

**GREATER PACIFIC BANCSHARES  
AND SUBSIDIARY**

Audited Consolidated Financial Statements

December 31, 2018



550 Howe Avenue, Suite 210  
Sacramento, California 95825  
Telephone: (916) 564-8727  
FAX: (916) 564-8728

## INDEPENDENT AUDITOR'S REPORT

The Shareholders and  
Board of Directors  
Greater Pacific Bancshares and Subsidiary  
Whittier, California

### **Report on the Financial Statements**

We have audited the accompanying consolidated financial statements of Greater Pacific Bancshares (the Company) and its wholly-owned subsidiary, Bank of Whittier, N.A., which comprise the consolidated balance sheets as of December 31, 2018 and 2017, and the related consolidated statements of operations, 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 consolidated 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 of 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 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.

The Shareholders and  
Board of Directors  
Greater Pacific Bancshares and Subsidiary

**Opinion**

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Greater Pacific Bancshares and its wholly-owned subsidiary, Bank of Whittier, N.A., as of December 31, 2018 and 2017, and the results of their operations and their cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

*Richardson & Company, LLP*

April 22, 2019

GREATER PACIFIC BANCSHARES  
AND SUBSIDIARY

CONSOLIDATED BALANCE SHEETS

December 31, 2018 and 2017

	2018	2017
<b>ASSETS</b>		
Cash and due from banks	\$ 751,198	\$ 748,196
Interest-bearing deposits in other banks	24,680,081	25,858,073
Loans, net of allowance of \$1,129,148 and \$1,090,554 as of December 31, 2018 and 2017, respectively	29,753,368	26,203,692
Premises and equipment, net	89,524	94,940
Federal Reserve stock, restricted, at cost	184,790	184,790
Accrued interest receivable and other assets	1,109,443	1,079,557
Mortgage servicing rights, at fair value	1,954,785	1,788,838
	<b>TOTAL ASSETS</b>	<b>\$ 58,523,189</b>
	<b>\$ 58,523,189</b>	<b>\$ 55,958,086</b>
<b>LIABILITIES</b>		
<b>Deposits</b>		
Noninterest-bearing demand	\$ 9,244,917	\$ 10,081,376
NOW, money market and savings	11,703,405	9,687,227
Time deposits	25,980,164	25,109,234
	<b>Total deposits</b>	<b>46,928,486</b>
	<b>46,928,486</b>	<b>44,877,837</b>
Accrued interest and other liabilities	695,102	591,031
	<b>TOTAL LIABILITIES</b>	<b>47,623,588</b>
	<b>47,623,588</b>	<b>45,468,868</b>
<b>SHAREHOLDERS' EQUITY</b>		
Common stock, no par value; 50,000,000 shares authorized; 1,795,286 shares at December 31, 2018 and 2017, issued and outstanding	6,520,854	6,517,003
Retained earnings	4,378,747	3,972,215
	<b>TOTAL SHAREHOLDERS' EQUITY</b>	<b>10,899,601</b>
	<b>10,899,601</b>	<b>10,489,218</b>
	<b>TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY</b>	<b>\$ 58,523,189</b>
	<b>\$ 58,523,189</b>	<b>\$ 55,958,086</b>

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

GREATER PACIFIC BANCSHARES  
AND SUBSIDIARY

CONSOLIDATED STATEMENTS OF OPERATIONS

For the years ended December 31, 2018 and 2017

	2018	2017
INTEREST INCOME		
Interest and fees on loans	\$ 1,411,032	\$ 1,161,012
Interest on taxable investment securities and other	11,099	11,064
Interest on interest-bearing deposits in other banks	499,190	299,874
Total interest income	1,921,321	1,471,950
INTEREST EXPENSE		
NOW, money market and savings	82,933	30,175
Time deposits	335,722	191,722
Total interest expense	418,655	221,897
NET INTEREST INCOME	1,502,666	1,250,053
Provision for loan losses	-	-
NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES	1,502,666	1,250,053
NON-INTEREST INCOME		
Service charges and fees	45,214	44,535
Mortgage banking revenue, net	624,443	476,536
Gain on sale of loans	665,858	810,577
Total non-interest income	1,335,515	1,331,648
NON-INTEREST EXPENSE		
Salaries and employee benefits	1,245,164	1,337,057
Occupancy and equipment	292,348	280,262
Other	726,139	661,499
Total non-interest expense	2,263,651	2,278,818
Income before taxes	574,530	302,883
Provision (Benefit) for income taxes	167,998	(28,224)
NET INCOME	\$ 406,532	\$ 331,107
NET INCOME PER SHARE	\$ 0.23	\$ 0.18
NET INCOME PER SHARE ASSUMING DILUTION	\$ 0.23	\$ 0.18
WEIGHTED AVERAGE SHARES OUTSTANDING	1,795,286	1,795,286

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

GREATER PACIFIC BANCSHARES  
AND SUBSIDIARY

CONSOLIDATED STATEMENTS OF CASH FLOWS

For the years ended December 31, 2018 and 2017

	2018	2017
<b>OPERATING ACTIVITIES</b>		
Net income	\$ 406,532	\$ 331,107
Adjustments to reconcile net loss to net cash provided (used) by operating activities:		
Depreciation	21,308	26,058
Stock option expense	3,851	3,851
Net change in mortgage servicing rights capitalized	(31,970)	(39,255)
Change in fair value of mortgage servicing rights	(133,977)	5,349
Net change in accrued interest receivable and other assets	(29,886)	(47,686)
Net change in accrued interest payable and other liabilities	104,071	(149,002)
<b>NET CASH PROVIDED BY OPERATING ACTIVITIES</b>	<b>339,929</b>	<b>130,422</b>
<b>INVESTING ACTIVITIES</b>		
Change in interest-bearing deposits in other financial institutions	1,177,992	3,448,298
Loan originations and repayments, net	(3,549,676)	641,360
Purchases of premises and equipment	(15,892)	(1,040)
<b>NET CASH (USED) PROVIDED BY INVESTING ACTIVITIES</b>	<b>(2,387,576)</b>	<b>4,088,618</b>
<b>FINANCING ACTIVITIES</b>		
Net change in deposits	2,050,649	(4,093,876)
<b>NET CASH PROVIDED (USED) BY FINANCING ACTIVITIES</b>	<b>2,050,649</b>	<b>(4,093,876)</b>
<b>NET INCREASE IN CASH AND CASH EQUIVALENTS</b>	<b>3,002</b>	<b>125,164</b>
Cash and cash equivalents at beginning of year	748,196	623,032
<b>CASH AND CASH EQUIVALENTS AT END OF YEAR</b>	<b>\$ 751,198</b>	<b>\$ 748,196</b>
<b>SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION:</b>		
Interest paid	\$ 400,053	\$ 211,975
Income taxes paid	\$ 61,500	\$ 84,500

