



REPORT OF INDEPENDENT AUDITORS
AND CONSOLIDATED FINANCIAL STATEMENTS

**PEOPLE'S BANK OF COMMERCE
(AN OREGON BANKING CORPORATION)
AND SUBSIDIARY**

December 31, 2017 and 2016



MOSSADAMS

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Note: These consolidated financial statements have not been reviewed or confirmed for accuracy or relevance by the Federal Deposit Insurance Corporation.

Report of Independent Auditors

To the Board of Directors and Stockholders
People's Bank of Commerce and Subsidiary

Report on the Financial Statements

We have audited the accompanying consolidated financial statements of People's Bank of Commerce (an Oregon Banking Corporation) and Subsidiary (the Bank), which comprise the consolidated balance sheets as of December 31, 2017 and 2016, and the related consolidated statements of income, comprehensive income, changes in stockholders' equity, and cash flows for the years then ended, and the related consolidated notes to the financial statements.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

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

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

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

Opinion

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

Other Matters***Other Information***

Our audit was conducted for the purpose of forming an opinion on the consolidated financial statements as a whole. The consolidating balance sheet and condensed consolidating income statement are presented for purposes of additional analysis and is not a required part of the consolidated financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the consolidated financial statements. The information has been subjected to the auditing procedures applied in the audit of the consolidated financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the consolidated financial statements or to the consolidated financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated in all material respects in relation to the consolidated financial statements as a whole.

A handwritten signature in black ink that reads "Moss Adams LLP". The signature is written in a cursive, flowing style.

Portland, Oregon
March 15, 2018

People's Bank of Commerce
Consolidated Balance Sheets

	December 31,	
	2017	2016
ASSETS		
Cash and cash equivalents	\$ 20,891,996	\$ 14,675,984
Investment securities		
Available-for-sale, at fair value	20,065,423	24,671,145
Held-to-maturity, at cost	8,472,520	8,510,078
Restricted equity securities	319,400	300,500
Loans held-for-sale	2,191,247	294,273
Factored accounts receivable, net of allowance	13,133,361	-
Loans, net of allowance for loan losses, and unearned income	206,257,695	196,995,118
Premises, equipment, and leasehold improvements, net of accumulated depreciation and amortization	12,195,800	6,969,889
Other real estate owned	3,128,821	3,275,081
Bank-owned life insurance	6,018,374	5,330,572
Goodwill	3,318,216	-
Investment in real estate joint venture	2,490,990	2,542,710
Accrued interest receivable and other assets	2,206,578	2,425,411
	<u>\$ 300,690,421</u>	<u>\$ 265,990,761</u>
LIABILITIES		
Noninterest-bearing demand deposits	\$ 117,587,030	\$ 97,207,577
Interest-bearing demand and money market accounts	108,912,233	108,721,937
Savings deposits	18,446,522	14,759,518
Time deposits	18,614,976	17,447,997
	<u>263,560,761</u>	<u>238,137,029</u>
Total deposits	263,560,761	238,137,029
Accrued interest payable and other liabilities	5,033,962	1,774,733
Borrowings	679,900	-
	<u>5,713,862</u>	<u>1,774,733</u>
Total liabilities	<u>269,274,623</u>	<u>239,911,762</u>
COMMITMENTS AND CONTINGENCIES (Notes 9 and 11)		
STOCKHOLDERS' EQUITY		
Common stock, \$5 par value, 4,000,000 shares authorized; 2,745,758 and 2,392,973 shares issued and outstanding at December 31, 2017 and 2016, respectively	13,728,790	11,395,110
Surplus	16,129,740	12,940,431
Unearned ESOP shares (65,000 and 0 shares, respectively)	(679,900)	-
Retained earnings	2,293,572	1,714,383
Accumulated other comprehensive (loss) income	(56,404)	29,075
	<u>31,415,798</u>	<u>26,078,999</u>
Total stockholders' equity	31,415,798	26,078,999
Total liabilities and stockholders' equity	<u>\$ 300,690,421</u>	<u>\$ 265,990,761</u>

People's Bank of Commerce

Consolidated Statements of Income

	Years Ended December 31,	
	2017	2016
INTEREST INCOME		
Interest and fees on loans	\$ 10,368,972	\$ 9,326,130
Interest on investment securities	703,570	810,922
Interest on federal funds sold	171,120	65,385
Total interest income	11,243,662	10,202,437
INTEREST EXPENSE		
Time deposit accounts	206,778	263,592
Interest-bearing deposit and savings accounts	228,245	215,640
Other borrowings	939	52
Total interest expense	435,962	479,284
NET INTEREST INCOME BEFORE PROVISION FOR LOAN LOSSES	10,807,700	9,723,153
PROVISION FOR LOAN LOSSES	52,307	366,345
NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES	10,755,393	9,356,808
NONINTEREST INCOME		
Asset-based financing income	1,227,193	-
Service charges and other fees	1,056,733	860,119
Gain on sale of loans	658,569	648,181
Mortgage brokerage fees	63,447	20,612
Net gain on sale of other real estate owned	54,605	-
Net gain on sale of investment securities	31,120	74,617
Other noninterest income	161,314	353,392
Total noninterest income	3,252,981	1,956,921
NONINTEREST EXPENSE		
Salaries and employee benefits	6,210,469	4,898,519
Occupancy and equipment	1,605,745	1,455,046
Professional fees	336,927	253,760
Data processing	246,576	226,503
Advertising and promotional	207,638	220,611
Supplies	156,619	89,874
Other noninterest expense	1,534,106	1,411,646
Total noninterest expense	10,298,080	8,555,959
INCOME BEFORE PROVISION FOR INCOME TAXES	3,710,294	2,757,770
PROVISION FOR INCOME TAXES	1,649,742	877,280
NET INCOME	\$ 2,060,552	\$ 1,880,490
Basic earnings per share of common stock	\$ 0.82	\$ 0.79
Diluted earnings per share of common stock	\$ 0.81	\$ 0.78

People's Bank of Commerce

Consolidated Statements of Comprehensive Income

	Years Ended December 31,	
	2017	2016
NET INCOME	\$ 2,060,552	\$ 1,880,490
Unrealized gain on securities		
Change in unrealized holding gain, pre-tax	(107,644)	6,646
Tax impact on change in unrealized holding gain	41,459	(2,552)
Reclassification adjustment for gains, pre-tax	(31,120)	(74,651)
Tax impact on reclassification adjustment for gains	11,826	28,666
Other comprehensive loss	(85,479)	(41,891)
COMPREHENSIVE INCOME	<u>\$ 1,975,073</u>	<u>\$ 1,838,599</u>

Consolidated Statements of Changes in Stockholders' Equity

	Common Stock		Surplus	Unearned ESOP Shares	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total Stockholders' Equity
	Shares	Amount					
BALANCE, December 31, 2015	2,166,236	\$ 10,831,180	\$ 12,209,022	-	\$ 915,753	\$ 70,966	\$ 24,026,921
Net income	-	\$ -	\$ -	-	\$ 1,880,490	\$ -	\$ 1,880,490
Change in net unrealized gain on investment securities available-for-sale, net of taxes	-	-	-	-	-	(41,891)	(41,891)
5% stock dividend	108,186	540,930	540,930	-	(1,081,860)	-	-
Cash in lieu of fractional shares	(234)	(1,170)	(1,170)	-	-	-	(2,340)
Options exercised	7,073	35,365	9,482	-	-	-	44,847
Restricted stock grants issued	1,000	5,000	(5,000)	-	-	-	-
Restricted stock grants forfeited	(3,239)	(16,195)	16,195	-	-	-	-
Stock-based compensation expense	-	-	170,972	-	-	-	170,972
BALANCE, December 31, 2016	2,279,022	\$ 11,395,110	\$ 12,940,431	-	\$ 1,714,383	\$ 29,075	\$ 26,078,999
Net income	-	\$ -	\$ -	-	\$ 2,060,552	\$ -	\$ 2,060,552
Change in net unrealized gain on investment securities available-for-sale, net of taxes	-	-	-	-	-	(85,479)	(85,479)
5% stock dividend	113,951	569,755	911,608	-	(1,481,363)	-	-
Cash in lieu of fractional shares	(247)	(1,235)	(1,977)	-	-	-	(3,212)
Options exercised	1,634	8,170	1,634	-	-	-	9,804
Restricted stock grants issued	30,000	150,000	(150,000)	-	-	-	-
Stock-based compensation expense	-	-	125,991	-	-	-	125,991
Stock issuances, net of offering costs	246,398	1,231,990	1,892,553	-	-	-	3,124,543
Unallocated shares issued to Employee Stock Ownership Plan	75,000	375,000	409,500	(784,500)	-	-	-
Allocation of 10,000 shares to Employee Stock Ownership Plan	-	-	-	104,600	-	-	104,600
BALANCE, December 31, 2017	2,745,758	\$ 13,728,790	\$ 16,129,740	(679,900)	\$ 2,293,572	\$ (56,404)	\$ 31,415,798

People's Bank of Commerce

Consolidated Statements of Cash Flows

	Years Ended December 31,	
	2017	2016
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income	\$ 2,060,552	\$ 1,880,490
Adjustments to reconcile net income to net cash from operating activities:		
Deferred income taxes	481,214	(91,463)
Provision for loan losses	52,307	366,345
Depreciation and amortization	523,563	375,341
Stock-based compensation expense	230,591	170,972
Amortization of premiums on investment securities	198,402	156,839
Realized gain on sale of investment securities	(21,575)	(74,651)
Gain on sale of other real estate owned	(54,605)	-
Net appreciation of bank-owned life insurance	(86,089)	(125,565)
Gain on sale of loans	(658,569)	(648,181)
Proceeds from the sale of loans held-for-sale	26,307,324	30,138,317
Production of loans held-for-sale	(27,545,729)	(27,391,809)
Changes in cash due to changes in certain assets and liabilities:		
Accrued interest receivable and other assets	(222,290)	229,027
Accrued interest payable and other liabilities	(423,089)	(97,262)
Net cash from operating activities	<u>842,007</u>	<u>4,888,400</u>
CASH FLOWS FROM INVESTING ACTIVITIES		
Net change in time deposits with other institutions	-	1,245,000
Purchase of investment securities available-for-sale	(5,124,464)	(6,339,296)
Proceeds from payments, calls, and sales of investment securities available-for-sale	9,452,153	18,273,742
Purchase of investment securities held to maturity	-	(338,485)
Purchase of restricted equity securities	(18,900)	(42,800)
Net increase in factored accounts receivable	(352,308)	-
Net increase in loans	(4,584,060)	(38,977,504)
Proceeds from sale of other real estate owned	276,048	-
Purchase of bank-owned life insurance	(601,713)	(500,000)
Bank-owned life insurance proceeds	-	725,251
Income from real estate joint venture	51,720	51,721
Purchase of loan portfolio	(4,806,007)	-
Cash paid in business combination, net of cash acquired	(1,442,747)	-
Payments made for purchase of premises, equipment, and leasehold improvements	<u>(5,579,539)</u>	<u>(2,217,366)</u>
Net cash from investing activities	<u>(12,729,817)</u>	<u>(28,119,737)</u>

