REPORT OF INDEPENDENT AUDITORS
AND FINANCIAL STATEMENTS

FIRST SOUND BANK

December 31, 2017 and 2016

MOSSADAMS

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MOSSADAMS

Report of Independent Auditors

To the Board of Directors
First Sound Bank

Report on the Financial Statements

We have audited the accompanying financial statements of First Sound Bank (the Bank), which comprise the balance sheets as of December 31, 2017 and 2016, and the related statements of income, comprehensive income, changes in shareholders' equity, and cash flows for the years then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

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

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

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

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of First Sound Bank 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.

Moss Adams LLP

Everett, Washington
April 18, 2018

First Sound Bank
Balance Sheets (dollars in thousands)

ASSETS

	December 31, 2017	December 31, 2016
Cash and cash equivalents	$ 755	$ 1,275
Interest-bearing deposits in other financial institutions	17,606	11,371
Investment securities, available for sale	955	1,039
Federal Home Loan Bank stock, at cost	563	599
Loans	122,990	118,980
Allowance for credit losses	(1,409)	(1,278)
Net loans	121,581	117,702
Premises and equipment, net	154	171
Accrued interest receivable	258	226
Foreclosed assets, net	1,912	2,385
Other assets	565	837
Total assets	$ 144,349	$ 135,605

LIABILITIES AND SHAREHOLDERS' EQUITY

	2017	2016
LIABILITIES		
Deposits	$ 120,533	$ 109,941
Borrowings	10,000	11,200
Accrued interest payable	24	20
Other liabilities	591	2,633
Total liabilities	131,148	123,794
SHAREHOLDERS' EQUITY		
Preferred stock (par value $0.01); 10,000 shares authorized, no shares issued and outstanding in 2017 and 2016	-	-
Common stock (no par value); authorized: 325,000,000 and 300,000 shares in 2017 and 2016, respectively; issued and outstanding: 315,183,328 and 293,673,541 shares in 2017 and 2016, respectively	61,324	60,239
Accumulated deficit	(48,114)	(48,423)
Accumulated other comprehensive loss	(9)	(5)
Total shareholders' equity	13,201	11,811
Total liabilities and shareholders' equity	$ 144,349	$ 135,605

See accompanying notes.

First Sound Bank
Statements of Income (dollars in thousands)

	Years Ended December 31, 2017	2016
INTEREST INCOME		
Interest and fees on loans	$ 5,303	$ 4,957
Interest on deposits in other financial institutions	153	64
Interest on investments	11	11
Total interest income	5,467	5,032
INTEREST EXPENSE		
Deposits	749	553
Borrowings	40	8
Total interest expense	789	561
Net interest income before provision for credit losses	4,678	4,471
PROVISION FOR CREDIT LOSSES	206	15
Net interest income after provision for credit losses	4,472	4,456
NONINTEREST INCOME		
Service charge income	115	124
Sublease income	208	373
Gain on sale of loans	333	87
Servicing fees	7	5
Other income	651	226
Total noninterest income	1,314	815
NONINTEREST EXPENSE		
Salaries and benefits	2,567	2,295
Occupancy expenses	799	999
Professional and regulatory expenses	443	334
Data processing	479	495
Loss (gain) on sale of foreclosed assets	241	(46)
Insurance expense	153	256
Loan and lease expense	48	70
Other operating expenses	747	736
Total noninterest expense	5,477	5,139
NET INCOME	$ 309	$ 132
EARNINGS PER COMMON SHARE		
Basic	$ -	$ -
Diluted	$ -	$ -
Weighted-average number of common shares outstanding		
Basic	296,510,338	292,909,653
Diluted	304,867,187	296,657,096

See accompanying notes.

Statements of Comprehensive Income (dollars in thousands)

	Years Ended December 31,	
	2017	2016
NET INCOME	$ 309	$ 132
Other comprehensive income (loss)		
Unrealized holding (loss) gain on securities available for sale	(4)	4
Other comprehensive (loss) income	(4)	4
COMPREHENSIVE INCOME	$ 305	$ 136

See accompanying notes.

First Sound Bank

Statements of Changes in Shareholders' Equity (dollars in thousands)

	Common Stock			Accumulated Other	Total
	Number of Shares	Amount	Accumulated Deficit	Comprehensive Loss	Shareholders' Equity
BALANCE, December 31, 2015	292,756,875	$ 60,180	$ (48,555)	$ (9)	$ 11,616
Net income	-	-	132	-	132
Vesting of restricted stock	916,666	-	-	-	-
Stock-based compensation	-	59	-	-	59
Unrealized gain on securities	-	-	-	4	4
BALANCE, December 31, 2016	293,673,541	60,239	(48,423)	(5)	11,811
Net income	-	-	309	-	309
Vesting of restricted stock	566,666	-	-	-	-
Stock-based compensation	-	38	-	-	38
Stock issued	20,943,121	1,047	-	-	1,047
Unrealized loss on securities	-	-	-	(4)	(4)
BALANCE, December 31, 2017	315,183,328	$ 61,324	$ (48,114)	$ (9)	$ 13,201

Statements of Cash Flows (dollars in thousands)

	Years Ended December 31, 2017	Years Ended December 31, 2016
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income	$ 309	$ 132
Adjustments to reconcile net income to net cash from operating activities		
Provision from credit losses	206	15
Amortization of premiums on investment securities	8	10
Depreciation and amortization	51	61
Gain on sale of loans	(333)	(87)
Gain on sale of foreclosed assets	-	(24)
Write down of foreclosed assets	200	-
Stock-based compensation	38	59
Increase (decrease) in cash due to changes in certain assets and liabilities		
Accrued interest receivable	(32)	18
Other assets	260	532
Other liabilities	(2,042)	1,752
Accrued interest payable	4	6
Net cash from operating activities	(1,331)	2,474
CASH FLOWS FROM INVESTING ACTIVITIES		
Net increase in interest-bearing deposits in other financial institutions	(6,235)	(2,294)
Purchase of securities available for sale	(300)	(499)
Proceeds from paydowns and maturities of securities available for sale	372	155
Loan originations, net of principal collections and sales	(3,752)	(7,901)
Change in Federal Home Loan Bank stock, net	36	(254)
Proceeds from sale of foreclosed assets	273	364
Additions to premises and equipment, net	(22)	(171)
Net cash from investing activities	(9,628)	(10,600)
CASH FLOWS FROM FINANCING ACTIVITIES		
Net change in borrowings	(1,200)	15,200
Paydown of borrowings	-	(8,600)
Proceeds from issuance of stock	1,047	-
Net change in deposits	10,592	1,844
Net cash from financing activities	10,439	8,444
Net (decrease) increase in cash and cash equivalents	(520)	318
CASH AND CASH EQUIVALENTS, beginning of year	1,275	957
CASH AND CASH EQUIVALENTS, end of year	$ 755	$ 1,275
SUPPLEMENTAL CASH AND NONCASH DISCLOSURES		
Cash paid during the year for interest	$ 785	$ 555
Unrealized (loss) gain on securities	$ (4)	$ 4

Note 1 – Nature of Operations and Summary of Significant Accounting Policies

Nature of operations – First Sound Bank (the Bank) operates a single branch in downtown Seattle, Washington. The Bank provides loan and deposit services to customers who are predominately small and midsized businesses and middle-income individuals in western Washington. The Bank also provides small commercial equipment financing agreements (EFA) to businesses that are located throughout the United States. Beginning in December 2017, the Bank ceased the EFA lending program.