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

GREATER PACIFIC BANCSHARES  
AND SUBSIDIARY

CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY

For the years ended December 31, 2018 and 2017

	Common Stock		Retained Earnings	Total
	Shares	Amount		
BALANCE AT JANUARY 1, 2017	1,795,286	\$ 6,513,152	\$ 3,641,108	\$ 10,154,260
Extension of stock option term		3,851		3,851
Net income for the year			331,107	331,107
BALANCE AT DECEMBER 31, 2017	1,795,286	6,517,003	3,972,215	10,489,218
Extension of stock option term		3,851		3,851
Net income for the year			406,532	406,532
BALANCE AT DECEMBER 31, 2018	<u>1,795,286</u>	<u>\$ 6,520,854</u>	<u>\$ 4,378,747</u>	<u>\$ 10,899,601</u>

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

GREATER PACIFIC BANCSHARES  
AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2018 and 2017

NOTE A – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Greater Pacific Bancshares (the Company), formed in 1987, is a bank holding company whose principal activity is the ownership and management of its wholly-owned subsidiary, Bank of Whittier, N.A. (the Bank). The Bank was incorporated in 1982 as a National Bank and, as such, is regulated by the Office of the Comptroller of the Currency. The regulations of this agency govern most aspects of the Bank's business. The Company opened a new branch in Richardson, Texas in June 2011. The financial statements of the Company are prepared in conformity with generally accepted accounting principles (GAAP) and general practice within the banking industry. The following is a summary of the significant accounting and reporting policies used in preparing the financial statements.

Principles of Consolidation: The consolidated financial statements include the accounts of the Company and its wholly-owned subsidiary, Bank of Whittier, N.A. All material intercompany accounts and transactions have been eliminated.

Nature of Operations: The Company provides a variety of banking services to individuals and businesses in its primary service areas of Los Angeles and Orange counties, California, Dallas-Fort Worth Metroplex, Texas and the immediate surrounding areas. The Company offers depository and lending services primarily to meet the needs of its business and professional clientele. These services include a variety of demand deposit, savings and time deposit, IRA and retirement account alternatives. The Company's lending activities are directed primarily towards granting short and medium-term real estate, commercial and consumer loans for such purposes as operating capital, business and professional financing, mortgage financing and personal financing.

Use of Estimates: The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

The determination of the adequacy of the allowance for loan losses is based on estimates that are particularly susceptible to significant changes in the economic environment and market conditions. In connection with the determination of the estimated losses on loans, management obtains estimated market values from reliable sources such as: Interthinx, tax assessed values from the county or Loopnet.com as part of its annual evaluation of its loan portfolio. Only under special cases where the credit facility is rated "substandard – grade 5" and is collateral dependent would management obtain an appraised value from an independent appraiser. The Company's loans are generally secured by specific items of collateral including real property, consumer assets, and business assets. Although the Company has a diversified loan portfolio, a substantial portion of its debtors' ability to honor their contracts is dependent on local economic conditions. While management uses available information to recognize losses on loans, further reductions in the carrying amounts of loans may be necessary based on changes in local economic conditions. Because of these factors, it is reasonably possible that the estimated losses on loans may change materially in the near term. However, the amount of the change that is reasonably possible cannot be estimated.

Mortgages Held for Delivery/Sale: Mortgage loans originated and intended for sale in the secondary market (Fannie Mae and Freddie Mac) are carried at the lower of aggregate cost or fair value, as determined by outstanding commitments from investors. Net unrealized losses, if any, are recorded as a valuation allowance and charged to earnings.

Mortgage loans held for sale are generally sold with servicing rights retained. The carrying value of mortgage loans sold is reduced by the amount allocated to the servicing right. Gains and losses on sales of mortgage loans are based on the difference between the selling price and the carrying value of the related loan sold.

Loans: Loans are stated at the amount of unpaid principal reduced by net deferred loan fees. Loan origination fees, net of direct origination costs, are deferred and recognized as an adjustment of the yield on the related loan. Amortization of net deferred loan fees is discontinued when the loan is placed on nonaccrual status. Interest on loans is accrued and credited to income based on the principal amount outstanding.



GREATER PACIFIC BANCSHARES  
AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

December 31, 2018 and 2017

NOTE A – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Allowance for Loan Losses: The allowance is maintained at a level which, in the opinion of management, is adequate to absorb probable losses inherent in the loan portfolio. Management determines the adequacy of the allowance based upon reviews of individual loans, recent loss experience, current economic conditions, the risk characteristics of the various categories of loans and other pertinent factors. The allowance is based on estimates, and ultimate losses may vary from the current estimates. These estimates are reviewed quarterly and, as adjustments become necessary, they are reported in earnings in the periods in which they become known. Loans deemed uncollectible are charged to the allowance. Provisions for loan losses and recoveries on loans previously charged off are added to the allowance.

All loans, except those to individuals, are considered impaired, based on current information and events, if it is probable that the Company will be unable to collect the scheduled payments of principal or interest when due according to the contractual terms of the loan agreement. Allowances on impaired loans are established based on the present value of expected future cash flows discounted at the loan's historical effective interest rate or, for collateral-dependent loans, on the fair value of the collateral. Cash receipts on impaired loans are used to reduce principal.

The Bank also maintains a separate allowance for off-balance-sheet commitments related to unfunded loan commitments and a mortgage recourse reserve related to various representations and warranties that reflect management's estimate of probable losses for mortgages for which they have a repurchase obligation. Management estimates anticipated losses using historical data and utilization assumptions. The allowance for off-balance-sheet commitments and mortgage recourse reserve is included in accrued interest payable and other liabilities on the consolidated balance sheet.