People's Bank of Commerce
Consolidated Statements of Cash Flows

	Years Ended December 31,	
	2017	2016
CASH FLOWS FROM FINANCING ACTIVITIES		
Net increase in deposit accounts	\$ 25,423,732	\$ 13,661,959
Proceeds from borrowings	784,500	-
Repayment of borrowings	(8,570,567)	-
Cash paid in lieu of fractional shares from stock dividend	(3,212)	(2,340)
Proceeds from stock options exercised	9,804	44,847
Proceeds from stock issuances	459,565	-
Net cash from financing activities	18,103,822	13,704,466
NET CHANGE IN CASH AND CASH EQUIVALENTS	6,216,012	(9,526,871)
CASH AND CASH EQUIVALENTS, beginning of year	14,675,984	24,202,855
CASH AND CASH EQUIVALENTS, end of year	<u>\$ 20,891,996</u>	<u>\$ 14,675,984</u>
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION		
Cash paid for interest	<u>\$ 457,452</u>	<u>\$ 502,137</u>
Cash paid for taxes	<u>\$ 1,165,000</u>	<u>\$ 900,000</u>
SUPPLEMENTAL DISCLOSURE OF NONCASH INVESTING ACTIVITIES		
Change in fair value of investment securities available-for-sale, net of taxes	<u>\$ (85,479)</u>	<u>\$ (41,891)</u>
Assets acquired and liabilities assumed in business combination:		
Factored accounts receivable	\$ 12,781,053	
Premises and equipment	169,935	
Other assets	55,022	
Borrowings	(8,465,967)	
Other liabilities	<u>(3,750,534)</u>	
Net assets acquired	<u>\$ 789,509</u>	
Common stock issued	<u>\$ 2,664,978</u>	

People's Bank of Commerce

Notes to Consolidated Financial Statements

Note 1 – Organization and Summary of Significant Accounting Policies

Organization

In July 1997, People's Bank of Commerce (the Bank) was incorporated and received regulatory approval to become a state-chartered institution authorized to provide banking services in the state of Oregon. The Bank is subject to the regulations of certain federal and state agencies and will undergo periodic examinations by those regulatory authorities.

The Bank, which is headquartered in Medford, Oregon, operates five full-service branches in Ashland, Central Point, Grants Pass, and Medford, Oregon, and provides banking services to businesses and individuals located primarily in Southern Oregon. During 2017, the Bank also acquired loans and assumed an operating lease for a lending office in Klamath Falls, Oregon.

The Company declared one 5% stock dividend during 2017 and 2016. All per share amounts and calculations in the accompanying consolidated financial statements have been restated to reflect the effects of these stock dividends.

On September 1, 2017, the Bank acquired all of the outstanding shares of Capital Associates, Inc. dba Steelhead Finance (Steelhead) for cash and exchange of the Bank's stock. Steelhead is an asset-based lender serving the commercial freight delivery industry as a factor of freight bills.

Consolidation principles

The consolidated financial statements include the accounts of the Bank and its wholly-owned subsidiary, Steelhead Finance. All intercompany balances and transactions have been eliminated in consolidation.

Management's estimates and assumptions

In preparing the consolidated financial statements, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities as of the date of the balance sheets, and revenues and expenses for the reporting periods. Actual results could differ significantly from management's estimates. Material estimates that are particularly susceptible to significant change in the near term relate to the determination of the allowance for loan losses, the valuation of investment securities available-for-sale, other real estate owned, deferred tax assets, and the fair value of financial instruments.

Cash and cash equivalents

Cash equivalents are generally short-term investments with a maturity of three months or less. Cash and cash equivalents include cash on hand, amounts due from banks, and federal funds sold. Generally, federal funds are purchased and sold within a one-day period.

The Bank maintains balances in correspondent bank accounts which, at times, may exceed federally insured limits. Management believes that its risk of loss associated with such balances is minimal due to the financial strength of correspondent banks. The Bank has not experienced any losses in such accounts.

People's Bank of Commerce

Notes to Consolidated Financial Statements

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

Investment securities

The Bank is required to specifically identify its investment securities as “available-for-sale,” “held-to-maturity,” or “trading accounts.” The Bank holds no trading securities. However, debt securities that the Bank has the positive intent and ability to hold to maturity are classified as held-to-maturity and recorded at amortized cost. Securities not classified as held to maturity are classified as available-for-sale and recorded at fair value. Premiums and discounts are recognized in interest income using the effective interest method over the period to maturity.

Available-for-sale securities consist of bonds, notes, and debentures. Securities are generally classified as available-for-sale if the instrument may be sold in response to such factors as: (1) changes in market interest rates and related changes in prepayment risk, (2) needs for liquidity, (3) changes in the availability of and the yield on alternative instruments, and (4) changes in funding sources and terms. Unrealized holding gains and losses, net of taxes, on available-for-sale securities are reported as a net amount in a separate component of equity until realized.

Fair values for these investment securities are based on quoted market prices. Gains and losses on the sale of available-for-sale securities are determined using the specific-identification method.

Management reviews investment securities on an ongoing basis for the presence of other-than-temporary impairment (OTTI) or permanent impairment, taking into consideration current market conditions; fair value in relationship to cost; extent and nature of the change in fair value; issuer rating changes and trends; whether management intends to sell a security or if it is likely that the Bank will be required to sell the security before recovery of the amortized cost basis of the investment, which may be maturity; and other factors. For debt securities, if management intends to sell the security, or it is likely that the Bank will be required to sell the security before recovering its cost basis, the entire impairment loss would be recognized in earnings as an OTTI. If management does not intend to sell the security and it is not likely that the Bank will be required to sell the security, but management does not expect to recover the entire amortized cost basis of the security, only the portion of the impairment loss representing credit losses would be recognized in earnings. The credit loss on a security is measured as the difference between the amortized cost basis and the present value of the cash flows expected to be collected. Projected cash flows are discounted by the original or current effective interest rate depending on the nature of the security being measured for potential OTTI. The remaining impairment related to all other factors, which is the difference between the present value of the cash flows expected to be collected and fair value, is recognized as a charge to other comprehensive income. Impairment losses related to all other factors are presented as separate categories within other comprehensive income.

People's Bank of Commerce

Notes to Consolidated Financial Statements

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

Factored accounts receivable, net of allowance

To help ensure collection of accounts receivable, Steelhead has required factoring clients to maintain factoring reserves of 5% to 20% of their monthly factoring activity. The factored accounts receivable are secured, and are presented net of an allowance for doubtful accounts. As of December 31, 2017, the allowance is \$37,663. Management estimates the allowance for doubtful accounts based on historical bad debt and losses and aging of current receivable balances. Management considers accounts to be past due after 60 days without a payment. Management's only measure of credit quality for factored accounts receivable is days past due. The amount of factored accounts receivable past due as of December 31, 2017 was insignificant.

Loans held-for-sale

Mortgage loans held-for-sale are carried at the lower of cost or estimated market value. Market value is determined on an aggregate loan basis. Market value adjustments that reduce the carrying value of loans held for sale are recorded within a valuation allowance account and charged to non-interest income.

Loans, net of allowance for loan losses, and unearned income

In the normal course of business, the Bank originates and services loans receivable from borrowers. Loans are stated at the amount of unpaid principal, net of an allowance for loan losses, and net of deferred loan fees or costs. Interest on loans is calculated using the simple-interest method on daily balances of the principal amount outstanding. Loan origination fees and certain direct origination costs are capitalized and recognized as an adjustment to the yield of the related loan.

Loans are classified as impaired when, based on current information and events, it is probable that the Bank will be unable to collect the scheduled payments of principal and interest when due, in accordance with the terms of the original loan agreement. The carrying value of impaired loans is based on the present value of expected future cash flows (discounted at each loan's effective interest rate) or, for collateral dependent loans, at fair value of the collateral. If the measurement of each impaired loan's value is less than the recorded investment in the loan, an impairment allowance is created by either charging the provision for loan losses or allocating an existing component of the allowance for loan losses.

Loans, including impaired loans, are classified as non-accrual if the collection of principal and interest is doubtful. Generally, this occurs when a loan is past due as to maturity or payment of principal or interest by 90 days or more, unless such loans are well-secured and in the process of collection. If a loan or portion thereof is partially charged-off, the loan is considered a troubled debt restructuring and impaired. Loans that are less than 90 days past due may also be classified as non-accrual if repayment in full of principal and/or interest is in doubt.

When a loan is classified as non-accrual, all uncollected accrued interest is reversed against interest income and the accrual of interest income is terminated. Generally, any cash payments are applied as a reduction of principal outstanding. In cases where the future collectability of the principal balance in full is expected, interest income may be recognized on a cash basis. A loan may be restored to accrual status when the borrower's financial condition improves so that full collection of principal is considered likely.

People's Bank of Commerce

Notes to Consolidated Financial Statements

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

A troubled debt restructuring is a formal restructure of a loan in which the Bank, for economic or legal reasons related to the borrower's financial difficulties, grants a concession to the borrower. The concessions may be granted in various forms, including reduction in the stated interest rate, reduction in the loan balance or accrued interest, and extension of the maturity date. Troubled debt restructurings are measured at the time of restructure for impairment, and are subjected to the Bank's impaired loan accounting policy.

The allowance for loan losses is established through a provision for loan losses charged to expenses. Loans are charged against the allowance for loan losses when management believes that the collectability of principal is unlikely. The allowance is an amount that management believes will be adequate to absorb possible losses on existing loans that may become uncollectible, based on evaluations of the collectability of loans and prior loan loss experience. These evaluations take into consideration such factors as changes in the nature and volume of the loan portfolio, overall portfolio quality, review of specific problem loans, and current economic conditions that may affect the borrower's ability to pay. Management carefully monitors changing economic conditions, the concentrations of loan categories and collateral, the financial condition of borrowers, the history of the loan portfolio, and historical peer group loan loss data to determine the adequacy of the allowance for loan losses. The allowance is based on estimates, and actual losses may vary from the estimates. No assurance can be given that adverse future economic conditions will not lead to delinquent loans, increases in the provision for loan losses, and/or charge-offs. In addition, regulatory agencies, as an integral part of their examination process, periodically review the estimated losses on loans. Such agencies may require the Bank to recognize additional losses based on their judgment about information available to them at the time of their examination.

