SANTA CRUZ
COUNTY BANK

Santa Cruz County Bank 2017 Annual Report

ABOUT SANTA CRUZ COUNTY BANK

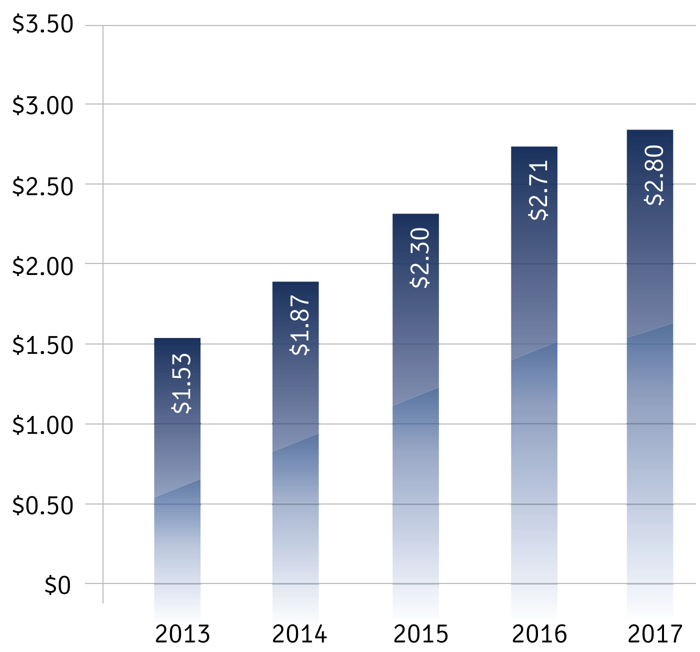
Founded by a group of local business people who share a common commitment to the Santa Cruz area, Santa Cruz County Bank opened its doors on February 3, 2004. Santa Cruz County Bank is a locally owned and operated community bank, serving the needs of the residents and businesses of Santa Cruz County. We believe strongly in the importance of local decision making and responsive customer service. We offer a complete line of depository products and lending solutions for businesses and individuals, including business term loans and lines of credit, commercial real estate financing, agricultural loans, SBA and USDA government guaranteed loans, credit cards, merchant services, mobile banking, remote deposit capture, and online services, including bill payment and cash management. Santa Cruz County Bank operates five full service banking offices located in Aptos, Capitola, Santa Cruz, Scotts Valley, and Watsonville, and two free standing ATM and Night Depositories in Santa Cruz and Aptos.

OUR MISSION

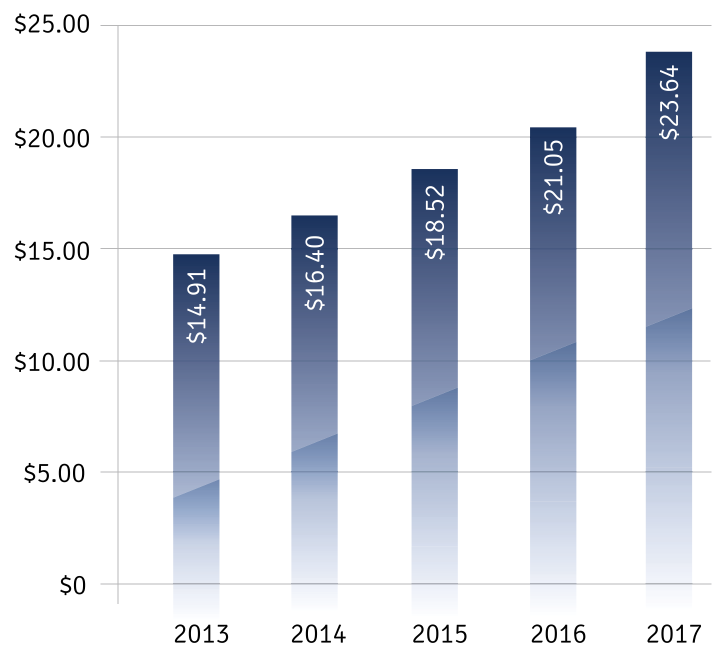
We are committed to our community by building lasting relationships and being a trusted partner that together empowers growth and economic vitality.

FIVE YEAR HISTORICAL PERFORMANCE

EARNINGS PER SHARE*



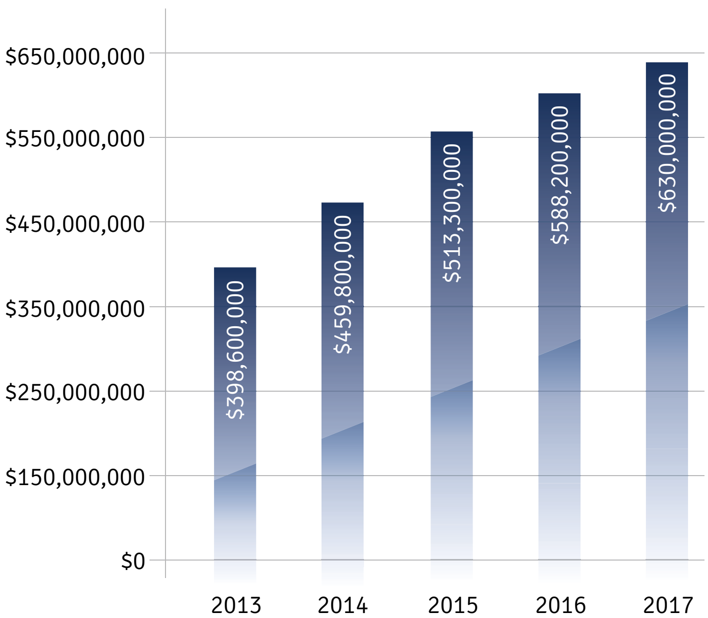
BOOK VALUE PER SHARE*



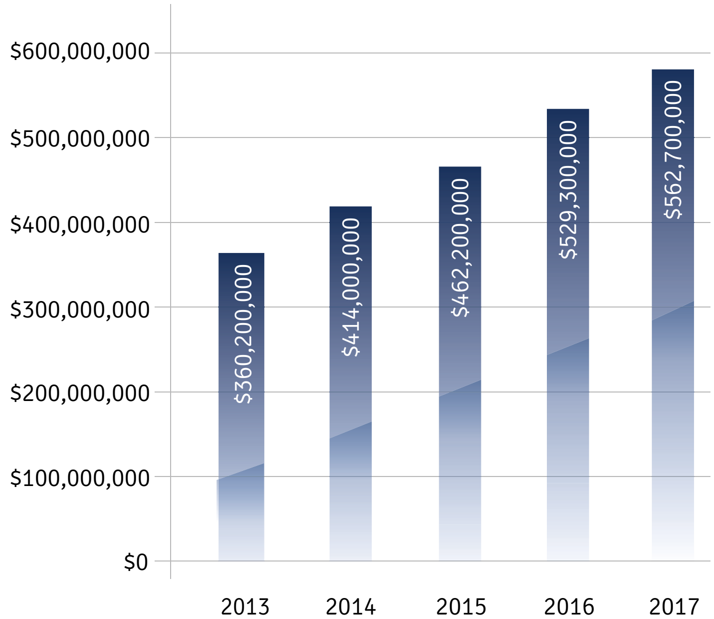
*Adjusted for 10% stock dividend paid on November 10, 2017.

FIVE YEAR HISTORICAL PERFORMANCE

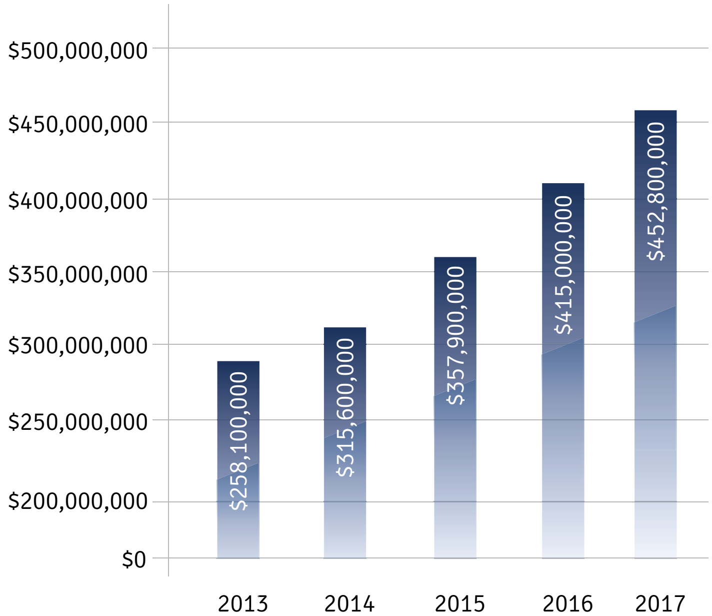
TOTAL ASSETS



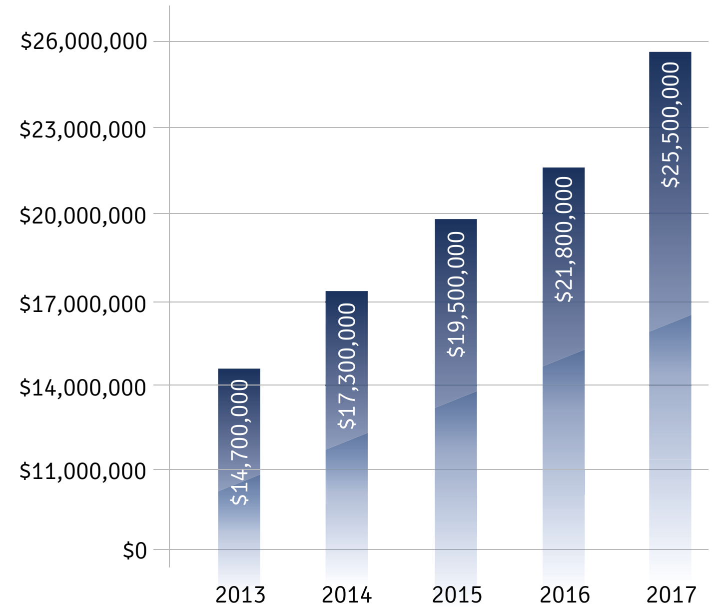
TOTAL DEPOSITS



GROSS LOANS



NET INTEREST INCOME



All numbers rounded to the nearest $100,000.

Santa Cruz County has been recognized as a "Super Premier" Performing Bank by Findley Reports for the past 8 years.

OUR CUSTOMERS SAY IT BEST

“ Banking at its best is local and personal. With Santa Cruz County Bank we have both. Our new expansion on the Santa Cruz Wharf is one example of how our growing business is fully supported because of where we choose to put our money.”

Eric & Ellen Gil, Owners of Sockshop & Shoe Company

"Tepui is proud to pioneer a new industry with the support of Santa Cruz County Bank."

-Evan Currid, Founder of Tepui Tents

SANTA CRUZ COUNTY BANK
LETTER TO SHAREHOLDERS

To Our Shareholders,

On behalf of the Board of Directors and Bank Management team we are pleased to present our Annual Report and financial statements for 2017.

2017 was an exceptional year for the Bank. We recorded record net income of $6.8 million, or $2.80 earnings per share for the year. This record was achieved even with a one-time reduction in earnings in the fourth quarter by $1.5 million due to changes in the U.S. Corporate tax rate. Total assets at year-end were $630 million, a $42 million increase, and total deposits were $563 million, a $33 million increase. The Bank's loan production in 2017 remained strong with gross loans of $453 million, a 9% net increase of $38 million, in gross loans outstanding as compared to 2016.

The Bank's solid growth in loan production was achieved while preserving exemplary credit quality within the portfolio. Maintaining outstanding asset quality is a hallmark of prudent lending practices and knowing your marketplace. On a statewide level, Santa Cruz County Bank ranked 1st in asset quality and 1st (lowest) in non-performing assets amongst 159 California banks by *Financial Management Consulting (FMC) Group* for its performance in 2017.

Santa Cruz County Bank ranks in the top tier of local, regional and statewide lender rankings for loan approvals through government guaranteed programs. The Bank is the top SBA lender in Santa Cruz County, 3rd in Silicon Valley, and ranks 37th in California out of 222 financial institutions for SBA loan production. Additionally, we are one of the top 10 USDA lenders in the State of California.

On a national level, Santa Cruz County Bank was named in *American Banker's Top Performing 200 Community Banks and Thrifts* in the United States based upon 3-year average return on equity. The Bank placed 24th out of 669 institutions in the nation. In addition, Santa Cruz County Bank ranked 3rd in overall performance among 159 California banks in 2017 by *Financial Management Consulting (FMC) Group.*

Technology has significantly changed the way the world connects, communicates, and functions. We remain committed to delivering and improving digital banking channels to provide the most advanced technology for customers to access their banking from anywhere in the world. In 2017, we launched *Mobile Payments*, whereby users have the capability to add their debit cards to mobile wallets on Smartphones and Smartwatches to make purchases. To protect our customers from the rising risk of fraud, we introduced the *CardValet App* in 2017, which allows the user to turn their card "on or off" in the event of a lost or stolen card, along with expense management card controls.

