PACIFIC VALLEY BANK

Annual Report 2018

Let's Get This Done!

A letter from the President

2018

Dear Shareholders,

The improved performance of Pacific Valley Bank within the past year is a source of pride for all of us here at the Bank. At December 31, 2018, the total assets of the Bank were $320.6 million, surpassing the $300 million benchmark, a key milestone for community banks. This represented record growth of $47 million or 17% since December 31, 2017, making Pacific Valley Bank the fastest growing bank in Monterey County for two consecutive years. The Board of Directors and Bank Management accomplished this by focusing on alignment with the Strategic Plan in 2018, and deploying resources to reinforce core infrastructure and enhance sustainable growth of the Bank. We are proud to share that we were on track with our growth plans in 2018, meeting key targets outlined in the Strategic Plan.

As of December 31, 2018, outstanding loan balances increased $38 million dollars over year end 2017. The aggressive growth of the loan portfolio was highly concentrated in loans secured by Commercial Real Estate. Of equal significance was the emphasis on good asset quality. The result of this is non-performing loans accounting for only 0.68% of the loan portfolio. Gross loan balances combined with the Bank's other earning assets resulted in interest income of $12.3 million. Net Income for the year exceeded all prior years in the Bank's history, ending at $2.5 million.

The headwinds we faced in 2018 and now in 2019 are the increased cost of funds, a growing issue throughout the banking industry. Increased competition for deposit growth outside of the traditional banking system is coming from internet banks offering higher interest rates. We are already seeing the effects of margin compression for all banks, particularly those seeking to "win" new customers by promising high rates. We recognize a need for greater diversification in our customer base and we are creating new business initiatives to meet evolving business needs, and to grow deposits.

Community banking is a dynamic industry, always in a state of evolution. With this comes higher expectations from our customers and shareholders. Expectations include technological innovation, while providing the personalized, friendly service expected from a local community bank. We are up to the challenge. Our staff is passionate about their work, and have the professional expertise which supports our proven track record of achieving positive results. We also know we could not have done this without you, our loyal shareholders. Your investment in Pacific Valley Bank has contributed to the success of the Bank. We appreciate you and hope that you will continue to be a part of Pacific Valley Bank's future.

Let's get this done!

Anker Fanoe

President & Chief Executive Office

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PACIFIC VALLEY BANK

FINANCIAL STATEMENTS
WITH
INDEPENDENT AUDITOR'S REPORT

DECEMBER 31, 2018 AND 2017

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INDEPENDENT AUDITOR'S REPORT

Board of Directors and Shareholders of
Pacific Valley Bank
Salinas, California

Report on Financial Statements
We have audited the accompanying financial statements of Pacific Valley Bank, which are comprised of the statements of financial condition as of December 31, 2018 and 2017, 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 Pacific Valley Bank as of December 31, 2018 and 2017, 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.

Vavrinek, Trine, Day + Co., LLP

Laguna Hills, California
March 29, 2019

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PACIFIC VALLEY BANK

STATEMENTS OF FINANCIAL CONDITION
DECEMBER 31, 2018 AND 2017

	2018	2017 Restated
ASSETS		
Cash and Due from Banks	$ 5,956,000	$ 16,564,000
Federal Funds Sold	53,460,000	29,043,000
Total Cash and Cash Equivalents	59,416,000	45,607,000
Time Deposits in Other Banks	7,595,000	11,760,000
Debt Securities Available for Sale	-	51,000
Loans, Net of Deferred Fees and Costs	248,718,000	210,519,000
Allowance for Loan Losses	(4,576,000)	(4,300,000)
Net Loans	244,142,000	206,219,000
Federal Home Loan and Other Bank Stocks, at Cost	1,336,000	1,172,000
Other Real Estate Owned	-	635,000
Premises and Equipment	744,000	783,000
Bank Owned Life Insurance	5,523,000	5,399,000
Accrued Interest and Other Assets	1,915,000	1,952,000
TOTAL ASSETS	$ 320,671,000	$ 273,578,000
LIABILITIES AND SHAREHOLDERS' EQUITY		
Deposits:		
Noninterest-Bearing	$ 113,785,000	$ 112,172,000
Interest-Bearing	172,581,000	129,417,000
Total Deposits	286,366,000	241,589,000
Accrued Interest and Other Liabilities	1,229,000	1,487,000
TOTAL LIABILITIES	287,595,000	243,076,000
Commitments and Contingencies (Notes D and K)		
Shareholders' Equity:		
Preferred Stock - 5,000,000 Shares Authorized, None Outstanding	-	-
Common Stock - No par value, 10,000,000 Shares Authorized, Shares Issued and Outstanding - 3,956,747 At December 31, 2018 and 3,596,996 at December 31, 2017	32,480,000	32,480,000
Retained Earnings (Deficit)	596,000	(1,978,000)
TOTAL SHAREHOLDERS' EQUITY	33,076,000	30,502,000
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	$ 320,671,000	$ 273,578,000

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

PACIFIC VALLEY BANK

STATEMENTS OF INCOME
FOR THE YEARS ENDED DECEMBER 31, 2018 AND 2017

	2018	2017
INTEREST INCOME		
Interest and Fees on Loans	$ 11,491,000	$ 9,792,000
Interest on Investment Securities	-	2,000
Interest on Federal Funds Sold and Other	766,000	673,000
Total Interest Income	12,257,000	10,467,000
INTEREST EXPENSE		
Interest on Savings, NOW, and Money Market Accounts	474,000	178,000
Interest on Time Deposits	378,000	109,000
Interest on Borrowings	189,000	-
Total Interest Expense	1,041,000	287,000
Net Interest Income	11,216,000	10,180,000
Provision (Benefit) for Loan Losses	250,000	(1,000,000)
Net Interest Income After Provision For Loan Losses	10,966,000	11,180,000
NONINTEREST INCOME		
Service Charges and Fees on Deposit Accounts	281,000	251,000
Other Service Charges and Fees	44,000	47,000
Gain on Sale of Other Real Estate Owned	493,000	13,000
Interchange Fees	95,000	86,000
Earnings on Bank Owned Life Insurance	124,000	132,000
Total Noninterest Income	1,037,000	529,000
NONINTEREST EXPENSE		
Salaries and Employee Benefits	5,489,000	5,588,000
Occupancy and Equipment Expense	703,000	721,000
Other Expenses	2,361,000	2,560,000
Total Noninterest Expense	8,553,000	8,869,000
Income Before Income Taxes	3,450,000	2,840,000
Income Taxes	994,000	1,270,000
NET INCOME	$ 2,456,000	$ 1,570,000
NET INCOME PER SHARE - BASIC	$ 0.62	$ 0.40
NET INCOME PER SHARE - DILUTED	$ 0.62	$ 0.40

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

PACIFIC VALLEY BANK

STATEMENTS OF COMPREHENSIVE INCOME
FOR THE YEARS ENDED DECEMBER 31, 2018 AND 2017

	2018	2017
Net Income	$ 2,456,000	$ 1,570,000
OTHER COMPREHENSIVE LOSS:		
Unrealized Gain and Loss on Securities Available for Sale:		
Unrealized Loss on Investment Securities	-	-
	-	-
Income Tax Expense (Benefit):		
Change in Net Unrealized Loss	-	
	-	-
TOTAL OTHER COMPREHENSIVE LOSS	-	-
TOTAL COMPREHENSIVE INCOME	$ 2,456,000	$ 1,570,000

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

PACIFIC VALLEY BANK

STATEMENT OF CHANGES IN SHAREHOLDERS' EQUITY
FOR THE YEARS ENDED DECEMBER 31, 2018 AND 2017

	Common Stock		Retained Earnings	Accumulated Other Comprehensive	
	Number of Shares	Amount	(Deficit)	Income (Loss)	Total
Balance January 1, 2017	3,596,996	$ 32,480,000	$ (3,548,000)	$ -	$ 28,932,000
Net Income	-	-	1,570,000	-	1,570,000
Balance at December 31, 2017	3,596,996	32,480,000	(1,978,000)	-	30,502,000
Adoption of New Accounting Standard, Net of Taxes of $49,000			118,000		118,000
10% Stock Dividend	359,751	-	-		-
Net Income	-	-	2,456,000	-	2,456,000
Balance at December 31, 2018	3,956,747	$ 32,480,000	$ 596,000	$ -	$ 33,076,000

