FIRST NATIONAL BANK ALASKA
Anchorage, Alaska

FINANCIAL STATEMENTS
December 31, 2017 and 2016

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Crowe Horwath LLP
Independent Member Crowe Horwath International

INDEPENDENT AUDITOR'S REPORT

The Board of Directors and Shareholders
First National Bank Alaska
Anchorage, Alaska

Report on the Financial Statements

We have audited the accompanying financial statements of First National Bank Alaska, which comprise the statements of financial condition as of December 31, 2017 and 2016, and the related statements of income, comprehensive income, cash flows, and changes in shareholders' equity for the years then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

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

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

(Continued)

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of First National Bank Alaska as of December 31, 2017 and 2016, and the results of its operations and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Report on Other Legal and Regulatory Requirements

We also have audited in accordance with auditing standards generally accepted in the United States of America, First National Bank Alaska's internal control over financial reporting as of December 31, 2017, based on criteria established in the 2013 Internal Control – Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) relevant to reporting objectives for the express purpose of meeting the regulatory requirements of Section 112 of the Federal Deposits Insurance Corporation Improvement Act (FDICIA) and our report dated March 7, 2018 expressed an unmodified opinion.

Crowe Horwath LLP

Crowe Horwath LLP

Oak Brook, Illinois
March 7, 2018

FIRST NATIONAL BANK ALASKA
STATEMENTS OF FINANCIAL CONDITION
December 31, 2017 and 2016
(Dollars in thousands, except per share data)

	2017	2016
ASSETS		
Cash and cash equivalents	$ 134,051	$ 79,127
Securities, available-for-sale	1,590,444	1,745,429
Real estate loans to be sold	16,036	12,089
Loans:		
Commercial and industrial	381,499	321,575
Real estate	1,413,652	1,336,228
Consumer and other	20,033	19,792
Total loans, gross	1,815,184	1,677,595
Less: Allowance for loan losses	17,825	16,600
Total loans, net	1,797,359	1,660,995
Premises and equipment, net	49,501	49,236
Other real estate owned, net	9,875	12,222
Due from brokers	9,988	-
Other assets	45,888	50,750
Total assets	$ 3,653,142	$ 3,609,848
LIABILITIES AND SHAREHOLDERS' EQUITY		
Liabilities:		
Deposits:		
Noninterest bearing	$ 1,231,762	$ 1,306,357
Interest bearing:		
Savings	692,712	665,791
NOW	200,395	207,270
Money market	181,221	159,044
Time	131,727	137,213
Total interest bearing	1,206,055	1,169,318
Total deposits	2,437,817	2,475,675
Securities sold under agreements to repurchase	687,064	629,966
Due to brokers	19,088	1,962
Other liabilities	12,296	9,510
Total liabilities	3,156,265	3,117,113
Shareholders' equity:		
Common stock, $100 par value (authorized: 400,000 shares) (issued and outstanding: 2017- 317,083; 2016 – 317,139)	31,708	31,714
Surplus	40,000	40,000
Retained earnings	433,335	427,264
Accumulated other comprehensive loss	(8,166)	(6,243)
Total shareholders' equity	496,877	492,735
Total liabilities and shareholders' equity	$ 3,653,142	$ 3,609,848

See accompanying notes to financial statements.

FIRST NATIONAL BANK ALASKA
STATEMENTS OF INCOME
Years ended December 31, 2017 and 2016
(Dollars in thousands, except per share data)

	2017	2016
Interest income and loan fees:		
Interest and fees on loans:		
Taxable	$ 94,850	$ 88,508
Nontaxable	2,009	2,162
Total interest and fees on loans	96,859	90,670
Interest and dividends on investment securities:		
Taxable	26,085	27,646
Nontaxable	5,055	4,345
Total interest and dividends on investment securities	31,140	31,991
Interest on cash and cash equivalents	953	390
Total interest and loan fee income	128,952	123,051
Interest expense:		
Interest on deposits	920	847
Interest on federal funds purchased and securities sold under agreements to repurchase	2,668	961
Total interest expense	3,588	1,808
Net interest and loan fee income	125,364	121,243
Provision for loan losses	2,586	2,422
Net interest and loan fee income after provision for loan losses	122,778	118,821
Noninterest income:		
Bankcard fees	7,669	8,166
Service charges on deposit accounts	5,268	5,723
Gain on sale of mortgage loans	2,406	3,322
Mortgage loan servicing income	1,989	1,817
Net gains (losses) on investment securities	(928)	1,404
Other noninterest income	6,969	7,016
Total noninterest income	23,373	27,448
Noninterest expense:		
Salaries and employee benefits	52,793	51,533
Occupancy expense, net	8,552	8,559
Furniture and equipment expense	2,065	2,182
Bankcard expenses	2,138	2,378
Other noninterest expense	19,052	19,863
Total noninterest expense	84,600	84,515
Income before taxes	61,551	61,754
Provision for income taxes	25,124	20,362
Net income	$ 36,427	$ 41,392
Earnings per common share	$ 114.87	$ 130.35

See accompanying notes to financial statements.

FIRST NATIONAL BANK ALASKA
STATEMENTS OF COMPREHENSIVE INCOME
Years ended December 31, 2017 and 2016
(Dollars in thousands)

	2017	2016
Net income	$ 36,427	$ 41,392
Other comprehensive loss –		
Unrealized losses on securities:		
Unrealized holding gains (losses) arising during the period, net of tax effect of $(733) and $5,293 in 2017 and 2016, respectively	(1,022)	(7,583)
Reclassification adjustment for (gains) losses included in net income, net of tax effect of $(382) and $577 in 2017 and 2016, respectively	546	(827)
Other comprehensive loss	(476)	(8,410)
Comprehensive Income	$ 35,951	$ 32,982

See accompanying notes to financial statements.

FIRST NATIONAL BANK ALASKA
STATEMENTS OF CASH FLOWS
Years ended December 31, 2017 and 2016
(Dollars in thousands)

	2017	2016
Cash flows from operating activities		
Net income	$ 36,427	$ 41,392
Adjustments to reconcile net income to net cash provided by operating activities:		
Amortization of premium on investment securities, net	13,610	13,800
Loss from equity method investment	1,701	1,377
Depreciation, accretion and amortization	5,229	5,522
Provision for loan losses	2,586	2,422
Deferred taxes	(1,740)	(624)
Gain on sale of mortgage loans	(2,406)	(3,322)
Net gain on the sales of other real estate owned	(143)	(184)
Valuation adjustment on other real estate owned	757	2,490
Net gain on the sale of premises and equipment	(129)	(7)
Net (gain) loss on investment securities	928	(1,404)
Real estate loans to be sold-originated	(148,525)	(190,046)
Real estate loans to be sold-shipped	145,903	190,208
Deferred tax expense from Federal tax reform	4,744	-
Net increase in other assets	(9,791)	(3,940)
Net increase in other liabilities	9,293	2,157
Net cash provided by operating activities	58,444	59,841
Cash flows from investing activities		
Proceeds from calls or maturities of securities, available-for-sale	110,979	473,536
Proceeds from sales of securities, available-for-sale	254,485	94,120
Purchase of securities, available-for-sale	(215,837)	(507,161)
Net purchases of Federal Home Loan Bank stock	(49)	(308)
Net redemptions of Federal Reserve Bank stock	4	7
Net increase in loans	(148,693)	(95,405)
Net (increase) decrease in participation loans	10,075	(31,516)
Proceeds from sales of premises and equipment	154	13
Purchase of land, premises and equipment	(3,602)	(2,708)
Improvements to other real estate owned	(85)	(225)
Proceeds from sales of other real estate owned	1,686	2,339
Net cash provided by (used in) investing activities	9,117	(67,308)
Cash flows from financing activities		
Net increase (decrease) in total deposits	(37,858)	50,053
Net increase (decrease) in securities sold under agreements to repurchase	57,098	(15,872)
Payments on notes and capital leases	(68)	(53)
Dividends paid	(31,711)	(26,977)
Retirement of common stock	(98)	(1,835)
Net cash provided by (used in) financing activities	(12,637)	5,316
Increase (decrease) in cash and cash equivalents	54,924	(2,151)
Cash and cash equivalents, January 1	79,127	81,278
Cash and cash equivalents, December 31	$ 134,051	$ 79,127

(Continued)

FIRST NATIONAL BANK ALASKA
STATEMENTS OF CASH FLOWS
Years ended December 31, 2017 and 2016
(Dollars in thousands)

	2017	2016
Supplemental disclosures of cash flow information:		
Cash paid during the year for interest	$ 3,565	$ 1,795
Cash paid during the year for income taxes	21,271	22,442
Noncash investing and financing activities:		
Transfer of loans to other real estate owned	$ 404	$ 546
Bank financed sales of other real estate owned	784	786
Due to brokers for security and loan purchases	19,088	1,962
Due from brokers for matured securities	9,988	-

See accompanying notes to financial statements.