Architect's rendering of the future Santa Cruz County Bank headquarters located at 75 River Street, Santa Cruz.

Since our beginning, it has been our mission to build trust and loyalty with each customer and maintain long-term relationships. We maintain ongoing partnerships with non-profit organizations, Chambers, and locals in our community. We are pleased to report Santa Cruz County Bank continues to shine as a community leader and partner to non-profit organizations in our community. In 2017, we achieved the highest number of votes for *Best Bank* in the *Good Times Readers' Poll* for the sixth consecutive year, and the *Sentinel Readers' Choice Poll* for the fourth consecutive year. In 2017, we received the *Big Step Award* for significantly increasing in the number of meals provided to individuals in need through *Second Harvest Food Bank.*

One of the largest employers and economic drivers in our marketplace is agriculture. In early 2018, we were recognized by the *Santa Cruz County Farm Bureau* at its National Agriculture Day luncheon with the *Al Smith Friend of Agriculture Award* for our role in supporting this important business sector through lending, volunteerism and educational donations.

Looking ahead, we are excited for the opening of the Bank's new headquarters in downtown Santa Cruz in the latter part of the year. The new and highly visible headquarters is located at the gateway to downtown Santa Cruz on the corner of Water and River Streets. Here, we look forward to providing new conveniences, greater visibility, better access, ample parking, and an inviting environment. Along with these improvements, we anticipate improved efficiency from the relocation of employees in our Santa Cruz branch, combined with our Administrative offices, under one roof.

We appreciate your investment in Santa Cruz County Bank, your continued support, and your banking referrals, all of which contribute to the success of your Bank. We look forward to a productive and prosperous year ahead.

William J. Hansen
Chairman of the Board

David Heald
President
Chief Executive Officer

2017 HIGHLIGHTS

- Total assets of $630 million.
- Total deposits of $563 million.
- Pretax income exceeded $13.4 million, a record.
- The Bank paid four quarterly $0.05 cash dividends and a 10% stock dividend to shareholders.
- Santa Cruz County Bank remained as the top SBA lender in Santa Cruz County, ranked 3rd in Silicon Valley, and ranked 37th statewide for the 2017 SBA fiscal year.
- As of June 30, 2017, the Bank ranked 5th largest in overall market share with 8.69% of deposits held by FDIC insured institutions in Santa Cruz County.
- The Bank received *5-Star "Superior"* ratings by *Bauer Financial Inc.* for its quarterly financial performance in 2017.
- Santa Cruz County Bank ranked 24th in the *Top 200 Performing Community Banks and Thrifts* in the *U.S. by American Banker* based upon 3-year return on equity.
- The Bank ranked 1st in asset quality, 1st (lowest) in non-performing assets and 3rd in overall financial performance for 2017 among 159 California banks by *Financial Management Consulting Group.*
- *Independent Community Bankers of America* ranked Santa Cruz County Bank in its *Top 25 Best Performing Community Banks* with the highest return on average assets and highest return on average equity ratios.
- The Bank was designated a *"Super Premier" Performing Bank* by *Findley Reports* for its 2017 financial performance.

INDEPENDENT AUDITOR'S REPORT

The Shareholders and Board of Directors
Santa Cruz County Bank
Santa Cruz, California

Report on the Financial Statements

We have audited the accompanying financial statements of Santa Cruz County 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 audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

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

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

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Santa Cruz County 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.

Crowe Horwath LLP

Crowe Horwath LLP

Sacramento, California
March 16, 2018

SANTA CRUZ COUNTY BANK
BALANCE SHEETS
December 31, 2017 and 2016

	2017	2016
ASSETS		
Cash and due from financial institutions	$ 12,313,818	$ 9,717,305
Federal funds sold	19,380,321	1,795,154
Cash and cash equivalents	31,694,139	11,512,459
Interest-bearing deposits in other financial institutions	88,528,000	98,921,000
Securities available for sale	18,171,315	17,951,978
Securities held to maturity (fair value 2017-$29,163,177; 2016-$34,858,595)	28,657,424	34,145,987
Loans held for sale	26,006,309	31,818,964
Loans, net of allowance of $9,106,258 in 2017; $8,193,091 in 2016	420,341,851	376,975,587
Federal Home Loan Bank stock, at cost	2,116,200	1,912,100
Pacific Coast Bankers Bank stock, at cost	170,000	170,000
Loan servicing rights	697,390	822,787
Premises and equipment, net	759,498	673,575
Accrued interest receivable	2,101,656	1,771,406
Bank owned life insurance	6,083,344	5,914,070
Deferred income tax	3,719,303	4,927,328
Other assets	917,357	714,410
TOTAL ASSETS	$ 629,963,786	$ 588,231,651
LIABILITIES AND SHAREHOLDERS' EQUITY		
Deposits		
Non-interest bearing	$ 242,497,582	$ 244,897,010
Interest bearing	320,161,365	284,414,139
Total deposits	562,658,947	529,311,149
Accrued interest payable	107,521	81,808
Other liabilities	9,916,770	8,122,413
Total liabilities	572,683,238	537,515,370
Commitments and contingent liabilities (Note 16)		
Shareholders' equity		
Preferred stock, no par value; 10,000,000 shares authorized; no shares issued or outstanding	-	-
Common stock, no par value; 30,000,000 shares authorized;	24,115,128	23,938,982
Additional paid-in capital	11,635,536	1,720,210
Retained earnings	21,966,055	25,427,885
Accumulated other comprehensive loss	(436,171)	(370,796)
Total shareholders' equity	57,280,548	50,716,281
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	$ 629,963,786	$ 588,231,651
Number of common shares issued and outstanding	2,422,924	2,190,786

See accompanying notes

SANTA CRUZ COUNTY BANK
STATEMENTS OF INCOME
Years ended December 31,

	2017	2016
Interest and dividend income		
Loans, including fees	$ 23,713,428	$ 19,845,838
Interest-bearing deposits in other financial institutions	1,246,400	1,098,395
Taxable securities	765,771	809,801
Tax-exempt securities	308,296	286,355
Dividends on FHLB and PCBB stock	157,817	241,604
Federal funds sold	120,153	40,180
Total interest and dividend income	26,311,865	22,322,173
Interest expense		
Deposits	772,407	552,309
Federal Home Loan Bank advances	17,463	14,382
Federal Funds purchased	16	16
Total interest expense	789,886	566,707
Net interest income	25,521,979	21,755,466
Provision for loan losses	912,500	783,900
Net interest income after provision for loan losses	24,609,479	20,971,566
Noninterest income		
Service charges on deposits	604,111	569,983
Net gains on sales of loans	872,294	1,411,849
Loan servicing fees	644,572	613,187
Gain on call of securities held to maturity	-	50,688
Other	1,197,732	1,116,832
Total noninterest income	3,318,709	3,762,539
Noninterest expense		
Salaries and employee benefits	8,094,865	7,491,329
Occupancy	1,179,445	1,021,265
Furniture and equipment	586,450	422,806
Marketing and business development	370,541	422,814
Data and item processing	683,510	663,348
Professional services	674,395	1,087,035
Federal deposit insurance	316,236	327,209
Provision for off balance sheet commitments	15,225	22,963
Other	2,569,957	2,572,326
Total noninterest expense	14,490,624	14,031,095
Income before income taxes	13,437,564	10,703,010
Income tax expense	6,679,166	4,211,546
Net income	$ 6,758,398	$ 6,491,464
Earnings per share:		
Basic	$ 2.80	$ 2.71
Diluted	$ 2.76	$ 2.67

See accompanying notes

SANTA CRUZ COUNTY BANK
STATEMENTS OF COMPREHENSIVE INCOME
Years ended December 31,

	2017	2016
Net income	$ 6,758,398	$ 6,491,464
Other comprehensive income:		
Unrealized losses on available for sale securities:		
Unrealized holding losses arising during the period	(37,683)	(173,839)
Reclassification adjustment for losses included in net income	-	-
Tax effect	16,752	71,542
Net of tax	(20,931)	(102,297)
Unrealized frozen gains on securities transferred to held to maturity		
Amortization of unrealized frozen gain during the period	19,867	51,483
Tax effect	(7,446)	(21,187)
Net of tax	12,421	30,296
Defined benefit pension plans:		
Net (loss)/gain arising during the period	(66,725)	515
Reclassification adjustment for amortization of prior service cost and net gain/loss included in net periodic pension cost	-	4,490
Tax effect	26,689	(2,059)
Net of tax	(40,036)	2,946
Total other comprehensive loss	(48,546)	(69,055)
Comprehensive income	$ 6,709,852	$ 6,422,409

See accompanying notes

SANTA CRUZ COUNTY BANK
STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY
Years ended December 31,

	Shares	Common Stock	Additional Paid-In Capital	Retained Earnings	Accumulated Other Comprehensive Loss	Total
Balance at January 1, 2016	2,164,651	$ 23,529,241	$ 1,494,878	$ 19,372,645	$ (301,741)	$ 44,095,023
Net income				6,491,464		6,491,464
Other comprehensive loss					(69,055)	(69,055)
Exercise of stock options, including tax benefit	26,135	409,741	44,532			454,273
Restricted stock awards and related expense	-		102,295			102,295
Stock-based compensation			78,505			78,505
Cash dividends declared ($0.20 per share)				(436,225)		(436,225)
Balance at December 31, 2016	2,190,786	$ 23,938,982	$ 1,720,210	$ 25,427,885	$ (370,796)	$ 50,716,281
Net income				6,758,398		6,758,398
Other comprehensive loss					(48,546)	(48,546)
Exercise of stock options, including tax benefit	232,138	176,146	1			176,147
Restricted stock awards and related expense	-		16,629			16,629
Stock-based compensation			112,390			112,390
Stock Dividend			9,786,306	(9,786,306)		-
Reclassification due to adoption of ASU 2018-02				16,829	(16,829)	-
Cash dividends declared ($0.20 per share)				(450,751)		(450,751)
Balance at December 31, 2017	2,422,924	$ 24,115,128	$ 11,635,536	$ 21,966,055	$ (436,171)	$ 57,280,548

See accompanying notes

SANTA CRUZ COUNTY BANK
STATEMENTS OF CASH FLOWS
Years ended December 31,

	2017	2016
Cash flows from operating activities		
Net income	$ 6,758,398	$ 6,491,464
Adjustments to reconcile net income to net cash from operating activities:		
Provision for loan losses	912,500	783,900
Depreciation and amortization of premises and equipment	324,856	208,166
Net amortization of securities	658,388	748,175
Net loan amortization and accretion	(568,041)	(574,942)
Deferred income tax benefit	(225,543)	(806,663)
Revaluation of deferred income taxes	1,469,562	-
Net realized gain on sales of securities	-	-
Net realized gain on call of securities held to maturity	-	(50,688)
Net gain on sale of loans	(872,294)	(1,411,849)
Stock-based compensation expense	129,019	180,800
Earnings on bank owned life insurance	(169,274)	(177,299)
Federal Home Loan Bank stock dividends	-	-
Originations of loans held for sale	(25,934,652)	(28,582,725)
Proceeds from loans held for sale	12,096,263	21,596,608
Net loss on sale/disposal of assets	1,355	407
Provision for unfunded loan commitments	15,225	22,963
Gain on sale of OREO	58,977	-
Writedowns on OREO	-	-
Deferred benefit expense	175,627	211,240
Decrease in deferred loan fees, net of costs	(624,382)	(171,102)
Increase in accrued interest receivable	(330,250)	(158,922)
Decrease in other assets	144,858	1,186,755
Increase in accrued interest payable	25,713	11,712
Increase in other liabilities	1,536,780	956,501
Net cash from operating activities	(4,416,915)	464,501
Cash flows from investing activities		
Redemption of certificates of deposit in other financial institutions	59,892,000	45,304,000
Purchase of certificates of deposit in other financial institutions	(49,499,000)	(58,639,000)
Available-for-sale securities:		
Sales	-	-
Maturities, prepayments and calls	1,294,000	253,000
Purchases	(1,999,574)	(8,248,649)
Principal repayments on securities available for sale	298,841	423,507
Held-to-maturity securities:		
Maturities, prepayments and calls	2,400,000	1,290,100
Purchases	-	-
Principal repayments on securities held to maturity	2,640,863	3,256,206
Loan originations and payments, net	(22,826,518)	(48,548,141)
Purchases of premises and equipment	(412,249)	(347,426)
Purchase of bank owned life insurance	-	-
Purchases of Federal Home Loan Bank stock	(204,100)	(204,100)
Purchase of Pacific Coast Bankers' Bank stock	-	-
Net proceeds from sales of OREO	(58,977)	-
Proceeds from sale of assets	115	-
Net cash from investing activities	(8,474,599)	(65,460,503)
Cash flows from financing activities		
Increase in deposits	33,347,798	67,076,119
Proceeds from Federal Home Loan Bank advances and other debt	674,370,000	816,917,000
Repayments on Federal Home Loan Bank advances and other debt	(674,370,000)	(816,917,000)
Cash dividends paid	(450,751)	(436,225)
Proceeds from exercise of stock options, including tax benefit	176,147	454,273
Proceeds from issuance of common stock	-	-
Net cash from financing activities	33,073,194	67,094,167
Net change in cash and cash equivalents	20,181,680	2,098,165
Beginning cash and cash equivalents	11,512,459	9,414,294
Ending cash and cash equivalents	$ 31,694,139	$ 11,512,459
Supplemental cash flow information		
Interest paid	$ 764,173	$ 554,995
Income taxes paid	5,610,000	4,800,000
Supplemental noncash disclosures		
Transfer from loans held for sale to portfolio loans	$ 19,150,233	$ 18,801,654