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

PACIFIC VALLEY BANK

STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED DECEMBER 31, 2018 AND 2017

	2018	2017
OPERATING ACTIVITIES		
Net Income	$ 2,456,000	$ 1,570,000
Adjustments to Reconcile Net Income to Net Cash		
From Operating Activities:		
Depreciation and Amortization	162,000	188,000
Provision (Benefit) for Loan Losses	250,000	(1,000,000)
Gain on Sale of Other Real Estate Owned	(493,000)	(13,000)
Earnings on Bank Owned Life Insurance	(124,000)	(132,000)
Deferred Income Taxes	499,000	1,236,000
Other Items	(602,000)	603,000
Total Adjustments	(308,000)	882,000
Net Cash From Operating Activities	2,148,000	2,452,000
INVESTING ACTIVITIES		
Net Change in Time Deposits in Other Banks	4,165,000	6,365,000
Principal Payments on Debt Securities Available for Sale	51,000	92,000
Net Change in Loans to Customers	(38,173,000)	(21,982,000)
Purchase of Federal Home Loan Bank Stock	(164,000)	(105,000)
Proceeds from Sale of Other Real Estate Owned	1,128,000	-
Purchases of Premises and Equipment	(123,000)	(57,000)
Net Cash From Investing Activities	(33,116,000)	(15,687,000)
FINANCING ACTIVITIES		
Net Change in Demand Deposits and Savings Accounts	11,637,000	32,008,000
Net Change in Time Deposits	33,140,000	(4,716,000)
Net Cash From Financing Activities	44,777,000	27,292,000
Net Increase in Cash and Cash Equivalents	13,809,000	14,057,000
Cash and Cash Equivalents at Beginning of Year	45,607,000	31,550,000
CASH AND CASH EQUIVALENTS AT END OF YEAR	$ 59,416,000	$ 45,607,000
Supplemental Disclosures of Cash Flow Information:		
Interest Paid	$ 1,039,000	$ 286,000
Taxes Paid	$ 645,000	$ 35,000
Loans Transferred to Other Real Estate Owned	$ -	$ 635,000

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

NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Nature of Operations

The Bank opened for business during September 2004. Our products and services are targeted to customers who operate small and middle-market businesses, professionals, high net worth individuals and families residing in Monterey County, California. We serve business and individual customers from three branch locations: Salinas, Monterey, and King City, California. Our mission is to "create prosperity in the community through excellence in banking". It is our goal to compete on responsive service and not solely on the basis of price.

Subsequent Events

The Bank has evaluated subsequent events for recognition and disclosure through March 29, 2019, which is the date the financial statements were available to be issued.

Use of Estimates in the Preparation of Financial Statements

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Cash and Cash Equivalents

For purposes of reporting cash flows, cash and cash equivalents include cash, due from banks, deposits with other financial institutions with original maturities ninety days or less and federal funds sold. Generally, federal funds are sold for periods of less than ninety days.

Cash and Due from Banks

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

The Bank maintains amounts due from banks, which may exceed federally insured limits. The Bank has not experienced any losses in such accounts.

Time Deposits in Other Banks

Interest-bearing certificates of deposits in other financial institutions mature within one year and are carried at cost.

NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued

Debt Securities

Debt securities are classified in three categories and accounted for as follows: debt securities that the Bank has the positive intent and ability to hold to maturity are classified as held-to-maturity and are measured at amortized cost; debt securities bought and held principally for the purpose of selling in the near term are classified as trading securities and are measured at fair value, with unrealized gains and losses included in earnings; debt securities not classified as either held-to-maturity or trading securities are deemed as available-for-sale and are measured at fair value, with unrealized gains and losses, net of applicable taxes, reported in a separate component of shareholders' equity. Gains or losses on sales of debt securities are determined on the specific identification method. Premiums and discounts are amortized or accreted using the interest method over the expected lives of the related securities.

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

Loans receivable that management has the intent and ability to hold for the foreseeable future or until maturity or payoff are reported at their outstanding unpaid principal balances reduced by any charge-offs or specific valuation accounts and net of deferred fees or costs on originated loans, or unamortized premiums or discounts on purchased loans. Loan origination fees and certain direct origination costs are capitalized and recognized as an adjustment of the yield of the related loan. Amortization of deferred loan fees is discontinued when a loan is placed on nonaccrual status.

Loans on which the accrual of interest has been discontinued are designated as nonaccrual loans. The accrual of interest on loans is discontinued when principal or interest is past due 90 days based on the contractual terms of the loan or when, in the opinion of management, there is reasonable doubt as to collectability. When loans are placed on nonaccrual status, all interest previously accrued but not collected is reversed against current period interest income. Income on nonaccrual loans is subsequently recognized only to the extent that cash is received and the loan's principal balance is deemed collectible. Interest accruals are resumed on such loans only when they are brought current with respect to interest and principal and when, in the judgment of management, the loans are estimated to be fully collectible as to all principal and interest.

NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued

Allowance for Loan Losses

The allowance for loan losses is a valuation allowance for probable incurred credit losses. Loan losses are charged against the allowance when management believes the uncollectibility of a loan balance is confirmed. Subsequent recoveries, if any, are credited to the allowance. Management estimates the allowance balance required using past loan loss experience, the nature and volume of the portfolio, information about specific borrower situations and estimated collateral values, economic conditions, and other factors. Allocations of the allowance may be made for specific loans, but the entire allowance is available for any loan that, in management's judgment, should be charged off. Amounts are charged-off when available information confirms that specific loans or portions thereof, are uncollectible. This methodology for determining charge-offs is consistently applied to each segment.

The Bank determines a separate allowance for each portfolio segment. The allowance consists of specific and general reserves. Specific reserves relate to loans that are individually classified as impaired. A loan is impaired when, based on current information and events, it is probable that the Bank will be unable to collect all amounts due according to the contractual terms of the loan agreement. Factors considered in determining impairment include payment status, collateral value, and the probability of collecting all amounts when due. Measurement of impairment is based on the expected future cash flows of an impaired loan, which are to be discounted at the loan's effective interest rate, or measured by reference to an observable market value, if one exists, or the fair value of the collateral for a collateral-dependent loan. The Bank selects the measurement method on a loan-by-loan basis except that collateral-dependent loans for which foreclosure is probable are measured at the fair value of the collateral.

The Bank recognizes interest income on impaired loans based on its existing methods of recognizing interest income on nonaccrual loans. 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 and classified as impaired with measurement of impairment as described above.

If a loan is impaired, a portion of the allowance is allocated so that the loan is reported, net, at the present value of estimated future cash flows using the loan's existing rate or at the fair value of collateral if repayment is expected solely from the collateral.

General reserves cover non-impaired loans and are based on historical loss rates for each portfolio segment, adjusted for the effects of qualitative or environmental factors that are likely to cause estimated credit losses as of the evaluation date to differ from the portfolio segment's historical loss experience. Qualitative factors include consideration of the following: changes in lending policies and procedures; changes in economic conditions, changes in the nature and volume of the portfolio; changes in the experience, ability and depth of lending management and other relevant staff; changes in the volume and severity of past due, nonaccrual and other adversely graded loans; changes in the loan review system; changes in the value of the underlying collateral for collateral-dependent loans; concentrations of credit and the effect of other external factors such as competition and legal and regulatory requirements.

NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued

Allowance for Loan Losses - Continued

Portfolio segments identified by the Bank include construction and land development, real estate, commercial and agriculture and consumer loans. Relevant risk characteristics for these portfolio segments generally include debt service coverage, loan-to-value ratios and financial performance on non-consumer loans and debt-to-income, collateral type and loan-to-value ratios for consumer loans.

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, the Federal Deposit Insurance Corporation ("FDIC") and California Department of Business Oversight, 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.

