510,829	$ 485,396	$ 460,774
Loans, net	473,922	381,289	363,545	314,806	289,948
Earning assets	575,843	523,475	502,381	474,751	445,977
Deposits	503,828	420,070	391,001	372,778	358,278
Federal Home Loan Bank advances	20,984	52,429	58,659	46,102	36,341
Shareholders' equity	60,295	59,987	59,326	65,061	64,864
Selected per common share data:					
Earnings per common share - basic	$ 0.96	$ 0.55	$ 0.83	$ 0.99	$ 0.90
Earnings per common share - diluted	$ 0.96	$ 0.54	$ 0.82	$ 0.98	$ 0.89
Weighted average shares used to calculate earnings per common share - basic	6,065	6,031	6,005	5,979	5,973
Weighted average shares used to calculate earnings per common share - diluted	6,072	6,059	6,036	6,048	6,038
Common shares oustanding at year end	6,066	6,041	6,020	5,979	5,973
Cash dividends per share	$ 0.48	$ 0.46	$ 0.38	$ 0.38	$ 0.35
Book value per common share	$ 10.14	$ 9.88	$ 9.74	$ 9.59	$ 9.03
Selected ratios:					
Return on average common shareholders' equity	9.66%	5.49%	8.37%	10.60%	10.44%
Return on average assets	0.99%	0.62%	0.97%	1.24%	1.19%
Common dividend payout ratio	49.97%	83.57%	46.43%	38.67%	39.31%
Net interest margin	3.75%	3.55%	3.72%	3.72%	3.79%
Efficiency ratio (1)	64.24%	68.49%	61.22%	53.78%	58.81%
Average common shareholders' equity to average assets	10.27%	11.22%	11.61%	13.40%	14.08%
Tier 1 leverage capital ratio	9.86%	10.23%	11.08%	10.53%	13.72%
Nonperforming assets to total assets (2)	0.34%	0.45%	0.65%	0.31%	1.28%
Nonperforming loans to total loans (2)	0.42%	0.62%	0.93%	0.46%	0.64%
Net charge-offs (recoveries) to average loans	0.06%	0.01%	(0.01)%	(0.12%)	(0.39)%
Allowance for loan losses to total loans	1.18%	1.18%	1.33%	1.36%	1.81%

(1) Efficiency ratio is commonly used in the Banking industry and is defined as non-interest expenses to net interest and non-interest income, net of securities gains (losses).

(2) Nonperforming loans is defined as loans on nonaccrual and accruing loans past due 90 days or more, Nonperfomrng assets is defined as nonperforming loans and other real estate owned through foreclosure

ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following discussion provides additional information about the financial condition of the Bank at December 31, 2018 and 2017 and results of operations for the years ended December 31, 2018, 2017 and 2016. The following analysis should be read in conjunction with the consolidated financial statements of the Bank and the notes thereto prepared in accordance with accounting principles generally accepted in the United States.

Stock Split Adjustment

The Board of Directors declared a five-for-four stock split on January 23, 2017 to common shareholders of record on February 28, 2017, with an issuance date of March 14, 2017. The impact of this stock split has been retroactively applied to periods presented with adjustments to the number of common shares and per common share values as if the stock split had occurred as of the beginning of each period presented.

Critical Accounting Policies and Estimates

The discussion and analysis of the Bank's results of operations and financial condition are based upon financial statements which have been prepared in accordance with accounting principles generally accepted in the United States. The preparation of these financial statements requires the Bank's management to make estimates and judgments that affect the reported amounts of assets and liabilities, income and expense, and the related disclosures of contingent assets and liabilities at the date of these financial statements. These estimates are discussed in more detail under "Financial Statements and Supplementary Data" "Notes to Consolidated Financial Statements - Summary of Significant Accounting Policies" on page 67.

The Bank believes these estimates and assumptions to be reasonably accurate; however, actual results may differ from these estimates under different assumptions or circumstances. Material estimates that are particularly susceptible to significant change in the near-term relate to the determination of the allowance for loan losses, consideration of goodwill impairment and consideration of potential other than temporary impairment on investment securities and other financial instruments.

Allowance for Loan Losses. The allowance for loan losses is determined first and foremost by promptly identifying potential credit weaknesses that could jeopardize repayment. The Bank's process for evaluating the adequacy of the allowance for loan losses includes determining estimated loss percentages for each credit based on the Bank's historical loss experience and other factors in the Bank's credit grading system and accompanying risk analysis for determining an adequate level of the allowance. The risks are assessed by rating each account based upon paying habits, loan-to-collateral value ratio, financial condition and level of classifications. The allowance for loan losses was $6,029,000 at December 31, 2018 compared to $5,236,000 at December 31, 2017.

The Bank maintains the allowance for loan losses to provide for probable incurred losses in the loan portfolio. Additions to the allowance for loan losses are established through a provision charged to expense. All loans which are judged to be uncollectible are charged against the allowance while any recoveries are credited to the allowance. The Bank's policy is to charge off any known losses at the time of determination. Any unsecured loan more than 90 days delinquent in payment of principal or interest and not in the process of collection is charged off in total. Secured loans are evaluated on a case-by-case basis to determine the ultimate loss potential to us subsequent to the liquidation of collateral. In those cases where we believe we are inadequately protected, a charge-off will generally be made to reduce the loan balance to a level equal to the liquidation value of the collateral unless we believe the collateral deficiency may be overcome by borrower cash flows.

The Bank's loan policy provides procedures designed to evaluate and assess the credit risk factors associated with the loan portfolio, to enable the Bank to assess such credit risk factors prior to granting new loans and to evaluate the sufficiency of the allowance for loan losses. The Bank conducts an assessment of the allowance on a monthly basis and undertakes a more critical evaluation quarterly. At the time of the quarterly review, the Board of Directors will examine and approve the adequacy of the allowance. The quarterly evaluation includes an assessment of the following factors: any external loan review and any recent regulatory examination, estimated potential loss exposure on each pool of loans, concentrations of credit, value of collateral, the level of delinquent and non-accrual loans, trends in loan volume, effects of any changes in lending policies and procedures, changes in lending personnel, current economic conditions at the local, state and national level and historical losses and recoveries.

Goodwill. We assess the carrying value of our goodwill at least annually in order to determine if this intangible asset is impaired. In reviewing the carrying value of our goodwill, we assess the recoverability of such assets by evaluating the fair value of the related business unit. If the carrying amount of goodwill exceeds its fair value, an impairment loss is recognized for the amount of the excess and the carrying value of goodwill is reduced accordingly. Any impairment would be required to be recorded during the period identified. No impairment was recorded related to this intangible asset in 2018, 2017 or 2016.

Investment Securities. We are obligated to assess, at each reporting date, whether there is an "other-than-temporary" impairment to our investment securities. Such impairment, if related to credit losses, must be recognized in current earnings rather than in other comprehensive income or loss, net of tax. We examine all individual securities that are in an unrealized loss position at each reporting date for other-than-temporary impairment (OTTI). Specific investment level factors we examine to assess impairment include, the severity and duration of the unrealized loss, the nature, financial condition and results of operations of the issuers of the securities and whether there has been any cause for default on the securities or any adverse change in the rating of the securities by the various rating agencies, as well as whether the decline in value is credit or liquidity related. Additionally, we reexamine our financial resources and our overall intent and ability to hold the securities until their fair values recover. There were no OTTI recorded in 2018, 2017 or 2016. We do not believe that we have any investment securities with material unrealized losses that would be deemed to be "other-than-temporarily impaired" as of December 31, 2018. Investment securities are discussed in more detail under "Investment Portfolio."

Overview

The Bank is a community bank serving Sonoma, Napa, San Francisco and Marin counties in California. It operates through five depository offices located in Santa Rosa, Petaluma, Rohnert Park and Healdsburg. The Bank has a loan production office located in Roseville, California. The Bank was founded as a savings and loan in 1982 under the name Summit Savings. On January 15, 1999, the Bank converted its charter to a California state-chartered commercial bank and thereby became subject to regulation, supervision and examination by the California Department of Business Oversight and the FDIC.

Results of Operations

Years Ended December 31, 2018, 2017 and 2016

The Bank's primary source of income is net interest income, which is the difference between interest income and fees derived from earning assets and interest paid on liabilities which fund those assets. Net interest income, expressed as a percentage of total average interest-earning assets, is referred to as the net interest margin. The Bank's net interest income is affected by changes in the volume and mix of interest-earning assets and interest-bearing liabilities. It is also affected by changes in yields earned on interest-earning assets and rates paid on interest-bearing deposits and other borrowed funds. The Bank also generates non-interest income, including transactional fees, service charges, office lease income, gains and losses on investment securities and gains on sold government guaranteed loans originated by the Bank. Non-interest expenses consist primarily of employee compensation and benefits, occupancy and equipment expenses and other operating expenses. The Bank's results of operations are also affected by its provision for loan losses. Results of operations may also be significantly affected by other factors including general economic and competitive conditions, mergers and acquisitions of other financial institutions within the Bank's market area, changes in market interest rates, government policies, and actions of regulatory agencies.

Net Income

The Bank had net income and net income available for common stockholders of $5,827,000 or $0.96 per diluted share, for the year ended December 31, 2018 compared to net income and net income available for common stockholders of $3,292,000, or $0.54 per diluted share, for the year ended December 31, 2017, and net income of $4,967,000 or $0.82 per diluted share, for the year ended December 31, 2016.

The return on average assets was 0.99%, 0.62% and 0.97% for the years ended December 31, 2018, 2017 and 2016, respectively.

The return on average common equity was 9.66%, 5.49%, and 8.37% for the years ended December 31, 2018, 2017 and 2016, respectively.

The Board of Directors adopted a strategy of positioning the Bank for accelerated growth in the second quarter of 2016. A partial result of this strategic shift was the increase of staffing and related expenses to increase the Bank's lending function. In prior years, increased personnel expenses created a timing difference between the increased expenses and the interest income that is generated from increased loan totals. Starting in 2018 the Bank began realizing positive impacts on net interest income because loans were increasing as a percent of the Bank's assets. The Bank has also improved net income by increasing the net interest margin by responding to the rising interest rate environment and provided a balanced offering of deposits and loans at competitive rates.

Net Interest Income and Net Interest Margin

Net interest income was $21,622,000 and the net interest margin was 3.75% for the year ended December 31, 2018, which represented a $3,050,000 or 16% increase over 2017. For the year ended December 31, 2017, net interest income was $18,572,000 and the net interest margin was 3.55%, which represented a $101,000 or 0.5% decrease over 2016. For the year ended December 31, 2016, net interest income was $18,673,000 and the net interest margin was 3.72%. At December 31, 2018, approximately 81% of the Bank's assets were comprised of net loans and 13% were comprised of investment securities compared to 72% of net loans and 14% of investment securities at December 31, 2017.

The yield on average interest-earning assets was 4.44% for the year ended December 31, 2018 and 3.96% for December 31, 2017. Yields on new loans are dependent on competition for those loans, which can mitigate general interest rate changes brought on by Federal Reserve policy. The yield on average interest-earning assets increased from 3.96% for the year ended December 31, 2017, primarily because of increased yields on the Bank's federal funds sold and interest-bearing deposits with banks, which experience rate adjustments as the Federal Reserve increases rates. The changes in the overall yield on average earning assets between the years 2018 and 2017 was primarily attributable to the effects of changes in general market interest rates impacting the re-pricing of the Bank's variable rate loan portfolio and calls on higher yielding government agency securities.

In 2018, average earning assets increased 10.0% with average investment securities decreasing 32.1% and average loans increasing 24.3%. In 2017, average earning assets increased 4.2% with average investment securities increasing 2.2% and average loans increasing 4.9%.

Net loans outstanding at December 31, 2018 was $504,549,000, a 15.3% increase over net loans at December 31, 2017. The difference in the percentage increase between net loans at year end compared to percentage increase for the average net loans for the year, is the result of the increase in net loans in 2018, primarily occurring during the second half of 2018.

For the year ended December 31, 2018, the cost of average interest-bearing liabilities was 1.01% compared with a cost of average interest-bearing liabilities of 0.60% for the year ended December 31, 2017 and 0.36% for the year ended December 31, 2016. The changes in cost of funds have been driven by the changing market interest rates over the periods. Additionally, the Bank increased rates paid on time deposits with maturity terms of 18 months to 2 years to attract and extend its liabilities during continued periods of rising rates.

The following table presents condensed average consolidated balance sheet information for the Bank, together with interest rates earned and paid on the various sources and uses of its funds for each of the periods presented. Average balances are based on daily average balances. Nonaccrual loans are included in loans with any interest collected reflected on a cash basis.

Average Balance Sheets and Analysis of Net Interest Income

	Year Ended December 31,								
	2018			2017			2016		
(Dollars in thousands)	Average Balance	Interest Income/ Expense	Average Rate	Average Balance	Interest Income/ Expense	Average Rate	Average Balance	Interest Income/ Expense	Average Rate
Assets									
Interest earning assets:									
Federal funds sold	$ 855	$ 14	1.69%	$ 1,903	$ 17	0.89%	$ 1,864	$ 7	0.37%
Interest-bearing deposits with banks	17,759	247	1.39%	19,103	162	0.85%	18,504	82	0.44%
Taxable investment securities	80,222	2,382	2.97%	118,095	3,126	2.65%	115,505	2,912	2.52%
Dividends on FHLB Stock	3,085	266	8.62%	3,085	232	7.52%	2,963	357	12.05%
Loans, net of unearned income (1)	473,922	22,663	4.78%	381,289	17,176	4.50%	363,545	16,549	4.55%
Total earning assets/interest income	575,843	25,572	4.44%	523,475	20,713	3.96%	502,381	19,907	3.96%
Non-earning assets	16,809			15,869			13,199		
Allowance for loan losses	(5,674)			(4,810)			(4,751)		
Total assets	$ 586,978			$ 534,534			$ 510,829		
Liabilities and Shareholders' Equity									
Interest-bearing liabilities:									
Deposits:									
Interest-bearing demand deposits	$ 69,744	$ 79	0.11%	$ 63,217	$ 82	0.13%	$ 58,098	$ 65	0.11%
Savings and money market	134,303	811	0.60%	85,057	170	0.20%	82,523	86	0.10%
Time deposits	167,261	2,619	1.57%	155,662	1,387	0.89%	142,749	704	0.49%
FHLB advances	20,984	441	2.10%	52,429	502	0.96%	58,659	379	0.65%
Total interest-bearing liabilities/interest expense	392,292	3,950	1.01%	356,365	2,141	0.60%	342,029	1,234	0.36%
Non interest-bearing deposits	132,520			116,134			107,631		
Other liabilities	1,871			2,048			1,843		
Total liabilities	526,683			474,547			451,503		
Shareholders' equity	60,295			59,987			59,326		
Total liabilities and shareholders' equity	$ 586,978			$ 534,534			$ 510,829		
Net interest income and margin (2)		$ 21,622	3.75%		$ 18,572	3.55%		$ 18,673	3.72%
Net interest spread (3)			3.43%			3.36%			3.60%

(1) The net amortization of deferred fees and (costs) on loans included in interest income was $(112,000), $(196,000) and $(118,000) for the years ended December 31, 2018, 2017 and 2016, respectively.

(2) Net interest margin is computed by dividing net interest income by average total earning assets.

(3) Net interest spread is the difference between the average rate earned on average total earning assets and the average rate paid on average total interest-bearing liabilities.

The following table shows the change in interest income and interest expense and the amount of change attributable to variances in volume and rates. The unallocated change in rate or volume variance has been allocated between the rate and volume variances in proportion to the absolute dollar amount in the change of each.

Volume and Yield/Rate Variances

	2018 Compared to 2017			2017 Compared to 2016		
	Change Due to			Change Due to		
(Dollars in thousands)	Volume	Rate	Net	Volume	Rate	Net
Interest income:						
Federal funds sold	$ (6)	$ 3	$ (3)	$ -	$ 10	$ 10
Interest-bearing deposits with banks	(11)	96	85	3	77	80
Taxable investment securities	(891)	147	(744)	57	157	214
Dividends on FHLB Stock	-	34	34	14	(139)	(125)
Loans, net	4,378	1,109	5,487	801	(174)	627
Total interest income	3,470	1,389	4,859	875	(69)	806
Interest expense:						
Interest-bearing demand deposits	8	(11)	(3)	6	11	17
Savings and money market	143	498	641	3	81	84
Time deposits	110	1,122	1,232	69	614	683
FHLB advances	(181)	120	(61)	(37)	160	123
Total interest expense	80	1,729	1,809	41	866	907
Increase (decrease) in net interest income	$ 3,390	$ (340)	$ 3,050	$ 834	$ (935)	$ (101)

Provision for Loan Losses

The Bank maintains an allowance for loan losses for probable incurred losses that are expected as an incidental part of the banking business. Write-offs of loans are charged against the allowance for loan losses, which is adjusted periodically to reflect changes in the volume of outstanding loans and estimated losses due to changes in the financial condition of borrowers or the value of property securing nonperforming loans, or changes in general economic conditions and other qualitative factors. Additions to the allowance for loan losses are made through a charge against income referred to as the "provision for loan losses."

The Bank's loan policy provides procedures designed to evaluate and assess the credit risk factors associated with the loan portfolio, to enable management to assess such credit risk factors prior to granting new loans and to evaluate the sufficiency of the allowance for loan losses. Management conducts an assessment of the allowance for loan losses on a monthly basis and undertakes a more critical evaluation quarterly. At the time of the quarterly review, the Board of

Directors evaluates and formally approves the adequacy of the allowance. The quarterly evaluation includes an assessment of the following factors: any external loan review and regulatory examination, estimated probable loss exposure on each pool of loans, concentrations of credit, value of collateral, the level of delinquent and non-accrual loans, trends in loan volume, effects of any changes in the lending policies and procedures, changes in lending personnel, current economic conditions at the local, state and national level, and a migration analysis of historical losses and recoveries for the prior twelve quarters.

At December 31, 2018, the Bank's allowance for loan losses totaled $6,029,000 or 1.18% of outstanding loans, compared with an allowance for loan losses of $5,236,000, or 1.18% of outstanding loans at December 31, 2017 and $4,765,000, or 1.33% of outstanding loans at December 31, 2016. For the year ended December 31, 2018, the Bank recorded a $530,000 provision for loan losses, primarily due to the increase in loans outstanding. For the year ended December 31, 2017, there was a $520,000 provision recorded and for the year ended December 31, 2016, no provision recorded for loan losses. The primary reason for no provision in 2016 was net recoveries of previously charged-off loans of $34,000 during 2016. The decline in percentage of allowance for loan losses to loans outstanding was primarily due to the reduction in adversely classified and nonaccrual loans.

Non-interest Income

The following table summarizes non-interest income recorded for the years indicated.

Non-interest Income

	Year Ended December 31,		
(in thousands)	2018	2017	2016
Service charges on deposit accounts	$ 765	$ 695	$ 748
Rental income	553	574	559
Net gain on loan sales	748	351	-
Net securities gains	27	72	692
Other income	216	23	22
Total non-interest income	$ 2,309	$ 1,715	$ 2,021

Service charges on deposit accounts were $765,000 for the year ended December 31, 2018, compared to $695,000 and $748,000 for the years ended December 31, 2017 and 2016. The Bank has experienced an increase in demand deposits, however deposit account activity service charges are dependent on the volume and types of transactions in the accounts.