See accompanying notes

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Nature of Operations: Santa Cruz County Bank, referred to as "the Bank", is a California state chartered bank which offers a full range of commercial and personal banking services to residents and businesses in Santa Cruz County, California, through its five full service offices located in Aptos, Capitola, Santa Cruz, Scotts Valley, and Watsonville. The Bank was incorporated on September 10, 2003 as Santa Cruz County Bank (In Organization) and commenced banking operations on February 3, 2004 (Inception), upon receipt of final regulatory approval. The Bank is subject to regulations and undergoes periodic examinations by the California Department of Business Oversight ("CDBO") and the Federal Deposit Insurance Corporation ("FDIC"). The Bank's deposits are insured by the FDIC up to applicable limits.

The majority of the Bank's business is conducted with customers located in Santa Cruz County and adjacent counties. Its primary deposit products are checking, savings, and term certificate accounts, and its primary lending products are commercial, multi-family, agriculture, loans supported by single-family residential real estate, municipal loans, government guaranteed loans, and installment loans. Substantially all loans are secured by specific items of collateral including business assets, consumer assets, and commercial and residential real estate. Bank products are also supported by various government guarantee programs. Commercial loans are expected to be repaid from cash flow from operations of businesses. There are no significant concentrations of loans to any one industry or customer. However, the customers' ability to repay their loans is dependent on the real estate and general economic conditions in the area.

Subsequent Events: The Bank has reviewed all events for recognition and disclosure from December 31, 2017 through March 16, 2018, which is the date the financial statements were available to be issued.

Use of Estimates: The preparation of financial statements, in conformity with U.S. generally accepted accounting principles, requires management to make estimates and assumptions based on available information that affect the reported amounts in the financial statements and the disclosures provided, and actual results could differ.

Cash Flows: For purposes of reporting cash flows, cash and cash equivalents include cash, deposits with other financial institutions with maturities fewer than 90 days, and federal funds sold. Federal funds are sold for a one day period and are highly liquid investments. Net cash flows are reported for customer loan and deposit transactions, interest-bearing deposits in other financial institutions, and federal funds purchased.

Interest-Bearing Deposits in Other Financial Institutions: Interest-bearing deposits in other financial institutions mature within three years and are carried at cost.

Investment Securities: Debt 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. Debt 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 recorded at fair value with unrealized holding gains and losses reported in other comprehensive income, net of tax. At the time of purchase, the Bank designates securities as either held to maturity or available for sale based on its investment objectives, operational needs, and intent.

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 magnitude and duration of the unrealized loss, and the financial condition and near-term prospects of the issuer. Management also assesses the intent and ability of the Bank to retain its investment in the securities for a period of time sufficient to allow for an anticipated recovery in fair value. If either of the criteria regarding intent or requirement to sell is met, the entire difference between amortized cost and fair value is recognized as impairment through earnings. For debt securities that do not meet the aforementioned criteria, the amount of impairment is split into two components as follows: 1) OTTI related to credit loss, which must be recognized in the income statement and 2) other-than-temporary impairment (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.

Loans Held for Sale: Loans originated and intended for sale in the secondary market are carried at the lower of aggregate cost or fair value. Net unrealized losses, if any, are recorded as a valuation allowance and charged to earnings.

Loans held for sale are generally sold with servicing rights retained. The carrying value of loans sold is reduced by the amount allocated to the servicing right. If the loans are sold with servicing retained, the fair value of the servicing asset or liability is recorded on the balance sheet. Gains and losses on the sold portion of the loans are recognized at the time of sale based on the difference between the sale proceeds and the carrying value of the related loans sold.

Loans Receivable: Loans that management has the intent and ability to hold for the foreseeable future or until maturity or payoff are reported at the amount of unpaid principal balances outstanding, net of deferred loan fees and costs, and an allowance for loan losses. Interest income is accrued on the unpaid principal balance daily and credited to income as it is earned. When a loan pays off or is sold, any unamortized balance of any related premiums, discounts, loan origination fees, and direct loan origination costs is recognized in income. Loan origination fees, net of certain direct origination costs, are deferred and recognized in interest income over the expected life of the loan using a method that approximates the level yield method without anticipating prepayments.

Interest income on loans is generally discontinued and placed on non-accrual status at the time the loan is 90 days delinquent or when management believes, after considering economic and business conditions and collection efforts, that the borrower's financial condition is such that collection of interest is doubtful unless the loan is well-secured and in the process of collection. Past-due status is based on the contractual terms of the loan. A loan is moved to non-accrual status in accordance with the Bank's policy, typically after 90 days of non-payment. In all cases, loans are placed on non-accrual or charged-off at an earlier date if collection of principal or interest is considered doubtful. Non-accrual loans and loans past due 90 days still on accrual include both smaller balance homogeneous loans that are collectively evaluated for impairment and individually classified impaired loans.

When a loan is placed on non-accrual status, all interest previously accrued but not collected is reversed against current period interest income. Interest received on such loans is accounted for on the cash-basis method and recognized only to the extent that cash is received and where the future collection of principal is probable, until qualifying for return to accrual. Generally, loans will be restored to an accrual status when all the principal and interest amounts contractually due are brought current and future payments are reasonably assured.

Concentration of Credit Risk: Most of the Bank’s business activity is with customers located within Santa Cruz County. Therefore, the Bank’s exposure to credit risk is significantly affected by changes in the economy in the Santa Cruz County area.

Allowance for Loan Losses: The allowance for loan losses is a valuation allowance for probable credit losses in the Bank's loan portfolio that have been incurred as of the balance sheet date. The allowance is established through a provision for loan losses which is charged to expense. Additions to the allowance are expected to maintain the adequacy of the total allowance after credit losses and loan growth. Loan losses are charged against the allowance when management believes the uncollectibility of a loan balance is confirmed. Cash received on previously charged-off amounts is recorded as a recovery to the allowance. Management estimates the allowance balance required using past loan loss experience, the nature and volume of the portfolio, information about specific borrower situations and estimated collateral values, economic conditions, and other factors. Allocations of the allowance may be made for specific loans, but the entire allowance is available for any loan that, in management’s judgment, should be charged-off.

The allowance consists of specific and general components. The specific component relates to loans that are individually classified as impaired when, based on current information and events, it is probable that the Bank will be unable to collect all amounts due according to the contractual terms of the loan agreement. Generally, the Bank identifies loans to be reported as impaired when such loans are in non-accrual status or classified in part or in whole as either doubtful or loss. Loans for which the terms have been modified resulting in a concession, and for which the borrower is experiencing financial difficulties, are considered troubled debt restructurings (TDRs) and classified as impaired.

Factors considered by management in determining impairment include payment status, collateral value, and the probability of collecting scheduled principal and interest payments when due. Loans that experience insignificant payment delays and payment shortfalls generally are not classified as impaired. Management determines the significance of payment delays and payment shortfalls on a case-by-case basis, taking into consideration all of the circumstances surrounding the loan and the borrower, including the length of the delay, the reasons for the delay, the borrower’s prior payment record, and the amount of the shortfall in relation to the principal and interest owed.

Commercial and commercial real estate loans over $100,000 are individually evaluated for impairment. Typically, loans below $100,000 from all class types are excluded from individual impairment analysis. When a loan is impaired, a portion of the allowance is allocated so that the loan is reported, net, at the present value of expected future cash flows discounted at the loan's effective interest rate, except that as a practical expedient, it may measure impairment based on a loan's observable market price, or the fair value of the collateral if the loan is collateral dependent. A loan is collateral dependent if the repayment of the loan is expected to be provided solely by the underlying collateral. Large groups of smaller balance homogeneous loans, such as consumer and residential real estate loans are collectively evaluated for impairment, and accordingly, they are not separately identified for impairment disclosures.

A restructuring of a debt constitutes a troubled debt restructuring (TDR) if the Bank, for economic or legal reasons related to the debtor's financial difficulties, grants a concession to the debtor that it would not otherwise consider. Restructured workout loans typically present an elevated level of credit risk as the borrowers are not able to perform according to the original contractual terms. Troubled debt restructurings 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 less estimated costs to sell. For TDRs that subsequently default, the Bank determines the amount of the 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 determination of the general reserve for loans that are not impaired is collectively evaluated and based on estimates made by management, to include, but not limited to, consideration of historical losses by portfolio segment, internal asset classifications, and qualitative factors to include economic trends in the Bank's service areas, industry experience and trends, geographic concentrations, estimated collateral values, the Bank's underwriting policies, the character of the loan portfolio, and probable losses inherent in the portfolio taken as a whole. The historical loss experience is determined by portfolio segment and is based on considerations of both the Bank’s actual historical loss history and losses of the peer group in which the Bank operates over the most recent 8 years.

The Bank maintains a separate allowance for each portfolio segment (loan type). These portfolio segments include commercial real estate, land and construction, commercial and industrial, agricultural land, real estate and production, and consumer loans (principally home equity loans). Portfolio classes are not distinguished from segments for reporting purposes. The allowance for loan losses attributable to each portfolio segment, which includes both impaired loans and loans that are not impaired, is combined to determine the Bank's overall allowance, hence, is included on the balance sheet.

The general reserve component of the allowance for loan losses also consists of reserve factors that are based on management's assessment of the following for each portfolio segment: (1) inherent credit risk, (2) historical losses, and (3) other qualitative factors. These reserve factors are inherently subjective and are driven by the repayment risk associated with each portfolio segment described below.

Commercial real estate – Commercial real estate mortgage loans generally possess a higher inherent risk of loss than other real estate portfolio segments, except land and construction loans. Adverse economic developments or an overbuilt market impact commercial real estate projects and may result in troubled loans. Trends in vacancy rates of commercial properties impact the credit quality of these loans. High vacancy rates reduce operating revenues and the ability for properties to produce sufficient cash flow to service debt obligations.

Land and construction – Land and construction loans generally possess a higher inherent risk of loss than other real estate portfolio segments. A major risk arises from the necessity to complete projects within specified cost and timelines. Trends in the construction industry significantly impact the credit quality of these loans, as demand drives construction activity. In addition, trends in real estate values significantly impact the credit quality of these loans, as property values determine the economic viability of construction projects.

Commercial and industrial – Commercial and industrial loans generally possess a lower inherent risk of loss than real estate portfolio segments because these loans are generally underwritten to existing cash flows of operating businesses. Debt coverage is provided by business cash flows and economic trends influenced by unemployment rates and other key economic indicators are closely correlated to the credit quality of these loans.

Agricultural land, real estate and production – Agricultural real estate mortgage loans generally possess a lower inherent risk of loss than other real estate portfolio segments, including land and construction loans. Adverse economic developments may result in troubled loans. Loans secured by crop production and livestock are especially vulnerable to two risk factors that are largely outside the control of Bank and borrowers: commodity prices and weather conditions.

Consumer – Comprised of single family residential real estate, home equity lines of credit, personal lines and installment loans. The degree of risk in residential real estate lending depends primarily on the loan amount in relation to collateral value, the interest rate and the borrower's ability to repay in an orderly fashion. These loans generally possess a lower inherent risk of loss than other real estate portfolio segments. An installment loan portfolio is usually comprised of a large number of small loans scheduled to be amortized over a specific period. Most installment loans are made directly for consumer purchases, but business loans granted for the purchase of heavy equipment or industrial vehicles may also be included. Economic trends determined by unemployment rates and other key economic indicators are closely correlated to the credit quality of these loans. Weak economic trends indicate that the borrowers' capacity to repay their obligations may be deteriorating.