Allowance for Credit Losses on Off-Balance Sheet Credit Exposures

The Bank also maintains a separate allowance for off-balance sheet commitments. Management estimates anticipated losses using historical data and utilization assumptions. The allowance for off-balance sheet commitments totaled $82,000 at December 31, 2018 and 2017, and is included in other liabilities on the balance sheet.

Federal Home Loan Bank ("FHLB") and Other Bank Stock

The Bank is a member of the FHLB system. Members are required to own a certain amount of stock based on the level of borrowings and other factors, and may invest in additional amounts. The Bank also has restricted securities in the form of capital stock invested in Pacific Coast Banker's Bank and The Independent Banker Bank. FHLB stock is carried at cost, classified as a restricted security, and periodically evaluated for impairment based on the ultimate recovery of par value. Both cash and stock dividends are reported as income. The Bank's investment in FHLB stock was approximately $1,080,000 and $916,000 at December 31, 2018 and 2017, respectively.

Pursuant to the adoption of ASU 2016-01 on January 1, 2018, the Bank elected the measurement alternative for measuring equity securities without readily determinable fair values at cost less impairment, plus or minus observable price changes in orderly transactions. The carrying amount of equity securities without readily determinable fair values is $256,000 as of December 31, 2018 and 2017, and includes investment in Pacific Coast Bankers' Bank ("PCBB") and The Independent Banker Bank stock. No gain or loss was recorded to income upon adoption the ASU during the year ended December 31, 2018. Adjustments to the carrying value of bankers bank stock is based on observable activity in the stock when available.

NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued

Other Real Estate Owned ("OREO")

Real estate acquired through foreclosure or deed in lieu of foreclosure is recorded at fair value at the date legal title is transferred, establishing a new cost basis by a charge to the allowance for loan losses, if necessary. Other real estate owned is carried at the lower of the Bank's carrying value of the property or its fair value, less estimated carrying costs and costs of disposition. Fair value is based on current appraisals less estimated selling costs. Any subsequent write-downs are charged against operating expenses and recognized as a valuation allowance. Operating expenses of such properties, net of related income, and gains and losses on their disposition are included in other operating expenses. As of December 31, 2018 the Bank had no other real estate owned.

Premises and Equipment

Land is carried at cost. Premises and equipment are carried at cost less accumulated depreciation and amortization. Depreciation is computed using the straight-line method over the estimated useful lives, which ranges from three to seven years for furniture and equipment and forty years for premises. Leasehold improvements are amortized using the straight-line method over the estimated useful lives of the improvements or the remaining lease term, whichever is shorter. Expenditures for betterments or major repairs are capitalized and those for ordinary repairs and maintenance are charged to operations as incurred.

Bank Owned Life Insurance

Bank owned life insurance is recorded at the amount that can be realized under insurance contracts at the date of the statement of financial condition, which is the cash surrender value adjusted for other charges or other amounts due that are probable at settlement.

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 reasonable estimated. Management does not believe there now are such matters that will have a material effect on the financial statements.

Revenue Recognition – Noninterest Income

The Bank adopted the provisions of ASU No. 2014-09, Revenue from Contracts with Customers (Topic 606), on January 1, 2018 and all subsequent ASUs that modified Topic 606. Results for reporting periods beginning after December 31, 2017 are presented under Topic 606, while prior period amounts have not been adjusted and continue to be reported in accordance with Topic 605. The Bank recognizes revenue as it is earned and noted no significant impact to its revenue recognition policies as a result of the adoption of ASU 2014-09. All of the Bank's revenue from contracts with customers within the scope of ASC 606 is recognized in non-interest income.

NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued

Revenue Recognition – Noninterest Income - Continued

In accordance with Topic 606, revenues are recognized when control of promised goods or services is transferred to customers in an amount that reflects the consideration the Bank expects to be entitled to in exchange for those goods or services. To determine revenue recognition for arrangements that an entity determines are within the scope of Topic 606, the Bank performs the following five steps: (i) identify the contract(s) with a customer; (ii) identify the performance obligation in the contract; (iii) determine the transaction price; (iv) allocate the transaction price to the performance obligation in the contract; and (v) recognize revenue when (or as) the Bank satisfies a performance obligation. The Bank only applies the five-step model to contracts when it is probable that the entity will collect the consideration it is entitled to in exchange for the goods or services it transfers to the customer. At contract inception, once the contract is determined to be within the scope of Topic 606, the Bank assesses the goods or services that are promised within each contract and identifies those that contain performance obligation, and assesses whether each promised good or service is distinct. The Bank then recognizes as revenue the amount of the transaction price that is allocated to the respective performance obligation when (or as) the performance obligation is satisfied.

The following is a discussion of key revenues within the scope of the new revenue guidance.

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

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

Gains/Losses on OREO Sales
Gains/losses on the sale of OREO are included in non-interest income and are generally recognized when the performance obligation is complete. This is typically at delivery of control over the property to the buyer at the time of each real estate closing.

NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued

Stock-Based Compensation

The Bank recognizes the cost of employee services received in exchange for awards of stock options, or other equity instruments, based on the grant-date fair value of those awards. This cost is recognized over the period which an employee is required to provide services in exchange for the award, generally the vesting period, on a straight-line basis.

The Bank has elected to account for forfeitures of stock-based awards as they occur. Excess tax benefits and tax deficiencies relating to stock-based compensation are recorded as income tax expense or benefit in the income statement when incurred.

See Note M for additional information on the Bank's stock option plan.

Income Taxes

Deferred income taxes are computed using the asset and liability method, which recognizes a liability or asset representing the tax effects, 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. Realization of tax benefits of deductible temporary differences and operating loss carryforwards depends on having sufficient taxable income of an appropriate character within the carryforward periods.

The Bank has adopted guidance issued by the Financial Accounting Standards Board ("FASB") that clarifies the accounting for uncertainty in tax positions taken or expected to be taken on a tax return and provides that the tax effects from an uncertain tax position can be recognized in the financial statements only if, based on its merits, the position is more likely than not to be sustained on audit by the taxing authorities. Interest and penalties related to uncertain tax positions are recorded as part of income tax expense.

Earnings Per Share ("EPS")

Basic EPS excludes dilution and is computed by dividing income available to common stockholders by the weighted-average number of common shares outstanding for the period. Diluted EPS reflects the potential dilution that could occur if securities or other contracts to issue common stock were exercised or converted into common stock or resulted in the issuance of common stock that then shared in the earnings of the entity.

Comprehensive Income

Changes in unrealized gains and losses on investment securities is the only component of accumulated other comprehensive income for the Bank.

NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued

Reclassifications and Restatement

The 2017 financial statements were restated to correct a transposition error in other liabilities on the statement of financial condition. The impact of the restatement is to reduce other liabilities and total liabilities by $360,000.

Certain reclassifications have been made in the 2017 financial statements to conform to the presentation used in 2018. These reclassifications had no impact on the Bank's previously reported net income and shareholders' equity.

Financial Instruments

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

Fair Value Measurement

Fair value is the exchange price that would be received for an asset or paid to transfer a liability (an 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. Current accounting guidance establishes a fair value hierarchy, which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. The guidance describes three levels of inputs that may be used to measure fair value:

> Level 1: Quoted prices (unadjusted) for identical assets or liabilities in active markets that the entity has the ability to access as of the measurement date.
>
> Level 2: Significant other observable inputs other than Level 1 prices such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data.
>
> Level 3: Significant unobservable inputs that reflect a Bank's own assumptions about the assumptions that market participants would use in pricing an asset or liability.

See Note N for more information and disclosures relating to the Bank's fair value measurements.

NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – Continued

Recently Adopted Accounting Pronouncements

In May 2014, the FASB issued ASU 2014-09 *Revenue from Contracts with Customers*, which requires an entity to recognize the amount of revenue to which it expects to be entitled for the transfer of promised goods or services to customers. The ASU replaces most existing revenue recognition guidance in GAAP. The new standard was effective for the Bank on January 1, 2018. Adoption of ASU 2014-09 did not have a material impact on the Bank's financial statements and related disclosures as the Bank's primary sources of revenues are derived from interest and dividends earned on loans, investment securities, and other financial instruments that are not within the scope of ASU 2014-09. The Bank's revenue recognition pattern for revenue streams within the scope of ASU 2014-09, including but not limited to service charges on deposit accounts and gains/losses on the sale of loans, did not change significantly from current practice. The standard permits the use of either the full retrospective or modified retrospective transition method. The Bank elected to use the modified retrospective transition method which requires application of ASU 2014-09 to uncompleted contracts at the date of adoption however, periods prior to the date of adoption were not retrospectively revised. The impact of the ASU on uncompleted contracts at the date of adoption resulted in the Bank recording a deferred gain from the sale of other real estate owned in a prior period. The deferred gain amounted to $118,000, net of taxes, and was recorded in retained earnings as of January 1, 2018.

