ENGEO, INC.
WEST SIDE MISSIONARY BAPTIST CHURCH
DUBLIN MANAGEMENT COMPANY
CARDOZA PROPERTIES INC.
DISCOVERY COUNSELING CENTER
THE LAYOVER
HANSON & FITCH INC
FARLEY'S COFFEE
BERKSHIRE HATHAWAY HOMESERVICES DRYSDALE PROPERTIES
AQUILA INC.
HALF MOON BAY RV PARK
THE RIEKES CENTER
THE GATHER RESTAURANT
THE SAN MATEO AREA CHAMBER OF COMMERCE
LONG BRANCH SALOON & FARMS
OAKLAND KIDS FIRST
LOWNEY ARCHITECTURE
DOMENICO WINERY
LONGFELLOW COMMUNITY ASSOCIATION

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ROCK THE BIKE
SCHOOL OF UNITY AND LIBERATION
LONGFELLOW COMMUNITY ASSOCIATION
NORTH BERKELEY INVESTMENT PARTNERS
AMERICAN HOSPICE
LOST & FOUND BEER GARDEN
ROCK THE BIKE
DOWNTOWN OAKLAND ASSOCIATION
YA TITTLE INSURANCE SERVICES
OPERATION DIGNITY
LAKE MERRITT UPTOWN DISTRICT ASSOCIATION
INTERFAITH COUNCIL OF ALAMEDA COUNTY
URBANCORE DEVELOPMENT, LLC
SANDRA J. WING HEALING THERAPIES FOUNDATION

2018 ANNUAL REPORT

Member FDIC
EQUAL HOUSING LENDER

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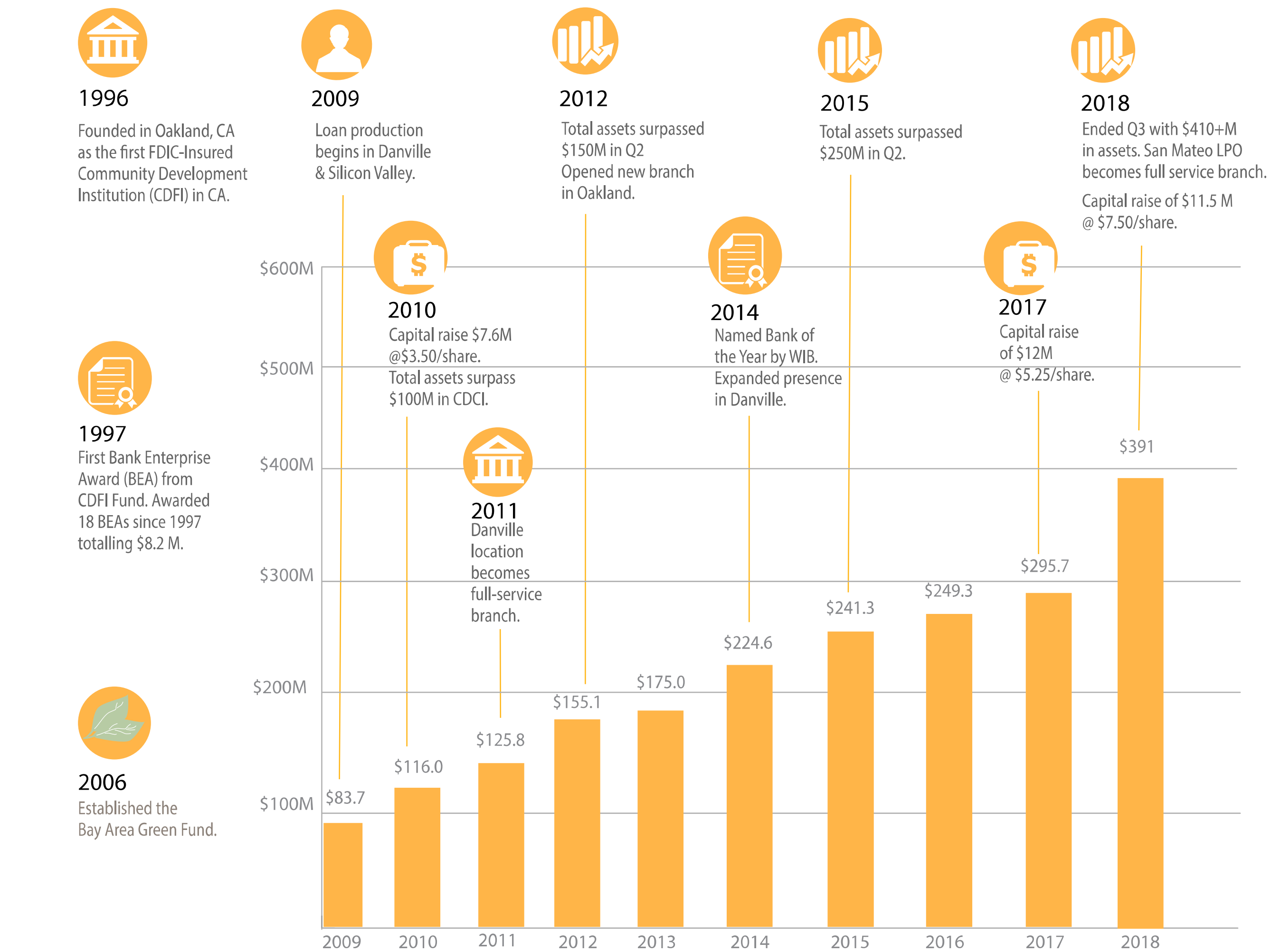
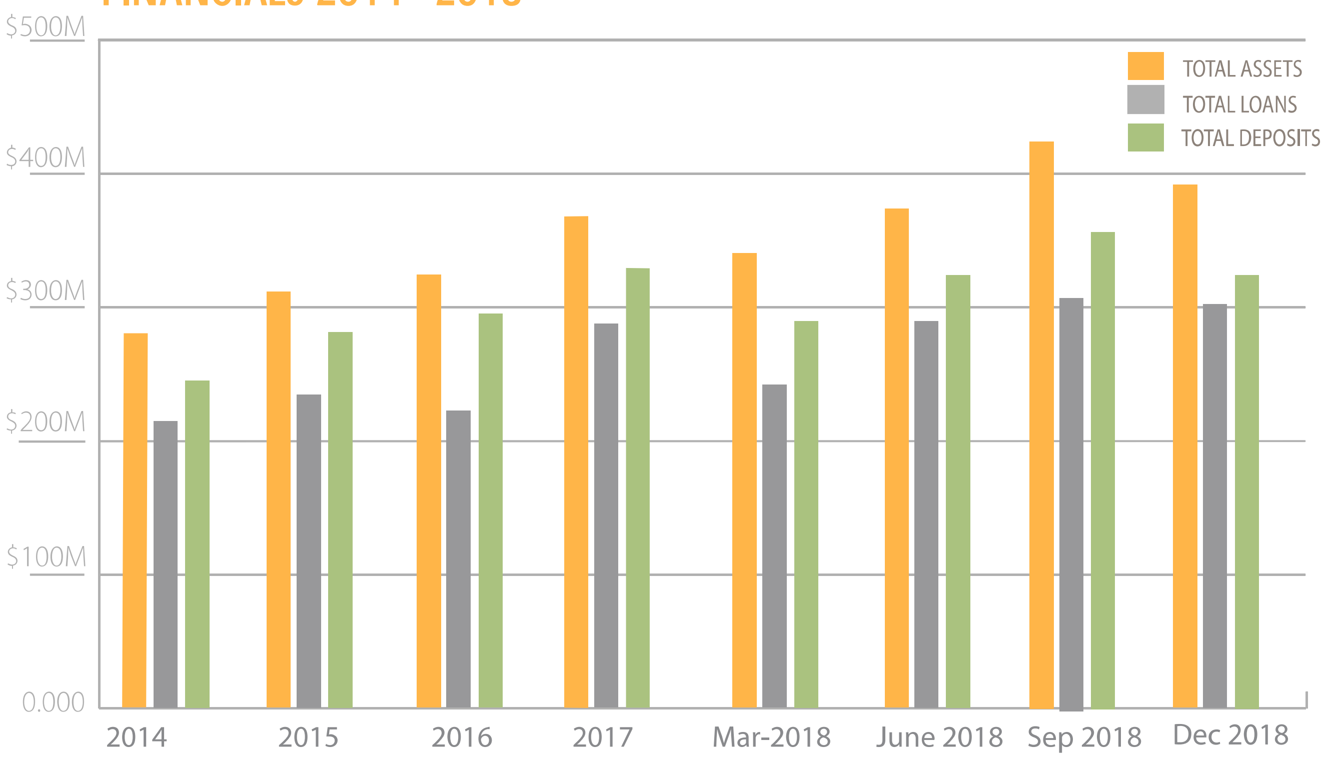