Income Recognition on Impaired and Nonaccrual Loans: Loans, including those considered impaired, are generally classified as nonaccrual if they are past due as to maturity or payment of principal or interest for a period of more than 90 days, unless such loans are well-secured and in the process of collection. If a loan or a portion of a loan is classified as doubtful or is partially charged off, the loan is classified as nonaccrual. Loans that are on a current payment status or past due less than 90 days may also be classified as nonaccrual if repayment in full of principal and/or interest is in doubt.

Loans may be returned to accrual status when all principal and interest amounts contractually due (including arrearages) are reasonably assured of repayment within an acceptable period of time, and there is a sustained period of repayment performance by the borrower, in accordance with the contractual terms of interest and principal.

While a loan is classified as nonaccrual and the future collectability of the recorded balance is doubtful, collections of interest and principal are generally applied as a reduction to the principal outstanding. When the future collectability of the recorded balance is expected, interest income may be recognized on a cash basis. In the case where a nonaccrual loan had been partially charged off, recognition of interest on a cash basis is limited to that which would have been recognized on the recorded balance at the contractual interest rate. Cash interest receipts in excess of that amount are recorded as recoveries to the allowance for loan losses until prior charge-offs have been fully recovered.

Premises and Equipment: Premises and equipment are stated at cost, less accumulated depreciation and amortization. The provision for depreciation and amortization is computed principally by the straight-line method over the shorter of the estimated useful lives of the related assets or the lease terms.

Mortgage Servicing Rights: When mortgage loans are sold with servicing retained, servicing rights are initially recorded at fair value with the income statement effect recorded in gains on sales of loans. Fair value is based on market prices for comparable mortgage servicing contracts, when available, or alternatively, is based on a valuation model that calculates the present value of estimated future net servicing income.

GREATER PACIFIC BANCSHARES  
AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

December 31, 2018 and 2017

NOTE A – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Under the fair value measurement method, the Company measure servicing rights at fair value at each reporting date and reports changes in fair value of servicing assets in earnings in the period in which the changes occur, and are included with mortgage banking revenue, net on the income statement. The fair values of servicing rights are subjected to significant fluctuations as a result of changes in estimated and actual prepayment speeds and default rates and losses. Servicing fee income, which is reported on the income statement as mortgage banking revenue, net, is recorded for fees earned for servicing loans. The fees are based on a contractual percentage of the outstanding principal; or a fixed amount per loan and are recorded as income when earned.

Service Charges on Deposit Accounts: The Company earns fees from its deposit customers for transaction-based and account maintenance services. Transaction-based fees, which include services such as ATM use fees, stop payment charges, statement rendering, and ACH fees, are recognized at the time the transaction is executed as that is the point in time the Company fulfills the customer's request. Account maintenance fees, which related primarily to monthly maintenance, are earned over the course of a month, representing the period over which the Company satisfies the performance obligation. Service charges on deposits are withdrawn from the customer's account balance.

Income Taxes: Provisions for income taxes are based on amounts reported in the statements of operations (after exclusion of non-taxable income such as interest on state and municipal securities) and include deferred taxes on temporary differences in the recognition of income and expense for tax and financial statement purposes. Deferred taxes are computed using the asset and liability method. Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of assets and liabilities and their respective tax basis. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply 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. Deferred tax assets are recognized for deductible temporary differences and tax credit carryforwards, and then a valuation allowance is established to reduce that deferred tax asset if it is "more likely than not" that the related tax benefits may not be realized.

Net Income Per Share of Common Stock: Net income per share of common stock is computed by dividing net income by the weighted average number of shares of common stock outstanding during the year. Net income per share – assuming dilution, is computed similar to net income per share except that the denominator is increased to include the number of additional common shares that would have been outstanding if the dilutive potential common shares had been issued. Included in the denominator is the dilutive effect of stock options computed under the treasury method.

Advertising: Advertising costs are charged to operations in the year incurred.

Off-Balance-Sheet Financial Instruments: In the ordinary course of business the Company has entered into off-balance sheet financial instruments consisting of commitments to extend credit. Such financial instruments are recorded in the financial statements when they become payable.

Operating Segments: Reportable segments are based on products and services, geography, legal structure, management structure and any other manner in which management desegregates a company for making operating decisions and assessing performance. The Company has determined that its business is comprised of a single operating segment. The Company's subsidiary and its operations are considered to be an immaterial component of the Company's operations and have not been reported as a separate operating segment.

Cash and Cash Equivalents: For the purpose of presentation in the Statement of Cash Flows, cash and cash equivalents are defined as those amounts included in the balance sheet caption "Cash and due from banks".

Subsequent events: The Company has evaluated subsequent events for recognition and disclosure through April 22, 2019, which is the date the financial statements were available to be issued.

GREATER PACIFIC BANCSHARES  
AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

December 31, 2018 and 2017

NOTE A – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

New Pronouncements: In February 2016, the FASB amended existing guidance that requires lessees recognize the following for all leases (with the exception of short-term leases) at the commencement date (1) A lease liability, which is a lessee’s obligation to make lease payments arising from a lease, measured on a discounted basis; and (2) A right-of-use asset, which is an asset that represents the lessee’s right to use, or control the use of, a specified asset for the lease term. The new guidance also requires enhanced disclosure about an entity’s leasing arrangements.

In June 2016, the FASB issued ASU No. 2016-13, Financial Instruments – Credit Losses (Topic 326) providing guidance to replace the incurred loss model with an expected loss model, which is referred to as the current expected credit loss (CECL) model. The CECL model is applicable to the measurement of credit losses on financial assets measure at amortized cost, including loan receivables and held to maturity debt securities. It also applies to off-balance sheet credit exposure not accounted for as insurance (loan commitments, standby letters of credit, financial guarantees, and other similar instruments) and net investments in certain leases recognized by a lessor. In addition, the amendments in this Update require credit losses be presented as an allowance rather than as a write-down on available-for-sale debt securities.

The amendments in this Update are effective for fiscal years beginning after December 15, 2020, including interim periods within those fiscal years, and will be applied through a cumulative-effect adjustment to retained earnings as of the beginning of the first reporting period in which the guidance is effective (that is, a modified-retrospective approach). The Company believes the amendments in this update will have an impact on the Company’s financial statements and is working to evaluate the significance of that impact.

NOTE B – RESTRICTIONS ON CASH AND DUE FROM BANKS

Cash and due from banks include amounts the Bank is required to maintain to meet certain target balance requirements of its correspondent bank. The total requirement at December 31, 2018 and 2017 was \$250,000.