The Bank owns its headquarters building with approximately half of the office space leased to nonaffiliated tenants. The building space was fully leased for each of the years 2016 through 2018. Lease income from this office building was $553,000, $574,000 and $559,000 for the years ended December 31, 2018, 2017 and 2016. The leases have annual rent increases. In 2018 the headquarters underwent construction improvements in the fourth quarter to accommodate needs for more staff. Two-thirds is now being occupied by the Bank and the Bank is leasing office space to two tenants.

Net securities gains can vary significantly from year to year based on the amount of investment securities sold or called and the net gain or loss realized. Additionally, gains or losses are highly dependent on the interest rate environment and its impacts on the fair market value of investment securities. In 2018, 2017 and 2016, the Bank sold or had calls on various government agency and corporate bonds with a net gain of $27,000 in 2018, $72,000 in 2017 and $692,000 in 2016.

Net gains on other real estate owned arises when the Bank sells foreclosed properties. The Bank has no other real estate owned at December 31, 2018. In 2018, the Bank received a recovery of $108,000 for a loss on sale of foreclosed property from a prior year which is reflected in Other Income.

In the second half of 2017, the Bank opened a loan production office in Roseville, California, which primarily focuses on loans partially guaranteed by the Small Business Administration (SBA) or United States Department of Agriculture (USDA). It also generates commercial real estate loans for the Bank's portfolio. Management may sell the guaranteed portion of the loans depending on market opportunities or for liquidity reasons. When a guaranteed portion of a loan is sold, a gain is recognized through a premium received on the sale. Total proceeds from sales of SBA guaranteed balances was $9,974,000 in 2018 with a gain recognized of $748,000. In 2017, the Bank recognized a gain of $351,000 from sales of SBA guaranteed loan balances in the amount of $5,097,000.

The increase in net gain on sales of loans in 2018 compared to 2017 was primarily due to a higher volume of guaranteed loans sold and to a lesser extent by an increase in the average net gain per loan sold. Losses inherent in loan relationships are mitigated by the portion of the loan that is guaranteed by U.S. government loan programs. A typical SBA 7(a) loan carries a 75% guarantee while USDA guarantees range from 50% to 90% depending on loan size and type, which reduces the risk profile of these loans.

Non-interest Expenses

The following table summarizes non-interest expenses recorded for the years indicated.

Non-interest Expenses

	Year Ended December 31,		
(in thousands)	2018	2017	2016
Salaries and employee benefits	$ 9,151	$ 7,788	$ 6,562
Occupancy and equipment	1,536	1,503	1,229
Other expenses	4,670	4,554	4,454
Total non-interest expenses	$ 15,357	$ 13,845	$ 12,245

Non-interest expenses, also referred to as operating expenses, is commonly expressed as a percentage of average assets for the period and as a percentage of operating revenues, or the efficiency ratio. The efficiency ratio divides the non-interest expenses by total revenues, which is defined as net interest income plus non-interest income, excluding net security gains. The non-interest expenses as a percent of annual average assets for 2018 was 2.6%, 2017 was 2.6% and 2016 was 2.4%. The efficiency ratio for 2018 was 64.24%, 2017 was 68.5% and was 61.2% for 2016. The improvement (decrease) in the efficiency ratio in 2018 is due to the increase in revenues being greater than the increase in non-interest expense for the year. The increases in the efficiency ratio in 2017 and 2016 were partly the result of increased expenses incurred as a result of the change in the Bank's strategy to increase employee levels to drive a greater volume in loans. Additionally, the severance of the Bank's former President and Chief Executive Officer in 2016 contributed to the higher efficiency ratio in that year.

Salaries and employee benefits expense increased $1,363,000 or 18% in 2018 compared to 2017 and increased $1,226,000 or 19% in 2017 compared to 2016. The increases were primarily attributable to an increased number of employees hired during each year and general salary and benefit increases. Annual salaries and bonuses have increased during the years and have been partially offset by deferred loan origination costs attributable to loan generation during the years. The deferred loan origination costs netted against salaries and employee benefits were $1,181,000, $1,141,000 and $734,000 for the years ended December 31, 2018, 2017 and 2016. The Bank employed a total of 89, 78 and 74 employees as of December 31, 2018, 2017 and 2016.

Occupancy and equipment expenses increased $33,000 or 2% in 2018 compared to 2017 and $274,000 or 22% in 2017 compared to 2016. Occupancy expenses include costs incurred with the Bank's owned headquarters building, four leased branch office buildings, an operations leased facility and a loan production office. The operations facility and loan production office leases commenced in 2017.

The following table summarizes the categories of other expenses.

Other Expenses

	Year Ended December 31,		
(in thousands)	2018	2017	2016
Data processing	$ 1,497	$ 1,278	$ 1,194
Professional fees	598	554	624
Director fees and expenses	545	479	518
Nasdaq listing and regulatory license expense	144	140	131
Advertising and promotion	808	828	883
Deposit and other insurance premiums	297	431	387
Telephone and postage	79	77	70
Other expenses	702	767	647
	$ 4,670	$ 4,554	$ 4,454

Data processing expenses are dependent on the Bank's implementation of new electronic delivery platforms such as mobile banking, and per account and transaction expenses from the

Bank's third party data service provider, corresponding to the increase in the number of new deposit and loan customers.

Professional fees vary depending on the use of legal, audit and consulting services. Director fees and expenses vary dependent on the number of directors, travel expenses incurred by directors for attendance of Board and number of committee meetings and director training expenses. Advertising and promotion expenses are dependent on the Bank's business development activities and targeted nonprofit charity business customers. Miscellaneous other expenses are incurred as a result of general operations.

Provision for Income Taxes

The Bank accrues income tax expense based on the anticipated tax rates during the financial period covered. The provision for income taxes for the years ended December 31, 2018, 2017 and 2016 was $2,217,000, $2,630,000 and $3,482,000. The combined effective Federal and State corporate income tax rates for the years ended December 31, 2018, 2017 and 2016 were 27.6%, 44.4% and 41.2%, respectively.

The increase in effective tax rate in 2017 and decrease in the effective tax rate in 2018, was the result of the enactment of the Tax Cuts and Jobs Act on December 22, 2017, which resulted in a write-down of the net deferred tax asset against 2017 earnings of $292,000 and lower tax rates applied in 2018.

Balance Sheet

December 31, 2018 and 2017

Investment Portfolio

Securities classified as available-for-sale for accounting purposes are recorded at their fair value on the balance sheet. Securities classified as held-to-maturity are recorded at amortized cost. At December 31, 2018, investment securities comprised 12.5% of total assets and 13.1% of earning assets. At December 31, 2017, investment securities comprised 14.2% of total assets and 14.5% of earning assets. The decline in the percentage of investments to total assets and earning assets was due to calls of bonds and bond sales that were incurred to partially fund the increase in the loan portfolio.

At December 31, 2018, there were $7,991,000 in investment securities classified as held-to-maturity and $7,984,000 at December 31, 2017. The increase in held-to-maturity securities was attributable to the accretion of the discount on the portfolio. Investment securities classified held-to-maturity are government sponsored agencies with interest rates that step-up over the life of the bonds.

Securities classified as available-for-sale were $70,174,000 and $78,770,000 for the 2018 and 2017 respective year ends. Changes in the fair value of available-for-sale securities (e.g., unrealized holding gains or losses) are reported as "other comprehensive income (loss)," net of tax, and carried as accumulated other comprehensive income or loss within shareholders' equity until realized. The accumulated other comprehensive income was in an unrealized loss position of $1,789,000 at December 31, 2018 and $597,000 at December 31, 2017.

The Bank utilizes the investment portfolio to manage liquidity and attract funding that requires collateralization. At December 31, 2018, investment securities with a fair value of $36,514,000 or 47% of the portfolio, were pledged to secure State of California and other municipal deposits. This compares to $50,417,000, or 58% of the portfolio pledged at December 31, 2017. At December 31, 2018, securities with a par value of $50,625,000 were callable within one year.

The composition of the investment portfolio by major category and contracted maturities or repricing of debt investment securities at December 31, 2018, 2017 and 2016 is shown below.

Investment Securities

	December 31,		
(in thousands)	2018	2017	2016
Held-to-maturity:			
Government agencies	$ 7,991	$ 7,984	$ 7,976
Available-for-sale:			
U.S. Treasuries	$ -	$ 5,982	$ 7,990
Government agencies	39,330	40,057	53,444
Mortgage-backed securities - residential	10,972	8,093	9,096
Corporate debt	19,872	24,638	37,241
Total available-for-sale	70,174	78,770	107,771
Total investment securities	$ 78,165	$ 86,754	$ 115,747

Contractual Maturity or Repricing Schedule and Weighted Average Yields of Securities
As of December 31, 2018

	Within One Year		After One But Within Five Years		After Five But Within Ten Years		After Ten Years	
(in thousands)	Carrying Amount	Yield	Carrying Amount	Yield	Carrying Amount	Yield	Carrying Amount	Yield
Held-to-maturity:								
Government agencies	$ -	-	$ -	-	$ 3,000	2.00%	$ 4,991	2.13%
Available-for-sale:								
U.S. Treasuries	$ -	-	$ -	-	$ -	-	$ -	-
Government agencies	-	-	1,931	2.54%	32,087	2.64%	5,312	2.46%
Mortgage-backed securities - residential	-	-	-	-	-	-	10,972	3.25%
Corporate debt	5,596	3.83%	10,312	4.03%	3,964	3.21%	-	-
Total available-for-sale	5,596	3.83%	12,243	3.82%	36,051	2.70%	16,284	2.99%
Total investment securities	$ 5,596	3.83%	$ 12,243	3.82%	$ 39,051	19.78%	$ 21,275	2.79%

As of December 31, 2018, the Bank did not own securities of any single issuer (other than U.S. Government agencies) whose aggregate book value was in excess of 10% of the Bank's total equity at the time of purchase.

Loan Portfolio

Loan categories used in presentations in this report conform to the categorizations used by regulatory Call Reports as described by the instructions issued by the Federal Financial Institutions Examination Council (FFIEC).

The following table shows the composition of the Bank's loan portfolio by amount and percentage of total loans for each major loan category at the dates indicated.

Loans

	December 31,									
(in thousands)	**2018**	%	**2017**	%	**2016**	%	**2015**	%	**2014**	%
Commercial & agricultural (1)	$ 107,910	21.1%	$ 102,957	23.2%	$ 81,519	22.7%	$ 75,018	21.6%	$ 68,371	24.0%
Real Estate - commercial	287,841	56.4%	242,066	54.7%	190,976	53.1%	175,374	50.4%	145,565	51.1%
Real estate - construction and land	24,330	4.8%	13,465	3.0%	7,897	2.2%	11,341	3.3%	11,175	3.9%
Real Estate - single family	56,648	11.1%	51,866	11.7%	51,044	14.2%	63,899	18.4%	46,590	16.4%
Real Estate - multifamily	33,623	6.6%	32,091	7.2%	27,533	7.7%	21,664	6.2%	13,095	4.6%
Consumer & lease financing	226	0.0%	385	0.1%	434	0.1%	652	0.2%	145	0.1%
	510,578	100%	442,830	100%	359,403	100%	347,948	100%	284,941	100%
LESS:										
Allowance for Loan Losses	(6,029)		(5,236)		(4,765)		(4,731)		(5,143)	
Total Loans, Net	$ 504,549		$ 437,594		$354,638		$343,217		$ 279,798	

(1) Includes loans secured by farmland.

The Bank experienced increased loan demand in 2018 and 2017. The 15% increase in net loans outstanding at December 31, 2018 compared to December 31, 2017, was primarily from the origination of commercial real estate and commercial & agricultural loans which often have larger dollar balances.

At December 31, 2018, the Bank had approximately $85,304,000 in undisbursed loan commitments, of which approximately $46,661,000 related to real estate loan types. This compares with undisbursed commitments of approximately $60,075,000 at December 31, 2017, of which approximately $26,511,000 related to real estate loan types. At December 31, 2018 and 2017, there were $3,707,000 and $3,485,000, respectively, in standby letters of credit outstanding.

The following table shows the maturity distribution of Real Estate Construction and Land and Commercial & Agricultural loans, including rate repricing intervals on variable rate loans, at December 31, 2018. In the following table, the term variable (generally referring to loans for which the interest rate will change immediately given a change in the underlying index) also includes loans with adjustable rates (loans for which the rate may change, but which are also limited in occurrence).

Loan Portfolio Maturity Structure at December 31, 2018

(in thousands)	Within One Year	After One But Within Five Years	After Five Years	Total
Real Estate - construction and land	$ 15,942	$ 8,388	$ -	$ 24,330
Commercial & agricultural	25,067	54,829	28,014	107,910
Total	$ 41,009	$ 63,217	$ 28,014	$ 132,240
Loans with:				
Fixed interest rates	$ 3,791	$ 18,918	$ 15,857	$ 38,566
Floating interest rates	37,218	44,299	12,157	93,674
Total	$ 41,009	$ 63,217	$ 28,014	$ 132,240

Loan Policies and Procedures

The Bank's underwriting practices include an analysis of the borrower's management, current economic factors, the borrower's ability to respond and adapt to economic changes outside its direct control and verification of primary and secondary sources of repayment. Risk within the loan portfolio is managed through the Bank's loan policies and underwriting. These policies are reviewed and approved annually by the Board of Directors.

- Management administers the loan policy, ensures proper loan documentation is maintained and develops the methodology for monitoring loan quality and the level of the allowance for loan losses and reports on these matters to the Board of Directors' Internal Asset Review Committee and the Board of Directors.

- The Board of Directors' Loan Committee meets regularly to evaluate problem assets and the adequacy of the allowance for loan losses. The Committee also reviews and makes recommendations to the Board of Directors regarding the adequacy of the allowance for loan losses, and is responsible for ensuring that an independent third party reviews the loan portfolio at least annually. Resultant reports are sent to this Committee and to the Audit Committee.

- The Board of Directors' Loan Committee is responsible for enforcement of the loan policy and has additional responsibilities which include approving loans or loan relationships for a customer that, when considered in the aggregate, exceed management's level of loan authority for that customer.

- The Board of Directors' Audit Committee also engages a third party to perform a review of management's asset and liability practices to ensure compliance with the Bank's policies.

- The Board of Directors retains overall responsibility for all loan functions and reviews material loan relationships.

Loan approvals are granted according to established policies, and lending officers are assigned approval authorities within their levels of training and experience. Interest rates reflect the risk inherent in loans and collateral is generally taken for purchase-money financing. Collateral may consist of accounts receivable, direct assignment of contracts, inventory, equipment and real estate. Unsecured loans may be made when warranted by the financial strength of the borrower.

Nonperforming Assets

Nonperforming assets consist of nonperforming loans and other real estate owned. Nonperforming loans are those for which the borrower fails to perform under the original terms of the obligation and consist of nonaccrual loans and accruing loans past due 90 days or more. Additionally, loans may be restructured due to deteriorating financial conditions and classified as troubled debt restructurings (TDRs). The TDR's may or may not be the same as those listed as nonaccrual or 90 days or more past due loans.

The following are the nonperforming assets for the respective periods:

Nonperforming Assets

	December 31,				
(in thousands)	2018	2017	2016	2015	2014
Nonaccrual loans	$ 2,124	$ 2,730	$ 3,351	$ 1,610	$ 1,815
Accruing loans past due 90 days or more	-	-	-	-	-
Total nonperforming loans	2,124	2,730	3,351	1,610	1,815
Other real estate owned	-	-	-	-	4,051
Total nonperforming assets	$ 2,124	$ 2,730	$ 3,351	$ 1,610	$ 5,866
Nonperforming loans to total loans	0.42%	0.62%	0.93%	0.46%	0.64%
Nonperforming assets to total assets	0.34%	0.45%	0.65%	0.31%	1.28%
Allowance for loan losses to nonperforming loans	283.84%	191.79%	142.23%	293.86%	283.39%

Nonperforming loans at December 31, 2018, consisted of six (6) loans to six (6) customers. Nonperforming loans included commercial real estate loans totaling $1,528,000 and loans collateralized by single and multifamily properties totaling $596,000. The Bank had no specific allowance for loan losses allocated to these loans due to the estimated value of underlying collateral.

There was no other real estate owned at December 31, 2018 and 2017.

The Bank may modify terms of loans to provide borrowers with relief if they are experiencing financial difficulty and may not be able to meet the original terms of the loan. These modifications classify the loan as a TDR. Loans that are classified as TDRs were $3,370,000 at December 31, 2018, of which $1,723,000 were considered performing loans and $1,647,000 are nonperforming loans and are included in the table above. The performing TDRs of $1,723,000 are primarily collateralized by single-family residential or commercial real estate properties.

Allowance for Loan Losses

The Bank maintains the allowance for loan losses to provide for inherent losses in the loan portfolio. Additions to the allowance for loan losses are established through a provision charged to expense. All loans which are judged to be uncollectible are charged against the allowance while any recoveries are credited to the allowance. The Bank’s policy is to charge off any known losses at the time of determination. Any unsecured loan more than 90 days delinquent in payment of principal or interest and not in the process of collection is charged off in total. Secured loans are evaluated on a case-by-case basis to determine the ultimate loss potential to us subsequent to the liquidation of collateral. In those cases where we believe we are inadequately protected, a charge-off will be made to reduce the loan balance to a level equal to the liquidation value of the collateral.

The Bank’s loan policy provides procedures designed to evaluate and assess the credit risk factors associated with the loan portfolio, to enable management to assess such credit risk factors prior to granting new loans and to evaluate the sufficiency of the allowance for loan losses. Management conducts an assessment of the allowance for loan losses on a monthly basis and undertakes a more critical evaluation quarterly. At the time of the quarterly review, the Board of Directors evaluates and approves the adequacy of the allowance. The quarterly evaluation includes an assessment of the following factors: any external loan review and regulatory examination, estimated probable loss exposure on each pool of loans, concentrations of credit, value of collateral, the level of delinquent and non-accrual loans, trends in loan volume, effects of any changes in lending policies and procedures, changes in lending personnel, current economic conditions at the local, state and national level and a migration analysis of historical losses and recoveries for the prior twelve quarters.

The following table sets forth an analysis of the allowance for loan losses and provision for loan losses for the periods indicated.

Summary of Activity in the Allowance for Loan Losses

(Dollars in thousands)	Year Ended December 31				
	2018	2017	2016	2015	2014
Balance at beginning of period	$ 5,236	$ 4,765	$ 4,731	$ 5,143	$ 5,412
Charge-offs:					
Commercial & agricultural	(28)	(79)	(50)	-	-
Real estate - commercial	-	-	(20)	-	(76)
Real estate - construction and land	-	-	-	-	-
Real Estate - single family	-	-	-	-	-
Real Estate - multifamily	-	-	-	-	-
Consumer & lease financing	-	-	-	(2)	(5)
Total loans charged-off	(28)	(79)	(70)	(2)	(81)
Recoveries:					
Commercial & agricultural	77	4	76	222	207
Real estate - commercial	-	1	6	-	977
Real estate - construction and land	-	-	-	-	-
Real Estate - single family	191	16	14	135	15
Real Estate - multifamily	-	-	-	-	-
Consumer & lease financing	23	9	8	33	13
Total recoveries	291	30	104	390	1,212
Net loans recovered (charged-off)	263	(49)	34	388	1,131
Provision for (reversal of) loan losses	530	520	-	(800)	(1,400)
Allowance for loan losses - end of period	$ 6,029	$ 5,236	$ 4,765	$ 4,731	$ 5,143
Loans:					
Average loans outstanding during period, net of unearned income	$ 473,922	$ 381,289	$ 363,545	$ 314,806	$ 289,948
Total loans at end of period, net of unearned income	$ 510,578	$ 442,830	$ 359,403	$ 347,948	$ 284,941
Ratios:					
Net loans recovered (charged-off) to average net loans	0.06%	0.01%	(0.01)%	(0.12)%	(0.39)%
Net loans recovered (charged-off) to total loans	0.05%	0.01%	(0.01)%	(0.11)%	(0.40)%
Allowance for loan losses to average net loans	1.27%	1.37%	1.31%	1.50%	1.77%
Allowance for loan losses to total loans	1.18%	1.18%	1.33%	1.36%	1.80%
Net loans recovered (charged-off) to beginning allowance for loan losses	5.02%	1.03%	(0.72)%	(7.54)%	(20.90)%
Net loans recovered (charged-off) to provision for loan losses (1)	49.62%	9.42%	NM	NM	NM

(1) Not meaningful

The following table summarizes the allocation of the allowance for loan losses by loan category and the amount of loans in each category as a percentage of total loans in each category as of the end of each year presented. The allocated and unallocated portions of the allowance for loan losses are available to the entire portfolio.