FIRST NATIONAL BANK ALASKA
STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY
Years ended December 31, 2017 and 2016
(Dollars in thousands, except per share data)

	Common Stock ($100 Par Value)	Surplus	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total Shareholders' Equity
Balance, January 1, 2016	$ 31,843	$ 40,000	$ 414,555	$ 2,167	$ 488,565
Net income	-	-	41,392	-	41,392
Other comprehensive loss, net of tax	-	-	-	(8,410)	(8,410)
Dividends declared - $85 per share	-	-	(26,977)	-	(26,977)
Retirement of common stock (1,294 shares)	(129)	-	(1,706)	-	(1,835)
Balance, December 31, 2016	31,714	40,000	427,264	(6,243)	492,735
Net income	-	-	36,427	-	36,427
Other comprehensive loss, net of tax	-	-	-	(476)	(476)
Dividends declared - $100 per share	-	-	(31,711)	-	(31,711)
Retirement of common stock (56 shares)	(6)	-	(92)	-	(98)
Reclassification due to Tax Cuts and Jobs Act	-	-	1,447	(1,447)	-
Balance, December 31, 2017	$ 31,708	$ 40,000	$ 433,335	$ (8,166)	$ 496,877

See accompanying notes to financial statements.

NOTE 1 - SIGNIFICANT ACCOUNTING AND REPORTING POLICIES

First National Bank Alaska (the Bank) is a full service commercial bank operated as a single segment, and as such, its principal activities include the receiving and lending of money. Additionally, the Bank provides trust banking services, escrow and contract collection services, bankcard services, and safe deposit box facilities. These services are for business, industry, and individuals primarily within the State of Alaska. Banking services are provided from 29 branches throughout Alaska. The accounting and reporting policies of the Bank conform with U.S. generally accepted accounting principles and the prevailing practices within the banking industry. Significant accounting and reporting policies are summarized below.

Subsequent Events: The Bank has evaluated subsequent events for recognition and disclosure through March 7, 2018, which is the date the financial statements were available to be issued.

Estimates: Use of accounting estimates in the preparation of financial statements, in order to conform with U.S. generally accepted accounting principles, requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Cash and Cash Equivalents: Cash and cash equivalents include cash and due from banks and overnight federal funds sold. Net cash flows are reported for customer loan and deposit transactions, securities sold under agreements to repurchase and federal funds purchased.

Securities, Available-for-Sale: Securities, available-for-sale are classified at the time of acquisition. The available-for-sale classification includes debt and marketable equity securities which are carried at estimated fair value. Unrealized holding gains or losses on securities, available-for-sale are included in other comprehensive income and as a separate component of shareholders' equity. Amortization of premiums and accretion of discounts are recognized using the level yield method. Realized gains and losses on sales of securities are computed using the specific identification method.

Management evaluates securities for other-than-temporary impairment (OTTI) on at least a quarterly basis, and more frequently when economic or market conditions warrant such an evaluation. For securities in an unrealized loss position, management considers the extent and duration of the unrealized loss, and the financial condition and near-term prospects of the issuer. Management also assesses whether it intends to sell, or it is more likely than not that it will be required to sell, a security in an unrealized loss position before recovery of its amortized cost basis. If either of the criteria regarding intent or requirement to sell is met, the entire difference between amortized cost and fair value is recognized as impairment through earnings. For debt securities that do not meet the aforementioned criteria, the amount of impairment is split into two components as follows: 1) OTTI related to credit loss, which must be recognized in the income statement and 2) OTTI related to other factors, which is recognized in other comprehensive income. The credit loss is defined as the difference between the present value of the cash flows expected to be collected and the amortized cost basis.

(Continued)

NOTE 1 - SIGNIFICANT ACCOUNTING AND REPORTING POLICIES (Continued)

Real Estate Loans to be Sold: Real estate loans to be sold are carried at the lower of cost or fair value in the aggregate. The Bank records and holds for sale one-to-four family and multifamily real estate loans which are originated pursuant to investor programs. Net unrealized losses, if any, are recognized through a valuation allowance by charges to other noninterest expense.

Loans: The Bank grants real estate, commercial, and consumer loans to customers. A substantial portion of the loan portfolio is represented by real estate loans throughout Alaska. The ability of the Bank's debtors to honor their contracts is dependent upon real estate and general economic conditions.

Loans that management has the intent and ability to hold for the foreseeable future, or until maturity or pay-off, generally are reported at their outstanding unpaid principal balances adjusted for charge-offs and any deferred fees or costs on originated loans. Interest income is accrued on the unpaid principal balance. Loan origination fees, net of certain direct origination costs, are deferred and recognized as an adjustment of the related loan yield using the effective interest method.

The accrual of interest on all classes of real estate and commercial loans is normally discontinued at the time a loan is 90 days delinquent. Past due status is based on the contractual terms of the loan. All classes within consumer and other loans are typically charged off no later than 120 days delinquent. In all cases, loans are placed on nonaccrual or charged off at an earlier date if collection of principal or interest is considered doubtful.

All interest accrued but not collected for loans that are placed on nonaccrual or charged off is reversed against interest income. Interest received on such loans is accounted for on the cash-basis or cost-recovery method, until qualifying for return to accrual. Loans are returned to accrual status when all the principal and interest amounts contractually due are brought current and future payments are reasonably assured.

Allowance for Loan Losses: The allowance for loan losses is a valuation allowance for probable incurred credit losses. The allowance for loan losses is established as losses are estimated to have occurred through a provision for loan losses charged to earnings. Loan losses are charged against the allowance when management believes the uncollectability of a loan balance is confirmed. Subsequent recoveries, if any, are credited to the allowance.

The allowance consists of specific and general components. The specific component relates to loans that are individually classified as impaired when, based on current information and events, it is probable that the Bank will be unable to collect all amounts due according to the contractual terms of the loan agreement. 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.

The general component is evaluated on a regular basis by management and is based upon management's periodic review of the collectability of non-impaired loans in light of historical loss experience, the nature and volume of the loan portfolio, adverse situations that may affect the borrower's ability to repay, estimated value of any underlying collateral and prevailing economic conditions. The historical loss experience is determined by portfolio segment and is based on the actual loss history of the Bank over the most recent 3, 5 or 7 years for consumer, commercial and real estate loans, respectively. The actual loss experience is supplemented with other qualitative factors based on the risks present for each portfolio segment.

(Continued)

NOTE 1 - SIGNIFICANT ACCOUNTING AND REPORTING POLICIES (Continued)

Management considers the following when assessing the risk of the loan portfolio segments:

Commercial and Industrial loans – are dependent on the strength of the industries of the related borrowers and the success of their businesses. Commercial loans are advanced for equipment purchases, to provide working capital or meet other financing needs of business enterprises. These loans may be secured by accounts receivable, inventory, equipment or other business assets. At the time of origination, financial information is obtained from the borrower to evaluate ability to repay the loans.

Real estate loans are considered by loan portfolio class as follows:

Commercial and Construction/Development loans – are dependent on the industries tied to these loans as well as the local real estate market. The loans are secured by the real estate, appraisals or other external valuations are obtained to support the loan amount. An evaluation of the project's cash flows is performed to evaluate the borrower's ability to repay the loan at the time of origination.

1-4 and multifamily residential loans – are affected by the local residential real estate market, the local economy, and, for variable rate mortgages, movement in indices tied to these loans. At the time of origination, the Bank evaluates the borrower's repayment ability through a review of credit scores and debt to income ratios. Appraisals or other external valuations are obtained to support the loan amount. Multifamily real estate loans are dependent on the industries tied to these loans as well as the local real estate market for the particular property segments. Appraisals or other external valuations are obtained to support the loan amount. An evaluation of the project's cash flows is performed to evaluate the borrower's ability to repay the loan at the time of origination.

Consumer and other loans – are dependent on local economies. Consumer loans are generally secured by consumer assets, but may be unsecured. At the time of origination, the Bank evaluates the borrower's repayment ability through a review of credit scores and an evaluation of debt to income ratios.

This evaluation is inherently subjective as it requires estimates that are susceptible to significant revision as more information becomes available. While management does not expect a substantial decline in real estate values and economic conditions in Alaska, a decline in these values or economic activities could have an impact on the value of collateral securing the loans as well as the ability for the repayment of loans resulting in a higher allowance for loan losses in the future.

A loan is considered impaired when, based on current information and events, it is probable that the Bank will be unable to collect the scheduled payments of principal or interest when due according to the contractual terms of the loan agreement. Factors considered by management in determining impairment include payment status, collateral value, and the probability of collecting scheduled principal and interest payments when due. Loans that experience insignificant payment delays and payment shortfalls generally are not classified as impaired. Management determines the significance of payment delays and payment shortfalls on a case-by-case basis, taking into consideration all of the circumstances surrounding the loan and the borrower, including the length of the delay, the reasons for the delay, the borrower's prior payment record and the amount of the shortfall in relation to the principal and interest owed. Impairment is measured on a loan by loan basis for commercial and construction loans by either the present value of expected future cash flows discounted at the loan's effective interest rate or the fair value of the collateral if the loan is collateral dependent. Loans for which the terms have been modified resulting in a concession, and for which the borrower is experiencing financial difficulty, are considered troubled debt restructurings and classified as impaired.

(Continued)

NOTE 1 - SIGNIFICANT ACCOUNTING AND REPORTING POLICIES (Continued)

Troubled debt restructurings are measured at the net present value of estimated future cash flows or where considered to be collateral dependent, the loan is reported, net, at the fair value of the collateral.