NOTE C – LOANS, NET

Major classifications of loans at December 31 are summarized as follows:

	<u>2018</u>	<u>2017</u>
Commercial	\$ 14,026,318	\$ 1,729,043
Commercial real estate	1,104,528	12,021,465
Home equity	14,899,017	13,017,351
Consumer	<u>371,586</u>	<u>143,444</u>
	30,401,449	26,911,303
Deferred loan costs, net	481,067	382,943
Allowance for credit losses	<u>(1,129,148)</u>	<u>(1,090,554)</u>
	<u>\$ 29,753,368</u>	<u>\$ 26,203,692</u>

GREATER PACIFIC BANCSHARES  
AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

December 31, 2018 and 2017

NOTE C – LOANS, NET (Continued)

The maturity and repricing of the loan portfolio is as follows at December 31:

	2018	2017
Three months or less	\$ 20,051,278	\$ 14,272,065
Over three months to twelve months	175,156	245,592
Over one year to three years	129,602	571,555
Over three years to five years	441,989	982,343
Over five years to fifteen years		
Variable rate loans at floor	7,147,629	8,164,207
Fixed rate loans	367,934	392,286
Over fifteen years		
Variable rate loans at floor		139,446
Fixed rate loans	2,087,861	2,143,809
	\$ 30,401,449	\$ 26,911,303

Variable rate loans that have reached their interest rate floor are presented in the table above based on the maturity date rather than the repricing date.

The Bank receives fees for servicing retained on mortgages delivered to Fannie Mae and Freddie Mac and for participations sold. Loans being serviced by the Bank for others, including participations sold, totaled approximately \$184,413,646 and \$181,175,649 for the years ended December 31, 2018 and 2017, respectively. The balance of loans serviced above includes loans that were transferred effective December 31, 2018 and 2017, but were not posted to the loan system until January 2019 and 2018, and thus are not reflected in the call report.

NOTE D – ALLOWANCE FOR LOAN LOSSES AND CREDIT QUALITY

The Company's methodology for assessing the appropriateness of the allowance consists of three key elements, which include the general allowance, the specific allowance and an allowance for changing environmental factors. These various components are factored into a single allowance analysis.

**General Allowance:** The determination of the general allowance is based on estimates made by management, including but not limited to, consideration of historical losses by portfolio segment, analysis of the economy, market, rate environment, underwriting standards and other criteria as identified by the Strategic Credit Assessment Group (SCAG). The portfolio segments include real estate, commercial and consumer loans. The general allowance consists of reserve factors that are based on charge-off history and management's assessment of each portfolio segment. These reserve factors are inherently subjective and are driven by the repayment risk associated with each portfolio segment described below:

Commercial Real Estate—These loans generally possess a higher inherent risk of loss than other segments. 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.

GREATER PACIFIC BANCSHARES  
AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

December 31, 2018 and 2017

NOTE D – ALLOWANCE FOR LOAN LOSSES AND CREDIT QUALITY (Continued)

**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.

**Home Equity**—The home equity loan portfolio is for 2<sup>nd</sup> mortgage jumbo financing/refinancing and home improvements. These are secured by 1-4 family residential property.

**Consumer**—The consumer loan portfolio is comprised of a large number of small loans scheduled to be amortized over a specific period. Consumer loans are made directly for consumer purchases.

**Specific Allowance:** Regular credit reviews of the portfolio also identify loans that are considered potentially impaired. A loan is considered impaired when, based on current information and events, the Company determines that they will probably not be able to collect all amounts due according to the loan contract, including scheduled interest payments. When the Company identifies a loan as impaired, they measure the impairment using discounted cash flows, except when the sole remaining source of repayment for the loans is the liquidation of the collateral. In these cases, they use the current fair value of the collateral, less selling costs. If the Company determines that the value of the impaired loan is less than the recorded investment in the loan, they either recognize an impairment reserve as a specific allowance to be provided for in the allowance or charge-off the impaired balance on collateral dependent loans if it is determined that such amount represents a confirmed loss. Loans determined to be impaired with a specific allowance are excluded from the general allowance so as not to double-count the loss exposure.

**Qualitative Factors:** This component of the allowance is management's best estimate of the probable impact that various qualitative factors may have on the loan portfolio. It is not allocated to specific loans or groups of loans, but rather is intended to absorb losses caused by several factors, including changes in the nature and volume of the portfolio, changes in the terms of loans, changes in lending policies and procedures, underwriting collection practices, changes in international, national, regional, and local economic and business conditions, changes in the experience and ability of lending management and staff, changes in the volume and severity of past due loans, changes in the volume of non-accrual loans, changes in the volume and severity of adversely classified or graded loans, changes in the quality of the Company's loan review system, changes in the value of underlying collateral, the existence and effect of any concentrations of credit, changes in the level of concentrations of credit and the effect of other external factors such as competition and legal and regulatory requirements.

Although management believes the allowance to be adequate, ultimate losses may vary from its estimates. The Board of Directors reviews the adequacy of the allowance quarterly, including consideration of current economic conditions, known and inherent risks in the portfolio, adverse situations that may affect the borrower's ability to repay, the estimated value of any underlying collateral, or past loan experience 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 OCC, review the adequacy of the allowance as an integral part of their examination process. These regulatory agencies may require additions to the allowance based on their judgment about information available at the time of their examinations.

GREATER PACIFIC BANCSHARES  
AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

December 31, 2018 and 2017

NOTE D – ALLOWANCE FOR LOAN LOSSES AND CREDIT QUALITY (Continued)

The following table summarizes activity related to the allowance for loan losses by loan portfolio segment and the allocation of the allowance for loan losses by loan portfolio segment and by impairment methodology for the year ended December 31, 2018 and 2017:

