

ALTA PACIFIC BANCORP

**CONSOLIDATED FINANCIAL STATEMENTS
WITH
INDEPENDENT AUDITOR'S REPORT**

DECEMBER 31, 2017 AND 2016

ALTAPACIFIC BANCORP
DECEMBER 31, 2017 AND 2016

CONTENTS

	Page
Independent Auditor's Report	1
 Financial Statements	
Consolidated Balance Sheets December 31, 2017 and 2016.....	2
Consolidated Statements of Income For the years ended December 31, 2017 and 2016	3
Consolidated Statements of Comprehensive Income (Loss) For the years ended December 31, 2017 and 2016	4
Consolidated Statement of Changes in Shareholders' Equity For the years ended December 31, 2017 and 2016	5
Consolidated Statements of Cash Flows For the years ended December 31, 2017 and 2016	6
 Notes to Consolidated Financial Statements	 7



VAVRINEK, TRINE, DAY & CO., LLP
Certified Public Accountants

VALUE THE *difference*

INDEPENDENT AUDITOR'S REPORT

Board of Directors and Shareholders of
AltaPacific Bancorp
Santa Rosa, California

We have audited the accompanying consolidated financial statements of AltaPacific Bancorp, which are comprised of the consolidated balance sheets as of December 31, 2017 and 2016, and the related consolidated statements of income, comprehensive income (loss), changes in shareholders' equity, and cash flows for the years then ended, and the related notes to the consolidated financial statements.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

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

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the consolidated 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 consolidated financial statements referred to above present fairly, in all material respects, the financial position of AltaPacific Bancorp as of December 31, 2017 and 2016, and the results of its operations and its cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

Vavrinek, Trine, Day & Co., LLP
Rancho Cucamonga, California
March 23, 2018

ALTAPACIFIC BANCORP

**CONSOLIDATED BALANCE SHEETS
DECEMBER 31, 2017 AND 2016**

	2017	2016
ASSETS		
Cash and due from banks	\$ 27,401,000	\$ 14,571,000
Interest-bearing deposits in banks	748,000	996,000
Available-for-sale investment securities	68,265,000	73,380,000
Loans, less allowance for loan losses of \$3,686,000 in 2017, and \$3,336,000 in 2016	291,998,000	229,763,000
Premises and equipment, net	4,146,000	3,097,000
Other real estate owned (OREO)	241,000	241,000
Bank owned life insurance	11,387,000	12,563,000
Accrued interest receivable and other assets	14,448,000	16,778,000
Total Assets	\$ 418,634,000	\$ 351,389,000
LIABILITIES AND SHAREHOLDERS' EQUITY		
Liabilities		
Deposits:		
Noninterest-bearing deposits	\$ 125,696,000	\$ 91,245,000
Interest-bearing deposits	209,451,000	185,461,000
Total Deposits	335,147,000	276,706,000
Other borrowings	13,406,000	5,000,000
Junior subordinated debentures	5,747,000	5,639,000
Accrued interest payable and other liabilities	6,306,000	6,879,000
Total Liabilities	360,606,000	294,224,000
Commitments and Contingencies (Note 11)	-	-
Shareholders' Equity		
Preferred stock, no par value, 10,000,000 shares authorized; none issued or outstanding	-	-
Common stock, no par value, 40,000,000 shares authorized; 6,207,596 and 6,184,081 shares issued and outstanding for 2017 and 2016, respectively	51,413,000	50,346,000
Retained earnings	6,461,000	6,423,000
Accumulated other comprehensive income	154,000	396,000
Total Shareholders' Equity	58,028,000	57,165,000
Total Liabilities and Shareholders' Equity	\$ 418,634,000	\$ 351,389,000

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

ALTAPACIFIC BANCORP

**CONSOLIDATED STATEMENTS OF INCOME
FOR THE YEARS ENDED DECEMBER 31, 2017 AND 2016**

	2017	2016
Interest Income		
Interest and fees on loans	\$ 17,365,000	\$ 17,404,000
Interest on available-for-sale investment securities	2,846,000	2,696,000
Interest on deposits with other financial institutions	16,000	2,000
Total Interest Income	20,227,000	20,102,000
Interest Expense		
Interest expense on deposits	1,032,000	970,000
Interest on borrowings	704,000	486,000
Total Interest Expense	1,736,000	1,456,000
Net Interest Income	18,491,000	18,646,000
Provision for Loan Losses	350,000	100,000
Net Interest Income After Provision for Loan Losses	18,141,000	18,546,000
Noninterest Income		
Service charges and fees	339,000	376,000
Bank owned life insurance	1,609,000	325,000
Gain on recovery of acquired loans	72,000	222,000
Miscellaneous income	7,000	43,000
Total Noninterest Income	2,027,000	966,000
Noninterest Expense		
Salaries and other employee benefits	9,599,000	7,703,000
Occupancy and equipment	1,472,000	1,322,000
Other	2,720,000	3,061,000
Total Noninterest Expense	13,791,000	12,086,000
Net Income Before Provision for Income Taxes	6,377,000	7,426,000
Provision for Income Taxes	2,404,000	3,051,000
Net Income	\$ 3,973,000	\$ 4,375,000
Income Per Share		
Basic	\$ 0.62	\$ 0.72
Diluted	\$ 0.62	\$ 0.70
Weighted average number of shares outstanding - basic	6,391,713	6,071,333
Weighted average number of shares outstanding - diluted	6,448,431	6,191,392

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

ALTAPACIFIC BANCORP

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)
FOR THE YEARS ENDED DECEMBER 31, 2017 AND 2016

	<u>2017</u>	<u>2016</u>
Net income	\$ 3,973,000	\$ 4,375,000
Other Comprehensive Income (Loss):		
Unrealized losses on securities available-for-sale	(410,000)	(590,000)
Income tax effect relating to available-for-sale securities	<u>168,000</u>	<u>242,000</u>
Total Other Comprehensive Loss	<u>(242,000)</u>	<u>(348,000)</u>
Total Comprehensive Income	<u>\$ 3,731,000</u>	<u>\$ 4,027,000</u>

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

ALTAPACIFIC BANCORP

**CONSOLIDATED STATEMENT OF CHANGES IN SHAREHOLDERS' EQUITY
FOR THE YEARS ENDED DECEMBER 31, 2017 AND 2016**

	Common Stock		Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total Shareholders' Equity
	Shares Outstanding	Amount			
Balance, January 1, 2016	5,667,927	\$46,343,000	\$ 5,216,000	\$ 744,000	\$ 52,303,000
Net income	-	-	4,375,000	-	4,375,000
Share-based compensation expense	-	139,000	-	-	139,000
Stock options exercised	383,443	2,240,000	-	-	2,240,000
5% stock dividend	294,480	3,166,000	(3,166,000)	-	-
Cash in lieu for fractional shares	-	-	(2,000)	-	(2,000)
Purchase and retirement of stock	(161,769)	(1,542,000)	-	-	(1,542,000)
Unrealized loss on available-for-sale investment securities, net of tax	-	-	-	(348,000)	(348,000)
Balance, December 31, 2016	6,184,081	\$50,346,000	\$ 6,423,000	\$ 396,000	\$ 57,165,000
Net income	-	-	3,973,000	-	3,973,000
Share-based compensation expense	-	184,000	-	-	184,000
Stock options exercised	315	1,000	-	-	1,000
5% stock dividend	290,187	3,932,000	(3,932,000)	-	-
Cash in lieu for fractional shares	-	-	(3,000)	-	(3,000)
Purchase and retirement of stock	(266,987)	(3,050,000)	-	-	(3,050,000)
Unrealized loss on available-for-sale investment securities, net of tax	-	-	-	(242,000)	(242,000)
Balance, December 31, 2017	6,207,596	\$51,413,000	\$ 6,461,000	\$ 154,000	\$ 58,028,000

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

ALTAPACIFIC BANCORP

**CONSOLIDATED STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED DECEMBER 31, 2017 AND 2016**

	2017	2016
Cash Flows From Operating Activities		
Net income	\$ 3,973,000	\$ 4,375,000
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for loan losses	350,000	100,000
Depreciation and amortization, net	137,000	(1,255,000)
Gain on disposal of premises and equipment	-	(24,000)
Deferred loan origination costs and fees, net	(816,000)	141,000
Share-based compensation	184,000	139,000
Deferred tax expense	1,236,000	1,350,000
Increase in cash surrender value of life insurance	(294,000)	(325,000)
Decrease (increase) in accrued interest receivable and other assets	1,301,000	(823,000)
(Decrease) increase in accrued interest payable and other liabilities	(573,000)	1,399,000
Other, net	-	1,000
Net Cash Flows Provided by Operating Activities	5,498,000	5,078,000
Cash Flows From Investing Activities		
Net (increase) decrease in interest-bearing deposits in banks	248,000	(996,000)
Purchase of available-for-sale investment securities	(11,284,000)	(11,287,000)
Purchase of Federal Reserve Bank stock	(4,000)	(1,000)
Purchase of Federal Home Loan Bank stock	(35,000)	(31,000)
Proceeds for maturity of corporate securities	3,000,000	-
Proceeds from principal payments of mortgage-backed securities	12,285,000	13,754,000
Increase in loans funded, net	(54,129,000)	(5,435,000)
Proceeds from sale of OREO	-	207,000
Proceeds from sale of premises and equipment	-	24,000
Purchase of premises and equipment	(1,608,000)	(982,000)
Net Cash Flows Used in Investing Activities	(51,527,000)	(4,747,000)
Cash Flows From Financing Activities		
Increase in demand and money market deposits, net	63,439,000	21,451,000
Decrease in time deposits, net	(4,998,000)	(7,178,000)
Purchase of life insurance	-	(1,000,000)
Proceeds from life insurance	1,470,000	-
Proceeds from issuance of common stock, net	1,000	2,240,000
Repurchase of common stock	(3,050,000)	(1,542,000)
Decrease in other borrowings	2,000,000	(15,000,000)
Fractional share from stock dividend	(3,000)	(2,000)
Net Cash Flows Provided by (Used in) Financing Activities	58,859,000	(1,031,000)
Net Increase (Decrease) in Cash and Cash Equivalents	12,830,000	(700,000)
Cash and Cash Equivalents, Beginning of Year	14,571,000	15,271,000
Cash and Cash Equivalents, End of Year	\$ 27,401,000	\$ 14,571,000
Supplemental Cash Flow Information:		
Interest paid	\$ 1,800,000	\$ 1,534,000
Taxes paid	\$ 1,245,000	\$ 1,300,000
Supplemental Disclosures of Noncash Investing Activities:		
Change in unrealized gain on securities available-for-sale	\$ 410,000	\$ 590,000

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

ALTAPACIFIC BANCORP

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2017 AND 2016

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The accounting and reporting policies of AltaPacific Bancorp (the Company) are in accordance with accounting principles generally accepted in the United States of America and conform to practices within the banking industry. A summary of the accompanying consolidated financial statements follows:

Nature of Operation

AltaPacific Bancorp is a California corporation registered as a bank holding company under the Bank Holding Company Act of 1956, as amended, and is headquartered in Santa Rosa, California. The Company was incorporated in March 2010, and subsequently acquired all of the outstanding shares of AltaPacific Bank (the Bank). The formation of the bank holding company provides the Company and the Bank greater flexibility in terms of operation, expansion, and diversification.