FINANCIALS 2014 - 2018



Dear Community Bank of the Bay Shareholder:

In last year's shareholder letter we introduced you to a plan that we called CBB 20-20. After finishing 2016 with total assets of $249 million, we developed this plan that committed the Bank to double its assets to $500 million by 2020. This equated to average annual growth of approximately 22% per year. To a person we felt confident that we could achieve this ambitious goal due to the economic strength of our markets, the team we had in place and the opportunities for quality additions that were presenting themselves.

In order to execute this plan we first had to raise capital and we met with a number of highly regarded institutional bank investors. Our story and opportunity was well received by these professional investors and we closed a $12 million capital round at $5.25 per share in March 2017. We quickly added a number of important members to our team and began to focus on growth. By the end of 2017 we had grown 18.6% to $296 million.

We are now pleased to report that we made even better progress in 2018 with year over year growth in excess of 32%. Because of seasonality for some of our clients, total assets actually exceeded $410 million in the third quarter before settling down to finish the year at $390.7 million. Deposits ended at $326 million, up $69.1 million or 26.9%, and loans ended the year at $315.4 million, up $77.4 million, or 32.5%. As a result, earning assets increased $89.5 million from the prior year, and were almost $33 million higher than 2018's average at year-end.

Importantly, while loans increased substantially, we were able to maintain credit quality. Non-performing assets decreased 32% during 2018 to only $941 thousand, or 0.3% of total loans.

The only area that trended away from us in 2018 was Margin. During the year we saw only a modest 16 basis point ("bp") increase in our Earning Assets yield while we experienced a 32 bp increase in our overall cost of funds. Part of the increase was due to our decision to add $15 million of three to five year borrowings to our liabilities in order to better match fund some longer maturity loans, but the majority of the increase was due to a shift in our deposit mix. As the Federal Reserve raised interest rates four times in 2018, depositors shifted funds from non-interest to interest bearing accounts. As a result, our non-interest bearing deposit balances declined from 39% of total deposits to 32%. Moreover, increased competition for all deposits pushed up money market rates by 32 bp and time deposit by 61 bp. The net result was a decrease in our Net Interest Margin of 13 bp to 4.22%.

This margin compression was not unexpected. In developing our plan we understood that to grow we would have to compete for larger clients who are naturally more price sensitive. We counted on the benefits of increased balance sheet leverage to offset the loss of yield and that formula has proven to be the case. We expect we will see a bit more of this rate verse volume tradeoff in the coming year as well.

In the end we can say that we are extremely happy with our 2018 results. We grew the key components of our balance sheet well in excess of budget and more than doubled Net Income while maintaining excellent credit quality. In fact, 2018 progressed so well that we started to think past the $500 million total asset target of our CBB 20-20 Plan.

We felt confident that the Bay Area economy would remain strong and that the economic renaissance that is happening in Oakland would continue for at least a few more years as thousands of new housing units, clustered downtown around our headquarters or near the City's eight BART Stations come on line, major employers continue to move in from higher priced San Francisco and Silicon Valley and small businesses form and thrive by serving the new arrivals. Even the 2017 Tax Cuts and Jobs Act favored Oakland with its creation of Opportunity Zones to spur investment in designated areas, many of which are located in and around Oakland.

But what really got us thinking beyond $500 million was the disruption in the Bay Area community banking industry. Since the end of 2017 five local banks were sold representing total assets of $2.8 billion. We saw this disruption not only as an opportunity to attract new clients, but as a unique chance to add talented professionals to our team.

With strong initial results in hand – by Q3 2018 we were already two-thirds of the way to our goal – we again approached our institutional investors about providing the capital to take full advantage of the opportunities before us. In October we closed a second institutional capital round for $11.5 million at $7.50 per share, and used some of the proceeds to redeem $4 million of preferred stock held by the US Treasury as part of its 2010 Community Development Capital Initiative program.

By the end of the year we had added three new officers, including two from one of the recently acquired banks. Tom Rodriguez joined as a VP Construction Lender and Steve Layshock joined as VP Relationship Manager. Both quickly began building profitable books of business. Dan Northway joined as SVP Chief Financial Officer after his $700 million bank, Scott Valley Bank was acquired, and his presence allowed our longtime CFO Chaula Pandya to assume the Chief Technology Officer role where she can focus on improving the efficiency of our technology and expanding our digital banking capabilities.

2018's efforts and accomplishments have positioned the Bank for continued success in 2019 and beyond. You have likely heard us say that community banks are substantially built on three things, capital, markets and people. We have a solid team of experienced and dedicated employees and a committed and well-rounded board. We have an enviable client base that is made up of individuals and organizations that any bank would be proud to work with. We have economically strong and growing markets. And we now have enough capital to compete for larger clients, grow well past $500 million and if necessary, provide a measure of safety in the event that the economy weakens. We have every reason to again look forward to the coming year with optimism and heightened 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 May 15, 2019 at 9:00 am.