Large groups of smaller balance homogeneous loans are collectively evaluated for impairment. Accordingly, the Bank does not separately identify all individual consumer loans for impairment disclosures.

Reserve for Unfunded Commitments: A reserve is established at a level that is considered adequate by management to provide for probable losses associated with commitments to lend funds under existing agreements. Management determines the adequacy of the reserve for unfunded commitments by evaluating the outstanding commitment levels, the expected conversion to loans, historical loss estimates, and other relevant factors. This evaluation is inherently subjective and actual losses may vary from current estimates. Changes in the reserve are reported in earnings in the periods they become known. The reserve for unfunded commitments is included in other liabilities in the accompanying statements of condition.

The recorded liability was $900 at December 31, 2017 and 2016.

Premises and Equipment: Premises and equipment, including leasehold improvements and software, are stated at cost less accumulated depreciation and amortization. Depreciation on premises and equipment is calculated on a declining balance basis over the estimated useful lives of the assets. The estimated useful life of buildings is 39 years, with some external elements using 15 years. The estimated useful life of software is 3 years and furniture and equipment is 5 to 7 years. Equipment under capital leases is stated at the present value of minimum lease payments. Equipment held under capital leases and leasehold improvements are amortized over the shorter of the lease term or estimated useful life of the asset. Maintenance and repairs are expensed as incurred, while improvements and construction costs are capitalized.

Federal Reserve Bank: This stock is a required holding of capital stock of the Federal Reserve Bank and is carried in other assets in the accompanying statements of condition at cost and periodically evaluated for impairment based on ultimate recovery of par value, ($2,151 and $2,155 as of 2017 and 2016, respectively). Calculation of the stock requirement is based solely on the capital structure of the Bank.

Federal Home Loan Bank Stock: This is a required stock holding of the Federal Home Loan Bank of Des Moines and is carried in other assets in the accompanying statements of condition at cost and periodically evaluated for impairment based on ultimate recovery of par value, ($4,332 and $4,283 as of 2017 and 2016, respectively). The minimum stock requirement is calculated based on the Bank's assets or qualifying loans, whichever applies.

(Continued)

NOTE 1 - SIGNIFICANT ACCOUNTING AND REPORTING POLICIES (Continued)

Other Real Estate Owned: Consists of properties acquired through foreclosure and is carried at the lower of fair value at acquisition date or current estimated fair value net of disposal costs. Physical possession of residential real estate property collateralizing a consumer mortgage loan occurs when legal title is obtained upon foreclosure or when the borrower conveys all interest in the property to satisfy the loan through completion of a deed in lieu of foreclosure or a similar legal agreement. At the time the property is acquired, it is recorded at estimated fair value less costs to sell, with any difference between this value and the outstanding balance on the loan charged against the allowance for loan losses. Subsequent to foreclosure, costs associated with holding the property are charged to expense as incurred. Subsequent write-downs and gains and losses recognized on the sale of these properties are included in noninterest expense.

Other real estate owned also includes bank premises that were transferred to other real estate owned due to no longer using the premises for Bank purposes and related regulatory requirements for these types of assets. These transfers from premises and equipment are made at the lower of cost or fair value.

Loan Commitments and Related Financial Instruments: This includes off-balance sheet credit instruments, such as commitments to make loans and commercial letters of credit, issued to meet customer financing needs. The face amount for these items represents the exposure to loss, before considering customer collateral or ability to repay. Such financial instruments are recorded when they are funded.

Originated Mortgage Servicing Rights (OMSRs): OMSRs are capitalized based on their fair value when the corresponding loans are sold. The purchased or originated rights to service loans are amortized in relation to the estimated period of net servicing income. The carrying value of mortgage servicing rights (MSRs) is evaluated on a disaggregated basis relative to loans originated in a given quarter for impairment if there are changes in market conditions, payoffs or loan delinquencies. Impairment of MSRs is recognized through a charge to noninterest income when the MSRs’ carrying amount exceeds its current fair value. MSRs are included in other assets in the accompanying statements of condition and are amortized into mortgage loan servicing income.

Transfers of Financial Assets: These are accounted for as sales, when control over the assets has been relinquished. Control over transferred assets is deemed to be surrendered when the assets have been isolated from the Bank, the transferee obtains the right (free of conditions that constrain it from taking advantage of that right) to pledge or exchange the transferred assets, and the Bank does not maintain effective control over the transferred assets through an agreement to repurchase them before their maturity.

Mortgage Loan Servicing Fees: These are based on a percentage of the interest collected and are included in income as related loan payments from mortgagors are collected offset by the amortization of the servicing rights.

Investments in Limited Partnerships: Investments where the underlying assets are qualified affordable housing projects are accounted for using either the cost method or equity method, depending on investment ownership percentage. Under the cost method, the Bank amortizes the excess of the carrying amount of the investment over its estimated residual value during the periods in which tax credits are allocated to the Bank. The amortization is included in other noninterest expense. Under the equity method, the Bank includes its proportionate share of income or loss in other noninterest income or expense.

(Continued)

NOTE 1 - SIGNIFICANT ACCOUNTING AND REPORTING POLICIES (Continued)

Bankcard Fees: These include income from interchange fees on both credit and debit cards, merchant fees earned on credit transactions, and miscellaneous set up and equipment rental fees. The Bank recognizes fee revenue as it is earned and collectability is reasonably assured. Expenses related to rebate reward programs are recorded when earned by cardholders.

Income Taxes: Income taxes are accounted for in accordance with Accounting Standards Codification (ASC) Topic 740. A current income tax asset or liability is recognized for estimated taxes payable or refundable on current year income tax returns. A deferred tax asset or liability is recognized for future tax effects attributable to temporary differences arising between the tax bases of assets or liabilities and their reported amounts in the financial statements. The measurement of current and deferred tax assets and liabilities is based on provisions of enacted tax law. The effect of a change in tax rates on deferred taxes is recognized in income in the period that includes the enactment date. In the event the Bank does not expect to realize future tax benefits, a valuation allowance would be established to reduce the amount of deferred tax assets.

A tax position is recognized as a benefit only if it is “more likely than not” that the tax position would be sustained in a tax examination, with a tax examination being presumed to occur. The amount recognized is the largest amount of tax benefit that is greater than 50% likely of being realized on examination. For tax positions not meeting the “more likely than not” test, no tax benefit is recorded.

The Bank recognizes interest and/or penalties related to income tax matters in income tax expense.

Earnings Per Common Share: These are computed on the basis of the weighted average number of shares outstanding. The weighted average number of shares outstanding were 317,113 and 317,544 for 2017 and 2016, respectively. The Bank does not have any potentially dilutive securities.

Loss Contingencies: Loss contingencies, including claims and legal actions arising in the ordinary course of business, are recorded as liabilities when the likelihood of loss is probable and an amount or range of loss can be reasonably estimated. Management does not believe there now are such matters that will have a material effect on the financial statements.

Fair Values of Financial Instruments: These are estimated using relevant market information and other assumptions, as more fully disclosed in estimated fair value of financial instruments footnote. Fair value estimates involve uncertainties and matters of significant judgment regarding interest rates, credit risk, prepayments, and other factors, especially in the absence of broad markets for particular items. Changes in assumptions or in market conditions could significantly affect these estimates.

Reclassifications: Reclassifications have been made to conform 2016 financial statement data with the 2017 presentation. Reclassifications had no effect on prior year net income or shareholders’ equity.

(Continued)

NOTE 1 - SIGNIFICANT ACCOUNTING AND REPORTING POLICIES (Continued)

Adoption of New Accounting Standards: In May 2014, the Financial Accounting Standards Board (FASB) amended existing guidance related to revenue from contracts with customers. This amendment supersedes and replaces nearly all existing revenue recognition guidance, including industry-specific guidance, establishes a new control-based revenue recognition model, changes the basis for deciding when revenue is recognized over time or at a point in time, provides new and more detailed guidance on specific topics and expands and improves disclosures about revenue. In addition, this amendment specifies the accounting for some costs to obtain or fulfill a contract with a customer. These amendments are effective for annual periods beginning after December 15, 2017. The Bank has elected to use the modified retrospective application, which requires application to uncompleted contracts at the date of adoption. Periods prior to the date of adoption are not retrospectively applied, but a cumulative effect is recognized as the date of initial application on uncompleted contracts. We are finalizing our assessment and have identified the revenue line items within the scope of this new guidance. Revenue streams within other noninterest income the Bank is evaluating include gains on sale of other real estate. We do not expect the new standard to result in a material change for revenue because the majority of the bank's financial instruments are not within the scope of the update.

In January 2016, the FASB amended existing guidance that requires public business entities to use the exit price notion when measuring the fair value of financial instruments for disclosure purposes. It requires separate presentation of financial assets and financial liabilities by measurement category and form of financial asset (i.e. securities or loans and receivables). It eliminates the requirement for public business entities to disclose the methods and significant assumptions used to estimate the fair value that is required to be disclosed for financial instruments measured at amortized cost. These amendments are effective for public business entities for fiscal years beginning after December 15, 2017. The effects of adopting of this standard is still being evaluated by management.