AltaPacific Bancorp's principal business is to serve as a holding company for the Bank and its principal source of income will be derived from dividends paid by the Bank. The payment of dividends by the Bank is subject to restrictions that could limit AltaPacific Bancorp's payment of dividends to its shareholders.

The Bank

AltaPacific Bank was organized under the laws of the State of California on February 16, 2006. The Bank opened for business as a State-chartered non-member bank on July 10, 2006. On November 5, 2010, the Company became a member of the Federal Reserve System (FRB). On August 3, 2009, the Bank amended its articles of incorporation to change its legal name from Atlantic Pacific Bank to AltaPacific Bank.

The Bank is subject to regulation by the California Department of Business Oversight (the DBO) and the Federal Reserve Board (FRB) and its deposits are insured by the Federal Deposit Insurance Corporation (FDIC) up to applicable legal limits. The Bank is headquartered in Santa Rosa, California, and also has branch offices in Ontario, Covina, Temecula, Riverside, and San Bernardino, California. The Bank provides products and services to customers who are predominately small to middle-market business, professionals, and not-for-profit organizations. Generally, deposits are insured by the FDIC up to \$250,000 per depositor.

Principles of Consolidation

The accounting and reporting policies of AltaPacific Bancorp and its subsidiary AltaPacific Bank (collectively the Company) conform with accounting principles generally accepted in the United States of America and prevailing practices within the banking industry. Significant inter-company balances and transactions have been eliminated through consolidation.

In accordance with U.S. GAAP, the Company's investments in Mission Oaks Capital Trust I are not consolidated and are accounted for under the equity method and included in other assets on the consolidated balance sheet. The junior subordinated debentures issued and guaranteed by the Company and held by the trust are reflected on the Company's consolidated balance sheet.

ALTAPACIFIC BANCORP

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2017 AND 2016

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Operating Segments

While the Company's executive officers monitor the revenue streams of the various products and services, operations are managed and financial performance is evaluated on a Company-wide basis. Operating results are not reviewed by senior management to make resource allocation or performance decisions. Accordingly, all of the financial service operations are considered by management to be aggregated in one reportable operating segment.

Reclassifications

Certain reclassifications have been made to the prior year's balances to conform to the classifications used in the current year.

Subsequent Events

The Company has evaluated subsequent events for recognition and disclosure through March 23, 2018, which is the date the financial statements were available to be issued.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions. These estimates and assumptions affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from these estimates. The allowance for loan losses, deferred tax assets, and fair values of financial instruments are particularly subject to change.

Cash and Cash Equivalents

For the purpose of the consolidated statement of cash flows, cash and cash equivalents consist of cash and due from banks and Federal funds sold. Generally, Federal funds are sold for one-day periods.

Federal Home Loan Bank and Federal Reserve Bank Stock

The Company, as a member of the Federal Home Loan Bank of San Francisco (FHLB) and the FRB, is required to hold shares of capital stock in the FHLB and FRB in an amount specified by regulation and is adjusted periodically based on a determination made by the FHLB and FRB. At December 31, 2017 and 2016, the Company owned \$1,712,000 and \$1,677,000, respectively, of FHLB stock. At December 31, 2017 and 2016, the Company owned \$1,594,000 and \$1,589,000, respectively, of FRB stock.

These investments are recorded at cost, carried as restricted securities, and are periodically evaluated for impairment. Cash and stock dividends are both reported as income. These stocks are included in accrued interest receivable and other assets on the balance sheet.

ALTAPACIFIC BANCORP

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2017 AND 2016

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Other Real Estate Owned

Assets acquired through or instead of loan foreclosure are initially recorded at fair value less costs to sell when acquired, establishing a new cost basis. These assets are subsequently accounted for at lower of cost or fair value less estimated costs to sell. If fair value declines subsequent to foreclosure, a valuation allowance is recorded through expense. Operating costs after acquisition are expensed.

Investment Securities

Investment securities are classified into the following categories:

- Available-for-sale securities, reported at fair value, with unrealized gains and losses, to the extent losses are not considered other than temporary, excluded from earnings and reported, net of taxes, as accumulated other comprehensive income (loss) within shareholders' equity.
- Held-to-maturity securities, which management has the positive intent and ability to hold, reported at amortized cost, adjusted for the accretion of discounts and amortization of premiums.

Management determines the appropriate classification of its investments at the time of purchase and may only change the classification in certain limited circumstances. All transfers between categories are accounted for at fair value. At December 31, 2017 and 2016, all securities are classified as available-for-sale and there were no transfers between categories for the years ended December 31, 2017 and 2016.

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.

An investment security is impaired when its carrying value is greater than its fair value. Investment securities that are impaired are evaluated on at least a quarterly basis and more frequently when economic or market conditions warrant such an evaluation to determine whether such a decline in their fair value is other than temporary. Management utilizes criteria such as the magnitude and duration of the decline and the intent and ability of the Company to retain its investment in the securities for a period of time sufficient to allow for an anticipated recovery in fair value, in addition to the reasons underlying the decline, to determine whether the loss in value is other than temporary. The term "other than temporary" is not intended to indicate that the decline is permanent, but indicates that the prospects for a near-term recovery of value is not necessarily favorable, or that there is a lack of evidence to support a realizable value equal to or greater than the carrying value of the investment. Once a decline in value is determined to be other than temporary, and management does not intend to sell the security or it is more likely than not that the Company will not be required to sell the security before recovery, only the portion of the impairment loss representing credit exposure is recognized as a charge to earnings, with the balance recognized as a charge to other comprehensive income. If management intends to sell the security or it is more likely than not that, the Company will be required to sell the security before recovering its forecasted cost, the entire impairment loss is recognized as a charge to earnings.

ALTAPACIFIC BANCORP

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2017 AND 2016**

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Loans

Loans are stated at their outstanding principal balances reduced by any charge-offs or specific valuation accounts and net of any deferred fees or costs on originated loans, or unamortized premiums or discounts on purchased loans. Interest is accrued daily based upon outstanding loan balances. However, when, in the opinion of management, loans are considered to be impaired and the future collectability of interest and principal is in serious doubt, loans are placed on nonaccrual status and the accrual of interest income is suspended. Any interest accrued but unpaid is charged against income. Payments received are applied to reduce principal to the extent necessary to ensure collection. Subsequent payments on these loans, or payments received on nonaccrual loans for which the ultimate collectability of principal is not in doubt, are applied first to earned but unpaid interest and then to principal. Generally, loans are placed on non-accrual status when they are 90 days past due. Past due status is based on the contractual terms of the loan. Loans are returned to accrual status when all the principal and interest amounts contractually due are brought current and future payments are reasonably assured. The Company's policy for placing loans on nonaccrual status, recording payments received on nonaccrual loans, resuming accrual of interest, and determining past due or delinquency status does not differ by portfolio segment, nor does it differ for loans modified in troubled debt restructurings.

All classified loans are evaluated for impairment and are considered impaired when, based on current information and events, it is probable that the Company will be unable to collect all amounts due (including both principal and interest) in accordance with the contractual terms of the loan agreement. The policy for recognizing interest on impaired loans is the same as the policy described above and does not differ by portfolio segment.

A restructuring of a debt constitutes a troubled debt restructuring (TDR) if the Company for economic or legal reasons related to the debtor's financial difficulties grants a concession to the debtor that it would not otherwise consider. Restructured workout loans typically present an elevated level of credit risk, as the borrowers are not able to perform according to the original contractual terms. Loans that are reported as TDRs are considered impaired and measured for impairment as described below.

Substantially all loan origination fees, commitment fees, direct loan origination costs and purchase premiums and discounts on loans are deferred and recognized as an adjustment of yield, to be amortized to interest income over the contractual term of the loan. The unamortized balance of deferred fees and costs is reported as a component of net loans.

ALTAPACIFIC BANCORP

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2017 AND 2016

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Allowance for Loan Losses

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

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

The Company recognizes interest income on impaired loans based on its existing methods of recognizing interest income on nonaccrual loans. Loans, for which the terms have been modified resulting in a concession, and for which the borrower is experiencing financial difficulties, are considered troubled debt restructurings and classified as impaired with measurement of impairment based on expected future cash flows discounted using the loan's effective rate immediately prior to the restructuring.

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

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

ALTAPACIFIC BANCORP

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2017 AND 2016

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Allowance for Loan Losses, (Continued)

Portfolio segments identified by the Company include commercial, commercial real estate construction (including land and development loans) commercial real estate mortgage, installment, and home equity lines of credit. Relevant risk characteristics for these portfolio segments generally include debt service coverage, loan-to-value ratios and financial performance on non-consumer loans and credit scores, debt-to income, collateral type, and loan-to-value ratios for consumer loans.

These risk ratings are also subject to examination by independent specialists engaged by the Company and the Company's regulators. During these internal reviews, management monitors and analyzes the financial condition of borrowers and guarantors, trends in the industries in which borrowers operate and the fair values of collateral securing these loans. These credit quality indicators are used to assign a risk rating to each individual loan. The risk ratings do not differ by portfolio segment, and can be grouped into five major categories, defined as follows:

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

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

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

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

Loss - Loans classified as loss are considered uncollectible and charged off immediately.