Sincerely,

William S. Keller
President & CEO

William E. Purcell
Chairman of the Board

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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, 2018 and 2017, 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, 2018 and 2017, and the results of its operations and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Moss Adams LLP

Stockton, California
April 1, 2019

Financial Statements

Community Bank of the Bay

Balance Sheets

December 31, 2018 and 2017

ASSETS

	2018	2017
Cash and due from banks	$ 29,978,694	$ 23,226,360
Federal funds sold	276,138	275,648
Total cash and cash equivalents	30,254,832	23,502,008
Interest-bearing deposits in banks	17,432,244	14,085,057
Available-for-sale investment securities	20,904,724	14,938,411
Loans, held for sale	1,537,686	2,620,051
Loans, less allowance for loan losses of $3,399,863 in 2018 and $3,473,818 in 2017	311,112,975	232,278,259
Premises and equipment, net	342,332	396,788
Bank-owned life insurance	4,255,252	4,139,553
Interest receivable and other assets	4,931,443	3,729,037
Total assets	$ 390,771,488	$ 295,689,164

LIABILITIES AND SHAREHOLDERS' EQUITY

	2018	2017
Deposits		
Non-interest bearing	$ 103,910,571	$ 100,671,414
Interest bearing	222,442,652	156,533,699
Total deposits	326,353,223	257,205,113
Interest payable and other liabilities	1,742,616	784,184
Other borrowings	15,000,000	-
Total liabilities	343,095,839	257,989,297
Commitments and contingencies (Note 11)		
Shareholder's equity		
Preferred stock, no par value; 10,000,000 shares authorized; 0 and 4,060 shares issued and outstanding in 2018 and 2017	-	4,060,000
Class A common stock, voting, no par value; 10,000,000 shares authorized; 8,130,922 and 6,582,787 shares issued and outstanding in 2018 and 2017, respectively	45,184,526	33,841,525
Class B common stock, non-voting, no par value; 10,000,000 shares authorized; 56,844 shares issued and outstanding in 2018 and 2017	1,421,100	1,421,100
Retained earnings / (accumulated deficit)	1,217,874	(1,537,321)
Accumulated other comprehensive (loss), net of taxes	(147,851)	(85,437)
Total shareholders' equity	47,675,649	37,699,867
Total liabilities and shareholders' equity	$ 390,771,488	$ 295,689,164

See accompanying notes and report of independent auditors.

Community Bank of the Bay
Statements of Income
Years Ended December 31, 2018 and 2017

	2018	2017
INTEREST INCOME		
Interest and fees on loans	$ 14,613,438	$ 10,313,264
Interest on investment securities	474,876	199,729
Interest on federal funds sold	489	96
Interest on deposits in banks	905,870	694,880
Total interest income	15,994,673	11,207,969
INTEREST EXPENSE		
Interest expense on deposits	1,952,058	936,713
Interest on borrowings	286,567	1
Total interest expense	2,238,625	936,714
Net interest income	13,756,048	10,271,255
PROVISION FOR LOAN LOSSES	300,000	325,000
Net interest income after provision for loan losses	13,456,048	9,946,255
NON-INTEREST INCOME		
Service charges	229,538	171,536
Government grant	466,681	227,282
Gain on sale of loans, net	445,881	277,785
Other income	458,395	462,359
Total non-interest income	1,600,495	1,138,962
NON-INTEREST EXPENSE		
Salaries and employee benefits	6,122,434	4,180,616
Stock option expense	357,748	282,354
Occupancy and equipment	1,592,103	1,386,857
Other expenses	2,822,724	2,260,998
Total non-interest expense	10,895,009	8,110,825
Net operating income before provision for income taxes	4,161,534	2,974,392
INCOME TAX EXPENSE	1,334,613	1,746,966
NET INCOME	2,826,921	1,227,426
DIVIDENDS ON PREFERRED STOCK	71,726	81,200
NET INCOME AVAILABLE TO COMMON SHAREHOLDERS	$ 2,755,195	$ 1,146,226
NET INCOME PER SHARE -- BASIC	$ 0.34	$ 0.17
NET INCOME PER SHARE -- DILUTED	$ 0.32	$ 0.17

Community Bank of the Bay
Statements of Comprehensive Income
Years Ended December 31, 2018 and 2017

	2018	2017
NET INCOME	$ 2,826,921	$ 1,227,426
UNREALIZED LOSS ON AVAILABLE-FOR-SALE SECURITIES	(88,504)	(85,437)
INCOME TAX BENEFIT	26,090	62,519
OTHER COMPREHENSIVE LOSS	(62,414)	(22,918)
TOTAL COMPREHENSIVE INCOME	$ 2,764,507	$ 1,204,508

See accompanying notes and report of independent auditors.

Community Bank of the Bay

Statements of Shareholders’ Equity

Years Ended December 31, 2018 and 2017

	Preferred Stock	Class A Common Stock Shares	Class A Common Stock Amount	Class B Common Stock Shares	Class B Common Stock Amount	Accumulated Deficit	Accumulated Comprehensive Loss	Total Shareholders’ Equity
BALANCES, January 1, 2017	$ 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
Issue of shares, net of offering costs	-	1,533,333	10,928,562	-	-	-	-	10,928,562
Stock option exercised	-	14,802	33,311	-	-	-	-	33,311
Stock option expense	-	-	381,128	-	-	-	-	381,128
Redemption of Preferred Stock	(4,060,000)	-	-	-	-	-	-	(4,060,000)
Dividend paid on preferred stock		-	-	-	-	(71,726)	-	(71,726)
Net income	-	-		-	-	2,826,921	-	2,826,921
Other comprehensive loss	-	-		-	-		(62,414)	(62,414)
BALANCES, December 31, 2018	$ -	8,130,922	$ 45,184,526	56,844	$ 1,421,100	$ 1,217,874	$ (147,851)	$ 47,675,649

Community Bank of the Bay
Statements of Cash Flows
Years Ended December 31, 2018 and 2017

	2018	2017
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income	$ 2,826,921	$ 1,227,426
Adjustments to reconcile net income to net cash from operating activities:		
Provision for loan losses	300,000	325,000
Change in deferred loan origination fees, net	438,834	(93,314)
Depreciation, amortization, and accretion	183,493	208,960
Proceeds from the sale of loans held for sale	4,829,158	3,271,836
Originations of loans held for sale	(4,379,068)	(4,747,557)
Gain on sale of loans, net	(445,881)	(277,785)
Stock option expense	381,128	282,354
Increase in cash surrender value of bank owned life insurance	(115,699)	(113,511)
(Increase) Decrease in interest receivable and other assets	(1,469,565)	143,152
Increase in interest payable and other liabilities	858,158	75,705
Net cash provided by operating activities	3,407,479	302,266
CASH FLOWS FROM INVESTING ACTIVITIES		
Proceeds from sold, called, and matured available-for-sale investment securities	1,250,000	-
Proceeds from principal repayments from available-for-sale investment securities	2,695,606	966,998
Purchases of available-for-sale investment securities	(10,000,423)	(12,578,702)
Purchase of FHLB stock	337,600	-
Purchase of interest-bearing deposits	(11,324,187)	-
Proceeds from maturities of interest-bearing deposits	7,977,000	6,109,025
Net increase in loans	(78,495,394)	(50,032,863)
Purchases of premises and equipment	(73,114)	(40,525)
Net cash used in investing activities	(87,632,912)	(55,576,067)

 See accompanying notes and report of independent auditors.