Although management believes the allowance to be adequate, ultimate losses may vary from its estimates. At least quarterly, the Board of Directors reviews the adequacy of the allowance, including consideration of the relative risks in the portfolio, current economic conditions and other factors. If the Board of Directors and management determine that changes are warranted based on those reviews, the allowance is adjusted. In addition, the Bank's primary regulators, FDIC and CDBO, as an integral part of their examination process, review the adequacy of the allowance. These regulatory agencies may require additions to the allowance based on their judgment about information available at the time of their examinations.

Loan Servicing Rights: When loans are sold with servicing retained, servicing rights are initially recorded at fair value with the income statement effect recorded in gains on sales of loans. Fair value is based on market prices for comparable loan servicing contracts, when available or alternatively, is based on a valuation model that calculates the present value of estimated future net servicing income. All classes of servicing assets are subsequently measured using the amortization method which requires servicing rights to be amortized into noninterest income in proportion to, and over the period of, the estimated future net servicing income of the underlying loans.

Servicing rights are evaluated for impairment based upon the fair value of the rights as compared to carrying amount. Impairment is determined by stratifying rights into groupings based on predominant risk characteristics, such as interest rate, loan type and investor type. Impairment is recognized through a valuation allowance for an individual grouping, to the extent that fair value is less than the carrying amount. If the Bank later determines that all or a portion of the impairment no longer exists for a particular grouping, a reduction of the allowance may be recorded as an increase to income. Changes in valuation allowances are reported with loan servicing fees income on the income statement. The fair values of servicing rights are subject to significant fluctuations as a result of changes in estimated and actual prepayment speeds and default rates and losses.

Servicing fee income, which is reported on the income statement as loan servicing fees, is recorded for fees earned on servicing loans. The fees are based on a fixed amount per loan and recorded as income when earned. The amortization of servicing rights is netted against loan servicing fee income. Servicing fees totaled $644,572 and $613,187 for the years ended December 31, 2017 and 2016, respectively. Late fees and ancillary fees related to loan servicing are not material.

Real Estate Owned: Assets acquired through or instead of foreclosure are initially recorded at fair value of the property, less estimated selling expenses, establishing a new cost basis. Any write-down to fair value at the time of transfer to foreclosed real estate is charged to the allowance for loan losses. These assets are subsequently accounted for at lower of cost or fair value less estimated costs to sell. If fair value declines subsequent to foreclosure, a valuation allowance is recorded through expense. Operating costs incurred after acquisition and in conjunction with the maintenance of real estate acquired through foreclosure are charged to expense as incurred.

Premises and Equipment: Premises and equipment are stated at cost less accumulated depreciation and amortization. Leasehold improvements are amortized over the shorter of the estimated useful life or the initial term of the respective leases. Certain operating leases contain incentives in the form of tenant improvement allowances or credits. Lease incentives are capitalized at the inception of the lease and amortized on a straight-line basis over the original lease term with useful lives ranging from 3 to 10 years. Furniture, fixtures and equipment are depreciated using the straight-line method with useful lives ranging from 5 to 7 years. All other maintenance and repair expenditures are expensed as incurred.

Federal Home Loan Bank Stock: The Bank, as a member of the Federal Home Loan Bank ("FHLB") system, is required to maintain an investment in the capital stock of the FHLB of San Francisco based on the level of borrowings and other factors, and may invest in additional amounts. FHLB stock is carried at cost, classified as restricted security, and periodically evaluated for impairment based on ultimate recovery of par value. The FHLB stock is redeemable at its par value of $100 per share at the discretion of the FHLB of San Francisco. The FHLB can suspend dividends and redemptions upon notification to its members. Both cash and stock dividends, if any, are reported as income.

Pacific Coast Bankers Bank Stock: Pacific Coast Bankers Bank ("PCBB") stock is carried at cost, classified as restricted security, and periodically evaluated for impairment based on ultimate recovery of par value. Both cash and stock dividends, if any, are reported as income.

Bank Owned Life Insurance: The Bank has purchased life insurance policies on certain key executives. Bank owned life insurance is recorded at the amount that can be realized under the insurance contract at the balance sheet date, which is the cash surrender value adjusted for other charges or other amounts due that are probable at settlement.

Loan Commitments and Related Financial Instruments: Financial instruments include off-balance sheet credit instruments, such as commitments to make loans and commercial letters of credit, issued to meet customer financing needs. The face amount for these items represents the exposure to loss, before considering customer collateral or ability to repay. Such financial instruments are recorded when they are funded.

Stock-Based Compensation: Compensation cost is recognized for stock options and restricted stock awards issued to employees and directors, based on the fair value of these awards at the date of grant. The Bank estimates the fair value of each stock option award as of the date of grant using a Black-Scholes-Merton model, while the market price of the Bank's common stock at the date of grant is used for restricted stock awards. Compensation cost is recognized over the required service period, generally defined as the vesting period. For awards with graded vesting, compensation cost is recognized on a straight-line basis over the requisite service period for the entire award.

Income Taxes: Income tax expense is the total of the current year income tax due or refundable and the change in deferred tax assets and liabilities. Deferred income taxes are computed using the asset and liability method, which represents the tax effects for the temporary differences between carrying amounts and tax bases of assets and liabilities, based on current tax law, of future deductible or taxable amounts attributable to events that have been recognized in the financial statements. A valuation allowance is established to reduce the deferred tax asset to the level at which it is "more likely than not" that the tax asset or benefits will be realized. Deferred tax assets and liabilities are calculated by applying current enacted tax rates against future deductible or taxable amounts. Realization of tax benefits of deductible temporary differences and operating loss carry forwards depends on having sufficient taxable income of an appropriate character within the carry forward periods.

The Bank uses a comprehensive model for recognizing, measuring, presenting and disclosing in the financial statements tax positions taken or expected to be taken on a tax return. A tax position is recognized as a benefit only if it is "more likely than not" that the tax position would be sustained in a tax examination, with a tax examination being presumed to occur. The amount recognized is the largest amount of tax benefit that is greater than 50% likely of being realized on examination. For tax positions not meeting the "more likely than not" test, no tax benefit is recorded.

The Bank recognizes interest and/or penalties related to income tax matters in income tax expense.

Retirement Plans: Pension expense is the net of service and interest cost, return on plan assets and amortization of gains and losses not immediately recognized. Employee 401(k) plan expense is the amount of matching contributions. Deferred compensation and supplemental retirement plan expense allocates the benefits over years of service.

Earnings Per Common Share: Basic earnings per common share are calculated by dividing net income by the weighted-average number of common shares outstanding during the period. Diluted earnings per common share includes the dilutive effect of additional potential common shares issuable under stock options. There is no adjustment to the number of outstanding shares for potential dilutive instruments, such as stock options, when a loss occurs because the conversion of potential common stock is anti-dilutive or when stock options are not in-the-money. Earnings per share are restated for all stock splits and stock dividends through the date of issuance of the financial statements.

Comprehensive Income: Comprehensive income consists of net income and other comprehensive (loss) income. Other comprehensive income includes the adjustment to fully recognize the liability associated with the supplemental executive retirement plan and unrealized gains and losses on securities available for sale, which are also recognized as separate components of equity.

Loss Contingencies: Loss contingencies, including claims and legal actions arising in the ordinary course of business, are recorded as liabilities when the likelihood of loss is probable and an amount or range of loss can be reasonably estimated.

Dividend Restriction: Banking regulations require maintaining certain capital levels and may limit the dividends paid by the Bank to shareholders.

Fair Value of Financial Instruments: The Bank’s estimated fair value amounts have been determined by the Bank using relevant market information and other assumptions, as more fully disclosed in a separate note. Fair value estimates involve uncertainties and matters of significant judgment regarding interest rates, credit risk, prepayments, and other factors, especially in the absence of broad markets for particular items. Changes in assumptions or in market conditions could significantly affect these estimates.

Reclassifications: Certain reclassifications have been made to prior period financial statements to conform to the current year presentation. These reclassifications had no impact on the Bank’s previously reported financial statements.

ADOPTION OF NEW ACCOUNTING STANDARDS

The following are descriptions of recently adopted accounting standards:

ASU 2016-09, Improvements to Employee Share-Based Payment Accounting:

In March 2016, the FASB amended existing guidance to simplify the accounting for share-based payment award transactions, including a) income tax consequences; b) classification of awards as either equity or liability; c) classification on the statement of cash flows; and d) policy election to estimate number of awards that are expected to vest (current GAAP) or account for forfeitures when they occur. The amendments are effective for public business entities for annual periods beginning after December 15, 2016, and interim periods within those annual periods. Early adoption is permitted for any interim or annual period. An entity that elects early adoption must adopt all the amendments in the same period. Amendments related to the timing of when excess tax benefits are recognized, minimum statutory withholding requirements, forfeitures, and intrinsic value should be applied using a modified retrospective transition method by means of cumulative-effect adjustment to equity as of the beginning of the period in which the guidance is adopted. Amendments related to the presentation of employee taxes paid on the statement of cash flows when an employer withholds shares to meet the minimum statutory withholding requirement should be applied retrospectively. Amendments requiring recognition of excess tax benefits and tax deficiencies in the income statement and the practical expedient for estimating expected term should be applied prospectively. An entity may elect to apply the amendments related to the presentation of excess tax benefits on the statement of the cash flow using either a prospective transition method or a retrospective transition method. The Bank adopted this standard on January 1, 2017 and it did not have a material effect on the Bank’s operating results or financial condition.

ASU 2018-02, Reporting Comprehensive Income (Topic 220): Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income:
In February 2018, FASB amended ASC Topic 220 to allow a reclassification from accumulated other comprehensive income (“AOCI”) to retained earnings for stranded tax effects resulting from the newly enacted Tax Cuts and Jobs Act (“Tax Act”). The amount of the reclassification consists of the difference between the historical corporate income tax rates and the newly enacted 21% corporate income tax rate. The amendments are effective for all entities for the interim and annual reporting periods beginning after December 15, 2018 and early adoption is permitted, including interim periods in those years. The Bank adopted the amendments as of December 31, 2017, which resulted in a net reclassification of $16,829 between AOCI and retained earnings.

NOTE 2. INVESTMENT SECURITIES

The following tables summarize the amortized cost and fair value of securities available for sale and held to maturity at December 31, 2017 and 2016 and the corresponding amounts of gross unrealized gains and losses recognized in accumulated other comprehensive income (loss) and gross unrecognized gains and losses:

December 31, 2017	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Available for sale:				
U.S. government sponsored agencies	$ 8,033,419	$ -	$ (92,219)	$ 7,941,200
Collateralized mortgage obligations	9,464,806	14,561	(66,387)	9,412,980
State and political subdivision	711,130	5,671	(1,102)	715,699
Corporate	101,575	-	(139)	101,436
Total available for sale	$ 18,310,930	$ 20,232	$ (159,847)	$ 18,171,315

	Amortized Cost	Gross Unrecognized Gains	Gross Unrecognized Losses	Estimated Fair Value
Held to maturity:				
U.S. government sponsored agencies	$ 6,000,584	$ 26,966	$ -	$ 6,027,550
Mortgage backed securities: residential	3,176,977	38,692	(7,985)	3,207,684
Collateralized mortgage obligations	9,748,494	113,964	(6,855)	9,855,603
State and political subdivision	9,731,369	340,971	-	10,072,340
Total held to maturity	$ 28,657,424	$ 520,593	$ (14,840)	$ 29,163,177

December 31, 2016	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Available for sale:				
U.S. government sponsored agencies	$ 6,048,850	$ 12,631	$ (67,952)	$ 5,993,529
Collateralized mortgage obligations	9,876,701	41,395	(71,952)	9,846,144
State and political subdivision	1,735,995	209	(16,898)	1,719,306
Corporate	392,364	694	(59)	392,999
Total available for sale	$ 18,053,910	$ 54,929	$ (156,861)	$ 17,951,978

	Amortized Cost	Gross Unrecognized Gains	Gross Unrecognized Losses	Estimated Fair Value
Held to maturity:				
U.S. government sponsored agencies	$ 8,508,166	$ 76,710	$ -	$ 8,584,876
Mortgage backed securities: residential	4,469,737	77,203	(499)	4,546,441
Collateralized mortgage obligations	11,361,691	209,547	(2,913)	11,568,325
State and political subdivision	9,806,393	352,696	(136)	10,158,953
Total held to maturity	$ 34,145,987	$ 716,156	$ (3,548)	$ 34,858,595

There were no transfers between available for sale and held to maturity during 2017 or 2016.