Premises, equipment, and leasehold improvements

Premises, equipment, and leasehold improvements are stated at cost, less accumulated depreciation and amortization. Depreciation and amortization are computed principally by the straight-line method over the estimated useful lives of the assets, or lease term in the case of leasehold improvements, which range from two to forty years.

Other real estate owned

Property and assets acquired through foreclosure or deed in lieu of foreclosure are initially recorded at fair value and are subsequently stated at the lower of the carrying value of the loan or the fair value of the assets received, less estimated costs to sell, at the date the asset is acquired. Adjustments that reduce loan balances to the lower carrying value at the time of foreclosure are recognized as charge-offs in the allowance for loan losses. Subsequent impairment write-downs to net realizable value, if any, or any disposal gains or losses are included in noninterest income or expense. Costs relating to the development and improvement of property are capitalized and holding costs are charged to expense as incurred.

Federal Home Loan Bank (FHLB) stock

At December 31, 2017 and 2016, the Bank held FHLB stock with a par value of \$319,400 and \$300,500, respectively. As a member of the FHLB system, the Bank is required to maintain a minimum investment level in FHLB stock based on specific percentages of the Bank's outstanding mortgages, total assets, or FHLB advances. This security is reported at par value, which represents the Bank's cost.

People's Bank of Commerce

Notes to Consolidated Financial Statements

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

Stock in the FHLB of Des Moines is classified as restricted stock and is evaluated for impairment based on ultimate recoverability. The determination of whether the investment is impaired is based on the Bank's assessment of the ultimate recoverability of par value rather than by recognizing temporary declines in value. The determination of whether a decline affects the ultimate recoverability is influenced by criteria such as (1) the significance of the decline in the net assets of the FHLB as compared to the capital stock amount for the FHLB and the length of time this situation has persisted, (2) commitments by the FHLB to make payments required by law or regulation and the level of such payments in relation to the operating performance of the FHLB, (3) the impact of the legislative and regulatory changes on institutions and, accordingly, on the customer base of the FHLB, and (4) the liquidity position of the FHLB. Management concluded that the Bank's FHLB stock investment was not impaired as of December 31, 2017.

Investment in real estate joint venture

During 2011, the Bank entered into a joint venture with another investor in a limited liability company formed to manage the construction and ownership of a new building that the Bank began to occupy at the end of 2012. The Bank accounted for its initial investment at 50% of total costs incurred to construct the new building. Following completion of construction and occupancy of the building, the Bank accounts for its investment in the limited liability company by following the equity method of accounting. Under this accounting treatment, the Bank recognizes its proportionate share of earnings and losses as a component of noninterest expense. During 2017 and 2016, the Bank recognized net income from its investment in the limited liability company of \$143,280 and \$162,916, respectively.

Goodwill

Goodwill arises from business combinations and represents the fair value of assets acquired net of liabilities assumed that exceeds the consideration provided at the acquisition date. Goodwill is not amortized, but instead is measured for impairment annually and when impairment is determined to exist, goodwill is written down through a charge to earnings. The Bank performs impairment testing using a qualitative approach to determine whether it is more likely than not that the fair value of a reporting unit is less than its carrying amount.

Income taxes

Income taxes are accounted for using an asset and liability approach that requires the recognition of deferred tax assets and liabilities for the expected future tax consequences of temporary differences between the financial statement and tax basis of assets and liabilities at the applicable enacted tax rates. Changes in enacted tax rates result in a revaluation of deferred tax assets and liabilities through the income tax provision in the period that the tax rate changes are enacted. A valuation allowance is provided when it is more likely than not that some portion or all of the deferred tax assets will not be realized. The Bank evaluates the realizability of its deferred tax assets by assessing its valuation allowance and by adjusting the amount of such allowance, if necessary.

People's Bank of Commerce

Notes to Consolidated Financial Statements

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

The Bank recognizes the tax benefit from uncertain tax positions only if it is more likely than not that the tax positions will be sustained on examination by taxing authorities, based on the technical merits of the position. The tax benefit is measured based on the largest benefit that has a greater than 50% likelihood of being realized upon ultimate settlement. The Bank does not anticipate that any amount of unrecognized tax benefits will significantly increase or decrease in the next 12 months. Additionally, the Bank recognizes interest and penalties related to income tax matters in income tax expense, although there were no interest and penalties recognized for the years ended December 31, 2017 and 2016.

Off-balance sheet financial instruments

The Bank holds no derivative financial instruments. However, in the ordinary course of business, the Bank enters into off-balance sheet financial instruments consisting of commitments to extend credit and standby letters of credit. These financial instruments are recorded in the consolidated financial statements when they are funded or related fees are incurred or received.

The Bank evaluates its exposure to off-balance sheet credit losses periodically for unfunded loan commitments and loans sold in the secondary market. The allowance for off-balance sheet credit losses is increased through charges to noninterest expense and is decreased by charge-offs or transfers to the allowance for loan losses at the time that the related loan is funded or the off-balance sheet credit exposure becomes probable and estimable. Management periodically evaluates the adequacy of this allowance based on the Bank's off-balance sheet credit loss experience, known and inherent risks in the portfolio, adverse situations which may increase the likelihood of loss, and current economic conditions. This reserve for unfunded loan commitments is included in the balance sheets under the caption "accrued interest payable and other liabilities."

Revenue recognition

Asset-based financing income on factored accounts receivable includes service fees and finance income. Service fee income from freight bills and other factored receivables purchased is calculated as a percentage of receivables purchased from clients plus a variable or fixed charge per bill. Finance income from factored receivables is recognized as income over the period the related factored receivables are outstanding. Fees charged vary among clients and are based upon a credit evaluation and expected profit contribution to Steelhead from each client.

Advertising and promotional expenses

Advertising and promotional costs are charged to expense during the period in which they are incurred.

Earnings per share

Basic earnings per share is computed by dividing net income available to stockholders by the weighted average number of common shares outstanding during the period, after giving retroactive effect to stock dividends and splits. Outstanding shares includes shares issued to the Employee Stock Ownership Plan and graded restricted stock units. Diluted earnings per share is computed similar to basic earnings per share except that the denominator is increased to include dilutive common equivalent shares for stock options assumed to be outstanding during the period utilizing the treasury-stock method.

People's Bank of Commerce

Notes to Consolidated Financial Statements

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

Stock compensation plans

The Bank has adopted stock-based compensation plans, and recognizes compensation expense based on the fair value of options or restricted stock awards on the date of grant. Share-based awards that do not require future service (i.e. fully vested awards at grant date) are expensed immediately. Share-based employee awards that require future service are amortized over the relevant service period. The phantom stock plans are settled in cash, based on the stock price on the vesting date, as they vest annually. The Bank recognizes share-based compensation expense on a straight-line basis.

Employee Stock Ownership Plan (ESOP)

Unallocated shares issued to the ESOP for eventual allocation to the Plan's participants serve as collateral for outstanding debt associated with the ESOP's purchase of such shares from the Bank. Unallocated shares are accounted for as a reduction in the value of outstanding common stock until such shares are legally released by the lender as collateral on the loan. Generally, this occurs as the loan is repaid. The Bank guarantees an outside loan carried by the ESOP and has recorded the loan within Borrowings on its consolidated balance sheet. As shares are released to be allocated to participants, the Bank recognizes compensation expense equal to the fair value of the shares when released.

Business combinations

The Bank accounts for business combinations under the acquisition method of accounting. The Bank recognizes the fair value of the assets acquired and liabilities assumed as of the date of acquisition, with any excess of the fair value of consideration provided over the fair value of the identifiable net tangible and intangible assets acquired recorded as goodwill. Transaction costs are expensed as incurred. The results of operations of the acquired business are included in the consolidated statements of income from the effective date of the acquisition, which is the date control is obtained.

Fair value measurements

Fair value is defined as the price that would be received to sell an asset, or paid to transfer a liability, in an orderly transaction between market participants at the measurement date. The Bank determines fair value based upon quoted prices when available or through the use of alternative approaches, such as matrix or model pricing, when market quotes are not readily accessible or available. The valuation techniques used are based on observable and unobservable inputs. Observable inputs reflect market data obtained from independent sources, while unobservable inputs reflect the Bank's market assumptions. These two types of inputs create the following fair value hierarchy:

Level 1 – Quoted prices in active markets for identical assets or liabilities.

Level 2 – Quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active, and model-derived valuations whose inputs are observable or whose significant value drivers are observable.

People's Bank of Commerce

Notes to Consolidated Financial Statements

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

Level 3 – Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the asset or liability. Unobservable inputs are used to measure fair value to the extent that observable inputs are not available. The Bank's own data used to develop unobservable inputs shall be adjusted for market consideration when reasonably available.

The Bank used the following methods and significant assumptions to estimate fair value for its assets measured and carried at fair value on a recurring or nonrecurring basis in the accompanying consolidated financial statements:

Investment securities available-for-sale – Investment securities available-for-sale are measured and carried at fair value on a recurring basis. For these securities, the Bank obtains fair value measurements from an independent pricing service. The fair value measurements consider observable data that may include dealer quotes, market spreads, cash flows, the U.S. Treasury yield curve, live trading levels, trade execution data, market consensus prepayment speeds, credit information, and the bond's terms and conditions, among other things (Level 1). When market quotes are not readily accessible or available, alternative approaches are utilized, such as matrix or model pricing (Level 2).

Impaired loans – Impaired loans are measured and adjusted to fair value on a non-recurring basis. Impaired loans are measured for impairment at the present value of expected future cash flows discounted at the loan's effective interest rate (Level 3), the loan's market price (Level 2), or the fair value of the collateral based on independent appraisals, less costs to sell, if the loan is collateral dependent (Level 3).

Other real estate owned – Other real estate owned is measured and adjusted to fair value on a nonrecurring basis. On the date that other real estate owned is received in satisfaction of a loan receivable, it is measured at fair value, less cost to sell, based on recent independent appraisals (Level 3). Subsequent to the acquisition date, it is measured for impairment and written down to its fair value, less costs to sell, based on updated independent appraisals (Level 3).