	2018	2017
CASH FLOWS FROM FINANCING ACTIVITIES		
Net increase in demand, interest bearing,		
and savings deposits	56,177,269	38,872,265
Net increase (decrease) in time deposits	12,970,841	(5,097,923)
Proceeds from other borrowings	15,000,000	-
Issue of common stock	11,499,997	12,000,004
Stock offering cost	(571,435)	(608,031)
Dividends paid on preferred stock	(71,726)	(81,200)
Redemption of preferred stock	(4,060,000)	-
Proceeds from exercise of stock options	33,311	11,029
Net cash provided by financing activities	90,978,257	45,096,144
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	6,752,824	(10,177,657)
CASH AND CASH EQUIVALENTS, beginning of year	23,502,008	33,679,665
CASH AND CASH EQUIVALENTS, end of year	$ 30,254,832	$ 23,502,008

SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION:		
Cash paid during the year for:		
Interest expense	$ 2,078,480	$ 937,579
Income taxes	$ 1,150,000	$ 1,067,000
Non-cash investing and financing activities:		
Net change in unrealized loss on available-for-sale securities	$ 88,504	74,531

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 to 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 are based upon the details underlying each loan agreement.

As of December 31, 2018 and 2017, 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, 2018 and 2017, 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.

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

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).

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 $1,230,800 and $893,200 at December 31, 2018 and 2017, 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.

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

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.

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.

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

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 $387,643 and $363,246 at December 31, 2018 and 2017, respectively. The Bank evaluated the servicing asset for impairment at December 31, 2018 and 2017 and determined that no valuation allowance was needed.

The Bank services loans that have been participated with other financial institutions totaling $27,664,826 and $29,133,222 as of December 31, 2018 and 2017, 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.

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

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, 2018 for loans sold during 2018 and 2017.

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.

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, 2018 and 2017.

The Bank recognizes interest accrued and penalties related to unrecognized tax benefits in tax expense. During the years ended December 31, 2018 and 2017, the Bank recognized no interest and penalties.

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

With few exceptions, the Bank is no longer subject to examinations by U.S. federal taxing authorities for years ended before December 31, 2015, and by state authorities for years ended before December 31, 2014.

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.

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 12.

Advertising Costs

The Bank expenses advertising costs as they are incurred. Advertising expense was $173,862 and $154,608 for the years ended December 31, 2018 and 2017, 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.

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Recent Accounting Pronouncements Adoption of New Accounting Standards

In January 2016, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2016-01, *Financial Instruments – Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities*. The new guidance is intended to improve the recognition and measurement of financial instruments. This ASU requires equity investments to be measured at fair value with changes in fair value recognized in net income. In addition, the amendment requires public business entities to use the exit price notion when measuring the fair value of financial instruments for disclosure purposes and requires separate presentation of financial assets and financial liabilities by measurement category and form of financial asset (i.e. securities or loans and receivables) on the balance sheet or the accompanying notes to the financial statements. The ASU also eliminates the requirement for public business entities to disclose the method(s) and significant assumptions used to estimate the fair value that is required to be disclosed for financial instruments measured at amortized cost on the balance sheet. The amendment also requires a reporting organization to present separately in other comprehensive income the portion of the total change in the fair value of the a liability resulting from a change in the instrument specific credit risk when the organization has elected to measure the liability at fair value in accordance with the fair value option for financial instruments. Upon the adoption of this ASU, the unrealized gain (loss) on securities investment reported at fair value is recognized in other comprehensive income (loss) on balance sheet. The Bank has adopted this provision. ASU No. 2016-01 did not have a material impact on its financial statements and disclosures. The disclosures to the Bank's financial statements have been updated appropriately using the exit price notion in "Note 18 – Disclosures About Fair Value of Financial Instruments."

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 June 2016, the FASB issued 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.

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

The Bank is currently evaluating the provisions of ASU No. 2016-13 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.

On January 1, 2018, the Bank adopted ASU 2014-09, *Revenue from Contracts with Customers* and all subsequent amendments to the ASU (collectively, "ASC 606"), which (i) creates a single framework for recognizing revenue from contracts with customers that fall within its scope and (ii) revises when it is appropriate to recognize a gain (loss) from the transfer of nonfinancial assets, such as OREO. To determine revenue recognition for arrangements that an entity determines are within the scope of Topic 606, the Bank performs the following five steps: (i) identify the contract(s) with a customer; (ii) identify the performance obligations in the contract; (iii) determine the transaction price; (iv) allocate the transaction price to the performance obligations in the contract; and (v) recognize revenue when the Bank satisfies a performance obligation. The majority of the Bank's revenue come from interest that are outside the scope of ASC 606. The Bank's services that fall with the scope of ASC 606 are presented within non-interest income and are recognized as revenue as the bank satisfies its obligation to the customer. Services within the scope of ASC 606 includes deposit service charges, NSF charges, gains (losses) on loan sales, ATM service charges and transaction fees, increase in cash surrender value of bank owned life insurance, and other miscellaneous fees. The Bank adopted ASC 606 using the modified retrospective method applied to all contracts not completed as of January 1, 2018. The adoption of ASC 606 did not result in a material change to the accounting for any of the in-scope revenue streams; as such, no cumulative effect adjustment was recorded.

Reclassification and Presentation

Certain balances in the 2017 presentation have been reclassified to conform to the 2018 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, 2018 and 2017, 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, 2018 are as follows:

	2018			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Mortgage-backed securities	$ 10,064,735	$ 15,974	$ (79,744)	$ 10,000,965
Treasuries	3,743,647	-	(2,334)	3,741,313
CMOs	7,306,032	-	(143,586)	7,162,446
	$ 21,114,414	$ 15,974	$ (225,664)	$ 20,904,724

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

The Bank had no proceeds from the sales of investment securities during the years ended December 31, 2018 and 2017. There were no gross realized gains or losses during 2018 and 2017.