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

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

ALTAPACIFIC BANCORP

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2017 AND 2016

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Allowance for Loan Losses, (Continued)

Real Estate Construction - Commercial real estate construction loans (including land and development loans) generally possess a higher inherent risk of loss than other real estate portfolio segments. A major risk arises from the necessity to complete projects within specified cost and time lines. Trends in the construction industry significantly impact the credit quality of these loans, as demand drives construction activity. In addition, trends in real estate values significantly impact the credit quality of these loans, as property values determine the economic viability of construction projects.

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

Consumer Installment - An installment loan portfolio is usually comprised of a large number of small loans scheduled to be amortized over a specific period. Most installment loans are made directly for consumer purchases, but business loans granted for the purchase of heavy equipment or industrial vehicles may also be included. Economic trends determined by unemployment rates and other key economic indicators are closely correlated to the credit quality of these loans. Weak economic trends indicate that the borrowers' capacity to repay their obligations may be deteriorating.

Consumer Other: Home Equity Lines of Credit - The degree of risk in the home equity lines of credit portfolio depends primarily on the loan amount in relation to collateral value, the interest rate, and the borrower's ability to repay in an orderly fashion. These loans generally possess a lower inherent risk of loss than other real estate portfolio segments. Economic trends determined by unemployment rates and other key economic indicators are closely correlated to the credit quality of these loans. Weak economic trends indicate that the borrowers' capacity to repay their obligations may be deteriorating.

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

There were no significant changes to the Company's accounting policies or methodologies with respect to the allowance for loan losses from the prior year.

ALTAPACIFIC BANCORP

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2017 AND 2016

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Allowance for Credit Losses on Off-Balance Sheet Credit Exposures

The Company also maintains a separate allowance for off-balance-sheet commitments. Management estimates anticipated losses using historical data and utilization assumptions. The allowance for off-balance sheet commitments is included in accrued interest payable and other liabilities on the balance sheet.

Premises and Equipment

Premises and equipment are carried at cost. Depreciation is determined using the straight-line method over the estimated useful lives of the related assets. The useful lives of premises range between 25 to 39 years. The useful lives of furniture, fixtures and equipment are estimated to be 3 to 10 years. Leasehold improvements are amortized over the lesser of the respective lease term (including renewal periods that are reasonably assured) or their useful lives, which are generally 3 to 10 years. Leased equipment meeting certain capital lease criteria is capitalized and the present value of the related lease payments is recorded as a liability. Amortization of capital leases is computed using a straight-line method over the shorter of the estimated and useful life of the equipment or the initial lease term.

Certain operating leases contain scheduled and specified rent increases or incentives in the form of tenant improvement allowances or credits. The scheduled rent increases are recognized on a straight-line basis over the lease term as an increase in the amount of rental expense recognized each period. Lease incentives, including tenant improvement credits, are capitalized at the inception of the lease and amortized on a straight-line basis over the lease term as a reduction of rental expense. Amounts accrued in excess of amounts paid related to the scheduled rent increases and the unamortized deferred tenant improvement credits are included in accrued interest payable and other liabilities on the balance sheet.

When assets are sold or otherwise disposed of, the cost and related accumulated depreciation or amortization are removed from the accounts, and any resulting gain or loss is recognized in income for the period. The cost of maintenance and repairs is charged to expense as incurred. The Company evaluates premises and equipment for financial impairment as events or changes in circumstances indicate that the carrying amount of such assets may not be fully recoverable.

Bank Owned Life Insurance

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

ALTAPACIFIC BANCORP

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2017 AND 2016

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Income Taxes

Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Deferred tax assets and liabilities are measured using enacted tax rates, which are expected to be applied to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date. A valuation allowance is recognized if, based on the weight of available evidence, management believes it is more likely than not that some portion or all of the deferred tax assets will not be realized.

The Company considers all tax positions recognized in its financial statements for the likelihood of realization. When tax returns are filed, it is highly certain that some positions taken would be sustained upon examination by the taxing authorities, while others are subject to uncertainty about the merits of the position taken or the amount of the position that would be ultimately sustained. The benefit of a tax position is recognized in the financial statements in the period during which, based on all available evidence, management believes it is more likely than not that the position will be sustained upon examination, including the resolution of appeals or litigation processes, if any. Tax positions taken are not offset or aggregated with other positions. Tax positions that meet the more-likely-than-not recognition threshold are measured as the largest amount of tax benefit that is more than 50 percent likely of being realized upon settlement with the applicable taxing authority. The portion of the benefits associated with tax positions taken that exceeds the amount measured as described above, if any, is reflected as a liability for unrecognized tax benefits in the accompanying balance sheet along with any associated interest and penalties that would be payable to the taxing authorities upon examination. Interest expense and penalties associated with unrecognized tax benefits, if any, are classified as income tax expense in the statement of operations. The Company does not have a liability for unrecognized tax benefits, or uncertain tax positions, and has not accrued for any interest or penalties as of December 31, 2017 and 2016.

Earnings Per Share (EPS)

Basic earnings per share (EPS), which excludes dilution, is computed by dividing net income by the weighted-average number of common shares outstanding for the period. 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 shares in the earnings of the Company. The treasury stock method is applied to determine the dilutive effect of stock options in computing diluted earnings per share. Stock options totaling 54,000 and 93,000 for the years ended December 31, 2017 and 2016, respectively, were considered anti-dilutive and were excluded from the computation of diluted earnings per share because the assumed proceeds from exercise price, tax benefits, and average future compensation exceeded the average market price of the Company's common stock.

ALTAPACIFIC BANCORP

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2017 AND 2016

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Share-Based Compensation

The Company has one share-based compensation plan, the Atlantic Pacific Bank 2006 Equity Incentive Plan (the Plan), which has been approved by its shareholders and permits the grant of stock options and restricted stock for up to 1,653,750 shares of the Company's common stock of which 881,927 were available for future grants at December 31, 2017. The Plan is designed to attract and retain employees and directors. The amount, frequency, and terms of share-based awards may vary based on competitive practices, the Company's operating results, and government regulations. New shares are issued upon option exercise or restricted share grants. The Plan does not provide for the settlement of awards in cash. The Plan requires that the option price may not be less than the fair market value of the stock at the date the option is granted, and that the stock must be paid in full at the time the option is exercised. All options expire on a date determined by the Board of Directors but not later than ten years from the date of grant. The vesting period is determined by the Board of Directors and is generally over a three to five year period.

Restricted stock awards are grants of shares of common stock that are subject to forfeiture until specific conditions or goals are met. Conditions may be based on continuing employment or achieving specified performance goals. During the period of restriction, participants holding restricted stock may have full voting and dividend rights. The restrictions lapse in accordance with a schedule or with other conditions determined by the board of directors. There have been no restricted stock awards granted since inception of the Company or its subsidiary.

The Company accounts for share-based compensation using a fair-value based method and requires that share-based compensation expense be recorded for all stock options that are ultimately expected to vest as the requisite service is rendered.

Management estimates the fair value of each option award as of the date of grant using a Black-Scholes-Merton option pricing formula and the following assumptions. Expected volatility is based on historical volatility of the Company's common stock over a preceding period commensurate with the expected term of the option. The "simplified" method described in the Securities and Exchange Commission's Staff Accounting Bulletin No. 110 is used to determine the expected term of the options. The risk-free interest rate is based on the U.S. Treasury yield curve in effect at the time of grant with substantially the same term as the expected term of the option. Expected dividend yield was not considered in the option pricing formula since cash dividends have not been paid and there are no current plans to do so in the foreseeable future. In addition to these assumptions, management makes estimates regarding pre-vesting forfeitures that will impact total compensation expense recognized under the Plan.

ALTAPACIFIC BANCORP

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2017 AND 2016**

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Fair Value Measurement

Fair value is the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. Current accounting guidance establishes a fair value hierarchy, which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. That guidance describes three levels of inputs that may be used to measure fair value:

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

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

Level 3: Significant unobservable inputs that reflect an entity's own assumptions about the factors that market participants would use in pricing an asset or liability

See Notes 17 and 18 for more information and disclosures relating to the Company's fair value measurements.

Comprehensive Income

Comprehensive income is reported in addition to net income for all periods presented. Comprehensive income is a more inclusive financial reporting methodology that includes disclosure of other comprehensive income or loss that historically has not been recognized in the calculation of net income. Unrealized gains and losses on the Company's available-for-sale investment securities are included in other comprehensive income, adjusted for realized gains or losses included in net income. Total comprehensive income or loss and the components of accumulated other comprehensive income or loss is presented in the consolidated statements of comprehensive income (loss).

ALTAPACIFIC BANCORP

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2017 AND 2016

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Recent Accounting Guidance Not Yet Effective

In May 2014, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") No. 2014-09, *Revenue from Contracts with Customers (Topic 606)*. This Update requires an entity to recognize revenue as performance obligations are met, in order to reflect the transfer of promised goods or services to customers in an amount that reflects the consideration the entity is entitled to receive for those goods or services. The following steps are applied in the updated guidance: (1) identify the contract(s) with a customer; (2) identify the performance obligations in the contract; (3) determine the transaction price; (4) allocate the transaction price to the performance obligations in the contract; and (5) recognize revenue when, or as, the entity satisfies a performance obligation. These amendments are effective for public business entities for annual reporting periods beginning after December 15, 2017, including interim periods within that reporting period and one year later for nonpublic business entities. Early adoption is permitted only as of annual reporting periods beginning after December 15, 2016, including interim reporting periods within that period. The Company is currently evaluating the effects of ASU 2014-09 on its consolidated financial statements and disclosures, if any.

In January 2016, the FASB issued ASU 2016-01, *Financial Instruments-Overall: Recognition and Measurement of Financial Assets and Financial Liabilities (Subtopic 825-10)*. Changes made to the current measurement model primarily affect the accounting for equity securities and readily determinable fair values, where changes in fair value will impact earnings instead of other comprehensive income. The accounting for other financial instruments, such as loans, investments in debt securities, and financial liabilities is largely unchanged. The Update also changes the presentation and disclosure requirements for financial instruments including a requirement that public business entities use exit price when measuring the fair value of financial instruments measured at amortized cost for disclosure purposes. This Update is generally effective for public business entities in fiscal years beginning after December 15, 2017, including interim periods within those fiscal years and one year later for nonpublic business entities. The Company is currently evaluating the effects of ASU 2016-01 on its consolidated financial statements and disclosures.