Use of estimates – The financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America and practices within the banking industry. Preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions based on available information. Actual results could differ from those estimates. Material estimates that are particularly susceptible to change in the near term relate to the determination of the allowance for loan losses, the valuation of other real estate owned, and the valuation allowance on the deferred tax asset.

All dollar amounts are stated in thousands, except per-share amounts.

Subsequent events – Subsequent events are events or transactions that occur after the balance sheet date but before financial statements are issued. The Bank recognizes in the 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 financial statements. The Bank's 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 the financial statements are available to be issued. The Bank has evaluated subsequent events through April 18, 2018, which is the date the financial statements are issued.

Cash and cash equivalents – For purposes of reporting cash flows, cash and cash equivalents include cash on hand, amounts due from banks, and federal funds sold, all with maturities of 90 days or less. Generally, federal funds are purchased and sold for one-day periods. Investments in federal funds sold are made with major banks as approved by the board of directors.

Interest-bearing deposits in other financial institutions – Interest-bearing deposits in other financial institutions mature within one year and are carried at cost. The balances in these accounts may fluctuate and, at times, exceed the insured limit set by the Federal Deposit Insurance Corporation (FDIC), which potentially subjects the Bank to credit risk. The Bank has not experienced any losses in such accounts.

Investment securities – Investment securities are classified as held to maturity and carried at amortized cost when management has the positive intent and ability to hold them to maturity. Investment securities are classified as available for sale when they might be sold before maturity. Equity securities with readily determinable fair values are classified as available for sale. Securities available for sale are carried at fair value, with unrealized holding gains and losses reported in other comprehensive income, net of tax.

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

Interest income includes amortization of purchase premium or discount. Premiums and discounts on securities are amortized on the level-yield method without anticipating prepayments, except for mortgage-backed securities where prepayments are anticipated. Gains and losses on sales are recorded on the trade date and determined using the specific identification method.

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

To determine OTTI for purchased beneficial interests that, on the purchase date, were not highly rated, the Bank compares the present value of the remaining cash flows as estimated at the preceding evaluation date to the current expected remaining cash flows. OTTI is deemed to have occurred if there has been an adverse change in the remaining expected future cash flows.

Federal Home Loan Bank stock – The Bank is a member of the Federal Home Loan Bank (FHLB) of Des Moines. As a member of the FHLB system, the Bank is required to maintain a minimum level of investment in FHLB stock, based on specified percentages of its outstanding FHLB advances. The Bank’s investment in FHLB stock is carried at cost, classified as a restricted security, and periodically evaluated for impairment based on ultimate recovery of par value ($100 per share).

Loans and allowance for credit losses – Loans receivable that management has the intent and ability to hold for the foreseeable future or until maturity or payoff are reported at their outstanding principal balances and adjusted for any charge-offs, the allowance for credit losses, any deferred fees or costs on originated loans, and unamortized premiums or discounts on purchased loans. Loan fees and certain direct loan origination costs are deferred, and the net fee or cost is recognized as an adjustment to interest income using the interest method.

Interest income on loans is accrued daily over the term of the loans based on the principal outstanding. The accrual of interest on loans is discontinued when, in management’s opinion, the borrower may be unable to meet payments as they become due, as well as when required by regulatory provision. Past-due status is based on contractual terms of loans. When interest accrual is discontinued, all unpaid accrued interest is reversed. Interest income is subsequently recognized only to the extent that cash payments are received until, in management’s judgment, the borrower has the ability to make contractual interest and principal payments, in which case the loan is returned to accrual status.

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

Most of the Bank's business activity is with customers located in the state of Washington. At December 31, 2017 and 2016, the Bank has $46,146 and $40,590, respectively, in loans in commercial real estate and construction, which represented 38% and 35% of the Bank's loan portfolio, respectively. A loan to any single borrower or a group of related borrowers is generally limited, by federal and state banking regulations, to 20% of the Bank's shareholders' equity, excluding accumulated other comprehensive income.

The Bank's EFA portfolio consists of small ticket equipment financing for term credit. The EFAs differ from direct financing lease contracts only in terms of legal ownership. They are a financing agreement only; ownership resides with the borrower. The states of California and Washington each have a concentration of over 10% of the EFA portfolio.

The allowance for credit losses is maintained at a level sufficient to provide for probable credit losses based on evaluating known and inherent risks in the loan portfolio. The allowance is provided based upon management's continuing analysis of the pertinent factors underlying the quality of the loan portfolio. These factors include changes in the size and composition of the loan portfolio, delinquency levels, actual loan loss experience, current economic conditions, and detailed analysis of individual loans for which full collectibility may not be ensured. The detailed analysis includes techniques to estimate the fair value of loan collateral and the existence of potential alternative sources of repayment. The allowance consists of specific, general, and unallocated components. The specific component relates to loans that are classified as impaired. For such loans classified as impaired, an allowance is established when the discounted cash flows (or collateral value or observable market price) of the impaired loan is lower than the carrying value of that loan. The general component covers nonimpaired loans and is based on historical loss experience adjusted for qualitative factors. An unallocated component is maintained to cover uncertainties that could affect management's estimate of probable losses. The unallocated component of the allowance reflects the margin of imprecision inherent in the underlying assumptions used in the methodologies for estimating specific and general losses in the portfolio.

When available information confirms that specific loans or portions thereof are uncollectible, identified amounts are charged against the allowance for credit losses. The existence of some or all of the following criteria will generally confirm that a loss has been incurred: the loan is significantly delinquent and the borrower has not demonstrated the ability or intent to bring the loan current; the Bank has no recourse to the borrower, or if it does, the borrower has insufficient assets to pay the debt; and/or the estimated fair value of the loan collateral is significantly below the current loan balance, and there is little or no near-term prospect for improvement.

A loan is considered impaired when the loan is 90 days past due or it is probable that a creditor will be unable to collect all amounts (principal and interest) due according to the contractual terms of the agreement. Smaller balance homogeneous loans, such as residential lines and consumer loans, are collectively evaluated for potential loss. When a loan has been identified as impaired, the amount of the impairment is measured by using discounted cash flows, except when, as a practical expedient, the current fair value of the collateral, reduced by costs to sell, is used. When the measurement of the impaired loan is less than the recorded investment in the loan (including accrued interest), impairment is recognized by creating or adjusting an allocation of the allowance for credit losses.

A provision for credit losses is charged against income and added to the allowance for credit losses based on regular assessments of the loan portfolio.

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

The allowance for credit losses is allocated to certain loan categories based on the relative risk characteristics, asset classifications, and actual loss experience of the loan portfolio. Although management has allocated the allowance for credit losses to various loan portfolio segments, the allowance is general in nature and is available for the loan portfolio in its entirety.