In January 2016, the FASB issued ASU 2016-01, *Financial Instruments–Overall: Recognition and Measurement of Financial Assets and Financial Liabilities*. The new standard was effective for the Bank on January 1, 2018. Adoption of ASU 2016-01 did not have a material impact on the Bank's financial statements. Changes made to the current measurement model primarily affect the accounting for equity securities with readily determinable fair values, where changes in fair value impact earnings instead of other comprehensive income. Equity securities without readily marketable fair values are to be carried at amortized cost, less impairment (if any) plus or minus changes resulting from observable price changes in orderly transactions for an identical investment or similar investment of the same issuer. The accounting for other financial instruments, such as loans, investments in debt securities, and financial liabilities is largely unchanged. Additionally, the Bank refined the calculation used to determine the disclosed fair value of loans held for investment as part of adopting this standard reflecting an exit price notion instead of an entrance price. The refined calculation did not have a significant impact on fair value disclosures.

Recent Accounting Guidance Not Yet Effective

In February 2016, the FASB issued Accounting Standards Update (ASU) 2016-02, *Leases (Topic 842)*. The most significant change for lessees is the requirement under the new guidance to recognize right-of-use assets and lease liabilities for all leases not considered short-term leases, which is generally defined as a lease term of less than 12 months. This change will result in lessees recognizing right-of-use assets and lease liabilities for most leases currently accounted for as operating leases under current lease accounting guidance. The amendments in this Update are effective for interim and annual periods beginning after December 15, 2018 for public business entities and one year later for all other entities. The Bank is currently evaluating the effects of ASU 2016-02 on its financial statements and disclosures. Based on leases outstanding at December 31, 2018, the Bank does not expect this ASU to have a material impact on the income statement, but does anticipate an increase of approximately $459,000 in assets and liabilities upon adoption on January 1, 2019.

NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – Continued

Recent Accounting Guidance Not Yet Effective - Continued

In June 2016, the FASB issued ASU No. 2016-13, *Measurement of Credit Losses on Financial Instruments (Topic 326).* This ASU significantly changes how entities will measure credit losses for most financial assets and certain other instruments that aren't measured at fair value through net income. In issuing the standard, the FASB is responding to criticism that today's guidance delays recognition of credit losses. The standard will replace today's "incurred loss" approach with an "expected loss" model. The new model, referred to as the current expected credit loss ("CECL") model, will apply to: (1) financial assets subject to credit losses and measured at amortized cost, and (2) certain off-balance sheet credit exposures. This includes, but is not limited to, loans, leases, held-to-maturity securities, loan commitments, and financial guarantees. The CECL model does not apply to available-for-sale ("AFS") debt securities. For AFS debt securities with unrealized losses, entities will measure credit losses in a manner similar to what they do today, except that the losses will be recognized as allowances rather than reductions in the amortized cost of the securities. As a result, entities will recognize improvements to estimated credit losses immediately in earnings rather than as interest income over time, as they do today. The ASU also simplifies the accounting model for purchased credit-impaired debt securities and loans. ASU 2016-13 also expands the disclosure requirements regarding an entity's assumptions, models, and methods for estimating the allowance for loan and lease losses. In addition, public business entities will need to disclose the amortized cost balance for each class of financial asset by credit quality indicator, disaggregated by the year of origination. ASU No. 2016-13 is effective for interim and annual reporting periods beginning after December 15, 2019 for SEC filers, one year later for non SEC filing public business entities and two years later for nonpublic business entities. Early adoption is permitted for interim and annual reporting periods beginning after December 15, 2018. Entities will apply the standard's provisions as a cumulative-effect adjustment to retained earnings as of the beginning of the first reporting period in which the guidance is effective (i.e., modified retrospective approach). The Bank is currently evaluating the provisions of ASU No. 2016-13 for potential impact on its financial statements and disclosures.

In August 2018, the FASB issued ASU No. 2018-13, *"Disclosure Framework - Changes to the Disclosure Requirements for Fair Value Measurement."* This ASU eliminates, adds and modifies certain disclosure requirements for fair value measurements. Among the changes, entities will no longer be required to disclose the amount of and reasons for transfers between Level 1 and Level 2 of the fair value hierarchy, but will be required to disclose the range and weighted average used to develop significant unobservable inputs for Level 3 fair value measurements. ASU No. 2018-13 is effective for all entities for interim and annual reporting periods beginning after December 15, 2019. Early adoption is permitted. As ASU No. 2018-13 only revises disclosure requirements, it will not have a material impact on the Bank's financial statements.

NOTE B - DEBT SECURITIES

Debt securities have been classified in the statements of financial condition according to management's intent. The amortized cost of securities and their approximate fair values at December 31 were as follows:

December 31, 2018	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Available-for-Sale Securities:				
Small Business Administration Pools	$ -	$ -	$ -	$ -
December 31, 2017				
Available-for-Sale Securities:				
Small Business Administration Pools	$ 51,000	$ -	$ -	$ 51,000

There were no sales of available-for-sale securities in 2018 and 2017.

NOTE C - LOANS

The Bank's loan portfolio consists primarily of loans to borrowers within Monterey County, California and surrounding communities. Although the Bank seeks to avoid concentrations of loans to a single industry or based upon a single class of collateral, real estate and real estate associated businesses are among the principal industries in the Bank's market area and, as a result, the Bank's loan and collateral portfolios are, to some degree, concentrated in those industries. The Bank's loan portfolio concentration in real estate secured credit at December 31, 2018 and 2017 was approximately 83% and 80%, respectively.

The Bank has pledged loans to secure lines of credit with the Federal Home Loan Bank as discussed in Note F.

At December 31, the composition of the loan portfolio is as follows:

	2018	2017
Construction and Land Development	$ 13,155,000	$ 8,145,000
Real Estate - Other:		
1-4 Family Residential	20,034,000	19,982,000
Multifamily Residential	17,916,000	14,596,000
Commercial Real Estate	137,894,000	115,135,000
Commercial and Agriculture:		
Commercial and Industrial	31,909,000	31,611,000
Agriculture Production	9,332,000	8,732,000
Secured by Farmland	17,234,000	10,604,000
Consumer and Other	1,244,000	1,714,000
Total Loans	248,718,000	210,519,000
Allowance for Loan Losses	(4,576,000)	(4,300,000)
Net Loans	$ 244,142,000	$ 206,219,000

The balance of unamortized loan origination costs and premiums, net of unamortized (fees), included in total loans was $870,000 and $438,000 as of December 31, 2018 and 2017, respectively.