In February 2016, the FASB issued Accounting Standards Update (ASU) 2016-02, *Leases (Topic 842)*. The most significant change for lessees is the requirement under the new guidance to recognize right-of-use assets and lease liabilities for all leases not considered short-term leases, which is generally defined as a lease term of less than 12 months. This change will result in lessees recognizing right-of-use assets and lease liabilities for most leases currently accounted for as operating leases under current lease accounting guidance. The amendments in this Update are effective for interim and annual periods beginning after December 15, 2018, for public business entities and one year later for all other entities. The Company is currently evaluating the effects of ASU 2016-02 on its consolidated financial statements and disclosures.

ALTAPACIFIC BANCORP

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2017 AND 2016

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Recent Accounting Guidance Not Yet Effective, (Continued)

In March 2016, the FASB issued ASU 2016-09, *Improvements to Employee Share-Based Payment Accounting (Topic 718)*. ASU 2016-09 includes provisions intended to simplify various aspects related to how share-based payments are accounted for and presented in the financial statements. Under ASU 2016-09, excess tax benefits and certain tax deficiencies will no longer be recorded in additional paid-in capital ("APIC"). Instead, they will record all excess tax benefits and tax deficiencies as income tax expense or benefit in the income statement, and APIC pools will be eliminated. In addition, the guidance requires excess tax benefits be presented as an operating activity on the statement of cash flows rather than as a financing activity. ASU 2016-09 also permits an accounting policy election for the impact of forfeitures on the recognition of expense for share-based payment awards. Forfeitures can be estimated, as required today, or recognized when they occur. This guidance is effective for public business entities for interim and annual reporting periods beginning after December 15, 2016, and for nonpublic business entities annual reporting periods beginning after December 15, 2017, and interim periods within the reporting periods beginning after December 15, 2018. Early adoption is permitted, but all of the guidance must be adopted in the same period. The Company is currently evaluating the provisions of ASU 2016-09 to determine the potential impact on its consolidated financial statements and disclosures.

In June 2016, the FASB issued ASU No. 2016-13, *Measurement of Credit Losses on Financial Instruments (Topic 326)*. This ASU significantly changes how entities will measure credit losses for most financial assets and certain other instruments that are not measured at fair value through net income. In issuing the standard, the FASB is responding to criticism that today's guidance delays recognition of credit losses. The standard will replace today's "incurred loss" approach with an "expected loss" model. The new model, referred to as the current expected credit loss ("CECL") model, will apply to: (1) financial assets subject to credit losses and measured at amortized cost, and (2) certain off-balance sheet credit exposures. This includes, but is not limited to, loans, leases, held-to-maturity securities, loan commitments, and financial guarantees. The CECL model does not apply to available-for-sale ("AFS") debt securities. For AFS debt securities with unrealized losses, entities will measure credit losses in a manner similar to what they do today, except that the losses will be recognized as allowances rather than reductions in the amortized cost of the securities. As a result, entities will recognize improvements to estimated credit losses immediately in earnings rather than as interest income over time, as they do today. The ASU also simplifies the accounting model for purchased credit-impaired debt securities and loans. ASU 2016-13 also expands the disclosure requirements regarding an entity's assumptions, models, and methods for estimating the allowance for loan and lease losses. In addition, public business entities will need to disclose the amortized cost balance for each class of financial asset by credit quality indicator, disaggregated by the year of origination. ASU No. 2016-13 is effective for interim and annual reporting periods beginning after December 15, 2019, for SEC filers, one year later for non SEC filing public business entities and annual reporting periods beginning after December 15, 2020, for nonpublic business entities and interim periods within the reporting periods beginning after December 15, 2021. Early adoption is permitted for interim and annual reporting periods beginning after December 15, 2018. Entities will apply the standard's provisions as a cumulative-effect adjustment to retained earnings as of the beginning of the first reporting period in which the guidance is effective (i.e., modified retrospective approach). The Company is currently evaluating the provisions of ASU No. 2016-13 for potential impact on its consolidated financial statements and disclosures.

ALTAPACIFIC BANCORP

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2017 AND 2016**

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

In January 2017, the FASB issued ASU No. 2017-04, Intangibles – Goodwill and Other (Topic 350): Simplifying the Accounting for Goodwill Impairment. This guidance removes Step 2 of the goodwill impairment test, which requires a hypothetical purchase price allocation, and goodwill impairment will simply be the amount by which a reporting unit's carrying value exceeds its fair value, not to exceed the carrying amount of goodwill. All other goodwill impairment guidance will remain largely unchanged. Entities will continue to have the option to perform a qualitative assessment to determine if a quantitative impairment test is necessary. The amendments in this Update are required for public business entities and other entities that have goodwill reported in their financial statements and have not elected the private company alternative for the subsequent measurement of goodwill. ASU No. 2017-04 is effective for interim and annual reporting periods beginning after December 15, 2021 for public business entities who are not SEC filers and one year later for all other entities. The Company is currently evaluating the effects of ASU 2017-04 on its consolidated financial statements and disclosures.

In February 2018, the FASB issued ASU 2018-02, Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income ("AOCI"). ASU 2018-02 allows entities to elect to reclassify stranded tax effects on items within AOCI, resulting from the new tax bill signed into law on December 22, 2017, to retained earnings. The amendments for this update are effective for periods beginning after December 15, 2018 with early adoption permitted. The Company has elected to adopt the new standard in 2018.

ALTAPACIFIC BANCORP

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2017 AND 2016**

NOTE 2 - INVESTMENT SECURITIES

The amortized cost and estimated fair value of available-for-sale investment securities at December 31, consisted of the following:

<u>December 31, 2017</u>	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Corporate securities	\$ 24,468,000	\$ 487,000	\$ (52,000)	\$ 24,903,000
Municipal securities	601,000	-	(16,000)	585,000
Mortgage-backed securities:				
Agency	28,276,000	60,000	(310,000)	28,026,000
Non-agency	14,659,000	213,000	(121,000)	14,751,000
Total Securities	<u>\$ 68,004,000</u>	<u>\$ 760,000</u>	<u>\$ (499,000)</u>	<u>\$ 68,265,000</u>
<u>December 31, 2016</u>				
Corporate securities	\$ 27,843,000	\$ 835,000	\$ (80,000)	\$ 28,598,000
Municipal securities	618,000	-	(32,000)	586,000
Mortgage-backed securities:				
Agency	29,719,000	200,000	(228,000)	29,691,000
Non-agency	14,529,000	224,000	(248,000)	14,505,000
Total Securities	<u>\$ 72,709,000</u>	<u>\$ 1,259,000</u>	<u>\$ (588,000)</u>	<u>\$ 73,380,000</u>

Net unrealized losses on available-for-sale investment securities totaling \$410,000 were recorded net of \$168,000 in tax benefits, within shareholders' equity for the year ended December 31, 2017. Net unrealized losses on available-for-sale investment securities totaling \$590,000 were recorded net of \$242,000 in tax benefits, within shareholders' equity for the year ended December 31, 2016. For the years ended December 31, 2017 and 2016, proceeds from the sales of securities available-for-sale were \$0-. There were no calls, or transfers of available-for-sale investment securities for the years ended December 31, 2017 or 2016.

ALTAPACIFIC BANCORP

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2017 AND 2016**

NOTE 2 - INVESTMENT SECURITIES, (CONTINUED)

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

	Less Than 12 Months		12 Months or More		Total	
	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
December 31, 2017						
Corporate securities	\$ -	\$ -	\$ 4,015,000	\$ (52,000)	\$ 4,015,000	\$ (52,000)
Municipal securities	-	-	585,000	(16,000)	585,000	(16,000)
Mortgage-backed securities:						
Agency	8,057,000	(79,000)	12,811,000	(231,000)	20,868,000	(310,000)
Non-agency	78,000	(1,000)	3,710,000	(120,000)	3,788,000	(121,000)
	<u>\$ 8,135,000</u>	<u>\$ (80,000)</u>	<u>\$ 21,121,000</u>	<u>\$ (419,000)</u>	<u>\$ 29,256,000</u>	<u>\$ (499,000)</u>
December 31, 2016						
Corporate securities	\$ 4,014,000	\$ (80,000)	\$ -	\$ -	\$ 4,014,000	\$ (80,000)
Municipal securities	586,000	(32,000)	-	-	586,000	(32,000)
Mortgage-backed securities:						
Agency	10,925,000	(207,000)	4,595,000	(21,000)	15,520,000	(228,000)
Non-agency	1,644,000	(8,000)	6,908,000	(240,000)	8,552,000	(248,000)
	<u>\$ 17,169,000</u>	<u>\$ (327,000)</u>	<u>\$ 11,503,000</u>	<u>\$ (261,000)</u>	<u>\$ 28,672,000</u>	<u>\$ (588,000)</u>

The Company had 39 agency residential mortgage-backed securities of which 26 were in an unrealized loss position as of December 31, 2017, and 25 non-agency residential mortgage-backed securities of which 10 were in an unrealized loss position as of December 31, 2017. Nine agency residential mortgage-backed securities and one non-agency residential mortgage-backed security had been in an unrealized loss position for less than 12 months, and 17 agency residential mortgage-backed securities and nine non-agency residential mortgage-backed securities had been in an unrealized loss position for more than 12 months as of December 31, 2017. The Company had 11 corporate securities of which two were in an unrealized loss position as of December 31, 2017. The corporate securities had been in a loss position for more than 12 months. The Company holds one municipal security which was in a loss position for more than 12 months as of December 31, 2017. These unrealized losses were primarily caused by illiquidity in the marketplace and downgrades made by the rating agencies of the issuers. Management performed an impairment analysis using detailed cash flow analysis to determine the recoverability of all principal and interest contractually due. This analysis projects prepayments, expected housing price changes, delinquency and default rates, expected loss severities, and interest rates, while factoring in the underlying collateral.