A troubled debt restructuring (TDR) is a loan for which the Bank, for reasons related to the borrower's financial difficulties, grants a concession to the borrower that the Bank would not otherwise consider. TDRs are individually evaluated for impairment and included in the separately identified impairment disclosures. TDRs are measured at the present value of estimated future cash flows using the loan's effective rate at inception. If a TDR is considered to be a collateral-dependent loan, the loan is reported, net, at the fair value of the collateral. For TDRs that subsequently default, the Bank determines the amount of allowance on that loan in accordance with the accounting policy for the allowance for loan losses on loans individually identified as impaired. The Bank incorporates recent historical experience related to TDRs including the performance of TDRs that subsequently default into the calculation of the allowance by loan portfolio segment.

The ultimate recovery of all loans is susceptible to future market factors beyond the Bank's control. These factors may result in losses or recoveries differing significantly from those provided in the financial statements. In addition, regulatory agencies, as an integral part of their examination process, periodically review the Bank's allowance for credit losses, and may require the Bank to make additions to the allowance based on their judgment about information available to them at the time of their examinations.

Loans held for sale – Loans held for sale consist of the guaranteed portion of Small Business Administration (SBA) loans the Bank intends to sell after origination and are reflected at the lower of aggregate cost or fair value. Loans are sold with servicing of the sold portion retained by the Bank. When the sale of the loan occurs, the premium received is combined with the estimated present value of future cash flows on the related servicing asset and recorded as a gain on sale of loans in noninterest income.

SBA servicing assets – The Bank accounts for SBA servicing rights as separately recognized servicing rights and initially measures them at fair value. Fair value is based on market prices for comparable servicing contracts, when available, or alternatively, is based on a valuation model that calculates the present value of estimated future net servicing income. The Bank subsequently measures each SBA servicing asset using the amortization method. Under the amortization method, servicing assets are amortized into noninterest income in proportion to, and over the period of, estimated net servicing income. The amortized assets are assessed for impairment or increased obligation, at the loan level, based on the fair value at each reporting date. As of December 31, 2017 and 2016, SBA servicing assets are not considered material and totaled $183 and $207, respectively, included in other assets on the balance sheets, from servicing $8.5 million and $8.3 million in loans, respectively.

Transfers of financial assets – Transfers of an entire financial asset, a group of entire financial assets, or participating interest in an entire financial asset are accounted for as sales when control over the assets has been surrendered. Control over transferred assets is deemed to be surrendered when (1) the assets have been isolated from the Bank, (2) the transferee obtains the right (free of conditions that constrain it from taking advantage of that right) to pledge or exchange the transferred assets, and (3) the Bank does not maintain effective control over the transferred assets through an agreement to repurchase them before their maturity.

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

Intangible assets – Intangible assets acquired in a purchase business combination and determined to have an indefinite useful life are not amortized, but tested for impairment at least annually or more frequently if events and circumstances exists that indicate that a goodwill impairment test should be performed. Intangible assets with definite useful lives are amortized over their estimated useful lives to their estimated residual values. There are no assets with indefinite lives on the balance sheets. Other intangible assets consist of a core deposit intangible. Amortization of the core deposit intangible is included in other noninterest expense. The gross carrying amount of the core deposit intangible equaled $69 and $81 for the year ended December 31, 2017 and 2016, respectively. Accumulated amortization totaled $37 and $25 with amortization expense of $12 and $14 for the year ended December 31, 2017 and 2016, respectively. The remaining balance will be amortized on an accelerated basis through 2025.

Foreclosed assets – Foreclosed assets acquired through, or in lieu of, foreclosure are to be sold and are initially recorded at the fair value of the properties less estimated costs of disposal, establishing a new cost basis. Any write-down to fair value at the time of transfer to foreclosed assets is charged to the allowance for credit losses. Properties are evaluated regularly to ensure that the recorded amounts are supported by their current fair values. Any subsequent reductions in carrying values, and revenue and expense from the operations of properties, are charged to operations.

Premises and equipment – Premises and equipment are stated at cost less accumulated depreciation, which is computed on the straight-line method over the estimated useful lives of the assets. Leasehold improvements are amortized over the term of the lease or the estimated useful life of the improvement, whichever is less. Asset lives range from 3 to 10 years. Gains or losses on dispositions are reflected in earnings. Assets are reviewed for impairment when events indicate their carrying value may not be recoverable. If management determines impairment exists, the asset is reduced with an offsetting charge to expense.

Advertising costs – Advertising costs are expensed as incurred. The amounts are not material to the financial statements.

Income taxes – The Bank records its provision for income taxes under the liability method. Deferred tax assets and liabilities are reflected at currently enacted income tax rates applicable to the period in which the deferred tax assets or liabilities are expected to be realized or settled. As changes in tax laws or rates are enacted, deferred tax assets and liabilities are adjusted through the provision for income taxes.

Deferred taxes result from temporary differences in the recognition of certain income and expense amounts between the Bank's financial statements and its tax return. The principal items giving rise to these differences include net operating losses, valuation adjustments on foreclosed properties, and allowance for credit losses. Because of unused net operating losses, the Bank has not recognized a tax benefit. The Bank's policy is to recognize interest and penalties associated with income tax matters in income tax expense.

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

Stock-based compensation – Compensation cost is recognized for stock options and restricted stock awards, and is measured at the fair value of these awards on their date of grant. A Black-Scholes model is used to estimate the fair value of stock options, whereas the market price of the Bank's common stock at the date of grant is used to estimate the fair value of restricted stock awards. Compensation cost is recognized over the required service period, generally defined as the vesting period for stock option awards and as the restriction period for restricted stock awards. For awards with graded vesting, compensation cost is recognized on a straight-line basis over the requisite service period for the entire award.

Earnings per common share – Basic earnings per common share is computed by dividing net income available to common shareholders, which consists of net income less dividends declared, by the weighted-average number of common shares outstanding during the period. Diluted earnings per common share is computed similar to basic earnings per common share except that the denominator is increased to include the number of additional common shares that would have been outstanding if dilutive potential common shares had been issued.

Fair value of financial instruments – Fair value is the price to sell an asset or transfer a liability in an orderly transaction between market participants. It represents an exit price at the measurement date. Market participants are buyers and sellers who are independent, knowledgeable, and willing and able to transact in the principal (or most advantageous) market for the asset and liability being measured. Current market conditions, including imbalances between supply and demand, are considered in determining fair value.

In measuring the fair value of an asset, the Bank assumes the highest and best use of the asset by a market participant to maximize the value of the asset, and does not consider the intended use of the asset.

Business segments – Substantially all of the Bank's operations involve the delivery of loan and deposit products to customers. Management makes operating decisions and assesses performance based on an ongoing review of the community banking operation, which constitutes the Bank's only operating segment for financial reporting purposes.

Reclassification – Certain reclassifications have been made to the prior-year financial statements to conform to the current-year presentation with no effect on net income or total shareholders' equity.