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. Under the new guidance, lessor accounting is largely unchanged. Certain targeted improvements were made to align, where necessary, lessor accounting with the lessee accounting model and Topic 606, Revenue from Contracts with Customers. These amendments are effective for annual periods beginning after December 15, 2018. Lessees (for capital and operating leases) and lessors (for sales-type, direct financing, and operating leases) must apply a modified retrospective transition approach for leases existing at, or entered into after, the beginning of the earliest comparative period presented in the financial statements. The modified retrospective approach would not require any transition accounting for leases that expired before the earliest comparative period presented. Lessees and lessors may not apply a full retrospective transition approach. Based on leases outstanding at December 31, 2017, the Bank does not expect the updates to have a material impact on the income statement, but does anticipate an increase in assets and liabilities resulting from the present value of future lease payments at the date of adoption.

(Continued)

NOTE 1 - SIGNIFICANT ACCOUNTING AND REPORTING POLICIES (Continued)

In June 2016, the FASB amended existing 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 measured at amortized cost, including loan receivables, held-to-maturity debt securities, and reinsurance receivables. It also applies to off-balance sheet credit exposures not accounted for as insurance (loan commitments, standby letters of credit, financial guarantees, and other similar instruments) and net investments in leases recognized by a lessor. For debt securities with other-than-temporary impairment, the guidance will be applied prospectively. For all other assets within the scope of CECL, a cumulative-effect adjustment will be recognized in retained earnings as of the beginning of the first reporting period in which the guidance is effective. These amendments are effective for annual periods beginning after December 15, 2020. The Bank has created a CECL implementation team and has been working with an external vendor regarding the development of a CECL-compliant model and gathering of the requisite data. At this time, management is still evaluating the impact of the standard.

NOTE 2 - CASH AND CASH EQUIVALENTS

The Bank is required to maintain an average daily reserve balance with the Federal Reserve Bank, or maintain such reserve balance in cash. The average daily reserve balance for the two-week maintenance period which encompassed December 31, 2017 and 2016 was $22,938 and $21,997, respectively.

(Continued)

(Dollars in thousands except per share data)

NOTE 3 - SECURITIES

The amortized cost and fair value of securities, available-for-sale are shown by contractual maturity. Expected maturities may differ from contractual maturities if borrowers have the right to call or prepay obligations with or without call or prepayment penalties. Amortized cost and fair values of securities, available-for-sale by maturity date, as of December 31, 2017:

	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value
December 31, 2017				
U.S. Treasury securities maturities:				
One to 5 years	$ 140,041	$ 31	$ 702	$ 139,370
Five to 10 years	1,968	-	13	1,955
Total	142,009	31	715	141,325
U.S. government-sponsored enterprises maturities:				
Within 1 year	138,572	199	275	138,496
One to 5 years	447,119	247	3,627	443,739
Five to 10 years	131,603	-	3,918	127,685
After 10 years	8,000	79	-	8,079
Total	725,294	525	7,820	717,999
States and political subdivisions maturities:				
Within 1 year	34,057	-	31	34,026
One to 5 years	153,044	340	745	152,639
Five to 10 years	85,562	397	995	84,964
After 10 years	56,497	355	202	56,650
Total	329,160	1,092	1,973	328,279
Mortgage-backed securities: residential	2,801	-	49	2,752
Mortgage-backed securities: commercial	79,986	-	716	79,270
Corporate bonds maturities:				
Within 1 year	29,791	1	15	29,777
One to 5 years	231,323	245	1,551	230,017
Five to 10 years	61,489	151	615	61,025
Total	322,603	397	2,181	320,819
Total securities, available-for-sale	$ 1,601,853	$ 2,045	$ 13,454	$ 1,590,444

(Continued)

(Dollars in thousands except per share data)

NOTE 3 - SECURITIES (Continued)

Within the state and political subdivisions category, the largest concentrations of securities, available-for-sale are held in Texas with 34%, Utah with 24%, and Hawaii with 14% of the category.

Gross unrealized losses on investment securities and the fair value of the related securities, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position, at December 31, 2017, were as follows:

	Less Than 12 Months		12 Months or More		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
2017						
Available-for-sale:						
U.S. Treasury	$ 72,074	$ 235	$ 44,593	$ 480	$ 116,667	$ 715
U.S. government-sponsored enterprises	201,820	792	356,242	7,028	558,062	7,820
States and political subdivisions	41,473	120	172,523	1,853	213,996	1,973
Mortgage-backed – residential	-	-	2,751	49	2,751	49
Mortgage-backed - commercial	79,270	716	-	-	79,270	716
Corporate bonds	68,072	235	166,074	1,946	234,146	2,181
Total	$ 462,709	$ 2,098	$ 742,183	$ 11,356	$1,204,892	$13,454

The unrealized holding losses on investments are the result of increasing interest rates. The contractual terms of these investments do not permit the issuer to redeem the securities at a price less than par, or at a time in which the securities amortized cost would be less than par. Unrealized losses on U.S. Treasury, U.S. government-sponsored enterprises, states and political subdivisions and corporate bonds have not been recognized into income because the issuer(s) bonds are of high credit quality, management does not intend to sell and it is likely that management will not be required to sell the securities prior to their anticipated recovery, and the decline in fair value is largely due to changes in interest rates and other market conditions. The fair value is expected to recover as the bonds approach maturity.

At December 31, 2017, all of the mortgage-backed securities held by the Bank were issued by U.S. government corporations (Ginnie Mae) or U.S. government-sponsored entities (Fannie Mae and Freddie Mac), institutions which the government has affirmed its commitment to support. Because the decline in fair value is attributable to changes in interest rates and illiquidity, and not credit quality, and because the Bank does not have the intent to sell these mortgage-backed securities and it is likely that it will not be required to sell the securities before their anticipated recovery, the Bank does not consider these securities to be other-than-temporarily impaired.

(Continued)

(Dollars in thousands except per share data)

NOTE 3 - SECURITIES (Continued)

The amortized cost and fair value of securities, available-for-sale are shown by contractual maturity. Amortized cost and fair values of securities, available-for-sale by maturity date, as of December 31, 2016:

	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value
December 31, 2016				
U.S. Treasury securities maturities:				
Within 1 year	$ 31,743	$ 127	$ -	$ 31,870
One to 5 years	164,492	938	195	165,235
Five to 10 years	29,879	-	249	29,630
Total	226,114	1,065	444	226,735
U.S. government-sponsored enterprises maturities:				
Within 1 year	94,079	471	5	94,545
One to 5 years	526,971	2,544	1,756	527,759
Five to 10 years	292,846	459	6,279	287,026
Total	913,896	3,474	8,040	909,330
States and political subdivisions maturities:				
Within 1 year	11,649	2	8	11,643
One to 5 years	169,370	71	1,245	168,196
Five to 10 years	107,132	9	2,622	104,519
After 10 years	10,399	-	560	9,839
Total	298,550	82	4,435	294,197
Mortgage-backed securities: residential	3,632	-	23	3,609
Corporate bonds maturities:				
Within 1 year	25,134	27	3	25,158
One to 5 years	220,751	580	1,479	219,852
Five to 10 years	67,953	67	1,472	66,548
Total	313,838	674	2,954	311,558
Total securities, available-for-sale	$ 1,756,030	$ 5,295	$ 15,896	$ 1,745,429

Within the state and political subdivisions category, the largest concentrations of securities, available-for-sale are held in Texas with 31%, Utah with 29%, and Alaska with 18% of the category.

(Dollars in thousands except per share data)

NOTE 3 - SECURITIES (Continued)

Gross unrealized losses on investment securities and the fair value of the related securities, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position, at December 31, 2016, were as follows:

	Less Than 12 Months		12 Months or More		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
2016						
Available-for-sale:						
U.S. Treasury	$ 19,691	$ 316	$ 34,835	$ 128	$ 54,526	$ 444
U.S. government-sponsored enterprises	254,849	7,417	197,154	623	452,003	8,040
States and political subdivisions	202,092	4,165	32,292	270	234,384	4,435
Mortgage-backed - residential	-	-	3,609	23	3,609	23
Corporate bonds	134,243	2,731	58,322	223	192,565	2,954
Total	$ 610,875	$ 14,629	$ 326,212	$ 1,267	$ 937,087	$ 15,896

Investment securities with carrying amounts of $1,099,366 and $1,054,297 at December 31, 2017 and 2016, respectively, were pledged to secure public and trust deposits, securities sold under agreements to repurchase, and for other purposes as required or permitted by law.

Realized gains on the disposition of investment securities totaled $315 and $1,406 in 2017 and 2016, respectively. Realized losses on the disposition of investment securities were $1,243 and $2 for 2017 and 2016, respectively.

NOTE 4 - LOANS

The loan portfolio consists of the following at December 31:

	2017	2016
Commercial and industrial	$ 381,499	$ 321,575
Real estate construction	243,087	290,389
Real estate mortgage	292,289	281,853
Real estate commercial	878,276	763,986
Consumer and other	20,033	19,792
Loans, gross	$ 1,815,184	$ 1,677,595

There were unamortized premiums of $3,171 and $1,508 from purchased government guaranteed loans and multifamily real estate loans as of December 31, 2017 and 2016, respectively. The Bank purchased $55,262 and $43,473 of government guaranteed loans in 2017 and 2016, respectively. The government guaranteed loan balances were $95,908 and $42,974 as of December 31, 2017 and 2016, respectively. Government guaranteed loans are included in commercial and industrial loans. Multifamily loans are included in real estate mortgage.