The following methods and assumptions were used by the Bank in estimating fair values of assets and liabilities not carried at fair value on a recurring or nonrecurring basis:

Cash and cash equivalents – The carrying amounts reported in the balance sheets for cash and cash equivalents approximate their fair value at the balance sheet date.

Investment securities held-to-maturity – Investment securities held-to-maturity are carried at amortized cost. For these securities, the Bank obtains fair value measurements from an independent pricing service. The fair value measurements consider observable data that may include dealer quotes, market spreads, cash flows, the U.S. Treasury yield curve, live trading levels, trade execution data, market consensus prepayment speeds, credit information, and the bond's terms and conditions, among other things (Level 1). When market quotes are not readily accessible or available, alternative approaches are utilized, such as matrix or model pricing (Level 2).

People's Bank of Commerce

Notes to Consolidated Financial Statements

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

Restricted equity securities – The Bank's investment in restricted equity securities are carried at par value which is expected to approximate fair value.

Loans held-for-sale – The carrying value of loans held-for-sale approximates fair value.

Loans receivable, net – For variable rate loans that re-price frequently and have no significant change in credit risk, fair value is equivalent to carrying value. Fair values for all other loans are estimated using discounted cash flow analyses using interest rates currently being offered for loans with similar terms to borrowers of similar credit quality.

Factored accounts receivable, net – The carrying value of factored accounts receivable approximates fair value as the factored receivables are purchased at market terms and are generally collectable within 90-days.

Borrowings – The fair value of borrowings is estimated by discounting future cash flows using rates currently offered for notes payable of similar remaining maturities.

Deposit liabilities – Fair value disclosed for demand deposits equals their carrying amount, which represents the amount payable on demand. The carrying amounts for variable-rate-interest-bearing deposit accounts and certificates of deposit approximate their fair value at the balance sheet date. Fair value for fixed-rate certificates of deposit is estimated using a discounted cash flow calculation that applies interest rates currently being offered on certificates to a schedule of aggregate expected monthly maturities on time deposits.

Off-balance sheet instruments – The Bank's off-balance sheet instruments include unfunded commitments to extend credit and standby letters of credit. The fair value of these instruments is not considered practicable to estimate because of the lack of quoted market prices and the inability to estimate fair value without incurring excessive costs.

The Bank assumes interest rate risk (the risk that general interest rate levels will change) as a result of its normal operations. Consequently, the fair value of the Bank's financial instruments will change when interest rate levels change, and that change may be either favorable or unfavorable to the Bank. Management attempts to match maturities of assets and liabilities to the extent believed necessary to minimize interest rate risk. However, borrowers with fixed-rate obligations are less likely to prepay in a rising rate environment and more likely to prepay in a falling rate environment. Conversely, depositors who are receiving fixed rates are more likely to withdraw funds before maturity in a rising rate environment and less likely to do so in a falling rate environment. Management monitors rates and maturities of assets and liabilities, and attempts to minimize interest rate risk by adjusting terms of new loans and deposits and by investing in securities with terms that mitigate the Bank's overall interest rate risk.

People's Bank of Commerce

Notes to Consolidated Financial Statements

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

Reclassifications

Certain reclassifications have been made to the prior year financial statements to conform to the current year presentation. These reclassifications have no effect on previously reported net income, earnings per share, or retained earnings.

Subsequent events

Subsequent events are events or transactions that occur after the balance sheet date but before 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 balance sheet, including the 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 through March 15, 2018, which is the date the consolidated financial statements became available to be issued.

People's Bank of Commerce

Notes to Consolidated Financial Statements

Note 2 – Business Combination

On September 30, 2017, the Bank acquired all of the outstanding stock of Capital Associates, Inc. dba Steelhead Finance (Steelhead) with consideration that comprised cash and the Bank's common stock. The transaction was accounted for under the acquisition method of accounting, and the assets and liabilities of Steelhead were recorded by the Bank at fair value. Under the terms of the merger agreement, the Bank paid cash totaling \$1,454,574 and issued 207,472 shares of the Bank's common stock with a fair value of \$2,664,978 in exchange for all of the outstanding shares of Steelhead's stock. The transaction resulted in goodwill totaling \$3,318,216, which is nondeductible for tax purposes, as this transaction was a nontaxable transaction. Following is a summary of the fair value of the assets acquired and liabilities assumed, along with the cash and common stock transferred as consideration in this transaction as of the acquisition date.

Assets acquired	
Factored accounts receivable	\$ 12,781,053
Premises and equipment	169,935
Other assets	<u>55,022</u>
Total assets acquired	<u>13,006,010</u>
Liabilities assumed	
Borrowings	8,465,967
Other liabilities	<u>3,750,534</u>
Total liabilities assumed	<u>12,216,501</u>
Net assets acquired	<u>789,509</u>
Merger consideration:	
Cash	1,442,747
Common stock	<u>2,664,978</u>
Goodwill recognized	<u><u>\$ 3,318,216</u></u>

People's Bank of Commerce
Notes to Consolidated Financial Statements

Note 3 – Investment Securities

Investment securities consist of the following as of December 31, 2017 and 2016:

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
<u>December 31, 2017</u>				
Investment securities available-for-sale:				
U.S. government agency obligations	\$ 5,004,117	\$ -	\$ (25,157)	\$ 4,978,960
SBA backed securities	1,991,421	33,584	(905)	2,024,100
Residential mortgage backed securities	7,438,882	-	(149,045)	7,289,837
Municipal securities	5,722,568	59,671	(9,713)	5,772,526
	<u>20,156,988</u>	<u>93,255</u>	<u>(184,820)</u>	<u>20,065,423</u>
Investment securities held to maturity:				
Municipal securities	<u>8,472,520</u>	<u>244,927</u>	<u>-</u>	<u>8,717,447</u>
Total investment securities:	<u>\$ 28,629,508</u>	<u>\$ 338,182</u>	<u>\$ (184,820)</u>	<u>\$ 28,782,870</u>
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
<u>December 31, 2016</u>				
Investment securities available-for-sale:				
U.S. government agency obligations	\$ 12,019,245	\$ 26,993	\$ (6,834)	\$ 12,039,404
SBA backed securities	2,721,568	56,345	(56)	2,777,857
Residential mortgage backed securities	7,323,067	-	(132,740)	7,190,327
Municipal securities	2,560,066	105,453	(1,962)	2,663,557
	<u>24,623,946</u>	<u>188,791</u>	<u>(141,592)</u>	<u>24,671,145</u>
Investment securities held to maturity:				
Municipal securities	<u>8,510,078</u>	<u>132,710</u>	<u>(75,204)</u>	<u>8,567,584</u>
Total investment securities:	<u>\$ 33,134,024</u>	<u>\$ 321,501</u>	<u>\$ (216,796)</u>	<u>\$ 33,238,729</u>

People's Bank of Commerce

Notes to Consolidated Financial Statements

Note 3 – Investment Securities (continued)

At December 31, 2017, the Bank had six available-for-sale investment securities in a loss position for less than 12 months, and 15 available-for-sale investment securities in a loss position for greater than 12 months as shown in the following table. None of the Bank's held-to-maturity investment securities were in a loss position at December 31, 2017.

	December 31, 2017					
	Less Than 12 Months		12 Months or Greater		Totals	
	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses
Investment securities available-for-sale:						
U.S. government agency obligations	\$ -	\$ -	\$ 4,978,960	\$ 25,157	\$ 4,978,960	\$ 25,157
SBA backed securities	124,114	436	106,237	469	230,351	905
Residential mortgage backed securities	716,625	8,750	6,573,212	140,295	7,289,837	149,045
Municipal securities	2,112,295	6,399	467,251	3,314	2,579,546	9,713
	<u>\$ 2,953,034</u>	<u>\$ 15,585</u>	<u>\$ 12,125,660</u>	<u>\$ 169,235</u>	<u>\$ 15,078,694</u>	<u>\$ 184,820</u>

At December 31, 2016, the Bank had eight available-for sale investment securities in a loss position for less than 12 months, and four available-for-sale investment securities in a loss position for greater than 12 months as shown in the following table. Eight of the Bank's held-to-maturity investment securities were in a loss position for less than 12 months, and one held-to-maturity investment security was in a loss position for greater than 12 months at December 31, 2016.

	December 31, 2016					
	Less Than 12 Months		12 Months or Greater		Totals	
	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses
Investment securities available-for-sale:						
U.S. government agency obligations	\$ -	\$ -	\$ 1,503,516	\$ 6,834	\$ 1,503,516	\$ 6,834
SBA backed securities	138,876	56	-	-	138,876	56
Residential mortgage backed securities	5,201,152	125,519	1,989,175	7,221	7,190,327	132,740
Municipal securities	471,519	1,962	-	-	471,519	1,962
	<u>5,811,547</u>	<u>127,537</u>	<u>3,492,691</u>	<u>14,055</u>	<u>9,304,238</u>	<u>141,592</u>
Investment securities held-to-maturity:						
Municipal securities	2,653,529	67,414	352,210	7,790	3,005,739	75,204
	<u>\$ 8,465,076</u>	<u>\$ 194,951</u>	<u>\$ 3,844,901</u>	<u>\$ 21,845</u>	<u>\$ 12,309,977</u>	<u>\$ 216,796</u>

Management believes that unrealized losses are solely the result of changes in interest rates since the securities have been purchased and that no other-than-temporary impairment exists.

In 2017, the Bank received proceeds of \$7,026,400 on the sale of available-for-sale securities, resulting in gross realized gains of \$21,575. In 2016, the Bank received proceeds of \$12,183,039 on the sale of available-for-sale securities, resulting in gross realized gains of \$80,656, and proceeds of \$739,057 on the sale of available-for-sale securities resulting in gross losses of \$6,039. During the years ended December 31, 2017 and 2016, no securities classified as held-to-maturity were sold. At December 31, 2017 and 2016, securities in the amount of \$2,786,174 and \$2,787,257, respectively, were pledged to secure public deposit.