Note 2 – Earnings Per Common Share

Earnings per common share at December 31:

	2017	2016
Net income available to common shareholders	$ 309	$ 132
Basic weighted-average common shares outstanding	296,510,338	292,909,653
Plus common stock options and nonvested shares considered outstanding for dilutive purposes (excludes antidilutive options and nonvested shares)	8,356,849	3,747,443
Diluted weighted-average common shares outstanding	304,867,187	296,657,096
Basic earnings per share	$ -	$ -
Diluted earnings per share	$ -	$ -
Antidilutive shares	1,070,804	981,879

Note 3 – Restricted Assets

Federal Reserve Board regulations require that the Bank maintain reserves in the form of cash on hand and deposit balances with the Federal Reserve Bank (FRB), based on a percentage of deposits. The amounts of such balances for the years ended December 31, 2017 and 2016, were approximately $958 and $1,127, respectively.

Note 4 – Investment Securities Available for Sale

Investment securities available for sale have been classified according to management's intent. Amortized cost of securities and their approximate fair value are as follows:

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
December 31, 2017				
Investment securities available for sale				
US Treasury	$ 550	$ -	$ -	$ 550
FHLMC mortgage-backed securities	413	-	(8)	405
	$ 963	$ -	$ (8)	$ 955
December 31, 2016				
Investment securities available for sale				
US Treasury	$ 499	$ -	$ -	$ 499
FHLMC mortgage-backed securities	545	-	(5)	540
	$ 1,044	$ -	$ (5)	$ 1,039

Gross unrealized losses on investment securities available-for-sale and the estimated fair value of the related securities, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position, were as follows as of December 31:

	Less Than 12 Months		12 Months or More		Total	
2017	Unrealized Losses	Estimated Fair Value	Unrealized Losses	Estimated Fair Value	Unrealized Losses	Estimated Fair Value
Investment securities available for sale						
FHLMC mortgage-backed securities	$ -	$ -	$ (8)	$ 405	$ (8)	$ 405
2016						
Investment securities available for sale						
FHLMC mortgage-backed securities	$ -	$ -	$ (5)	$ 540	$ (5)	$ 540

The Bank had one investment security with gross unrealized losses for the years then ended December 31, 2017 and 2016. Unrealized losses have not been recognized into income because management does not intend to sell and does not expect it will be required to sell the investment. The unrealized loss is largely due to changes in market conditions and interest rates, rather than credit quality. The fair value is expected to recover as the underlying security in the portfolio approaches maturity date and market conditions improve. The Bank does not consider this security to be other than temporarily impaired at December 31, 2017 or 2016.

There were no sales of securities during the years ended December 31, 2017 or 2016.

Note 4 – Investment Securities Available for Sale (continued)

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

	Amortized Cost	Fair Value
Due in 1 year or less	$ 450	$ 450
Due in 1 to 5 years	100	100
Due in over 10 years	413	405
	$ 963	$ 955

Securities carried at approximately $955 and $1,039 were pledged to the FRB at December 31, 2017 and 2016, respectively, for other purposes required or permitted by law.

Note 5 – Loans and Allowance for Credit Losses

Loans at December 31 consist of the following:

	2017	2016
Commercial	$ 13,332	$ 14,905
Real estate		
Commercial	42,468	37,705
Residential	13,246	10,356
Construction	3,678	2,885
Equipment finance	43,984	46,393
Consumer	666	603
Government guaranteed	4,500	4,803
	121,874	117,650
Premium on purchased loans	52	69
Deferred loan origination fees, net of costs	1,064	1,261
	$ 122,990	$ 118,980

Note 5 – Loans and Allowance for Credit Losses (continued)

Certain related parties of the Bank, principally Bank directors and their associates, were loan customers of the Bank in the ordinary course of business during 2017 and 2016. During the year ended December 31, 2017, the Bank experienced no additions and had pay-downs of $1,742, with an ending balance of $0 as of December 31, 2017. During the year ended December 31, 2016, the Bank experienced no additions and pay-downs of $41, with an ending balance of $1,742 as of December 31, 2016.

Loans of approximately $58,219 and $25,380 at December 31, 2017 and 2016, respectively, were pledged to secure the FHLB and Federal Reserve Bank of San Francisco.

The following table presents the activity in the allowance for credit losses by segment for the years ended December 31, 2017 and 2016:

2017	Beginning Balance	Provision (Benefit) for Loan Losses	Charge-offs	Recoveries	Ending Balance
Commercial	$ 194	$ (37)	$ -	$ 13	$ 170
Real estate					
Commercial	425	35	-	-	460
Residential	33	9	-	-	42
Construction	47	12	-	-	59
Equipment finance	577	34	(167)	79	523
Consumer	1	16	-	-	17
Government guaranteed	1	(1)	-	-	-
Unallocated	-	138	-	-	138
	$ 1,278	$ 206	$ (167)	$ 92	$ 1,409
2016					
Commercial	$ 221	$ (109)	$ -	$ 82	$ 194
Real estate					
Commercial	388	37	-	-	425
Residential	61	(28)	-	-	33
Construction	27	18	-	2	47
Equipment finance	694	126	(410)	167	577
Consumer	5	(4)	-	-	1
Government guaranteed	-	1	-	-	1
Unallocated	26	(26)	-	-	-
	$ 1,422	$ 15	$ (410)	$ 251	$ 1,278

Note 5 – Loans and Allowance for Credit Losses (continued)

The allowance for credit losses and recorded investment in loans receivable as of December 31 are as follows:

	Allowance for Credit Losses			Loans		
2017	Ending Balance	Ending Balance Individually Evaluated for Impairment	Ending Balance Collectively Evaluated for Impairment	Ending Balance	Ending Balance Individually Evaluated for Impairment	Ending Balance Collectively Evaluated for Impairment
Commercial	$ 170	$ -	$ 170	$ 13,332	$ -	$ 13,332
Real estate						
Commercial	460	-	460	42,468	5,369	37,099
Residential	42	-	42	13,246	-	13,246
Construction	59	-	59	3,678	-	3,678
Equipment finance	523	-	523	43,984	-	43,984
Consumer	17	-	17	666	-	666
Government guaranteed	-	-	-	4,500	-	4,500
Unallocated	138	-	138	-	-	-
	$ 1,409	$ -	$ 1,409	$ 121,874	$ 5,369	$ 116,505
2016						
Commercial	$ 194	$ -	$ 194	$ 14,905	$ -	$ 14,905
Real estate						
Commercial	425	-	425	37,705	163	37,542
Residential	33	-	33	10,356	-	10,356
Construction	47	-	47	2,885	-	2,885
Equipment finance	577	-	577	46,393	-	46,393
Consumer	1	-	1	603	-	603
Government guaranteed	1	-	1	4,803	-	4,803
Unallocated	-	-	-	-	-	-
	$ 1,278	$ -	$ 1,278	$ 117,650	$ 163	$ 117,487

Credit quality indicator Federal regulations provide for the classification of lower quality loans and other assets, such as debt and equity securities, as substandard, doubtful, or loss. An asset is considered substandard if it is inadequately protected by the current net worth and pay capacity of the borrower or of any collateral pledged. Substandard assets include those characterized by the distinct possibility that the Bank will sustain some loss if the deficiencies are not corrected. Assets classified as doubtful have all the weaknesses inherent in those classified as substandard, with the added characteristic that the weaknesses present make collection or liquidation in full highly questionable and improbable on the basis of currently existing facts, conditions, and values. Assets classified as loss are those considered uncollectible and of such little value that their continuance as assets without the establishment of a specific loss reserve is not warranted. The grade for special mention is assigned to loans that have been criticized based upon known characteristics such as periodic payment delinquency or deteriorating financial condition of the borrower and/or guarantors.