Allocation of Allowance for Loan Losses

	Year Ended December 31,									
	2018		2017		2016		2015		2014	
(in thousands)	**Allowance Allocation**	**Amount of Category Loans to Total Loans**	**Allowance Allocation**	**Amount of Category Loans to Total Loans**	**Allowance Allocation**	**Amount of Category Loans to Total Loans**	**Allowance Allocation**	**Amount of Category Loans to Total Loans**	**Allowance Allocation**	**Amount of Category Loans to Total Loans**
Commercial & agricultural	$ 904	21.1%	$ 682	23.2%	$ 744	22.7%	$ 1,008	21.6%	$ 534	24.0%
Real estate - commercial	2,830	56.4%	2,697	54.7%	1,764	53.1%	940	50.4%	1,861	51.1%
Real estate - construction and land	705	4.8%	443	3.0%	266	2.2%	57	3.3%	216	3.9%
Real estate - single family units	684	11.1%	595	11.7%	577	14.2%	237	18.4%	141	16.4%
Real estate - multifamily	308	6.6%	319	7.2%	330	7.7%	43	6.2%	13	4.6%
Consumer & lease financing	6	0.0%	14	0.1%	19	0.1%	6	0.2%	10	0.1%
Unallocated	592		486		1,065		2,440		2,368	
Total	$ 6,029	100%	$ 5,236	100%	$ 4,765	100%	$ 4,731	100%	$ 5,143	100%

The changes from year to year for the allocation by loan category are attributable to the growth of the category and management's assessment of the quality of the individual loans within the category. Additionally, other qualitative factor allocations are applied to each category of loans and represents various qualitative factors in the determination of the adequacy of the allowance for loan losses and includes the size of individual credits, concentrations and general economic conditions. Management considers these qualitative factors in their evaluation of the adequacy of the allowance for loan losses.

The changes in the allowance allocations for the various loan categories at December 31, 2018 compared to December 31, 2017 were primarily attributable to the general increase in total loans in the categories and the level of the internally classified loans in each category.

An unallocated allowance can arise from fluctuations in the amount of classified ("credit grades") and specific allocations to nonperforming loans between periods. Management and the Board of Directors reviews the amount of and reasons for unallocated allowances and whether unallocated allowances have arisen due to periodic fluctuations in the credit grades or have arisen due to changes in qualitative factors or changes in lending strategies. If an unallocated allowance has arisen from other than periodic fluctuations in credit grades or other than potential temporary factors, then it may be determined that a portion of the allowance for loan losses should be reversed.

In addition to the allowance for loan losses, the Bank maintains an allowance for losses for undisbursed loan commitments, which is reported in other liabilities on the consolidated balance sheets. This allowance was $244,000 at December 31, 2018 and $160,000 at December 31, 2017.

Deposits

Deposits are the Bank's primary source of funds. The Bank employs business development officers and branch office personnel to solicit commercial demand deposits. The Bank focuses on obtaining deposits from the communities it serves but occasionally may accept deposits from outside its market area or receive brokered deposits.

The following table sets forth total deposits by type.

Deposits by Type

	Year Ended December 31,			
	2018		2017	
	Balance	% of Total	Balance	% of Total
Demand Accounts	$ 185,663	37.0%	$ 256,603	48.1%
Savings and Money Market	129,877	26.0%	109,666	20.6%
Time Deposits	185,649	37.0%	167,244	31.3%
Total Deposits	$ 501,189		$ 533,513	

The Bank's strategy is to increase its funding from local deposits and to lower its dependence on institutional funding such as brokered time deposits, State of California time deposits and FHLB borrowings. Strategies employed to increase local deposits include a nonprofit business account that provides a donation award for balances maintained and promoting rates of 18-month to two-year term time deposits.

At the 2017-year end, the Bank received a one-time, large deposit of approximately $55 million which was held on deposit at the Federal Reserve Bank. This deposit was withdrawn during 2018 resulting in the decline in demand accounts between 2018 and 2017.

The Bank offers local depositors with deposits in excess of $250,000 and who are concerned with FDIC insurance limits, a deposit placement service through a program called CDARS and ICS. Through this program amounts in excess of $250,000 can be placed in certificates of deposit or demand accounts at other institutions and the Bank receives reciprocal deposits from other institutions within the network. At December 31, 2018 and 2017, there were $19,515,000 and $16,150,000 in CDARS time deposits and $25,124,000 and $25,698,000 in ICS demand deposits, respectively. In addition to these deposits, the Bank had $3,086,000 and $28,059,000 at December 31, 2018 and 2017 in wholesale brokered deposits.

Certain time deposits are received through a program run by the Treasurer of the State of California to place public deposits with community banks. At December 31, 2018 and 2017, the State of California had $48,500,000 in time deposits with the Bank with maturities of up to six months and collateralized by investment securities or mortgage loans.

The following table sets forth the average balances by deposit category and the interest cost for the periods indicated.

Average Deposit Balances and Rates Paid

	Year Ended December 31,					
	2018		2017		2016	
(in thousands)	Average Balance	Average Rate	Average Balance	Average Rate	Average Balance	Average Rate
Non interest-bearing demand deposits	$ 132,520		$ 116,134		$ 107,631	
Interest-bearing demand deposits	69,744	0.11%	63,217	0.13%	58,098	0.11%
Savings and money market	134,303	0.60%	85,057	0.20%	82,523	0.10%
Time certificates under $100,000	31,621	1.33%	49,035	0.94%	41,197	0.51%
Time certificates $100,000 or over	135,640	1.62%	106,627	0.87%	101,552	0.48%
Total deposits	$ 503,828	0.69%	$ 420,070	0.39%	$ 391,001	0.22%

The following table sets forth the maturities of time certificates of deposit of $100,000 or more outstanding at December 31, 2018 and 2017.

Maturity of Time Deposits of $100,000 or More

(in thousands)	December 31, 2018	December 31, 2017
Time deposits of $100,000 or more maturing in:		
Three months or less	$ 73,167	$ 66,831
Over three through six months	10,344	7,709
Over six to twelve months	48,651	30,813
Over twelve months	23,670	15,755
Total time deposits of $100,000 or more	$ 155,832	$ 121,108

Borrowings

Borrowings were $56,800,000 and $15,000,000 at December 31, 2018 and 2017, respectively. Borrowings consisted of FHLB advances. Management utilizes FHLB advances when the terms are deemed advantageous compared to raising time deposits and to manage overall liquidity. The increase in FHLB advances was the result of an increase in loans and decline in deposits between 2018 and 2017.

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

The Bank monitors earning asset and deposit levels, developments and trends in interest rates, liquidity, capital adequacy and marketplace opportunities. Risks associated with interest rate changes and market risk are managed through the Bank's Asset Liability and Investment Policies. These policies are reviewed and approved annually by the Board of Directors, and oversight is provided by the Asset Liability and Investment Committee of the Board. Management responds to all of these to protect and possibly enhance net interest income, while managing risks within acceptable levels as set forth in the Bank's policies. In addition, alternative business plans and transactions are contemplated for their potential impact. This process is known as asset/liability management and is carried out by changing the maturities and relative proportions of the various types of loans, investments, deposits and borrowings in the ways described above.

The tool most commonly used to manage and analyze the interest rate sensitivity of a bank is known as a computer simulation model. To quantify the extent of risks in both the Bank's current position and in transactions it might make in the future, the Bank uses a model to simulate the impact of different interest rate scenarios on net interest income. The hypothetical impact of both sudden (up to an immediate change in interest rates of +/- 4.00%) and smaller incremental interest rate changes are modeled at least quarterly, representing the primary means the Bank uses for interest rate risk management decisions.

The Bank is normally liability sensitive during a one-year period meaning that during one year, more liabilities will reprice than loans. Liability sensitive banks would expect an increase in the net interest margin if interest rates decline and the net interest margin to decline when rates increase. However various factors influence the change in the Bank's margin when general market interest rates change. These factors include, but are not limited to, the growth and mix of new assets, deposit liabilities and borrowings, the extension or contraction of maturities of new and renewed assets and liabilities, the particular shape of the general economic yield curve, and the general influence on pricing by competition in the local market for loans and deposits. Additionally, when economic rates change, there is an immediate impact from loans that are tied to a daily "prime lending or other index rate." The repricing of liabilities to offset this change requires time for deposits to mature and renew. Based strictly on maturing time deposits and borrowings, and without the other factors listed above, it normally will take three months for the Bank to reprice liabilities to offset a prime rate change.

At December 31, 2018, the computer simulation model for a +2.00% interest rate shock results in the Bank's net interest income for a twelve-month period to decrease by 0.3% or $1,735,000. A negative 2.00% interest rate shock results in the Bank's net interest income for a twelve-month period to increase by 0.1% or $450,000. Computer simulation models use information from the Bank's loan and deposit system at a static point in time and bases the repricing of assets and liabilities on contractual terms, and certain assumptions as to movements of various rate indexes and management assumptions regarding when to reprice certain portfolios not linked to an index. The actual results experienced from interest rate changes can vary from the results of the simulation.

The Bank monitors a ratio called the economic value of equity which is the theoretical projected change in fair values of financial assets (loans, investment securities, deposits and borrowings) that may impact equity for a given change in interest rates. Major assumptions used in determining the fair values include maturities, repricing periods, and decay rates of non-maturity deposits. As the calculation is highly dependent on assumptions, as well as the change in the shape of the yield curve being modeled, it is not considered to be an exact calculation, but is used as an interest rate risk monitoring tool. The computer simulation model for a +2.00% non-parallel interest rate shock results in an 8.1% decrease in the economic value of equity. A negative 2.00% non-parallel interest rate shock results in a 2.4% increase in the economic value of equity.

When preparing its modeling, the Bank makes significant assumptions about the lag in the rate of change and impacts of optionality in various asset and liability categories. The Bank bases its assumptions on past experience and comparisons with other banks and tests the validity of its assumptions by reviewing actual results with past projected expectations annually. As the impact of changing interest rates depends on assumptions, actual experience can materially differ from projections. The purpose of the model is to forecast the likely impact in order for management to monitor exposures to interest rate risk and make adjustments to the balance sheet if needed.

Liquidity and Capital Resources

Maintenance of adequate liquidity requires that sufficient resources be available at all times to meet cash flow requirements of the Bank. Liquidity in a banking institution is required primarily to provide for deposit withdrawals and the credit needs of customers and to take advantage of lending and investment opportunities as they arise. A bank may achieve desired liquidity from both assets and liabilities. Cash and deposits held in other banks, federal funds sold, other short-term investments, maturing loans and investments, payments of principal and interest on loans and investments, and potential loan sales are sources of asset liquidity. Deposit growth and access to credit lines established with correspondent banks, primarily with the FHLB, Federal Reserve and access to brokered certificates of deposits are sources of liability liquidity. The Bank reviews its liquidity position on a regular basis based upon its current position and expected trends of loans and deposits. Management believes that the Bank maintains adequate sources of liquidity to meet its liquidity needs.

The Bank’s liquid assets, defined as cash, deposits with banks, Federal funds sold and unpledged investment securities, totaled $62,964,000 and $107,035,000 at December 31, 2018 and December 31, 2017, respectively, and constituted 10% and 18%, respectively, of total assets on those dates.

At December 31, 2018, the Bank had $178,573,000 in borrowing lines of credit from the FHLB and correspondent banks with $56,800,000 in outstanding advances from the FHLB. At December 31, 2017, these lines of credit available were $161,753,000 with $15,000,000 in FHLB advances outstanding. The primary sources of cash during 2016, 2017 and 2018 were from cash generated from operating activities, sales, calls and maturities of investment securities, increases in deposit balances and changes in FHLB advances. Primary uses of cash were for loan originations, investment securities purchases and to fund a net change in demand products.

In 2018, cash was primarily provided in 2018 by $10.2 million in calls and maturities of investment securities, $9.3 million from proceeds on sale of loans, $18.4 million in net change in certificate of deposits and $41.8 million in net change in FHLB advances. Cash was used in 2018 primarily to fund a $74.8 million net change in loans, fund a net change in demand, savings and money market deposits of $50.7 million and purchase $3.5 million in investment securities.

In 2017, cash was primarily provided by $46.3 million in calls, maturities and sales of investment securities, $111.2 million in net change of demand, savings and money market deposits, $38 million in net change in certificates of deposit, $5.1 million from the sale of loans and operating activities of $4.2 million in 2017. Cash was used in 2017 primarily to purchase $17 million in investment securities, fund a $86.9 million net change in loans and fund a net change in FHLB advances of $53.9 million.

In 2016, cash was primarily provided by $86.6 million in calls and maturities of investment securities, $13.5 million increase in demand, savings and money market deposits, $24.1 million in new FHLB advances and operating activities of $5.2 million in 2016. Cash was used in 2016 primarily to purchase $71 million in investment securities, fund a $10.8 million net change in loans, fund a net change of certificates of deposit of $26.5 million and repay $11 million in FHLB advances.

For additional information, please see the Consolidated Statements of Cash Flows in Item 8 of this Form 10-K.

The Board of Directors recognizes that a strong capital position is vital to growth, continued profitability, and depositor and investor confidence. The policy of the Board of Directors is to maintain sufficient capital at not less than the "well-capitalized" thresholds established by banking regulators. The Bank has maintained capital ratios in excess of regulatory requirements.

Shareholders' equity also includes the Bank's accumulated other comprehensive income or (loss), net of taxes of $(1,789,000) at December 31, 2018 and $(597,000) at December 31, 2017. Other comprehensive income (loss) reflects the fair value adjustment, net of tax, of investment securities classified as available-for-sale. This will fluctuate based on the amount of securities classified as available-for-sale and changes in market interest rates. Total shareholders' equity was $61,520,000 at December 31, 2018 and $59,677,000 at December 31, 2017.

Federal regulations establish guidelines for calculating "risk-adjusted" capital ratios and minimum ratio requirements. Under these regulations, banks are required to maintain a total capital ratio of 8.0%, common equity Tier 1 capital ratio of 4.5%, and Tier 1 risk-based capital (primarily shareholders' equity) of at least 6.0% of risk-weighted assets. The Bank had a total capital ratio of 11.6%, common equity Tier 1 capital and Tier 1 risk-based capital ratios of 10.5% at December 31, 2018 and was "well-capitalized" under the regulatory guidelines.

In addition, regulators have adopted a minimum leverage ratio standard for Tier 1 capital to average assets. The minimum ratio for top-rated institutions may be as low as 4%. However, regulatory agencies have stated that most institutions should maintain ratios at least 1 to 2 percentage points above the 4% minimum. As of December 31, 2018, the Bank's leverage ratio was 9.9%. Capital levels for the Bank remain above established regulatory capital requirements. The Bank excludes other comprehensive income for regulatory capital computations.

Quarterly dividends are paid out of retained earnings. The Bank paid $0.48 or $2,912,000 in dividends on common stock during 2018. The California Financial Code restricts total dividend payment of any bank in any calendar year without permission of the California Department of Business Oversight, to the lesser of (1) the bank's retained earnings or (2) the bank's net income for its last three fiscal years, less distributions made to shareholders during the same three-year period. The Bank is not subject to this restriction based on its current dividend levels as of December 31, 2018.

Although the Bank's regulatory capital ratios are in excess of requirements and notwithstanding the requirements of the California Financial Code, the Board of Directors reviews and declares dividends on a quarterly basis and there is no assurance that future dividends will be declared.

Impact of Inflation

The primary impact of inflation on the Bank is its effect on interest rates. The Bank's primary source of income is net interest income, which is affected by changes in interest rates. The Bank attempts to limit the impact of inflation on its net interest margin through management of rate-sensitive assets and liabilities and analyses of interest rate sensitivity. The effect of inflation on premises and equipment as well as on non-interest expenses has not been significant for the periods presented.

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

SUMMIT STATE BANK AND SUBSIDIARY

CONSOLIDATED FINANCIAL STATEMENTS

AS OF DECEMBER 31, 2018 AND 2017

AND FOR THE YEARS ENDED

DECEMBER 31, 2018, 2017 and 2016

AND

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

MOSSADAMS

Report of Independent Registered Public Accounting Firm

To the Shareholders and the Board of Directors of
Summit State Bank and Subsidiary

Opinions on the Financial Statements and Internal Control over Financial Reporting

We have audited the accompanying consolidated balance sheets of Summit State Bank and subsidiary (the “Company”) as of December 31, 2018 and 2017, the related consolidated statements of income, comprehensive income, changes in shareholders’ equity, and cash flows for each of the three years in the period ended December 31, 2018, and the related notes (collectively referred to as the “consolidated financial statements”). We also have audited the Company’s internal control over financial reporting as of December 31, 2018, based on criteria established in Internal Control - Integrated Framework (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission (“COSO”).

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of the Company as of December 31, 2018 and 2017, and the consolidated results of its operations and its cash flows for each of the three years in the period ended December 31, 2018, in conformity with accounting principles generally accepted in the United States of America. Also in our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2018, based on criteria established in Internal Control - Integrated Framework (2013) issued by COSO.

Basis for Opinions

The Company’s management is responsible for these consolidated financial statements, for maintaining effective internal control over financial reporting, and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management Report on Internal Control over Financial Reporting. Our responsibility is to express an opinion on the Company’s consolidated financial statements and an opinion on the Company’s internal control over financial reporting based on our audits. We are a public accounting firm registered with the Public Company Accounting Oversight Board (United States) (“PCAOB”) and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audits in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement, whether due to error or fraud, and whether effective internal control over financial reporting was maintained in all material respects.

Our audits of the consolidated financial statements included performing procedures to assess the risks of material misstatement of the consolidated financial statements, whether due to error or fraud, and performing procedures to respond to those risks. Such procedures included examining, on a test basis, evidence regarding the amounts and disclosures in the consolidated financial statements. Our audits also included evaluating the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audits also included performing such other procedures as we considered necessary in the circumstances. We believe that our audits provide a reasonable basis for our opinions.

Definition and Limitations of Internal Control Over Financial Reporting

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

/ s / Moss Adams LLP

Sacramento, California
March 18, 2019

We have served as the Company's auditor since 2012.

Management's Report on Internal Control over Financial Reporting

Management of the Bank is responsible for establishing and maintaining adequate internal control over financial reporting. Internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with U.S. generally accepted accounting principles ("GAAP"). The Bank’s internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the Bank's assets; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with GAAP, and that receipts and expenditures are being made only in accordance with authorizations of management and board of directors; and (3) provide reasonable assurance regarding prevention, or timely detection and correction of unauthorized acquisition, use, or disposition of the Bank's assets that could have a material effect on the financial statements.