People's Bank of Commerce
Notes to Consolidated Financial Statements

Note 3 – Investment Securities (continued)

The amortized cost and estimated fair value of investment securities by contractual maturity at December 31, 2017 are as follows:

	Available-for-Sale		Held-to-Maturity	
	Amortized Cost	Estimated Fair Value	Amortized Cost	Estimated Fair Value
Due within one year	\$ 999,934	\$ 999,659	\$ -	\$ -
Due from one year through five years	9,334,335	9,253,428	463,804	472,730
Due from five years through ten years	3,841,959	3,824,067	1,710,061	1,779,564
Due after ten years	5,980,760	5,988,269	6,298,655	6,465,153
	<u>\$ 20,156,988</u>	<u>\$ 20,065,423</u>	<u>\$ 8,472,520</u>	<u>\$ 8,717,447</u>

Note 4 – Loans, Net of Allowance for Loan Losses, and Unearned Income

The composition of loan balances is summarized as follows as of December 31:

	2017	2016
Real estate loans	\$ 172,688,847	\$ 167,502,697
Commercial loans	23,618,665	20,769,074
Construction loans	10,116,799	7,862,620
Consumer loans	2,395,394	3,273,546
Total loans	208,819,705	199,407,937
Allowance for loan losses	(2,399,541)	(2,342,256)
Unearned income, net of deferred costs	(162,469)	(70,563)
Loans, net of allowance for loan losses, and unearned income	<u>\$ 206,257,695</u>	<u>\$ 196,995,118</u>

During 2017, the Bank acquired loans with aggregate outstanding principal balances approximating \$4,778,000 and assumed an operating lease for a lending office in Klamath Falls, Oregon for cash consideration totaling \$4,806,007.

People's Bank of Commerce

Notes to Consolidated Financial Statements

Note 4 – Loans, Net of Allowance for Loan Losses, and Unearned Income (continued)

The following table displays the activity and allocation of the allowance for loan losses to significant segments of the loan portfolio at December 31:

	2017					Total
	Real Estate	Commercial	Construction	Consumer	Unallocated	
Allowance for loan losses						
Beginning balance	\$ 1,766,369	\$ 463,935	\$ 40,941	\$ 45,421	\$ 25,590	2,342,256
Charge-offs	-	(7,721)	-	-	-	(7,721)
Recoveries	2,215	9,184	1,300	-	-	12,699
Provision for loan losses	(171,401)	80,397	(7,993)	(21,776)	173,080	52,307
Ending balance	<u>\$ 1,597,183</u>	<u>\$ 545,795</u>	<u>\$ 34,248</u>	<u>\$ 23,645</u>	<u>\$ 198,670</u>	<u>\$ 2,399,541</u>
Ending balance						
Loans individually evaluated for impairment	<u>\$ 198,327</u>	<u>\$ 11,132</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 209,459</u>
Ending balance						
Loans collectively evaluated for impairment	<u>\$ 1,398,856</u>	<u>\$ 534,663</u>	<u>\$ 34,248</u>	<u>\$ 23,645</u>	<u>\$ 198,670</u>	<u>\$ 2,190,082</u>
2016						
	Real Estate	Commercial	Construction	Consumer	Unallocated	Total
Allowance for loan losses						
Beginning balance	\$ 1,544,417	\$ 291,109	\$ 56,653	\$ 46,904	\$ 24,715	\$ 1,963,798
Charge-offs	-	(61)	-	-	-	(61)
Recoveries	2,810	3,364	6,000	-	-	12,174
Provision for loan losses	219,142	169,523	(21,712)	(1,483)	875	366,345
Ending balance	<u>\$ 1,766,369</u>	<u>\$ 463,935</u>	<u>\$ 40,941</u>	<u>\$ 45,421</u>	<u>\$ 25,590</u>	<u>\$ 2,342,256</u>
Ending balance						
Loans individually evaluated for impairment	<u>\$ 202,633</u>	<u>\$ 12,208</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 214,841</u>
Ending balance						
Loans collectively evaluated for impairment	<u>\$ 1,563,736</u>	<u>\$ 451,727</u>	<u>\$ 40,941</u>	<u>\$ 45,421</u>	<u>\$ 25,590</u>	<u>\$ 2,127,415</u>

People's Bank of Commerce

Notes to Consolidated Financial Statements

Note 4 – Loans, Net of Allowance for Loan Losses, and Unearned Income (continued)

The following table displays the activity and allocation of loans evaluated individually and collectively for impairment to significant segments of the loan portfolio at December 31:

		2017				
		Real Estate	Commercial	Construction	Consumer	Total
Loans						
Ending balance		\$ 172,688,847	\$ 23,618,665	\$ 10,116,799	\$ 2,395,394	\$ 208,819,705
Ending balance						
Loans individually						
evaluated for						
impairment		\$ 1,310,752	\$ 691,461	\$ -	\$ -	\$ 2,002,213
Ending balance						
Loans collectively						
evaluated for						
impairment		\$ 171,378,095	\$ 22,927,204	\$ 10,116,799	\$ 2,395,394	\$ 206,817,492
		2016				
		Real Estate	Commercial	Construction	Consumer	Total
Loans						
Ending balance		\$ 167,502,697	\$ 20,769,074	\$ 7,862,620	\$ 3,273,546	\$ 199,407,937
Ending balance						
Loans individually						
evaluated for						
impairment		\$ 1,355,553	\$ 789,193	\$ -	\$ -	\$ 2,144,746
Ending balance						
Loans collectively						
evaluated for						
impairment		\$ 166,147,144	\$ 19,979,881	\$ 7,862,620	\$ 3,273,546	\$ 197,263,191

The Bank's risk rating methodology assigns risk ratings ranging from 1 to 10, where a higher rating represents higher risk. Assignment of a risk rating is done on the individual loan rather than at the borrower level. Loans are graded from inception and on a continuing basis until the debt is repaid. The risk rating categories can be generally described by the following groupings:

Pass (1-6) – An acceptable asset carrying a normal degree of credit risk exhibiting the capacity to perform according to the repayment terms.

Special Mention (7) – A special mention asset has potential weaknesses that deserve management's close attention. If left uncorrected, these potential weaknesses may result in a deterioration of the repayment prospects for the asset or in the Bank's credit position at some future date. Special mention assets are not adversely classified and do not expose an institution to sufficient risk to warrant adverse classification.

People's Bank of Commerce

Notes to Consolidated Financial Statements

Note 4 – Loans, Net of Allowance for Loan Losses, and Unearned Income (continued)

Substandard (8) – A substandard asset is inadequately protected by the current sound worth and paying capacity of the obligor or of the collateral pledged. Assets so classified must have a well-defined weakness or weaknesses that jeopardize the liquidation of the debt.

Doubtful (9) – Any asset classified doubtful has all the weaknesses inherent in one classified special mention with the added characteristic that the weaknesses make collection or liquidation in full, on the basis of currently existing facts, conditions, and value, highly questionable and improbable.

Loss (10) – Assets classified loss are considered uncollectible and of such minimal value that the continuance as bankable assets are not warranted. This classification does not mean that the asset has absolutely no recovery or salvage value but that it is not practical or desirable to defer writing off this basically worthless asset even though a partial recovery may occur in the future.

The following table represents loan portfolio information by loan type and credit grade as of December 31:

		2017				
		Real Estate	Commercial	Construction	Consumer	Total
Grade						
Pass	\$	166,547,172	\$ 21,347,832	\$ 10,116,799	\$ 2,395,394	\$ 200,407,197
Special Mention		2,437,090	604,729	-	-	3,041,819
Substandard		3,704,585	1,666,104	-	-	5,370,689
Doubtful		-	-	-	-	-
Loss		-	-	-	-	-
Total	\$	<u>172,688,847</u>	<u>\$ 23,618,665</u>	<u>\$ 10,116,799</u>	<u>\$ 2,395,394</u>	<u>\$ 208,819,705</u>
		2016				
		Real Estate	Commercial	Construction	Consumer	Total
Grade						
Pass	\$	161,034,814	\$ 18,464,540	\$ 7,862,620	\$ 3,273,546	\$ 190,635,520
Special Mention		2,444,450	530,431	-	-	2,974,881
Substandard		4,023,433	1,774,103	-	-	5,797,536
Doubtful		-	-	-	-	-
Loss		-	-	-	-	-
Total	\$	<u>167,502,697</u>	<u>\$ 20,769,074</u>	<u>\$ 7,862,620</u>	<u>\$ 3,273,546</u>	<u>\$ 199,407,937</u>

People's Bank of Commerce
Notes to Consolidated Financial Statements

Note 4 – Loans, Net of Allowance for Loan Losses, and Unearned Income (continued)

Past due loans are loans for which principal and interest were not paid timely according to the contractual payment terms. The following table represents loans past due by loan category as of December 31:

2017						
	30 – 59 Days Past Due	60 – 89 Days Past Due	Greater than 90 Days Past Due	Total Past Due	Current	Total Loans
Real estate	\$ -	\$ -	\$ -	\$ -	\$ 172,688,847	\$ 172,688,847
Commercial	-	-	-	-	23,618,665	23,618,665
Construction	-	-	-	-	10,116,799	10,116,799
Consumer	-	-	-	-	2,395,394	2,395,394
	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 208,819,705</u>	<u>\$ 208,819,705</u>
2016						
	30 – 59 Days Past Due	60 – 89 Days Past Due	Greater than 90 Days Past Due	Total Past Due	Current	Total Loans
Real estate	\$ -	\$ -	\$ 69,853	\$ 69,853	\$ 167,432,844	\$ 167,502,697
Commercial	-	-	-	-	20,769,074	20,769,074
Construction	-	-	-	-	7,862,620	7,862,620
Consumer	8,784	-	-	8,784	3,264,762	3,273,546
	<u>\$ 8,784</u>	<u>\$ -</u>	<u>\$ 69,853</u>	<u>\$ 78,637</u>	<u>\$ 199,329,300</u>	<u>\$ 199,407,937</u>

As of December 31, 2017, no loans were carried on nonaccrual status. As of December 31, 2016, real estate loans totaling \$69,853 and that were greater than 90 days past due were carried on nonaccrual status.

