Community
BANK OF THE BAY

TRUST
RESPECT
COMMITMENT
RELATIONSHIP
SUSTAINABILITY
EMPOWERMENT

2017 ANNUAL REPORT

Dear Community Bank of the Bay Shareholder:

We are pleased to provide a progress report on our CBB 20-20 Strategic Plan, and present 2017 operating results and what they might portend for the future.

As we discussed in last year's letter, we entered 2017 somewhat capital constrained, having grown over $180 million since the 2010 capital raise. Total capital stood at a reasonable 13.64 percent but included $4 million of preferred stock that we anticipated redeeming in 2018. Redeeming the preferred stock would have resulted in a common equity tier 1 capital ratio of only 10.05 percent, literally in the 6th percentile for peer banks according to the Federal Deposit Insurance Corporation's Uniform Bank Performance Report. Managing to this constraint resulted in 2016 being the first year since 2008 where we failed to increase loans outstanding. With a local economy that was gaining strength and capital markets that were attracted to our historic growth, we took advantage of the opportunity to add new capital in the first quarter of 2017 and developed our CBB 20-20 Strategic Plan to reignite growth and improve returns.

Our Plan called for adding experienced personnel and realigning certain job functions and operating procedures for better production and efficiency, training branch personnel to be more sales oriented and converting our San Mateo office to a full service branch. We also planned to introduce new service offerings, technology-based delivery systems and targeted marketing to better attract the new generation of entrepreneurs that are adding such energy to our communities.

Management and the board committed to make these investments while maintaining profitability levels and I am pleased to say that outside of the one-time effect of the year-end Tax Reform Act signed into law on December 22, 2017, we largely accomplished our goals.

We strengthened business development by adding three experienced Relationship Managers, including SVP, Oakland Regional Manager Landon Baines and SVP, Community Banking Manager Jenniffer Collins, and promoted AVP Helen Wyman to the role of Oakland Community Banking Officer to better utilize her passion and deep community roots. Mr. John Barr rejoined the bank as Chief Credit Officer and realigned credit and underwriting with SVP Mike Cook. We also moved the core of our Loan Servicing Department from Campbell to Oakland to improve efficiencies. These are just some of the key personnel, and departmental moves that were made in 2017, and more followed in early 2018, including the introduction of Mr. Mukhtar Ali as Chief Operating Officer.

People are the key to any successful organization and we feel good about the team we have assembled and look forward to the results that can be achieved. Two areas that remain a work in progress are in updating and expanding our customer experience technology and marketing. Both initiatives are well underway and should be fully deployed within the next three to six months.

Our key initiatives also carried through to the board of directors, where we were able to add two experienced business leaders in Mr. Sam Hedgpeth, a successful technology entrepreneur and financial educator, and Mr. Ken Seideman, managing partner of a CPA firm with offices and strong business ties in both the East Bay and Peninsula markets. In addition to their experience and expertise, these new directors contributed greatly to the heightened expectations and goals that we set for ourselves in our CBB 20-20 Plan.

On the whole we believe we have made good progress in executing our CBB 20-20 Plan. With a talented team and adequate capital in place we were once again able to compete for quality clients and serve the financial needs of our communities. The result was that our Bank was able to report a number of financial records in 2017. All three of the key balance sheet measures experienced meaningful growth and finished the year at new highs. Total assets ended the year at $295.7 million and with deposits and loans finishing at $257.2 million and $238.5 million respectively. Deposit growth of 15.1 percent featured a 32.2 percent increase in non-interest bearing deposit accounts, while loans increased by 27.8% having been aided by almost $12 million of single family mortgages that we purchased in order to add leverage and diversification to the balance sheet.

The combination of earning asset growth, interest rate increases and expense control even while adding to staff, offset a $460 thousand decline in premium income from the sale of SBA Loans to generate pre-tax income almost exactly in line with the prior year. Only a one-time $455 thousand write down of our deferred tax asset associated with the 2017 Tax Reform Act caused Net Profit after Taxes to decline.

We believe that 2017's efforts have positioned the Bank for sustained success in 2018 and we entered the year with $34.5 million more in loans outstanding than 2017's average. Having these additional earning assets on the books from the beginning of the year will be a driver of revenue growth, and we expect to steadily add more of these valuable earning assets to our balance sheet throughout the year.

This year will also mark another important milestone for us as we expect to redeem the preferred stock we sold to the US Treasury in 2010 as part of its Community Development Capital Initiative program. The Treasury's investment was extremely important to us and other certified community development financial institutions during the great recession and augmented our local capital initiatives during a very difficult economic time. We have worked hard since then to build a more sustainable institution and we are fully confident that we are in a position to redeem the Treasury's $4 million investment in full.

In summation, we are pleased with our current position. Our local markets remain strong and the trend of increasing interest rates and reduced corporate tax rates are both good for our Bank. We look forward to the year with cautious optimism and heightened expectations.

In closing I will simply ask for your business. Support your investment by working with your Bank whenever possible, especially by maintaining your checking and investment deposits with us. While we pride ourselves on being responsive and resourceful lenders, deposits are truly the lifeblood of a bank and we simply cannot grow safely and soundly without them. If you already do bank with us then I sincerely thank you, and ask that you also consider referring others to us. We will work very hard to exceed their expectations.

Thank you again for your investment in Community Bank of the Bay. All of us at the Bank and on the board appreciate your continued support.

We welcome your attendance at our annual shareholder meeting to be held at the Community Bank of the Bay headquarters in Oakland on June 13, 2018 at 9:00 am.

Sincerely,

William S. Keller
President & CEO

William E. Purcell
Chairman of the Board

REPORT OF INDEPENDENT AUDITORS
AND FINANCIAL STATEMENTS

COMMUNITY BANK OF THE BAY

December 31, 2017 and 2016

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Report of Independent Auditors

The Board of Directors and Shareholders
Community Bank of the Bay

Report on the Financial Statements

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

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

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

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the Bank'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 Bank'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 Community Bank of the Bay as of December 31, 2017 and 2016, and the results of its operations and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Moss Adams LLP

Stockton, California
April 11, 2018

Financial Statements

ASSETS

	December 31, 2017	December 31, 2016
Cash and due from banks	$ 23,226,360	$ 33,429,100
Federal funds sold	275,648	250,565
Total cash and cash equivalents	23,502,008	33,679,665
Interest-bearing deposits in banks	14,085,057	20,194,082
Available-for-sale investment securities	14,938,411	3,361,043
Loans, held for sale	2,620,051	866,545
Loans, less allowance for loan losses of $3,473,818 in 2017 and $3,173,518 in 2016	232,278,259	182,477,082
Premises and equipment, net	396,788	528,465
Bank-owned life insurance	4,139,553	4,026,042
Interest receivable and other assets	3,729,037	3,897,529
Total assets	$ 295,689,164	$ 249,030,453

LIABILITIES AND SHAREHOLDERS' EQUITY

	December 31, 2017	December 31, 2016
DEPOSITS		
Non-interest bearing	$ 100,671,414	$ 76,175,651
Interest bearing	156,533,699	147,255,120
Total deposits	257,205,113	223,430,771
INTEREST PAYABLE AND OTHER LIABILITIES	784,184	708,479
Total liabilities	257,989,297	224,139,250
COMMITMENTS AND CONTINGENCIES (Note 10)		
SHAREHOLDERS' EQUITY		
Preferred stock, no par value; 10,000,000 shares authorized; 4,060 shares issued and outstanding in 2017 and 2016	4,060,000	4,060,000
Class A common stock, voting, no par value; 10,000,000 shares authorized; 6,582,787 and 4,290,107 shares issued and outstanding in 2017 and 2016, respectively	33,841,525	22,156,169
Class B common stock, non-voting, no par value; 10,000,000 shares authorized; 56,844 shares issued and outstanding in 2017 and 2016	1,421,100	1,421,100
Accumulated deficit	(1,537,321)	(2,683,547)
Accumulated other comprehensive (loss), net of taxes	(85,437)	(62,519)
Total shareholders' equity	37,699,867	24,891,203
Total liabilities and shareholders' equity	$ 295,689,164	$ 249,030,453

	Years Ended December 31, 2017	2016
INTEREST INCOME		
Interest and fees on loans	$ 10,424,444	$ 10,209,965
Interest on investment securities	199,729	165,765
Interest on federal funds sold	96	3
Interest on deposits in banks	583,700	377,081
	11,207,969	10,752,814
INTEREST EXPENSE		
Interest expense on deposits	936,713	822,856
Interest on borrowings	1	25
Total interest expense	936,714	822,881
Net interest income	10,271,255	9,929,933
PROVISION FOR LOAN LOSSES	325,000	-
Net interest income after provision for loan losses	9,946,255	9,929,933
NON-INTEREST INCOME		
Service charges	171,536	250,240
Government grant	227,282	-
Gain on sale of securities	-	9,469
Gain on sale of loans, net	277,785	727,860
Other income	441,456	474,847
Total non-interest income	1,118,059	1,462,416
NON-INTEREST EXPENSES		
Salaries and employee benefits	4,180,616	4,495,425
Stock option expense	282,354	233,898
Occupancy and equipment	1,365,954	1,339,604
Other expenses	2,260,998	2,347,427
Total non-interest expenses	8,089,922	8,416,354
Net operating income before provision for income taxes	2,974,392	2,975,995
INCOME TAX EXPENSE	1,746,966	1,187,000
Net income	1,227,426	1,788,995
Dividends on preferred stock	81,200	81,200
Net income available to common shareholders	$ 1,146,226	$ 1,707,795
NET INCOME PER SHARE – BASIC	$ 0.17	$ 0.39
NET INCOME PER SHARE – DILUTED	$ 0.17	$ 0.38

Community Bank of the Bay
Statements of Comprehensive Income

	Years Ended December 31, 2017	Years Ended December 31, 2016
NET INCOME	$ 1,227,426	$ 1,788,995
UNREALIZED (LOSS) GAIN on available-for-sale securities	(85,437)	(4,212)
RECLASSIFICATION ADJUSTMENT FOR net gain realized and reported in net income	-	(9,469)
Net unrealized (losses) gains	(85,437)	(13,681)
INCOME TAX EXPENSE	62,519	-
OTHER COMPREHENSIVE LOSS	(22,918)	(13,681)
TOTAL COMPREHENSIVE INCOME	$ 1,204,508	$ 1,775,314

See accompanying notes and report of independent auditors.