A summary of the changes in the allowance for loan losses as of December 31 follows:

	2018	2017
Balance at Beginning of Year	$ 4,300,000	$ 3,421,000
Provision (Benefit) Charged to Expense	250,000	(1,000,000)
Recoveries on Loans Charged Off	26,000	1,879,000
	4,576,000	4,300,000
Less Loans Charged Off	-	-
	$ 4,576,000	$ 4,300,000

NOTE C - LOANS - Continued

The following table presents the activity in the allowance for loan losses for the year 2018 and 2017, and the recorded investment in loans and impairment method as of December 31, 2018 and 2017 by portfolio segment:

December 31, 2018	Construction and Land Development	Real Estate - Other	Commercial and Agriculture	Consumer	Total
Allowance for Loan Losses:					
Beginning of Year	$ 203,000	$ 2,886,000	$ 1,191,000	$ 20,000	$ 4,300,000
Provisions (Benefit)	170,000	67,000	29,000	(16,000)	250,000
Charge-offs	-	-	-	-	-
Recoveries	-	-	26,000	-	26,000
End of Year	$ 373,000	$ 2,953,000	$ 1,246,000	$ 4,000	$ 4,576,000
Reserves:					
Specific	$ -	$ -	$ 61,000	$ -	$ 61,000
General	373,000	2,953,000	1,185,000	4,000	4,515,000
	$ 373,000	$ 2,953,000	$ 1,246,000	$ 4,000	$ 4,576,000
Loans Evaluated for Impairment:					
Individually	$ -	$ 1,675,000	$ 156,000	$ -	$ 1,831,000
Collectively	13,155,000	174,169,000	58,319,000	1,244,000	246,887,000
	$ 13,155,000	$175,844,000	$ 58,475,000	$ 1,244,000	$ 248,718,000
December 31, 2017					
Allowance for Loan Losses:					
Beginning of Year	$ 208,000	$ 1,915,000	$ 1,263,000	$ 35,000	$ 3,421,000
Provisions (Benefit)	(1,448,000)	535,000	(72,000)	(15,000)	(1,000,000)
Charge-offs	-	-	-	-	-
Recoveries	1,443,000	436,000	-	-	1,879,000
End of Year	$ 203,000	$ 2,886,000	$ 1,191,000	$ 20,000	$ 4,300,000
Reserves:					
Specific	$ -	$ -	$ 47,000	$ -	$ 47,000
General	203,000	2,886,000	1,144,000	20,000	4,253,000
	$ 203,000	$ 2,886,000	$ 1,191,000	$ 20,000	$ 4,300,000
Loans Evaluated for Impairment:					
Individually	$ 538,000	$ 1,816,000	$ 160,000	$ -	$ 2,514,000
Collectively	7,607,000	147,897,000	50,787,000	1,714,000	208,005,000
	$ 8,145,000	$149,713,000	$ 50,947,000	$ 1,714,000	$ 210,519,000

NOTE C - LOANS - Continued

The Bank categorizes loans into risk categories based on relevant information about the ability of borrowers to service their debt such as current financial information, historical payment experience, collateral adequacy, credit documentation, and current economic trends, among other factors. The Bank analyzes loans individually by classifying the loans as to credit risk. This analysis typically includes larger, non-homogeneous loans such as commercial real estate and commercial and industrial loans. This analysis is performed on an ongoing basis as new information is obtained. The Bank uses the following definitions for risk ratings:

Pass - Loans classified as pass include loans not meeting the risk ratings defined below.

Special Mention - Loans classified as special mention have a potential weakness that deserves management's close attention. If left uncorrected, these potential weaknesses may result in deterioration of the repayment prospects for the loan or of the institution's credit position at some future date.

Substandard - Loans classified as substandard are inadequately protected by the current net worth and paying capacity of the obligor or of the collateral pledged, if any. Loans so classified have a well-defined weakness or weaknesses that jeopardize the liquidation of the debt. They are characterized by the distinct possibility that the institution will sustain some loss if the deficiencies are not corrected.

Doubtful - A loan 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 risk category of loans by class of loans was as follows as of December 31, 2018:

December 31, 2018	Pass	Special Mention	Substandard	Doubtful	Total
Construction and Land Development	$ 13,155,000	$ -	$ -	$ -	$ 13,155,000
Real Estate - Other:					
1-4 Family Residential	18,734,000	-	1,300,000	-	20,034,000
Multifamily Residential	17,668,000	248,000	-	-	17,916,000
Commercial Real Estate	136,448,000	1,071,000	375,000	-	137,894,000
Commercial and Agriculture:					
Commercial and Industrial	31,520,000	-	389,000	-	31,909,000
Agriculture Production	9,332,000	-	-	-	9,332,000
Secured by Farmland	13,556,000	3,678,000	-	-	17,234,000
Consumer and Other	1,244,000	-	-	-	1,244,000
	$241,657,000	$ 4,997,000	$ 2,064,000	$ -	$ 248,718,000

NOTE C - LOANS - Continued

The risk category of loans by class of loans was as follows as of December 31, 2017:

December 31, 2017	Pass	Special Mention	Substandard	Doubtful	Total
Construction and Land Development	$ 7,607,000	$ -	$ 538,000	$ -	$ 8,145,000
Real Estate - Other:					
1-4 Family Residential	18,576,000	-	1,406,000	-	19,982,000
Multifamily Residential	14,596,000	-	-	-	14,596,000
Commercial Real Estate	112,433,000	-	2,702,000	-	115,135,000
Commercial and Agriculture:					
Commercial and Industrial	31,573,000	38,000	-	-	31,611,000
Agriculture Production	8,572,000	-	160,000	-	8,732,000
Secured by Farmland	10,604,000	-	-	-	10,604,000
Consumer and Other	1,714,000	-	-	-	1,714,000
	$205,675,000	$ 38,000	$ 4,806,000	$ -	$ 210,519,000

An aging analysis of the loan portfolio by past due, nonaccrual and current loans presented by loan class is as follows as of December 31, 2018:

December 31, 2018	30-89 Days Past Due	Over 90 Days Past Due and Still Accruing	Nonaccrual	Current	Total Loans
Construction and Land Development	$ -	$ -	$ -	$ 13,155,000	$ 13,155,000
Real Estate - Other:					
1-4 Family Residential		-	1,300,000	18,734,000	20,034,000
Multifamily Residential	-	-	-	17,916,000	17,916,000
Commercial Real Estate	-	-	375,000	137,519,000	137,894,000
Commercial and Agriculture:					
Commercial and Industrial	-	-	26,000	31,883,000	31,909,000
Agriculture Production	-	-	-	9,332,000	9,332,000
Secured by Farmland	-	-	-	17,234,000	17,234,000
Consumer and Other	-	-	-	1,244,000	1,244,000
	$ -	$ -	$ 1,701,000	$247,017,000	$248,718,000

NOTE C - LOANS - Continued

An aging analysis of the loan portfolio by past due, nonaccrual and current loans presented by loan class is as follows as of December 31, 2017:

December 31, 2017	30-89 Days Past Due	Over 90 Days Past Due and Still Accruing	Nonaccrual	Current	Total Loans
Construction and Land Development	$ -	$ -	$ 538,000	$ 7,607,000	$ 8,145,000
Real Estate - Other:					
1-4 Family Residential	130,000	-	-	19,852,000	19,982,000
Multifamily Residential	-	-	-	14,596,000	14,596,000
Commercial Real Estate	-	-	410,000	114,725,000	115,135,000
Commercial and Agriculture:					
Commercial and Industrial	-	-	-	31,611,000	31,611,000
Agriculture Production	-	-	-	8,732,000	8,732,000
Secured by Farmland	-	-	-	10,604,000	10,604,000
Consumer and Other	-	-	-	1,714,000	1,714,000
	$ 130,000	$ -	$ 948,000	$209,441,000	$210,519,000

Information relating to individually impaired loans presented by class of loans was as follows as of December 31:

			Impaired Loans				
December 31, 2018	Unpaid Principal Balance	Recorded Investment	Without Specific Allowance	With Specific Allowance	Related Allowance	Average Recorded Investment	Interest Income Recognized
Construction and Land Development	$ -	$ -	$ -	$ -	$ -	$ -	$ -
Real Estate - Other:							
1-4 Family Residential	1,322,000	1,300,000	1,300,000	-	-	718,000	-
Multifamily Residential	-	-	-	-	-	-	-
Commercial Real Estate	424,000	375,000	375,000	-	-	509,000	-
Commercial and Agriculture:							
Commercial and Industrial	29,000	26,000	26,000	-	-	34,000	-
Agriculture Production	130,000	130,000	-	130,000	61,000	159,000	11,000
	$ 1,905,000	$1,831,000	$ 1,701,000	$ 130,000	$ 61,000	$ 1,420,000	$ 11,000
December 31, 2017							
Construction and Land Development	$ 627,000	$ 538,000	$ 538,000	$ -	$ -	$ 479,000	$ -
Real Estate - Other:							
1-4 Family Residential	1,406,000	1,406,000	1,406,000	-	-	281,000	14,000
Multifamily Residential	-	-	-	-	-	389,000	-
Commercial Real Estate	424,000	410,000	410,000	-	-	2,172,000	24,000
Commercial and Agriculture:							
Commercial and Industrial	-	-	-	-	-	364,000	27,000
Agriculture Production	160,000	160,000	-	160,000	47,000	297,000	12,000
	$ 2,617,000	$2,514,000	$ 2,354,000	$ 160,000	$ 47,000	$ 3,982,000	$ 77,000

Cash basis income recognized on impaired loans for the years ended December 31, 2018 and 2017 was not material.