Management conducted an assessment of the effectiveness of internal control over financial reporting as of December 31, 2018, utilizing the framework established in Internal Control - Integrated Framework (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Based on this assessment, Management has concluded that the Company maintained effective internal control over financial reporting as of December 31, 2018.

The Bank's independent registered public accounting firm, Moss Adams LLP, has issued an attestation report on our internal control over financial reporting, which appears on the previous page.

/s/ James E. Brush
James E. Brush
President and Chief Executive Officer

/s/ Camille D. Kazarian
Camille D. Kazarian
Executive Vice President and Chief Financial Officer

SUMMIT STATE BANK AND SUBSIDIARY
CONSOLIDATED BALANCE SHEETS
(In thousands except share data)

	December 31, 2018	December 31, 2017
ASSETS		
Cash and due from banks	$ 21,693	$ 68,814
Federal funds sold	-	2,000
Total cash and cash equivalents	21,693	70,814
Investment securities:		
Held-to-maturity, at amortized cost	7,991	7,984
Available-for-sale (at fair value; amortized cost of $72,716 in 2018 and $79,617 in 2017)	70,174	78,770
Total investment securities	78,165	86,754
Loans, less allowance for loan losses of $6,029 in 2018 and $5,236 in 2017	504,549	437,594
Bank premises and equipment, net	5,803	5,279
Investment in Federal Home Loan Bank stock, at cost	3,085	3,085
Goodwill	4,119	4,119
Other real estate owned	-	-
Accrued interest receivable and other assets	4,690	3,219
Total assets	$ 622,104	$ 610,864
LIABILITIES AND SHAREHOLDERS' EQUITY		
Deposits:		
Demand - non interest-bearing	$ 120,011	$ 190,861
Demand - interest-bearing	65,652	65,742
Savings	25,817	30,102
Money market	104,060	79,564
Time deposits that meet or exceed the FDIC insurance limit	83,071	68,927
Other time deposits	102,578	98,317
Total deposits	501,189	533,513
Federal Home Loan Bank advances	56,800	15,000
Accrued interest payable and other liabilities	2,595	2,674
Total liabilities	560,584	551,187
Commitments and contingencies (Note 10)		
Shareholders' equity		
Preferred stock, no par value; 20,000,000 shares authorized; no shares issued and outstanding	-	-
Common stock, no par value; shares authorized - 30,000,000 shares; issued and outstanding 6,066,475 in 2018 and 6,041,475 in 2017	36,967	36,847
Retained earnings	26,342	23,427
Accumulated other comprehensive loss, net of tax	(1,789)	(597)
Total shareholders' equity	61,520	59,677
Total liabilities and shareholders' equity	$ 622,104	$ 610,864

The accompanying notes are an integral part of these audited consolidated financial statements.

SUMMIT STATE BANK AND SUBSIDIARY

CONSOLIDATED STATEMENTS OF INCOME

(In thousands except earnings per share data)

	Year Ended December 31,		
	2018	**2017**	**2016**
Interest income:			
Interest and fees on loans	$ 22,663	$ 17,176	$ 16,549
Interest on deposits with banks	247	162	82
Interest on federal funds sold	14	17	7
Interest on investment securities	2,382	3,126	2,912
Dividends on FHLB stock	266	232	357
Total interest income	25,572	20,713	19,907
Interest expense:			
Deposits	3,509	1,639	855
Federal Home Loan Bank advances	441	502	379
Total interest expense	3,950	2,141	1,234
Net interest income before provision for loan losses	21,622	18,572	18,673
Provision for loan losses	530	520	-
Net interest income after provision for loan losses	21,092	18,052	18,673
Non-interest income:			
Service charges on deposit accounts	765	695	748
Rental income	553	574	559
Net gain on loan sales	748	351	-
Net securities gain	27	72	692
Other income	216	23	22
Total non-interest income	2,309	1,715	2,021
Non-interest expense:			
Salaries and employee benefits	9,151	7,788	6,562
Occupancy and equipment	1,536	1,503	1,229
Other expenses	4,670	4,554	4,454
Total non-interest expense	15,357	13,845	12,245
Income before provision for income taxes	8,044	5,922	8,449
Provision for income taxes	2,217	2,630	3,482
Net income	$ 5,827	$ 3,292	$ 4,967
Basic earnings per common share	$ 0.96	$ 0.55	$ 0.83
Diluted earnings per common share	$ 0.96	$ 0.54	$ 0.82
Basic weighted average shares of common stock outstanding	6,065	6,031	6,005
Diluted weighted average shares of common stock outstanding	6,072	6,059	6,036

The accompanying notes are an integral part of these audited consolidated financial statements.

SUMMIT STATE BANK AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(In thousands)

	Year Ended December 31,		
	2018	**2017**	**2016**
Net income	$ 5,827	$ 3,292	$ 4,967
Change in securities available-for-sale:			
Unrealized holding (losses) gains on available-for-sale securites arising during the period	(1,563)	751	(1,697)
Reclassification adjustment for gains realized in net income on available-for-sale securities	(27)	(72)	(692)
Net unrealized (losses) gains , before provision for income tax	(1,590)	679	(2,389)
Provision for income tax benefit (expense)	398	(286)	1,003
Total other comprehensive (loss) income, net of tax	(1,192)	393	(1,386)
Comprehensive income	$ 4,635	$ 3,685	$ 3,581

The accompanying notes are an integral part of these audited consolidated financial statements.

SUMMIT STATE BANK AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY
(In thousands except share and per share data)

	Common Stock		Retained	Accumulated Other Comprehensive	Total Shareholders'
	Shares	Amount	Earnings	Income (Loss)	Equity
Balance, January 1, 2016	5,979	$ 36,704	$ 20,120	$ 501	$ 57,325
Net income			4,967		4,967
Other comprehensive loss				(1,386)	(1,386)
Stock-based compensation expense		21			21
Exercise of stock options	41	1			1
Cash dividends - $0.38 per share			(2,306)		(2,306)
Balance, December 31, 2016	6,020	36,726	22,781	(885)	58,622
Net income			3,292		3,292
Other comprehensive income				393	393
Tax effect of reclass from accumulated other comprehensive income			105	(105)	-
Exercise of stock options	21	121			121
Cash dividends - $0.46 per share			(2,751)		(2,751)
Balance, December 31, 2017	6,041	36,847	23,427	(597)	59,677
Net income			5,827		5,827
Other comprehensive loss				(1,192)	(1,192)
Exercise of stock options	25	120			120
Cash dividends - $0.48 per share			(2,912)		(2,912)
Balance, December 31, 2018	6,066	$ 36,967	$ 26,342	$ (1,789)	$ 61,520

The accompanying notes are an integral part of these audited consolidated financial statements.

SUMMIT STATE BANK AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF CASH FLOWS
(In thousands)

	Year Ended December 31,		
	2018	**2017**	**2016**
Cash flows from operating activities:			
Net income	$ 5,827	$ 3,292	$ 4,967
Adjustments to reconcile net income to net cash from operating activities:			
Depreciation and amortization	346	339	312
Securities amortization and accretion, net	158	387	598
Net change in deferred loan fees	(1,293)	(1,336)	(615)
Provision for loan losses	530	520	-
Net securities gains	(27)	(72)	(692)
Net gain on loan sales	(748)	(351)	-
Deferred tax impairment due to tax rate change	-	292	-
Net change in accrued interest receivable and other assets	(907)	531	1,696
Net change in accrued interest payable and other liabilities	(79)	743	(1,063)
Share-based compensation expense	-	-	21
Tax benefit from stock-based compensation	(61)	(103)	-
Net cash from operating activities	3,746	4,242	5,224
Cash flows from investing activities:			
Net change in time deposits with banks	-	248	496
Purchases of held-to-maturity investment securities	-	-	(7,971)
Purchases of available-for-sale investment securities	(3,476)	(16,971)	(63,035)
Proceeds from sales of available-for-sale investment securities	-	36,721	878
Proceeds from calls of held-to-maturity investment securities	-	-	6,000
Proceeds from calls and maturities of available-for-sale investment securities	10,239	9,605	80,673
Purchase of Federal Home Loan Bank stock	-	-	(384)
Net change in loans	(74,789)	(86,886)	(10,806)
Purchases of bank premises and equipment, net	(870)	(205)	(227)
Proceeds from sales of loans other than loans originated for resale	9,345	5,097	-
Net cash (used in) from investing activities	(59,551)	(52,391)	5,624

SUMMIT STATE BANK AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF CASH FLOWS
(In thousands)

	Year Ended December 31,		
	2018	**2017**	**2016**
Cash flows from financing activities:			
Net change in demand, savings and money market deposits	(50,729)	111,273	13,564
Net change in certificates of deposit	18,405	37,989	(26,559)
Net change in short term Federal Home Loan Bank advances	41,800	(53,900)	9,100
Issuance of long term Federal Home Loan Bank advances	-	-	15,000
Repayment of long term Federal Home Loan Bank advances	-	-	(11,000)
Dividends paid on common stock	(2,912)	(2,751)	(2,306)
Proceeds from exercise of stock options	120	121	1
Net cash from (used in) financing activities	6,684	92,732	(2,200)
Net change in cash and cash equivalents	(49,121)	44,583	8,648
Cash and cash equivalents at beginning of year	70,814	26,231	17,583
Cash and cash equivalents at end of period	$ 21,693	$ 70,814	$ 26,231
Supplemental disclosure of cash flow information:			
Cash paid during the period for:			
Interest	$ 3,827	$ 2,080	$ 1,260
Income taxes	$ 3,220	$ 2,665	$ 3,590

SUMMIT STATE BANK AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

General

On January 15, 1999, Summit State Bank (the "Bank") received authority to transact business as a California state-chartered commercial bank and is subject to regulation, supervision and examination by the California Department of Business Oversight and the Federal Deposit Insurance Corporation. The Bank was organized under a charter granted by the Department of Savings and Loan of the State of California under the name Summit Savings. The Bank was incorporated on December 20, 1982. The Bank converted to a federal savings bank under a charter granted by the Office of Thrift Supervision on May 24, 1990. The Bank provides a variety of banking services to individuals and businesses in its primary service area of Sonoma County, California. The Bank's branch locations include Santa Rosa, Petaluma, Rohnert Park and Healdsburg. The Bank offers depository and lending services primarily to meet the needs of its business and individual clientele. These services include a variety of transaction, money market, savings and time deposit account alternatives. The Bank's lending activities are directed primarily towards commercial real estate, construction and business loans. The Bank utilizes its subsidiary Alto Service Corporation for its deed of trust services.

The accounting and reporting policies of the Bank and its subsidiary conform with accounting principles generally accepted in the United States of America and prevailing practices within the banking industry.

Stock Split Adjustment

The Board of Directors declared a five-for-four stock split on January 23, 2017 to common shareholders of record on February 28, 2017 and issued on March 14, 2017. The impact of this stock split has been retroactively applied to periods presented with adjustments to the number of common shares and per common share values as if the stock split had occurred as of the beginning of each period presented.

Principles of Consolidation

The consolidated financial statements include the accounts of the Bank and its wholly-owned subsidiary, Alto Service Corporation. All significant intercompany accounts and transactions have been eliminated in consolidation.

Reclassification

Some items in the prior year financial statements were reclassified to conform to the current presentation. Reclassifications had no effect on prior year net income or shareholders' equity.

Use of Estimates

The preparation of financial statements in conformity with U.S. Generally Accepted Accounting Principles requires management to make estimates and assumptions. These estimates and assumptions affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from these estimates. The allowance for loan losses, goodwill impairment and fair values of investment securities and other financial instruments are particularly subject to change.

Cash and Cash Equivalents

For the purpose of the consolidated statement of cash flows, the Bank considers cash and due from banks with original maturities under 90 days and Federal funds sold to be cash equivalents. Generally, Federal funds are sold for one-day periods. Net cash flows are reported for customer loan and deposit transactions, time deposits in banks and short-term borrowings with an original maturity of 90 days or less.

Investment Securities

Investments are classified into the following categories:

- Available-for-sale securities, reported at fair value, with unrealized gains and losses excluded from earnings and reported, net of taxes, as accumulated other comprehensive income (loss) within shareholders' equity.

- Held-to-maturity securities, which management has the positive intent and ability to hold to maturity, reported at amortized cost, adjusted for the accretion of discounts and amortization of premiums.

Management determines the appropriate classification of its investments at the time of purchase and may only change the classification in certain limited circumstances. All transfers between categories are accounted for at fair value.

Gains or losses on the sale of investment securities are recorded on the trade date and are computed on the specific identification method. Interest earned on investment securities is reported in interest income, net of applicable adjustments for accretion of discounts and amortization of premiums on the level yield method.

Management evaluates securities for other-than-temporary impairment ("OTTI") on at least a quarterly basis, and more frequently when economic or market conditions warrant such an evaluation. For securities in an unrealized loss position, management considers the extent and duration of the unrealized loss, and the financial condition and near-term prospects of the issuer. Management also assesses whether it intends to sell, or it is more likely than not that it will be required to sell, a security in an unrealized loss position before recovery of its amortized cost basis. If either of the criteria regarding intent or requirement to sell is met, the entire difference between amortized cost and fair value is recognized as impairment through earnings. For debt securities that do not meet the aforementioned criteria, the amount of impairment is split into two components as follows: 1) OTTI related to credit loss, which must be recognized in the income statement for available-for-sale and held-to-maturity investments and 2) OTTI related to other factors, which is recognized in other comprehensive income or (loss) for available-for-sale investments. The credit loss is defined as the difference between the present value of the cash flows expected to be collected and the amortized cost basis.

Investment in Federal Home Loan Bank Stock

In order to borrow from the Federal Home Loan Bank of San Francisco (FHLB), the Bank is required to maintain an investment in the capital stock of the FHLB. The investment is carried at cost and is generally redeemable at par. Both cash and stock dividends are reported as income.

Loans

Loans that management has the intent and ability to hold for the foreseeable future or until maturity are stated at principal balances outstanding, net of deferred loan origination fees and costs and the allowance for loan losses, adjusted for accretion of discounts or amortization of premiums. Interest is accrued daily based upon outstanding loan balances. However, for all loan classes, when in the opinion of management, loans are considered to be impaired and the future collectability of interest and principal is in serious doubt, loans are placed on nonaccrual status and the accrual of interest income is suspended. Any interest previously accrued, but unpaid, is charged against income. Payments received are applied to reduce principal to the extent necessary to ensure collection. Subsequent payments on these loans, or payments received on nonaccrual loans for which the ultimate collectability of principal is not in doubt, are applied first to earned but unpaid interest and then to principal.

Substantially all loan origination fees, commitment fees, direct loan origination costs and purchase premiums and discounts on loans are deferred and recognized in interest income using the level yield method, to be amortized to interest income over the contractual term of the loan. The unamortized balance of deferred fees and costs is reported as a component of net loans.

Non-accrual loans and loans past due 90 days still on accrual include both smaller balance homogeneous loans that are collectively evaluated for impairment and individually classified impaired loans. A loan is moved to non-accrual status in accordance with the Bank's policy, typically after 90 days of non-payment.

For loans whose contractual terms have been restructured in a manner which grants a concession to a borrower experiencing financial difficulties ("troubled debt restructuring"), they are returned to accrual status when there has been a sustained period of repayment performance (generally, six consecutive monthly payments) according to the modified terms and there is reasonable assurance of repayment and of performance.

Allowance for Loan Losses

The allowance for loan losses is a valuation allowance for probable incurred credit losses. Loan losses are charged against the allowance when management believes the un-collectability of a loan balance is confirmed. Loans or portions of loans are charged off when there is a distinct probability of loss identified. A distinct probability of loss exists when it has been determined that any remaining sources of repayment are not sufficient to cover all outstanding principal. The probable loss is immediately calculated based on the value of the remaining sources of repayment and charged to the allowance for loan losses. Subsequent recoveries, if any, are credited to the allowance. Management estimates the allowance balance required using past loan loss experience, the nature and volume of the portfolio, information about specific borrower situations and estimated collateral values, economic conditions, and other factors. Allocations of the allowance may be made for specific loans, but the entire allowance is available for any loan that, in management's judgment, should be charged-off.

A loan is impaired when, based on current information and events, it is probable that the Bank will be unable to collect all amounts due according to the contractual terms of the loan agreement. Commercial & agricultural, real estate-commercial, real estate-construction and land, and real estate-multifamily loans are individually evaluated for impairment. Large groups of smaller balance homogeneous loans such as real estate-single family units and consumer & lease financing are collectively evaluated for impairment, and accordingly, they are not separately identified for impairment disclosures. Impaired loans are measured on the present value of expected future cash flows discounted at the loan's original effective interest rate. As a practical expedient, impairment may be measured based on the loan's observable market price or the fair value of the collateral if the loan is collateral dependent. When the measure of the impaired loan is less than the recorded investment in the loan, the impairment is recorded through an allocation of a portion of the allowance for loan losses. Loans, for which the terms have been modified granting concessions to the borrower that the Bank would not otherwise consider, and for which the borrower is experiencing financial difficulties, are considered troubled debt restructurings and classified as impaired. Troubled debt restructurings are measured at the present value of estimated future cash flows using the loan's effective interest rate at inception.

The allowance consists of specific and general components. The specific component relates to loans that are individually classified as impaired. The general component covers loans that are both non-impaired and non-classified and is based on historical loss experience adjusted for qualitative factors. The historical loss experience is determined by portfolio segment and is based on the actual loss history experienced by the Bank over the most recent eight years. This actual loss experience is supplemented with other economic factors based on the risks present for each portfolio segment. These economic factors include consideration of the following: levels of and trends in delinquencies and impaired loans; levels of and trends in charge-offs and recoveries; trends in volume and terms of loans; effects of any changes in risk selection and underwriting standards; other changes in lending policies, procedures, and practices; experience, ability, and depth of lending management and other relevant staff; national and local economic trends and conditions; industry conditions; and effects of changes in credit concentrations. The following portfolio segments have been identified: commercial & agricultural, real estate mortgage loans and consumer & lease financing. Real estate mortgage loans have been further classified according to the following risk characteristics: commercial, construction and land, single family units and multifamily units. Loan categories used in presentations in this report conform to the categorizations used by regulatory Call Reports as described by the instructions issued by the Federal Financial Institutions Examination Council (FFIEC).

Commercial and Agricultural Loans - Commercial and agricultural credit is extended to commercial customers for use in normal business operations to finance working capital needs, equipment purchases, farm land, or other projects. The majority of these borrowers are customers doing business within our geographic regions. These loans are generally underwritten individually and secured with the assets of the company and the personal guarantee of the business owners. Commercial & agricultural loans are made based primarily on the historical and projected cash flow of the borrower and the underlying collateral provided by the borrowers. This category includes loans secured by farmland.

Commercial and Multifamily Real Estate Loans - Commercial and multifamily real estate loans are subject to underwriting standards and processes similar to commercial loans. These loans are viewed primarily as cash flow loans and the repayment of these loans is largely dependent on the successful operation of the property. Loan performance may be adversely affected by factors impacting the general economy or conditions specific to the real estate market such as geographic location and property type.

Construction and Land Real Estate Loans - Construction and land real estate loans are extended to qualified commercial and individual customers and are underwritten and secured by the assets of the company or individual. Commercial construction credits may also be secured with personal guarantees of the business owner. Credits are underwritten to meet the general credit policy criteria for current and projected cash flow coverage and loan-to-value. Terms for construction and land loans are typically of shorter duration and have more restrictive advance rates than similar commercial credit or single-family residences. Both types of credit may be refinanced to a long-term loan upon completion of construction. The majority of these credits are with customers doing business within the Bank’s geographic region.