NOTE 4 – AVAILABLE-FOR-SALE INVESTMENT SECURITIES (CONTINUED)

Available-for-sale investment securities with unrealized losses at December 31, 2018 and 2017 are summarized and classified according to the duration of the loss period as follows:

	2018					
	Less than 12 months		12 months or more		Total	
	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
Mortgage-backed securities	$ 292,250	$ (4,395)	$ 4,304,368	$ (75,349)	$ 4,596,618	$ (79,744)
Treasuries	3,741,313	(2,334)	-	-	3,741,313	(2,334)
CMOs	-	-	7,162,446	(143,586)	7,162,446	(143,586)
	$ 4,033,563	$ (6,729)	$ 11,466,814	$ (218,935)	$ 15,500,377	$ (225,664)

	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)

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 no 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 31 and 22 investment securities with unrealized losses at December 31, 2018 and 2017, 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, 2018 and 2017 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, 2018	
	Amortized Cost	Estimated Fair Value
Due after five years through ten years	$ 12,276,782	$ 12,226,212
Due after ten years	8,837,632	8,678,512
	$ 21,114,414	$ 20,904,724

NOTE 5 – LOANS AND THE ALLOWANCE FOR LOAN LOSSES

Outstanding loans, by class, are summarized as follows:

	December 31, 2018	December 31, 2017
Commercial	$ 86,994,338	$ 72,535,144
Commercial real estate		
Non-owner occupied	125,725,333	79,621,101
Owner occupied	60,112,871	46,996,103
Construction and land	22,569,217	26,633,858
Consumer and other	19,606,631	10,022,589
	315,008,390	235,808,795
Deferred loan fees and costs, net	(495,552)	(56,718)
Allowance for loan losses	(3,399,863)	(3,473,818)
	$ 311,112,975	$ 232,278,259

Salaries and employee benefits totaling $730,233 and $585,686 have been deferred as loan origination costs for the years ended December 31, 2018 and 2017, respectively.

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, and 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 AND THE ALLOWANCE FOR LOAN LOSSES (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 AND THE ALLOWANCE FOR LOAN LOSSES (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, 2018 and 2017:

December 31, 2018	Pass	Special Mention	Substandard	Doubtful	Totals
Commercial	$ 84,717,340	$ 572,748	$ 1,704,250	$ -	$ 86,994,338
Commercial real estate					
Non-owner occupied	125,725,333	-	-	-	125,725,333
Owner occupied	57,909,951	-	2,202,920	-	60,112,871
Construction and land	19,732,237	-	2,836,980	-	22,569,217
Consumer and other	19,606,631	-	-	-	19,606,631
Total	$ 307,691,492	$ 572,748	$ 6,744,150	$ -	$ 315,008,390

December 31, 2017	Pass	Special Mention	Substandard	Doubtful	Totals
Commercial	$ 67,989,112	$ 612,976	$ 3,933,056	$ -	$ 72,535,144
Commercial real estate					
Non-owner occupied	79,621,101	-	-	-	79,621,101
Owner occupied	44,720,520	-	2,275,583	-	46,996,103
Construction and land	20,352,378	-	6,281,480	-	26,633,858
Consumer and other	8,849,846	553,122	619,621	-	10,022,589
Total	$ 221,532,957	$ 1,166,098	$ 13,109,740	$ -	$ 235,808,795

NOTE 5 – LOANS AND THE ALLOWANCE FOR LOAN LOSSES (CONTINUED)

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.

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 AND THE ALLOWANCE FOR LOAN LOSSES (CONTINUED)

Age Analysis of Past Due Loans

The age analysis of past due loans by class as of December 31, 2018 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	$ 948,513	$ -	$ 453,695	$ 1,402,208	$ 84,189,922	$ 86,994,338	$ -
Commercial real estate							
Non-owner occupied	-	-	-	-	125,725,333	125,725,333	-
Owner occupied	-	-	-	-	60,112,871	60,112,871	-
Construction and land	-	-	-	-	22,569,217	22,569,217	-
Consumer and other	-	-	300,000	300,000	19,006,631	19,606,631	-
Total	$ 948,513	$ -	$ 753,695	$ 1,702,208	$ 311,603,974	$ 315,008,390	$ -

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	$ 70,884,842	$ 72,535,144	$ -
Commercial real estate							
Non-owner occupied	-	-	-	-	79,621,101	79,621,101	-
Owner occupied	-	-	-	-	46,996,103	46,996,103	-
Construction and land	-	-	-	-	26,633,858	26,633,858	-
Consumer and other	-	-	-	-	10,022,589	10,022,589	-
Total	$ 83,586	$ -	$ 741,565	$ 825,151	$ 234,158,493	$ 235,808,795	$ -

NOTE 5 – LOANS AND THE ALLOWANCE FOR LOAN LOSSES (CONTINUED)

Information related to impaired loans by class as of December 31, 2018 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	$ 261,692	$ -	$ -	$ -	$ 593,825	$ 855,517
With a specific allowance recorded	266,905	-	-	-	-	266,905
Total recorded investment in impaired loans	$ 528,597	$ -	$ -	$ -	$ 593,825	$ 1,122,422
Unpaid principal balance of impaired loans:						
With no specific allowance recorded	$ 303,179	$ -	$ -	$ -	$ 668,737	$ 971,916
With a specific allowance recorded	329,072	-	-	-	-	329,072
Total unpaid principal balance of impaired loans	$ 632,251	$ -	$ -	$ -	$ 668,737	$ 1,300,988
Specific allowance	$ 11,688	$ -	$ -	$ -	$ -	$ 11,688
Average recorded investment in impaired loans during the year	$ 623,944	$ -	$ -	$ -	$ 606,723	$ 1,230,667
Interest income recognized in impaired loans during the year	$ 177,533	$ -	$ -	$ -	$ 74,913	$ 252,446

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	$ 722,260	$ -	$ -	$ -	$ 620,084	$ 1,342,344
With a specific allowance recorded	26,479	-	-	-	-	26,479
Total recorded investment in impaired loans	$ 748,739	$ -	$ -	$ -	$ 620,084	$ 1,368,823
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

NOTE 5 – LOANS AND THE ALLOWANCE FOR LOAN LOSSES (CONTINUED)

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

	December 31, 2018	December 31, 2017
Commercial	$ 528,597	$ 748,739
Commercial real estate		
Non-owner occupied	-	-
Owner occupied	-	-
Construction and land	-	-
Consumer and other	593,825	620,084
	$ 1,122,422	$ 1,368,823

Changes in the allowance for loan losses, by class, for the year ended December 31, 2018 were as follows:

	Commercial	Commercial Real Estate	Construction and Land	Consumer and other	Unallocated	Total
Allowance for credit losses						
Beginning balance	$ 1,276,658	$ 1,338,822	$ 672,983	$ 185,355	$ -	$ 3,473,818
Charge-offs	(634,877)	-	-	-	-	(634,877)
Recoveries	253,813	7,109	-	-	-	260,922
Provision	(261,299)	562,910	(396,214)	(90,870)	485,473	300,000
Ending balance	$ 634,295	$ 1,908,841	$ 276,769	$ 94,485	$ 485,473	$ 3,399,863
Period-end amount allocated to:						
Loans individually evaluated for impairment	$ 11,668	$ -	$ -	$ -	$ -	$ 11,668
Loans collectively evaluated for impairment	622,627	1,908,841	276,769	94,485	485,473	3,388,195
Ending balance	$ 634,295	$ 1,908,841	$ 276,769	$ 94,485	$ 485,473	$ 3,399,863
Loans						
Individually evaluated for impairment	$ 528,597	$ -	$ -	$ 593,825	$ -	$ 1,122,422
Collectively evaluated for impairment	86,465,741	185,838,204	22,569,217	19,012,806	-	313,885,968
Ending balance	$ 86,994,338	$ 185,838,204	$ 22,569,217	$ 19,606,631	$ -	$315,008,390

NOTE 5 – LOANS AND THE ALLOWANCE FOR LOAN LOSSES (CONTINUED)

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

	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	$ 748,739	$ -	$ -	$ 620,084	$ -	$ 1,368,823
Collectively evaluated for impairment	71,786,405	126,617,204	26,633,858	9,402,505	-	234,439,972
Ending balance	$ 72,535,144	$ 126,617,204	$ 26,633,858	$ 10,022,589	$ -	$235,808,795

NOTE 5 – LOANS AND THE ALLOWANCE FOR LOAN LOSSES (CONTINUED)

The following table summarizes loans to customers whose loan terms were modified in troubled debt restructurings during the years ended December 31, 2018 and 2017:

	Year Ended December 31, 2018		
	Number of Contracts	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment
Troubled Debt Restructurings			
Commercial	2	$ 137,699	$ 137,699
	2	$ 137,699	$ 137,699

	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

During 2018 and 2017, there were two and three 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, 2018 and 2017.

Interest recognized for cash payments received on non-accrual loans was not significant for the years ended December 31, 2018 and 2017. At December 31, 2018 and 2017, there were no loans over 90 days past due that were still accruing interest.

There were no troubled debt restructurings in 2018 and 2017 that subsequently defaulted.

NOTE 6 – PREMISES AND EQUIPMENT

Premises and equipment consisted of the following:

	December 31, 2018	December 31, 2017
Leasehold improvements	$ 398,054	$ 381,649
Furniture, fixtures, and equipment	767,025	711,395
	1,165,079	1,093,044
Less accumulated depreciation and amortization	(822,747)	(696,256)
	$ 342,332	$ 396,788

Depreciation and amortization included in occupancy and equipment expense totaled $127,570 and $172,202 for the years ended December 31, 2018 and 2017, respectively.

NOTE 7 – INTEREST-BEARING DEPOSITS

Interest-bearing deposits consisted of the following:

	December 31, 2018	December 31, 2017
NOW accounts	$ 26,530,479	$ 13,784,687
Money market	130,732,546	91,432,261
Savings	3,671,626	2,779,591
Time, under $250,000	14,676,654	13,937,556
Time, $250,000 or more	46,831,347	34,599,604
	$ 222,442,652	$ 156,533,699

Aggregate annual maturities of time deposits are as follows:

Years Ending December 31,	
2019	$ 48,209,648
2020	11,144,256
2021	1,574,736
2022	386,295
2023	193,066
	$ 61,508,001

NOTE 7 – INTEREST-BEARING DEPOSITS (CONTINUED)

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

	Years Ended December 31, 2018	2017
NOW accounts	$ 26,199	$ 9,068
Money market	1,258,702	604,677
Savings	3,908	4,959
Time	663,249	318,009
	$ 1,952,058	$ 936,713

NOTE 8 – FHLB ADVANCES AND LINES OF CREDIT

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 $0 and $6,025,949 and estimated fair market values totaling $0 and $6,067,391 were pledged at December 31, 2018 and 2017, respectively. Loans with an unpaid principal balance of $103,179,462 and $81,652,348 were pledged at December 31, 2018 and 2017, respectively. Collateralized borrowing capacity at the FHLB was $56,790,008 and $56,665,174 as of December 31, 2018 and 2017, respectively.

The Bank utilized $10,900,000 of its collateralized borrowing capacity for Letters of Credit at both December 31, 2018 and 2017, and had $15,000,000 and $0 long term outstanding borrowings from the FHLB as of December 31, 2018 and 2017, respectively. Net remaining borrowing capacity at the FHLB was $30,890,008 and $45,765,174 as of December 31, 2018 and 2017, respectively.

Annual maturities and interest rates of FHLB advances are as follows:

Years Ending December 31,	Rate(%)	Current Par ($)
2019		$ -
2020	2.4475	2,000,000
2021	2.5645	4,000,000
2021	2.8980	5,000,000
2022	2.6680	4,000,000
		$ 15,000,000

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, 2018 and 2017, respectively.

NOTE 9 – INCOME TAXES

Income tax expense for the years ended December 31, 2018 and 2017, consists of the following:

	Years Ended December 31, 2018	Years Ended December 31, 2017
Current		
Federal	$ 947,522	$ 1,105,666
State	487,464	338,500
	1,434,986	1,444,166
Deferred		
Federal	(71,260)	314,700
State	(29,113)	(11,900)
	(100,373)	302,800
Income tax expense	$ 1,334,613	$ 1,746,966

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:

	2018		2017	
	Amount	Percent	Amount	Percent
Tax at statutory rate	$ 873,922	21%	$ 1,011,000	34%
State income tax	362,098	9%	215,000	7%
Change in federal tax rate	-	0%	456,000	15%
Bank owned life insurance	(24,297)	-1%	(39,000)	-1%
Equity compensation	37,019	1%	53,000	2%
Other	85,871	1%	50,966	2%
	$ 1,334,613	31%	$ 1,746,966	59%

NOTE 9 – INCOME TAXES (CONTINUED)

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

	December 31,	
	2018	2017
Deferred tax assets		
Net operating loss carryforwards	$ 71,575	$ 84,920
Allowance for loan losses	918,903	852,445
Unrealized losses on available-for-sale investment securities	61,992	35,827
Nonaccrual loan interest	28,913	50,328
Non-qualified stock options	267,129	223,478
State income tax	100,896	66,102
Other	81,304	79,421
Total deferred tax assets	1,530,712	1,392,521
Deferred tax liabilities		
Depreciation on premises and equipment	(24,767)	(44,494)
Deferred loan costs	(259,064)	(227,229)
Other	(14,499)	(14,499)
	(298,330)	(286,222)
Net deferred income tax asset	$ 1,232,382	$ 1,106,299

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, 2018 and 2017, the valuation allowance remained at $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 – RELATED PARTY TRANSACTIONS

The Bank, in the normal course of business, makes loans to and received 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 Bank's related party loans are summarized below:

	December 31, 2018	December 31, 2017
Aggregate amount outstanding, beginning of year	$ 77,896	$ 84,839
New loans, advances, or additions during year	3,200,000	-
Repayments during year	(1,077,896)	(6,943)
Aggregate amount outstanding, end of year	$ 2,200,000	$ 77,896
Unused loan commitments	$ 2,300,000	$ 3,500,000

Related party deposits amounted to $8,160,525 and $547,473 as of December 31, 2018 and 2017, respectively.