People's Bank of Commerce

Notes to Consolidated Financial Statements

Note 4 – Loans, Net of Allowance for Loan Losses, and Unearned Income (continued)

The following table represents a comparison of impaired loans with and without specific allowance recorded for the period ended December 31:

		2017				
		Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized
With no related allowance recorded						
	Real estate	\$ 132,653	\$ 132,653		\$ 139,015	\$ 14,152
	Commercial	-	-		-	-
	Construction	-	-		-	-
	Consumer	-	-		-	-
		<u>\$ 132,653</u>	<u>\$ 132,653</u>		<u>\$ 139,015</u>	<u>\$ 14,152</u>
With allowance recorded						
	Real estate	\$ 1,178,099	\$ 1,178,099	\$ 198,327	\$ 1,193,599	\$ 104,750
	Commercial	691,461	691,461	11,132	706,761	43,995
	Construction	-	-	-	-	-
	Consumer	-	-	-	-	-
		<u>\$ 1,869,560</u>	<u>\$ 1,869,560</u>	<u>\$ 209,459</u>	<u>\$ 1,900,360</u>	<u>\$ 148,745</u>
Total						
	Real estate	\$ 1,310,752	\$ 1,310,752	\$ 198,327	\$ 1,332,614	\$ 118,902
	Commercial	691,461	691,461	11,132	706,761	43,995
	Construction	-	-	-	-	-
	Consumer	-	-	-	-	-
		<u>\$ 2,002,213</u>	<u>\$ 2,002,213</u>	<u>\$ 209,459</u>	<u>\$ 2,039,375</u>	<u>\$ 162,897</u>
		2016				
		Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized
With no related allowance recorded						
	Real estate	\$ 91,651	\$ 91,651		\$ 93,659	\$ 10,480
	Commercial	-	-		-	-
	Construction	-	-		-	-
	Consumer	-	-		-	-
		<u>\$ 91,651</u>	<u>\$ 91,651</u>		<u>\$ 93,659</u>	<u>\$ 10,480</u>
With allowance recorded						
	Real estate	\$ 1,263,902	\$ 1,263,902	\$ 202,633	\$ 1,280,573	\$ 67,318
	Commercial	789,193	789,193	12,208	807,502	46,933
	Construction	-	-	-	-	-
	Consumer	-	-	-	-	-
		<u>\$ 2,053,095</u>	<u>\$ 2,053,095</u>	<u>\$ 214,841</u>	<u>\$ 2,088,075</u>	<u>\$ 114,251</u>
Total						
	Real estate	\$ 1,355,553	\$ 1,355,553	\$ 202,633	\$ 1,374,232	\$ 77,798
	Commercial	789,193	789,193	12,208	807,502	46,933
	Construction	-	-	-	-	-
	Consumer	-	-	-	-	-
		<u>\$ 2,144,746</u>	<u>\$ 2,144,746</u>	<u>\$ 214,841</u>	<u>\$ 2,181,734</u>	<u>\$ 124,731</u>

People's Bank of Commerce
Notes to Consolidated Financial Statements

Note 4 – Loans, Net of Allowance for Loan Losses, and Unearned Income (continued)

Troubled debt restructurings

At December 31, 2017 and 2016, impaired loans of \$1,955,938 and \$2,089,789, respectively, were classified as troubled debt restructured loans. The restructurings were granted in response to borrower financial difficulty, and generally provide for a temporary modification of loan repayment terms.

The types of modifications offered can generally be described in the following categories:

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

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

Payment modification – A modification in which the payment amount is changed.

Combination modification – Any other type of modification, including the use of multiple types of modifications.

There were no newly restructured loans that occurred during the year ended December 31, 2017. There was one newly restructured loan totaling \$69,593 that occurred during 2016. The modification extended the term of the contract. During 2017 and 2016, there were no troubled debt restructures that subsequently defaulted within twelve months of restructuring.

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Notes to Consolidated Financial Statements

Note 5 – Premises, Equipment, and Leasehold Improvements

The composition of premises, equipment, and leasehold improvements is summarized as follows as of December 31:

	<u>2017</u>	<u>2016</u>
Land	\$ 2,775,747	\$ 2,260,007
Bank premises	6,641,402	4,955,511
Construction in Progress	3,270,304	114,292
Furniture and equipment	2,677,538	2,106,008
Leasehold improvements	220,461	144,807
Automobiles and agreements	<u>33,493</u>	<u>-</u>
	15,618,945	9,580,625
Less accumulated depreciation and amortization	<u>(3,423,145)</u>	<u>(2,610,736)</u>
Premises, equipment, and leasehold improvements, net of accumulated depreciation and amortization	<u>\$ 12,195,800</u>	<u>\$ 6,969,889</u>

Depreciation and amortization expense for the years ended December 31, 2017 and 2016 was \$523,563 and \$375,341, respectively.

Note 6 – Time Deposits

Time certificates of deposit of \$250,000 and over totaled \$2,059,628 and \$1,285,854 at December 31, 2017 and 2016, respectively.

As of December 31, 2017, the scheduled maturities for all time deposits are as follows:

Years ending December 31, 2018	\$ 9,528,427
2019	3,708,622
2020	1,085,599
2021	8,297
2022	4,234,318
Thereafter	<u>49,713</u>
	<u>\$ 18,614,976</u>

People's Bank of Commerce

Notes to Consolidated Financial Statements

Note 7 – Borrowings

Federal Home Loan Bank advances

As a member of the Federal Home Loan Bank of Des Moines (FHLB), the Bank has entered into an “Advances, Security, and Deposit Agreement” with the FHLB.

Borrowings under the credit arrangement are collateralized by the Bank's FHLB stock as well as deposits or other instruments, which may be pledged. As of December 31, 2017 and 2016, the Bank had no outstanding borrowings with the FHLB. As of December 31, 2017, the Bank had \$13,041,957 in available borrowing capacity with FHLB.

Federal funds line of credit

The Bank has obtained lines of credit totaling \$7,000,000 with two correspondent banks. One federal fund line for \$3,000,000 will expire or renew at the discretion of the correspondent bank. A second line for \$4,000,000 was established with a term extending from June 30, 2017 through June 30, 2018. There were no balances outstanding on these lines of credit as of December 31, 2017 and 2016.

Leveraged ESOP loan

During 2017, the Bank established a leveraged employee stock ownership plan (the Plan) and the Plan purchased 75,000 shares of the Bank's common stock with proceeds received from a related party loan in the amount of \$784,500. The loan requires monthly interest and principal payments, carries an annual interest rate of 5.5%, matures September 1, 2022, is secured by unallocated ESOP shares, and may be prepaid at any time. The outstanding balance of this loan was \$679,900 at December 31, 2017.

Note 8 – Income Taxes

The provision for income taxes consists of the following as of December 31:

	2017	2016
Current income taxes		
Federal	\$ 875,472	\$ 765,591
State	293,056	203,152
Total current income taxes	<u>1,168,528</u>	<u>968,743</u>
Deferred income taxes		
Federal	387,487	(73,649)
State	93,727	(17,814)
Total deferred income taxes	<u>481,214</u>	<u>(91,463)</u>
Provision for income taxes	<u><u>\$ 1,649,742</u></u>	<u><u>\$ 877,280</u></u>

People's Bank of Commerce

Notes to Consolidated Financial Statements

Note 8 – Income Taxes (continued)

Net deferred tax assets, in the accompanying balance sheets, include the following components as of December 31:

	<u>2017</u>	<u>2016</u>
Deferred tax assets (liabilities)		
Allowance for loan losses	\$ 558,266	\$ 771,493
Supplemental executive retirement plan	420,996	512,491
Accrued bonuses	118,355	109,424
Split-dollar liability	35,109	45,084
Unrealized losses on investment securities available-for-sale	35,161	-
Reserve for off-balance sheet instruments	22,008	19,397
Other	<u>153</u>	<u>61,334</u>
	<u>1,190,048</u>	<u>1,519,223</u>
Depreciation and organization costs	(136,617)	(116,240)
Prepays	(108,444)	(101,722)
Loan origination costs	(3,482)	(69,689)
Intangible assets - permits and licenses	(33,305)	(44,218)
Unrealized gains on investment securities available-for-sale	-	(18,124)
Other	<u>(166,899)</u>	<u>-</u>
	<u>(448,747)</u>	<u>(349,993)</u>
Net deferred tax assets	<u><u>\$ 741,301</u></u>	<u><u>\$ 1,169,230</u></u>

A valuation allowance has not been recognized as an offset to the net deferred tax assets since management believes it is more likely than not that all deferred tax assets will be utilized in future periods.

People's Bank of Commerce

Notes to Consolidated Financial Statements

Note 8 – Income Taxes (continued)

The following summarizes the differences between the provision for income taxes for consolidated financial statement purposes and the federal statutory rate of 34.00% for the years ended December 31, 2017 and 2016:

	2017	
Federal, at statutory rate	\$ 1,261,500	34.0%
State, net of federal benefit	186,108	5.0%
Tax-exempt interest, net of expenses	(116,361)	-3.1%
Bank-owned life insurance	(33,588)	-0.9%
Effect of federal income tax rate change	394,688	10.6%
Other	(42,605)	-1.1%
	<u>\$ 1,649,742</u>	<u>44.5%</u>
Tax expense, at effective rate	<u>\$ 1,649,742</u>	<u>44.5%</u>

Note 9 – Financial Instruments with Off-Balance Sheet Risk

In the normal course of business to meet the financing needs of its customers, the Bank is a party to financial instruments with off-balance sheet risk. These financial instruments include commitments to extend credit and the issuance of letters of credit. These instruments involve, to varying degrees, elements of credit and interest-rate risk in excess of the amount recognized in the balance sheets. The contractual amounts of those instruments reflect the extent of involvement the Bank has in particular classes of financial instruments.

The Bank's exposure to credit loss in the event of nonperformance by the other party to the financial instruments for commitments to extend credit and letters of credit written is represented by the contractual amount of those instruments. The Bank uses the same credit policies in making commitments and conditional obligations as it does for on-balance sheet instruments.

Commitments to extend credit are agreements to lend to customers as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Since many of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. The amount of collateral obtained, if deemed necessary by the Bank upon extension of credit, is based on management's credit evaluation of the counter party. Collateral held varies but may include accounts receivable, inventory, property and equipment, and income-producing properties.

Letters of credit written are conditional commitments issued by the Bank to guarantee the performance of a customer to a third party. Those guarantees are primarily issued to support bonding requirements for real estate developers and contractors. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loan facilities to customers. The Bank holds cash, marketable securities, or real estate as collateral supporting those commitments for which collateral is deemed necessary.

People's Bank of Commerce

Notes to Consolidated Financial Statements

Note 9 – Financial Instruments with Off-Balance Sheet Risk (continued)

A summary of the notional amounts of the Bank's financial instruments with off-balance sheet risk as of December 31, 2017, is as follows:

Commitments to extend credit	
Commercial	\$ 18,504,176
Construction	15,581,808
Residential	7,339,859
Consumer	<u>3,645,357</u>
	<u>\$ 45,071,200</u>
Commercial and standby letters of credit	<u>\$ 1,125,300</u>

Note 10 – Concentrations of Credit Risk

All of the Bank's loans, commitments, and commercial and standby letters of credit have been granted to customers in the Bank's market area. The majority of such customers are also depositors of the Bank. Concentrations of credit by type of loan are set forth in Note 4.