Consumer and Lease Financing Loans - Consumer and lease financing loans are primarily comprised of loans made directly to consumers. These loans have a specific underwriting matrix which consists of several factors including debt to income, type of collateral and loan to collateral value, credit history and relationship to the borrower. Consumer and lease financing lending uses risk-based pricing in the underwriting process.

Single Family Residential Loans - Single family residential mortgage loans represent loans to consumers for the purchase or refinance of a residence. These loans are generally financed up to 30 years, and in most cases, are extended to borrowers to finance their primary residence. Real estate market values at the time of origination directly affect the amount of credit extended, and in the event of default, subsequent changes in these values may impact the severity of losses. Additionally, commercial loans may be categorized as Single Family Residential if the loan is secured by a mortgage on a home. These loans are underwritten as described in Commercial and Agricultural Loans above and have terms such as interest rates and maturities as a standard Commercial Loan.

The Bank is subject to periodic examinations by its federal and state regulatory examiners and may be required by such regulators to recognize additions to the allowance for loan losses based on their assessment of credit information available to them at the time of their examinations. The process of assessing the adequacy of the allowance for loan losses is necessarily subjective. Further, and particularly in times of economic downturns, it is reasonably possible that future credit losses may exceed historical loss levels and may also exceed management’s current estimates of incurred credit losses inherent within the loan portfolio. As such, there can be no assurance that future charge-offs will not exceed management’s current estimate of what constitutes a reasonable allowance for credit losses.

Valuation of Goodwill

Goodwill and intangible assets acquired in a purchase business combination and determined to have an indefinite useful life are not amortized, but tested for impairment at least annually. The Bank has selected September 30 as the date to perform the annual impairment test. Intangible assets with definite useful lives are amortized over their estimated useful lives to their estimated residual values. Goodwill is the only intangible asset with an indefinite life on our balance sheet.

Management assesses the carrying value of our goodwill at least annually in order to determine if this intangible asset is impaired. In reviewing the carrying value of our goodwill, we assess the recoverability of such assets by evaluating the fair value of the related business unit. If the carrying amount of goodwill exceeds its fair value, an impairment loss is recognized for the amount of the excess and the carrying value of goodwill is reduced accordingly. Any impairment would be required to be recorded during the period identified.

The annual evaluation of goodwill for impairment uses various estimates and assumptions. Management performed an assessment of qualitative factors impacting the Bank and determined goodwill was not impaired at December 31, 2018.

Other Real Estate Owned

Other real estate owned includes real estate acquired in full or partial settlement of loan obligations. When property is acquired, any excess of the Bank's recorded investment in the loan balance and accrued interest income over the estimated fair market value of the property, less costs to sell, is charged against the allowance for loan losses. A valuation allowance for losses on other real estate, if needed, is maintained to provide for declines in value. The allowance is established through a provision for losses on other real estate which is included in other expenses. Subsequent gains or losses on sales or write-downs resulting from impairment are recorded in other income or expenses as incurred. Operating costs after acquisition are expensed and any rental income from the properties are recorded as income. There was no other real estate owned at December 31, 2018 and 2017.

Bank Premises and Equipment

Land is carried at cost. Buildings, furniture, fixtures, and equipment are carried at cost less accumulated depreciation. Depreciation is determined using the straight-line method over the estimated useful lives of the related assets. The useful lives of buildings are estimated to be 39 years and furniture, fixtures and equipment are estimated to be 3 to 15 years. Leasehold improvements are amortized over the estimated useful life of the asset or the term of the related lease, whichever is shorter. When assets are sold or otherwise disposed of, the cost and related accumulated depreciation are removed from the accounts, and any resulting gain or loss is recognized in income for the period. The cost of maintenance and repairs is charged to expense as incurred.

The Bank evaluates premises and equipment for financial impairment as events or changes in circumstances indicate that the carrying amount of such assets may not be fully recoverable.

Income Taxes

The Bank files its income taxes on a consolidated basis with its subsidiary. The allocation of income tax expense (benefit) represents each entity's proportionate share of the consolidated provision for income taxes. Income tax expense is the total of the current year income tax due or refundable and the change in deferred tax assets and liabilities.

Deferred tax assets and liabilities are recognized for the tax consequences of temporary differences between the reported amounts of assets and liabilities and their tax basis. Deferred tax assets and liabilities are adjusted for the effects of changes in tax laws and rates on the date of enactment. A valuation allowance, if needed, reduces deferred tax assets to the amount expected to be realized. On the consolidated balance sheet, net deferred tax assets are included in accrued interest receivable and other assets.

A tax position is recognized as a benefit only if it is "more likely than not" that the tax position would be sustained in a tax examination, with a tax examination being presumed to occur. The amount recognized is the largest amount of tax benefit that is greater than 50% likely of being realized on examination. For tax positions not meeting the "more likely than not" test, no tax benefit is recorded.

The Bank recognizes interest and/or penalties related to income tax matters in income tax expense. The Bank has not accrued any potential interest and penalties as of December 31, 2018 and December 31, 2017 and for the three years ended December 31, 2018 for uncertainties related to income taxes.

Earnings Per Common Share

Basic earnings per common share (EPS), which excludes dilution, is computed by dividing income available to common shareholders by the weighted-average number of common shares outstanding for the period. Diluted earnings per share reflects the potential dilution that could occur if contracts to issue common stock, such as stock options, result in the issuance of common stock which shares in the earnings of the Bank. Stock options for 3,318, 8,087 and 26,198 shares of common stock were not considered in computing diluted earnings per share for 2018, 2017 and 2016 because they were anti-dilutive.

The factors used in the earnings per common share computation follow:

(in thousands except earnings per share)	2018	2017	2016
Basic			
Net income available for common shareholders	$ 5,827	$ 3,292	$ 4,967
Weighted average common shares outstanding	6,065	6,031	6,005
Basic earnings per common share	$ 0.96	$ 0.55	$ 0.83
Diluted			
Net income available for common shareholders	$ 5,827	$ 3,292	$ 4,967
Weighted average common shares outstanding for basic earnings per common share	6,065	6,031	6,005
Add: Dilutive effects of assumed exercises of stock options	7	28	31
Average shares and dilutive potential common shares	6,072	6,059	6,036
Diluted earnings per common share	$ 0.96	$ 0.54	$ 0.82

Share-Based Compensation

Compensation cost is recognized for stock options and stock appreciation rights (“SARs) granted to employees, based on the fair value of these awards at the date of grant. A Black-Scholes model is utilized to estimate the fair value of stock options and SARs. Compensation cost is recognized over the required service period, generally defined as the vesting period.

Revenue Recognition

The Bank records revenue from contracts with customers in accordance with Accounting Standards Codification Topic 606, “Revenue from Contracts with Customers” (“Topic 606”). Under Topic 606, the Bank must identify the contract with a customer, identify the performance obligations in the contract, determine the transaction price, allocate the transaction price to the performance obligations in the contract, and recognize revenue when (or as) the Bank satisfies a performance obligation.

Most of our revenue-generating transactions are not subject to Topic 606, including revenue generated from financial instruments, such as our loans and investment securities. In addition, certain noninterest income streams such as fees associated with mortgage servicing rights, gains on sales of loans, financial guarantees, derivatives, and certain credit card fees are also not in scope of the new guidance. The Bank's noninterest revenue streams are largely based on transactional activity, or standard month-end revenue accruals such as asset management fees based on month-end market values. Consideration is often received immediately or shortly after the Bank satisfies its performance obligation and revenue is recognized. The Bank does not typically enter into long-term revenue contracts with customers, and therefore, does not experience significant contract balances. As of December 31, 2018, and December 31, 2017, the Bank did not have any significant contract balances. The Bank has evaluated the nature of its revenue streams and determined that further disaggregation of revenue into more granular categories beyond what is presented on the Consolidated Statements of Income was not necessary. The following are descriptions of revenues within the scope of ASC 606.

Deposit service charges - The Bank earns fees from its deposit customers for account maintenance, transaction-based 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 Bank is used. The Bank 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.

Rental Income – Leases originated by the Bank are recorded as rental income and included in the other non-interest income category. Rental income is recognized in the month in which the revenue covers. Leasehold improvements and operational expenses associated with the rental proper are recorded separate from the income as an expense.

Gain/loss on other real estate owned, net - The Bank 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 Bank finances the sale of other real estate owned to the buyer, the Bank 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 Bank adjusts the transaction price and related gain or loss on sale if a significant financing component is present

Adoption of New Accounting Standards

In January 2016, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (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. The ASU is effective for financial statements issued for fiscal years beginning after December 15, 2017, and interim periods within those fiscal years. The Bank adopted the ASU in the first quarter of 2018 and the consolidated financial statements and related footnotes reflect the changes required.

In May 2014, the FASB issued ASU No. 2014-09, *Revenue from Contracts with Customers (Topic 606).* In March 2016, the FASB issued ASU No. 2016-08, superseding most industry-specific revenue recognition guidance in the FASB Accounting Standards Codification. The core principle of the new guidance is that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. The guidance identifies five specific steps that entities should apply in order to achieve this principle. Entities must identify the contract with a customer, identify the performance obligations in the contract, determine the transaction price, allocate the transaction price to the performance obligations in the contract, and recognize revenue when (or as) we satisfy the performance obligations. Revenue has not been recognized in the current reporting period that results from performance obligations satisfied in previous periods. Our primary sources of revenue are derived from interest earned on loans, interest and dividends earned on investment securities, and other financial instruments that are not within the scope of Topic 606. We have evaluated the nature of our contracts with customers and determined that further disaggregation of revenue from contracts with customers into more granular categories beyond what is presented in the Consolidated Statements of Income was not necessary. We fully satisfy our performance obligations on our contracts with customers as services are rendered and the transaction prices are typically fixed, charged either on a periodic basis or based on activity. Because performance obligations are satisfied as services are rendered and the transaction prices are fixed, there is little judgment involved in applying Topic 606 that significantly affects the determination of the amount and timing of revenue from contracts with customers. The ASU is effective for interim and annual periods beginning after December 15, 2017. The Bank adopted the ASU in the first quarter of 2018 on a modified retrospective method and the consolidated financial statements and related footnotes reflect the required changes. There was no adjustment to retained earnings as a result of the adoption.

In August 2016, the FASB issued ASU No. 2016-15, *Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments*. This ASU provides guidance on how to present and classify eight specific cash flow issues in the statement of cash flows. The ASU was effective for fiscal years beginning after December 15, 2017. The amendments should be applied using a retrospective transition method to each period presented, if practical. The Bank adopted the ASU in the first quarter of 2018 and the required changes are reflected in the consolidated financial statements and related footnotes.

In February 2018, the FASB issued ASU No. 2018-02, *Income Statement-Reporting Comprehensive Income (Topic 220): Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income."* ASU 2018-02 was issued to address the income tax accounting treatment of the stranded tax effects within other comprehensive income due to the prohibition of backward tracing due to an income tax rate change that was initially recorded in other comprehensive income. This issue came about from the enactment of the Tax Cuts and Jobs Act on December 22, 2017 that changed the Company's income tax rate from 35% to 21%. The ASU changed current accounting whereby an entity may elect to reclassify the stranded tax effect from accumulated other comprehensive income to retained earnings. The ASU is effective for periods beginning after December 15, 2018 although early adoption is permitted. The Bank early adopted ASU 2018-02 in 2017 and reclassified its stranded tax debit of $105,000 within accumulated other comprehensive income to retained earnings at December 31, 2017.

Recently Issued Accounting Standards Not Yet Adopted

In February of 2016, the FASB issued ASU No. 2016-02, *Leases (Topic 842).* This Update was issued to increase transparency and comparability among organizations by recognizing lease assets and lease liabilities on the balance sheet and disclosing key information about leasing arrangements. The core principle of Topic 842 is that a lessee should recognize the assets and liabilities that arise from leases. All leases create an asset and a liability for the lessee in accordance with FASB Concepts Statement No. 6, Elements of Financial Statements, and, therefore, recognition of those lease assets and lease liabilities represents an improvement over previous GAAP, which did not require lease assets and lease liabilities to be recognized for most leases. For public companies, the amendments in this update are effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. Lease commitments will be reflected on the balance sheet as lease assets and lease liabilities. ASU 2018-11 provides an optional alternative transition method to initially apply the new leases standard at the adoption date (collectively, with ASU 2016-02, Topic 842). Topic 842 now allows for the use of either the modified retrospective adoption method or the alternative transition method. The Bank estimates that the adoption of this standard will result in an increase in assets of approximately $1,140,000 to recognize the present value of the lease obligations with a corresponding increase in liabilities in January 2019. The Bank does not expect this to have a material impact on the Bank's results of operations or cash flows.

In June of 2016, the FASB issued ASU No. 2016-13, *Financial Instruments – Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments.* The amendments are intended to improve financial reporting by requiring timelier recording of credit losses on loans and other financial instruments held by financial institutions and other organizations. The ASU requires the measurement of all expected credit losses for financial assets held at the reporting date based on historical experience, current conditions, and reasonable and supportable forecasts. Financial institutions and other organizations will now use forward-looking information to better inform their credit loss estimates. Many of the loss estimation techniques applied today will still be permitted, although the inputs to those techniques will change to reflect the full amount of expected credit losses. Organizations will continue to use judgment to determine which loss estimation method is appropriate for their circumstances. The ASU requires enhanced disclosures to help investors and other financial statement users to better understand significant estimates and judgments used in estimating credit losses, as well as the credit quality and underwriting standards of an organization's portfolio. These disclosures include qualitative and quantitative requirements that provide additional information about the amounts recorded in the financial statements. In addition, the ASU amends the accounting guidance for credit losses on available-for-sale debt securities and purchased financial assets with credit deterioration. The amendment is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2019. Early application will be permitted for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2018. We currently have a CECL model in place that will run parallel to the existing practice. At the end of the test period (year-end 2019) the model will be live and the impact the new standard will have on our consolidated financial statements will be provided at that time.

In March 2017, the FASB issued ASU No. 2017-08, *Receivables – Nonrefundable Fees and Other Costs (Subtopic 310-20), Premium Amortization on Purchased Callable Debt Securities.* Under current GAAP, entities normally amortize the premium as an adjustment of yield over the contractual life of the instrument. This guidance shortens the amortization period for certain callable debt securities held at a premium to the earliest call date. This update is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2018. The adoption of this ASU is not expected to have a material impact on the Bank's consolidated financial statements.

In January of 2017, the FASB issued ASU No. 2017-04, *Intangibles - Goodwill and Other (Topic 350): Simplifying the Test for Goodwill Impairment.* The amendments are intended to simplify the subsequent measurement of goodwill, and the amendments eliminate Step 2 from the goodwill impairment test. The annual, or interim, goodwill impairment test is performed by comparing the fair value of a reporting unit with its carrying amount. An impairment charge should be recognized for the amount by which the carrying amount exceeds the reporting unit's fair value; however, the loss recognized should not exceed the total amount of goodwill allocated to that reporting unit. In addition, income tax effects from any tax-deductible goodwill on the carrying amount of the reporting unit should be considered when measuring the goodwill impairment loss, if applicable. The amendments also eliminate the requirements for any reporting unit with a zero or negative carrying amount to perform a qualitative assessment and, if it fails that qualitative test, to perform Step 2 of the goodwill impairment test. An entity still has the option to perform the qualitative assessment for a reporting unit to determine if the quantitative impairment test is necessary. The amendments should be applied on a prospective basis. The nature of and reason for the change in accounting principle should be disclosed upon transition. The amendment is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2019. Early application will be permitted for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2019. Early adoption is permitted for interim or annual goodwill impairment tests performed on testing dates after January 1, 2017. Management does not anticipate any potential impact from the new standard on our consolidated financial statements.

In August 2018, the FASB issued ASU No. 2018-13, Fair Value Measurement (Topic 820): Disclosure Framework - Changes to the Disclosure Requirements for Fair Value Measurement. The amendments in this update remove, modify or add disclosure requirements for fair value measurements to improve the effectiveness of disclosures. The update is effective for the Bank on January 1, 2020, with early adoption permitted, and allows for either the prospective or retrospective adoption method. Management is currently evaluating the potential impact of adoption to the Bank's Consolidated Financial Statements.

Operating segments

While the Bank's chief decision makers monitor the revenue streams of the Bank's various products and services, operations are managed and financial performance is evaluated on a bank-wide basis. Operating segments are aggregated into one segment as operating results for all segments are substantially the same.

2. INVESTMENT SECURITIES

The amortized costs and estimated fair value of investment securities at December 31, 2018 and 2017 consisted of the following:

	December 31, 2018			
(in thousands)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Held-to-maturity:				
Government agencies	$ 7,991	$ -	$ (379)	$ 7,612
Available-for-sale:				
Government agencies	41,365	-	(2,035)	39,330
Mortgage-backed securities - residential	11,217	1	(246)	10,972
Corporate debt	20,134	134	(396)	19,872
Total available-for-sale	72,716	135	(2,677)	70,174
Total investment securities	$ 80,707	$ 135	$ (3,056)	$ 77,786

	December 31, 2017			
(in thousands)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Held-to-maturity:				
Government agencies	$ 7,984	$ -	$ (114)	$ 7,870
Available-for-sale:				
U.S. Treasuries	$ 6,006	$ -	$ (24)	$ 5,982
Government agencies	41,247	75	(1,265)	40,057
Mortgage-backed securities - residential	8,159	9	(75)	8,093
Corporate debt	24,205	608	(175)	24,638
Total available-for-sale	79,617	692	(1,539)	78,770
Total investment securities	$ 87,601	$ 692	$ (1,653)	$ 86,640

The activity related to recorded gross gains and gross losses of investment securities for the years ended December 31 is reflected in the table below:

(in thousands)	Year Ended December 31 2018	2017	2016
Proceeds from sales	$ -	$ 36,721	$ 878
Proceeds from calls	1,366	2,798	37,933
Gross realized gains on sales and calls	27	556	744
Gross realized losses on sales and calls	-	(484)	(52)

Net unrealized losses on available-for-sale investment securities totaling $2,542,000, $847,000 and $1,526,000 are recorded, net of $135,000, $356,000 and $641,000 in tax benefit, as accumulated other comprehensive income within shareholders' equity at December 31, 2018, 2017 and 2016, respectively.