	Preferred Stock	Class A Common Stock		Class B Common Stock		Accumulated Deficit	Accumulated Other Comprehensive Loss	Total Shareholders' Equity
		Shares	Amount	Shares	Amount			
BALANCES, January 1, 2016	$ 4,060,000	4,175,591	$ 21,528,681	56,844	$ 1,421,100	$ (4,391,342)	$ (48,838)	$ 22,569,601
Stock option exercised	-	114,516	393,590	-	-	-	-	393,590
Stock option expense	-	-	233,898	-	-	-	-	233,898
Dividend paid on preferred stock	-	-	-	-	-	(81,200)	-	(81,200)
Net income	-	-	-	-	-	1,788,995	-	1,788,995
Other comprehensive loss	-	-	-	-	-	-	(13,681)	(13,681)
BALANCES, December 31, 2016	4,060,000	4,290,107	22,156,169	56,844	1,421,100	(2,683,547)	(62,519)	24,891,203
Issue of shares, net of offering costs	-	2,285,715	11,391,973	-	-	-	-	11,391,973
Stock option exercised	-	6,965	11,029	-	-	-	-	11,029
Stock option expense	-	-	282,354	-	-	-	-	282,354
Dividend paid on preferred stock	-	-	-	-	-	(81,200)	-	(81,200)
Net income	-	-	-	-	-	1,227,426	-	1,227,426
Other comprehensive loss	-	-	-	-	-	-	(22,918)	(22,918)
BALANCES, December 31, 2017	$ 4,060,000	6,582,787	$ 33,841,525	56,844	$ 1,421,100	$ (1,537,321)	$ (85,437)	$ 37,699,867

See accompanying notes and report of independent auditors.

Community Bank of the Bay
Statements of Cash Flows

	Years Ended December 31, 2017	2016
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income	$ 1,227,426	$ 1,788,995
Adjustments to reconcile net income to net cash from operating activities:		
Provision for loan losses	325,000	-
Change in deferred loan origination fees, net	(93,314)	33,626
Depreciation, amortization, and accretion	208,960	206,133
Gain on sale of securities	-	(9,469)
Proceeds from the sale of loans held for sale	3,271,836	7,292,413
Originations of loans held for sale	(4,747,557)	(5,551,152)
Gain on sale of loans, net	(277,785)	(727,860)
Stock option expense	282,354	233,898
Increase in cash surrender value of bank owned life insurance	(113,511)	(119,571)
Decrease in interest receivable and other assets	143,152	297,956
Increase (decrease) in interest payable and other liabilities	75,705	(146,906)
Net cash provided by operating activities	302,266	3,298,063
CASH FLOWS FROM INVESTING ACTIVITIES		
Proceeds from sold, called, and matured available-for-sale investment securities	-	2,458,159
Proceeds from principal repayments from available-for-sale investment securities	966,998	490,152
Purchases of available-for-sale investment securities	(12,578,702)	(2,520,988)
Purchase of interest-bearing deposits	-	(5,782,082)
Proceeds from maturities of interest-bearing deposits	6,109,025	-
Net (increase) decrease in loans	(50,032,863)	11,892,661
Purchases of premises and equipment	(40,525)	(91,302)
Purchases of FHLB stock	-	(59,900)
Proceeds from sale of premises and equipment	-	45,707
Net cash (used in) provided by investing activities	(55,576,067)	6,432,407

	Years Ended December 31, 2017	2016
CASH FLOWS FROM FINANCING ACTIVITIES		
Net increase in demand, interest bearing, and savings deposits	38,872,265	11,328,409
Net decrease in time deposits	(5,097,923)	(5,867,520)
Issue of common stock	12,000,004	-
Stock offering cost	(608,031)	-
Dividends paid on preferred stock	(81,200)	(81,200)
Proceeds from exercise of stock options	11,029	393,590
Net cash provided by financing activities	45,096,144	5,773,279
NET (DECREASE) INCREASE IN CASH AND CASH EQUIVALENTS	(10,177,657)	15,503,749
CASH AND CASH EQUIVALENTS, beginning of year	33,679,665	18,175,916
CASH AND CASH EQUIVALENTS, end of year	$ 23,502,008	$ 33,679,665
SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION:		
Cash paid during the year for:		
Interest expense	$ 937,485	$ 817,123
Income taxes	$ 1,067,000	$ 1,220,000

Note 1 – Organization and Nature of Business

General

Community Bank of the Bay (the Bank) is a California state chartered bank that commenced banking operations on July 22, 1996. The Bank provides a range of banking services to individuals and businesses in the greater San Francisco Bay area, especially businesses employing residents of low and moderate income neighborhoods. The Bank's primary source of revenue is generated from providing loans to customers who are predominately small and middle market businesses and individuals residing in the surrounding areas.

Note 2 – Summary of Significant Accounting Policies

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

Use of Estimates

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

The allowance for loan losses is the most significant accounting estimate reflected in the Bank's financial statements. The allowance for loan losses includes charges to reduce the recorded balances of loans receivable to their estimated net realizable value, as appropriate. The allowance is based on estimates, and ultimate losses may vary from current estimates. These estimates for losses are based on individual assets and their related cash flow forecasts, sales values, independent appraisals, the volatility of certain real estate markets, and concern for disposing of real estate in distressed markets. Although management of the Bank believes the estimates underlying the calculation of specific allowances are reasonable, there can be no assurances that the Bank could ultimately realize these values. In addition to providing valuation allowances on specific assets where a decline in value has been identified, the Bank establishes general valuation allowances for losses based on the overall portfolio composition, general market conditions, concentrations, and prior loss experience.

Other significant management judgments and accounting estimates reflected in the Bank's financial statements include:

- Decisions regarding the timing and placement of loans on non-accrual;
- Determination, recognition, and measurement of impaired loans;
- Determination and evaluation of deferred tax assets and liabilities;
- Determination of the fair value of stock option awards; and
- Determination of the fair value of financial instruments.

Note 2 – Summary of Significant Accounting Policies (continued)

Concentrations of Credit Risk
Assets and liabilities that subject the Bank to concentrations of credit risk consist of loans and deposits. Most of the Bank's customers are located within Alameda and Contra Costa counties and the surrounding areas. The Bank's primary lending products are discussed in Note 5 to the financial statements. The Bank did not have any significant concentrations in its business with any one customer or industry. The Bank obtains what it believes to be sufficient collateral to secure potential losses on loans. The extent and value of collateral varies based upon the details underlying each loan agreement.

As of December 31, 2017 and 2016, the Bank had cash deposits at other financial institutions in excess of FDIC insured limits. However, as the Bank places these deposits with major financial institutions and monitors the financial condition of these institutions, management believes the risk of loss to be minimal.

Cash and Cash Equivalents
For purposes of the statements of cash flows, the Bank considers cash, due from banks, money market funds, federal funds sold, and securities purchased under agreements to resell to be cash equivalents. All have original maturities of three months or less.

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

Management determines the appropriate classification of its investment securities at the time of purchase and may only change the classification in certain limited circumstances. At December 31, 2017 and 2016, all of the Bank's investments were classified as available-for-sale.

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

Investments with fair values that are less than amortized cost are considered impaired. Impairment may result from either a decline in the financial condition of the issuing entity or, in the case of fixed interest rate investments, from rising interest rates. At each financial statement date, management assesses each investment to determine if impaired investments are temporarily impaired or if the impairment is other than temporary. This assessment includes a determination of whether the Bank intends to sell the security, or if it is more likely than not that the Bank will be required to sell the security before recovery of its amortized cost basis less any current-period credit losses. For debt securities that are considered other than temporarily impaired and that the Bank does not intend to sell and will not be required to sell prior to recovery of the amortized cost basis, the amount of impairment is separated into the amount that is credit related (credit loss component) and the amount due to all other factors. The credit loss component is recognized in earnings and is calculated as the difference between the security's amortized cost basis and the present value of its expected future cash flows. The remaining difference between the security's fair value and the present value of the future expected cash flows is deemed to be due to factors that are not credit related and is recognized in other comprehensive income (loss).

Note 2 – Summary of Significant Accounting Policies (continued)

Investment in Federal Home Loan Bank Stock
In order to borrow from the Federal Home Loan Bank (FHLB), the Bank is required to maintain an investment in FHLB capital stock. The investment of $893,200 and $893,200 at December 31, 2017 and 2016, respectively, is carried at cost, redeemable at par, at the discretion of the FHLB, and included in interest receivable and other assets on the balance sheets.

Loans and Loan Fees
Loans are reported at their principal outstanding balance net of charge-offs. Loan origination fees and certain direct loan origination costs are deferred and the net amounts are amortized to interest income by a method that approximates a level yield over the contractual life of the underlying loans.

Income Recognition on Loans
Interest on loans, other than discounted installment loans, is credited to income based on the principal amount outstanding on a daily basis. Interest on discounted installment loans is recognized by a method which approximates the effective interest method. Interest accruals are discontinued on certain loans when collection of principal or interest is considered doubtful, or when a loan becomes contractually past due by 90 days or more with respect to interest or principal. When a loan is placed on non-accrual status, all interest previously accrued but not collected is reversed against current period interest income. Income on such loans is then recognized only to the extent that cash is received and where the future collection of principal is probable. Interest accruals are resumed on such loans when, in the judgment of management, the loans are estimated to be fully collectible as to both principal and interest.