(Continued)

(Dollars in thousands except per share data)

NOTE 4 - LOANS (Continued)

Real estate loans serviced for others as of December 31, 2017 and 2016 were $1,219,163 and $1,238,020, respectively. Custodial balances, associated with these loans and held in noninterest bearing demand accounts, amounted to $9,100 and $9,750 as of December 31, 2017 and 2016, respectively.

As of December 31, 2017 and 2016 the aggregate indebtedness of all related parties (directors and executive officers of the Bank and their family members) was $12,891 and $11,930, respectively.

NOTE 5 - ALLOWANCE FOR LOAN LOSSES

The following is an analysis of the changes in the allowance for loan losses by portfolio segment for the period ended:

	Commercial and Industrial	Real Estate	Consumer and Other	Total
2017				
Allowance for loan losses:				
Beginning balance, January 1, 2017	$ 3,334	$ 12,916	$ 350	$ 16,600
Provision for loan losses	1,547	949	90	2,586
Loans charged-off	(1,294)	(228)	(223)	(1,745)
Recoveries	128	73	183	384
Ending Balance, December 31, 2017	$ 3,715	$ 13,710	$ 400	$ 17,825
2016				
Allowance for loan losses:				
Beginning balance, January 1, 2016	$ 3,674	$ 11,102	$ 374	$ 15,150
Provision for loan losses	440	1,887	95	2,422
Loans charged-off	(907)	(91)	(215)	(1,213)
Recoveries	127	18	96	241
Ending Balance, December 31, 2016	$ 3,334	$ 12,916	$ 350	$ 16,600

(Continued)

(Dollars in thousands except per share data)

NOTE 5 - ALLOWANCE FOR LOAN LOSSES (Continued)

The following table presents the balance in the allowance for loan losses and the recorded investment in loans by portfolio segment and based on impairment method as of December 31, 2017 and 2016:

2017	Commercial and Industrial	Real Estate	Consumer and Other	Total
Allowance for loan losses:				
Ending allowance balance attributable to loans:				
Individually evaluated for impairment	$ 100	$ 1,175	$ -	$ 1,275
Collectively evaluated for impairment	3,615	12,535	400	16,550
Total ending allowance balance	$ 3,715	$ 13,710	$ 400	$ 17,825
Loans:				
Individually evaluated for impairment	$ 2,600	$ 19,223	$ 16	$ 21,839
Collectively evaluated for impairment	380,245	1,402,157	19,976	1,802,378
Total loans outstanding balance	$ 382,845	$ 1,421,380	$ 19,992	1,824,217
Deferred loan fees, net				(9,033)
Total loans				$ 1,815,184

2016	Commercial and Industrial	Real Estate	Consumer and Other	Total
Allowance for loan losses:				
Ending allowance balance attributable to loans:				
Individually evaluated for impairment	$ 120	$ 580	$ -	$ 700
Collectively evaluated for impairment	3,214	12,336	350	15,900
Total ending allowance balance	$ 3,334	$ 12,916	$ 350	$ 16,600
Loans:				
Individually evaluated for impairment	$ 540	$ 19,394	$ -	$ 19,934
Collectively evaluated for impairment	321,110	1,324,058	19,741	1,664,909
Total loans outstanding balance	$ 321,650	$ 1,343,452	$ 19,741	1,684,843
Deferred loan fees, net				(7,248)
Total loans				$ 1,677,595

(Continued)

(Dollars in thousands except per share data)

NOTE 5 - ALLOWANCE FOR LOAN LOSSES (Continued)

The following table summarizes our nonaccrual loans and loans past due by loan class as of December 31, 2017 and 2016:

	30-89 Days Past Due	Greater Than 89 Days Past Due	Total Past Due	Current	Total Loans	Non-accrual
December 31, 2017						
Commercial and industrial	$ 926	$ 140	$ 1,066	$ 381,779	$ 382,845	$ 2,070
Real Estate						
Construction and development	1,399	173	1,572	243,655	245,227	306
1– 4 and multifamily residential	5,924	40	5,964	287,115	293,079	153
Commercial real estate	4,522	188	4,710	878,364	883,074	6,406
Consumer and other	59	-	59	19,933	19,992	-
Total	$ 12,830	$ 541	$ 13,371	$ 1,810,846	1,824,217	8,935
Deferred loan fees, net					(9,033)	(47)
Total loans					$ 1,815,184	$ 8,888
December 31, 2016						
Commercial and industrial	$ 1,219	$ 312	$ 1,531	$ 320,119	$ 321,650	$ 535
Real Estate						
Construction and development	104	26	130	292,407	292,537	475
1– 4 and multifamily residential	1,856	304	2,160	280,514	282,674	555
Commercial real estate	2,602	3,611	6,213	762,028	768,241	6,655
Consumer and other	58	-	58	19,683	19,741	-
Total	$ 5,839	$ 4,253	$ 10,092	$ 1,674,751	1,684,843	8,220
Deferred loan fees, net					(7,248)	(39)
Total loans					$ 1,677,595	$ 8,181

Loans greater than 89 days past due and accruing are $0 and $239 at December 31, 2017 and 2016, respectively.

(Continued)

(Dollars in thousands except per share data)

NOTE 5 - ALLOWANCE FOR LOAN LOSSES (Continued)

The following table presents information related to impaired loans, net of deferred fees, by class of loans as of December 31, 2017:

December 31, 2017	Unpaid Principal Balance	Recorded Investment	Allowance for Loan Losses Allocated	Average Recorded Investment	Interest Income Recognized	Cash Basis Interest Recognized
With no allowance recorded:						
Commercial and industrial	$ 2,834	$ 2,529	$ -	$ 1,476	$ 185	$ 239
Real estate						
Construction and other	1,055	823	-	752	59	61
1-4 and multifamily residential	1,362	1,310	-	1,316	100	102
Commercial real estate	10,987	9,791	-	9,786	707	730
Consumer and other	-	-	-	-	-	-
Subtotal	16,238	14,453	-	13,330	1,051	1,132
With an allowance recorded:						
Commercial and industrial	153	152	100	82	12	14
Real estate						
Construction and other	2,694	2,091	600	1,464	166	161
1-4 and multifamily residential	2,177	2,125	225	1,885	137	136
Commercial real estate	3,151	2,915	350	2,899	175	173
Consumer and other	16	16	-	8	2	2
Subtotal	8,191	7,299	1,275	6,338	492	486
Total	$ 24,429	$ 21,752	$ 1,275	$ 19,668	$ 1,543	$ 1,618

(Continued)

(Dollars in thousands except per share data)

NOTE 5 - ALLOWANCE FOR LOAN LOSSES (Continued)

The following table presents information related to impaired loans, net of deferred fees, by class of loans as of December 31, 2016:

December 31, 2016	Unpaid Principal Balance	Recorded Investment	Allowance for Loan Losses Allocated	Average Recorded Investment	Interest Income Recognized	Cash Basis Interest Recognized
With no allowance recorded:						
Commercial and industrial	$ 675	$ 382	$ -	$ 313	$ 44	$ 22
Real estate						
Construction and other	1,757	1,259	-	1,113	71	52
1-4 and multifamily residential	1,661	1,581	-	1,385	74	74
Commercial real estate	12,272	11,068	-	9,771	683	442
Consumer and other	-	-	-	-	-	-
Subtotal	16,365	14,290	-	12,582	872	590
With an allowance recorded:						
Commercial and industrial	162	151	120	87	1	1
Real estate						
Construction and other	1,565	838	80	822	219	98
1-4 and multifamily residential	1,720	1,665	200	1,691	109	106
Commercial real estate	3,078	2,883	300	2,921	258	127
Consumer and other	-	-	-	-	-	-
Subtotal	6,525	5,537	700	5,521	587	332
Total	$ 22,890	$ 19,827	$ 700	$ 18,103	$ 1,459	$ 922

(Continued)

(Dollars in thousands except per share data)

NOTE 5 - ALLOWANCE FOR LOAN LOSSES (Continued)

The Bank categorizes loans into risk categories based on relevant information about the ability of borrowers to service their debt such as: current financial information, historical payment experience, credit documentation, public information, and current economic trends, among other factors. The Bank analyzes loans individually by classifying loans as to credit risk. Formal analysis of classified loans is performed quarterly, including all loans 60 days delinquent. Ongoing evaluation of certain performing loans is conducted through internal credit examinations and loan committee reviews.

The Bank uses the following definitions for risk ratings:

Pass/Watch: Loans classified as pass/watch include current loans performing in accordance with contractual terms, pools of homogenous residential real estate and installment/consumer loans that are not individually risk rated and loans which exhibit certain risk factors that require greater than usual monitoring by management.

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

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

Doubtful/Loss: Loans classified as doubtful/loss 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 existing facts, conditions, and values, highly questionable and improbable.