There were 42 investment securities in a continuous unrealized loss position greater than 12 months at December 31, 2018. At December 31, 2018, the Bank held 12 investment securities which were in an unrealized loss position for less than twelve months. Management periodically evaluates each investment security for other than temporary impairment, relying primarily on industry analyst reports and observation of market conditions and interest rate fluctuations. All of the impairment appearing in the investment securities portfolio valuations is considered to be temporary. The measured impairment in the securities values is primarily attributable to changes in long-term interest rates, market shifts of the Treasury yield curve and other variable market and economic conditions. The measured impairment in securities values did not result from any significant or persistent deterioration in the underlying credit quality of any of the investments. The securities portfolio consists primarily of debt securities with non-contingent contractual cash flows. Full realization of the principal balance is expected upon final maturity. Management has the intent and ability to hold the securities until recovery of the carrying value, which could be at the final maturity. Investment securities with unrealized losses at December 31, 2018 and 2017 are summarized and classified according to the duration of the loss period as follows:

	December 31, 2018					
	Less than 12 Months		12 Months or More		Total	
(in thousands)	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Debt Securities:						
Held-to-maturity:						
Government agencies	$ -	$ -	$ 7,612	$ (379)	$ 7,612	$ (379)
Available-for-sale:						
Government agencies	10,230	(190)	29,100	(1,845)	39,330	(2,035)
Mortgage-backed securities - residential	235	(5)	7,047	(241)	7,282	(246)
Corporate debt	1,400	(16)	5,933	(380)	7,333	(396)
Total available-for-sale	11,865	(211)	42,080	(2,466)	53,945	(2,677)
Total investment securities	$ 11,865	$ (211)	$ 49,692	$ (2,845)	$ 61,557	$ (3,056)

	December 31, 2017					
	Less than 12 Months		12 Months or More		Total	
(in thousands)	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Debt Securities:						
Held-to-maturity:						
Government agencies	$ -	$ -	$ 7,870	$ (114)	$ 7,870	$ (114)
Available-for-sale:						
U.S. Treasuries	$ -	$ -	$ 5,982	$ (24)	$ 5,982	$ (24)
Government agencies	8,566	(93)	21,063	(1,172)	29,629	(1,265)
Mortgage-backed securities - residential	7,617	(75)	-	-	7,617	(75)
Corporate debt	2,505	(45)	3,921	(130)	6,426	(175)
Total available-for-sale	18,688	(213)	30,966	(1,326)	49,654	(1,539)
Total investment securities	$ 18,688	$ (213)	$ 38,836	$ (1,440)	$ 57,524	$ (1,653)

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

	Held-to-Maturity		Available-for-Sale	
(in thousands)	Amortized Cost	Fair Value	Amortized Cost	Fair Value
Within one year	$ -	$ -	$ 5,576	$ 5,596
After one year through five years	-	-	12,260	12,243
After five years through ten years	3,000	2,878	37,671	36,051
After ten years	4,991	4,734	5,992	5,312
	7,991	7,612	61,499	59,202
Investment securities not due at a single maturity date:				
Mortgage-backed securities - residential	-	-	11,217	10,972
	$ 7,991	$ 7,612	$ 72,716	$ 70,174

Investment securities with amortized costs totaling $38,404,000 and $51,386,000 and estimated fair values totaling $36,514,000 and $50,417,000 were pledged to secure State of California and other municipal deposits at December 31, 2018 and 2017 (see Note 6).

3. LOANS

Outstanding loans are summarized as follows:

(in thousands)	December 31, 2018	December 31, 2017
Commercial & agricultural	$ 107,910	$ 102,957
Real estate - commercial	287,841	242,066
Real estate - construction and land	24,330	13,465
Real estate - single family	56,648	51,866
Real estate - multifamily	33,623	32,091
Consumer & lease financing	226	385
	510,578	442,830
Allowance for loan losses	(6,029)	(5,236)
	$ 504,549	$ 437,594

Changes in the allocation of allowance for loan losses by loan class for the years ended December 31, 2018, 2017 and 2016 are as follows:

(in thousands)	Year Ended December 31, 2018				
	Balance at December 31, 2017	Provision (reversal)	Charge-offs	Recoveries	Balance at December 31, 2018
Commercial & agricultural	$ 682	$ 173	$ (28)	$ 77	$ 904
Real estate - commercial	2,697	133	-	-	2,830
Real estate - construction and land	443	262	-	-	705
Real estate - single family	595	(102)	-	191	684
Real estate - multifamily	319	(11)	-	-	308
Consumer & lease financing	14	(31)	-	23	6
Unallocated	486	106	-		592
Total	$ 5,236	$ 530	$ (28)	$ 291	$ 6,029

(in thousands)	Year Ended December 31, 2017				
	Balance at December 31, 2016	Provision (reversal)	Charge-offs	Recoveries	Balance at December 31, 2017
Commercial & agricultural	$ 744	$ 13	$ (79)	$ 4	$ 682
Real estate - commercial	1,764	932	-	1	2,697
Real estate - construction and land	266	177	-	-	443
Real estate - single family	577	2	-	16	595
Real estate - multifamily	330	(11)	-	-	319
Consumer & lease financing	19	(14)	-	9	14
Unallocated	1,065	(579)	-	-	486
Total	$ 4,765	$ 520	$ (79)	$ 30	$ 5,236

(in thousands)	Year Ended December 31, 2016				
	Balance at December 31, 2015	Provision (reversal)	Charge-offs	Recoveries	Balance at December 31, 2016
Commercial & agricultural	$ 1,008	$ (290)	$ (50)	$ 76	$ 744
Real estate - commercial	940	838	(20)	6	1,764
Real estate - construction and land	57	209	-	-	266
Real estate - single family	237	326	-	14	577
Real estate - multifamily	43	287	-	-	330
Consumer & lease financing	6	5	-	8	19
Unallocated	2,440	(1,375)	-	-	1,065
Total	$ 4,731	$ -	$ (70)	$ 104	$ 4,765

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

(in thousands)	December 31, 2018					
	Allowance for Loan Losses:			Loans:		
	Individually Evaluated for Impairment	Collectively Evaluated for Impairment	Total Ending Allowance Balance	Loans Individually Evaluated for Impairment	Loans Collectively Evaluated for Impairment	Total Ending Loans Balance
Commercial & agricultural	$ 351	$ 553	$ 904	$ 718	$ 107,192	$ 107,910
Real estate - commercial	-	2,830	2,830	1,538	286,303	287,841
Real estate - construction and land	-	705	705	-	24,330	24,330
Real estate - single family	-	684	684	1,098	55,550	56,648
Real estate - multifamily	-	308	308	-	33,623	33,623
Consumer & lease financing	-	6	6	-	226	226
Unallocated	-	592	592	-	-	-
Total	$ 351	$ 5,678	$ 6,029	$ 3,354	$ 507,224	$ 510,578

(in thousands)	December 31, 2017					
	Allowance for Loan Losses:			Loans:		
	Individually Evaluated for Impairment	Collectively Evaluated for Impairment	Total Ending Allowance Balance	Loans Individually Evaluated for Impairment	Loans Collectively Evaluated for Impairment	Total Ending Loans Balance
Commercial & agricultural	$ -	$ 682	$ 682	$ 404	$ 102,553	$ 102,957
Real estate - commercial	-	2,697	2,697	1,655	240,411	242,066
Real estate - construction and land	-	443	443	-	13,465	13,465
Real estate - single family	-	595	595	1,125	50,741	51,866
Real estate - multifamily	-	319	319	-	32,091	32,091
Consumer & lease financing	-	14	14	-	385	385
Unallocated	-	486	486	-	-	-
Total	$ -	$ 5,236	$ 5,236	$ 3,184	$ 439,646	$ 442,830

The recorded investment in the aforementioned disclosure and the next several disclosures do not include accrued interest receivable and net deferred fees because such amounts are not considered material. Accrued interest receivable for the total loan portfolio was $1,353,000 and $1,408,000 and net deferred loan costs were $131,000 and $133,000 as of December 31, 2018 and 2017. Loans with balances less than $250,000 that are identified as impaired are not measured individually for impairment on the basis they represent small-balance loans that are collectively evaluated for impairment.

The following table presents impaired loans individually evaluated for impairment by class of loans:

(in thousands)	Commercial & agricultural	Real estate - commercial	Real estate - construction and land	Real estate - single family	Real estate - multifamily	Consumer & lease financing	Total
December 31, 2018							
Recorded investment in impaired loans:							
With no related allowance recorded	$ 540	$ 1,904	$ -	$ 1,292	$ 111	$ -	$ 3,847
With an allowance recorded	351	-	-	-	-	-	351
Total recorded investment in impaired loans	$ 891	$ 1,904	$ -	$ 1,292	$ 111	$ -	$ 4,198
Unpaid principal balance of impaired loans:							
With no related allowance recorded	$ 663	$ 2,136	$ -	$ 1,400	$ 177	$ -	$ 4,376
With an allowance recorded	351	-	-	-	-	-	351
Total unpaid principal balance of impaired loans	$ 1,014	$ 2,136	$ -	$ 1,400	$ 177	$ -	$ 4,727
Allowance for loan losses allocation	$ 351	$ -	$ -	$ -	$ -	$ -	$ 351
Average recorded investment in impaired loans during the year ended December 31, 2018	585	1,992	-	1,482	120	-	4,179
Interest income recognized on impaired loans during the year ended December 31, 2018	27	47	-	51	12	-	137
December 31, 2017							
Recorded investment in impaired loans:							
With no related allowance recorded	$ 627	$ 2,071	$ -	$ 1,532	$ 130	$ -	$ 4,360
With an allowance recorded	-	-	-	-	-	-	-
Total recorded investment in impaired loans	$ 627	$ 2,071	$ -	$ 1,532	$ 130	$ -	$ 4,360
Unpaid principal balance of impaired loans:							
With no related allowance recorded	$ 746	$ 2,202	$ -	$ 1,610	$ 184	$ -	$ 4,742
With an allowance recorded	-	-	-	-	-	-	-
Total unpaid principal balance of impaired loans	$ 746	$ 2,202	$ -	$ 1,610	$ 184	$ -	$ 4,742
Allowance for loan losses allocation	$ -	$ -	$ -	$ -	$ -	$ -	$ -
Average recorded investment in impaired loans during the year ended December 31, 2017	964	3,438	-	1,706	139	-	6,247
Interest income recognized on impaired loans during the year ended December 31, 2017	43	161	-	52	-	-	256
Average recorded investment in impaired loans during the year ended December 31, 2016	2,335	2,973	-	1,534	159	-	7,001
Interest income recognized on impaired loans during the year ended December 31, 2016	70	176	-	53	-	-	299

The following table presents the recorded investment in nonaccrual loans and loans past due over 90 days still accruing by class of loans as of December 31, 2018 and 2017:

(in thousands)	December 31, 2018 Nonaccrual	December 31, 2018 Loans Past Due Over 90 Days Still Accruing	December 31, 2017 Nonaccrual	December 31, 2017 Loans Past Due Over 90 Days Still Accruing
Commercial & agricultural	$ -	$ -	$ 223	$ -
Real estate - commercial	1,528	-	1,665	-
Real estate - construction and land	-	-	-	-
Real estate - single family	485	-	712	-
Real estate - multifamily	111	-	130	-
Consumer & lease financing	-	-	-	-
Total	$ 2,124	$ -	$ 2,730	$ -

The following table presents the aging of the recorded investment in past due loans, inclusive of nonaccrual loans, as of December 31, 2018 by class of loans:

(in thousands)	30 - 59 Days Past Due	60 - 89 Days Past Due	Greater Than 90 Days Past Due	Total Past Due	Loans Not Past Due	Total
Commercial & agricultural	$ -	$ -	$ -	$ -	$ 107,910	$ 107,910
Real estate - commercial	188	-	177	365	287,476	287,841
Real estate - construction and land	-	-	-	-	24,330	24,330
Real estate - single family	-	-	291	291	56,357	56,648
Real estate - multifamily	-	-	-	-	33,623	33,623
Consumer & lease financing	-	-	-	-	226	226
Total	$ 188	$ -	$ 468	$ 656	$ 509,922	$ 510,578

The following table presents the aging of the recorded investment in past due loans, inclusive of nonaccrual loans, as of December 31, 2017 by class of loans:

(in thousands)	30 - 59 Days Past Due	60 - 89 Days Past Due	Greater Than 90 Days Past Due	Total Past Due	Loans Not Past Due	Total
Commercial & agricultural	$ 100	$ -	$ 192	$ 292	$ 102,665	$ 102,957
Real estate - commercial	1,317	222	194	1,733	240,333	242,066
Real estate - construction and land	-	-	-	-	13,465	13,465
Real estate - single family	138	-	304	442	51,424	51,866
Real estate - multifamily	-	-	-	-	32,091	32,091
Consumer & lease financing	-	-	-	-	385	385
Total	$ 1,555	$ 222	$ 690	$ 2,467	$ 440,363	$ 442,830

A loan is considered past due if a scheduled payment of interest or principal that is due is unpaid for 30 days or more.

Troubled Debt Restructurings

From time to time, the Bank may agree to modify the contractual terms of a borrower's loan. In cases where such modifications represent a concession to a borrower experiencing financial difficulty, the modification is considered a troubled debt restructuring ("TDR"). At December 31, 2018 and 2017, loans modified in a TDR totaled $3,370,000 and $2,182,000 which are included in the impaired loan disclosures above. The total TDRs includes $1,647,000 and $552,000 that are also included in nonperforming loans at December 31, 2018 and 2017. TDRs had specific loss allocations of $0 as of December 31, 2018 and 2017.

Three was one loan secured by farmland and one loan secured by commercial real estate property that were modified as troubled debt restructurings during the year ended December 31, 2018. The pre-modification and post-modification balances of the restructured loans were $187,000 and $1,243,000, respectively.

There was one real estate – single family residence loan modified as a troubled debt restructuring during the year ended December 31, 2017. The pre-modification and post-modification balance of the restructured loan was $234,000. The loan was modified to term it out over 60 months. No additional allowances or charge-offs resulted from loans modified as troubled debt restructurings during the years ended December 31, 2018 and 2017. There were no loans modified as troubled debt restructurings for which there was a payment default within twelve months following the modification during the years ended December 31, 2018 and 2017. A loan is considered to be in payment default once it is 90 days contractually past due under the modified terms.

In order to determine whether a borrower is experiencing financial difficulty, an evaluation is performed of the probability that the borrower will be in payment default on any of its debt in the foreseeable future without the modification. This evaluation is performed under the Bank's internal underwriting policy.

Credit Quality Indicators

The Bank categorizes loans into risk categories based on relevant information about the ability of borrowers to service their debt such as: current financial information, historical payment experience, credit documentation, public information, and current economic trends, among other factors. The Bank analyzes loans individually by classifying the loans as to credit risk. This analysis is performed on a quarterly basis for loans in excess of $250,000. Smaller balances are graded at origination and updated based on payment status and other information obtained from borrowers. The Bank uses the following definitions for risk ratings:

SPECIAL MENTION- Loans in this category are considered "criticized" from a regulatory point of view but are not considered "classified" until the risk classification becomes substandard or worse. Loans in this category represent above average risk and potential weakness which may, if not corrected, weaken the loan and threaten repayment at some future date.

SUBSTANDARD- Loans in this category have well defined weakness that jeopardize full repayment of the debt, although loss does not seem likely. Loss potential does not have to exist in individual loans in the Substandard classification, but will be apparent in the aggregate. Typically, these loans have not met repayment plans as agreed. The primary source of repayment may have failed to materialize; repayment may be dependent on collateral liquidation or other secondary sources. Bankrupt borrowers and those with continuously past due payments are considered substandard.

DOUBTFUL- Loans in this category have all the characteristics of substandard loans with the added weakness that payment in full or liquidation in full is highly questionable and improbable. The possibility of loss is extremely high, but because of certain important and reasonably specific pending factors, which may work to the strengthening of the loan, its classification as an estimated loss is deferred until the amount of the loss may be more accurately determined.

PASS- Loans not meeting any of the three criteria above that are analyzed individually as part of the above described process are considered to be pass rated loans.

Based on recent analysis performed as of December 31, 2018 and 2017, the risk category of loans by class of loans is as follows:

2018 (in thousands)	Pass	Special Mention	Substandard	Doubtful	Total
Commercial & agricultural	$ 98,368	$ -	$ 9,542	$ -	$ 107,910
Real estate - commercial	286,228	86	1,527	-	287,841
Real estate - construction and land	24,330	-	-	-	24,330
Real estate - single family	56,163	-	485	-	56,648
Real estate - multifamily	33,512	-	111	-	33,623
Consumer & lease financing	226	-	-	-	226
Total	$ 498,827	$ 86	$ 11,665	$ -	$ 510,578

2017 (in thousands)	Pass	Special Mention	Substandard	Doubtful	Total
Commercial & agricultural	$ 94,105	$ -	$ 8,852	$ -	$ 102,957
Real estate - commercial	237,189	3,211	1,666	-	242,066
Real estate - construction and land	13,465	-	-	-	13,465
Real estate - single family	51,154	-	712	-	51,866
Real estate - multifamily	31,961	-	130	-	32,091
Consumer & lease financing	385	-	-	-	385
Total	$ 428,259	$ 3,211	$ 11,360	$ -	$ 442,830

Salaries and employee benefits totaling $1,181,000, $1,141,000 and $734,000 have been deferred as loan origination costs for the years ended December 31, 2018, 2017 and 2016, respectively.

Loans totaling $317,896,000 and $242,215,000 were pledged to secure borrowings with the Federal Home Loan Bank or State of California time deposits at December 31, 2018 and 2017, respectively (see Notes 6 and 8).

4. OTHER REAL ESTATE OWNED

There was no other real estate owned (OREO) at year end December 31, 2018 and 2017. There were no sales of OREO properties in 2018, 2017 or 2016.

5. BANK PREMISES AND EQUIPMENT

Bank premises and equipment consisted of the following:

	December 31,	
(in thousands)	2018	2017
Land	$ 1,184	$ 1,184
Building	7,570	7,597
Furniture, fixtures and equipment	2,888	2,389
Leasehold improvements	812	798
	12,454	11,968
Less accumulated depreciation and amortization	(6,651)	(6,689)
	$ 5,803	$ 5,279

Depreciation and amortization included in occupancy and equipment expense totaled $346,000, $339,000 and $342,000 for the years ended December 31, 2018, 2017 and 2016, respectively.

6. INTEREST-BEARING DEPOSITS

The aggregate amount of maturities of all time deposits is as follows:

Year Ending December 31,	(in thousands)
2019	$ 152,684
2020	32,396
2021	271
2022	82
2023	216
Thereafter	-
	$ 185,649

Interest expense recognized on interest-bearing deposits was as follows:

	Year Ended December 31,		
(in thousands)	2018	2017	2016
Interest-bearing demand	$ 79	$ 82	$ 65
Savings	47	27	10
Money market	764	143	76
Time deposits	2,619	1,387	704
	$ 3,509	$ 1,639	$ 855

Significant deposit relationships included $48,500,000 at December 31, 2018 and 2017 of public deposits from the State of California with maturity terms of one to three months. Wholesale brokered deposits included in deposits were $3,086,000 and $28,059,000 at December 31, 2018 and 2017. Deposits of $44,639,000 and $41,848,000 were through reciprocal deposit programs.

7. BORROWINGS

The Bank has a total of $19,000,000 in Federal funds lines of credit with four correspondent banks at December 31, 2018 with interest payable at the then current rate. The Bank maintains a letter of credit facility totaling $4,000,000 with a correspondent bank to guarantee international letters of credit issued to certain customers. There are $3,707,000 and $3,485,000 of letters of credit issued on behalf of the Bank's customers as of December 31, 2018 and 2017, respectively. There were no borrowings outstanding under the Federal funds lines of credit as of December 31, 2018 or 2017.

8. FEDERAL HOME LOAN BANK ADVANCES

Each advance is payable at its maturity date, with a prepayment penalty for fixed rate advances. The advances were collateralized by $317,896,000 and $232,030,000 of loans under a blanket lien arrangement at December 31, 2018 and 2017. Based on this collateral the Bank was eligible to borrow up to a total of $199,680,000 and $140,753,000 of which $127,880,000 and $125,753,000 was available for additional advances as of December 31, 2018 and 2017. Advance balances averaged $20,984,000 in 2018 and $52,429,000 in 2017.