NOTE C - LOANS - Continued

At December 31, 2018 and 2017, the Bank had approximately $130,000 and $160,000 in recorded investment in loans identified as troubled debt restructurings, respectively, and had allocated approximately $61,000 and $47,000 as specific reserves for these loans, respectively. The Bank has committed not to lend additional amounts to customers with outstanding loans that are classified as troubled debt restructurings as of December 31, 2018. No loans were modified as troubled debt restructurings during 2018 and 2017.

There were no loans modified as troubled debt restructuring for which there was a payment default within twelve months following the modification during the years ended December 31, 2018 and 2017. A loan is considered to be in payment default once it is 90 days contractually past due under the modified terms.

NOTE D - PREMISES AND EQUIPMENT

A summary of premises and equipment as of December 31 follows:

	2018	2017
Land	$ 111,000	$ 111,000
Bank Premises	284,000	284,000
Leasehold Improvements	1,187,000	1,153,000
Furniture, Fixtures, and Equipment	1,623,000	1,534,000
	3,205,000	3,082,000
Less Accumulated Depreciation and Amortization	(2,461,000)	(2,299,000)
	$ 744,000	$ 783,000

Depreciation and amortization included in occupancy and equipment expense totaled $162,000 and $186,000 during the years ended December 31, 2018 and 2017, respectively.

NOTE D - PREMISES AND EQUIPMENT - Continued

The Bank has entered into a lease for its main office, which will expire in March 2021. The lease also includes provisions for options to extend the lease. The Bank has leased its Monterey branch location, which will expire in May 2020. The lease also includes a provision to extend the lease for an additional three years. The leases include provisions for periodic rent increases as well as payment by the lessee of certain operating expenses. Rental expense relating to these leases and other short term rentals was approximately $233,000 and $228,000 for the years ended December 31, 2018 and 2017, respectively.

At December 31, 2018, the future lease rental payable under noncancellable operating lease commitments for the Bank's main office and Monterey branch was as follows:

2019	$ 261,000
2020	225,000
2021	50,000
	$ 536,000

The minimum rental payments shown above are given for the existing lease obligations and are not a forecast of future rental expense.

NOTE E - DEPOSITS

Deposits consist of the following at December 31:

	2018	2017
Deposits:		
Noninterest-bearing Demand	$ 113,785,000	$ 112,172,000
Savings and NOW Accounts	30,527,000	30,112,000
Money Market Accounts	83,538,000	73,929,000
Time Deposits Under $250,000	37,170,000	20,105,000
Time Deposits $250,000 and Over	21,346,000	5,271,000
Total Deposits	$ 286,366,000	$ 241,589,000

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

2019	$ 53,375,000
2020	3,482,000
2021	1,633,000
2022	-
2023	26,000
	$ 58,516,000

NOTE E - DEPOSITS - Continued

The Bank's ten largest deposit relationships represent approximately $94,639,000 or 33% of the total outstanding deposits of the Bank. The loss of any one of these large depositors could have a material impact on our operations. However, some of these large depositors have other business relationships with us, such as commercial loans and lines of credit, and or are related parties, which we believe mitigates the risk of a material decline in these deposits.

NOTE F - OTHER BORROWINGS

The Bank may borrow up to $14,000,000 overnight on an unsecured basis from three correspondent banks. As of December 31, 2018 and 2017, no amounts were outstanding under these arrangements.

As of December 31, 2018, the Bank had an available line of credit with the Federal Home Loan Bank of San Francisco ("FHLB") secured by the assets of the Bank. Under this line, the Bank may borrow up to $55,281,000 subject to providing adequate collateral and continued compliance with the Advances and Security Agreement and other eligibility requirements established by the FHLB. The Bank has pledged all of its loans as collateral for this line. As of December 31, 2018 and 2017, no advances were outstanding under this arrangement.

NOTE G - INCOME TAXES

The provision for income taxes for the years ended December 31, consists of the following:

	2018	2017
Current:		
Federal	$ 494,000	$ 33,000
State	1,000	1,000
	495,000	34,000
Deferred Taxes	499,000	1,089,000
Deferred Tax Asset Adjustment for Enacted Change in Tax Rate	-	147,000
	$ 994,000	$ 1,270,000

Income tax expense for 2017 includes a downward adjustment of net deferred assets in the amount of $147,000, recorded as a result of the enactment of H.R. 1 Tax Cuts and Jobs Act on December 22, 2017. The Act reduced corporate Federal tax rates from 34% to 21% effective January 1, 2018.

The Bank is subject to federal income tax and franchise tax of the state of California. Income tax returns for years ending on or after December 31, 2015 and 2014 are open to audit by the federal and state authorities, respectively. The Bank does not expect the total amount of unrecognized tax benefits to significantly increase or decrease within the next twelve months.

NOTE G - INCOME TAXES - Continued

At December 31, 2018 the Bank has California tax credit carryforwards of $81,000 which expire in 2024 and California alternative minimum tax credit carryforwards of $5,000 which do not expire.

Deferred taxes are a result of differences between income tax accounting and generally accepted accounting principles with respect to income and expense recognition. The following is a summary of the components of the net deferred tax asset accounts recognized in the accompanying statement of financial condition at December 31:

	2018	2017
Deferred Tax Assets:		
Depreciation Differences	$ 111,000	$ 102,000
Allowance for Loan Losses Due to Tax Limitations	339,000	265,000
Nonaccrual Loan Interest	94,000	119,000
Stock-Based Compensation	-	1,000
Net Operating Loss Carryforwards	-	160,000
Tax Credits	68,000	386,000
Other Assets and Liabilities	147,000	201,000
	759,000	1,234,000
Deferred Tax Liabilities:		
Deferred Loan Costs	(149,000)	(147,000)
Other Assets and Liabilities	(101,000)	(79,000)
	(250,000)	(226,000)
Net Deferred Tax Assets	$ 509,000	$ 1,008,000

A comparison of the federal statutory income tax rates to the Bank's effective income tax rates follows:

	2018		2017	
	Amount	Rate	Amount	Rate
Statutory Federal Tax	$ 725,000	21.0%	$ 966,000	34.0%
State Tax, Net of Federal Benefit	288,000	8.3%	196,000	6.9%
Tax Impact from Enacted Change in Tax Rate	-	-	147,000	5.2%
Tax Free Income	(26,000)	(0.8%)	(45,000)	(1.6%)
Other Items, Net	7,000	0.3%	6,000	0.2%
	$ 994,000	28.8%	$ 1,270,000	44.7%

NOTE H - OTHER EXPENSES

Other expenses as of December 31 are comprised of the following:

	2018	2017
Professional Fees	$ 356,000	$ 560,000
Data Processing	815,000	819,000
Director Fees and Expenses	242,000	162,000
Office Expenses	91,000	80,000
Marketing and Business Promotion	227,000	147,000
Insurance	111,000	188,000
Other Expenses	519,000	604,000
	$ 2,361,000	$ 2,560,000

NOTE I - RELATED PARTY TRANSACTIONS

In the ordinary course of business, the Bank has extended credit to and received deposits from certain members of its Board of Directors and Executive Officers and companies in which they have an interest. These related parties had outstanding deposits at the Bank approximating $11.5 million and $11.0 million and outstanding loans of $2.3 million plus $2.0 million in available credit and $2.4 million outstanding plus $1.0 million in available credit, at December 31, 2018 and 2017, respectively.