ALTAPACIFIC BANCORP

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2017 AND 2016**

NOTE 2 - INVESTMENT SECURITIES, (CONTINUED)

The Company held 38 agency residential mortgage-backed securities of which 19 were in an unrealized loss position as of December 31, 2016, and 22 non-agency residential mortgage-backed securities of which 14 were in an unrealized loss position as of December 31, 2016. Nine agency residential mortgage-backed securities had been in an unrealized loss position for less than 12 months, and three non-agency residential mortgage-backed securities had been in an unrealized loss position for more than 12 months. The Company held two corporate securities, which were in an unrealized loss position as of December 31, 2016. The corporate securities had been in a loss position for less than 12 months. The Company holds one municipal security, which was in a loss position as of December 31, 2016. The municipal security had been in a loss position for less than 12 months. These unrealized losses were primarily caused by illiquidity in the marketplace and downgrades made by the rating agencies of the issuers. Management performed an impairment analysis using detailed cash flow analysis to determine the recoverability of all principal and interest contractually due. This analysis projects prepayments, expected housing price changes, delinquency and default rates, expected loss severities, and interest rates, while factoring in the underlying collateral.

For all securities in an unrealized loss position, based on management's analysis, and because management does not have the intent to sell these securities nor does management believe it is more likely than not that the Company will be required to sell these securities before a recovery of amortized cost, the Company does not consider these investments to be other-than-temporarily impaired at December 31, 2017 and 2016.

The amortized cost and estimated fair value of available-for-sale investment securities at December 31, 2017, by contractual maturity are shown below.

	Amortized Cost	Estimated Fair Value
Corporate Securities		
Less than one year	\$ 4,020,000	\$ 4,051,000
One through five years	13,948,000	14,278,000
Five through ten years	6,500,000	6,574,000
	24,468,000	24,903,000
Municipal Securities		
Five through ten years	601,000	585,000
Mortgage-backed Securities		
One through five years	5,490,000	5,407,000
Five through ten years	2,575,000	2,568,000
After ten years	20,211,000	20,051,000
	28,276,000	28,026,000
Non-agency Securities		
Five through ten years	338,000	343,000
After ten years	14,321,000	14,408,000
	14,659,000	14,751,000
	\$ 68,004,000	\$ 68,265,000

ALTAPACIFIC BANCORP

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2017 AND 2016**

NOTE 2 - INVESTMENT SECURITIES, (CONTINUED)

Actual maturities may differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without prepayment penalties.

Investment securities with amortized cost totaling \$28,276,000 and estimated fair values totaling \$28,026,000 were pledged to secure borrowings with the Federal Home Loan Bank at December 31, 2017. Investment securities with amortized cost totaling \$29,719,000 and estimated fair values totaling \$29,691,000 were pledged to secure borrowings with the Federal Home Loan Bank at December 31, 2016 (see Note 9).

NOTE 3 - LOANS

Outstanding loans are summarized below:

	December 31,	
	2017	2016
Commercial	\$ 22,185,000	\$ 17,372,000
Real estate:		
Construction	39,353,000	41,938,000
Mortgage	231,622,000	168,289,000
Installment	2,959,000	4,068,000
Home equity lines of credit	100,000	2,783,000
Loans Receivable	296,219,000	234,450,000
Allowances for loan losses	(3,686,000)	(3,336,000)
Net deferred loan origination fees	(535,000)	(1,351,000)
Loans Receivable, net	\$ 291,998,000	\$ 229,763,000

Salaries and employee benefits totaling \$193,000 and \$197,000 were deferred as loan origination costs for the years ended December 31, 2017 and 2016, respectively.

As of December 31, 2017 and 2016, the Company's loans included the remaining unaccreted discount of \$939,000 and \$2,206,000, respectively, related to the acquisition of Stellar Business Bank in 2012, and Mission Oaks Bancorp in 2014.

Certain loans are pledged as collateral for available borrowings with the FHLB. Pledged loans totaled \$189,929,000 and \$168,587,000 at December 31, 2017 and 2016, respectively (see Note 9).

ALTAPACIFIC BANCORP

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2017 AND 2016**

NOTE 4 - ALLOWANCE FOR LOAN LOSSES

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

	2017	2016
Balance, beginning of year	\$ 3,336,000	\$ 3,235,000
Provision for credit losses	350,000	100,000
Recoveries of loans previously charged off	-	1,000
Balance, end of year	\$ 3,686,000	\$ 3,336,000

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

December 31, 2017	Commercial	Real Estate Construction	Real Estate Mortgage	Installment	Home Equity Lines of Credit	Total
Allowance for						
Loan Losses:						
Beginning of Year	\$ 312,000	\$ 750,000	\$ 2,181,000	\$ 47,000	\$ 46,000	\$ 3,336,000
Provisions (credits)	317,000	(131,000)	209,000	(1,000)	(44,000)	350,000
End of Year	\$ 629,000	\$ 619,000	\$ 2,390,000	\$ 46,000	\$ 2,000	\$ 3,686,000
Reserves:						
General	\$ 629,000	\$ 619,000	\$ 2,390,000	\$ 46,000	\$ 2,000	\$ 3,686,000
Loans Evaluated for						
Impairment:						
Individually	\$ 46,000	\$ -	\$ -	\$ -	\$ -	\$ 46,000
Collectively	22,139,000	39,353,000	231,622,000	2,959,000	100,000	296,173,000
	\$ 22,185,000	\$ 39,353,000	\$ 231,622,000	\$ 2,959,000	\$ 100,000	\$ 296,219,000

ALTAPACIFIC BANCORP

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2017 AND 2016**

NOTE 4 - ALLOWANCE FOR LOAN LOSSES (CONTINUED)

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

December 31, 2016	Commercial	Real Estate Construction	Real Estate Mortgage	Installment	Home Equity Lines of Credit	Total
Allowance for Loan Losses:						
Beginning of Year	\$ 367,000	\$ 811,000	\$ 1,932,000	\$ 66,000	\$ 59,000	\$ 3,235,000
Provisions (credits)	(55,000)	(61,000)	249,000	(20,000)	(13,000)	100,000
Recoveries	-	-	-	1,000	-	1,000
End of Year	<u>\$ 312,000</u>	<u>\$ 750,000</u>	<u>\$ 2,181,000</u>	<u>\$ 47,000</u>	<u>\$ 46,000</u>	<u>\$ 3,336,000</u>
Reserves:						
General	<u>\$ 312,000</u>	<u>\$ 750,000</u>	<u>\$ 2,181,000</u>	<u>\$ 47,000</u>	<u>\$ 46,000</u>	<u>\$ 3,336,000</u>
Loans Evaluated for Impairment:						
Individually	\$ 64,000	\$ -	\$ -	\$ 165,000	\$ -	\$ 229,000
Collectively	17,308,000	41,938,000	168,289,000	3,903,000	2,783,000	234,221,000
	<u>\$ 17,372,000</u>	<u>\$ 41,938,000</u>	<u>\$ 168,289,000</u>	<u>\$ 4,068,000</u>	<u>\$ 2,783,000</u>	<u>\$ 234,450,000</u>

ALTAPACIFIC BANCORP

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2017 AND 2016**

NOTE 4 - ALLOWANCE FOR LOAN LOSSES (CONTINUED)

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

December 31, 2017	Pass	Special Mention	Substandard	Impaired	Total
Commercial	\$ 20,081,000	\$ 1,430,000	\$ 628,000	\$ 46,000	\$ 22,185,000
Real estate:					
Construction	39,353,000	-	-	-	39,353,000
Mortgage	230,782,000	292,000	548,000	-	231,622,000
Installment	2,959,000	-	-	-	2,959,000
Home equity lines of credit	100,000	-	-	-	100,000
	<u>\$ 293,275,000</u>	<u>\$ 1,722,000</u>	<u>\$ 1,176,000</u>	<u>\$ 46,000</u>	<u>\$ 296,219,000</u>
December 31, 2016					
Commercial	\$ 16,356,000	\$ 625,000	\$ 327,000	\$ 64,000	\$ 17,372,000
Real estate:					
Construction	41,938,000	-	-	-	41,938,000
Mortgage	166,510,000	304,000	1,475,000	-	168,289,000
Installment	3,903,000	-	-	165,000	4,068,000
Home equity lines of credit	2,783,000	-	-	-	2,783,000
	<u>\$ 231,490,000</u>	<u>\$ 929,000</u>	<u>\$ 1,802,000</u>	<u>\$ 229,000</u>	<u>\$ 234,450,000</u>

As of December 31, 2017, there were no commercial loans past due between 30 and 89 days and still accruing. At December 31, 2017, there were no loans past due 90 days or more and still accruing. At December 31, 2016, there were two commercial loans past due between 30 and 89 days and still accruing. Nonaccrual loans presented by loan class were as follows as of December 31, 2017 and 2016.

	Nonaccrual	
	2017	2016
Commercial	\$ 46,000	\$ 64,000
Installment	-	165,000
	<u>\$ 46,000</u>	<u>\$ 229,000</u>

ALTAPACIFIC BANCORP

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2017 AND 2016**

NOTE 4 - ALLOWANCE FOR LOAN LOSSES (CONTINUED)

Information relating to individually impaired loans presented by class of loans was as follows as of December 31, 2017 and 2016:

<u>December 31, 2017</u>	Unpaid Principal Balance	Recorded Investment	Related Allowance	Average Recorded Investment	Interest Income Recognized
Without a Related Allowance Recorded					
Commercial	\$ 58,000	\$ 46,000	\$ -	\$ 68,000	\$ 2,000
<u>December 31, 2016</u>					
Without a Related Allowance Recorded					
Commercial	\$ 78,000	\$ 64,000	\$ -	\$ 89,000	\$ 2,000
Real estate	-	-	-	305,000	319,000
Installment	166,000	165,000		138,000	13,000
	<u>\$ 244,000</u>	<u>\$ 229,000</u>	<u>\$ -</u>	<u>\$ 532,000</u>	<u>\$ 334,000</u>

There was no interest income included above recognized on a cash basis in 2017 or 2016.

Troubled Debt Restructurings (TDR)

There were no new TDRs in 2017 and 2016.