	Commercial Real Estate	Commercial	Home Equity	Consumer	Total
<u>2018</u>					
<u>Allowance for credit losses</u>					
Beginning balance	\$ 495,121	\$ 69,143	\$ 520,554	\$ 5,736	\$ 1,090,554
Charge-offs					-
Recoveries		35,104	3,490		38,594
Provision	26,865	(64,089)	29,451	7,773	-
Ending balance	<u>\$ 521,986</u>	<u>\$ 40,158</u>	<u>\$ 553,495</u>	<u>\$ 13,509</u>	<u>\$ 1,129,148</u>
Ending balance:					
Collectively evaluated for impairment	<u>\$ 521,986</u>	<u>\$ 40,158</u>	<u>\$ 553,495</u>	<u>\$ 13,509</u>	<u>\$ 1,129,148</u>
<u>Loans</u>					
Ending balance:					
Collectively evaluated for impairment	<u>\$ 14,026,318</u>	<u>\$ 1,104,528</u>	<u>\$ 14,899,017</u>	<u>\$ 371,586</u>	<u>\$ 30,401,449</u>
	Commercial Real Estate	Commercial	Home Equity	Consumer	Total
<u>2017</u>					
<u>Allowance for credit losses</u>					
Beginning balance	\$ 448,410	\$ 67,779	\$ 530,293	\$ 7,425	\$ 1,053,907
Charge-offs					-
Recoveries		33,242	3,405		36,647
Provision	46,711	(31,878)	(13,144)	(1,689)	-
Ending balance	<u>\$ 495,121</u>	<u>\$ 69,143</u>	<u>\$ 520,554</u>	<u>\$ 5,736</u>	<u>\$ 1,090,554</u>
Ending balance:					
Collectively evaluated for impairment	<u>\$ 495,121</u>	<u>\$ 69,143</u>	<u>\$ 520,554</u>	<u>\$ 5,736</u>	<u>\$ 1,090,554</u>
<u>Loans</u>					
Ending balance:					
Collectively evaluated for impairment	<u>\$ 12,021,465</u>	<u>\$ 1,729,043</u>	<u>\$ 13,017,351</u>	<u>\$ 143,444</u>	<u>\$ 26,911,303</u>

Credit Quality of Loans: The Company assigns a risk rating to loans over a certain threshold and periodically performs detailed reviews of all such loans to identify credit risks and to assess the overall collectability of the portfolio. 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. These risk ratings can be grouped into the following major categories, defined as follows:

GREATER PACIFIC BANCSHARES  
AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

December 31, 2018 and 2017

NOTE D – ALLOWANCE FOR LOAN LOSSES AND CREDIT QUALITY (Continued)

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

Watch List—A watch list loan possesses some uncertainty as the borrower’s financial condition is perceived to be in a state of transition and require closer monitoring.

Special Mention—A special mention loan has potential weaknesses that deserve management’s close attention.

Substandard—A substandard loan is inadequately protected by the current sound worth and paying capacity of the obligor or of the collateral pledged, if any. These loans have a well-defined weakness, or weaknesses, that jeopardize the liquidation of the debt and are characterized by distinct possibility that the Bank will sustain some loss if the deficiencies are not corrected.

Doubtful—Loans classified as doubtful have characteristics of those classified as substandard but the weaknesses make collection or liquidation in full questionable and improbable based on currently existing facts, conditions and collateral values.

Loss—Loans classified as loss are considered uncollectible or of such little value.

The following table shows the loan portfolio allocated by management’s internal risk ratings at December 31, 2018 and 2017:

	<u>Commercial Real Estate</u>	<u>Commercial</u>	<u>Home Equity</u>	<u>Consumer</u>	<u>Total</u>
<u>2018</u>					
Grade:					
Pass	\$ 14,026,318	\$ 1,104,528	\$ 14,899,017	\$ 371,586	\$ 30,401,449
Watch					-
Special Mention					-
Substandard					-
Doubtful					-
Total	<u>\$ 14,026,318</u>	<u>\$ 1,104,528</u>	<u>\$ 14,899,017</u>	<u>\$ 371,586</u>	<u>\$ 30,401,449</u>
	<u>Commercial Real Estate</u>	<u>Commercial</u>	<u>Home Equity</u>	<u>Consumer</u>	<u>Total</u>
<u>2017</u>					
Grade:					
Pass	\$ 11,898,128	\$ 1,729,043	\$ 13,017,351	\$ 143,444	\$ 26,787,966
Watch	123,337				123,337
Special Mention					-
Substandard					-
Doubtful					-
Total	<u>\$ 12,021,465</u>	<u>\$ 1,729,043</u>	<u>\$ 13,017,351</u>	<u>\$ 143,444</u>	<u>\$ 26,911,303</u>

There were no impaired loans at December 31, 2018 and 2017.

There were no past due loans or loans on nonaccrual at December 31, 2018 and 2017.

GREATER PACIFIC BANCSHARES  
AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

December 31, 2018 and 2017

NOTE E – PREMISES AND EQUIPMENT

Premises and equipment consisted of the following at December 31:

	2018	2017
Leasehold improvements	\$ 242,440	\$ 239,840
Furniture, fixtures and equipment	682,286	668,994
	924,726	908,834
Less: Accumulated depreciation	(835,202)	(813,894)
	\$ 89,524	\$ 94,940

Depreciation and amortization included in occupancy and equipment expense totaled \$21,308 and \$26,058 respectively, in 2018 and 2017.

NOTE F – MORTGAGE SERVICING RIGHTS

The following table presents the changes in the Bank's mortgage servicing rights for the years ended December 31:

	2018	2017
Fair value, beginning of year	\$ 1,788,838	\$ 1,754,932
Additions for new mortgage servicing rights capitalized	59,359	82,858
Reduction of servicing assets	(27,389)	(43,603)
Changes in fair value:		
Due to changes in model inputs and assumptions	133,977	(5,349)
	133,977	(5,349)
Fair value, end of year	\$ 1,954,785	\$ 1,788,838
Balance of loans serviced for others	\$ 184,413,646	\$ 181,175,649
Mortgage servicing rights as a percentage of serviced loans	1.06%	0.99%

The balance of loans serviced above includes loans that were originated effective December 31, 2018 and 2017, but were not posted to the loan system until January 2019 and 2018. The amounts of contractually specified servicing fees, late fees and ancillary fees earned, recorded in mortgage banking revenue on the consolidated statements of operations, were \$458,496 and \$442,630 for the years ended December 31, 2018 and 2017, respectively. Changes in fair value are also included in mortgage banking revenue on the consolidated statements of operations.

The fair value of servicing rights is calculated through a discounted cash flow analysis using a computer pricing model. The valuation is based on the objective characteristics of the portfolio (loan amount, note rate, current loan age, amortization period, escrow balance, etc.), commonly used industry assumptions (prepayment speeds, float earnings rates, discount rates, cost to service, cost of advances) and supplemented by actual portfolio performance characteristics unique to the Bank. The assumptions taken into account are those that are typically employed by entities who own the mortgage servicing asset. The valuation takes into account the unique characteristics of the secondary servicing market. The market value of the servicing can vary based upon the level of prepayments, especially when rates fall. Higher prepayments would negatively impact the recorded value of the mortgage servicing rights.