NOTE J - EARNINGS PER SHARE ("EPS")

The following is a reconciliation of net income and shares outstanding to the income and number of shares used to compute EPS:

	2018		2017	
	Income	Shares	Income	Shares
Net Income as Reported	$ 2,456,000		$ 1,570,000	
Weighted Average Shares				
Outstanding During the Year	-	3,956,747	-	3,956,747
Used in Basic and Dilutive EPS	$ 2,456,000	3,956,747	$ 1,570,000	3,956,747

At December 31, 2018 and 2017 there were 0 and 1,100 stock options, respectively, that could potentially dilute earnings per share in the future that were not included in the computation of diluted earnings per share because to do so would have been antidilutive.

During 2018, the Bank declared a 10% stock dividend. The per share data in the income statement and footnotes have been adjusted to give effect to this dividend.

NOTE K - COMMITMENTS

In the ordinary course of business, the Bank enters into financial commitments to meet the financing needs of its customers. Those instruments involve, to varying degrees, elements of credit and interest rate risk not recognized in the Bank's financial statements.

The Bank's exposure to loan loss in the event of nonperformance on commitments to extend credit and standby letters of credit is represented by the contractual amount of those instruments. The Bank uses the same credit policies in making commitments as it does for loans reflected in the financial statements.

As of December 31, 2018 and 2017, the Bank had the following outstanding financial commitments whose contractual amount represents credit risk:

	2018	2017
Commitments to Extend Credit	$ 44,283,000	$ 33,269,000
Standby Letters of Credit	2,387,000	2,221,000
	$ 46,670,000	$ 35,490,000

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. Since many of the commitments are expected to expire without being drawn upon, the total amounts do not necessarily represent future cash requirements. The Bank evaluates each client's credit worthiness on a case-by-case basis. The amount of collateral obtained, if deemed necessary by the Bank, is based on management's credit evaluation of the customer. The majority of the Bank's commitments to extend credit and standby letters of credit are secured by real estate, equipment, or personal property.

NOTE L - EMPLOYEE BENEFIT PLAN

The Bank adopted a 401(k) Plan for its employees. Under the plan, eligible employees may defer a portion of their salaries. The plan also provides for a matching contribution by the Bank. The Bank made contributions of $108,000 and $78,000 for 2018 and 2017, respectively.

NOTE M - STOCK-BASED COMPENSATION

The Bank's 2004 Stock Option Plan was approved by its shareholders in April 2005. Under the terms of the 2004 Stock Option Plan, officers and key employees may be granted both nonqualified and incentive stock options and directors and organizers, who are not also an officer or employee, may only be granted nonqualified stock options. The Plan provides for options to purchase 555,750 shares of common stock at a price not less than 100% of the fair market value of the stock on the date of the grant. Stock options expire no later than ten years from the date of the grant and generally vest over three to five years. The Plan provides for accelerated vesting if there is a change of control, as defined in the Plan. The Plan expired in September 2014. All options outstanding may be exercised until their expiration date, however no new options can be issued under this plan.

NOTE M - STOCK-BASED COMPENSATION - Continued

During 2017 the board of directors of the Bank approved the 2017 Omnibus Stock Incentive Plan ("2017 Plan"). The plan was approved in July 2018 by the shareholders. Under the terms of the 2017 Plan, officers and key employees may be granted both nonqualified and incentive stock options and directors and other consultants, who are not also an officer or employee, may only be granted nonqualified stock options. The 2017 Plan also permits the grant of stock appreciation rights ("SARs"), restricted shares, deferred shares, performance shares and performance unit awards. The 2017 Plan provides for the total number of awards of common stock that may be issued over the term of the plan not to exceed 1,079,098 shares, of which a maximum of 539,549 shares may be granted as incentive stock options. The aggregated number of awards that may be granted to an individual participant may not exceed 100,000 shares per year. Stock options and performance share and unit awards are granted at a price not less than 100% of the fair market value of the stock on the date of grant. The 2017 plan provides for accelerated vesting if there is a change of control as defined in the 2017 Plan. Equity awards generally vest over three to five years. Stock options expire no later than ten years from the date of grant.

A summary of the status of the Bank's stock option plans as of December 31, 2018 and changes during the period ended thereon is presented below:

	Shares	Weighted-Average Exercise Price	Weighted-Average Remaining Contractual Term	Aggregate Intrinsic Value
Outstanding at Beginning of Year	1,100	$ 9.09		
Granted	-	$ -		
Exercised	-	$ -		
Forfeited	(1,100)	$ 9.09		
Outstanding at End of Year	-	$ -	0.0 Years	$ -
Options Exercisable	-	$ -	0.0 Years	$ -

NOTE N - FAIR VALUE MEASUREMENT

The following is a description of valuation methodologies used for assets and liabilities recorded at fair value:

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

Other Real Estate Owned
Other real estate owned represents real estate that has been foreclosed and adjusted to fair value. At the time of foreclosure, these assets are recorded at fair value less costs to sell, which becomes the asset's new basis. Any write-downs based on the asset's fair value at the date of foreclosure are charged to the allowance for loan losses. The fair value of other real estate owned is generally based on recent real estate appraisals or broker opinions, obtained from independent third parties, which are frequently adjusted by management to reflect current conditions and estimated selling costs (Level 3).

Appraisals for collateral-dependent loans and other real estate owned are performed by certified general appraisers whose qualifications and licenses have been reviewed and verified by the Bank. Once received, a member of the loan department reviews the assumptions and approaches utilized in the appraisal as well as the overall resulting fair value. The Bank also determines what additional adjustments, if any, should be made to the appraisal values on any remaining other real estate owned to arrive at fair value. No significant adjustments to appraised values have been made as a result of this comparison process as of December 31, 2018.

No assets or liabilities were measured at fair value at December 31, 2018.

The following table provides a hierarchy and fair value for each major category of assets and liabilities measured at fair value at December 31:

	Fair Value Measurements Using				
December 31, 2017	Level 1	Level 2	Level 3	Total	Losses
Assets Measured at Fair Value on a Recurring Basis					
Available-for-Sale Securities	$ -	$ 51,000	$ -	$ 51,000	$ -
Assets Measured at Fair Value on a Non-recurring Basis					
Other Real Estate Owned					
Commercial Real Estate-Non Owner	$ -	$ -	$ 635,000	$ 635,000	$ -

NOTE N - FAIR VALUE MEASUREMENT - Continued

Qualitative information about the Bank's non-recurring Level 3 fair value measurements at December 31 follows:

December 31, 2017	Fair Value Amount	Valuation Technique	Unobservable Input	Range Weighted Average
Other Real Estate Owned:				
Commercial Real Estate	$ 635,000	3rd Party Appraisals	Liquidation and Selling Costs	10%

NOTE O - FAIR VALUE OF FINANCIAL INSTRUMENTS

The fair value of a financial instrument is the amount at which the asset or obligation could be exchanged in a current transaction between willing parties, other than in a forced or liquidation sale. Fair value estimates are made at a specific point in time based on relevant market information and information about the financial instrument.

These estimates do not reflect any premium or discount that could result from offering for sale at one time the entire holdings of a particular financial instrument. Because no market value exists for a significant portion of the financial instruments, fair value estimates are based on judgments regarding future expected loss experience, current economic conditions, risk characteristics of various financial instruments, and other factors. These estimates are subjective in nature, involve uncertainties and matters of judgment and, therefore, cannot be determined with precision. Changes in assumptions could significantly affect the estimates.

Fair value estimates are based on financial instruments both on and off the balance sheet without attempting to estimate the value of anticipated future business and the value of assets and liabilities that are not considered financial instruments. Additionally, tax consequences related to the realization of the unrealized gains and losses can have a potential effect on fair value estimates and have not been considered in many of the estimates.

The following methods and assumptions were used to estimate the fair value of significant financial instruments not previously presented:

Cash and Cash Equivalents
The carrying amounts of cash and short term instruments approximate fair values.

Time Deposits in Other Banks
Fair values for time deposits with other banks are estimated using discounted cash flow analyses, using interest rates currently being offered with similar terms.