Allowance for Loan Losses
The allowance for loan losses is established through a provision for loan losses charged to operations. The adequacy of the allowance for loan losses is periodically evaluated by the Bank in order to maintain the allowance at a level that, in the opinion of management, is adequate to absorb losses inherent in existing loans. Management's evaluation of the adequacy of the allowance is based on a consideration of the Bank's historical loss experience, known and inherent risks in the loan portfolio, including adverse circumstances that may affect the ability of the borrower to repay interest and/or principal, the estimated value of any underlying collateral, and an analysis of the levels and trends of delinquencies and charge-offs. Actual results could differ from those estimates.

When a loan or portion of a loan is determined to be uncollectible, the portion deemed uncollectible is charged against the allowance and subsequent recoveries, if any, are credited to the allowance.

The allowance consists of specific, general, and unallocated components. The specific component relates to loans that are classified as impaired. Impaired loans, as defined, are measured based on the present value of expected future cash flows discounted at the loan's effective interest rate or the fair value of the collateral, if the loan is collateral dependent. The general component relates to non-impaired loans and is based on historical loss experience adjusted for qualitative factors. An unallocated component may be maintained to cover uncertainties that could affect management's estimate of probable losses. The unallocated component of the allowance reflects the margin of imprecision inherent in the underlying assumptions used in the methodologies for estimating specific and general losses in the portfolio.

Note 2 – Summary of Significant Accounting Policies (continued)

A loan is considered impaired if, based on current information and events, it is probable that the Bank will be unable to collect the scheduled payments of principal or interest when due, according to the contractual terms of the loan agreement.

Troubled Debt Restructuring
In situations where, for economic or legal reasons related to a borrower's financial difficulties, the Bank grants a concession to the borrower that it would not otherwise consider, the related loan is classified as a troubled debt restructuring. The Bank measures any loss on the troubled debt restructuring in accordance with the guidance concerning impaired loans set forth above. Additionally, loans modified in troubled debt restructurings are generally placed on non-accrual status at the time of restructuring. These loans are returned to accrual status after the borrower demonstrates performance with the modified terms for a sustained period of time (generally six months) and has the capacity to continue to perform in accordance with the modified terms of the restructured debt.

Loans Held for Sale
The Bank has originated government guaranteed loans to customers under the Small Business Administration (SBA) program. The SBA provides guarantees of 75% to 90% of each loan. For some of these loans, the Bank sells the guaranteed portion of the loan to a third party and retains the unguaranteed portion in its own portfolio. Loans held for sale include government loans and are reported at the lower of cost or fair value. Fair value is based on what secondary markets are currently offering for portfolios with similar characteristics. Gains or losses on the sale of loans that are held for sale are recognized at the time of the sale, subject to the expiration of any warranty or recourse provisions, and determined by the difference between net sale proceeds and the net book value of the loans less the estimated fair value of any retained mortgage servicing rights and estimated discount recognized against the retained portion of the loan.

Servicing Assets
Periodically, the Bank sells loans and retains the servicing rights. The gain or loss on sale of loans depends in part on the previous carrying amount of the financial assets involved in the transfer, allocated between the assets sold and the retained interests based on their relative fair value at the date of transfer. To obtain fair values, quoted market prices are used, if available. However, quotes are generally not available for retained interests, so the Bank generally estimates fair value based on the present value of future expected cash flows using management's best estimates of the key assumptions – credit losses, prepayment speeds, forward yield curves, and discount rates commensurate with the risks involved.

The Bank measures servicing assets initially at fair value and amortizes the servicing rights in proportion to, and over the period of, estimated net servicing revenues. Management assesses servicing rights for impairment as of each financial reporting date. Fair value adjustments that encompass market-driven valuation changes and the runoff in value that occurs from the passage of time are each separately reported. Total servicing assets included in other assets were $363,246 and $649,710 at December 31, 2017 and 2016, respectively. The Bank evaluated the servicing asset for impairment at December 31, 2017 and 2016 and determined that no valuation allowance was needed.

Note 2 – Summary of Significant Accounting Policies (continued)

The Bank services loans that have been participated with other financial institutions totaling $29,133,222 and $41,492,230 as of December 31, 2017 and 2016, respectively. Control over these loans was surrendered without recourse and, therefore, the sold balances are not included on the Bank's balance sheets.

Transfers of Financial Assets

Transfers of financial assets are accounted for as sales when control over the assets has been surrendered. Control over transferred assets is deemed to be surrendered when: (1) the assets have been isolated from the Bank, (2) the transferee obtains the rights (free of conditions that prevent it from taking advantage of that right, beyond a more than trivial benefit to the transferor) to pledge or exchange the transferred assets, and (3) the Bank does not maintain effective control over the transferred assets through an agreement to repurchase them before their maturity.

The Bank sells certain portions of government guaranteed loans in the secondary market. These sales are recorded by the Bank when control is surrendered and any warranty period or recourse provision expires. There were no warranty or recourse provisions outstanding at December 31, 2017 for loans sold during 2017 and 2016.

Premises and Equipment

Premises and equipment are stated at cost less accumulated depreciation and amortization. Depreciation and amortization are provided for in amounts sufficient to relate the cost of depreciable assets to operations over their estimated service lives using the straight-line basis. The estimated lives used in determining depreciation are:

Leasehold improvements	5 years
Furniture, fixtures, and equipment	3 – 7 years

Leasehold improvements are amortized over the lesser of the useful life of the asset or the term of the lease. The straight-line method of depreciation is followed for all assets for financial reporting purposes, but accelerated methods are used for tax purposes. Deferred income taxes have been provided for the resulting temporary differences.

Bank-Owned Life Insurance

The Bank has purchased insurance on the lives of Bank executives. The policies accumulate asset values to meet future liabilities including payment of employee benefits such as split dollar life insurance agreements, which provide an insurance benefit to the family of the individual on whom the policy is held. The cash surrender value of policies is recorded as an asset on the balance sheets. Increases in the cash surrender value are recorded as other non-interest income in the statements of income.

Note 2 – Summary of Significant Accounting Policies (continued)

Other Real Estate Owned
Other real estate owned is comprised of property acquired through foreclosure in satisfaction of indebtedness. These properties are recorded at fair value less estimated selling costs at the time of foreclosure establishing a new cost basis. Revised estimates to the fair value less cost to sell are reported as adjustments to the carrying amount of the asset, provided that such adjusted value is not in excess of the carrying amount at acquisition. Initial losses on properties acquired through full or partial satisfaction of debt are treated as credit losses and charged to the allowance for loan losses at the time of acquisition. Subsequent declines in value from the recorded amounts, routine holding costs, and gains or losses upon disposition, if any, are included in non-interest income or expense as incurred.

Income Taxes
The Bank uses the asset and liability method to account for income taxes. Under such method, deferred tax assets and liabilities are recognized for the future tax consequences of differences between financial statement carrying amounts of existing assets and liabilities and their respective tax basis (temporary differences). Deferred tax assets and liabilities are reflected at currently enacted income tax rates applicable to the year in which the deferred tax assets or liabilities are expected to be realized or settled. As changes in tax laws or rates are enacted, deferred tax assets and liabilities are adjusted through the provision for income taxes in the year of enactment.

A valuation allowance is established to the extent that it is more likely than not that the benefits associated with the deferred tax assets will not be fully realized.

The Bank had no unrecognized tax benefits at December 31, 2017 and 2016.

The Bank recognizes interest accrued and penalties related to unrecognized tax benefits in tax expense. During the years ended December 31, 2017 and 2016, the Bank recognized no interest and penalties.

With few exceptions, the Bank is no longer subject to examinations by U.S. federal taxing authorities for years ended before December 31, 2014, and by state authorities for years ended before December 31, 2013.

Comprehensive Income
Comprehensive income includes net income and other comprehensive income. The Bank's primary source of comprehensive income is unrealized gains and losses on securities available for sale. Reclassification adjustments result from gains or losses on securities that are realized and included in net income of the current period that also had been included in other comprehensive income as unrealized holding gains or losses in the period in which they arose. Total comprehensive income and the components of accumulated other comprehensive income are presented in the statements of comprehensive income.

Note 2 – Summary of Significant Accounting Policies (continued)

Stock-Based Compensation
The Bank recognizes compensation expense for awards of stock options to employees and directors based on the grant-date fair value of those awards. The fair value of each option granted is estimated on the date of grant using the Black-Scholes options-pricing model. The assumptions used in this model include an estimate of expected volatility, which is based on the historical volatility of the price of similar bank stocks, and an estimate of the expected option term, which is based on consideration of the vesting period and contractual term of the option. In addition, the Bank estimates the number of options expected to be forfeited based on historical forfeiture rates. The risk-free interest rates are equal to the U.S. Treasury yield at the time of the grant and commensurate with the expected term of the grant. Expense is recognized over the vesting period of the options. The Bank's stock compensation plan and related assumptions used in determining the fair value of awards are discussed in Note 11.

Advertising Costs
The Bank expenses advertising costs as they are incurred. Advertising expense was $154,608 and $123,206 for the years ended December 31, 2017 and 2016, respectively.

Net Income Per Share
Basic net income per share amounts are computed by dividing net income available to common shareholders by the weighted average number of common shares outstanding during the year. Diluted earnings per share reflects the potential dilution that could occur if securities or other contracts to issue common stock, such as stock options, result in the issuance of common stock which share in the earnings of the Bank. The treasury stock method is applied to determine the dilutive effect of stock options when computing diluted earnings per share. However, dilutive earnings per share amounts are not presented when a net loss occurs because the conversion of potential common stock is anti-dilutive.