NOTE 5 - PREMISES AND EQUIPMENT

Premises and equipment consisted of the following:

	<u>2017</u>	<u>2016</u>
Buildings and improvements	\$ 2,519,000	\$ 1,857,000
Furniture, fixtures and equipment	4,957,000	4,514,000
Leasehold improvements	2,999,000	2,496,000
	<u>10,475,000</u>	<u>8,867,000</u>
Accumulated depreciation and amortization	(6,329,000)	(5,770,000)
	<u>\$ 4,146,000</u>	<u>\$ 3,097,000</u>

Depreciation and amortization included in occupancy and equipment expense totaled \$559,000 and \$408,000 for the years ended December 31, 2017 and 2016, respectively.

ALTAPACIFIC BANCORP

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2017 AND 2016**

NOTE 6 - CORE DEPOSIT INTANGIBLE ASSET

The core deposit intangible asset (CDI) is associated with the acquisition of Stellar Business Bank in 2012, and the acquisition of Mission Oaks Bancorp in 2014. The CDI asset is subject to amortization and is included in other assets on the Company's balance sheet. The following tables summarize the gross carrying amount, accumulated amortization and net carrying amount of CDI and provide an estimate for future amortization as of December 31, 2017.

	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
Core deposit intangible	<u>\$ 1,760,000</u>	<u>\$ (1,213,000)</u>	<u>\$ 547,000</u>
<u>Year Ending</u>			<u>Amount</u>
2018			\$ 156,000
2019			140,000
2020			123,000
2021			107,000
2022			21,000
Total			<u>\$ 547,000</u>

NOTE 7 - INTEREST-BEARING DEPOSITS

Interest-bearing deposits consisted of the following:

	<u>2017</u>	<u>2016</u>
Savings accounts	\$ 5,368,000	\$ 3,192,000
Money market accounts	168,390,000	147,598,000
Interest-bearing demand accounts	18,163,000	12,142,000
Time certificate of deposit accounts under \$250,000	7,392,000	13,981,000
Time certificate of deposit accounts over \$250,000	10,138,000	8,548,000
	<u>\$ 209,451,000</u>	<u>\$ 185,461,000</u>

ALTAPACIFIC BANCORP

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2017 AND 2016**

NOTE 7 - INTEREST-BEARING DEPOSITS (CONTINUED)

The maturity of time deposits is as follows:

	<u>2017</u>	<u>2016</u>
Within one year	\$ 16,397,000	\$ 14,266,000
One year to three years	1,020,000	8,263,000
Three years to five years	113,000	-
	<u>\$ 17,530,000</u>	<u>\$ 22,529,000</u>

Interest expense recognized on interest-bearing deposits for the years ended December 31, consists of the following:

	<u>2017</u>	<u>2016</u>
Savings and money market accounts	\$ 857,000	\$ 749,000
Interest-bearing demand accounts	16,000	12,000
Time certificate of deposit accounts under \$250,000	32,000	47,000
Time certificate of deposit accounts over \$250,000	127,000	162,000
	<u>\$ 1,032,000</u>	<u>\$ 970,000</u>

NOTE 8 - INCOME TAXES

The following is a summary of the provision for income taxes for the years ended December 31:

	<u>2017</u>	<u>2016</u>
Current Taxes:		
Federal	\$ 817,000	\$ 1,232,000
State	351,000	469,000
	<u>1,168,000</u>	<u>1,701,000</u>
Deferred Taxes:		
Federal	381,000	1,039,000
State	93,000	311,000
Deferred tax asset adjustment for enacted change in tax rate	762,000	-
	<u>1,236,000</u>	<u>1,350,000</u>
Income Tax Expense	<u>\$ 2,404,000</u>	<u>\$ 3,051,000</u>

ALTAPACIFIC BANCORP

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2017 AND 2016**

NOTE 8 - INCOME TAXES (CONTINUED)

Income tax expense for 2017 includes a downward adjustment of net deferred tax assets in the amount of \$762,000, recorded as a result of the enactment of H.R.1 Tax Cuts and Jobs Act on December 22, 2017. The Act reduced the corporate Federal tax rate from 34% to 21% effective January 1, 2018.

The following table reconciles the statutory tax rate to the consolidated effective income tax rate for the years ended December 31:

	<u>2017</u>	<u>2016</u>
Federal tax rate	34.0%	34.0%
State taxes, net of Federal tax benefits	7.2%	7.2%
Bank owned life insurance	-8.6%	-1.5%
Stock option compensation	0.8%	0.5%
Merger Expenses	0.0%	1.1%
Tax impact from enacted change in tax rate	12.0%	0.0%
Other items, net	-7.7%	-0.2%
Provision for Income Tax	<u>37.7%</u>	<u>41.1%</u>

Deferred tax assets (liabilities) at December 31, 2017 and 2016, consisted of the following:

	<u>2017</u>	<u>2016</u>
Deferred Tax Assets:		
Allowance for loan losses due to tax limitations	\$ 162,000	\$ 81,000
Organization costs	155,000	271,000
Share-based compensation	41,000	45,000
Unrealized losses on available-for-sale investment securities reported in net income	130,000	181,000
Net operating losses	760,000	1,360,000
Depreciation	188,000	387,000
Reserves	1,031,000	964,000
Other	-	61,000
Total Deferred Tax Assets	<u>2,467,000</u>	<u>3,350,000</u>
Deferred Tax Liabilities:		
Unrealized losses on available-for-sale investment securities reported in other comprehensive income	107,000	275,000
Acquisition accounting adjustments	454,000	218,000
Other	117,000	-
Total Deferred Tax Liabilities	<u>678,000</u>	<u>493,000</u>
Net Deferred Tax Assets	<u>\$ 1,789,000</u>	<u>\$ 2,857,000</u>

ALTAPACIFIC BANCORP

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2017 AND 2016

NOTE 8 - INCOME TAXES (CONTINUED)

The determination of the amount of deferred income tax assets which are more likely than not to be realized is primarily dependent on projections of future earnings, which are subject to uncertainty and estimates that may change given economic conditions and other factors. The realization of deferred income tax assets is assessed and a valuation allowance is recorded if it is more likely than not that all or a portion of the deferred tax asset will not be realized. "More likely than not" is defined as greater than a 50 percent chance. All available evidence, both positive and negative is considered to determine whether, based on the weight of that evidence, a valuation allowance is needed. Based upon its analysis of available evidence, management has determined that it is "more likely than not" that the Company's deferred income tax assets as of December 31, 2017 and 2016, will be fully realized and therefore no valuation allowance was recorded.

At December 31, 2017, the Company had Federal and State net operating loss carryforwards (NOLs) of approximately \$2,585,000 and \$2,532,000, respectively. The Federal and State NOLs expire in 2028.

The Company files income tax returns in the United States and California jurisdictions. There are currently no pending Federal, State or local income tax examinations by tax authorities. Federal and California tax returns for 2014 to 2016 and 2013 to 2016, respectively, are currently open for examination. The Company does not anticipate any significant changes with respect to unrecognized tax benefits within the next 12 months.

NOTE 9 - BORROWINGS

The Company has unsecured Federal funds lines of credit with three of its correspondent banks under which it can borrow up to \$20,000,000. There were no outstanding lines of credit at December 31, 2017.

The Company has a borrowing arrangement with the Federal Home Loan Bank of San Francisco under which it may borrow an amount not to exceed 25 percent of total assets. Various loans totaling approximately \$189,929,000 were pledged to secure FHLB borrowings as of December 31, 2017. In addition, investment securities with amortized costs of \$28,276,000 and estimated fair values of \$28,026,000 were pledged to secure the borrowing arrangement as of December 31, 2017. The total borrowing capacity under these arrangements was \$145,501,000 at December 31, 2017. Various loans totaling approximately \$168,587,000 were pledged to secure FHLB borrowings as of December 31, 2016. In addition, investment securities with amortized cost totaling \$29,719,000 and estimated fair values of \$29,691,000 were pledged to secure the borrowing arrangement as of December 31, 2016. The total borrowing capacity under these arrangements was \$133,984,000 at December 31, 2016.

ALTAPACIFIC BANCORP

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2017 AND 2016**

NOTE 9 – BORROWINGS (CONTINUED)

Total FHLB advances outstanding at December 31, 2017 and December 31, 2016 consisted of the following:

Borrowings	Balance at December 31,					
	2017			2016		
	Amount	Average Balance	Weighted Average Rate	Amount	Average Balance	Weighted Average Rate
Short-term	<u>\$ 7,000,000</u>	<u>\$ 9,836,000</u>	<u>1.06%</u>	<u>\$ 5,000,000</u>	<u>\$ 27,101,000</u>	<u>0.71%</u>

For the year ended December 31, 2017, the Company also had \$6,406,000 in other borrowings as a result of a sold loan that did not qualify for sale accounting. This agreement is recorded as a financing transaction as the Bank maintains effective control over the transferred loan. The dollar amount of the loan underlying the sale agreement continues to be carried in the Bank's loan portfolio, and the transfer is reported as a secured borrowing with pledge of collateral. The bank did not have such agreements for the year ended December 31, 2016.

NOTE 10 - JUNIOR SUBORDINATED DEBT SECURITIES

The Company through the acquisition of Mission Oaks Bancorp, assumed the outstanding amount of Mission's junior subordinated debentures of \$7,500,000. Mission's Capital Trust I (the Trust) was formed by Mission Oaks Bancorp in 2006 for the sole purpose of issuing trust preferred securities fully and unconditionally guaranteed by the Company. The Company issued \$7,732,000 of junior subordinated debentures to the Trust in exchange for ownership of all of the common security of the Trust and the proceeds of the preferred securities sold by the Trust. The Company is not considered the primary beneficiary of this Trust, therefore the Trust is not consolidated in the Company's financial statements, but rather the fair value of the junior subordinated debentures is shown as a liability. The Company's investment in the common stock of the Trust is \$232,000 and is included in other assets. At acquisition in May 2014, the debentures were recorded at a fair value of \$5,351,000, with the discount being accreted to interest expense over the remaining life of the debentures.

The Company may redeem the subordinated debentures, in whole or in part, in a principal amount with integral multiples of \$1,000, at any time at 100 percent of the principal amount, plus accrued and unpaid interest. The subordinated debentures mature on June 15, 2036. The Company has the option to defer interest payments on the subordinated debentures from time to time for a period not to exceed five consecutive years.