NOTE 11 – 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 February 2019 and April 2024. During 2014, the Bank entered into a lease agreement with a related party, which expired March 31, 2018 and was not renewed, for its Campbell loan production office. The Bank has determined that these lease terms are similar to those that would be available from a third party.

During 2014, the Bank moved its Danville branch to a new location in Danville. The Bank sub-let the previous Danville location under an operating lease agreement. The lease expired in October 2017. Total rental income, offsetting rent expense, amounted to $0 and $82,033 at December 31, 2018 and 2017, respectively.

NOTE 11 – COMMITMENTS AND CONTINGENCIES (CONTINUED)

At December 31, 2018, the future minimum rental payments and income under non-cancelable operating leases are as follows:

Years Ending December 31,	Payments
2019	$ 627,747
2020	498,918
2021	513,886
2022	529,303
2023	446,188
2024	439,775
	$ 3,055,817

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 $633,906 and $576,687 for the years ended December 31, 2018 and 2017, 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, 2018 and 2017, the Bank had commitments to extend credit of approximately $54,199,891 and $39,930,681, respectively. There were $628,300 and $523,400 in standby letters of credit issued at December 31, 2018 and 2017, 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 11 – 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 12 – 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 was carried at liquidation value of $1,000 per share, must be redeemed after ten years, and carried 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 carried an initial fixed dividend rate of 2% increasing to 9% after eight years, with dividends payable quarterly. The Bank paid dividends totaling $71,726 and $81,200, respectively, during each of the years ended December 31, 2018 and 2017, after receiving approval from the Department of Business Oversight (DBO) and their shareholders. In October, 2018, the Bank redeemed the 4,060 shares of Series A-1 preferred stock.

Stock Issuance

In October 2018 and March 2017, the Bank completed private placements to institutions and accredited investors of 1,533,333 and 2,285,715 shares of Series A common stock resulting in proceeds to the Bank, net of offering costs, of $10,928,562 and $11,391,973, respectively.

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, the Bank had an accumulated deficit. Therefore, no amount was available for dividends to shareholders that year. As discussed above, the Bank received approval from the DBO to make dividend payments on the Series A-1 preferred stock during 2018 and 2017.

NOTE 12 – SHAREHOLDERS' EQUITY (CONTINUED)

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, 2018		
	Income (Numerator)	Shares (Denominator)	Per-Share Amount
Basic EPS:			
Net income available to common shareholders	$ 2,755,195	8,130,922	$ 0.34
Effect of dilutive securities:			
Stock options		359,179	
Diluted EPS:			
Net income available to common shareholders plus assumed conversions	$ 2,755,195	8,490,101	$ 0.32

	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

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.

NOTE 12 – SHAREHOLDERS' EQUITY (CONTINUED)

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. Shares of the Bank's common stock reserved under this plan amounted to 1,324,338 and 1,106,420 as of December 31, 2018 and 2017, respectively.

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 2018 and 2017, respectively: no expected dividends; expected volatility between 30.42% and 54.67% in 2018 and 53.28% and 55.40% in 2017; risk-free interest rates between 2.63% and 2.96% in 2018 and 1.90% and 2.35% in 2017; and expected options term of ten years.

The following tables summarizes information about stock options outstanding at December 31, 2018 and 2017:

	December 31, 2018	
	Shares	Weighted Average Exercise Price
Outstanding at beginning of period	995,691	$ 3.94
Granted	480,500	$ 6.66
Exercised	(14,802)	$ 3.84
Forfeited / canceled / expired	(266,350)	$ 5.65
Outstanding at end of period	1,195,039	$ 4.55

The Bank recognized $357,748 and $282,354 in stock option expense for the years ended December 31, 2018 and 2017, respectively. There is approximately $1,103,479 and $737,053 in unrecognized compensation cost remaining as of December 31, 2018 and 2017, respectively, which is expected to be recognized over a weighted-average period of 3.67 years and 3.65 years, respectively. The Bank had 566,302 and 470,954 incentive stock options and 628,737 and 524,737 non-statutory stock options outstanding as of December 31, 2018 and 2017, respectively.

NOTE 12 – SHAREHOLDERS' EQUITY (CONTINUED)

A summary of options outstanding follows:

	Year Ended December 31,	
	2018	2017
Weighted-average fair value of options granted during the year	$ 3.35	$ 3.11
Intrinsic value of options exercised	$ 50,462	$ 2,057
Options exercisable at year end	783,070	684,639
Weighted-average exercise price	$ 3.80	$ 3.54
Intrinsic value	$ 2,347,579	$ 1,856,880
Weighted-average remaining contractual life	4.31 Years	4.76 Years
Options outstanding at year end	1,195,039	941,208
Weighted-average exercise price	$ 4.66	$ 3.89
Intrinsic value	$ 2,622,783	$ 2,221,373
Weighted-average remaining contractual life	5.87 Years	5.81 Years

NOTE 13 – 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.

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, 2018 and 2017.

NOTE 13 – REGULATORY MATTERS (CONTINUED)

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, 2018:						
Common equity Tier 1 (to risk-weighted assets)	$ 47,435,000	14.04%	$ 15,199,965	≥ 4.5%	$ 20,266,620	≥ 6.5%
Total risk-based capital (to risk-weighted assets)	$ 50,917,000	15.07%	$ 27,022,160	≥ 8.0%	$ 33,777,700	≥ 10.0%
Tier 1 capital (to risk-weighted assets)	$ 47,435,000	14.04%	$ 13,511,080	≥ 4.0%	$ 20,266,620	≥ 6.0%
Tier 1 capital (to average assets)	$ 47,435,000	12.06%	$ 15,746,840	≥ 4.0%	$ 19,683,550	≥ 5.0%
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%

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 14 – GOVERNMENT GRANT

The Bank was awarded $466,681 and $227,282, respectively, in 2018 and 2017, 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.

NOTE 15 – NON-INTEREST INCOME AND REVENUE FROM CONTRACTS WITH CUSTOMERS

All of the Bank's revenue from contracts with customers within the scope of ASC 606 is recognized in non-interest income. Revenues that fall within the scope of ASC 606 include service charges and fee income and revenue from various sources included in other income. Certain non-interest income streams such as BEA awards and fees associated with SBA servicing rights are not within the scope of the new guidance.