Recent Accounting Pronouncements Adoption of New Accounting Standards
In June 2016, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2016-13, *Financial Instruments – Credit Losses* (Topic 326): *Measurement of Credit Losses on Financial Instruments*. The ASU will require the earlier recognition of credit losses on loans and other financial instruments based on an expected loss model, replacing the incurred loss model that is currently in use. Under the new guidance, an entity will measure all expected credit losses for financial instruments held at the reporting date based on historical experience, current conditions, and reasonable and supportable forecasts. The expected loss model will apply to loans and leases, unfunded lending commitments, held-to-maturity debt securities and other debt instruments measured at amortized cost. The impairment model for available-for-sale debt securities will require the recognition of credit losses through a valuation allowance when fair value is less than amortized cost, regardless of whether the impairment is considered to be other-than-temporary. The new guidance is effective on January 1, 2020, with early adoption permitted on January 1, 2019. The Bank is currently evaluating the provisions of this ASU and will be monitoring developments and additional guidance to determine the timing of adoption and the potential outcome the amendments will have on our financial condition and results of operations.

Note 2 – Summary of Significant Accounting Policies (continued)

In February 2016, the FASB issued ASU No. 2016-02, *Leases* (Topic 842). This ASU revises the accounting related to lessee accounting. Under the new guidance, lessees will be required to recognize a right-of-use asset and a lease liability for all leases. The new lease guidance also simplified the accounting for sale and leaseback transactions primarily due to the recognition of lease assets and lease liabilities. ASU No. 2016-02 is effective for the first interim period within annual periods beginning after December 15, 2018. The standard is required to be adopted using the modified retrospective transition approach for leases existing at, or entered into after, the beginning of the earliest comparative period presented in the financial statements. We do not anticipate that this ASU will have a significant impact on the Bank's financial statements.

In August 2015, the FASB issued ASU No. 2015-14 which deferred the effective date of ASU No. 2014-09, *Revenue from Contracts with Customers* (Topic 606). As a result of the deferral, the guidance in ASU No. 2014-09 will be effective for the Bank for reporting periods beginning after December 15, 2017. The update modifies the guidance companies use to recognize revenue from contracts with customers for transfers of goods or services and transfers of nonfinancial assets, unless those contracts are within the scope of other standards. The guidance also requires new qualitative and quantitative disclosures, including information about contract balances and performance obligations. The Bank is currently evaluating the provisions of this ASU and will be monitoring developments and additional guidance to determine the timing of adoption and the potential outcome the amendments will have on the financial condition and results of operations.

Reclassification and Presentation
Certain balances in the 2016 presentation have been reclassified to conform to the 2017 presentation. This reclassification had no impact on net earnings, total assets, total liabilities or shareholders' equity.

Note 3 – Cash and Due from Banks

Cash and due from banks includes balances with the Federal Reserve Bank and other correspondent banks. The average reserve requirements are based on a percentage of the Bank's deposit liabilities. In addition, the Federal Reserve Bank requires the Bank to maintain a certain minimum balance at all times. At December 31, 2017 and 2016, the Bank's cash balances were sufficient to comply with this reserve requirement and, therefore, no such reserve balances were required to be held with the Federal Reserve Bank.

Note 4 – Available-for-Sale Investment Securities

The amortized cost and estimated fair value of available-for-sale securities as of December 31, 2017 and 2016 are as follows:

2017	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Mortgage-backed securities	$ 3,677,987	$ 2,542	$ (6,008)	$ 3,674,521
CMOs	11,381,610	4,833	(122,553)	11,263,890
	$ 15,059,597	$ 7,375	$ (128,561)	$ 14,938,411

2016	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Mortgage-backed securities	$ 2,597,132	$ 1,070	$ (47,201)	$ 2,551,001
CMOs	810,566	2,909	(3,433)	810,042
	$ 3,407,698	$ 3,979	$ (50,634)	$ 3,361,043

Proceeds from the sales of investment securities totaled $0 and $2,304,232 during the years ended December 31, 2017 and 2016, respectively. Gross realized gains totaled $0 and $9,469 during 2017 and 2016, respectively. There were no gross realized losses during 2017 and 2016.

Available-for-sale investment securities with unrealized losses at December 31, 2017 and 2016 are summarized and classified according to the duration of the loss period as follows:

2017	Less than 12 months		12 months or more		Total	
	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
Mortgage-backed securities	$ -	$ -	$ 3,172,961	$ (6,008)	$ 3,172,961	$ (6,008)
CMOs	1,907,001	(55,057)	8,670,631	(67,496)	10,577,632	(122,553)
	$ 1,907,001	$ (55,057)	$11,843,592	$ (73,504)	$13,750,593	$ (128,561)

2016	Less than 12 months		12 months or more		Total	
	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
Mortgage-backed securities	$ 427,639	$ (3,433)	$ -	$ -	$ 427,639	$ (3,433)
CMOs	1,907,742	(34,982)	326,372	(12,219)	2,234,114	(47,201)
	$ 2,335,381	$ (38,415)	$ 326,372	$ (12,219)	$ 2,661,753	$ (50,634)

Note 4 – Available-for-Sale Investment Securities (continued)

Certain investment securities shown above currently have fair values less than amortized cost and, therefore, contain unrealized losses. The Bank does not have the intent to sell the investments that are temporarily impaired, and it is more likely than not that the Bank will not be required to sell those investments before recovery of the amortized cost basis. The Bank has evaluated these securities and has determined that the decline in value is not other than temporary and is related to the change in market interest rates since purchase. The decline in value is not related to any company or industry specific event. These temporary unrealized losses relate principally to current interest rates for similar types of securities. In analyzing an issuer's financial condition, management considers whether the securities are issued by the federal government or its agencies, whether downgrades by bond rating agencies have occurred, and the results of reviews of the issuer's financial condition. There were 22 and 6 investment securities with unrealized losses at December 31, 2017 and 2016, respectively. The Bank anticipates full recovery of amortized cost with respect to these securities at maturity or sooner in the event of a more favorable market interest rate environment.

The amortized cost and estimated fair value of available-for-sale investment securities at December 31, 2017 and 2016 by contractual maturity are shown below. Expected maturities will differ from contractual maturities because the issuers of the securities may have the right to call or prepay obligations with or without call or prepayment penalties.

	December 31, 2017	
	Amortized Cost	Estimated Fair Value
Due after five years through ten years	$ 4,398,483	$ 4,370,956
Due after ten years	10,661,114	10,567,455
	$ 15,059,597	$ 14,938,411

Investment securities with amortized cost of $6,025,950 and estimated fair value of $6,067,392 were pledged to secure public funds, lines of credit, and Federal Home Loan Bank advances at December 31, 2017. No investment securities were pledged as of December 31, 2016.

Note 5 – Loans

Outstanding loans, by class, are summarized as follows:

	December 31, 2017	December 31, 2016
Commercial	$ 50,108,919	$ 46,679,597
Commercial real estate		
Non-owner occupied	73,969,748	44,057,448
Owner occupied	65,492,796	61,438,776
Construction and land	23,706,558	27,408,762
Consumer and other	22,530,774	6,216,049
	235,808,795	185,800,632
Deferred loan fees and costs, net	(56,718)	(150,032)
Allowance for loan losses	(3,473,818)	(3,173,518)
	$ 232,278,259	$ 182,477,082

Salaries and employee benefits totaling $585,686 and $222,000 have been deferred as loan origination costs for the years ended December 31, 2017 and 2016, respectively.

The Bank, in the normal course of business, makes loans to its directors, officers, principal shareholders, and their associates. In management's opinion, these transactions are on substantially the same terms as comparable transactions with other customers of the Bank. At December 31, 2017, one line of credit in the amount of $1,000,000 was approved for a director of the Bank. There were no amounts outstanding from related parties at December 31, 2017 and 2016.

The Bank has certain lending policies and procedures in place that are designed to maximize loan income within an acceptable level of risk. Management reviews and approves these policies and procedures on a regular basis. A reporting system supplements the review process by providing management with frequent reports related to loan production, loan quality, concentrations of credit, loan delinquencies, and non-performing and potential problem loans. Diversification in the loan portfolio is a means of managing risk associated with fluctuations in economic conditions.

Commercial loans are underwritten after evaluating and understanding the borrower's ability to operate profitably and prudently expand its business. Underwriting standards are designed to promote relationship banking rather than transactional banking. Once it is determined that the borrower's management possesses sound ethics and solid business acumen, the Bank's management examines current and projected cash flows to determine the ability of the borrower to repay their obligations as agreed. Commercial loans are primarily made based on the identified cash flows of the borrower and secondarily on the underlying collateral provided by the borrower. The cash flows of borrowers, however, may not be as expected and the collateral securing these loans may fluctuate in value. Most commercial loans are secured by the assets being financed or other business assets such as accounts receivable or inventory and may incorporate a personal guarantee; however, some short-term loans may be made on an unsecured basis. In the case of loans secured by accounts receivable, the availability of funds for the repayment of these loans may be substantially dependent on the ability of the borrower to collect amounts due from its customers.

Note 5 – Loans (continued)

Commercial real estate loans are subject to underwriting standards and processes similar to commercial loans, in addition to those of real estate loans. These loans are viewed primarily as cash flow loans and secondarily as loans secured by real estate. Commercial real estate lending typically involves higher loan principal amounts and the repayment of these loans is generally largely dependent on the successful operation of the property securing the loan or the business conducted on the property securing the loan. Commercial real estate loans may be more adversely affected by conditions in the real estate markets or in the general economy. The properties securing the Bank's commercial real estate portfolio are diverse in terms of type and geographic location. This diversity helps reduce the Bank's exposure to adverse economic events that affect any single market or industry. Management monitors and evaluates commercial real estate loans based on collateral, geography, and risk grade criteria. As a general rule, the Bank avoids financing single-purpose projects unless other underwriting factors are present to help mitigate risk. The Bank also utilizes third-party experts to provide insight and guidance about economic conditions and trends affecting market areas it serves. In addition, management tracks the level of owner-occupied commercial real estate loans versus non-owner occupied loans.