NOTE O - FAIR VALUE OF FINANCIAL INSTRUMENTS - Continued

Loans

Fair values of loans, excluding loans held for sale, are based on the exit price notion set forth by ASU 2016-01 effective January 1, 2018 and estimated using discounted cash flow analyses. The estimation of fair values of loans results in a Level 3 classification as it requires various assumptions and considerable judgement to incorporate factors relevant when selling loans to market participants, such as funding costs, return requirements of likely buyers and performance expectations of the loans given the current market environment and quality of loans. Estimated fair value of loans carried at cost at December 31, 2017 were based on an entry price notion.

Federal Home Loan and Other Bank Stock

The fair value of Federal Home Loan and other Bank Stock is not readily determinable due to the lack of its transferability.

Deposits

The fair values disclosed for demand deposits, including interest and non-interest demand accounts, savings, and certain types of money market accounts are, by definition based on carrying value. Fair value for fixed-rate certificates of deposit is estimated using a discounted cash flow calculation that applies interest rates currently being offered on certificates to a schedule of aggregate expected monthly maturities on time deposits. Early withdrawal of fixed-rate certificates of deposit is not expected to be significant.

Accrued Interest Receivable and Payable

The fair value of accrued interest receivable and payable approximate their carrying amounts.

Off-Balance Sheet Financial Instruments

The fair value of commitments to extend credit and standby letters of credit is estimated using the fees currently charged to enter into similar agreements. The fair value of these financial instruments is not material.

The fair value hierarchy level and estimated fair value of financial instruments at December 31, 2018 and 2017 are summarized as follows:

		2018		2017	
	Fair Value Hierarchy	Carrying Value	Fair Value	Carrying Value	Fair Value
Financial Assets:					
Cash and Cash Equivalents	Level 1	$59,416,000	$59,416,000	$45,607,000	$45,607,000
Time Deposits in Other Banks	Level 1	7,595,000	7,595,000	11,760,000	11,760,000
Investment Securities	Level 2	-	-	51,000	51,000
Loans, net	Level 3	244,142,000	245,577,000	206,219,000	206,219,000
Federal Home Loan and Other Bank Stock	N/A	1,336,000	N/A	1,172,000	N/A
Accrued Interest Receivable	Level 2	1,052,000	1,052,000	760,000	760,000
Financial Liabilities:					
Deposits	Level 2	286,366,000	285,846,000	241,589,000	241,589,000
Accrued Interest Payable	Level 2	5,000	5,000	3,000	3,000

NOTE P - REGULATORY MATTERS

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

In July 2013, the federal bank regulatory agencies approved the final rules implementing the Basel Committee on Banking Supervision's capital guidelines for U.S. banks. The new rules became effective on January 1, 2015, with certain of the requirements phased-in over a multi-year schedule, and fully phased in by January 1, 2019. Under 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% by January 1, 2019. The capital conservation buffer for 2018 is 1.875% and for 2017 is 1.25%. The net unrealized gain or loss on available for sale securities is not included in computing regulatory capital.

Quantitative measures established by regulation to ensure capital adequacy require the Bank to maintain minimum amounts and ratios (set forth in the following table) of total, Tier 1 and CET1 capital (as defined in the regulations) to risk-weighted assets (as defined), and of Tier 1 capital (as defined) to average assets (as defined). Management believes, as of December 31, 2018 and 2017, that the Bank meets all capital adequacy requirements.

NOTE P - REGULATORY MATTERS - Continued

As of December 31, 2018 and 2017, the most recent notification from the FDIC 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 Bank's category). To be categorized as well-capitalized, the Bank must maintain minimum ratios as set forth in the table below.

The following table also sets forth the Bank's actual capital amounts and ratios:

			Amount of Capital Required			
	Actual		For Capital Adequacy Purposes		To Be Well-Capitalized Under Prompt Corrective Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
As of December 31, 2018:						
Total Capital (to Risk-Weighted Assets)	$ 35,726,000	14.38%	$ 19,869,000	8.00%	$ 24,836,000	10.00%
Tier 1 Capital (to Risk-Weighted Assets)	$ 32,603,000	13.13%	$ 14,902,000	6.00%	$ 19,869,000	8.00%
CET1 Capital (to Risk-Weighted Assets)	$ 32,603,000	13.13%	$ 11,176,000	4.50%	$ 16,143,000	6.50%
Tier 1 Capital (to Average Assets)	$ 32,603,000	11.11%	$ 11,734,000	4.00%	$ 14,667,000	5.00%
As of December 31, 2017:						
Total Capital (to Risk-Weighted Assets)	$ 32,127,000	14.94%	$ 17,203,000	8.00%	$ 21,504,000	10.00%
Tier 1 Capital (to Risk-Weighted Assets)	$ 29,416,000	13.68%	$ 12,902,000	6.00%	$ 17,203,000	8.00%
CET1 Capital (to Risk-Weighted Assets)	$ 29,416,000	13.68%	$ 9,677,000	4.50%	$ 13,978,000	6.50%
Tier 1 Capital (to Average Assets)	$ 29,416,000	11.07%	$ 10,629,000	4.00%	$ 13,286,000	5.00%

The California Financial Code provides that a bank may not make a cash distribution to its shareholders in excess of the lesser of the bank's undivided profits or the bank's net income for its last three fiscal years less the amount of any distribution made to the bank's shareholders during the same period.

Notes

Pacific Valley Bank Corporate Information

Annual Meeting of Shareholders

The annual meeting of shareholders of Pacific Valley Bank will be held Wednesday, May 22, 2019 at 6:00 P.M. in the Downtown Main Branch Office located at 422 Main Street, Salinas, CA 93901. All shareholders are cordially invited.

Stock Transfer Agent and Registrar

Pacific Valley Bank's stock transfer agent, Continental, maintains all shareholder records and can assist with stock transfer and registration, address changes, and changes or corrections in Social Security or Tax Identification numbers.

Continental Stock Transfer & Trust
Attn: Customer Service
1 State Street, 30th Floor
New York, NY 10004-1561
Overnight/courier
1 State Street, 30th Floor
New York, NY 10004--1561Phone: (800) 509-5586 Email: cstmail@continentalstock.com
Website: www.continentalstock.com

Stock Listing

Pacific Valley Bank is listed on the Over the Counter Bulletin Board (www.otcbb.com) under the symbol PVBK.

Independent Auditors

Vavrinek, Trine, Day & Co., LLP
25231 Paseo De Alicia, Suite 100
Laguna Hills, CA 92653

Legal Counsel
Loren P. Hansen, Esq,
Loren P. Hansen, APC
1301 Dove Street, Suite 370
Newport Beach, CA 92660

Corporate Office
Pacific Valley Bank
422 Main Street
Salinas, CA 93901

Market Makers

Wedbush Securities
One SW Columbia Street, Suite 1000
Portland, OR 97258
Contact: Joey Warmenhoven
(866) 662-0351

Raymond James & Associates
One Embarcadero Center, Suite 650
San Francisco, CA 94111
Contact: John Thomas Cavendar
(415) 616-8935

Western Financial Corporation
600 B Street, Suite 2204
San Diego, CA 92101
Contact: Steven M. Levenson
(800) 488-5990 (619) 234-3235

Pacific Valley Bank Locations

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422 Main Street
Salinas, CA 93901
(831) 771-4330

Monterey
498 Alvarado Street
Monterey, CA 93940
(831) 645-6560

King City
302 Broadway
King City, CA 93930
(831) 385-2200

Board of Directors

Andrew P. Ausonio
President and CEO, Ausonio, Incorporated

Michael D. Cling
Attorney

Anthony M. Cosentino
Real Estate Broker
Vice President, Cosentino Realty Company Inc./
Columbus Property Management

Lucio P. Cosentino
President and CEO
Cosentino Realty Co., Inc./
Columbus Property Management

Anker Fanoe
President & CEO, Pacific Valley Bank

Robert LaBrier
Retired Senior Vice President, American Ag Credit

Guillermo Nieto, Sr.
General Partner, The Nieto Limited Partnership

Joseph L. Robello
Chairman of the Board
Retired Telecommunications Company Owner

Gordon Rubbo
Certified Public Accountant

Senior Management

Anker Fanoe
President & CEO

Lee-Ann Cimino
Executive Vice President & Chief Financial Officer

Carol Corsetti
Executive Vice President & Chief Credit Officer