During 2017, the Bank's loan policy did not allow the extension of credit to any single borrower or group of related borrowers in excess of \$1,200,000 on an unsecured basis and \$2,400,000 on a secured basis, without approval from the Senior Loan Committee.

People's Bank of Commerce

Notes to Consolidated Financial Statements

Note 11 – Commitments and Contingencies

Lease commitments

As of December 31, 2017, the Bank leased branch office space under two operating lease agreements. One of the branch leases expires in 2018 while the other branch lease expires in 2036.

Future minimum lease payments associated with the office space lease and other agreements are as follows:

Years ending December 31,	2018	\$ 399,456
	2019	362,088
	2020	360,860
	2021	369,220
	2022	377,787
	Thereafter	<u>1,210,511</u>
		<u><u>\$ 3,079,922</u></u>

For the years ended December 31, 2017 and 2016, rent expense was \$443,203 and \$435,159, respectively. As discussed in Note 1, the Bank pays rent to a related party as part of a real estate joint venture. Rent paid to the related party was \$263,892 and \$258,717 for the years ended December 31, 2017 and 2016, respectively.

Legal contingencies

The Bank may become a defendant in certain claims and legal actions arising in the ordinary course of business. As of December 31, 2017, the Bank was not involved in any current matters expected to have a material adverse effect on its financial condition or results of operations.

Construction commitment

As of December 31, 2017, the Bank has entered into a construction contract for the remodel and build-out of a branch and administrative space in Medford, Oregon. The amount committed for the completion of the contract is \$6.5 million, of which approximately \$3.2 million has been capitalized as construction in progress as of December 31, 2017.

Note 12 – Transactions with Related Parties

Certain directors, executive officers, and principal stockholders are customers of and have had banking transactions with the Bank in the ordinary course of business, and the Bank expects to have such transactions in the future.

All loans and commitments to lend included in such transactions are made in compliance with applicable laws on substantially the same terms (including interest rates and collateral) as those prevailing at the time for comparable transactions with other persons and, in the opinion of the management of the Bank, do not involve more than the normal risk of collection or present any other unfavorable features.

People's Bank of Commerce

Notes to Consolidated Financial Statements

Note 12 – Transactions with Related Parties (continued)

The amount of loans and loan commitments outstanding to directors, executive officers, and principal stockholders with the Bank was as follows as of December 31:

	2017	2016
Balance, beginning of year	\$ 3,362,889	\$ 4,157,604
Loans made and advances	821,026	2,793,823
Repayments and pay offs	(741,901)	(3,007,940)
Loans removed from related parties	<u>(2,860,013)</u>	<u>(580,598)</u>
Balance, end of year	<u>\$ 582,001</u>	<u>\$ 3,362,889</u>
Outstanding loan commitments	<u>\$ 156,591</u>	<u>\$ 760,722</u>

In addition, the Bank has a loan to its other 50% member in the limited liability company that owns its headquarters building. The loan carries an interest rate of 6.25%, matures in December of 2037, and is collateralized by member's interest in the land on which the building is located. The loan was originated for the purpose of funding the partner's portion of construction costs of the new administrative office and had a balance of \$1,894,517 as of December 31, 2017.

As discussed in Note 7, the Bank established a leveraged ESOP during 2017 and financed the sale of 75,000 shares of the Bank's common stock to the ESOP through a loan made by a related party in the amount of \$784,500.

Related party deposits held by the Bank at December 31, 2017 and 2016, were \$20,116,672 and \$17,705,986, respectively.

Note 13 – Stock-Based Compensation Plans

Under its stock-based compensation plans, the Bank may grant nonqualified stock options and restricted stock awards to its directors, officers, and employees for up to 282,966 shares of common stock.

The exercise price of each option must be at least equal to 100% of the market price of the Bank's stock on the date of grant. An option's maximum term is 10 years.

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Notes to Consolidated Financial Statements

Note 13 – Stock-Based Compensation Plans (continued)

The following summarizes stock option activity under the plans, adjusted for stock dividends:

	Number of Shares	Weighted Average Exercise Price	Aggregate Intrinsic Value	Weighted Average Contractual Term
Options under grant as of December 31, 2016	<u>75,899</u>	\$ 6.55		4.87
Options expired	-	\$ -		
Options exercised	(1,634)	\$ 6.00	\$ 11,356	
Adjustment for stock dividends	<u>3,713</u>			
Options under grant as of December 31, 2017	<u>77,978</u>	\$ 6.24		3.86
Options exercisable as of December 31, 2017	<u>77,978</u>	\$ 6.24		3.86

Proceeds received from stock options exercised in 2017 were \$9,804.

The Bank determines fair value of stock options at grant date using the Black-Scholes pricing model that takes into account the stock price at the grant date, the exercise price, the expected life of the option, the volatility of the underlying stock, the expected dividend yield, and the risk-free interest rate over the expected life of the option. The expected term of options granted is derived from historical data on employee exercise and post-vesting employment termination behavior. The risk-free rate for periods within the contractual life of the option is based on the U.S. Treasury yield curve in effect at the time of the grant. Expected volatility is based on the historical volatility of an index of comparable bank stocks.

The Black-Scholes option valuation model requires the input of highly subjective assumptions, including the expected life of the stock-based award and stock price volatility.

These assumptions represent management's best estimates, but involve inherent uncertainties and the application of management judgment. As a result, if other assumptions had been used, the Bank's recorded stock-based compensation expense could have been materially different. Additionally, the effects of applying this accounting model are not indicative of future amounts that may be realized by the option holders upon exercise.

People's Bank of Commerce

Notes to Consolidated Financial Statements

Note 13 – Stock-Based Compensation Plans (continued)

The Bank expenses stock options on a straight-line basis over the options' related vesting term. As of December 31, 2017, there was no unrecognized compensation expense related to the granting of stock options.

The following table summarizes restricted stock award activity under the plan for the year ended December 31, 2017:

	Number of Shares	Weighted Average Fair Value
Restricted stock awards unvested at December 31, 2016	<u>32,136</u>	\$ 8.14
Awards vested	(14,882)	\$ 9.20
Award granted	30,000	\$ 12.95
Awards forfeited	-	
Adjustment for stock dividends	<u>1,606</u>	
Restricted stock awards unvested at December 31, 2017	<u>48,860</u>	\$ 11.34

As of December 31, 2017, there was \$150,300 of unrecognized stock-based compensation expense related to nonvested restricted stock awards. The cost is expected to be recognized over a weighted average period of 1.7 years as of December 31, 2017.

Compensation expense recognized for stock-based compensation plans was \$125,991 and \$170,972 for the years ended December 31, 2017 and 2016, respectively.

Under its phantom stock plan, the Bank may award cash or stock compensation to its directors, officers, and employees for up to 150,000 shares. Liability based awards have no impact on the number of shares available to be issued within the plan. Phantom stock awards participate in stock dividends.

People's Bank of Commerce

Notes to Consolidated Financial Statements

Note 13 – Stock-Based Compensation Plans (continued)

The Bank granted phantom stock awards which are settled in cash when they vest. The following table summarizes activity for outstanding phantom stock awards for the years ended December 31, 2017 and 2016:

	2017	2016
Balance, beginning of year	\$ 45,240	\$ 24,500
Granted	4,000	25,500
Vested	(10,537)	(5,985)
Adjustment for stock dividend	2,262	1,225
Forfeited or expired	-	-
	<u> </u>	<u> </u>
Balance, end of year	<u>\$ 40,965</u>	<u>\$ 45,240</u>

As of December 31, 2017, based on the value of the Bank's stock, the value of the phantom stock awards outstanding was \$530,000. Expense will be recognized as the awards vest, based on the settlement value upon vesting. The weighted average vesting period for the awards is 3.75 years.

Total compensation expense recognized for phantom stock-based compensation plans was \$136,451 and \$60,449 for the year ended December 31, 2017 and 2016, respectively.

Note 14 – Employee Benefit Plans and Agreements

The Bank adopted a 401(k) plan in which substantially all employees participate. Employees may contribute the maximum amount permissible under federal tax laws.

During 2017, the Bank established a leveraged Employee Stock Ownership Plan (ESOP) with 75,000 unallocated shares of the Bank's common stock with a fair value of \$784,500. As the loan is repaid, shares are released and available to be allocated to participants no less frequently than annually. During 2017, the Bank made principal payments on the loan totaling \$104,600 and released 10,000 shares for allocation.

The Bank is required to contribute 3% of each eligible employee's compensation under safe harbor provisions. For the years ended December 31, 2017 and 2016, the Bank's expense attributable to contributions to these plans was \$132,813 and \$118,183, respectively.

Beginning in 2005, the Bank entered into supplemental retirement plans with key executive officers. In 2006, to support its obligations under these plans and to provide death benefits to selected employees, the Bank acquired bank-owned life insurance. The Bank's liability pursuant to these supplemental retirement plans was \$1,689,025 and \$1,429,093 as of December 31, 2017 and 2016, respectively. These amounts are included on the balance sheet among "accrued interest payable and other liabilities." For 2017 and 2016, compensation expense related to these plans was \$259,932 and \$167,015, respectively. During the year ended December 31, 2016 the bank collected \$725,251 in gross death benefit proceeds on bank-owned life insurance policies. No such proceeds were collected during 2017.

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Notes to Consolidated Financial Statements

Note 15 – Earnings Per Share

The following table illustrates the computations of basic and diluted earnings per share for the years ended December 31 (adjusted for the 2017 and 2016 stock dividends):

	Net Income	Weighted Average Shares	Per Share Amount
For the year ended December 31, 2017			
Basic income per share	\$ 2,060,552	2,503,688	\$ 0.82
Stock options		<u>31,851</u>	
Diluted income per share	\$ 2,060,552	<u>2,535,539</u>	<u>\$ 0.81</u>
For the year ended December 31, 2016			
Basic income per share	\$ 1,880,490	2,390,652	\$ 0.79
Stock options		<u>18,437</u>	
Diluted income per share	\$ 1,880,490	<u>2,409,089</u>	<u>\$ 0.78</u>

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Notes to Consolidated Financial Statements

Note 16 – Fair Value of Financial Instruments

Assets are displayed at fair value in the table below based upon recurring or nonrecurring measurement status. Recurring assets are initially measured at fair value and are required to be re-measured at fair value in the consolidated financial statements at each reporting date. Assets measured on a nonrecurring basis are assets that, due to an event or circumstance, were required to be re-measured at fair value after initial recognition in the consolidated financial statements at some time during the reporting period.