The proceeds from sales and calls of investment securities and the associated gains and losses during 2017 and 2016 are listed below:

	2017	2016
Proceeds	$ 3,694,000	$ 1,543,100
Gains	-	$ 50,688
Losses	-	-

The tax provision related to the net realized gain was $20,861 for year-end 2016.

The amortized cost and estimated fair value of debt securities are shown by contractual maturity. Expected maturities may differ from contractual maturities if borrowers have the right to call or prepay obligations with or without call or prepayment penalties. Securities not due at a single maturity date are shown separately.

	December 31, 2017		**December 31, 2016**	
	Amortized Cost	Estimated Fair Value	Amortized Cost	Estimated Fair Value
Available for sale:				
Within one year	$ 3,005,336	$ 2,997,790	$ 1,302,520	$ 1,302,436
One to five years	5,728,937	5,646,253	6,526,647	6,459,509
Five to ten years	111,851	114,292	348,042	343,890
Mortgage-backed securities	9,464,806	9,412,980	9,876,701	9,846,143
Total	$ 18,310,930	$ 18,171,315	$ 18,053,910	$ 17,951,978
Held to maturity:				
Within one year	$ 5,045,156	$ 5,053,399	$ 2,437,891	$ 2,447,306
One to five years	6,842,171	6,976,205	10,624,724	10,829,224
Five to ten years	2,782,621	2,911,289	3,239,534	3,324,074
Beyond ten years	1,062,005	1,158,997	2,012,410	2,143,225
Mortgage-backed securities	12,925,471	13,063,287	15,831,428	16,114,766
Total	$ 28,657,424	$ 29,163,177	$ 34,145,987	$ 34,858,595

Investment securities pledged at year-end 2017 and 2016 had a carrying amount of $24,606,000 and $18,107,000, respectively, and were pledged to secure public deposits.

At year-end 2017 and 2016, there were no holdings of securities of any one issuer, other than the U.S. Government and its agencies, in an amount greater than 10% of shareholders' equity.

The following table summarizes investment securities with unrealized and unrecognized losses at December 31, 2017 and December 31, 2016, aggregated by major security type and length of time in a continuous unrealized or unrecognized loss position:

December 31, 2017	Less than 12 months		12 months or more		Total	
Available for sale:	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
U.S. government sponsored agencies	$ 5,973,200	$ (38,742)	$ 1,968,000	$ (53,477)	$ 7,941,200	$ (92,219)
Collateralized mortgage obligations	4,923,306	(11,323)	3,108,521	(55,064)	8,031,827	(66,387)
State and political subdivision	363,495	(1,102)	-	-	363,495	(1,102)
Corporate	101,436	(139)	-	-	101,436	(139)
Total available for sale	$ 11,361,437	$ (51,306)	$ 5,076,521	$ (108,541)	$ 16,437,958	$ (159,847)

	Less than 12 months		12 months or more		Total	
Held to maturity:	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Mortgage backed securities: residential	$ 1,396,113	$ (7,440)	$ 43,143	$ (545)	$ 1,439,256	$ (7,985)
Collateralized mortgage obligations	1,226,954	(6,855)	-	-	1,226,954	(6,855)
Total held to maturity	$ 2,623,067	$ (14,295)	$ 43,143	$ (545)	$ 2,666,210	$ (14,840)

December 31, 2016	Less than 12 months		12 months or more		Total	
Available for sale:	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
U.S. government sponsored agencies	$ 2,969,960	$ (67,952)	$ -	$ -	$ 2,969,960	$ (67,952)
Collateralized mortgage obligations	4,232,363	(71,952)	-	-	4,232,363	(71,952)
State and political subdivision	1,098,881	(16,898)	-	-	1,098,881	(16,898)
Corporate	116,059	(59)	-	-	116,059	(59)
Total available for sale	$ 8,417,263	$ (156,861)	$ -	$ -	$ 8,417,263	$ (156,861)

	Less than 12 months		12 months or more		Total	
Held to maturity:	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Mortgage backed securities: residential	$ 54,765	$ (499)	$ -	$ -	$ 54,765	$ (499)
Collateralized mortgage obligations	1,319,525	(2,913)	-	-	1,319,525	(2,913)
State and political subdivision	105,264	(136)	-	-	105,264	(136)
Total held to maturity	$ 1,479,554	$ (3,548)	$ -	$ -	$ 1,479,554	$ (3,548)

Unrealized losses on corporate bonds have not been recognized into income because the issuers bonds are of high credit quality (rated AA or higher), management does not intend to sell and it is likely that management will not be required to sell the securities prior to their anticipated recovery, and the decline in fair value is largely due to changes in interest rates and other market conditions. The issuers continue to make timely principal and interest payments on the bonds. The fair value is expected to recover as the bonds approach maturity.

As of December 31, 2017, the Bank's security portfolio consisted of 86 investment securities, 27 of which were in an unrealized loss position. The majority of unrealized losses are related to the Bank's collateralized mortgage obligations and U.S. government sponsored agencies as discussed below.

Collateralized Mortgage Obligations:

At December 31, 2017, 100% of the collateralized mortgage obligations held by the Bank were issued by U.S. Government or government-sponsored entities and agencies, primarily Fannie Mae and Freddie Mac, institutions which the government has affirmed its commitment to support. Because the decline in fair value is attributable to changes in interest rates and illiquidity, and not credit quality, and because the Bank does not have the intent to sell these mortgage backed securities and it is likely that it will not be required to sell the securities before their anticipated recovery, the Bank does not consider these securities to be other-than-temporarily impaired at December 31, 2017. The Bank's mortgage backed securities portfolio does not include non-agency collateralized mortgage obligations.

NOTE 3. LOANS RECEIVABLE

The outstanding loan portfolio balances at December 31, 2017 and 2016 are as follows:

	December 31, 2017	December 31, 2016
Commercial and industrial	$ 101,566,417	$ 92,668,532
Commercial real estate	223,062,594	201,250,906
Land and construction	51,059,381	43,813,207
Agricultural land, real estate and production	19,165,688	18,535,459
Consumer	31,966,848	26,897,775
Gross loans receivable	426,820,928	383,165,879
Net deferred loan fees	2,627,181	2,002,799
Allowance for loan losses	(9,106,258)	(8,193,091)
Loans receivable, net	$ 420,341,851	$ 376,975,587

The following table presents the activity in the allowance for loan losses by portfolio segment for each of the years ending December 31, 2017 and December 31, 2016:

December 31, 2017:	Commercial and Industrial	Commercial Real Estate	Land and Construction	Agricultural Land, Real Estate and Production	Consumer	Unallocated	Total
Allowance for loan losses:							
Beginning balance	$ 2,046,052	$ 2,998,443	$ 2,855,463	$ 102,437	$ 205,623	$ (14,927)	$ 8,193,091
Provision for loan losses	158,481	289,869	405,246	88,007	15,264	(44,367)	912,500
Loans charged-off	-	-	-	(19,590)	-	-	(19,590)
Recoveries	13,694	-	-	-	6,563	-	20,257
Total ending allowance balance	$ 2,218,227	$ 3,288,312	$ 3,260,709	$ 170,854	$ 227,450	$ (59,294)	$ 9,106,258

December 31, 2016:	Commercial and Industrial	Commercial Real Estate	Land and Construction	Agricultural Land, Real Estate and Production	Consumer	Unallocated	Total
Allowance for loan losses:							
Beginning balance	$ 2,196,707	$ 2,404,630	$ 2,149,439	$ 46,789	$ 232,084	$ 332,561	$ 7,362,210
Provision for loan losses	(138,616)	540,240	706,024	55,648	(31,908)	(347,488)	783,900
Loans charged-off	(18,217)	(7,133)	-	-	(53)	-	(25,403)
Recoveries	6,178	60,706	-	-	5,500	-	72,384
Total ending allowance balance	$ 2,046,052	$ 2,998,443	$ 2,855,463	$ 102,437	$ 205,623	$ (14,927)	$ 8,193,091

The following table presents the balance in the allowance for loan losses and the recorded investment in loans by portfolio segment and based on impairment method as of December 31, 2017 and 2016:

December 31, 2017:	Commercial and Industrial	Commercial Real Estate	Land and Construction	Agricultural Land, Real Estate and Production	Consumer	Unallocated	Total
Allowance for loan losses							
Ending allowance balance attributable to loans:							
Individually evaluated for impairment	$ -	$ -	$ -	$ -	$ -	$ -	$ -
Collectively evaluated for impairment	2,218,227	3,288,312	3,260,709	170,854	227,450	(59,294)	9,106,258
Total ending allowance balance	$ 2,218,227	$ 3,288,312	$ 3,260,709	$ 170,854	$ 227,450	$ (59,294)	$ 9,106,258
Loans							
Loans individually evaluated for impairment	$ -	$ -	$ -	$ -	$ -	$ -	$ -
Loans collectively evaluated for impairment	101,566,417	223,062,594	51,059,381	19,165,688	31,966,848	-	426,820,928
Total ending loans balance	$ 101,566,417	$ 223,062,594	$ 51,059,381	$ 19,165,688	$ 31,966,848	$ -	$ 426,820,928

December 31, 2016:	Commercial and Industrial	Commercial Real Estate	Land and Construction	Agricultural Land, Real Estate and Production	Consumer	Unallocated	Total
Allowance for loan losses							
Ending allowance balance attributable to loans:							
Individually evaluated for impairment	$ -	$ 21,702	$ -	$ -	$ -	$ -	$ 21,702
Collectively evaluated for impairment	2,046,052	2,976,741	2,855,463	102,437	205,623	(14,927)	8,171,389
Total ending allowance balance	$ 2,046,052	$ 2,998,443	$ 2,855,463	$ 102,437	$ 205,623	$ (14,927)	$ 8,193,091
Loans							
Loans individually evaluated for impairment	$ -	$ 149,939	$ -	$ -	$ -	$ -	$ 149,939
Loans collectively evaluated for impairment	92,668,532	201,100,967	43,813,207	18,535,459	26,897,775	-	383,015,940
Total ending loans balance	$ 92,668,532	$ 201,250,906	$ 43,813,207	$ 18,535,459	$ 26,897,775	$ -	$ 383,165,879

The bank did not have any impaired loans at the end of 2017. The following table presents information related to impaired loans, by class of loans as of and for the year ended December 31, 2016:

	Unpaid Principal Balance	Recorded Investment	Allowance for loan losses allocated	Average Recorded Investment	Interest Income Recognized	Cash Basis Interest Recognized
With an allowance recorded:						
Commercial real estate	$ 149,939	$ 149,939	$ 21,702	$ 151,701	$ 10,268	$ -
Total	149,939	149,939	21,702	151,701	10,268	-
Total:						
Commercial real estate	149,939	149,939	21,702	151,701	10,268	-
Total	$ 149,939	$ 149,939	$ 21,702	$ 151,701	$ 10,268	$ -

The recorded investment in loans excludes accrued interest receivable and loan origination fees, net due to immateriality. For purposes of this disclosure, the unpaid principal balance is not reduced for partial charge-offs.

Non-accrual loans and loans past due 90 days still on accrual include both smaller balance homogeneous loans that are collectively evaluated for impairment and individually classified impaired loans. The Bank had no loans in non-accrual or past due over 90 days still on accrual as of December 31, 2017 and December 31, 2016.

The Bank had no past-due loans 30 days or more at year-end 2017 and year-end 2016.

Troubled Debt Restructurings:
As of December 31, 2017 and 2016, the Bank had no troubled debt restructurings.

Credit Quality Indicators:
The Bank assigns a risk rating category to all loans based on relevant information about the ability of borrowers to service their debt such as: current financial condition of borrowers and guarantors, historical payment experience, credit documentation, public information, and current economic trends. The Bank performs detailed reviews for sample loans over $300,000 along with a smaller sample of loans under $300,000 as well as all loans with an outstanding balance greater than $1,500,000 to identify credit risks and to assess the overall collectability of the portfolio. The analysis is performed on a semi-annual basis. These risk ratings are also subject to examination by independent specialists engaged by the Bank and the Bank's regulators. The risk ratings can be grouped into four major categories, defined as follows:

> ***Pass*** – A pass loan is a credit with no existing or known potential weaknesses deserving of management's close attention.

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

Substandard – A substandard loan is not adequately protected by the current sound worth and paying capacity of the borrower or the value of the collateral pledged, if any. Loans classified as substandard have a well-defined weakness or weaknesses that jeopardize the liquidation of the debt. Well defined weaknesses include a project's lack of marketability, inadequate cash flow or collateral support, failure to complete construction on time or the project's failure to fulfill economic expectations. They are characterized by the distinct possibility that the Bank will sustain some loss if the deficiencies are not corrected.

Doubtful –Loans classified doubtful have all the weaknesses inherent in those classified as substandard with the added characteristic that the weaknesses make collection or liquidation in full, on the basis of currently known facts, conditions and values, highly questionable, and improbable.