Note 5 – Loans and Allowance for Credit Losses (continued)

EFAs are classified by the Bank as pass or doubtful, depending on the payment status of the borrower. Pass EFAs are listed as current and are reserved for based on a calculated rate using gross charge-off data from prior periods, weighted based on the total charge-offs tracked by origination date. Impaired EFAs classified as doubtful are not individually evaluated for impairment; rather, they are treated as a homogeneous pool for reserving purposes. The Bank uses a 12-month trailing average of net EFA charge-offs to derive a reserve percentage at the measurement date.

When the Bank classifies problem assets as either special mention, substandard, or doubtful pursuant to federal regulations, it may establish a specific allowance in an amount it deems prudent and approved by management and the board to address the risk specifically, or it may allow the loss to be addressed in the general allowance. General allowances represent loss allowances that have been established to recognize the inherent risk associated with lending activities, but which, unlike specific allowances, have not been specifically allocated to the particular problem assets. When an insured institution classifies problem assets as a loss, pursuant to federal regulations, it is required to charge off such assets in the period in which they are deemed uncollectible. The Bank's determination as to the classification of its assets and the amount of its valuation allowances is subject to review by the FDIC and the Washington State Department of Financial Institutions, both of which can require the establishment of additional loss allowances.

Additionally, the Bank categorizes loans as performing or nonperforming based on payment activity. Loans that are more than 90 days past due and nonaccrual loans are considered nonperforming.

The following tables show credit quality indicators as of December 31:

Credit risk profile by internally assigned grade

December 31, 2017	Pass	Special Mention	Substandard	Doubtful	Total
Commercial	$ 13,223	$ 59	$ 50	$ -	$ 13,332
Real estate					
Commercial	37,099	-	5,369	-	42,468
Residential	13,246	-	-	-	13,246
Construction	3,678	-	-	-	3,678
Equipment finance	43,875	-	-	109	43,984
Consumer	666	-	-	-	666
Government guaranteed	4,500	-	-	-	4,500
	$ 116,287	$ 59	$ 5,419	$ 109	$ 121,874
December 31, 2016					
Commercial	$ 14,738	$ 167	$	$ -	$ 14,905
Real estate					
Commercial	34,638	2,026	1,041	-	37,705
Residential	10,356	-	-	-	10,356
Construction	2,885	-	-	-	2,885
Equipment finance	46,244	-	-	149	46,393
Consumer	603	-	-	-	603
Government guaranteed	4,803	-	-	-	4,803
	$ 114,267	$ 2,193	$ 1,041	$ 149	$ 117,650

Note 5 – Loans and Allowance for Credit Losses (continued)

The following table shows the age analysis of past due loans receivable as of December 31:

	30-59 Days Past Due	60-89 Days Past Due	90 Days or More	Total Past Due	Current	Total Loans and Leases	Recorded Investment > 90 Days and Accruing
December 31, 2017							
Commercial	$ -	$ -	$ -	$ -	$ 13,332	$ 13,332	$ -
Real estate							
Commercial	-	-	5,369	5,369	37,099	42,468	-
Residential	-	-	-	-	13,246	13,246	-
Construction	-	-	-	-	3,678	3,678	-
Equipment finance	457	87	109	653	43,331	43,984	-
Consumer	-	-	-	-	666	666	-
Government guaranteed	-	-	-	-	4,500	4,500	-
	$ 457	$ 87	$ 5,478	$ 6,022	$ 115,852	$ 121,874	$ -
December 31, 2016							
Commercial	$ 1,055	$ -	$ -	$ 1,055	$ 13,850	$ 14,905	$ -
Real estate							
Commercial	-	-	13	13	37,692	37,705	-
Residential	-	-	-	-	10,356	10,356	-
Construction	-	-	-	-	2,885	2,885	-
Equipment finance	-	42	149	191	46,202	46,393	-
Consumer	-	-	-	-	603	603	-
Government guaranteed	-	721	-	721	4,082	4,803	-
	$ 1,055	$ 763	$ 162	$ 1,980	$ 115,670	$ 117,650	$ -

The following table shows impaired loans at December 31:

December 31, 2017	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized
With related allowance recorded					
Equipment finance	$ 109	$ 109	$ 5	$ 129	$ -
With no allowance recorded					
Commercial	-	-	-	-	-
Commercial real estate	5,369	5,369	-	2,766	-
Total					
Commercial real estate	$ 5,369	$ 5,369	$ -	$ 2,766	$ -
Equipment finance	109	109	5	129	-
December 31, 2016					
With related allowance recorded					
Equipment finance	$ 149	$ 149	$ 7	$ 165	$ -
With no allowance recorded					
Commercial	-	-	-	86	-
Commercial real estate	163	257	-	189	8
Total					
Commercial	$ -	$ -	$ -	$ 86	$ -
Commercial real estate	163	257	-	189	8
Equipment finance	149	149	7	165	-

Note 5 – Loans and Allowance for Credit Losses (continued)

The following table shows loans receivable on nonaccrual status as of December 31:

	2017	2016
Commercial real estate	$ 5,369	$ 163
Equipment finance	109	149
	$ 5,478	$ 312

There were no loans classified as troubled debt restructurings for the years ended December 31, 2017 and 2016. These loans are included in the impaired loan disclosures. A troubled debt restructuring is a loan to a borrower that is experiencing financial difficulty that has been modified from its original terms and conditions in such a way that the Bank is granting the borrower a concession of some kind. The Bank has granted a variety of concessions to borrowers in the form of loan modifications, such as rate, term, payment, or a combination thereof.

During 2017 and 2016, there were no loans modified as troubled debt restructurings.

Note 6 – Premises and Equipment

Components of premises and equipment as of December 31:

	2017	2016
Leasehold improvements	$ 589	$ 589
Furniture and equipment	1,063	1,061
	1,652	1,650
Less accumulated depreciation and amortization	(1,498)	(1,479)
Premises and equipment, net	$ 154	$ 171

Depreciation and amortization expense totaled $39 and $61 for the years ended December 31, 2017 and 2016, respectively.

The Bank leases its premises under operating leases that expire through November 2021. Minimum rental commitments under noncancelable leases having an original or remaining term of more than one year for future years ending December 31 are as follows:

2018	$ 369
2019	371
2020	383
2021	361
	$ 1,484

Note 6 – Premises and Equipment (continued)

The lease pertaining to the Bank headquarters, with a lease term through November 30, 2021, contains an escalation clause based on increases in property taxes and other costs. Rental expense under operating leases was $710 and $876 for the years ended December 31, 2017 and 2016, respectively. The Bank also leases one office space in Factoria, a lease acquired through the Eastside Commercial Bank (Eastside) acquisition, which had lease terms that ended January 2018 and minimal rental commitments of $9. The Factoria lease was not renewed.