		Fair Value Measurements Using		
		Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
	Carrying Value			
<u>Recurring items as of December 31, 2017</u>				
Investment securities available-for-sale				
U.S. government agency obligations	\$ 4,978,960	\$ -	\$ 4,978,960	\$ -
SBA backed securities	2,024,100	-	2,024,100	-
Residential mortgage backed securities	7,289,837	-	7,289,837	-
Municipal securities	5,772,526	-	5,772,526	-
Total investment securities available-for-sale	<u>\$ 20,065,423</u>	<u>\$ -</u>	<u>\$ 20,065,423</u>	<u>\$ -</u>

		Fair Value Measurements Using		
		Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
	Carrying Value			
<u>Recurring items as of December 31, 2016</u>				
Investment securities available-for-sale:				
U.S. government agency obligations	\$ 12,039,404	\$ -	\$ 12,039,404	\$ -
SBA backed securities	2,777,857	-	2,777,857	-
Residential mortgage backed securities	7,190,327	-	7,190,327	-
Municipal securities	2,663,557	-	2,663,557	-
Total investment securities available-for-sale	<u>\$ 24,671,145</u>	<u>\$ -</u>	<u>\$ 24,671,145</u>	<u>\$ -</u>

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Notes to Consolidated Financial Statements

Note 16 – Fair Value of Financial Instruments (continued)

The following tables disclose fair value information about all financial instruments, whether carried or not carried at fair value on the balance sheet, where it is practicable to estimate that value.

		Fair Value at December 31, 2017			
	Carrying Amount	Total	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Financial assets					
Cash and cash equivalents	\$ 20,891,996	\$ 20,891,996	\$ 20,891,996	\$ -	\$ -
Investment securities available-for-sale	20,065,423	20,065,423	-	20,065,423	-
Investment securities held to maturity	8,472,520	8,717,447	-	8,717,447	-
Factored accounts receivable	13,133,361	13,133,361	-	13,133,361	-
Restricted equity securities	319,400	319,400	319,400	-	-
Loans held-for-sale	2,191,247	2,191,247	-	2,191,247	-
Loans receivable, gross	208,819,705	214,205,629	-	-	214,205,629
Financial liabilities					
Noninterest-bearing demand deposits	\$ 117,587,030	\$ 117,587,030	\$ -	\$ 117,587,030	\$ -
Interest-bearing demand, money market accounts, and savings deposits	127,358,755	127,358,755	-	127,358,755	-
Time certificates of deposit	18,614,976	17,700,830	-	-	17,700,830
Borrowings	679,900	-	-	679,900	-
		Fair Value at December 31, 2016			
	Carrying Amount	Total	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Financial assets					
Cash and cash equivalents	\$ 14,675,984	\$ 14,675,984	\$ 14,675,984	\$ -	\$ -
Investment securities available-for-sale	24,671,145	24,671,145	-	24,671,145	-
Investment securities held to maturity	8,510,078	8,567,584	-	8,567,584	-
Restricted equity securities	300,500	300,500	300,500	-	-
Loans held-for-sale	294,273	294,273	-	294,273	-
Loans receivable, gross	199,407,937	155,538,191	-	-	155,538,191
Financial liabilities					
Noninterest-bearing demand deposits	\$ 97,207,577	\$ 97,207,577	\$ -	\$ 97,207,577	\$ -
Interest-bearing demand, money market accounts, and savings deposits	123,481,455	123,481,455	-	123,481,455	-
Time certificates of deposit	17,477,997	18,465,116	-	-	18,465,116

The Bank normally intends to hold the majority of its financial instruments until maturity; it does not expect to realize many of the estimated amounts disclosed. The disclosures also do not include estimated fair value amounts for items which are not defined as financial instruments but which have significant value. These include such off-balance sheet items as core deposit intangibles on non-acquired deposits. The Bank does not believe that it would be practicable to estimate a representational fair value for these types of items as of December 31, 2017 and 2016.

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Notes to Consolidated Financial Statements

Note 17 – Regulatory Matters

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

Quantitative measures established by regulation to ensure capital adequacy require the Bank to maintain minimum amounts and ratios (set forth in the following table) of total capital, Tier 1 capital, and common equity Tier 1 to risk-weighted assets, and of Tier 1 capital to average assets (as defined in the regulations).

The Bank's capital amounts and ratios are substantially equivalent and as of December 31, 2017 and 2016 are as follows:

(dollars in thousands)	Actual		For Capital Adequacy Purposes		To Be Well-Capitalized under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
<u>December 31, 2017</u>						
Total capital to risk-weighted assets	\$ 30,583	12.0%	\$ 20,386	≥8.0%	\$ 25,483	≥10.0%
Tier 1 capital to risk-weighted assets	28,102	11.0%	15,290	≥6.0%	20,386	≥8.0%
Common Equity Tier 1 Capital to risk-weighted assets	28,102	11.0%	11,467	≥4.5%	16,564	≥6.5%
Tier 1 capital to average assets	28,102	9.4%	12,006	≥4.0%	15,008	≥5.0%
<u>December 31, 2016</u>						
Total capital to risk-weighted assets	\$ 28,353	13.4%	\$ 16,986	≥8.0%	\$ 21,232	≥10.0%
Tier 1 capital to risk-weighted assets	25,961	12.2%	12,739	≥6.0%	16,986	≥8.0%
Common Equity Tier 1 Capital to risk-weighted assets	25,961	12.2%	9,554	≥4.5%	13,801	≥6.5%
Tier 1 capital to average assets	25,961	9.7%	10,681	≥4.0%	13,351	≥5.0%

As of the most recent notifications from its regulatory agencies, the Bank was categorized as well-capitalized under the regulatory framework for prompt corrective action. To be categorized as adequately capitalized, the Bank must maintain minimum total risk-based capital, Tier 1 risk-based capital, and Tier 1 leverage capital ratios as set forth in the following table. There are no conditions or events since that notification that management believes may have changed the Bank's category.

People's Bank of Commerce

Notes to Consolidated Financial Statements

Note 17 – Regulatory Matters (continued)

The Bank is required to establish and phase-in a “conservation buffer,” consisting of a common equity Tier 1 capital amount equal to 2.5% of risk-weighted assets by 2019. An institution that does not meet the conservation buffer requirement will be subject to restrictions on certain activities including payment of dividends, stock repurchases, and discretionary bonuses to executive officers. The phase-in began in 2016 and increases 0.625% annually until fully phased-in by 2019.

Supplementary Information

People's Bank of Commerce

Consolidating Balance Sheet

	December 31, 2017			
	People's Bank of Commerce	Steelhead Finance	Eliminations	Consolidated
ASSETS				
Cash and cash equivalents	\$ 20,891,996	\$ 1,505,766	\$ (1,505,766)	\$ 20,891,996
Investment securities				
Available-for-sale, at fair value	20,065,423	-	-	20,065,423
Held-to-maturity, at cost	8,472,520	-	-	8,472,520
Restricted equity securities	319,400	-	-	319,400
Loans held-for-sale	2,191,247	-	-	2,191,247
Factored accounts receivable, net of allowance	-	13,133,361	-	13,133,361
Loans, net of allowance for loan losses, and unearned income	206,255,742	1,953	-	206,257,695
Premises, equipment, and leasehold improvements, net of accumulated depreciation and amortization	12,035,508	160,292	-	12,195,800
Other real estate owned	3,128,821	-	-	3,128,821
Bank-owned life insurance	6,018,374	-	-	6,018,374
Goodwill	-	3,318,216	-	3,318,216
Investment in real estate joint venture	2,490,990	-	-	2,490,990
Investment in subsidiary	3,785,718	-	(3,785,718)	-
Intercompany loan	11,255,522	-	(11,255,522)	-
Accrued interest receivable and other assets	2,227,040	16,768	(37,230)	2,206,578
Total assets	\$ 299,138,301	\$ 18,136,356	\$ (16,584,236)	\$ 300,690,421
LIABILITIES				
Total deposits	\$ 265,066,527	\$ -	\$ (1,505,766)	\$ 263,560,761
Accrued interest payable and other liabilities	1,976,076	3,095,116	(37,230)	5,033,962
Intercompany loan	-	11,255,522	(11,255,522)	-
Borrowings	679,900	-	-	679,900
Total liabilities	267,722,503	14,350,638	(12,798,518)	269,274,623
STOCKHOLDERS' EQUITY				
Common stock, \$5 par value, 4,000,000 shares authorized; 2,745,758 and 2,279,022 shares issued and outstanding at December 31, 2017 and 2016, respectively	13,728,790	-	-	13,728,790
Surplus	16,129,740	3,318,216	(3,318,216)	16,129,740
Unearned ESOP shares (65,000 and 0 shares, respectively)	(679,900)	-	-	(679,900)
Retained earnings	2,293,572	467,502	(467,502)	2,293,572
Accumulated other comprehensive loss	(56,404)	-	-	(56,404)
Total stockholders' equity	31,415,798	3,785,718	(3,785,718)	31,415,798
Total liabilities and stockholders' equity	\$ 299,138,301	\$ 18,136,356	\$ (16,584,236)	\$ 300,690,421

People's Bank of Commerce

Condensed Consolidating Statement of Income

	For the Year Ended December 31, 2017			
	People's Bank of Commerce	Steelhead Finance	Eliminations	Consolidated
INTEREST INCOME	\$ 11,243,662	\$ -	\$ -	\$ 11,243,662
INTEREST EXPENSE	435,032	930	-	435,962
NET INTEREST INCOME BEFORE PROVISION FOR LOAN LOSSES	10,808,630	(930)	-	10,807,700
PROVISION FOR LOAN LOSSES	52,307	-	-	52,307
NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES	10,756,323	(930)	-	10,755,393
NONINTEREST INCOME	2,306,760	1,413,723	(467,502)	3,252,981
NONINTEREST EXPENSE	9,538,401	759,679	-	10,298,080
INCOME BEFORE PROVISION FOR INCOME TAXES	3,524,682	653,114	(467,502)	3,710,294
PROVISION FOR INCOME TAXES	1,464,130	185,612	-	1,649,742
NET INCOME	<u>\$ 2,060,552</u>	<u>\$ 467,502</u>	<u>\$ (467,502)</u>	<u>\$ 2,060,552</u>