Advances from the Federal Home Loan Bank were $56,800,000 at December 31, 2018, with maturities from January 2019 through March 2019 and fixed rates from 2.56% to 2.58%. Advances were $15,000,000 at December 31, 2017, with maturity in February 2018 at a fixed rate of 1.00%

At December 31, 2018, FHLB fixed rate advances are scheduled to mature as follows:

(in thousands)	Weighted Average Interest Rate	December 31, 2018
Due on or before December 31, 2019	2.57%	$ 56,800
		$ 56,800

9. INCOME TAXES

The provision for income taxes for the years ended December 31, 2018, 2017 and 2016 consisted of the following:

(in thousands)

2018	Federal	State	Total
Current	$ 1,494	$ 1,028	$ 2,522
Deferred	(128)	(177)	(305)
Provision for income taxes	$ 1,366	$ 851	$ 2,217
2017	**Federal**	**State**	**Total**
Current	$ 1,973	$ 785	$ 2,758
Deferred	(36)	(92)	(128)
Provision for income taxes	$ 1,937	$ 693	$ 2,630
2016	**Federal**	**State**	**Total**
Current	$ 2,115	$ 766	$ 2,881
Deferred	450	151	601
Provision for income taxes	$ 2,565	$ 917	$ 3,482

Deferred tax assets (liabilities) are comprised of the following:

(in thousands)	December 31, 2018	December 31, 2017
Deferred tax assets:		
Allowance for loan losses	$ 1,411	$ 817
Future benefit of state tax deduction	225	232
Net unrealized losses on available-for-sale investment securities	752	251
Other accruals	72	149
Total deferred tax assets	2,460	1,449
Deferred tax liabilities:		
Federal Home Loan Bank stock dividends	(64)	(64)
Deferred loan costs	(677)	(548)
Prepaid expenses and other	(28)	(31)
Bank premises and equipment	(275)	(196)
Other accruals		-
Total deferred tax liabilities	(1,044)	(839)
Net deferred tax assets	$ 1,416	$ 610

The provision for income taxes differs from amounts computed by applying the statutory Federal income tax rates to operating income before income taxes. The significant items comprising these differences for the years ended December 31, 2018, 2017 and 2016 consisted of the following:

	2018		2017		2016	
(in thousands)	Amount	Rate %	Amount	Rate %	Amount	Rate %
Federal income tax expense, at statutory rate	$ 1,689	21.0%	$ 2,013	34.0%	$ 2,873	34.0%
State franchise tax expense, net of Federal tax effect and other	528	6.6%	325	5.5%	609	7.2%
Impact of Tax Cut and Jobs Act	-	-	292	4.9%	-	-
Total income tax expense	$ 2,217	27.6%	$ 2,630	44.4%	$ 3,482	41.2%

The Bank's 2017 results include the impact of the enactment of the Tax Cuts and Jobs Act, which was signed into law on December 22, 2017. The law includes significant changes to the U.S. corporate tax system, including a Federal corporate rate change reduction from 34% to 21%. In 2017, the Bank applied this newly enacted corporate federal income tax of 21%, resulting in approximately a $292 thousand increase to tax expense for the deferred tax asset write down. The final impact of the tax rate change may differ due to changes in assumptions made by the Bank or actions the Bank may take as a result of tax reform.

The Bank had no unrecognized tax benefits and recorded no interest and penalties for the years ended December 31, 2018 and 2017. The Bank does not expect a significant change in unrecognized tax benefits in the next twelve months. The Bank and its subsidiary are subject to U.S. federal income tax as well as income tax of the State of California. The Bank is no longer subject to examination by federal taxing authorities for tax years 2015 and prior and by California taxing authorities for tax years 2014 and prior.

10. COMMITMENTS AND CONTINGENCIES

Leases

The Bank leases various equipment and offices under non-cancelable operating leases. These leases include various renewal and termination options and rental adjustment provisions. Rental expense included in occupancy and equipment expense totaled $489,000, $428,000 and $297,000 for the years ended December 31, 2018, 2017 and 2016, respectively. Future minimum lease payments for the next five years are as follows:

Year Ending December 31,	(in thousands)	
2019	$	434
2020		417
2021		282
2022		134
2023		72
	$	1,339

The Bank has operating leases with third parties for office space in its head office building. The leases are for periods from three to four years and contain renewal options. Rental income totaled $553,000, $574,000 and $559,000 for the years ended December 31, 2018, 2017 and 2016 respectively. Minimum future non-cancellable lease payments from these operating leases are as follows:

Year Ending December 31,	(in thousands)	
2019	$	326
2020		336
2021		346
2022		39
2023		-
	$	1,047

Federal Reserve Requirements

Banks are required to maintain reserves with the Federal Reserve Bank equal to a percentage of their reservable deposits less vault cash. The reserve requirement was $10,415,000 and $8,168,000 as of December 31, 2018 and 2017.

Financial Instruments with Off-Balance-Sheet Risk

The Bank is a party to financial instruments with off-balance-sheet risk in the normal course of business in order to meet the financing needs of its clients and to reduce its own exposure to fluctuations in interest rates. These financial instruments consist of commitments to extend credit and standby letters of credit. These instruments involve, to varying degrees, elements of credit and interest rate risk in excess of the amount recognized on the consolidated balance sheets.

The Bank's exposure to credit loss in the event of nonperformance by the other party for commitments to extend credit and standby letters of credit is represented by the contractual amount of those instruments. The Bank uses the same credit policies in making commitments and standby letters of credit as it does for loans included on the consolidated balance sheets.

The contractual amounts of financial instruments with off-balance-sheet risk at year end were as follows:

	December 31,			
(in thousands)	2018		2017	
	Fixed Rate	Variable Rate	Fixed Rate	Variable Rate
Commitments to make loans	$ -	$ 8,665	$ 1,686	$ 18,549
Unused lines of credit	1,805	83,499	7,559	52,516
Standby letters of credit	-	3,707	-	3,485

Commitments to extend credit are agreements to lend to a client 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 some of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. The Bank evaluates each client's creditworthiness on a case-by-case basis. The amount of collateral obtained, if deemed necessary by the Bank upon extension of the credit, is based on management's credit evaluation of the borrower. Collateral held relating to these commitments varies, but may include securities, equipment, accounts receivable, inventory and deeds of trust on residential real estate and income-producing commercial properties.

Standby letters of credit are conditional commitments issued by the Bank to guarantee the performance of a client to a third party. The credit risk involved in issuing standby letters of credit is essentially the same as that involved in extending loans to clients. The fair value of the liability related to these standby letters of credit, which represents the fees received for issuing the guarantees, was not significant at December 31, 2018 and 2017. The Bank recognizes these fees as revenue over the term of the commitment or when the commitment is used.

At December 31, 2018, real estate loan commitments represent 56% of total commitments and are generally secured by property with a loan-to-value ratio not to exceed 80%. Commercial loan commitments represent approximately 44% of total commitments and are generally secured by collateral other than real estate or are unsecured.

The FHLB issued a $15,000,000 letter of credit on the Bank’s behalf to pledge for deposits from the State of California. The letter of credit expires in December 2019.

Concentrations of Credit Risk

The Bank's business activity is primarily with clients located within Northern California. Although the Bank has a diversified loan portfolio, a significant portion of its clients' ability to repay loans is dependent upon the real estate market and various economic factors within Sonoma County. Generally, loans are secured by various forms of collateral. The Bank's loan policy requires sufficient collateral be obtained as necessary to meet the Bank's relative risk criteria for each borrower. The Bank's collateral consists primarily of real estate, accounts receivable, inventory and other financial instruments.

Correspondent Banking Agreements

The Bank maintains funds on deposit with other federally insured financial institutions under correspondent banking agreements, and $1,896,000 in deposits were uninsured at December 31, 2018.

Contingencies

The Bank is subject to legal proceedings and claims which arise in the ordinary course of business. In the opinion of management, the amount of ultimate liability with respect to such actions will not materially affect the consolidated financial condition or results of operations of the Bank.

11. SHAREHOLDERS' EQUITY

Regulatory Capital

The Bank is subject to certain regulatory capital requirements administered by the Federal Deposit Insurance Corporation (FDIC). Failure to meet these minimum capital requirements can initiate certain mandatory and possibly additional discretionary actions by regulators that, if undertaken, could have a direct material effect on the Bank's financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Bank must meet specific capital guidelines that involve quantitative measures of the Bank's consolidated assets, liabilities and certain off-balance-sheet items as calculated under regulatory accounting practices. The Bank's capital amounts and classification are also subject to qualitative judgments by the regulators about components, risk weightings and other factors.

On July 2, 2013, the federal banking agencies substantially amended the regulatory risk-based capital rules applicable to the Bank. Effective January 1, 2015 the revised rules create “Common equity tier 1,” a new measure of regulatory capital closer to pure tangible common equity than the present Tier 1 definition. The required minimum risk-based capital ratio for Common equity tier 1 is 4.5 percent and with a 2.5 percent capital conservation buffer. The revised capital rules require the Bank to meet the capital conservation buffer requirement on January 1, 2019 in order to avoid constraints on capital distributions, such as dividends and equity repurchases, and certain bonus compensation for executive officers. These new capital rules also change the risk-weights of certain assets for purposes of the risk-based capital ratios and phase out certain instruments as qualifying capital. When the new capital rule arrived, the minimum capital requirements plus the conservation buffer will exceed the well-capitalized thresholds. This 0.5 percentage-point cushion allows institutions to dip into a portion of their capital conservation buffer before reaching a status that is considered less than well capitalized for prompt corrective action purposes.

Quantitative measures established by regulation to ensure capital adequacy require the Bank to maintain minimum amounts and ratios of total and Tier 1 capital to risk-weighted assets and of Tier 1 capital to average assets. Each of these components is defined in the regulations. The Bank met all its capital adequacy requirements as of December 31, 2018 and 2017.

At December 31, 2018, the Bank is considered well capitalized under the regulatory framework for prompt corrective action. To be categorized as well capitalized, the Bank must maintain minimum common equity Tier 1 capital, total risk-based, Tier 1 risk-based and Tier 1 leverage ratios as set forth below.

The Bank elected not to include Other Accumulated Comprehensive Income in the regulatory capital calculations.

The Bank’s actual and required capital amounts and ratios consisted of the following:

(in thousands)	2018 Amount	2018 Ratio	2017 Amount	2017 Ratio
Common Equity Tier 1 Capital Ratio				
Summit State Bank	$ 58,915	10.5%	$ 56,089	11.6%
Minimum requirement with capital conservation buffer (1)	$ 39,316	7.0%	$ 33,891	7.0%
Minimum requirement for "Well-Capitalized" institution	$ 36,508	6.5%	$ 31,471	6.5%
Minimum regulatory requirement	$ 25,275	4.5%	$ 21,787	4.5%
Tier 1 Capital Ratio				
Summit State Bank	$ 58,915	10.5%	$ 56,089	11.6%
Minimum requirement with capital conservation buffer (1)	$ 47,741	8.5%	$ 41,154	8.5%
Minimum requirement for "Well-Capitalized" institution	$ 44,933	8.0%	$ 38,733	8.0%
Minimum regulatory requirement	$ 33,700	6.0%	$ 29,050	6.0%
Total Capital Ratio				
Summit State Bank	$ 65,188	11.6%	$ 61,485	12.7%
Minimum requirement with capital conservation buffer (1)	$ 58,975	10.5%	$ 50,837	10.5%
Minimum requirement for "Well-Capitalized" institution	$ 56,166	10.0%	$ 48,416	10.0%
Minimum regulatory requirement	$ 44,933	8.0%	$ 38,733	8.0%
Tier 1 Leverage Ratio				
Summit State Bank	$ 58,915	9.9%	$ 56,089	10.2%
Minimum requirement for "Well-Capitalized" institution	$ 29,874	5.0%	$ 27,406	5.0%
Minimum regulatory requirement	$ 23,899	4.0%	$ 21,925	4.0%

(1) Includes 2.5% capital conservation buffer effective January 1, 2019.

Dividends

Upon declaration by the Board of Directors, all shareholders of record will be entitled to receive dividends. The California Financial Code restricts the total dividend payment of any bank in any calendar year without permission of the California Department of Business Oversight, to the lesser of (1) the Bank's retained earnings or (2) the Bank's net income for its last three fiscal years, less distributions made to shareholders during the same three-year period. At December 31, 2018, the current regular dividend rate of $0.12 per quarter is not subject to the foregoing restrictions and approval.

Stock-Based Compensation Plans

The Bank has a 2007 and a 2013 Stock Option Plan (stock option plan or the Plan), which are shareholder approved, with each Plan permitting the grant of share options to Bank employees for up to 187,500 shares of common stock. Option awards are generally granted with an exercise price equal to the fair value of the Bank’s common stock at the date of grant; those option awards have vesting periods of 5 years unless otherwise approved by the Board of Directors and have 10-year contractual terms. As of December 31, 2018, there were 187,500 shares available for future grants under the 2013 Plan.

The Bank has granted Stock Appreciation Rights (“SARs”) in 2018, 2017 and 2016 to key employees and directors. The SARs provide long-term incentives to the employees and directors by providing a cash payment of the difference between the market price of the Bank's common stock at time of exercise and the price at the grant date. The expiration of the SARs is ten years, and each has an annual vesting of 20% for the first five years. The SARs granted to Directors have immediate vesting and an expiration of 10 years. The compensation expense is accrued each reporting period as a liability.

The fair value of each option and SARs award is estimated on the date of grant using a closed form option valuation (Black-Scholes) model that uses the assumptions noted in the table below. Expected volatility is based on the historical volatilities of the Bank's stock. The Bank uses historical data to estimate option and SARs exercise and post-vesting termination behavior. Employee and management options are tracked separately. The expected term of options and SARs granted is based on historical data and represents the period of time that options and SARs granted are expected to be outstanding, which takes into account that the options and SARs are not transferable. The risk-free interest rate for the expected term of the option and SARs is based on the U.S. Treasury yield curve in effect at the time of the grant. The dividend yield of the Bank's common stock is used as of the date of the grant.

For the years ended December 31, 2018, 2017 and 2016, there was $69,000, $17,000 and $24,000 in compensation costs related to non-vested stock options and SARs granted. As of December 31, 2018, 2017 and 2016, there was $204,000, $118,000 and $68,000 of total unrecognized compensation costs related to non-vested stock options and SARs granted. At December 31, 2018, there were 10,625 vested options outstanding with an exercise price of $4.40 and 25,000 options exercised with a range of exercise prices of $4.60 to $5.02 during the year.

Information related to the stock option plan follows:

	2018	2017	2016
Intrinsic value of options exercised	$ 199,000	$ 161,000	$ 447,000
Cash received from option exercises	120,000	121,000	1,000
Tax benefit realized from option exercises	59,000	67,000	12,000
Weighted average fair value of options granted	-	-	-

A summary of the activity in the stock option plan follows:

	Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term	Aggregate Intrinsic Value
Year Ended December 31, 2018				
Outstanding at beginning of the year	35,625	$ 4.69		
Granted	-	-		
Exercised	(25,000)	4.81		
Forfeited or expired	-	-		
Outstanding at end of the year	10,625	$ 4.40	3 years	$ 78,000
Vested or expected to vest	10,625	$ 4.40	3 years	$ 78,000
Exercisable at end of year	10,625	$ 4.40	3 years	$ 78,000
Year Ended December 31, 2017				
Outstanding at beginning of the year	57,250	$ 5.04		
Granted	-	-		
Exercised	(21,625)	5.62		
Forfeited or expired	-	-		
Outstanding at end of the year	35,625	$ 4.69	2 years	$ 282,000
Vested or expected to vest	35,625	$ 4.69	2 years	$ 282,000
Exercisable at end of year	35,625	$ 4.69	2 years	$ 282,000
Year Ended December 31, 2016				
Outstanding at beginning of the year	136,395	$ 5.16		
Granted	-	-		
Exercised	(79,145)	5.26		
Forfeited or expired	-	-		
Outstanding at end of the year	57,250	$ 5.04	3 years	$ 398,000
Vested or expected to vest	57,250	$ 5.04	3 years	$ 398,000
Exercisable at end of year	57,250	$ 5.04	3 years	$ 398,000

A summary of the activity for the SARs agreements follows:

	Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term	Aggregate Intrinsic Value
Year Ended December 31, 2018				
Outstanding at beginning of the year	45,000	$ 12.00		
Granted	90,000	14.33		
Exercised	-	-		
Forfeited or expired	-	-		
Outstanding at end of the year	135,000	$ 13.55	10 years	$ 360,090
Vested or expected to vest	135,000	$ 13.55	10 years	$ 360,090
Exercisable at end of year	64,000	$ 12.41	10 years	$ 139,238
Year Ended December 31, 2017				
Outstanding at beginning of the year	25,000	$ 11.60		
Granted	20,000	12.50		
Exercised	-	-		
Forfeited or expired	-	-		
Outstanding at end of the year	45,000	$ 12.00	9 years	$ 132,000
Vested or expected to vest	45,000	$ 12.00	9 years	$ 132,000
Exercisable at end of year	5,000	$ 11.60	9 years	$ 14,000
Year Ended December 31, 2016				
Outstanding at beginning of the year	-	$ -		
Granted	25,000	11.60		
Exercised	-	-		
Forfeited or expired	-	-		
Outstanding at end of the year	25,000	$ 11.60	10 years	$ 71,000
Vested or expected to vest	25,000	$ 11.60	10 years	$ 71,000
Exercisable at end of year	-	$ -	-	$ -

The weighted average fair value of SARs granted was $2.53, $3.03, and $2.86 for the SAR grants made in 2018, 2017, and 2016 respectively. Weighted average assumptions used in the determination of the fair value of the SAR grants were as follows:

	2018	2017	2016
Expected life in years	10	10	10
Expected dividend yield	4.15%	3.84%	3.03%
Expected price volatility	32.09%	28.04%	28.77%
Risk-free interest rate	2.83%	2.40%	2.49%

12. OTHER EXPENSES

Other expenses consisted of the following:

	Year Ended December 31,		
(in thousands)	2018	2017	2016
Data processing	$ 1,497	$ 1,278	$ 1,194
Professional fees	598	554	624
Director fees and expenses	545	479	518
Nasdaq listing and regulatory license expense	144	140	131
Advertising and promotion	808	828	883
Deposit and other insurance premiums	297	431	387
Telephone and postage	79	77	70
Other expenses	702	767	647
	$ 4,670	$ 4,554	$ 4,454

13. EMPLOYEE BENEFIT PLAN

401(k) Employee Savings Plan

The Bank has a 401(k) Employee Savings Plan (the "Plan"), qualified under the Internal Revenue Code (Code), whereby participants may defer a percentage of their compensation, but not in excess of the maximum allowed under the Code. Bank contributions, as determined by the Board of Directors, are discretionary and vest immediately. Contributions by the Bank totaled $224,000, $175,000 and $137,000 for the years ended December 31, 2018, 2017 and 2016, respectively.

14. RELATED PARTY TRANSACTIONS

During the normal course of business, the Bank enters into loans with related parties, including executive officers and directors. Other changes are the result of changes in related parties during the year. The following is a summary of the aggregate activity involving related party borrowers. These loans are made at arm's length and are consistent with what other borrowers receive.

(in thousands)	2018	2017
Balance, January 1	$ 8,498	$ 6,531
New borrowings	1,599	4,097
Amounts repaid	(2,045)	(2,130)
Balance, December 31	$ 8,052	$ 8,498
Undisbursed commitments to related parties	$ 1,250	$ 1,960

At December 31, 2018 and 2017, deposits of related parties amounted to $3,727,000 and $5,112,000, respectively.

15. FAIR VALUE

Accounting standards establish a fair value hierarchy which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. The standard describes three levels of inputs that may be used to measure fair value:

Level 1: Quoted prices (unadjusted) for identical assets or liabilities in active markets that the entity has the ability to access as of the measurement date.

Level 2: Significant other observable inputs other than Level 1 prices such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data.