Note 7 – Foreclosed Assets

The following table presents foreclosed assets as of December 31:

	2017	2016
Beginning balance	$ 2,385	$ 2,725
Sales	(273)	(364)
Gains on sales	-	24
Write-downs	(200)	-
Ending balance	$ 1,912	$ 2,385

Foreclosed assets includes undeveloped land at December 31, 2017 and 2016.

Note 8 – Deposits

The composition of deposits at December 31 is as follows:

	2017	2016
Demand deposits, noninterest-bearing	$ 28,317	$ 30,696
Savings and interest-bearing demand	62,241	50,080
Time certificates	29,975	29,165
	$ 120,533	$ 109,941

Note 8 – Deposits (continued)

Time deposits maturing in years ending December 31 are as follows:

2018	$ 24,652
2019	3,550
2020	992
2021	38
2022	743
	$ 29,975

As of December 31, 2017 and 2016, there were $3,000 and $1,030, respectively, of brokered deposits outstanding.

Related party deposits totaled $1,268 and $2,963 at December 31, 2017 and 2016, respectively.

As of December 31, 2017 and 2016, there were $5,567 and $3,340, respectively, of time certificates that met or exceeded the $250 FDIC-insured limits.

Note 9 – Borrowings

The Bank has a credit line with the FHLB of Des Moines totaling 25% of the Bank's assets, dependent on sufficient collateral at the time of borrowing and FHLB stock ownership. At December 31, 2017 and 2016, $23,803 and $1,470, respectively, was available.

The details of the borrowings are as follows at December 31, 2017:

	Amount	Rate
Overnight borrowings, variable rate borrowing	$ 10,000,000	1.63%

The Bank has a credit line with the FRB for which the amount is based on collateral pledged, subject to interest at the then-current rate. At December 31, 2017 and 2016, $8,750 and $6,526, respectively, was available. At December 31, 2017 and 2016, there were no outstanding borrowings on this line.

The Bank also has lines-of-credit agreements with an unaffiliated banks totaling $8 million. These lines provide for lending at the bank's federal fund rates. There were no borrowings outstanding at December 31, 2017 and 2016.

Note 10 – Employee Benefits

The Bank has a combined 401(k) and profit sharing plan, and a money purchase plan covering substantially all employees. Contributions to the Bank's 401(k) and profit sharing plan consist of a 3% safe harbor nonelective contribution and profit sharing contributions, which are both at the discretion of its board of directors. The Bank made safe harbor elections of $76 and $75 for the years ended December 31, 2017 and 2016, respectively.

Note 11 – Income Taxes

The Bank has not provided for income taxes in 2017 or 2016 as a result of the net losses incurred in previous years and carried forward.

The Bank's 2017 results included the impact of the enactment of the Tax Cuts and Jobs Act, which was signed into law on December 22, 2017. The law includes significant changes to the U.S. corporate tax system, including a Federal corporate rate reduction from 34% to 21%. In 2017, the Bank applied the newly enacted corporate federal income tax rate of 21% to its ending deferred tax assets, resulting in a reduction in deferred tax assets, before valuation allowance, of $1.2 million.

Tax effects of temporary differences that give rise to significant portions of deferred tax assets and liabilities at December 31 are as follows:

	2017	2016
Deferred tax assets		
Operating loss carryforward	$ 1,617	$ 2,717
Intangibles	651	1,255
Other, net	238	324
Nonaccrual interest	26	5
Accrued rent	15	8
Fixed asset basis	126	180
Purchase accounting adjustments	15	110
Total deferred tax assets	2,688	4,599
Deferred tax liabilities		
Deferred income	69	(1)
Loan origination costs	222	538
Allowance for credit losses	396	713
Total deferred tax liabilities	687	1,250
Net deferred tax assets before valuation allowance	2,001	3,349
Valuation allowance	(2,001)	(3,349)
Net deferred tax assets	$ -	$ -

Note 11 – Income Taxes (continued)

Pursuant to Sections 382 and 383 of the Internal Revenue Code, annual use of net operating loss and credit carryforwards may be limited in the event a cumulative change in ownership of more than 50 percent occurs within a three-year period. The Bank determined that such ownership changes occurred as of July 9, 2010, and February 20, 2013. This ownership change resulted in limitations on the use of net operating loss carryforwards, including the inability to use approximately $40.4 million of the federal net operating loss carryforward. Pursuant to Section 382, a portion of the limited net operating loss carryforwards becomes available for use each year. Approximately $170,000 of the restricted net operating loss carryforwards will become available each year. Additionally, net operating losses acquired from Eastside are subject to Section 382 annual limitations in the amount of approximately $11,000 per year. At December 31, 2016, the net operating losses not subject to limitations are estimated to be $4.1 million.

Management recorded a valuation allowance against deferred tax assets for the years ended December 31, 2017 and 2016, based on its estimate of future reversal and utilization. When determining the amount of deferred tax assets that are more likely than not to be realized and, therefore, recorded as a benefit, the Bank conducts a regular assessment of all available information. This information includes, but is not limited to, taxable income in prior periods, projected future income, and projected future reversals of deferred tax items. Based on these criteria, the Bank determined that it was necessary to retain a valuation allowance against deferred tax assets.

Prior to the impact of the Section 382 limitations, the Bank has federal net operating loss carryforwards of approximately $55.0 million at December 31, 2017. As a result of Section 382 limitations, total usable federal operating loss carryforwards total $7.7 million. Federal net operating loss carryforwards, to the extent not used, will begin to expire in 2025.

At December 31, 2017 and 2016, the Bank had no unrecognized tax benefits. The Bank recognizes interest accrued and penalties related to unrecognized tax benefits in tax expense. During the years ended December 31, 2017 and 2016, the Bank recognized no interest and penalties. The Bank files income tax returns in the U.S. federal jurisdiction. With few exceptions, the Bank is no longer subject to U.S. federal income tax examinations by tax authorities for years before 2014.

Note 12 – Commitments and Contingencies

The Bank is party to financial instruments with off-balance-sheet risk in the normal course of business to meet the financing needs of its customers. These financial instruments include commitments to extend credit and standby letters of credit. These instruments involve, to varying degrees, elements of credit risk in excess of the amount recognized on the balance sheets.

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 standby letters of credit 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.

Note 12 – Commitments and Contingencies (continued)

A summary of the Bank's commitments at December 31 is as follows:

	2017	2016
Commitments to extend credit		
Real estate secured	$ 10,750	$ 5,659
Commercial lines of credit	14,620	14,260
Total commitments to extend credit	$ 25,370	$ 19,919

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Because many of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. The Bank's experience has been that approximately 60% of loan commitments are drawn upon by customers. The Bank evaluates each customer's creditworthiness on a case-by-case basis. The amount of collateral obtained, if deemed necessary by the Bank upon extension of credit, is based on management's credit evaluation of the party. Collateral held varies, but may include accounts receivable, inventory, property and equipment, residential real estate, and income-producing commercial properties.

Note 13 – Stock Compensation Plans and Stock Warrants

Stock options – In May 2013, the Bank adopted the 2013 Long-Term Equity Incentive Plan (the Equity Plan). The Equity Plan permits the grant of nonqualified stock options, incentive stock options, restricted stock, and restricted stock unit awards. The Equity Plan authorizes 20,300,000 shares for grant, subject to no more than 4,060,000 shares being issued as restricted stock grants or restricted stock unit awards of which the Bank has 493,335 and 210,001 remaining to grant as of December 31, 2017 and 2016, respectively. The Bank has 7,450,001 options/shares remaining to grant as of December 31, 2017 and 2016.