The following table shows the loan portfolio by class allocated by management's internal risk ratings at December 31, 2017 and 2016:

December 31, 2017	Commercial and Industrial	Commercial Real Estate	Land and Construction	Agricultural Land, Real Estate and Production	Consumer	Total
Pass	$ 97,119,624	$ 208,817,891	$ 51,059,381	$ 19,165,688	$ 31,966,848	$ 408,129,432
Special Mention	1,877,425	11,414,087	-	-	-	13,291,512
Substandard	2,569,368	2,830,616	-	-	-	5,399,984
Doubtful	-	-	-	-	-	-
Total	$ 101,566,417	$ 223,062,594	$ 51,059,381	$ 19,165,688	$ 31,966,848	$ 426,820,928

December 31, 2016	Commercial and Industrial	Commercial Real Estate	Land and Construction	Agricultural Land, Real Estate and Production	Consumer	Total
Pass	$ 89,315,917	$ 193,314,605	$ 43,813,207	$ 18,535,459	$ 26,897,775	$ 371,876,963
Special Mention	3,302,079	7,022,019	-	-	-	10,324,098
Substandard	50,536	914,282	-	-	-	964,818
Doubtful	-	-	-	-	-	-
Total	$ 92,668,532	$ 201,250,906	$ 43,813,207	$ 18,535,459	$ 26,897,775	$ 383,165,879

NOTE 4. FAIR VALUE

Fair Value Hierarchy:
Fair Value is the exchange price that would be received for an asset or paid to transfer a liability (exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. The Bank groups its assets and liabilities measured at fair value in three levels. Valuations within these levels are based upon:

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

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

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

The Bank used the following methods and significant assumptions to estimate fair value:

Cash and Cash Equivalents: The carrying amount of cash and cash equivalents is a reasonable estimate of fair value and are classified as Level 1.

Interest-Bearing Deposits in Other Financial Institutions: The fair values were calculated using discounted cash flow models based on market rates resulting in a Level 2 classification.

Investment Securities: The fair values of securities classified as available for sale and held to maturity are based on quoted market prices, if available (Level 1) at the reporting date. For securities where quoted prices are not available, fair values are calculated based on market prices of similar securities (Level 2), using matrix pricing. Matrix pricing is a mathematical technique commonly used to price debt securities that are not actively traded, values debt securities without relying exclusively on quoted prices for the specific securities but rather relying on the securities' relationship to other benchmark quoted securities (Level 2 inputs). For securities where quoted prices or market prices of similar securities are not available, fair values are calculated using discounted cash flows or other market indicators (Level 3).

Loans Held For Sale: Loans held for sale are carried at the lower of cost or fair value, which is evaluated on a pool-level basis. The fair value of loans held for sale is determined using quoted prices for similar assets, adjusted for specific attributes of that loan or other observable market data, such as outstanding commitments from third party investors (Level 2).

Loans: The fair value of fixed rate loans is determined as the present value of expected future cash flows discounted at the current interest rate that represents a mix of residential and commercial real estate. The market rate is initially set at the 30-year mortgage rate resulting in a Level 3 classification. Variable rate loans that reprice frequently with changes in approximate market rates were valued using the outstanding principal balance resulting in a Level 3 classification.

Off-Balance Sheet Instruments: The estimated fair value of loan commitments and contingent liabilities at December 31, 2017 and December 31, 2016 approximate their current book values.

Impaired Loans: The fair value of impaired loans with specific allocations of the allowance for loan losses is generally based on recent real estate appraisals. These appraisals may utilize a single valuation approach or a combination of approaches including comparable sales and the income approach. Adjustments are routinely made in the appraisal process by the independent appraisers to adjust for differences between the comparable sales and income data available for similar loans and collateral underlying such loans resulting in a Level 3 classification of the inputs for determining fair value.

Bankers' Bank Stock: Bankers' Bank Stock includes Federal Home Loan Bank Stock and Pacific Coast Bankers Bank Stock. The Federal Home Loan Bank investment is carried at cost and is redeemable at par with certain restrictions. It is not practical to determine fair value of bank stock due to restrictions placed on its transferability.

Accrued Interest Receivable/Payable: The respective carrying values of certain on-balance-sheet financial instruments approximated their fair values. These financial instruments include accrued interest receivable and accrued interest payable. Carrying values were assumed to approximate fair values for these financial instruments as they are short term in nature and their recorded amounts approximate fair values or are receivable or payable on demand. The Bank does not use derivative financial instruments. The carrying amounts of accrued interest approximate their fair value resulting in a Level 2 or Level 3 classification.

Deposits: The fair values of demand deposits, savings deposits, and money market deposits without defined maturities were the amounts payable on demand at the reporting date resulting in a Level 1 classification. For variable rate deposits where the Bank has the contractual right to change rates, carrying value was assumed to approximate fair value resulting in a Level 1 classification. For certificates of deposit with defined maturities, the fair values were calculated using discounted cash flow models based on market interest rates for different product types and maturity dates. The discount rates used were based on rates for comparable deposits resulting in a Level 2 classification.

Assets Recorded at Fair Value

The Bank's assets and liabilities measured at fair value on a recurring and non-recurring basis as of December 31, 2017 and 2016 are summarized below:

Recurring Basis

The Bank is required or permitted to record the following assets at fair value on a recurring basis.

	December 31, 2017			
	Fair Value	Quoted Prices in Active Markets for Identical Assets Level 1	Significant Other Observable Inputs Level 2	Significant Unobservable Inputs Level 3
Securities available for sale:				
U.S. government sponsored agencies	$ 7,941,200	$ -	$ 7,941,200	$ -
Collateralized mortgage obligations	9,412,980	-	9,412,980	-
State and political subdivision	715,699	-	715,699	-
Corporate	101,436	-	101,436	-
Total assets measured at fair value	$18,171,315	$ -	$ 18,171,315	$ -

	December 31, 2016			
	Fair Value	Quoted Prices in Active Markets for Identical Assets Level 1	Significant Other Observable Inputs Level 2	Significant Unobservable Inputs Level 3
Securities available for sale:				
U.S. government sponsored agencies	$ 5,993,529	$ -	$ 5,993,529	$ -
Collateralized mortgage obligations	9,846,144	-	9,846,144	-
State and political subdivision	1,719,306	-	1,719,306	-
Corporate	392,999	-	392,999	-
Total assets measured at fair value	$17,951,978	$ -	$ 17,951,978	$ -

There were no transfers between Level 1 and Level 2 during 2017 and 2016. There were no recurring Level 3 assets or liabilities measured at fair value during 2017 or 2016.

Non-recurring Basis

The Bank may be required, from time to time, to measure certain assets at fair value on a non-recurring basis. These include assets that are measured at the lower of cost or market value that were recognized at fair value, which was below cost at the reporting date. There were no assets measured at fair value at year-end 2017. The following table is the assets measured at fair value at year-end 2016:

	December 31, 2016:				
	Fair Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total Gains (Losses)
Impaired Loans:					
Commercial Real Estate	$ 128,237	$ -	$ -	$ 128,237	$ 12,110

The carrying amounts and estimated fair values of financial instruments not carried at fair value, at December 31, 2017 and 2016 are as follows:

December 31, 2017

(Dollars in thousands)	Carrying Amount	Level 1	Level 2	Level 3	Total
Financial Assets:					
Cash and cash equivalents	$ 31,694	$ 31,694	$ -	$ -	$ 31,694
Interest bearing deposits in other Financial Institutions	88,528	-	88,306	-	88,306
Held to maturity securities	28,657	-	29,163	-	29,163
Loans held for sale	26,006	-	26,006	-	26,006
Loans, net	420,342	-	-	426,792	426,792
Bankers' Bank stock	2,286	N/A	N/A	N/A	N/A
Accrued interest receivable	2,102	2	366	1,734	2,102
Financial Liabilities:					
Noninterest-bearing demand deposits	$ 242,498	$ 242,498	$ -	$ -	$ 242,498
Interest-bearing demand deposits	84,844	87,079	-	-	87,079
Savings and money market deposits	162,750	162,601	-	-	162,601
Time certificates of deposit	72,568	-	72,214	-	72,214
Accrued interest payable	108	6	102	-	108

December 31, 2016

(Dollars in thousands)	Carrying Amount	Level 1	Level 2	Level 3	Total
Financial Assets:					
Cash and cash equivalents	$ 11,512	$ 11,512	$ -	$ -	$ 11,512
Interest bearing deposits in other Financial Institutions	98,921	-	99,053	-	99,053
Held to maturity securities	34,146	-	34,859	-	34,859
Loans held for sale	31,819	-	31,819	-	31,819
Loans, net	376,976	-	-	377,824	377,824
Bankers' Bank stock	2,082	N/A	N/A	N/A	N/A
Accrued interest receivable	1,771	47	381	1,343	1,771
Financial Liabilities:					
Noninterest-bearing demand deposits	$ 244,897	$ 244,897	$ -	$ -	$ 244,897
Interest-bearing demand deposits	70,534	72,394	-	-	72,394
Savings and money market deposits	141,650	141,577	-	-	141,577
Time certificates of deposit	72,230	-	72,241	-	72,241
Accrued interest payable	82	6	76	-	82

Management monitors the availability of observable market data to assess the appropriate classification of financial instruments within the fair value hierarchy. Changes in economic conditions or model-based valuation techniques may require the transfer of financial instruments from one fair value level to another. In such instances, the transfer is reported at the beginning of the reporting period.

Management evaluates the significance of transfers between levels based upon the nature of the financial instrument and size of the transfer relative to total assets, total liabilities or total earnings.

There were no transfers between Level 1, Level 2, and Level 3 during 2017.

NOTE 5. LOAN SERVICING

Activity for loan servicing rights follows:

	2017	2016
Loan servicing rights:		
Beginning of year	$ 822,787	$ 728,482
Additions	263,515	491,690
Disposals	-	-
Amortized to expense	(388,912)	(397,385)
End of year	$ 697,390	$ 822,787

NOTE 6. PREMISES AND EQUIPMENT

The following presents the cost of premises and equipment including leasehold improvements and the related accumulated depreciation and amortization at December 31, 2017 and 2016:

	December 31, 2017	December 31, 2016
Leasehold improvements	$ 1,873,288	$ 1,747,411
Furniture, fixtures and equipment	1,572,317	1,461,799
Software and capitalized data & item processing	163,965	140,453
Computer equipment	679,941	626,028
Construction-in-progress	2,700	248,439
Total premises and equipment	4,292,211	4,224,130
Less accumulated depreciation and amortization	(3,532,713)	(3,550,555)
Premises and equipment, net	$ 759,498	$ 673,575

Depreciation expense was $324,856 and $208,166 for 2017 and 2016, respectively.

Operating Leases: The Bank leases certain branch properties and equipment under long-term operating lease agreements. These leases expire on various dates through 2032 and have various renewal options of five years each. Some leases may include a free rent period or have net operating costs associated with them.

In addition to the office building leases, the Bank has two leases for ATM and night depository kiosks. The operating leases had initial terms of five years each and various renewal options of three years each.

Building and kiosk rent expense for the years ended December 31, 2017 and 2016, was approximately $656,000 and $612,000, respectively. Lease commitments, before considering renewal options that generally are present, for future years are as follows:

Year ending December 31,	
2018	658,000
2019	515,000
2020	438,000
2021	398,000
2022	342,000
Thereafter	3,681,000
	$ 6,032,000

NOTE 7. DEPOSITS

Interest-bearing deposits consisted of the following:

	December 31, 2017	December 31, 2016
NOW accounts	$ 84,844,101	$ 70,533,664
Money Market	123,653,340	112,600,993
Time Deposits	72,567,577	72,230,372
Savings	39,096,347	29,049,110
Total Interest-Bearing Deposits	$ 320,161,365	$284,414,139

Time deposits that meet or exceed the FDIC Insurance limit of $250,000 at year-end 2017 and 2016 were $32,969,366 and $33,460,483, respectively.

The scheduled maturities for all time deposits for the next five years were as follows:

	2017
2018	$ 70,607,094
2019	814,523
2020	905,246
2021	232,714
2022	8,000
	$ 72,567,577

As of December 31, 2017, the Bank had brokered deposits totaling $4,425,337 and $900,613 at December 31, 2016.

NOTE 8. BORROWED FUNDS

At December 31, 2017, the Bank had federal funds borrowing guidance lines with its correspondent banks in an aggregate amount of $11,000,000 on an unsecured basis. In addition, the Bank has established a secured borrowing arrangement, secured by loans totaling approximately $250,004,884, with the Federal Home Loan Bank of San Francisco (“FHLB”). As of December 31, 2017, the Bank had $130,755,452 in borrowing capacity available through the FHLB under which overnight and term advances were available. These advances are secured by assets including the Bank’s ownership interest in the capital stock of the FHLB, securities and loans.