GREATER PACIFIC BANCSHARES  
AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

December 31, 2018 and 2017

NOTE G – TIME DEPOSITS

Time deposits that meet or exceed the FDIC insurance limit of \$250,000 at December 31, 2018 and 2017 were \$9,287,041 and \$8,368,823, respectively.

The maturities of time deposits at December 31 are as follows:

	<u>2018</u>	<u>2017</u>
Due in one year or less	\$ 25,601,719	\$ 24,881,609
Due from one to three years	378,445	218,462
Due from three to five years		9,163
	<u>\$ 25,980,164</u>	<u>\$ 25,109,234</u>

NOTE H – FEDERAL FUNDS CREDIT LINE

The Company has a federal funds line of credit agreement through June 30, 2019. The maximum borrowings available under this line amounted to \$2,500,000 at December 31, 2018 and 2017. At December 31, 2018 and 2017, there were no borrowings outstanding under this agreement.

NOTE I – OTHER EXPENSES

Other expenses consisted of the following at December 31:

	<u>2018</u>	<u>2017</u>
Data processing	\$ 136,463	\$ 126,850
Professional services	114,778	108,440
Office expenses	75,508	75,569
Regulatory assessments	50,824	44,894
Marketing expense	50,514	35,891
Directors' fees and expenses	16,122	24,410
Messenger and courier expenses	10,566	10,304
Other expenses	271,364	235,141
	<u>\$ 726,139</u>	<u>\$ 661,499</u>

Other expenses in 2018 consists primarily of loan origination-related expenses (\$97,477), software license and internet fees (\$62,084), bank and other fees (\$32,482), and insurance (\$36,772). Other expenses in 2017 consisted primarily of loan origination-related expenses (\$112,024), software license and internet fees (\$43,025), bank and other fees (\$36,374), and insurance (\$12,257).

NOTE J – RETIREMENT PLANS

The Company had a defined contribution retirement plan covering substantially all of the Company's employees. Employees may elect to have a portion of their compensation contributed to the plan in conformity with the requirements of Section 401(k) of the Internal Revenue Code. The Company may make contributions to the plan at the discretion of the Board of Directors in an amount not to exceed the maximum amount deductible under the profit sharing plan rules of the Internal Revenue Service. All employees are eligible for participation following 12 months of employment and 1,000 hours of service each plan year. The Company's contributions vest over a three-year period. The Company made contributions totaling \$25,305 and \$26,776 for the years ended December 31, 2018 and 2017, respectively.

GREATER PACIFIC BANCSHARES  
AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

December 31, 2018 and 2017

NOTE K – INCOME TAXES

The components of income tax expense included in the statements of operations were as follows for the years ended December 31:

	<u>2018</u>	<u>2017</u>
Currently payable:		
Federal	\$ 69,588	\$ 100,740
State	21,617	26,877
	<u>91,205</u>	<u>127,617</u>
Deferred tax (benefit) expense:		
Federal	47,442	(157,123)
State	29,351	1,282
	<u>76,793</u>	<u>(155,841)</u>
Net provision for income taxes	<u>\$ 167,998</u>	<u>\$ (28,224)</u>

The following is a reconciliation of income taxes computed at the Federal statutory rate of 21% in 2018 and 34% in 2017 to the effective income tax rate used for the provision for income taxes:

	<u>2018</u>	<u>2017</u>
Income tax at Federal statutory rate	\$ 120,652	\$ 102,980
State franchise taxes, less Federal income tax benefit	39,633	18,584
Revaluation of deferred taxes due to the Tax Cuts and Jobs Act of 2017		(154,494)
Meals and entertainment	487	798
Nondeductible expenses and other	7,226	3,908
Provision for income taxes	<u>\$ 167,998</u>	<u>\$ (28,224)</u>

In December 2017, H.R. 1, known as the Tax Cuts and Jobs Act of 2017 (the Act), was signed into law. The Act makes changes to the U.S. Internal Revenue Code of 1986, including a decrease in the federal corporate tax rate to 21% from 34%, effective January 1, 2018. As a result of the enactment of this law, the Company revalued its deferred tax assets during the year ended December 31, 2017 from a combined federal and California tax rate of 41.15% to a combined rate of 29.56%. The amount totaling (\$154,494) described as “Revaluation of deferred taxes due to the Tax Cuts and Jobs Act of 2017” in the table above represents the effect of revaluing the Company’s deferred taxes due to the enactment of the Act.

GREATER PACIFIC BANCSHARES  
AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

December 31, 2018 and 2017

NOTE K – INCOME TAXES (Continued)

The tax effects of temporary differences that give rise to the components of the net deferred tax assets as of December 31 were as follows:

	2018	2017
Deferred tax assets:		
Allowance for loan losses	\$ 219,691	\$ 219,691
Reserve for mortgage servicing rights	51,910	48,349
Depreciation	8,308	8,094
Total deferred tax assets	279,909	276,134
Deferred tax liabilities:		
Mortgage servicing rights	(577,905)	(528,845)
Adjustment to cash basis	(169,582)	(136,800)
State franchise tax	(1,670)	(2,703)
Total deferred tax liabilities	(749,157)	(668,348)
Net deferred tax liabilities	\$ (469,248)	\$ (392,214)

Amounts presented for the tax effects of temporary differences are based upon estimates and assumptions and could vary from amounts ultimately reflected on the Company's tax returns. Accordingly, the variances from amounts reported for prior years are primarily the result of adjustments to conform to the tax returns as filed.

Income tax receivable was \$18,066 and \$47,763, at December 31, 2018 and 2017, respectively.

The Company and its subsidiary file an income tax return in the U.S. federal jurisdiction and file a franchise tax return in the State of Texas and the State of California jurisdictions. The Company is no longer subject to U.S. federal income tax examinations and State franchise tax examinations by taxing authorities for years prior to 2015 and 2014, respectively.

There have been no adjustments identified for unrecognized tax benefits requiring an adjustment to the income statement under FASB ASC 740-10. The Bank recognizes interest accrued and penalties related to unrecognized tax benefits, if any, in tax expense.