With respect to loans to developers and builders that are secured by non-owner occupied properties that the Bank may originate from time to time, the Bank generally requires the borrower to have had an existing relationship with the Bank and have a proven record of success. Construction loans are underwritten utilizing feasibility studies, independent appraisal reviews, sensitivity analysis of absorption and lease rates, and financial analysis of the developers and property owners. Construction loans are generally based upon estimates of costs and value associated with the completed project. These estimates may be inaccurate. Construction loans often involve the disbursement of substantial funds with repayment substantially dependent on the success of the ultimate project. Sources of repayment for these types of loans may be pre-committed permanent loans from approved long-term lenders, sales of developed property, or an interim loan commitment from the Bank until permanent financing is obtained. These loans are closely monitored by on-site inspections and are considered to have higher risks than other real estate loans due to their ultimate repayment being sensitive to interest rate changes, governmental regulation of real property, general economic conditions, and the availability of long-term financing.

Consumer loans primarily consist of home equity lines of credit and loans and other personal loans. The Bank originates consumer loans utilizing credit history information, debt-to-income ratio, and loan-to-value ratio analysis. The Bank also evaluates the consumer's liquid assets and their ability to supplement cash flow for debt payment. To monitor and manage consumer loan risk, policies and procedures are developed and modified, as needed. This activity, coupled with relatively small loan amounts that are spread across many individual borrowers, minimizes risk. Underwriting standards for home equity loans include, but are not limited to, a maximum loan-to-value percentage of 80%, collection remedies, the number of such loans a borrower can have at one time, and documentation requirements. Personal loans are nearly evenly split between mobile home loans along with a small number of direct auto loans and installment loans. Personal unsecured loans are offered to consumers with additional underwriting procedures in place, including net worth and borrower's verified liquid assets analysis. In general, personal loans usually have a higher degree of risk than other types of loans.

Note 5 – Loans (continued)

The Bank utilizes an independent third party loan review consultant to review and validate the credit risk program on a periodic basis. Results of these reviews are presented to management and the Bank's Board of Directors. The loan review process complements and reinforces the risk identification and assessment decisions made by lenders and credit personnel, as well as the Bank's policies and procedures.

The following tables summarizes the credit quality indicators related to the Bank's loans, by class, as of December 31, 2017 and 2016:

December 31, 2017	Pass	Special Mention	Substandard	Doubtful	Totals
Commercial	$ 45,562,887	$ 612,976	$ 3,933,056	$ -	$ 50,108,919
Commercial real estate					
Non-owner occupied	73,969,748	-	-	-	73,969,748
Owner occupied	63,217,213	-	2,275,583	-	65,492,796
Construction and land	17,425,078	-	6,281,480	-	23,706,558
Consumer and other	21,358,031	553,122	619,621	-	22,530,774
Total	$ 221,532,957	$ 1,166,098	$ 13,109,740	$ -	$ 235,808,795

December 31, 2016	Pass	Special Mention	Substandard	Doubtful	Totals
Commercial	$ 40,494,669	$ 3,688,710	$ 2,496,218	$ -	$ 46,679,597
Commercial real estate					
Non-owner occupied	43,491,841	565,607	-	-	44,057,448
Owner occupied	60,010,621	1,428,155	-	-	61,438,776
Construction and land	20,898,116	6,510,646	-	-	27,408,762
Consumer and other	5,547,312	-	668,737	-	6,216,049
Total	$ 170,442,559	$ 12,193,118	$ 3,164,955	$ -	$ 185,800,632

As a part of the on-going monitoring of the credit quality of the Bank's loan portfolio, management monitors certain credit quality indicators including trends related to risk grade classifications, concentrations, net charge-offs, non-performing loans, and general economic conditions.

Note 5 – Loans (continued)

The Bank uses a risk grading system to assign a risk grade to each of its loans. Loans are graded on a scale of 1 to 9, with grades 1 to 5 being termed pass loans and grades 6, 7, 8, and 9 being termed special mention, substandard, doubtful, and loss, respectively. A description of the general characteristics of the nine grades is as follows:

Pass (grades 1-5) **–** These loans generally conform to the Bank's underwriting criteria and evidence an acceptable level of credit risk.

Special Mention (grade 6) **–** These loans have weaknesses that require management's close attention. These weaknesses expose the Bank to a sufficient degree of risk to warrant classification. If left uncorrected, these weaknesses will result in deterioration of the loan's repayment prospects or the borrower's credit position at a future date. Loans in this category are currently protected, but are potentially weak. The loans may (particularly in the short term) constitute a greater than average credit risk, but do not presently expose the Bank to a sufficient degree of risk to warrant adverse classification. This is a temporary classification pending identification of improvement or deterioration in the criticized asset.

Substandard (grade 7) **–** Substandard loans are inadequately protected by the current net worth and financial capacity of the borrower or 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 Bank will sustain some loss if the deficiencies are not corrected. Loss potential, while existing in the aggregate amount of substandard loans, does not have to exist in individual loans classified substandard.

Doubtful (grade 8) **–** Loans classified doubtful have all the weaknesses inherent in those classified as substandard with the added characteristic that the weaknesses make collection in full, on the basis of currently existing facts, conditions, and values, highly questionable and improbable. The probability of loss is extremely high but because of certain important and reasonably specific pending factors which may work to strengthen (or weaken) the loan, its classification as an estimated loss is deferred until its more exact status may be determined. Pending factors that may necessitate a doubtful classification include bankruptcy or liquidation procedures, capital injection, or perfecting liens on additional collateral refinancing plans. The Bank considers doubtful to be a temporary classification and will only classify an asset, or portion of an asset, as such when information is not available to conclude as to classification or more clearly define the potential for loss.

Loss (grade 9) **–** Assets classified loss are considered uncollectible and of such little value that their continuance as assets is not warranted. This classification does not mean that an asset has absolutely no recovery or salvage value, but rather that it is not practical or desirable to defer writing off a basically worthless asset even though partial recovery may be affected in the future. Losses are taken in the period in which they are identified as uncollectible.

Note 5 – Loans (continued)

Age Analysis of Past Due Loans

The age analysis of past due loans by class as of December 31, 2017 consisted of the following:

	30-59 Days Past Due	60-89 days Past Due	Greater Than 90 Days	Total Past Due	Current	Total Loans	Recorded Investment > 90 days and Accruing
Commercial	$ 83,586	$ -	$ 741,565	$ 825,151	$ 49,283,768	$ 50,108,919	$ -
Commercial real estate							
Non-owner occupied	-	-	-	-	73,969,748	73,969,748	-
Owner occupied	-	-	-	-	65,492,796	65,492,796	-
Construction and land	-	-	-	-	23,706,558	23,706,558	-
Consumer and other	-	-	-	-	22,530,774	22,530,774	-
Total	$ 83,586	$ -	$ 741,565	$ 825,151	$234,983,644	$235,808,795	$ -

The age analysis of past due loans by class as of December 31, 2016 consisted of the following:

	30-59 Days Past Due	60-89 Days Past Due	Greater Than 90 Days	Total Past Due	Current	Total Loans	Recorded Investment > 90 Days and Accruing
Commercial	$ 537,519	$ -	$ 492,308	$ 1,029,827	$ 45,649,770	$ 46,679,597	$ -
Commercial real estate							
Non-owner occupied	-	-	-	-	44,057,448	44,057,448	-
Owner occupied	-	-	-	-	61,438,776	61,438,776	-
Construction and land	-	-	-	-	27,408,762	27,408,762	-
Consumer and other	-	-	668,737	668,737	5,547,312	6,216,049	-
Total	$ 537,519	$ -	$ 1,161,045	$ 1,698,564	$184,102,068	$185,800,632	$ -

Note 5 – Loans (continued)

Information related to impaired loans by class as of December 31, 2017 and for the year then ended consisted of the following:

	Commercial	Commercial Real Estate Non-Owner Occupied	Commercial Real Estate Owner Occupied	Construction and Land	Consumer and other	Total
Recorded investment in impaired loans:						
With no specific allowance recorded	$ 766,691	$ -	$ -	$ -	$ 619,621	$ 1,386,312
With a specific allowance recorded	26,479	-	-	-	-	26,479
Total recorded investment in impaired loans	$ 793,170	$ -	$ -	$ -	$ 619,621	$ 1,412,791
Unpaid principal balance of impaired loans:						
With no specific allowance recorded	$ 887,812	$ -	$ -	$ -	$ 668,737	$ 1,556,549
With a specific allowance recorded	27,802	-	-	-	-	27,802
Total unpaid principal balance of impaired loans	$ 915,614	$ -	$ -	$ -	$ 668,737	$ 1,584,351
Specific allowance	$ 3,336	$ -	$ -	$ -	$ -	$ 3,336
Average recorded investment in impaired loans during the year	1,728,703	-	-	-	668,737	2,397,440
Interest income recognized in impaired loans during the year	121,121	-	-	-	49,116	170,237

Information related to impaired loans by class as of December 31, 2016 and for the year then ended consisted of the following:

	Commercial	Commercial Real Estate Non-Owner Occupied	Commercial Real Estate Owner Occupied	Construction and Land	Consumer	Total
Recorded investment in impaired loans:						
With no specific allowance recorded	$ 1,161,163	$ -	$ -	$ -	$ 627,651	$ 1,788,814
With a specific allowance recorded	228,189	-	-	-	-	228,189
Total recorded investment in impaired loans	$ 1,389,352	$ -	$ -	$ -	$ 627,651	$ 2,017,003
Unpaid principal balance of impaired loans:						
With no specific allowance recorded	$ 1,305,124	$ -	$ -	$ -	$ 668,737	$ 1,973,861
With a specific allowance recorded	242,909	-	-	-	-	242,909
Total unpaid principal balance of impaired loans	$ 1,548,033	$ -	$ -	$ -	$ 668,737	$ 2,216,770
Specific allowance	$ 113,927	$ -	$ -	$ -	$ -	$ 113,927
Average recorded investment in impaired loans during the year	$ 1,974,408	$ 804,633	$ 207,882	$ -	$ 885,166	$ 3,872,089
Interest income recognized in impaired loans during the year	$ 100,156	$ -	$ -	$ -	$ 19,744	$ 119,900

Note 5 – Loans (continued)

Year-end non-accrual loans, segregated by class, are as follows:

	December 31, 2017	December 31, 2016
Commercial	$ 748,739	$ 1,389,352
Commercial real estate		
Non-owner occupied	-	-
Owner occupied	-	-
Construction and land	-	-
Consumer and other	620,084	627,651
	$ 1,368,823	$ 2,017,003

Changes in the allowance for loan losses, by class, for the year ended December 31, 2017 were as follows:

Allowance for Credit Losses and Recorded Investment in Financing Receivables
For the Year Ended December 31, 2017

	Commercial	Commercial Real Estate	Construction and Land	Consumer and other	Unallocated	Total
Allowance for credit losses						
Beginning balance	$ 956,585	$ 1,230,228	$ 687,328	$ 198,416	$ 100,961	$ 3,173,518
Charge-offs	(328,411)	-	-	-	-	(328,411)
Recoveries	300,297	3,414	-	-	-	303,711
Provision	348,187	105,180	(14,345)	(13,061)	(100,961)	325,000
Ending balance	$ 1,276,658	$ 1,338,822	$ 672,983	$ 185,355	$ -	$ 3,473,818
Period-end amount allocated to:						
Loans individually evaluated for impairment	$ 3,336	$ -	$ -	$ -	$ -	$ 3,336
Loans collectively evaluated for impairment	1,273,322	1,338,822	672,983	185,355	-	3,470,482
Ending balance	$ 1,276,658	$ 1,338,822	$ 672,983	$ 185,355	$ -	$ 3,473,818
Loans						
Individually evaluated for impairment	$ 793,170	$ -	$ -	$ 619,621		$ 1,412,791
Collectively evaluated for impairment	49,315,749	139,462,544	23,706,558	21,911,153	-	234,396,004
Ending balance	$ 50,108,919	$ 139,462,544	$ 23,706,558	$ 22,530,774	$ -	$ 235,808,795

Note 5 – Loans (continued)

Changes in the allowance for loan losses, by class, for the year ended December 31, 2016 were as follows:

Allowance for Credit Losses and Recorded Investment in Financing Receivables
For the Year Ended December 31, 2016

	Commercial	Commercial Real Estate	Construction and Land	Consumer and other	Unallocated	Total
Allowance for credit losses						
Beginning balance	$ 1,418,113	$ 1,043,262	$ 218,952	$ 193,989	$ 613,662	$ 3,487,978
Charge-offs	(668,055)	-	-	-	-	(668,055)
Recoveries	206,527	142,641	-	4,427	-	353,595
Provision	-	44,325	468,376	-	(512,701)	-
Ending balance	$ 956,585	$ 1,230,228	$ 687,328	$ 198,416	$ 100,961	$ 3,173,518
Period-end amount allocated to:						
Loans individually evaluated for impairment	$ 113,927	$ -	$ -	$ -	$ -	$ 113,927
Loans collectively evaluated for impairment	842,658	1,230,228	687,328	198,416	100,961	3,059,591
Ending balance	$ 956,585	$ 1,230,228	$ 687,328	$ 198,416	$ 100,961	$ 3,173,518
Loans						
Individually evaluated for impairment	$ 1,389,352	$ -	$ -	$ 627,651	$ -	$ 2,017,003
Collectively evaluated for impairment	45,290,245	105,496,224	27,408,762	5,588,398	-	183,783,629
Ending balance	$ 46,679,597	$ 105,496,224	$ 27,408,762	$ 6,216,049	$ -	$ 185,800,632

Note 5 – Loans (continued)

The following table summarizes loans to customers whose loan terms were modified in troubled debt restructurings during the years ended December 31, 2017 and 2016:

	Year Ended December 31, 2017		
	Number of Contracts	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment
Troubled Debt Restructurings			
Commercial	3	$ 125,234	$ 125,234
	3	$ 125,234	$ 125,234

	Year Ended December 31, 2016		
	Number of Contracts	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment
Troubled Debt Restructurings			
Commercial	4	$ 420,983	$ 420,983
	4	420,983	420,983

During 2017 and 2016, there were three and four loans, respectively, that were modified and considered troubled debt restructurings because specific interest rate concessions or payment term concessions were granted to the borrower. The Bank had no obligations to lend additional funds on the restructured loans as of December 31, 2017 and 2016.

Interest recognized for cash payments received on non-accrual loans was not significant for the years ended December 31, 2017 and 2016. At December 31, 2017 and 2016, there were no loans over 90 days past due that were still accruing interest.

There were no troubled debt restructurings in 2017 and 2016 that subsequently defaulted.

Note 6 – Premises and Equipment

Premises and equipment consisted of the following:

	December 31, 2017	December 31, 2016
Leasehold improvements	$ 381,649	$ 381,649
Furniture, fixtures, and equipment	711,395	670,870
	1,093,044	1,052,519
Less accumulated depreciation and amortization	(696,256)	(524,054)
	$ 396,788	$ 528,465

Depreciation and amortization included in occupancy and equipment expense totaled $172,202 and $175,779 for the years ended December 31, 2017 and 2016, respectively.

Note 7 – Interest-Bearing Deposits

Interest-bearing deposits consisted of the following:

	December 31, 2017	December 31, 2016
Savings	$ 2,779,591	$ 2,450,377
Money market	91,432,261	81,685,710
NOW accounts	13,784,687	9,483,950
Time, under $250,000	13,937,556	13,934,138
Time, $250,000 or more	34,599,604	39,700,945
	$ 156,533,699	$ 147,255,120

Aggregate annual maturities of time deposits are as follows:

Years Ending December 31,	
2018	$ 44,785,169
2019	1,674,733
2020	1,278,710
2021	747,000
2022	51,548
	$ 48,537,160

Note 7 – Interest-Bearing Deposits (continued)

Interest expense related to interest-bearing deposits consisted of the following:

	Years Ended December 31, 2017	Years Ended December 31, 2016
Savings	$ 4,959	$ 1,479
Money market	604,677	480,972
NOW accounts	9,068	9,829
Time	318,009	330,576
	$ 936,713	$ 822,856

The Bank, in the normal course of business, receives deposits from its directors, officers, principal shareholders, and their associates. In management's opinion, these transactions are on substantially the same terms as comparable transactions with other customers of the Bank. The aggregate amount of deposits received from related parties at December 31, 2017 and 2016 was $648,535 and $565,980, respectively.

Note 8 – FHLB Advances and Other Borrowings

FHLB Advances

During 2006, the Bank entered into an arrangement with the FHLB under which it may borrow, on either a short-term or long-term basis, up to 25% of its assets provided that adequate collateral has been pledged. Investment securities with amortized costs totaling $6,025,950 and $0 and estimated fair market values totaling $6,067,392 and $0 were pledged at December 31, 2017 and 2016, respectively.

The Bank had no outstanding secured advances at December 31, 2017 and December 31, 2016.

Lines of Credit

The Bank has three unsecured available lines of credit totaling $11,000,000 with three of its correspondent banks. There were no borrowings outstanding under these arrangements at December 31, 2017 and 2016, respectively. The Bank has blanket lien financing availability at the FHLB totaling $51,904,548 and $37,701,008 as of December 31, 2017 and 2016, respectively. Additionally, the Bank had collateral borrowing capacity at the FHLB totaling $41,004,548 and $26,801,008 as of December 31, 2017 and 2016, respectively. The Bank had no long term outstanding borrowings from the FHLB as of December 31, 2017 and 2016.

Note 9 – Income Taxes

Income tax expense for the years ended December 31, 2017 and 2016, consists of the following:

	Years Ended December 31,	
	2017	2016
Current		
Federal	$ 1,105,666	$ 686,800
State	338,500	247,000
	1,444,166	933,800
Deferred		
Federal	314,700	188,700
State	(11,900)	64,500
	302,800	253,200
Income tax expense	$ 1,746,966	$ 1,187,000

The Bank's 2017 results included the impact of the enactment of the Tax Cuts and Jobs Act, which was signed into law on December 22, 2017. The law includes significant changes to the U.S. corporate tax system, including a Federal corporate rate reduction from 34% to 21%. In 2017, the Bank applied the newly enacted corporate federal income tax rate of 21%, resulting in approximately a $456,000 increase in tax expense. The final impact of the tax rate change may differ due to changes in assumptions made by the Bank or actions the Bank may take as a result of tax reform.

Reconciliation of the provision for income tax expense based on the federal statutory income tax rate to actual income tax expense is provided as follows:

	2017		2016	
	Amount	Percent	Amount	Percent
Tax at statutory rate	$ 1,011,000	34%	$ 1,012,000	34%
State income tax	215,000	7%	206,000	7%
Change in federal tax rate	456,000	15%	-	0%
Bank owned life insurance	(39,000)	-1%	(41,000)	-1%
Equity compensation	53,000	2%	52,000	2%
Other	50,966	2%	(42,000)	-2%
	$ 1,746,966	59%	$ 1,187,000	40%

Note 9 – Income Taxes (continued)

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

	December 31, 2017	December 31, 2016
Deferred tax assets		
Net operating loss carryforwards	$ 85,000	$ 166,000
Allowance for loan losses	852,000	1,081,000
Unrealized losses on available-for-sale investment securities	36,000	19,000
Nonaccrual loan interest	50,000	-
Non-qualified stock options	224,000	265,000
State income tax	66,000	109,000
Other	78,000	148,000
Total deferred tax assets	1,391,000	1,788,000
Deferred tax liabilities		
Depreciation on premises and equipment	(44,000)	(100,000)
Deferred loan costs	(227,000)	(192,000)
Other	(14,000)	(20,000)
	(285,000)	(312,000)
Net deferred income tax asset	$ 1,106,000	$ 1,476,000

The tax benefit of net operating losses, temporary differences, and credit carryforwards are recorded as an asset to the extent that management assesses that realization is “more likely than not.” Realization of the future tax benefits is dependent on the Bank’s ability to generate sufficient taxable income within the carryforward period. During the years ended December 31, 2017 and 2016, the valuation allowance remained at $0 and $0.