The following table summarizes our internal risk rating by loan class based on the most recent analysis performed as of December 31, 2017 and 2016:

	Pass/ Watch	Special Mention	Sub- Standard	Doubtful/ Loss	Total
December 31, 2017					
Commercial and Industrial	$ 379,010	$ 882	$ 2,870	$ 83	$ 382,845
Real Estate,					
Construction and development	240,902	253	4,072	-	245,227
1-4 and multifamily residential	285,468	915	6,682	14	293,079
Commercial real estate	866,175	3,627	13,015	257	883,074
Consumer and other	19,976	-	-	16	19,992
Total	$ 1,791,531	$ 5,677	$ 26,639	$ 370	1,824,217
Deferred loan fees, net					(9,033)
Total					$ 1,815,184

(Dollars in thousands except per share data)

NOTE 5 - ALLOWANCE FOR LOAN LOSSES (Continued)

	Pass/ Watch	Special Mention	Sub-Standard	Doubtful/ Loss	Total
December 31, 2016					
Commercial and Industrial	$ 318,163	$ 2,405	$ 927	$ 155	$ 321,650
Real Estate					
Construction and development	290,033	321	2,183	-	292,537
1-4 and multifamily residential	274,281	1,438	6,955	-	282,674
Commercial real estate	753,041	987	14,084	129	768,241
Consumer and other	19,709	27	5	-	19,741
Total	$ 1,655,227	$ 5,178	$ 24,154	$ 284	1,684,843
Deferred loan fees, net					(7,248)
Total					$ 1,677,595

Troubled Debt Restructurings:

At December 31, 2017 and 2016, the Bank had loans of $16,708 and $16,742 classified as troubled debt restructurings, respectively, which are included in impaired loans. These loans had allocated specific reserves of $396 and $632 at December 31, 2017 and 2016, respectively. The Bank has committed to lend $30 and $134 as of December 31, 2017 and 2016, respectively, to customers with outstanding loans that are classified as troubled debt restructurings.

During the year ended December 31, 2017, the terms of certain loans were modified as troubled debt restructurings. The modification of the terms of such loans included one or a combination of the following: an extension of the maturity date at a stated rate of interest lower than the current market rate for new debt with similar risk or a temporary deferral of all or part of the original periodic principal payments.

Commercial loans: There were no restructuring of commercial loan stated interest rates. There were two maturity date extensions of 4 years. The temporary deferrals of all or part of the scheduled principal payments were for periods ranging from 4 years to 8.6 years.

Commercial real estate loans: There was one restructuring of a commercial real estate loan stated interest rate for 15 years and its maturity date was extended 7 years and deferrals of all or part of the loan’s scheduled principal payments were for 15 years.

Consumer loans: There was one restructuring of a consumer loan stated interest rate for 2 months and its maturity date extension of 3 months and deferrals of all or part of the loan’s scheduled principal payments were for 2 months.

There were no restructurings of construction loans and 1-4 and multifamily residential loans.

NOTE 5 - ALLOWANCE FOR LOAN LOSSES (Continued)

During the year ended December 31, 2016, the terms of certain loans were modified as troubled debt restructurings. The modification of the terms of such loans included one or a combination of the following: an extension of the maturity date at a stated rate of interest lower than the current market rate for new debt with similar risk or a temporary deferral of all or part of the original periodic principal payments.

Commercial loans: There were no restructurings of commercial loans stated interest rates. There were no extensions of maturity dates, but temporary deferrals of all or part of the scheduled principal payments were for periods ranging from 4 years to 9 years.

1-4 and multifamily residential loans: There were no restructurings of commercial real estate loans stated interest rates. Extensions of maturity dates were for periods ranging from 2 months to 7 years and temporary deferrals of all or part of the scheduled principal payments were for periods ranging from 2 years to 13 years.

Commercial real estate loans: There was one restructuring of a commercial real estate loan stated interest rate for 8 years. There was one maturity date extension of 6 months and deferrals of all or part of the loan’s scheduled principal payments were for periods ranging from 4 years to 8 years.

There were no restructurings of commercial and consumer loans.

(Dollars in thousands except per share data)

NOTE 5 - ALLOWANCE FOR LOAN LOSSES (Continued)

The following table presents loans by class modified as troubled debt restructurings that occurred during the years ended December 31, 2017 and 2016:

	Number of Loans	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment
2017 Troubled Debt Restructurings:			
Commercial	2	$ 266	$ 266
Real estate:			
Construction and other	-	-	-
1-4 and multifamily residential	-	-	-
Commercial real estate	1	576	508
Consumer and other	1	16	-
Total	4	$ 858	$ 774
2016 Troubled Debt Restructurings:			
Commercial	2	$ 241	$ 241
Real estate:			
Construction and other	-	-	-
1-4 and multifamily residential	3	306	306
Commercial real estate	2	1,968	1,968
Consumer and other	-	-	-
Total	7	$ 2,515	$ 2,515

The troubled debt restructurings described in the above table had allocated specific reserves of $85 and $105 as of December 31, 2017 and 2016 and resulted in no charge-offs during the years ended December 31, 2017 and 2016.

There were no loans that defaulted (became at least 60 days past due) during December 31, 2017 after having been modified as a troubled debt restructuring within the previous 12 months. There was one commercial real estate loan with a recorded investment of $71 that defaulted during December 31, 2016 after having been modified as a troubled debt restructuring within the previous 12 months.

The troubled debt restructurings that subsequently defaulted did not have a specific reserve as of December 31, 2017 and 2016 and resulted in no charge-offs during the years ended December 31, 2017 and 2016.

In order to determine whether a borrower is experiencing financial difficulty, an evaluation is performed of the probability that the borrower will be in payment default on any of its debt in the foreseeable future without the modification. This evaluation is performed under the Bank’s internal underwriting policy.

(Dollars in thousands except per share data)

NOTE 6 - PREMISES AND EQUIPMENT

The following is a summary of the major components of premises and equipment as of December 31:

	2017	2016
Land	$ 13,898	$ 13,898
Bank premises	78,222	76,468
Leasehold improvements	122	219
Furniture and equipment	33,797	32,742
Construction in process	1,026	633
Total premises and equipment	127,065	123,960
Less: Accumulated depreciation and amortization	77,564	74,724
Premises and equipment, net	$ 49,501	$ 49,236

Depreciation and amortization expense on premises and equipment for the years ended December 31, 2017 and 2016 totaled $3,667 and $3,726, respectively.

NOTE 7 - OTHER REAL ESTATE OWNED

The following is an analysis of the changes in other real estate owned:

	2017	2016
Balance, January 1	$ 17,103	$ 19,975
Acquired upon foreclosure	404	546
Capitalized improvements	85	225
Dispositions	(2,178)	(3,491)
Depreciation	(147)	(152)
Balance, December 31	15,267	17,103
Less Devaluation Reserves:		
Balance, January 1	(4,881)	(2,907)
Impairments subsequent to foreclosure	(757)	(2,490)
Dispositions	246	516
Balance, December 31	(5,392)	(4,881)
Other real estate owned, net	$ 9,875	$ 12,222

Net gains on sales of other real estate owned included in other noninterest expense for the years ended December 31, 2017 and 2016, totaled $143 and $184, respectively. Operating expenses, net of rental income totaled $198 and $43 for the years ended December 31, 2017 and 2016, respectively.

(Dollars in thousands except per share data)

NOTE 8 - MORTGAGE SERVICING RIGHTS

The following is an analysis of the changes in mortgage servicing rights:

	2017	2016
Balance, January 1,	$ 3,146	$ 3,254
Additions -		
Capitalization of servicing assets	1,080	1,489
Subtractions:		
Amortization	(1,146)	(1,176)
Accelerated amortization due to early payoffs	(255)	(421)
Balance, December 31,	$ 2,825	$ 3,146

Mortgage loan servicing income is comprised of the following:

	2017	2016
Mortgage loan servicing fees	$ 3,390	$ 3,414
Amortization of costs	(1,146)	(1,176)
Accelerated amortization due to early payoffs	(255)	(421)
Mortgage loan servicing income	$ 1,989	$ 1,817

Mortgage servicing rights (MSRs) are accounted for under the amortization method. MSRs are included in other assets. MSRs are initially recorded at estimated fair value and are then amortized in proportion to and over the period of estimated net servicing income. The fair value of MSRs is estimated at the present value of the estimated expected future cash flows using a discount rate equivalent with the risks involved. MSRs are amortized against mortgage loan servicing income over seven years based upon prepayment assumptions. Those prepayment assumptions predict mortgages will pay off or refinance at lower levels during the first 30 months and at a constant level over the remaining 54 months. Accordingly, MSRs are amortized against mortgage loan servicing income at higher levels during the initial 30 months. If actual payments received exceed the prepayment assumptions, an impairment is recorded. An impairment of $0 and $94 has been recorded for 2017 and 2016, respectively.

NOTE 9 - DEPOSITS

Total deposits by type of depositor as of December 31:

	2017	2016
Deposits of individuals, partnerships, and corporations	$ 2,385,844	$ 2,401,745
Deposits of U.S. government	817	828
Deposits of states and political subdivisions	51,041	72,936
Other deposits	115	166
Total deposits	$ 2,437,817	$ 2,475,675

(Dollars in thousands except per share data)

NOTE 9 – DEPOSITS (Continued)

As of December 31, 2017 and 2016 the aggregate deposits of related parties (directors and executive officers of the Bank and their family members) were $10,692 and $14,317, respectively.