The subordinated debentures may be included in Tier 1 capital (with certain limitations applicable) under current regulatory guidelines and interpretations. The subordinated debentures have a variable rate of interest of three month London Interbank Offered Rate (LIBOR) plus 1.65 percent. At December 31, 2017, the interest rate for the subordinated debentures was 3.24 percent. At December 31, 2017, the carrying value of the subordinated debentures totaled \$5,747,000.

ALTAPACIFIC BANCORP

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2017 AND 2016**

NOTE 11 - COMMITMENTS AND CONTINGENCIES

Operating Leases

The Company leases certain buildings used for branch offices and administrative facilities under long-term, non-cancelable lease agreements, which have been accounted for as operating leases. Such lease agreements expire between 2019 and 2023, and contain renewal options for various periods.

Future minimum lease payments are as follows:

December 31,	Amount
2018	\$ 510,000
2019	365,000
2020	266,000
2021	216,000
2022	139,000
Thereafter	83,000
Total	\$ 1,579,000

Rental expense included in occupancy and equipment expense totaled \$540,000 and \$566,000 for the years ended December 31, 2017 and 2016, respectively. Management does not plan on exercising renewal options at some of the locations.

Financial Instruments With Off-Balance Sheet Risk

The Company 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 the following at December 31, 2017 and 2016, respectively:

	2017	2016
Financial instruments whose contract amounts represent credit risks:		
Commitments to extend credit	\$ 66,958,000	\$ 57,081,000
Standby letters of credit	1,881,000	2,815,000
	\$ 68,839,000	\$ 59,896,000

The Company's exposure to credit loss in the event of nonperformance by the other party for commitments to extend credit is represented by the contractual amount of those instruments. The Company uses the same credit policies in making commitments as it does for loans included on the balance sheet.

ALTAPACIFIC BANCORP

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2017 AND 2016**

NOTE 11 - COMMITMENTS AND CONTINGENCIES (CONTINUED)

Financial Instruments With Off-Balance Sheet Risk, (Continued)

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 Company evaluates each customer's creditworthiness on a case-by-case basis. The amount of collateral obtained, if deemed necessary by the Company 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.

At December 31, 2017, commercial loan commitments represent approximately 39 percent of total commitments and are generally unsecured or secured by collateral other than real estate and have variable interest rates. Real estate loan commitments represent approximately 61 percent of total commitments and are generally secured by property with a loan-to-value ratio not to exceed 80 percent. The majority of real estate commitments also have variable interest rates. Home equity lines of credit represent less than one percent of total commitments and are generally secured by residential real estate and have both variable and fixed interest rates.

Concentrations of Credit Risk

The Company grants real estate mortgage, real estate construction, and commercial loans to customers throughout the counties of Sonoma, Marin, San Francisco, San Bernardino, Riverside, and Los Angeles. Although management intends to continue to diversify the Company's loan portfolio, a substantial portion of the portfolio is secured by commercial and residential real estate at December 31, 2017 and 2016.

In management's judgment, a concentration of loans exists in real estate related loans with approximately 96 percent of the Company's loans being real estate related. Although management believes the loans within this concentration have no more than the normal risk of collectability, a substantial decline in the performance of the economy in general or a decline in real estate values in the Company's primary market area, in particular, could have an adverse impact on the collectability of these loans. Personal and business income represents the primary source of repayment for a majority of these loans.

Correspondent Companying Agreements

The Company maintains funds on deposit with other federally insured financial institutions under correspondent banking agreements. Coverage through December 31, 2017, was \$250,000 per depositor available under the FDIC's general deposit insurance rules.

ALTAPACIFIC BANCORP

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2017 AND 2016**

NOTE 12 - RELATED PARTY TRANSACTIONS

As of December 31, 2017, the Company's balance sheet included deposits from executive officers and directors and their related companies totaling \$9,588,000 and \$8,190,000, respectively. There were no loans to executive officers and directors and their related companies as of December 31, 2017 and 2016.

As of December 31, 2017 and 2016, there were no undisbursed commitments.

In management's opinion, the terms and conditions associated with these arrangements are comparable to those of transactions with unaffiliated parties.

NOTE 13 - SHARE-BASED COMPENSATION

Stock Option Awards

A summary of option activity under the Plan for the years ended December 31, 2017, is presented below:

	2017		Weighted Average Remaining Contractual Term	Aggregate Intrinsic Value
	Options	Exercise Price		
Balance, beginning of year	313,727	\$ 7.52		
Granted	89,644	9.78		
Exercised	(331)	8.44		
Forfeited or expired	(10,103)	7.74		
Balance, end of year	<u>392,937</u>	<u>8.03</u>	<u>6.63 Years</u>	<u>\$ 1,595,438</u>
Options exercisable	<u>180,161</u>	<u>\$ 6.79</u>	<u>4.44 Years</u>	<u>\$ 954,928</u>
Options available for granting	<u>881,927</u>			

ALTAPACIFIC BANCORP

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2017 AND 2016

NOTE 13 - SHARE-BASED COMPENSATION (CONTINUED)

As of December 31, 2017, the unrecognized share-based compensation expense related to non-vested stock option awards totaled \$656,000. That cost is expected to be amortized on a straight-line basis over a weighted average period of 8.5 years and will be adjusted for subsequent changes in estimated forfeitures. Total compensation cost included in operating expenses was \$184,000 and \$139,000 for the years ended December 31, 2017 and 2016, respectively. The weighted-average grant date fair value of options vested during the year was \$159,000 and \$105,000 for the years ended December 31, 2017 and 2016, respectively.

The following stock option information is for the year ended December 31:

	<u>2017</u>	<u>2016</u>
Dividend yield	0.00%	0.00%
Expected life	6.50 Years	6.50 Years
Expected volatility	39.73%	38.28%
Risk-free interest rate	2.10%	1.60%
Weighted-average grant date fair value	\$4.41	\$3.65

NOTE 14 - SHAREHOLDERS' EQUITY

Cash Dividends

Holders of Company common stock are entitled to receive dividends declared by the Board of Directors out of funds legally available, therefore, under certain Federal laws and regulations governing the banking and financial services business. In addition, the Company is subject to certain restrictions under certain Federal and State laws and regulations governing banks which limit their ability to transfer funds to the Company through intercompany loans, advances, or cash dividends.

Stock Dividends

On December 6, 2017, the Board of Directors declared a five percent stock dividend which was payable on February 23, 2018. All share and per share amounts have been restated to give retroactive effect to this five percent stock dividend.

ALTAPACIFIC BANCORP

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2017 AND 2016**

NOTE 15 - BENEFIT PLANS

Salary Continuation Agreements and Officer Supplemental Life Insurance Plans

The Company has entered into salary continuation agreements with certain officers. The plans provide for annual benefits for up to fifteen years after retirement or death. The benefit obligation under these plans totaled \$3,624,000 and \$2,415,000, and was fully accrued for the years ended December 31, 2017 and 2016, respectively. The expense recognized under these arrangements totaled \$1,135,000 and \$533,000 for the years ended December 31, 2017 and 2016, respectively. Certain officers of the Company have supplemental life insurance policies with death benefits available to the officers' beneficiaries.

In connection with these plans, the Company has purchased, single premium life insurance policies with cash surrender values totaling \$11,387,000 and \$12,563,000 at December 31, 2017 and 2016, respectively.

Profit Sharing Plan

In 2006, the Company adopted a 401(k) Plan (the Plan) covering substantially all employees 21 years of age or older with three months of service. Eligible employees may elect to make tax deferred contributions up to the maximum amount allowed by law. The Plan is a Safe Harbor Plan and currently matches employee contributions up to four percent of compensation. In addition, the Company may make an annual discretionary profit-sharing contribution. Employee contributions, Company matching contributions, and related earnings are always 100 percent vested. Company profit-sharing contributions and related earnings vest 20 percent a year, with 100 percent vesting after five years of service. The Company's expense for matching contributions was \$205,000 and \$171,000 for the years ended December 31, 2017 and 2016, respectively. The Company did not make a discretionary profit-sharing contribution for the years ended December 31, 2017 or 2016.

NOTE 16 - OTHER EXPENSES

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

	<u>2017</u>	<u>2016</u>
Data processing	\$ 786,000	\$ 812,000
Professional fees	492,000	920,000
Telephone and postage	197,000	192,000
Office supplies	171,000	145,000
Amortization of intangible assets	169,000	183,000
Regulatory assessments	162,000	193,000
Advertising and promotion	97,000	100,000
Correspondent bank charges	59,000	61,000
Shareholder relations	28,000	20,000
OREO	22,000	21,000
Other	537,000	414,000
	<u>\$ 2,720,000</u>	<u>\$ 3,061,000</u>

ALTAPACIFIC BANCORP

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2017 AND 2016**

NOTE 17 - FAIR VALUE OF FINANCIAL INSTRUMENTS

The estimated carrying fair values of the Company's financial instruments at December 31, 2017 and 2016 are as follows:

	December 31, 2017		Fair Value Measurements at Using:		
	Carrying Amount	Fair Value	Level 1	Level 2	Level 3
Assets					
Cash and due from banks	\$ 27,401,000	\$ 27,401,000	\$ 27,401,000	\$ -	\$ -
Interest bearing deposits in banks	748,000	748,000		748,000	
Available-for-sale investment securities	68,265,000	68,265,000	-	68,265,000	-
Loans, net	291,998,000	275,758,000	-	-	275,758,000
Federal Reserve Bank stock	1,594,000	1,594,000	-	1,594,000	-
Federal Home Loan Bank stock	1,712,000	1,712,000	-	1,712,000	-
Accrued interest	1,254,000	1,254,000	1,254,000	-	-
Liabilities					
Deposits	\$ 335,147,000	\$ 335,063,000	\$ 322,817,000	\$ 12,246,000	\$ -
Other borrowings	13,406,000	13,406,000	13,406,000	-	-
Junior subordinated debentures	5,747,000	5,747,000	-	5,747,000	-
Accrued interest	22,000	22,000	22,000	-	-
	December 31, 2016		Fair Value Measurements at Using:		
	Carrying Amount	Fair Value	Level 1	Level 2	Level 3
Assets					
Cash and due from banks	\$ 14,571,000	\$ 14,571,000	\$ 14,571,000	\$ -	\$ -
Interest bearing deposits in banks	996,000	996,000	-	996,000	-
Available-for-sale investment securities	-	-	-	-	-
Available-for-sale investment securities	73,380,000	73,380,000	-	73,380,000	-
Loans, net	229,763,000	226,866,000	-	-	226,866,000
Federal Reserve Bank stock	1,589,000	1,589,000	-	1,589,000	-
Federal Home Loan Bank stock	1,677,000	1,677,000	-	1,677,000	-
Accrued interest	1,104,000	1,104,000	1,104,000	-	-
Liabilities					
Deposits	\$ 276,706,000	\$ 276,910,000	\$ 262,458,000	\$ 14,452,000	\$ -
Other borrowings	5,000,000	5,000,000	5,000,000	-	-
Junior subordinated debentures	5,639,000	5,639,000	-	5,639,000	-
Accrued interest	30,000	30,000	30,000	-	-

ALTAPACIFIC BANCORP

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2017 AND 2016**

NOTE 17 - FAIR VALUE OF FINANCIAL INSTRUMENTS, (CONTINUED)

These estimates do not reflect any premium or discount that could result from offering the Company's entire holdings of a particular financial instrument for sale at one time, nor do they attempt to estimate the value of anticipated future business related to the instruments. In addition, the tax ramifications related to the realization of unrealized gains and losses can have a significant effect on fair value estimates and have not been considered in any of these estimates.