The Bank has usable net operating loss carryforwards of approximately $412,000 for federal tax purposes that begin to expire in 2020. The Tax Reform Act of 1986 and the California Conformity Act of 1987 imposes substantial restrictions on the utilization of net operating loss carryforwards when an “ownership change,” as defined in the Internal Revenue Code, has occurred. Some of the Bank’s federal and state net operating losses have each been limited to usage of approximately $71,500 annually due to ownership changes.

Note 10 – Commitments and Contingencies

Lease Commitments

The Bank leases certain facilities where it conducts its operations on a month-to-month basis. The Bank has entered into term leases for its Danville, San Mateo, Oakland and Emeryville locations. The Bank is responsible for common area maintenance, taxes, and insurance to the extent these exceed the base year amounts. The leases expire between December 2018 and March 2023. During 2014, the Bank entered into a lease agreement with a related party, expiring March 31, 2018, for their Campbell loan production office. The Bank has determined that these lease terms are similar to those that would be available from a third party.

Note 10 – Commitments and Contingencies (continued)

During 2014, the Bank moved their Danville branch to a new location in Danville. The Bank is sub-leasing the previous Danville location under an operating lease agreement. The lease expired in October 2017. Total rental income, offsetting rent expense, amounted to $82,033 and $82,689 at December 31, 2017 and 2016, respectively.

At December 31, 2017, the future minimum rental payments and income under non-cancelable operating leases are as follows:

Years Ending December 31,	Payments
2018	$ 660,964
2019	373,611
2020	108,184
2021	111,430
2022	133,995
	$ 1,388,184

The minimum rental payments shown above are given for the existing lease obligations and are not a forecast of future rental expense. The Bank recognized rent expense of $576,687 and $557,669 for the years ended December 31, 2017 and 2016, respectively.

Financial Instruments with Off-Balance-Sheet Risk

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

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

At December 31, 2017 and 2016, the Bank had commitments to extend credit of approximately $39,930,681 and $13,727,301, respectively. There were $523,400 and $945,775 in standby letters of credit issued at December 31, 2017 and 2016, respectively.

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

Note 10 – Commitments and Contingencies (continued)

Standby letters of credit are conditional commitments issued by the Bank to guarantee the performance or financial obligation 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 loans to customers.

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

Note 11 – Shareholders' Equity

Preferred Stock
In January 2009, the Bank issued 1,747 shares of Series A, fixed rate non-cumulative perpetual preferred stock to the U.S. Treasury as part of the Treasury's Capital Purchase Program (CPP). The non-cumulative preferred stock is carried at liquidation value of $1,000 per share and must be redeemed after ten years and carries a fixed dividend rate of 5% with dividends payable quarterly. In September 2010, the Bank redeemed 1,747 shares of Series A preferred stock and issued 4,060 shares of Series A-1, fixed rate non-cumulative perpetual preferred stock issued as part of the Treasury's Community Development Capital Initiative (CDCI). The newly issued shares carry an initial fixed dividend rate of 2% increasing to 9% after eight years, with dividends payable quarterly. The Bank paid dividends totaling $81,200 during each of the years ended December 31, 2017 and 2016, after receiving approval from the Department of Business Oversight (DBO) and their shareholders.

Stock Issuance
On March 10, 2017, the Bank completed a private placement to institutions and accredited investors of 2,285,715 shares of Series A common stock resulting in proceeds to the Bank, net of offering costs, of $11,391,973.

Note 11 – Shareholders' Equity (continued)

Dividend Restrictions
Upon declaration by the Board of Directors, all shareholders of record will be entitled to receive dividends. The California Financial Code provides that, unless the Bank receives prior approval from the California Commissioner of Financial Institutions, the total amount of dividend payments a California state-chartered bank can make in any calendar year cannot exceed the lesser of: (1) the Bank's retained earnings or (2) the Bank's net income for its last three fiscal years, less distributions made to shareholders during the same three-year period. At December 31, 2017 and 2016, the Bank had an accumulated deficit. Therefore, no amount is available for dividends to shareholders. As discussed above, the Bank received approval from the DBO to make dividend payments on the Series A-1 preferred stock during 2017 and 2016.

Earnings Per Share
Earnings per share (EPS) is calculated based on the weighted average common shares outstanding during the period. Basic EPS excludes dilution and is calculated by dividing net income available to common shareholders by the weighted average common shares outstanding. 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.

	Year Ended December 31, 2017		
	Income (Numerator)	Shares (Denominator)	Per-Share Amount
Basic EPS:			
Net income available to common shareholders	$ 1,146,226	6,639,631	$ 0.17
Effect of dilutive securities:			
Stock options	-	233,355	
Diluted EPS:			
Net income available to common shareholders plus assumed conversions	$ 1,146,226	6,872,986	$ 0.17

	Year Ended December 31, 2016		
	Income (Numerator)	Shares (Denominator)	Per-Share Amount
Basic EPS:			
Net income available to common shareholders	$ 1,707,795	4,346,951	$ 0.39
Effect of dilutive securities:			
Stock options		167,502	
Diluted EPS:			
Net income available to common shareholders plus assumed conversions	$ 1,707,795	4,514,453	$ 0.38

Note 11 – Shareholders' Equity (continued)

Stock Option Plan
The Bank's 2001 Stock Option Plan expired during 2011. The Bank has option grants still outstanding under that Plan. During 2012, the Board of Directors and shareholders approved the adoption of the Community Bank of the Bay 2012 Stock Option Plan. The plan includes both non-statutory stock options, which may be granted to directors, employees, and consultants, and incentive stock options, which may be granted to employees. The price of non-statutory and incentive stock options may not be less than 100%, respectively, of the fair market value of the common stock on the date of the grant.

However, if an individual at the time of the grant owns stock representing more than 10% of the voting rights of all classes of the stock, then the price of the stock options may not be less than 110% of the fair market value of the common stock on the date of the grant. The term of stock options is determined by the Board of Directors, but may not exceed ten years from the date of the grant unless, in the case of an incentive stock option, an individual at the time of grant owns stock representing more than 10% of the voting rights of all classes of the stock, then the maximum term is five years. As of December 31, 2017 1,106,420 shares of the Bank's common stock are reserved under this plan.

The fair value of each option granted is estimated on the date of grant using the Black-Scholes options-pricing model with the following weighted-average assumptions used for grants in 2017 and 2016, respectively: no expected dividends; expected volatility between 53.28% and 55.40% in 2017 and between 48.87% and 59.33% in 2016; risk-free interest rates between 1.90% and 2.35% in 2017 and 1.46% and 2.35% in 2016; and expected options term of ten years.

The following tables summarizes information about stock options outstanding at December 31, 2017 and 2016:

	December 31, 2017	
	Shares	Weighted Average Exercise Price
Outstanding at beginning of period	925,099	$ 3.80
Granted	144,000	$ 5.14
Exercised	(2,675)	$ 4.12
Forfeited / canceled / expired	(70,733)	$ 4.42
Outstanding at end of period	995,691	$ 3.94

The Bank recognized $282,354 and $233,898 in stock option expense for the years ended December 31, 2017 and 2016, respectively. There is approximately $737,053 and $694,839 in unrecognized compensation cost remaining as of December 31, 2017 and 2016, respectively, which is expected to be recognized over a weighted-average period of 3.65 years and 3.68 years, respectively. The Bank had 470,954 and 439,262 incentive stock options and 524,737 and 485,837 non-statutory stock options outstanding as of December 31, 2017 and 2016, respectively.

Note 11 – Shareholders' Equity (continued)

A summary of options outstanding follows:

	Year Ended December 31,	
	2017	2016
Weighted-average fair value of options granted during the year	$ 3.11	$ 2.82
Intrinsic value of options exercised	$ 2,057	$ 146,305
Options exercisable at year end	684,639	606,927
Weighted-average exercise price	$ 3.54	$ 3.45
Intrinsic value	$ 1,856,880	$ 1,029,012
Weighted-average remaining contractual life	4.76 Years	5.41 Years
Options outstanding at year end	941,208	925,099
Weighted-average exercise price	$ 3.89	$ 3.80
Intrinsic value	$ 2,221,373	$ 1,254,816
Weighted-average remaining contractual life	5.81 Years	6.53 Years

Note 12 – Regulatory Matters

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

Note 12– Regulatory Matters (continued)

Quantitative measures established by regulation to ensure capital adequacy require the Bank to maintain minimum amounts and ratios of comment equity Tier 1, total and Tier 1 capital to risk-weighted assets, and of Tier 1 capital to average assets. Each of these components is defined in the regulations. Management believes that the Bank met all capital adequacy requirements as of December 31, 2017 and 2016.

To be categorized as well-capitalized, the Bank must maintain minimum total risk-based, Tier 1 risk-based, and Tier 1 leverage ratios as set forth in the following table:

	Actual		For Capital Adequacy Purposes		To be well Capitalized under PCA	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
December 31, 2017:						
Common equity Tier 1						
(to risk-weighted assets)	$ 33,435,000	13.82%	$ 10,884,555	≥ 4.5%	$ 15,722,135	≥ 6.5%
Total risk-based capital						
(to risk-weighted assets)	$ 40,525,000	16.75%	$ 19,350,320	≥ 8.0%	$ 24,187,900	≥ 10.0%
Tier 1 capital						
(to risk-weighted assets)	$ 37,495,000	15.50%	$ 9,675,160	≥ 4.0%	$ 14,512,740	≥ 6.0%
Tier 1 capital						
(to average assets)	$ 37,495,000	12.55%	$ 11,952,400	≥ 4.0%	$ 14,940,500	≥ 5.0%
December 31, 2016:						
Common equity Tier 1						
(to risk-weighted assets)	$ 20,499,000	10.05%	$ 9,175,230	≥ 4.5%	$ 13,253,110	≥ 6.5%
Total risk-based capital						
(to risk-weighted assets)	$ 27,813,000	13.64%	$ 16,311,520	≥ 8.0%	$ 20,389,400	≥ 10.0%
Tier 1 capital						
(to risk-weighted assets)	$ 24,559,000	12.05%	$ 8,155,760	≥ 4.0%	$ 12,233,640	≥ 6.0%
Tier 1 capital						
(to average assets)	$ 24,559,000	9.48%	$ 10,366,240	≥ 4.0%	$ 12,957,800	≥ 5.0%

The Federal Reserve and the FDIC approved final capital rules in July 2013 that substantially amend the existing capital rules for banks. These new rules reflect, in part, certain standards initially adopted by the Basel Committee on Banking Supervision in December 2010 (which standards are commonly referred to as Basel III) as well as requirements contemplated by the Dodd-Frank Act. Under the new capital rules, the Bank will be required to meet certain minimum capital requirements that differ from current capital requirements. The rules implement a new capital ratio of common equity Tier 1 capital to risk-weighted assets.