Time deposits have aggregate maturities as of December 31 as follows:

Maturity:	2016
2018	115,859
2019	7,312
2020	2,936
2021	2,722
2022	2,898
Total time deposits	$ 131,727

Time deposits that meet or exceed the FDIC Insurance Limit of $250 were $55,942 and $57,458 as of December 31, 2017 and 2016, respectively.

NOTE 10 - SECURITIES SOLD UNDER AGREEMENTS TO REPURCHASE

Investment securities, primarily including U.S. Treasuries and U.S. government-sponsored enterprises, with carrying amounts of $885,174 and $784,195 at December 31, 2017 and 2016, respectively, were pledged to secure securities sold under agreements to repurchase. As of December 31, 2017 all repurchase agreements matured within 1 business day.

As of December 31, 2017 and 2016, aggregate repurchase agreement balances of related parties (directors and executive officers of the Bank and their family members) were $909 and $3,254, respectively.

NOTE 11 - LEASES

The Bank is party to various operating leases for the rental of premises and equipment. Total rental expenses for Bank premises and equipment were $322 and $326 as of December 31, 2017 and 2016, respectively.

In 2017, the Bank entered into an obligation for a capital lease covering mail equipment. The gross amount of mail equipment, including installation costs, and related accumulated amortization under the capital lease was $358 and $113 as of December 31, 2017. Amortization of assets held under capital leases is included with depreciation expense.

(Dollars in thousands except per share data)

NOTE 11 – LEASES (Continued)

Aggregate minimum rental commitments under noncancelable operating leases (with initial or remaining lease terms in excess of one year) and future minimum capital lease payments as of December 31, 2017 were:

	Capital Leases	Operating Leases
Year ended December 31:		
2018	$ 72	$ 132
2019	72	84
2020	72	78
2021	72	78
2022	11	78
Thereafter	-	3,445
Total minimum lease payments	$ 299	$ 3,895

NOTE 12 - SHAREHOLDERS' EQUITY

Since November 2008 the Bank has been authorized to repurchase up to a value of $100,000 of its outstanding common stock on the open market and through privately negotiated transactions. The original program term expired in August 2009 and has been renewed annually since that period. The existing authority expires March 13, 2018.

Repurchase transactions are accounted for as a reduction in common stock and retained earnings. Repurchases are funded from available capital and retired. These transactions have not impacted the surplus balance of $40,000 as of December 31, 2017 and 2016, which is maintained to comply with regulatory requirements. Changes to surplus require regulatory approval.

During 2017, the Bank repurchased a total of 56 shares of common stock representing an aggregate purchase value of $98, at an average price per share of $1,741. During 2016, the Bank repurchased a total of 1,294 shares of common stock representing an aggregate purchase value of $1,835, at an average price per share of $1,418. Cumulative shares of 27,676 have been repurchased under the program since inception for a combined purchase total of $44,596.

On December 21, 2017, the Board of Directors adopted and approved resolutions to effect a forward split of all issued and outstanding shares of the bank's common stock at a ratio of 10-for-1 subject to the approval of the bank's shareholders on April 24, 2018.

At the January 25, 2018 Board of Directors meeting, cash dividends of $25 per share were declared, payable March 15, 2018 to shareholders of record as of March 1, 2018.

NOTE 13 - LITIGATION

From time to time in the normal course of business, various claims are asserted against the Bank. Management and legal counsel are of the opinion that ultimate resolution of the matters presently known to exist will not have a material effect on the Bank’s financial statements.

The Bank’s payment services include acquisition of Visa credit card transactions from merchants who use the Bank’s merchant services. In order to be able to acquire those transactions the Bank is a member of the Visa U.S.A. credit card association.

During 2004, Discover Financial Services, Inc. filed an action against Visa U.S.A. and others seeking treble damages and injunctive relief under Federal antitrust laws. Also in 2004, American Express Travel Related Services Company, Inc. filed a similar action against Visa U.S.A. and others. There was other related litigation as well.

During 2007, Visa closed a restructuring of its organization. As part of this reorganization, the Visa U.S.A. by-laws were amended and included an indemnification provision whereby the Bank, as a member of Visa U.S.A., is required to indemnify Visa for acts and omissions of the Bank related to the Visa network and for certain specified litigation involving Visa U.S.A. An escrow arrangement was established anticipating the use of escrowed funds to pay the amount of certain Visa U.S.A. litigation expenses and settlements, including the Discover and American Express cases discussed above. Consequently, under ASC Topic 460, the Bank was required to measure the indemnification obligation related to the Visa litigation at fair value.

In late 2007 and 2008, respectively, Visa Inc., Visa U.S.A. and Visa International entered into agreements with American Express and Discover Financial Services to resolve all current litigation between them. Under the agreements Visa Inc. agreed to pay American Express $2,065,000 and $1,888,000 to Discover Financial Services. The Bank’s membership proportion according to the number of shares it was issued upon restructuring is 0.02331% after share repurchase adjustments.

The Bank has carried reserves for litigation expense for proportional exposure under these matters deemed covered litigation by VISA Inc. since 2007. The reserve is $1,500 as of December 31, 2017 and 2016. The Bank has not recorded in its financial statements any value for its membership interest in Visa Inc.

The Bank has a $1,500 escrow receivable as of December 31, 2017 and 2016, respectively, representing the Bank’s proportionate share of remaining escrowed funds Visa set aside to the purpose of settling these litigation claims.

The specified litigation discussed above includes outstanding unresolved claims against Visa U.S.A., which are complex and subject to substantial uncertainty and unspecified damages. As such, the ultimate outcome of the cases and corresponding indemnification may be significantly different than the value estimated in the December 31, 2017 financial statements.

(Dollars in thousands except per share data)

NOTE 14 - EMPLOYEE BENEFIT PLANS

The bank offers a 401(k) plan for all employees whom have attained 18 years of age. Participants are allowed to make voluntary salary deferral of up to 50% of their eligible pay subject to certain limitations. For 2017, the maximum amount that may be deferred by participants is $18. Additionally, participants who reach the age of 50 by the end of the calendar year are eligible to make a “catch-up contribution” in an amount up to $6. The participant’s salary deferral plus any earnings they generate are 100% vested.

The bank will make matching contributions equal to 50% of the portion of each participant’s before-tax contributions (excluding “catch-up contributions”) that do not exceed 7.5% of the participant’s eligible pay. Matching contributions made by the bank, including any earnings generated, are vested beginning at 20% after completion of one full year of service, increasing 20% each year until fully vested at five years of service. The 2017 combined limit of all employee and employer contributions to an individual participant’s account is $54.

The bank has a qualified non-contributory profit sharing plan for all employees. The annual profit sharing contribution can be made only from profits and the amount is determined by the Board of Directors.

The contribution to the profit sharing and 401(k) plan was $1,500 for each of the years ended December 31, 2017 and 2016.

NOTE 15 - PROVISION FOR INCOME TAXES

The provision for income taxes is comprised of the following as of December 31:

	2017	2016
Current:		
Federal	$ 20,364	$ 17,975
State	3,203	3,011
Total current	23,567	20,986
Deferred:		
Federal	(2,585)	(531)
Deferred expense from Federal tax reform	4,744	-
State	(602)	(93)
Total deferred	1,557	(624)
Provision for income taxes	$ 25,124	$ 20,362

(Dollars in thousands except per share data)

NOTE 15 - PROVISION FOR INCOME TAXES (Continued)

Income tax expense differed from the Federal statutory rate of 35% for 2017 and 2016 for the following reasons:

	2017	%	2016	%
Tax expense at federal statutory rate	$ 21,543	35.00%	$ 21,614	35.00%
Increase (decrease) resulting from:				
State tax, net of Federal tax effect	2,010	3.27	1,902	3.08
Disallowed interest expense	118	0.19	56	0.09
Interest exempt from federal taxation	(2,451)	(3.98)	(2,247)	(3.64)
Low income housing tax credits	(957)	(1.55)	(998)	(1.62)
Deferred tax writedown from change in Federal tax rate	4,744	7.71	-	-
Other items, net	117	0.19	35	0.06
Provision for income taxes	$ 25,124	40.83%	$ 20,362	32.97%

The tax effect of temporary differences that give rise to the Bank's deferred tax assets and deferred tax liabilities are comprised of the following:

	2017	2016
Deferred tax assets:		
Allowance for loan losses	$ 5,067	$ 6,824
Mortgage servicing rights	315	397
Interest collected on nonperforming loans	854	1,422
Vacation accrual	975	1,375
Accumulated depreciation and amortization	1,008	1,437
Other real estate owned valuation reserve	2,157	2,899
Net unrealized holding loss on securities, available-for-sale	3,243	4,358
Low income housing projects	345	52
Other	399	766
Total deferred tax assets	14,363	19,530
Deferred tax liabilities:		
Net deferred loan fees	2,450	3,752
Deferred loan costs	545	1,276
Other	732	1,194
Total deferred tax liabilities	3,727	6,222
Net deferred tax assets	$ 10,636	$ 13,308

Net deferred tax assets are included in other assets in the statements of financial condition. Net deferred tax liabilities are included in other liabilities in the statements of financial condition. The Bank believes that it is more likely than not that the previous taxes paid and results of future operations will generate sufficient taxable income to realize deferred tax assets.