GREATER PACIFIC BANCSHARES  
AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

December 31, 2018 and 2017

NOTE L – EARNINGS PER SHARE

The following is a computation of basic and diluted earnings per share for the years ended December 31:

	<u>2018</u>	<u>2017</u>
Basic:		
Net income	<u>\$ 406,532</u>	<u>\$ 331,107</u>
Weighted-average common shares outstanding	<u>1,795,286</u>	<u>1,795,286</u>
Earnings per share	<u>\$ 0.23</u>	<u>\$ 0.18</u>
Diluted:		
Net income	<u>\$ 406,532</u>	<u>\$ 331,107</u>
Weighted-average common shares outstanding	1,795,286	1,795,286
Net effect of dilutive stock options - based on the Treasury stock method using average market price	<u>-</u>	<u>-</u>
Weighted-average common shares outstanding and common stock equivalents	<u>1,795,286</u>	<u>1,795,286</u>
Earnings per share - assuming dilution	<u>\$ 0.23</u>	<u>\$ 0.18</u>

Options to purchase 65,000 shares of common stock at \$5.00 per share were outstanding during 2018 and 2017 but were not included in the computation of diluted earnings per share because the options' exercise price was not greater than the average market price of the common shares.

NOTE M – STOCK OPTION PLAN

The Bank has a stock option plan established in 2000 under which incentive and non-qualified stock options, as defined under the Internal Revenue Code, may be granted. The Bank's Stock Option Plan provides for the granting of a maximum of 200,000 shares of the Bank's common stock to directors and employees at an exercise price not less than the fair market value of the shares on the date of grant and for a term of no more than 10 years. The purchase price of exercised options is payable in cash or with common stock previously acquired by the optionee. Options granted vest immediately. Generally, if an optionee's employment is terminated, the options expire.

GREATER PACIFIC BANCSHARES  
AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

December 31, 2018 and 2017

NOTE M – STOCK OPTION PLAN (Continued)

The options outstanding as of December 31, 2018 and 2017 were accounted for using the intrinsic method. The Company recorded compensation expense beginning in 2013 for the value of all 65,000 options, where their expiration date was extended for an additional three years. The options were extended again in 2016 for an additional three years.

A summary of stock option activity follows:

	Incentive Stock Options							
	2018				2017			
	Shares	Weighted-Average Exercise Price	Weighted-Average Remaining Contractual Term	Aggregate Intrinsic Value	Shares	Weighted-Average Exercise Price	Weighted-Average Remaining Contractual Term	Aggregate Intrinsic Value
Outstanding at beginning and end of year	65,000	\$ 5.00	0.66 Years	\$ -	65,000	\$ 5.00	1.66 Years	\$ -
Options exercisable at end of year	65,000	5.00	0.66 Years	\$ -	65,000	5.00	1.66 Years	\$ -

Upon the exercise of stock options, new shares are issued. No stock options were exercised during 2018 or 2017.

NOTE N – RELATED PARTY TRANSACTIONS

During the normal course of business, the Bank has entered into transactions with its directors, executive officers, significant shareholders and their affiliates (related parties). The Bank's policy prohibits loans to related parties. As of December 31, 2018 and 2017, the Bank had no outstanding loans to any officers, directors, or companies with which they are associated. The Bank sold a 53.57% participating interest in a loan to directors and officers and their related interests with a principal loan balance of \$2,705,397 at December 31, 2018. The Bank has received deposits from directors and officers and their related interests totaling \$3,184,609 and \$3,372,540 at December 31, 2018 and 2017, respectively.

NOTE O – CONTINGENT LIABILITIES AND COMMITMENTS

Lease Commitments: The Bank leases all of its facilities under noncancellable operating leases. In November 2013, the Bank extended its Whittier lease through October 31, 2019. The Bank leases a facility in Richardson, Texas and operates a second full service banking facility. This lease expires on October 31, 2021. As of December 31, 2018, future minimum lease payments under all noncancellable operating leases are:

Year ended December 31:	
2019	\$ 188,955
2020	72,282
2021	60,235
Total minimum lease commitments	\$ 321,472

Rent expense for the years ended December 31, 2018 and 2017 for all operating leases totaled \$222,630 and \$221,157, respectively.

GREATER PACIFIC BANCSHARES  
AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

December 31, 2018 and 2017

NOTE P – CONCENTRATIONS OF CREDIT RISK

Most of the Company's business activity is with customers located within the State of California, primarily within Los Angeles, Orange, Riverside, and San Bernardino Counties, and the State of Texas in the Dallas/Fort Worth area. While a significant amount of the Company's loans have been granted to customers in the Company's market area, 51% and 52% of the loans were made outside of the area as of December 31, 2018, and 2017, respectively. General economic conditions or natural disasters affecting the primary market area could affect the ability of customers to repay loans and the value of real property used as collateral. The loans are expected to be repaid from cash flow or proceeds from the sale of selected assets of the borrowers. The Company requires that all loans have adequate collateral to secure the loans or that the borrower have evidence of sufficient cash flows to repay loans when the loans are made. All collateral must have an appraisal, if applicable, and collateral is generally secured by liens. The Company's access to this collateral is through judicial procedures.

The concentrations of credit by type of loan are set forth in Note D. While the Company has a diversified loan portfolio, approximately 94% of these loans are secured by real estate. The distribution of commitments to extend credit approximates the distribution of loans outstanding. The Company has loan commitments in the following industries: retail trade, 10%; commercial building, 11%; consumer credit facilities, 52%; educational services, 11%; and non-profit and faith-based organizations, 12%. The National Banking Laws, Title 12 of the United States Code, generally restricts loans to a single borrower or group of related borrowers and investments by the Company to 25% of the sum of the Company's equity capital plus the allowance for loan losses, subject to certain adjustments. The Company evaluates each customer's credit worthiness 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 customer. Collateral held varies but may include residential and commercial real property, marketable securities, accounts receivable, inventory, equipment and savings accounts.

NOTE Q – REGULATORY MATTERS

The Bank, as a national bank, is subject to the dividend restrictions set forth by the Office of the Comptroller of the Currency (OCC). Under such restrictions, the Bank may not, without the prior approval of the OCC, declare dividends in excess of the sum of the current year's net income plus the retained earnings from the prior two years. As of December 31, 2018, \$1,111,006 was available for dividend distribution without prior approval, which has been reinvested into the Bank.