The Bank had no borrowed funds outstanding at December 31, 2017 and December 31, 2016 under these arrangements.

NOTE 9. PENSION AND OTHER POSTRETIREMENT BENEFIT PLANS

Effective October 1, 2004, the Bank established the Supplemental Executive Retirement Plan (SERP), an unfunded noncontributory defined benefit pension plan. The SERP provides retirement benefits to a select group of key executives and senior officers based on years of service and final average salary. The Bank uses December 31 as the measurement date for this Plan.

The following table reflects the changes in obligations and plan assets of the defined benefit pension plan for the years ended December 31, 2017 and 2016.

	2017	2016
Change in benefit obligation		
Beginning benefit obligation	$ 2,586,342	$ 2,422,502
Service cost	116,039	111,418
Interest cost	98,481	95,332
Actuarial gain (loss)	66,725	(515)
Benefits paid	(43,455)	(42,395)
Ending benefit obligation	2,824,132	2,586,342
Change in plan assets		
Beginning plan assets	-	-
Employer contributions	43,455	42,395
Benefits paid	(43,455)	(42,395)
Ending plan assets	-	-
Funded status at end of year	$ (2,824,132)	$ (2,586,342)

The amounts recognized in accumulated other comprehensive income at December 31 consist of:

Change in benefit obligation	2017	2016
Unrecognized net actuarial gain	$ (86,639)	$ (153,364)
Unrecognized prior service cost	-	-
Net liability recognized in earnings	$ (86,639)	$ (153,364)

The components of net periodic benefit cost at December 31 are as follows:

	Year ended December 31,		
	2018	2017	2016
Components of net periodic benefit cost	(forecast)		
Service cost	$ 125,882	$ 116,039	$ 111,418
Interest cost	95,263	98,481	95,332
Amortization of prior service cost	-	-	4,490
Net periodic benefit cost	$ 221,145	$ 214,520	$ 211,240

Assumptions

Weighted average assumptions used to determine pension benefit obligations and net periodic pension cost at December 31:

	2017	2016
Discount rate used to determine net periodic benefit cost	3.84%	3.97%
Discount rate used to determine benefit obligations	3.40%	3.84%
Future salary increases	N/A	N/A

NOTE 10. EMPLOYEE BENEFIT PLANS

401(k) Plan: All employees of the Bank are eligible to participate in the Bank's 401(k) benefit plan, which is a tax-deferred savings plan designed to assist employees in preparing for their retirement years. The 401(k) Plan allows employees to contribute to the plan up to certain limits prescribed by the Internal Revenue Service. The Bank matches 25% of contributions up to 4% of compensation. Total expense for the years ended December 31, 2017 and December 31, 2016 was $111,964 and $110,809, respectively.

NOTES TO FINANCIAL STATEMENTS

Split-Dollar Life Insurance: The Bank accounts for split-dollar life insurance in accordance with ASC 715-60, Compensation - Nonretirement Postemployment Benefits, which requires that endorsement split-dollar life insurance arrangements which provide a postretirement benefit to an employee be recorded based on the substance of the agreement with the employee. If the employer has effectively agreed to provide the employee with a death benefit, the employer should accrue, over the service period, a liability for the actuarial present value of the future death benefit as of the employee's expected retirement date. The total liability recorded as of years ended December 31, 2017 and December 31, 2016 was $1,037,646 and $1,076,539, respectively. Total expense recognized during the years ended December 31, 2017 and December 31, 2016 was ($38,893) and $78,008, respectively.

NOTE 11. INCOME TAXES

The provision for income taxes is as follows for the years ended December 31, 2017 and 2016:

	2017	2016
Current expense:		
Federal	$ 4,018,570	$ 3,529,913
State	1,433,408	1,488,296
Total current	5,451,978	5,018,209
Deferred expense:		
Federal	$ 1,292,922	$ (553,499)
State	(65,734)	(253,164)
Total deferred	1,227,188	(806,663)
Total provision	$ 6,679,166	$ 4,211,546

On December 22, 2017, the Tax Act was signed into law. The Tax Act significantly revised the U.S. income tax laws, which impacted our year ended December 31, 2017, including lowering the corporate income tax rate from 35% to 21% effective January 1, 2018. We recognized additional discrete tax expense of $1.5 million for the year ended December 31, 2017, primarily due to the remeasurement of our deferred tax assets and liabilities following enactment of the Tax Act.

The effective tax rates differ from the federal statutory rate of 35% applied to income before income taxes due to the following for the years ended December 31, 2017 and 2016:

	2017	2016
Federal statutory rate	35.00%	34.00%
State income tax, net of federal effect	6.62%	7.62%
Revaluation of deferred income taxes	10.93%	0.00%
Tax exempt interest	(1.82%)	(2.08%)
Bank owned life insurance	(0.44%)	(0.56%)
Split dollar expense	(0.10%)	0.25%
Stock-based compensation	(0.18%)	(0.07%)
Other	(0.29%)	0.19%
Net	49.72%	39.35%

Deferred income taxes are the result of differences between income tax accounting and accounting principles generally accepted in the United States of America, with respect to income and expense recognition. The effect of a change in tax law is recognized on the date of enactment. As a result of the Tax Act, the Bank remeasured our deferred tax assets and liabilities at the lower enacted corporate tax rate and our net deferred tax asset was reduced during the fourth quarter of 2017. The table below reflects the reduction in deferred tax assets and liabilities in 2017 following the enactment of the Tax Act. The tax effects of temporary differences that gave rise to deferred tax assets and deferred tax liabilities at December 31, 2017 and 2016 are as follows:

	2017	2016
Allowance for loan losses	$ 2,562,047	$ 3,101,020
Deferred compensation	860,529	1,127,509
Accruals	1,170,839	1,452,433
Current state income tax	321,253	477,132
Premises and equipment	-	25,946
Unrealized loss on available for sale securities and pension	39,858	20,692
Other deferred tax assets	57,500	210,061
Gross deferred tax assets	5,012,026	6,414,793
Deferred loan costs	(1,205,420)	(1,410,897)
Premises and equipment	(36,556)	-
Other deferred tax liabilities	(50,747)	(76,569)
Gross deferred tax liabilities	(1,292,723)	(1,487,466)
Net deferred tax asset	$ 3,719,303	$ 4,927,327

Management believes, that it is more likely than not, that the deferred tax assets will be realized as a result of expected continued profitability. Accordingly, no valuation allowance has been established as of December 31, 2017 or December 31, 2016.

The Bank does not expect the total amount of unrecognized tax benefits to significantly increase or decrease within the next twelve months.

The bank did not have any interest and penalties recorded in the income statement for the year ended December 31, 2017 and December 31, 2016.

NOTE 12. RELATED PARTY TRANSACTIONS

Loan related activity to directors, officers, and principal shareholders and their associates during 2017 were as follows:

	2017
Beginning balance	$ 1,039,580
New loans or disbursements	6,939,866
Principal repayments	(427,383)
Ending balance	$ 7,552,063

At December 31, 2017 and 2016, no related party loans were on non-accrual or classified for regulatory reporting purposes. Deposits from principal officers, directors, and their affiliates at year-end 2017 and 2016 were $687,390 and $1,202,175, respectively.

NOTE 13. STOCK-BASED COMPENSATION

The Bank has two share based compensation plans as described below. Total compensation cost that has been charged against income for those plans was $129,019 and $180,800 for 2017 and 2016, respectively. The total income tax benefit was $54,986 and $47,836 for 2017 and 2016, respectively.

The Bank estimates the fair value of each option award as of the date of grant using a Black-Scholes-Merton option pricing formula and the following assumptions. Expected volatility is based on historical volatility of similar entities over a preceding period commensurate with the expected term of the option because the Bank's common stock has been publicly traded for a shorter period than the expected term for the options. The "simplified" method described in the Securities and Exchange Commission's Staff Accounting Bulletin No. 110 is used to determine the expected term of the options due to the lack of sufficient historical data. The risk-free interest rate is based on the U.S. Treasury yield curve in effect at the time of grant with substantially the same term as the expected term of the option. There were no options granted during the years ended 2017 and 2016.

2003 Stock Option Plan: The Bank adopted a qualified stock option plan (the “Option Plan”) for employees, non-employee directors and Bank founders, under which a maximum of 500,202 shares of Bank’s common stock may be issued. The Option Plan calls for the exercise prices of the options to be equal to or greater than the fair market value of the stock at the time of grant. Options granted to Bank founders who are not also Bank directors or Bank officers were fully vested upon the date of grant. All other options shares granted have daily vesting over the first four years of the option contract. All option contracts for founders who are not also Bank directors or Bank officers have expiration dates of 10 years from the date of grant. All director and employee option contracts have expiration dates on the earlier of termination of service or 10 years from the date of grant. The Option Plan expired during 2014 and was replaced with the 2014 Omnibus Plan (the “Omnibus Plan”).

All options granted under the Option Plan have a 10 year term and have been issued with exercise prices at the fair market value of the underlying shares at the date of grant. The non-qualified stock option awards to the organizers vested 100% immediately, whereas regular stock option awards to directors and employees vest over a four year period from the date the options were granted.

The following is a summary of the activity relating to the Bank’s 2003 stock option plan for the year ended December 31, 2017 as presented below:

	Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Life	Aggregate Intrinsic Value
Options outstanding at beginning of year	41,918	$12.28		
Granted	-	-		
Exercised	(11,564)	$12.90		
Expired	-	$0.00		
Forfeited	-	$0.00		
Options outstanding at end of year	30,354	$12.05	2.53 years	$1,120,305
Options fully vested and expected to vest	30,354			$1,120,305
Exercisable at end of year	30,354	$12.05	2.53 years	$1,120,305

Information related to the stock option plan during the year follows:

	2017
Intrinsic value of options exercised	$ 283,096
Cash received from option exercises	149,197
Tax benefit realized from option exercises	30,720
Weighted average fair value of options granted	-

As of December 31, 2017, there was no unrecognized compensation cost related to non-vested stock options granted under the plan. All shares issued under this plan fully vested during the year 2016.

2014 Omnibus Plan: The Bank adopted the Omnibus Plan in May 2014 for employees and non-employee directors, which will continue in effect until February 19, 2024. The Omnibus Plan allows qualified stock option grants for employees and non-qualified restricted stock awards for officers and non-employee directors. The maximum number of shares of common stock that may be issued under this plan is 469,970 unless amended by the Board or the shareholders of the Bank.

The Omnibus Plan permits the grant of non-statutory options, incentive stock options and restricted stock awards to directors and employees of the Bank. Options granted under the Omnibus Plan may be incentive stock options or non-statutory stock options, as determined by the plan administrator at the time of grant of an option, however incentive stock options may be granted only to employees. In addition, restricted stock awards may be granted under the Omnibus Plan to directors and employees.

The per share exercise price for the shares to be issued upon exercise of any option shall be such price as is determined by the plan administrator, but no less than 100 percent of the fair market value per share on the date of grant. All option contracts have expiration dates on the earlier of termination of service or 10 years from the date of grant.

The following is a summary of the activity relating to the Bank's incentive stock options under plan for the year ended December 31, 2017 as presented below:

Incentive Stock Options	Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Life	Aggregate Intrinsic Value
Options outstanding at beginning of year	32,450	$19.76		
Granted	-	-		
Exercised	(1,512)	$17.82		
Forfeited or expired	(2,475)	$17.82		
Options outstanding at end of year	28,463	$20.03	6.95 years	$823,078
Options fully vested and expected to vest	26,859			$780,888
Exercisable at end of year	21,957	$19.29	6.79 years	$651,166

Information related to the stock option plan during the year follows:

		2017
Intrinsic value of options exercised	$	29,800
Cash received from option exercises		26,950
Tax benefit realized from option exercises		2,372
Weighted average fair value of options granted		8.07

As of December 31, 2017, there was $40,619 of total unrecognized compensation cost related to non-vested stock options granted under the plan. The cost is expected to be recognized over a weighted average period of 1.42 years.

The following is a summary of the activity relating to the Bank's non-vested shares under this plan for the year ended December 31, 2017 as presented below:

Nonvested Shares	Shares	Weighted Average Grant Date Fair Value
Nonvested awards at beginning of year	7,040	$23.18
Granted	-	-
Vested	(3,080)	$23.18
Forfeited	-	$0.00
Nonvested awards at end of year	3,960	$23.18

As of December 31, 2017, there was $62,551 of total unrecognized compensation cost related to non-vested shares granted under the plan. The cost is expected to be recognized over a weighted average period of 1.62 years. The total fair value of shares vested during the years ended December 31, 2017 and December 31, 2016 was $71,400 and $112,400.