The following methods and assumptions were used to estimate the fair value of significant financial instruments:

Financial Assets

The carrying amounts of cash, short-term investments, due from customers on acceptance and Bank acceptances outstanding are considered to approximate fair value. Short-term investments include federal funds sold, securities purchased under agreements to resell, and interest-bearing deposits with banks. The determination of the fair value of investment securities is discussed below. The fair value of loans are estimated using a combination of techniques, including discounting estimated future cash flows and quoted market prices of similar instruments where available.

Financial Liabilities

The carrying amounts of deposit liabilities payable on demand, and other borrowed funds are considered to approximate fair value. For fixed maturity deposits, fair value is estimated by discounting estimated future cash flows using currently offered rates for deposits of similar remaining maturities. The fair value of long-term debt is based on rates currently available to the Bank for debt with similar terms and remaining maturities. The fair values of subordinated debentures are determined based on the current market value for like instruments of a similar maturity and structure.

Off-Balance Sheet Financial Instruments

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

ALTAPACIFIC BANCORP

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2017 AND 2016

NOTE 18 - FAIR VALUE MEASUREMENTS

The following description of valuation methodologies used for assets recorded at fair value:

Securities

The fair values of securities available for sale are determined by obtaining quoted prices on nationally recognized securities exchanges (Level 1) or matrix pricing, which is a mathematical technique used widely in the industry to value debt securities without relying exclusively on quoted prices for specific securities but rather by relying on the securities relationship to other benchmark quoted securities resulting in a Level 2 classification.

Collateral-Dependent Impaired Loans

The Company does not record loans at fair value on a recurring basis. However, from time to time, fair value adjustments are recorded on these loans to reflect (1) partial write-downs, through charge-offs or specific reserve allowances, that are based on the current appraised or market-quoted value of the underlying collateral. The fair value estimated for collateral-dependent impaired loans are generally based on recent real estate appraisals or broker opinions, obtained from independent third parties, which are frequently adjusted by management to reflect current conditions (Level 3).

Other Real Estate Owned

Other real estate owned represents real estate that has been foreclosed and adjusted to fair value, less selling costs. At the time of foreclosure, these assets are recorded at fair value less costs to sell, which becomes the asset's new basis. Any write-downs based on the asset's fair value at the date of foreclosure are charged to the allowance for loan losses. The fair value of other real estate owned is generally based on recent real estate appraisals or broker opinions, obtained from independent third parties, which are frequently adjusted by management to reflect current conditions and estimated selling costs (Level 2).

ALTAPACIFIC BANCORP

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2017 AND 2016**

NOTE 18 - FAIR VALUE MEASUREMENTS (CONTINUED)

Assets Recorded at Fair Value

The following table's present information about the Company's assets and liabilities measured at fair value on a recurring and nonrecurring basis:

<u>December 31, 2017</u>	Fair Value Measurements		
	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>
Assets Measured at Fair Value on a Recurring Basis			
Securities available-for-sale	\$ -	\$ 68,265,000	\$ -
Assets Measured at Fair Value on a Non-Recurring Basis			
Other real estate owned	\$ -	\$ 241,000	\$ -
<u>December 31, 2016</u>			
Assets Measured at Fair Value on a Recurring Basis			
Securities available-for-sale	\$ -	\$ 73,380,000	\$ -
Assets Measured at Fair Value on a Non-Recurring Basis			
Other real estate owned	\$ -	\$ 241,000	\$ -

The Company did not incur any losses recognized for write-down of other real estate owned for the years ended December 31, 2017 and 2016.

The Company had no liabilities measured at fair value on a recurring or non-recurring basis at December 31, 2017 and 2016.

ALTAPACIFIC BANCORP

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2017 AND 2016**

NOTE 19 - MINIMUM REGULATORY CAPITAL REQUIREMENTS

Regulatory Capital

The Company and Bank are subject to certain regulatory capital requirements administered by the Board of Governors of the Federal Reserve System and the Federal Deposit Insurance Corporation (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 Company's consolidated financial statements. As a small bank holding company, the Company is not subject to specific regulatory capital requirements. The risk-based capital guidelines described below apply on a consolidated basis to bank holding companies with consolidated assets of \$1 billion or more. For bank holding companies with less than \$1 billion in consolidated assets, the guidelines will be applied on a bank-only basis unless: (a) the parent bank holding company is engaged in nonbank activity involving significant leverage; or (b) the parent company has a significant amount of outstanding debt that is held by the general public. Because neither (a) nor (b) apply to the Company, regulators look to the Bank's capital ratios when assessing the adequacy of the Company's capital.

Under capital adequacy guidelines, the Bank must meet specific capital guidelines that involve quantitative measures of their assets, liabilities and certain off-balance-sheet items as calculated under regulatory accounting practices. These quantitative measures are established by regulation and require that minimum amounts and ratios of total, Tier 1 capital, and Common Equity Tier 1 to risk-weighted assets and of Tier 1 capital to average assets be maintained as set forth in the table below. The Company's and Bank's capital amounts and classification are also subject to qualitative judgments by the regulators about components, risk weightings, and other factors. The final rules implementing Basel Committee on Banking Supervision's capital guidelines for U.S. banks (Basel III rules) became effective for the Company on January 1, 2015, with full compliance with all of the requirements being phased in over a multi-year schedule, and fully phased in by January 1, 2019. Under the Basel III rules, the Company must hold a capital conservation buffer above the adequately capitalized risk-based capital ratios. The capital conservation buffer is being phased in from 0.0 percent for 2015, to 2.50 percent by 2019. The capital conservation buffer for 2017 is 1.250 percent. The net unrealized gain or loss on available-for-sale securities is not included in computing regulatory capital. Capital amounts and ratios for December 31, 2014, are calculated using Basel I rules. Management believes the Company and Bank met all of their capital adequacy requirements as of December 31, 2017 and 2016.

The Bank is also subject to additional capital guidelines under the regulatory framework for prompt corrective action. To be categorized as well capitalized, the Bank must maintain minimum ratios of total and Tier 1 capital to risk-weighted assets and Tier 1 capital to average assets as set forth in the table on the following page. The most recent notification from the FRB categorized the Bank as well capitalized under these guidelines. There are no conditions or events since that notification that management believes have changed the Bank's category.

ALTAPACIFIC BANCORP

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2017 AND 2016**

NOTE 19 - MINIMUM REGULATORY CAPITAL REQUIREMENTS (CONTINUED)

The Bank's actual capital amounts and notations of December 31, 2017 and 2016 are as follows:

	Actual		For Capital Adequacy Purposes		To Be Well-Capitalized Under Prompt Corrective Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
As of December 31, 2017						
Common equity tier 1 capital (to risk-weighted assets)	\$58,323,000	16.5%	\$ 15,896,000	4.5%	\$ 22,961,000	6.5%
Total capital (to risk-weighted assets)	62,126,000	17.6%	28,260,000	8.0%	35,325,000	10.0%
Tier 1 capital (to risk-weighted assets)	58,323,000	16.5%	21,195,000	6.0%	28,260,000	8.0%
Tier 1 capital (to average assets)	58,323,000	13.7%	17,001,000	4.0%	21,251,000	5.0%
As of December 31, 2016						
Common equity tier 1 capital (to risk-weighted assets)	\$56,199,000	19.2%	\$ 13,194,000	4.5%	\$ 19,059,000	6.5%
Total capital (to risk-weighted assets)	59,652,000	20.3%	23,457,000	8.0%	29,321,000	10.0%
Tier 1 capital (to risk-weighted assets)	56,199,000	19.2%	17,593,000	6.0%	23,457,000	8.0%
Tier 1 capital (to average assets)	56,199,000	15.3%	14,719,000	4.0%	18,398,000	5.0%

NOTE 20 - QUALIFIED AFFORDABLE HOUSING PROJECT INVESTMENTS

The Company began investing in qualified housing projects in 2016. At December 31, 2017 and 2016, the balance of the investment for qualified affordable housing projects totaled \$1,182,000 and \$1,953,000, respectively. This balance is reflected in the accrued interest and other assets line on the consolidated balance sheets. Total unfunded commitments related to the investments in qualified housing projects totaled \$1,340,000 and \$1,685,000 at December 31, 2017 and 2016, respectively. The Company expects to fulfill these commitments during the year ending 2025.

During the year ended December 31, 2017 and 2016, the Company recognized amortization expense on these investments of \$141,000 and \$31,000, respectively which was included within pretax income on the consolidated statements of income.

Additionally, during the years ended December 31, 2017 and 2016, the Company recognized tax credits and other benefits from its investment in affordable housing tax credits of \$111,000 and \$29,000, respectively. The Company had no impairment losses during the years ended December 31, 2017 and 2016

ALTAPACIFIC BANCORP

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2017 AND 2016**

NOTE 21 - SUBSEQUENT EVENT

On December 6, 2017, the Board of Directors declared a five percent stock dividend which was payable on February 23, 2018. All share and per share amounts have been restated to give retroactive effect to this five percent stock dividend.