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

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

GREATER PACIFIC BANCSHARES  
AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

December 31, 2018 and 2017

NOTE Q – REGULATORY MATTERS (Continued)

As of December 31, 2018, the most recent notification from the OCC categorized the Bank as well capitalized under the regulatory framework for prompt corrective action. To be categorized as well capitalized, the Bank must maintain minimum total risk-based, Tier I risk-based, Common Equity Tier 1 risk-based and Tier I leverage ratios as set forth in the table. There are no conditions or events since that notification that management believes have changed the Bank's category. The Bank's actual capital amounts and ratios are also presented in the table. There are no conditions or events since that notification that management believes have changed the institution's category.

	Actual		For Capital Adequacy Purposes				To Be Well Capitalized	
	Amount	Ratio	Amount	Ratio	Amount	Ratio	Amount	Ratio
(in thousands)								
As of December 31, 2018								
Total Capital								
(to Risk Weighted Assets)	\$ 11,028	22.63%	≥ \$ 3,898	≥ 8.00%	≥ \$ 4,873	≥ 10.00%		
Tier I Capital								
(to Risk Weighted Assets)	\$ 10,409	21.36%	≥ \$ 2,924	≥ 6.00%	≥ \$ 3,898	≥ 8.00%		
Common Equity Tier 1 Capital								
(to Risk Weighted Assets)	\$ 10,409	21.36%	≥ \$ 2,193	≥ 4.50%	≥ \$ 3,167	≥ 6.50%		
Tier I Capital								
(to Average Assets)	\$ 10,409	17.89%	≥ \$ 2,328	≥ 4.00%	≥ \$ 2,910	≥ 5.00%		

	Actual		For Capital Adequacy Purposes				To Be Well Capitalized	
	Amount	Ratio	Amount	Ratio	Amount	Ratio	Amount	Ratio
(in thousands)								
As of December 31, 2017								
Total Capital								
(to Risk Weighted Assets)	\$ 10,633	23.75%	≥ \$ 3,581	≥ 8.00%	≥ \$ 4,476	≥ 10.00%		
Tier I Capital								
(to Risk Weighted Assets)	\$ 10,063	22.48%	≥ \$ 2,686	≥ 6.00%	≥ \$ 3,581	≥ 8.00%		
Common Equity Tier 1 Capital								
(to Risk Weighted Assets)	\$ 10,063	22.48%	≥ \$ 2,014	≥ 4.50%	≥ \$ 2,910	≥ 6.50%		
Tier I Capital								
(to Average Assets)	\$ 10,063	17.97%	≥ \$ 2,240	≥ 4.00%	≥ \$ 2,800	≥ 5.00%		

The Federal Deposit Insurance Corporation (“FDIC”), published interim final rules (the “Basel III Capital Rules”) establishing a new comprehensive capital framework for U.S. banking organizations. Under the Basel III Capital Rules, in order to avoid limitations on capital distributions, including dividend payments and certain discretionary bonus payments to executive officers, a banking organization must hold a capital conservation buffer composed of common equity tier 1 capital above its minimum risk-based capital requirements. The effects of accumulated other comprehensive income items are not excluded from common equity tier 1 capital; however, the Company made a one-time permanent election to exclude these items in order to avoid significant variations in the level of capital depending on the impact of interest rate fluctuations on the fair value of the Company's investments portfolio. Phase-in of the capital conservation buffer requirements will begin January 1, 2016 and be fully phased-in on January 1, 2019. A banking organization with a buffer greater than 2.5 percent would not be subject to limits on capital distributions or discretionary bonus payments. The Bank does not expect to be subject to limits on capital distributions or discretionary bonus payments due to these requirements.

GREATER PACIFIC BANCSHARES  
AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

December 31, 2018 and 2017

NOTE R – FAIR VALUE MEASUREMENT

Fair value is a market-based measure considered from the perspective of a market participant who holds the asset or owes the liability rather than an entity-specific measure. Therefore, even when market assumptions are not readily available, the Company's own assumptions are set to reflect those that market participants would use in pricing the asset or liability at the measurement date, including during periods of market dislocation, the observability of prices and inputs may be reduced for many instruments. This condition could cause an instrument to be reclassified from Level 1 to Level 2 or from Level 2 to Level 3.

In general, fair values are determined by:

Level 1 inputs utilize quoted prices (unadjusted) in active markets for identical assets or liabilities that the Company has the ability to access.

Level 2 inputs include quoted prices for similar assets and liabilities in active markets, and inputs other than quoted prices that are observable for the asset or liability, such as interest rates and yield curves that are observable at commonly quoted intervals. Fair values determined by Level 2 inputs utilize inputs other than quoted prices included in Level 1 that are observable for the asset or liability, either directly or indirectly.

Level 3 inputs are unobservable inputs for the asset or liability, and include situations where there is little, if any, market activity for the asset or liability.

The following table presents information about the Company's assets and liabilities measured at fair value on a nonrecurring basis as of December 31, 2018 and 2017, and indicate the fair value hierarchy of the valuation techniques utilized by the Company to determine such fair value.

	Total	Level 1	Level 2	Level 3	Total Gains (Losses)
December 31, 2018:					
Mortgage servicing rights	\$ 1,954,785		\$ 1,954,785		
December 31, 2017:					
Mortgage servicing rights	\$ 1,788,838		\$ 1,788,838		

The following methods were used to estimate the fair value of each class of financial instrument above:

*Mortgage Servicing Rights* – Mortgage servicing rights do not trade in an active market with readily observable prices. Accordingly, the Company determines the fair value of mortgage servicing rights using a valuation model that calculates the present value of estimated future net servicing income. Fair value measurements of the mortgage servicing rights use significant unobservable inputs and, accordingly, are classified as Level 3.

The following table presents quantitative information about level 3 fair value measurements for assets measured at fair value on a non-recurring basis at December 31, 2018 and 2017:

	Fair Value	Valuation Techniques	Unobservable Inputs	Range	Weighted Average
December 31, 2018:					
Mortgage servicing rights	\$ 1,954,785	Discounted cash flow approach	Constant prepayment rate Discount rate	17.5% 10.5% to 11.0%	17.5%
December 31, 2017:					
Mortgage servicing rights	\$ 1,788,838	Discounted cash flow approach	Constant prepayment rate Discount rate	17.5% 10.5% to 11.0%	17.5%