The restricted stock grants are valued at fair market value at date of grant. The restricted stock grants vest over a period of three years, and expense is recognized using the straight-line method.

The Bank uses the Black-Scholes option valuation model to determine the weighted-average fair value of options. The Bank uses assumptions on expected life, risk-free rate, expected volatility, and dividend yield to determine such values. The expected life of options is derived using the simplified method. The risk-free rate is based on Treasury instruments in effect on the date of grant whose terms are consistent with the expected life of the Bank's stock options. Expected volatility is based on historical volatility of the Bank's stock. The dividend yield is based on historical experience and expected future changes. The Bank has not historically paid dividends on its common stock. A summary of inputs for options granted in 2016 is presented below. No options were granted in 2017.

	2016
Risk-free interest rate	1.44%
Dividend yield rate	0.00%
Expected volatility	36.01%
Expected term (in years)	5 years

Note 13 – Stock Compensation Plans and Stock Warrants

A summary of the status of the Bank's stock option plan activity for the year ended December 31, 2017, is presented below:

	Shares Underlying Options	Weighted-Average Exercise Price	Aggregate Intrinsic Value	Weighted-Average Remaining Contractual Life (Years)
Options outstanding, December 31, 2016	9,000,000	$ 0.05	$ -	
Granted	-	-	-	
Exercised	-	-	-	
Expired/forfeited	-	-	-	
Options outstanding, December 31, 2017	9,000,000	$ 0.05	$ -	6.06
Options exercisable, December 31, 2017	9,000,000	$ 0.05	$ -	6.06

The following summarizes the restricted stock plan of nonvested shares and changes for the year ended December 31, 2017:

	Shares	Weighted-Average Grant-Date Fair Value
Nonvested stock grants at beginning of year	1,166,666	$ 0.07
Granted	750,000	0.05
Vested	(566,666)	0.07
Expired/forfeited	(533,334)	0.07
Nonvested stock grants at end of year	816,666	$ 0.07

As of December 31, 2017, there was $19 of unrecognized compensation cost related to nonvested share-based compensation agreements granted under both plans expected to be recognized over three years.

Note 14 – Regulatory Matters

The Bank is subject to various regulatory capital requirements administered by the federal banking agencies. Failure to meet minimum capital requirements can initiate certain mandatory—and possibly additional discretionary—actions by regulators that, if undertaken, could have a direct material effect on the Bank's financial statements. Under capital adequacy guidelines of the regulatory framework for prompt corrective action, the Bank must meet specific capital adequacy 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 classification is also subject to qualitative judgments by the regulators about components, risk weightings, and other factors.

Note 14 – Regulatory Matters (continued)

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 Tier 1 capital (as defined in the regulations) to total average assets (as defined), and minimum ratios of Tier 1, common equity Tier 1 and total capital (as defined) to risk-weighted assets (as defined).

As of December 31, 2017, the most recent notification from the Bank's regulator categorized the Bank as well capitalized under the regulatory framework for prompt corrective action. To be categorized as well capitalized, the Bank must maintain minimum total risk-based, Tier 1 risk-based, common equity Tier 1, and Tier 1 leverage ratios, as set forth in the table. There are no conditions or events since that notification that management believes have changed the Bank's category.

The Bank's actual capital amounts and ratios are also presented in the table.

	Actual		For Capital Adequacy Purposes		For Capital Adequacy with Capital Buffer		To Be Well Capitalized Under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio	Amount	Ratio
As of December 31, 2017								
Tier I capital (to average assets)	$ 13,136	9.36%	$ 5,617	≥ 4.00%	N/A		$ 7,021	≥ 5.00%
Tier I capital (to risk-weighted assets)	13,136	11.04%	7,141	≥ 6.00%	8,629	≥ 7.25%	9,522	≥ 8.00%
Common equity Tier 1 capital (to risk-weighted assets)	13,136	11.04%	5,356	≥ 4.50%	6,844	≥ 5.75%	7,736	≥ 6.50%
Total capital (to risk-weighted assets)	14,565	12.24%	9,521	≥ 8.00%	11,009	≥ 9.25%	11,901	≥ 10.00%
As of December 31, 2016								
Tier I capital (to average assets)	$ 11,756	9.26%	$ 5,078	≥ 4.00%	N/A		$ 6,347	≥ 5.00%
Tier I capital (to risk-weighted assets)	11,756	10.00%	7,054	≥ 6.00%	7,789	≥ 6.63%	11,756	≥ 8.00%
Common equity Tier 1 capital (to risk-weighted assets)	11,756	10.00%	5,290	≥ 4.50%	6,025	≥ 5.13%	7,642	≥ 6.50%
Total capital (to risk-weighted assets)	13,054	11.10%	9,405	≥ 8.00%	10,140	≥ 8.63%	11,756	≥ 10.00%

The final rules implementing Basel Committee on Banking Supervision's capital guidelines for U.S. banks (Basel III rules) became effective for the Bank on January 1, 2015, with full compliance with all of the requirements being phased in over a multi-year schedule, and fully phased in by January 1, 2019. Under the Basel III rules, the Bank must hold a capital conservation buffer above the adequately capitalized risk-based capital ratios. The capital conservation buffer is being phased in from 0.0% for 2015 to 2.50% by 2019. The capital conservation buffer for 2017 is 1.250%. The net unrealized gain or loss on available-for-sale securities is not included in computing regulatory capital. Management believes that as of December 31, 2017, the Bank meets all capital adequacy requirements to which it is subject.

Note 15 – Fair Value of Financial Instruments

Fair value determination – Fair value is based on quoted market prices, when available, for identical or similar assets or liabilities. In the absence of quoted market prices, management determines the fair value of the Bank's assets and liabilities using valuation models or third-party pricing services, both of which rely on market-based parameters when available, such as interest rate yield curves, option volatilities and credit spreads, or unobservable inputs. Unobservable inputs may be based on management's judgment, assumptions, and estimates related to credit quality, liquidity, interest rates, and other relevant inputs.

Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) 820 establishes a three-level valuation hierarchy for determining fair value that is based on the transparency of the inputs used in the valuation process. The inputs used in determining fair value in each of the three levels of the hierarchy are as follows:

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

Level 2 – Either: (i) quoted prices for similar assets or liabilities; (ii) observable inputs, such as interest rates or yield curves; or (iii) inputs derived principally from or corroborated by observable market data.

Level 3 – Unobservable inputs.

The hierarchy gives the highest ranking to Level 1 inputs and the lowest ranking to Level 3 inputs. The level in the fair value hierarchy within which the fair value measurement in its entirety falls is determined based on the lowest level input that is significant to the overall fair value measurement.