NOTE 14. REGULATORY CAPITAL MATTERS

Regulatory Capital: The Bank is subject to various regulatory capital adequacy requirements administered by the banking regulatory agencies. Capital adequacy guidelines and, additionally for banks, prompt corrective action regulations, involve quantitative measures of assets, liabilities, and certain off-balance-sheet items calculated under regulatory accounting practices. Capital amounts and classifications are also subject to qualitative judgments by regulators. Failure to meet minimum capital requirements can initiate certain mandatory and possibly additional discretionary actions by regulators that, if undertaken, would have a direct material effect on the Bank's financial statements. 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 at the rate of 0.625% per year from 0.0% in 2015 to 2.50% on January 1, 2019. The capital conservation buffer for 2017 is 1.25% and for 2016 is 0.625%. The net unrealized gain or loss on available for sale securities is not included in computing regulatory capital. Management believes as of December 31, 2017, the Bank meets all capital adequacy requirements to which they are subject.

Prompt corrective action regulations define five classifications: well-capitalized, adequately capitalized, undercapitalized, significantly undercapitalized, and critically undercapitalized, although these terms are not used to represent overall financial condition. If adequately capitalized, regulatory approval is required to accept brokered deposits. If undercapitalized, capital distributions are limited, as is asset growth and expansion, and capital restoration plans are required. At year-end 2017 and 2016, the most recent regulatory notifications categorized the Bank as well-capitalized under the regulatory framework for prompt corrective action. There are no conditions or events since that notification that management believes have changed the institution's category.

Actual and required capital amounts and ratios are presented below at year-end.

(Dollars in thousands)	Actual		Required for Capital Adequacy Purposes		To Be Well Capitalized Under Prompt Corrective Action Regulations	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
As of December 31, 2017						
Total capital to risk weighted assets	$ 63,968	12.87%	$ 45,984	9.250%	$ 49,712	10.00%
Tier 1 (Core) capital to risk weighted assets	$ 57,717	11.61%	$ 36,041	7.250%	$ 39,770	8.00%
Common Tier 1 (CET1) to risk weighted assets	$ 57,717	11.61%	$ 28,584	5.750%	$ 32,313	6.50%
Tier 1 (Core) capital to average assets	$ 57,717	9.15%	$ 25,236	4.000%	$ 31,545	5.00%

(Dollars in thousands)	Actual		Required for Capital Adequacy Purposes:		To Be Well Capitalized Under Prompt Corrective Action Regulations	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
As of December 31, 2016						
Total capital to risk weighted assets	$ 56,613	12.89%	$ 37,893	8.625%	$ 43,934	10.00%
Tier 1 (Core) capital to risk weighted assets	$ 51,087	11.63%	$ 29,107	6.625%	$ 35,148	8.00%
Common Tier 1 (CET1) to risk weighted assets	$ 51,087	11.63%	$ 22,516	5.125%	$ 28,557	6.50%
Tier 1 (Core) capital to average assets	$ 51,087	8.67%	$ 23,557	4.000%	$ 29,446	5.00%

Dividend Restrictions: The Board of Directors may, to the extent of such earnings and the Bank's net capital requirements and subject to the provisions of the California Financial Code, declare and pay a portion of such earnings to its shareholders as dividends. No cash dividend will be declared without a complete analysis of capital impact, current economic assessment, and current risk analysis.

NOTE 15. LOAN COMMITMENTS AND OTHER RELATED ACTIVITIES

Restrictions on Cash and Due from Banks: The Bank is subject to Federal Reserve Act Regulation D, which requires banks to maintain average reserve balances with the Federal Reserve Bank. Reserve requirements are offset by usable cash reserves. The Bank had no reserve requirement at December 31, 2017 and December 31, 2016.

At times, the Bank maintains deposit amounts at corresponding banks that exceed federally insured limits. The Bank has not experienced any losses on amounts exceeding the insured limits.

Loan Commitments: The Bank is a party to financial instruments with off-balance sheet risk in the normal course of business to meet the financing needs of its customers. These financial instruments include commitments to extend credit, standby letters of credit, overdraft protection and financial guarantees. Those instruments involve, to varying degrees, elements of credit and interest rate risk in excess of the amount recognized in the balance sheets. The contract 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 for commitments to extend credit, standby letters of credit, and financial guarantees 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 a customer as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Since many of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. The Bank evaluates each customer's credit worthiness 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. Collateral held varies but may include cash, securities, accounts receivable, inventory, property, plant and equipment, residential real estate and income-producing commercial properties.

Standby letters of credit and financial guarantees written are conditional commitments issued by the Bank to guarantee the performance of a customer to a third party. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loan facilities to customers. Financial instruments whose contract amounts represent credit risk at December 31, 2017 and December 31, 2016 are as follows:

	December 31,	
	2017	2016
Commitments to extend credit	$134,081,869	$118,857,200
Standby letters of credit	543,146	772,939
	$134,625,015	$119,630,139

NOTE 16. EARNINGS PER SHARE

Earnings Per Share: The Bank declared a 10% stock dividend during the fourth quarter 2017. The share and per share data have been adjusted for both 2017 and 2016 to reflect the stock dividend. Cash was paid in lieu of fractional shares based on the closing price on the date of record. A reconciliation of the numerators and denominators of the basic and diluted earnings per share computation is as follows:

	Net Income	Weighted Average Number of Shares	Per Share Amount
December 31, 2017			
Basic earnings per share	$ 6,758,398	2,412,333	$ 2.80
Effect of dilutive stock based compensation	-	39,846	
Diluted earnings per share	$ 6,758,398	2,452,179	$ 2.76

	Net Income	Weighted Average Number of Shares	Per Share Amount
December 31, 2016			
Basic earnings per share	$ 6,491,464	2,396,136	$ 2.71
Effect of dilutive stock based compensation	-	33,498	
Diluted earnings per share	$ 6,491,464	2,429,634	$ 2.67

Stock options for 5,000 shares of common stock were not considered in computing diluted earnings per common share for the year ended December 31, 2016, because they were anti-dilutive. There were no anti-dilutive common shares for the year ended December 31, 2017.

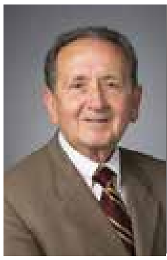
BOARD OF DIRECTORS S

WILLIAM J. HANSEN, CHAIRMAN

PRESIDENT & CEO
HANSEN INSURANCE CO.

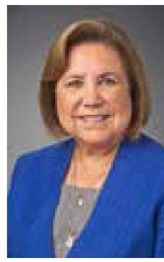
HARVEY J. NICKELSON

RETIRED BANK CEO
& COMMUNITY VOLUNTEER



GEORGE R. GALLUCCI

RETIRED BANKER
& REGISTERED INVESTMENT ADVISOR



TILA BAÑUELOS

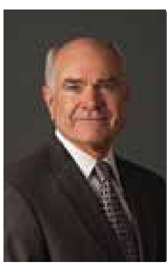
PRESIDENT & CEO
MAS MAC INC.
MCDONALD'S RESTAURANTS

THOMAS N. GRIFFIN

DIRECTOR & PRESIDENT
GRUNSKY, EBEY, FARRAR & HOWELL

KENNETH R. CHAPPELL

CPA, PARTNER-IN-CHARGE
HUTCHINSON & BLOODGOOD, LLP



DAVID V. HEALD

PRESIDENT & CEO
SANTA CRUZ COUNTY BANK

BANK FOUNDERS

A group of local business people joined to create a local, community bank focused on serving the residents and businesses of Santa Cruz County when it became apparent that the last of the local independent banks was soon to be taken over by a large out-of-area bank holding company. This group that we recognize as Founders all contributed time, money, and talent, not only to the Bank's organizing effort, but continue to be involved and support our Bank as customers, referring family, friends and business contacts to us, and serving as ambassadors of the Bank in our community.

Richard Alderson	Kenneth R. Chappell*	David V. Heald*	Stuart Mumm
Joseph Anzalone†	Kate & Fred Chen	Mark Holcomb	George Ow, Jr.
Tila Bañuelos*	Marshall Delk	Steven G. John**	Louis Rittenhouse
Victor Bogard h	George R. Gallucci*	Mateo Lettunich	Frank Saveria
Anthony & Rebecca Campos	Thomas N. Griffin*	Robert Lockwood	Robert† & Bjorg Yonts
Charles Canfield	William J. Hansen*	William Moncovich	

**denotes Bank Director **denotes former Bank Director †denotes deceased*

SANTA CRUZ COUNTY BANK OFFICERS, SVP & ABOVE

AS PICTURED LEFT TO RIGHT:

SATI KANWAR
Senior Vice President
SBA Business Development Officer

ANGELO DEBERNARDO, JR.
Executive Vice President
Chief Lending Officer

TRACY RUELAS-HASHIMOTO
Senior Vice President
Controller & Finance Manager

FREDERICK L. CAIOCCA
Executive Vice President
Regional Credit Manager

JAIME MANRIQUEZ
Senior Vice President
CIO-CISO, Information Technology & Security

SUSAN CHANDLER
Senior Vice President
SBA Department Manager

DOUGLAS FISCHER
Senior Vice President
Relationship Manager

VICTOR F. DAVIS
Senior Vice President
Chief Financial Officer & Cashier

MARY ANNE CARSON
Senior Vice President
Chief Marketing Officer

DAVID HEALD
President
Chief Executive Officer

JANICE ZAPPA
Senior Vice President
Corporate Secretary

CREEDENCE SHAW
Senior Vice President
Chief Credit Officer

NOT PICTURED ABOVE

HEATHER LA FONTAINE
Executive Vice President
Chief Administrative Officer

SANTA CRUZ COUNTY BANK VICE PRESIDENTS

AS PICTURED LEFT TO RIGHT:

VENTURA LEÒN
Vice President
Branch Administrator

ADAM WEISS
Vice President
Relationship Manager

CHRISTINA MAFFIA
Vice President
Regional Relationship Manager

JOSHUA PETERSON
Vice President
Compliance Officer

JARON REYES
Vice President
Relationship Manager

MARSHALL DELK
Vice President
Senior Regional Relationship Manager

JOHN KIRK
Vice President
Central Operations Manager

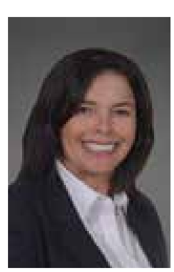
SHAWN LIPMAN
Vice President
Senior Relationship Manager

LUCY DESAUTELS
Vice President
Note Department Manager

CHUCK MAFFIA
Vice President
Regional Manager

NOT PICTURED ABOVE

JORGE REGUERIN
Vice President
SBA Business Development Officer



BARBARA PERKINS
Vice President
SBA Business Development Officer

STOCK INFORMATION

Santa Cruz County Bank stock is publicly traded on the OTC marketplace under the stock symbol SCZC. Stock purchase orders may be placed through a brokerage firm or one of the Market Makers listed below.

MARKET MAKERS

D.A. Davidson & Co.
P.O. Box 1688 (US Mail)
42605 Moonridge Road
Big Bear Lake,
CA 92315
800.288.2811
Katy Ehlers
Michael Natzic

Monroe Financial Partners
100 North Riverside
Plaza, Suite 1620
Chicago, IL 60606
312.506.8743
Steve Schroeder, CFA

Raymond James & Associates
One Embarcadero
Center, Suite 650
San Francisco, CA 94111
888.317.8986
John Cavender

StockCross Financial Services, Inc. Equity Trading
15 Exchange Place,
Suite 615
Jersey City, NJ 07302
800.993.2075
Tim Padala

Wedbush Securities
One SW Columbia Street,
Suite 1000
Portland, OR 97258
866.662.0351
Joey Warmenhoven

SHAREHOLDER INFORMATION

Shareholders with questions regarding their account, stock transfers and registration, lost certificates or change of address should contact their broker, or if held directly, contact the Bank's transfer agent listed below:

Computershare Investor Services P.O. Box 30170, College Station, TX 77842-3170

800.962.4284, www.computershare.com

BANKING LOCATIONS

APTOS 7775 Soquel Dr. 831.662.6000
CAPITOLA 819 Bay Ave. 831.464.5300
SANTA CRUZ 720 Front St. 831.457.5000
SCOTTS VALLEY 4604 Scotts Valley Dr. 831.461.5000
WATSONVILLE 595 Auto Center Dr. 831.761.7600

ADDITIONAL ATM & NIGHT DEPOSITORY LOCATIONS

DOMINICAN HOSPITAL 1555 Soquel Dr., Santa Cruz
DELUXE FOODS 783-25 Rio Del Mar Blvd., Aptos

SANTA CRUZ COUNTY BANK

www.sccountybank.com

MEMBER FDIC

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