The Bank earns fees from its deposit customers for account maintenance, transaction-based activity, and overdraft services. Account maintenance fees consist primarily of account fees and analyzed account fees charged on deposit accounts on a monthly basis. The performance obligation is satisfied, and the fees are recognized on a monthly basis as the service period is completed. Transaction-based fees on deposit accounts are charged to deposit customers for specific services provided to the customer, such as non-sufficient funds fees, overdraft fees, and wire fees. The performance obligation is completed as the transaction occurs, and the fees are recognized at the time each specific service is provided to the customer. Premiums on the sale of loans are recognized when the loan is sold, and performance obligation is complete. Other income includes income from various sources and is recognized when the performance obligation is complete.

Non-interest income consisted of the following for the years ended December 31:

	2018	2017
Service charges and fee income	$ 229,538	$ 171,536
BEA awards	466,681	227,282
Premiums on sale of loans	445,881	277,785
Change in cash surrender value of BOLI	115,699	113,511
Loan document and packaging fees	113,850	88,199
SBA servicing income	105,238	175,775
Other	123,608	84,874
Total non-interest income	$ 1,600,495	$ 1,138,962

NOTE 16 – OTHER EXPENSES

Other expenses consisted of the following for the years ended December 31:

	2018	2017
Professional fees	$ 628,002	$ 718,140
Data processing	476,602	409,271
Sundry losses	326,407	6,908
Loan related expenses	237,828	131,346
Advertising	173,862	154,608
Title company deposit expenses	157,409	138,911
Donations	102,179	59,430
Insurance	76,017	67,827
Regulatory assessments	61,769	153,865
Other operating expenses	582,649	419,035
Total other expenses	$ 2,822,724	$ 2,259,341

NOTE 17 – 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 made contributions of $178,145 and $0 for the years ended December 31, 2018 and 2017, respectively.

NOTE 18 – 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.

NOTE 18 – DISCLOSURES ABOUT FAIR VALUE OF FINANCIAL INSTRUMENTS (CONTINUED)

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

		2018		2017	
	Fair Value Hierarchy	Carrying Amounts	Estimated Fair Values	Carrying Amounts	Estimated Fair Values
Financial assets:					
Cash and cash equivalents	Level 1	$ 30,254,832	$ 30,254,832	$ 23,502,008	$ 23,502,008
Interest bearing deposits in banks	Level 2	17,432,244	17,237,000	14,085,057	13,972,377
Securities available-for-sale	Level 2	20,904,724	20,904,724	14,938,411	14,938,411
FHLB stock	Level 2	1,230,800	1,230,800	893,200	893,200
Loans [1]	Level 3	312,650,661	314,559,000	234,898,310	232,622,000
Interest receivable	Level 2	1,025,568	1,025,568	875,527	872,527
Financial liabilities:					
Non-maturity deposits	Level 2	264,845,222	266,511,000	208,667,953	208,667,953
Time deposits	Level 2	61,508,001	61,067,000	48,537,160	48,174,000
Interest payable	Level 2	201,142	201,142	41,091	41,091
Off-balance-sheet liabilities:					
Undisbursed loan commitments	Level 3	-	541,999	-	399,000

1 – The estimated fair value of loans for December 31, 2018 reflects an exit price assumption. The December 31, 2017 fair value is not based on an exit price.

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.

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.

NOTE 18 – DISCLOSURES ABOUT FAIR VALUE OF FINANCIAL INSTRUMENTS (CONTINUED)

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, 2018 and 2017, as well as assets and liabilities for which a non-recurring change in the fair value has been recorded as of December 31, 2018 and 2017. 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, 2018	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	$ 7,599,069	$ -	$ 7,599,069	$ -
Treasuries	3,741,312		3,741,312	
CMOs	9,564,343	-	9,564,343	-
Total	$ 20,904,724	$ -	$ 20,904,724	$ -

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	$ -

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.

NOTE 18 – DISCLOSURES ABOUT FAIR VALUE OF FINANCIAL INSTRUMENTS (CONTINUED)

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.

NOTE 18 – DISCLOSURES ABOUT FAIR VALUE OF FINANCIAL INSTRUMENTS (CONTINUED)

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.

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 19 – SUBSEQUENT EVENTS

The Bank has evaluated the effects of subsequent events that have occurred after the period ending December 31, 2018 and through April 1, 2019, which is the date the financial statements were available to be issued.

BOARD OF DIRECTORS

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President, Purcell International

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President, Bay Business Credit

BEN MACKOVAK
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Manufacturing Inc.

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DANIEL A. NORTHWAY
SVP, Chief Financial Officer

JOHN BARR
SVP, Chief Credit Officer

CHAULA M. PANDYA
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MARGIE PERRY
SVP, Chief Customer Experience Officer

MARK ROACH
SVP, Chief Banking Officer

TED DEL MUNDO
SVP, Credit Services Manager

WILBUR E. HOBBS, JR.
SVP, Chief Lending Officer

WILLIAM X. SMITH
SVP, Chief Risk Officer, Corporate Secretary

MICHAEL COOK
SVP, Credit Administration

JENNIFFER COLLINS
SVP, Director of Community Banking

LANDON BAINES
SVP, Oakland Regional Manager

DAVID MEYER
SVP, Danville Regional Manager

Values Are Not Words, They Are Who We Are.

"(CBB helped us purchase) a 4,000 sq ft unit. We established a business incubator, and provided low rents to three new businesses. That's community banking!"

Rev. Kenneth Chambers,
West Side Missionary Baptist Church
Executive Director, Interfaith Council of Alameda County (ICAC)

"The staff is so great. Every time I come in everyone is so nice and helpful!"

Dona Gomez, Board Member, Longfellow Community Association (Oakland)

"Such a super-responsive and supportive team; (they) take the time to help our startup continue to accelerate and succeed!"

Taariq Lewis
CEO and Founder of Aquila, Inc.

"CBB has been a breath of fresh air for our cancer charity. We value our relationship with the entire team and are grateful for CBB's support to our cause."

Sandra Wing, CEO
Sandra J. Wing Healing Therapies Foundation

"(CBB) always takes the time to make sure all our financial reporting is on track. Being a customer of Community Bank of the Bay is like doing business with concerned, caring, genuine extended family members."

Dominick Chirichillo
Owner & Winemaker
Domenico Winery

"CBB provides incredible client service and completely understands our business needs."

Uri Eliahu, GE
President
ENGEO Incorporated

"In today's world, we are grateful for the outstanding service provided by our bankers at CBB…and we feel confident that our money is safe with their 5-star Bauer Financial rating."

Tim Clemen,
Chief Financial Officer
Dublin Management Company

"Community Bank of the Bay has simplified the banking of our four corporations and more than one hundred trusts accounts. Having confidence in knowing that (CBB) is on top of everything has allowed (us) to focus on quality and growth."

Chris T. Rontal, CFO
Cardoza Properties, Inc.,

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