Level 3: Significant unobservable inputs that reflect a reporting entity's own assumptions about the assumptions that market participants would use in pricing an asset or liability.

The fair values of most securities available for sale are determined by matrix pricing, which is a mathematical technique widely used in the industry to value debt securities without relying exclusively on quoted prices for the specific securities but rather by relying on the securities' relationship to other benchmark quoted securities (Level 2 inputs).

The fair value of impaired loans that are collateral dependent are generally based on real estate appraisals. These appraisals may utilize a single valuation approach or a combination of approaches including comparable sales and the income approach. Adjustments are routinely made in the appraisal process by the appraisers to adjust for differences between the comparable sales and income data available. Such adjustments are usually significant and typically result in a Level 3 classification of the inputs for determining fair value.

Estimated fair values are disclosed for financial instruments for which it is practicable to estimate fair value. These estimates are made at a specific point in time based on relevant market data and information about the financial instruments. These estimates do not reflect any premium or discount that could result from offering the Bank's entire holdings of a particular financial instrument for sale at one time, nor do they attempt to estimate the value of anticipated future business related to the instruments. In addition, the tax ramifications related to the realization of unrealized gains and losses can have a significant effect on fair value estimates and have not been considered in any of these estimates.

Because no active market exists for a significant portion of the Bank's financial instruments, fair value estimates are based on judgments regarding current economic conditions, risk characteristics of various financial instruments and other factors. These estimates are subjective in nature and involve uncertainties and matters of significant judgment and therefore cannot be determined with precision. Changes in assumptions could significantly affect the fair values presented. The prior period fair values for loans disclosed are not determined in a manner consistent with the current period fair values disclosed because of a change in methodology due to the adoption of ASU 2016-01 as described in Note 1 Summary of Significant Accounting Polices in these Notes to Consolidated Financial Statements.

The following table presents a summary of the carrying value and fair value by level of financial instruments on the Bank’s consolidated balance sheet at December 31, 2018 and 2017:

	December 31, 2018			December 31, 2017		
(in thousands)	Carrying Amount	Fair Value	Fair Value Hierarchy	Carrying Amount	Fair Value	Fair Value Hierarchy
Financial assets:						
Cash and due from banks	$ 21,693	$ 21,693	Level 1	$ 68,814	$ 68,814	Level 1
Federal funds sold	-	-	Level 1	2,000	2,000	Level 1
Investment securities - held-to-maturity	7,991	7,612	Level 2	7,984	7,870	Level 2
Investment securities - available-for-sale	70,174	70,174	Level 2	78,770	78,770	Level 2
Loans, net of allowance	504,549	492,112	Level 3	437,594	450,626	Level 3
Investment in FHLB stock	3,085	3,085	Level 2	3,085	3,085	Level 2
Accrued interest receivable	1,831	1,831	Level 1	1,960	1,960	Level 1
Financial liabilities:						
Deposits	$ 501,189	$ 498,428	Level 2	$ 533,513	$ 532,976	Level 2
FHLB advances	56,800	56,803	Level 2	15,000	15,000	Level 2
Accrued interest payable	259	259	Level 1	136	136	Level 1

Assets Measured on a Recurring Basis

Assets measured at fair value on a recurring basis are summarized below:

		Fair Value Measurements at December 31, 2018 (In thousands)		
	December 31, 2018	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets:				
Securities available-for-sale:				
U.S. Treasuries	$ -	$ -	$ -	$ -
Government agencies	39,330	-	39,330	-
Mortgage-backed securities - residential	10,972	-	10,972	-
Corporate debt	19,872	-	19,872	-
Total securities available-for-sale	$ 70,174	$ -	$ 70,174	$ -

		Fair Value Measurements at December 31, 2017 (In thousands)		
	December 31, 2017	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets:				
Securities available-for-sale:				
U.S. Treasuries	$ 5,982	$ -	$ 5,982	$ -
Government agencies	40,057	-	40,057	-
Mortgage-backed securities - residential	8,093	-	8,093	-
Corporate debt	24,638	-	24,638	-
Total securities available-for-sale	$ 78,770	$ -	$ 78,770	$ -

Changes in fair value are recognized in other comprehensive income (loss)

Transfers between levels of the fair value hierarchy are recognized on the actual date of the event or circumstances that caused the transfer, which generally corresponds with the Bank's quarterly valuation process. There were no transfers between any levels during 2018 or 2017.

Assets Measured on a Non-Recurring Basis

No assets were measured at fair value on a non-recurring basis at December 31, 2018 or 2017.

Impaired loans are valued at the fair value less estimated disposal costs of collateral. Impaired loans with specific loss allocations had a principal balance of $351,000 with a valuation allowance of $351,000 at December 31, 2018. There were no impaired loans with specific loss allocations at December 31, 2017.

16. SUBSEQUENT EVENTS

Subsequent events are events or transactions that occur after the consolidated balance sheet date but before the consolidated financial statements are issued. The Bank recognizes in the consolidated financial statements the effects of all subsequent events that provide additional evidence about conditions that existed at the date of the consolidated balance sheet, including these estimates inherent in the process of preparing the consolidated financial statements. The Bank'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 Bank has evaluated subsequent events after December 31, 2018 for potential recognition and disclosure matters.

On January 28, 2019, the Board of Directors declared a $0.12 per common share cash dividend to shareholders of record at the close of business on February 19, 2019, that was paid on February 26, 2019.

17. QUARTERLY FINANCIAL DATA (Unaudited)

	2018				
				Earnings Per Common Share	
(in thousands except EPS data)	Interest Income	Net Interest Income	Net Income	Basic	Diluted
First quarter	$ 6,054	$ 5,164	$ 1,740	$ 0.29	$ 0.29
Second quarter	6,119	5,090	1,461	0.24	0.24
Third quarter	6,551	5,432	1,505	0.25	0.25
Fourth quarter	6,848	5,406	1,121	0.18	0.18

	2017				
				Earnings Per Common Share	
	Interest Income	Net Interest Income	Net Income	Basic	Diluted
First quarter	$ 4,832	$ 4,450	$ 881	$ 0.15	$ 0.15
Second quarter	4,981	4,487	930	0.15	0.15
Third quarter	5,186	4,382	1,001	0.17	0.17
Fourth quarter	5,714	4,733	480	0.08	0.07

ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

None.

ITEM 9A. CONTROLS AND PROCEDURES

Effectiveness of Disclosure Controls and Procedures

The Bank, under the supervision and with the participation of its management, including the Chief Executive Officer and the Chief Financial Officer, evaluated the effectiveness of the design and operation of the Bank's "disclosure controls and procedures" (as defined in Rule 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended) as of December 31, 2018. Based on that evaluation, the Chief Executive Officer and the Chief Financial Officer concluded that the Bank's disclosure controls and procedures are effective.

During the quarter ended December 31, 2018, there have been no changes in the Bank's internal controls over financial reporting that have materially affected, or are reasonably likely to materially affect, these controls.

Report of Management on Internal Control Over Financial Reporting

Management of the Bank is responsible for establishing and maintaining adequate internal control over financial reporting for the Bank (as defined in Rule 13a-15(f) and 15d-15(f) under the Securities Exchange Act of 1934, as amended).

The Bank's management, including the Chief Executive Officer and Chief Financial Officer, has assessed the effectiveness of the Bank's internal control over financial reporting as of December 31, 2018, presented in conformity with accounting principles generally accepted in the United States of America. In making this assessment, management used the criteria applicable to the Bank as set forth by the Committee of Sponsoring Organizations of the Treadway Commission in the 2013 *Internal Control—Integrated Framework.* Based upon such assessment, management believes that, as of December 31, 2018, the Bank's internal control over financial reporting is effective based upon those criteria.

This annual report includes an attestation report of the Bank's registered public accounting firm regarding internal control over financial reporting. Management's report on internal control over financial reporting is set forth in ITEM 8.

ITEM 9B. OTHER INFORMATION

None.

PART III

ITEM 10. DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE

We intend to file a definitive proxy statement for the 2019 Annual Meeting of Shareholders (or “the Proxy Statement”) with the FDIC within 120 days of December 31, 2018. Information regarding directors of Summit State Bank will appear under the caption —Proposal 1: “Election of Directors” in the Proxy Statement and is incorporated herein by reference. Information about Summit State Bank’s Audit Committee Financial Expert will appear under the caption “The Committees of the Board—Audit Committee” and is incorporated herein by reference. The Bank has adopted a code of ethics applicable to all of our directors and employees, including the principal executive officer, principal financial officer and principal accounting officer.

Information regarding section 16(a) filing requirements will appear under the caption “Section 16(a) Beneficial Ownership Reporting Compliance” in the Proxy Statement and is incorporated herein by reference.

ITEM 11. EXECUTIVE COMPENSATION

Information regarding executive compensation will appear under the captions “EXECUTIVE OFFICERS OF THE BANK,” “EXECUTIVE COMPENSATION, EMPLOYMENT CONTRACTS” AND BOARD OF DIRECTORS’ REPORT ON COMPENSATION,” in the Proxy Statement and is incorporated herein by reference.

ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS

The following table summarizes information as of December 31, 2018 relating to equity compensation plans of Summit State Bank pursuant to which grants of options, restricted stock, or other rights to acquire shares may be granted from time to time.

Plan category	**Number of securities to be issued upon exercise of outstanding options**	**Weighted average exercise price of outstanding options**	**Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column (a))**
Equity compensation plans: Approved by security holders	10,625	$ 4.40	187,500

Information regarding security ownership of certain beneficial owners and management and related shareholder matters will appear under the caption “EQUITY COMPENSATION PLAN INFORMATION,” “SECURITY OWNERSHIP OF MANAGEMENT” AND “PRINCIPAL SHAREHOLDERS” in the Proxy Statement and is incorporated herein by reference.

ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS, AND DIRECTOR INDEPENDENCE

Information regarding certain relationships and related transactions will appear under the caption “TRANSACTIONS WITH RELATED PERSONS” in the Proxy Statement and is incorporated herein by reference.

ITEM 14. PRINCIPAL ACCOUNTING FEES AND SERVICES

Information regarding fees paid to our independent registered public accounting firm, will appear under the caption —Proposal 2. Ratification of Selection of Independent Public Accounts “FEES PAID TO INDEPENDENT PUBLIC ACCOUNTANTS” in the Proxy Statement and is incorporated herein by reference.

PART IV

ITEM 15. EXHIBITS AND FINANCIAL STATEMENT SCHEDULES

(a) 1. *Financial Statements*

The following documents are filed as part of this report:

Report of Independent Registered Public Accounting Firm
Consolidated Balance Sheets at December 31, 2018 and 2017
Consolidated Statements of Income for each of the years in the three-year period ended December 31, 2018
Consolidated Statements of Comprehensive Income for each of the years in the three-year period ended December 31, 2018
Consolidated Statements of Changes in Shareholders' Equity for each of the years in the three-year period ended December 31, 2018
Consolidated Statements of Cash Flows for each of the years in the three-year period ended December 31, 2018
Notes to Consolidated Financial Statements

2. *Financial Statement Schedules*

Not applicable

3. *Exhibits*

(b) *Exhibits Required by Item 601 of Regulation S-K*

Reference is made to the Exhibit Index on page 104 for exhibits filed as part of this report.

(c) *Additional Financial Statements*

Not applicable.

ITEM 16. FORM 10-K SUMMARY

None.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

Summit State Bank

By *[/s/ Camille D. Kazarian]* March 18, 2019

Camille D. Kazarian
Executive Vice President and
Chief Financial Officer
(Principal Financial and Accounting Officer)

Summit State Bank

By */s/ James E. Brush* March 18, 2019

James E. Brush
President and
Chief Executive Officer
(Principal Executive Officer)

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the Registrant in the capacities and on the dates indicated.

Dated:	March 18, 2019	*/s/ James E. Brush* James E. Brush, President and Chief Executive Officer (Principal Executive Officer) and Director
Dated:	March 18, 2019	*/s/ Jeffery B. Allen* Jeffery B. Allen, Director
Dated:	March 18, 2019	*/s/ Josh C. Cox, Jr.* Josh C. Cox, Jr., Director
Dated:	March 18, 2019	*/s/ Bridget M. Doherty* Bridget M. Doherty, Director
Dated:	March 18, 2019	*/s/ Todd R. Fry* Todd R. Fry, Director
Dated:	March 18, 2019	*/s/ Allan J. Hemphill* Allan J. Hemphill, Chairman of the Board and Director
Dated:	March 18, 2019	*/s/ Camille D. Kazarian* Camille D. Kazarian, Executive Vice President and Chief Financial Officer (Principal Financial and Accounting Officer)
Dated:	March 18, 2019	*/s/ Richard E. Pope* Richard E. Pope, Director
Dated:	March 18, 2019	*/s/ Nicholas J. Rado* Nicholas J. Rado, Director
Dated:	March 18, 2019	*/s/ Marshall T. Reynolds* Marshall T. Reynolds, Director
Dated:	March 18, 2019	*/s/ John W. Wright* John W. Wright, Director

EXHIBIT INDEX

EXHIBIT NO.	EXHIBIT
3.1	Articles of Incorporation of the registrant [(1) (2) (3)]
3.2	Amendment of Articles of Incorporation dated January 23, 2017 [(4)]
3.3	By-laws of the registrant [(5)]
4.1	Specimen of the registrant's common stock certificate [(1) (2) (3)]
4.2	The total amount of the registrant's long-term debt does not exceed 10 percent of the total assets of the registrant and its subsidiaries on a consolidated basis. Pursuant to Item 601(b)(4)(iii)(A) of Regulation S-K, the registrant agrees to file any instrument with respect to such long-term debt upon request of the FDIC.
10.1	2007 Stock Option Plan [(6)]
10.2	2013 Equity Incentive Plan [(7)]
10.3	Change in Control Agreement with Dennis Kelley [(8)]
10.4	Change in Control Agreement with Genie Del Secco [(9)]
10.5	Change in Control Agreement with Brandy Seppi [(10)]
10.6	Change in Control Agreement with Brian Reed [(11)]
10.7	Change in Control Agreement with Camille Kazarian [(12)]
10.8	Cash Incentive Bonus Plan [(13)]
10.9	Stock Appreciation Rights Agreement with Directors and Officers [(14)]
14.1	Code of Ethics [(15)]
21.1	Subsidiaries of the registrant [(1)]
31.1	Rule 13a-14(a)/15d-14(a) Certification
31.2	Rule 13a-14(a)/15d-14(a) Certification
32.1	Section 1350 certifications

(1) Incorporated by reference from Summit State Bank's Form 10 filed with the FDIC on June 19, 2006.
(2) Incorporated by reference from Summit State Bank's Form 10/A Amendment No. 1 filed with the FDIC on July 12, 2006.
(3) Incorporated by reference from Summit State Bank's Form 10/A Amendment No. 2 filed with the FDIC on July 13, 2006.
(4) Incorporated by reference from Summit State Bank's Form 10-K filed with the FDIC on March 23, 2017.
(5) Incorporated by reference from Summit State Bank's Form 8-K filed with the FDIC on January 24, 2018.
(6) Incorporated by reference from Summit State Bank's Definitive Proxy Statement filed with the FDIC on April 27, 2007.
(7) Incorporated by reference from Summit State Bank's Definitive Proxy Statement filed with the FDIC on June 10, 2013.
(8) Incorporated by reference from Summit State Bank's Form 10-Q filed with the FDIC on November 13, 2014.
(9) Incorporated by reference from Summit State Bank's Form 8-K filed with the FDIC on January 18, 2018.
(10) Incorporated by reference from Summit State Bank's Form 10-K filed with the FDIC on March 12, 2015.
(11) Incorporated by reference from Summit State Bank's Form 8-K filed with the FDIC on February 14, 2017.
(12) Incorporated by reference from Summit State Bank's Form 8-K filed with the FDIC on December 4, 2018.
(13) Incorporated by reference from Summit State Bank's Form 8-K filed with the FDIC on April 22, 2016.
(14) Incorporated by reference from Summit State Bank's Form 8-K filed with the FDIC on December 14, 2016, December 22, 2017, August 2, 2018 and December 18, 2018.
(15) Incorporated by reference from Summit State Bank's Form 10-K filed with the FDIC on March 28, 2007.

EXHIBIT 31.1
Certification pursuant to Rule 13a-14(a)/15d-14(a) as adopted pursuant to §302 of the Sarbanes-Oxley Act of 2002.

I, James E. Brush, Chief Executive Officer, certify that:

1. I have reviewed this annual report on Form 10-K of Summit State Bank (the Registrant);

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the Registrant as of, and for, the periods presented in this report;

4. The Registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a- 15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the Registrant and have:

(a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the Registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

(b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

(c) Evaluated the effectiveness of the Registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures as of the end of the period covered by this report based on such evaluation; and

(d) Disclosed in this report any change in the Registrant's internal control over financial reporting that occurred during the Registrant's most recent fiscal quarter (the Registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the Registrant's internal control over financial reporting; and

5. The Registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the Registrant's auditors and the audit committee of Registrant's Board of Directors (or persons performing the equivalent functions):

(a) all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting, which are reasonably likely to adversely affect the Registrant's ability to record, process, summarize and report financial information; and

(b) any fraud, whether or not material, that involves management or other employees who have a significant role in the Registrant's internal control over financial reporting.

Dated: *March 18, 2019* *\/s/ James E. Brush*
James E. Brush
President and Chief Executive Officer
(Principal Executive Officer)

EXHIBIT 31.2
Certification pursuant to Rule 13a-14(a)/15d-14(a) as adopted pursuant to §302 of the Sarbanes-Oxley Act of 2002.

I, Camille D. Kazarian, Chief Financial Officer, certify that:

1. I have reviewed this annual report on Form 10-K of Summit State Bank (the Registrant);

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the Registrant as of, and for, the periods presented in this report;

4. The Registrant’s other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a- 15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the Registrant and have:

(a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the Registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

(b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

(c) Evaluated the effectiveness of the Registrant’s disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures as of the end of the period covered by this report based on such evaluation; and

(d) Disclosed in this report any change in the Registrant’s internal control over financial reporting that occurred during the Registrant’s most recent fiscal quarter (the Registrant’s fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the Registrant’s internal control over financial reporting; and

5. The Registrant’s other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the Registrant’s auditors and the audit committee of Registrant’s Board of Directors (or persons performing the equivalent functions):

(a) all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting, which are reasonably likely to adversely affect the Registrant's ability to record, process, summarize and report financial information; and

(b) any fraud, whether or not material, that involves management or other employees who have a significant role in the Registrant's internal control over financial reporting.

Dated: *March 18, 2019* *<u>/s/ Camille D. Kazarian</u>*
Camille D. Kazarian
Executive Vice President and Chief Financial Officer
(Principal Financial and Accounting Officer)

EXHIBIT 32.1
Certification pursuant to 18 U.S.C. §1350

In connection with the annual report on Form 10-K of Summit State Bank (the Registrant) for the year ended December 31, 2018, as filed with the Federal Deposit Insurance Corporation, the undersigned hereby certify pursuant to 18 U.S.C. §1350, as adopted pursuant to §906 of the Sarbanes-Oxley Act of 2002, that:

1) such Form 10-K fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and

2) the information contained in such Form 10-K fairly presents, in all material respects, the financial condition and results of operations of the Registrant.

Dated: *March 18, 2019*

/s/ James E. Brush
James E. Brush
President and Chief Executive Officer
(Principal Executive Officer)

Dated: *March 18, 2019*

/s/ Camille D. Kazarian
Camille D. Kazarian
Executive Vice President and Chief Financial Officer
(Principal Financial and Accounting Officer)