Qualitative disclosures of valuation techniques – Securities available for sale consist of U.S. government and agency securities and U.S. agency mortgage-backed securities. The Bank reports securities available for sale at fair value on a recurring basis. The fair value of the Bank's securities available for sale is determined using Level 1 inputs, which are derived from quoted prices in active markets, and Level 2 inputs, which are derived from quoted prices for identical or similar assets in markets that are active or not active: that is, markets in which there are a few transactions for the asset, the prices are not current, or price quotations vary substantially either over time or among market makers, or in which little information is released publicly.

Assets measured at fair value on a recurring basis – The balance of securities available for sale at December 31, the fair value of which is disclosed on a recurring basis (there were no transfers between Level 1 and Level 2 measurements in 2017 or 2016), is presented below:

	Level 1	Level 2	Level 3	Total
December 31, 2017				
Investment securities available for sale				
US Treasuries	$ -	$ 550	$ -	$ 550
FHLMC mortgage-backed securities	-	405	-	405
	$ -	$ 955	$ -	$ 955
December 31, 2016				
Investment securities available for sale				
US Treasuries	$ -	$ 499	$ -	$ 499
FHLMC mortgage-backed securities	-	540	-	540
	$ -	$ 1,039	$ -	$ 1,039

Note 15 – Fair Value of Financial Instruments (continued)

Fair value on a nonrecurring basis – Certain assets are measured at fair value on a nonrecurring basis; that is, the instruments are not measured at fair value on an ongoing basis but are subject to fair value adjustments in certain circumstances (for example, when there is evidence of impairment). The following presents such assets carried on the balance sheet by caption and by level within the FASB ASC 820 hierarchy as of December 31:

	Level 1	Level 2	Level 3	Total Fair Value
December 31, 2017				
Impaired loans	$ -	$ -	$ 5,478	$ 5,478
Foreclosed assets	-	-	1,912	1,912
December 31, 2016				
Impaired loans	$ -	$ -	$ 312	$ 312
Foreclosed assets	-	-	2,385	2,385

Quantitative information about Level 3 fair value measurements – The range and weighted average of the significant unobservable inputs used to fair value Level 3 nonrecurring assets during the year ending December 31, 2017 and 2016, along with the valuation techniques used, are shown in the following table:

	Fair Value at December 31, 2017	Valuation Technique	Unobservable Input	Weighted Average[1]
Impaired loans	$ 5,478	Market comparable	Adjustment to appraisal value	7%
Foreclosed assets	1,912	Market comparable	Adjustment to appraisal value	7%

[1] Discount to appraised value

	Fair Value at December 31, 2016	Valuation Technique	Unobservable Input	Weighted Average[1]
Impaired loans	$ 312	Market comparable	Adjustment to appraisal value	7%
Foreclosed assets	2,385	Market comparable	Adjustment to appraisal value	7%

[1] Discount to appraised value

Impaired loans are measured based on the present value of expected future cash flows, discounted at the loan's effective interest rate, or, as a practical expedient, at the loan's observable market price or the fair value of the collateral, if the loan is collateral-dependent. Changes in these values are recorded in income as an adjustment to the allowance for credit losses.

Foreclosed assets in the preceding table represent real estate or other assets that have been foreclosed and adjusted to fair value. At the time of foreclosure, these assets are recorded at the lower of the carrying amount of the loan or fair value less costs to sell, which becomes the asset's new basis. Any write-downs are based on the asset's fair value at the date of foreclosure and are charged to the allowance for credit losses. Management periodically performs valuations to determine whether the asset's fair value has further declined. Fair value adjustments are recorded as a reduction to noninterest expense.

Note 15 – Fair Value of Financial Instruments (continued)

The fair value estimates below are subjective in nature and involve uncertainties and matters of significant judgment; therefore, they are not necessarily indicative of the amounts the Bank could realize in a current market exchange. The Bank has not included certain material items in its disclosure, such as the value of the long-term relationships with the Bank's lending and deposit clients, since this is an intangible and not a financial instrument. Additionally, the estimates do not include any tax ramifications. There may be inherent weaknesses in any calculation technique and changes in the underlying assumptions used, including discount rates and estimates of future cash flows that could materially affect the results. For all of these reasons, the aggregation of the fair value calculations presented herein do not represent, and should not be construed to represent, the underlying value of the Bank.

The estimated fair value of the Bank's financial instruments at December 31 is as follows:

	Carrying	Fair Value Measurements Using		
2017	Value	Level 1	Level 2	Level 3
Financial assets				
Cash and cash equivalents	$ 755	$ 755	$ -	$ -
Interest-bearing deposits in other financial institutions	17,606	17,606	-	-
Securities available for sale	955	-	955	-
FHLB stock	563	-	563	-
Loans, net	121,581	-	-	120,396
Accrued interest receivable	258	258	-	-
Financial liabilities				
Demand deposits	$ 90,558	$ 90,558	$ -	$ -
Time deposits	29,975	-	29,856	-
Borrowings	10,000	-	10,000	-
Accrued interest payable	24	24	-	-
2016				
Financial assets				
Cash and cash equivalents	$ 1,275	$ 1,275	$ -	$ -
Interest-bearing deposits in other financial institutions	11,371	11,371	-	-
Securities available for sale	1,039	-	1,039	-
FHLB stock	599	-	599	-
Loans, net	117,702	-	-	118,723
Accrued interest receivable	226	226	-	-
Financial liabilities				
Demand deposits	$ 80,776	$ 80,776	$ -	$ -
Time deposits	29,165	-	29,077	-
Borrowings	11,200	-	11,193	-
Accrued interest payable	20	20	-	-

Note 15 – Fair Value of Financial Instruments (continued)

The following methods and assumptions were used by the Bank in estimating the fair value of financial instruments, as disclosed in the financial statements:

Cash and cash equivalents and interest-bearing deposits in other financial institutions, accrued interest – The recorded amount is a reasonable estimate of fair value.

Securities available for sale – Fair values are based on quoted market prices, if available. If a quoted market price is not available, fair value is estimated using quoted market prices for similar securities.

Federal Home Loan Bank stock – The carrying value of Federal Home Loan Bank stock approximates fair value.

Loans – For variable-rate loans that reprice frequently and have no significant change in credit risk, fair value is based on carrying value. The fair value of fixed-rate loans is estimated using discounted cash flow analyses, using interest rates currently being offered for loans with similar terms to borrowers of similar credit quality. The fair value of impaired loans is estimated using discounted cash flow analyses or underlying collateral values, where applicable.

Deposits – The fair value of deposits with no stated maturity date is included at the amount payable on demand. The fair value of fixed-rate certificates of deposit is estimated using a discounted cash flow calculation based on interest rates currently offered on similar certificates. The carrying amount of variable-rate certificates of deposit approximates fair value at the reporting date.

Borrowings – Fixed and variable-term borrowings are valued using a discounted replacement cost of funds approach. Option structures use discounted market price less an appropriate spread to adjust for the option.

Off-balance-sheet instruments – The fair value of commitments to extend credit is estimated using fees currently charged to enter into similar agreements, taking into account the remaining terms of the agreements and the present creditworthiness of the customers. Because the majority of the Bank’s off-balance-sheet instruments consist of non-fee-producing, variable-rate commitments, the Bank has determined that they do not have a distinguishable fair value.

The Bank assumes interest rate risk (the risk that general interest rate levels will change) as a result of its normal operations. As a result, 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.

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