Note 13 – Government Grant

In 2017, the Bank was awarded $227,282 by the United States Treasury Department in recognition of its community development activities under the Bank Enterprise Award Program (the BEA). Management believes that the Bank has complied, in all material aspects, with all of the covenants and requirements under the BEA agreement and that it is not, and has not been, in default with any of the terms, requirements, or minimum levels of qualified activities of such agreement. The Treasury Department did not issue BEA grants in 2016.

Note 14 – Other Expenses

Other expenses consisted of the following:

	December 31, 2017	December 31, 2016
Professional fees	$ 718,140	$ 856,592
Advertising	154,608	123,206
Data processing	409,271	412,258
Regulatory assessments	153,865	156,564
Insurance	67,827	83,065
Other operating expenses	757,287	715,742
Total	$ 2,260,998	$ 2,347,427

Note 15 – Employee Benefits

Defined Contribution Plan

The Bank adopted a 401(k) defined contribution plan effective January 1, 1997. All employees of the Bank may participate in the plan upon completion of certain eligibility requirements. The Bank matches employee's contributions on a discretionary basis. The Bank contributed $0 and $27,000 for the years ended December 31, 2017 and 2016, respectively.

Note 16 – Disclosures about Fair Value of Financial Instruments

Fair values of financial instruments are management's estimates of the values at which instruments could be exchanged in a transaction between willing parties. These estimates are subjective and may vary significantly from amounts that would be realized in actual transactions. Further, the tax ramifications related to the realization of the unrealized gains and losses can have a significant effect on the fair value estimates and have not been considered in any of these estimates.

The estimated fair values of the Bank's financial instruments as of December 31 are approximately as follows:

		2017		2016	
	Fair Value Hierarchy	Carrying Amounts	Estimated Fair Values	Carrying Amounts	Estimated Fair Values
Financial assets:					
Cash and cash equivalents	Level 1	$ 23,502,008	$ 23,502,008	$ 33,679,665	$ 33,679,665
Interest bearing deposits in banks	Level 2	14,085,057	13,972,377	20,194,082	20,134,000
Securities available-for-sale	Level 2	14,938,411	14,938,411	3,361,043	3,361,043
FHLB stock	Level 2	893,200	893,200	893,200	893,200
Loans, net	Level 3	234,898,310	232,622,000	183,343,627	184,570,000
Interest receivable	Level 2	872,527	872,527	569,824	569,824
Financial liabilities:					
Non-maturity deposits	Level 2	208,667,953	208,667,953	169,795,688	169,795,688
Time deposits	Level 2	48,537,160	48,174,000	53,635,083	53,991,000
Interest payable	Level 2	41,091	41,091	41,862	41,862
Off-balance-sheet liabilities:					
Undisbursed loan commitments	Level 3	-	399,000	-	137,000

The Bank utilizes fair value measurements to record fair value adjustments to certain assets and liabilities and to determine fair value disclosures. The Bank groups assets and liabilities at fair value in a three-level valuation hierarchy for disclosure of fair value measurement. The valuation hierarchy is based on the transparency of inputs to the valuation of an asset or liability as of the measurement date.

Note 16 – Disclosures about Fair Value of Financial Instruments (continued)

In general, fair values determined by Level 1 inputs utilize quoted prices (unadjusted) in active markets for identical assets or liabilities that the Bank has the ability to access. Fair values determined by Level 2 inputs utilize inputs other than quoted prices included in Level 1 that are observable for the asset or liability, either directly or indirectly. Level 2 inputs include quoted prices for similar assets and liabilities in active markets, and inputs other than quoted prices that are observable for the asset or liability, such as interest rates and yield curves that are observable at commonly quoted intervals. Level 3 inputs are unobservable inputs for the asset or liability, and include situations where there is little, if any, market activity for the asset or liability.

In certain cases, the inputs used to measure fair value may fall into different levels of the fair value hierarchy. In such cases, the level in the fair value hierarchy within which the fair value measurement in its entirety falls has been determined based on the lowest level input that is significant to the fair value measurement in its entirety. The Bank's assessment of the significance of a particular input to the fair value measurement in its entirety requires judgment, and considers factors specific to the asset or liability. Some fair value measurements, such as available-for-sale securities, are performed on a recurring basis, while others such as other real estate owned and impaired loans are performed on a non-recurring basis.

The following table presents information about the Bank's assets and liabilities measured at fair value on a recurring basis as of December 31, 2017 and 2016, as well as assets and liabilities for which a non-recurring change in the fair value has been recorded as of December 31, 2017 and 2016. These tables indicate the fair value hierarchy of the valuation techniques utilized by the Bank to determine such fair value.

Description of Assets	December 31, 2017	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Available-for-sale securities:				
Mortgage-backed securities	$ 3,674,520	$ -	$ 3,674,520	$ -
CMOs	11,263,891	-	11,263,891	-
Total	$ 14,938,411	$ -	$ 14,938,411	$ -

Description of Assets	December 31, 2016	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Available-for-sale securities:				
Mortgage-backed securities	$ 810,042	$ -	$ 810,042	$ -
CMOs	2,551,001	-	2,551,001	-
Total	$ 3,361,043	$ -	$ 3,361,043	$ -

Note 16 – Disclosures About Fair Value of Financial Instruments (continued)

Transfers between levels in the fair value hierarchy are recognized on the actual date of the event or circumstances that caused the transfer, which generally corresponds to the Bank's quarterly valuation process.

Fair value measurements for impaired loans are based on either collateral values supported by appraisals or observed market prices. Any loss recognized on impaired loans is not recorded directly as an adjustment to current earnings but rather as an adjustment component in determining the overall adequacy of the allowance for loan losses. Such adjustments to the estimated fair value of impaired loans may result in increases or decreases to the provision for loan losses recorded in current earnings.

The following methods and assumptions were used to estimate the fair value of each class of financial instrument for which it is practicable to estimate that value:

Cash and Cash Equivalents
For short-term instruments, including cash and due from banks, the carrying amount is a reasonable estimate of fair value.

Interest-Bearing Deposits in Banks
Represents time deposits held at other financial institutions. The fair values are estimated using a discounted cash flow calculation that applies interest rates currently being offered on certificates to a schedule of aggregated expected monthly maturities.

Securities
Fair values for investment securities are based on quoted market prices when available or through the use of alternative approaches, such as a matrix or model pricing, when market quotes are not readily accessible or available.

FHLB Stock and Other Investments
For FHLB stock and other investments, the carrying amount is a reasonable estimate of fair value.

Loans
For variable rate loans that reprice frequently and with no significant change in credit risk, fair values are based on carrying values. The fair values for fixed rate loans are estimated using discounted cash flow analysis, using interest rates currently being offered for loans with similar terms to borrowers of similar credit quality. The carrying amount of interest receivable approximates its fair value. The Bank's allowance for loan and lease losses is a reasonable estimate of the valuation allowance needed to adjust computed fair values for the quality of certain loans in the portfolio.

Interest Receivable and Payable
For interest receivable and payable, the carrying amount is estimated to be the fair value.

Impaired Loans
The Bank utilizes current appraisals and applies discount factors estimated and modeled for consistency by management to arrive at the estimate of fair value for all collateral dependent loans.

Note 16 – Disclosures about Fair Value of Financial Instruments (continued)

Other Real Estate Owned
The Bank utilizes current appraisals discounted for estimated selling costs to arrive at the estimate of fair value for all other real estate owned.

Deposit Liabilities
The fair values disclosed for non-maturity deposits (e.g., interest and non-interest checking, statement savings, and money market accounts) are, by definition, equal to the amount payable at the reporting date (i.e., their carrying amounts). The fair values for fixed-rate certificates of deposit are estimated using a discounted cash flow calculation that applies interest rates currently being offered on certificates to a schedule of aggregated expected monthly maturities on time deposits. The carrying amount of interest payable approximates its fair value.

FHLB Borrowings
The fair value of the borrowings is calculated based on the discounted value of the contractual cash flows using current rates at which such borrowings can currently be obtained.

Secured Borrowings
The fair value approximates book value as they represent short-term borrowings connected to the sale of loans.

Commitments to Extend Credit
The fair value of commitments is estimated using the fees currently charged to enter into similar agreements, taking into account the remaining terms of the agreements and the present creditworthiness of the counterparties. For fixed-rate loan commitments, fair value also considers the difference between current levels of interest rates and the committed rates.

Limitations
Fair value estimates are made at a specific point in time, based on relevant market information and other 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 Bank's entire holdings of a particular financial instrument.

Note 17 – Subsequent Events

The Bank has evaluated the effects of subsequent events that have occurred after the period ending December 31, 2017 and through April 11, 2018, which is the date the financial statements were available to be issued.

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SVP, Credit Services Manager

Mukhtar Ali
EVP, Chief Operating Officer

John Z. Barr
SVP, Chief Credit Officer

Margie Perry
SVP, Chief Customer Experience Officer

Jenniffer Collins
SVP, Director of Community Banking

Landon Baines
SVP, Oakland Regional Manager

Wilbur E. Hobbs, Jr.
SVP, Chief Lending Officer

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