NOTE 15 - PROVISION FOR INCOME TAXES (Continued)

During December 2017, the Tax Cuts and Jobs Act (the Act) was signed into law, which reduces the Bank's federal tax rate from 35% to 21% effective in 2018. The Bank was required to re-measure, through income tax expense, its deferred tax assets and liabilities using the enacted tax rate, the rate that deferred taxes are expected to be recovered or settled. This re-measurement of the deferred taxes resulted in additional provision for income taxes of $4,744 during 2017. The Company also early adopted ASU 2018-02 and reclassified out of accumulated other comprehensive loss and into retained earnings $1,447 of tax benefit due to re-measuring the deferred tax assets on securities available for sale.

As a further result of the Act, the Bank was required to re-measure their investment in certain community development projects at the new, lower federal tax rate. As a result of the re-measurement, the Bank recognized impairment expense of $620 within Other Interest Expense on the Statement of Income.

The Bank does not have any material uncertain tax positions or unrecognized tax benefits for additional disclosure in the financial statements.

The total amount of interest and penalties recorded in the income statement for the years ended December 31, 2017 and 2016 were immaterial and no amounts are accrued for interest and penalties at December 31, 2017 or 2016.

The Bank is subject to U.S. federal income tax as well as income tax for the state of Alaska and various other state income and franchise taxes. The Bank is no longer subject to examination by taxing authorities for years before 2014.

The Bank had purchased, at a discount, tax credits under the Alaska Film Production Incentive Program, which awards transferable tax credits to film producers who choose to film in Alaska. These credits can be used towards the Bank's State of Alaska tax liability and are fully negotiable and assignable for up to three years from the date of issuance. The Bank anticipates fully utilizing the credits against a portion of its State of Alaska tax liability. The Bank used $428 and $152 of the Alaska film tax credits as of December 31, 2017 and 2016, respectively, to offset its State of Alaska tax obligations. As of December 31, 2017, there was $0 in remaining tax credits.

NOTE 16 - ESTIMATED FAIR VALUE OF FINANCIAL INSTRUMENTS

GAAP requires disclosure of the estimated fair values of certain financial assets and liabilities, both on and off-balance sheet, for which it is practical to estimate the fair value. Because the estimated fair values provided herein exclude disclosure of the fair value of certain other financial instruments and all non-financial instruments, any aggregation of the estimated fair value amounts presented would not represent the underlying value of the Bank. Examples of non-financial instruments having significant value include the future earnings potential of significant customer relationships and the value of the Bank's trust department operations and other fee-generating businesses. In addition, other significant assets including property, plant, and equipment and mortgage servicing rights for portfolio loans are not considered financial instruments and, therefore, have not been valued.

NOTE 16 - ESTIMATED FAIR VALUE OF FINANCIAL INSTRUMENTS (Continued)

Various methodologies and assumptions have been utilized in management's determination of the estimated fair value of the Bank's financial instruments, which are detailed below. The fair value estimates are made at a discrete point in time based on relevant market information. Because no market exists for a significant portion of these financial instruments, fair value estimates are based on judgments regarding future expected economic conditions, loss experience, and risk characteristics of the financial instruments. These estimates are subjective, involve uncertainties, and cannot be determined with precision. Changes in assumptions could significantly affect the estimates. In addition to the valuation methodology explained above for financial instruments recorded at fair value, the following methods and assumptions were used in estimating the fair value of financial instruments that are carried at cost in the Statements of Condition as of December 31, 2017 and 2016:

Cash and Cash Equivalents: The carrying amount is a reasonable estimate of the fair value.

Securities, Available-for-Sale: Where quoted prices are available in an active market for identical securities, they are utilized. If quoted market prices are not available, then fair values are estimated by using pricing models and quoted prices of securities with similar characteristics.

Real Estate Loans To Be Sold: The carrying amount plus unearned loan fees is a reasonable estimate of the fair value as it reflects the short-term nature of the commitment and a commitment to sell at a fixed price.

Loans: The fair value is estimated by discounting the future scheduled cash flows using the current rates at which similar loans with similar maturities would be made to similar borrowers plus unearned income. The fair value of delinquent and nonaccrual loans are estimated on an individual basis, taking into account management's estimate of probable losses associated with the loan, and discounting the estimated future cash flows using current rates for similar maturities. The fair value does not necessarily represent an exit price.

Federal Reserve Bank (FRB) and Federal Home Loan Bank (FHLB) of Des Moines Stock: The stock is required to be sold back at its par value. It is not practicable to determine the fair value of FRB or FHLB stock due to restrictions placed on transferability.

Interest Receivable: The carrying amount is a reasonable estimate of the fair value.

Deposits: The carrying value of demand deposits, savings accounts, NOW accounts and money market accounts approximates fair value.

Time Deposits: The fair value is estimated by discounting the future cash flows using rates currently offered for time deposits of similar remaining maturities, which are based on an observation and evaluation of current market rates.

Securities Sold Under Agreements to Repurchase: The carrying amount is a reasonable estimate of the fair value.

Notes Payable and Capital Leases: The carrying amounts are reasonable estimates of the fair value of notes payable and capital leases.

Interest Payable: The carrying amount is a reasonable estimate of the fair value.

(Dollars in thousands except per share data)

NOTE 16 - ESTIMATED FAIR VALUE OF FINANCIAL INSTRUMENTS (Continued)

The fair value estimates presented herein are based on pertinent information available to management as of December 31, 2017 and 2016. Although management is not aware of any factors that would significantly affect the estimated fair value amounts, such amounts have not been comprehensively revalued for purposes of these financial statements since that date, and current estimates of fair value may differ significantly from the amounts presented herein.

Amounts and estimated fair value of financial instruments as of December 31,

	2017		2016	
	Carrying Amount	Estimated Fair Value	Carrying Amount	Estimated Fair Value
Financial assets:				
Cash and cash equivalents	$ 134,051	$ 134,051	$ 79,127	$ 79,127
Securities, available-for-sale	1,590,444	1,590,444	1,745,429	1,745,429
Real estate loans to be sold	16,036	16,240	12,089	12,145
Loans:				
Commercial and industrial	377,784	367,148	318,241	316,330
Real estate	1,399,942	1,321,657	1,323,312	1,325,689
Consumer and other	19,633	20,548	19,442	18,901
Total loans, net	1,797,359	1,709,353	1,660,995	1,660,920
Federal Reserve Bank stock	2,151	N/A	2,155	N/A
Federal Home Loan Bank stock	4,332	N/A	4,283	N/A
Interest receivable	16,702	16,702	16,603	16,603
Financial liabilities:				
Deposits:				
Non-interest bearing	1,231,762	1,231,762	1,306,357	1,306,357
Interest bearing:				
Savings	692,712	692,712	665,791	665,791
NOW	200,395	200,395	207,270	207,270
Money market	181,221	181,221	159,044	159,044
Time	131,727	132,717	137,213	138,319
Total interest bearing	1,206,055	1,207,045	1,169,318	1,170,424
Total deposits	2,437,817	2,438,807	2,475,675	2,476,781
Securities sold under agreements to repurchase	687,064	687,064	629,966	629,966
Notes payable and capital lease obligations	299	299	9	9
Interest payable	112	112	85	85

NOTE 16 - ESTIMATED FAIR VALUE OF FINANCIAL INSTRUMENTS (Continued)

In accordance with ASC Topic 820, we measure some of the financial assets and financial liabilities disclosed in the following tables at fair value in three levels based on the markets in which the assets and liabilities are traded and reliability of the assumptions used to determine fair value. The levels are:

Level 1 Valuations for assets and liabilities traded in active exchange markets, or interest in open-end mutual funds that allow the Bank to sell its ownership interest back to the fund at net asset value (NAV) on a daily basis. Valuations are obtained from readily available pricing sources for market transactions involving identical assets, liabilities, or funds. Level 1 includes U.S. Treasury Securities.

Level 2 Valuations for assets and liabilities traded in less active dealer, or broker markets, such as quoted prices for similar assets or liabilities or quoted prices in markets that are not active. Level 2 includes U. S. government-sponsored enterprises, securities of state and political subdivisions, residential mortgage-backed securities, and corporate bonds. Valuations are usually obtained from third party pricing services for identical or comparable assets or liabilities.

Level 3 Valuations for assets and liabilities that are derived from other valuation methodologies, such as option pricing models, discounted cash flow models and similar techniques, and not based on market exchange, dealer, or broker traded transactions. Level 3 valuations incorporate certain assumptions and projections in determining the fair value assigned to such assets or liabilities.

(Dollars in thousands except per share data)

NOTE 16 - ESTIMATED FAIR VALUE OF FINANCIAL INSTRUMENTS (Continued)

Assets measured at fair value on a recurring basis:

		Fair Value Measurements Using		
	Total	Quoted Prices in Active Markets For Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
2017				
Securities:				
U.S. Treasury securities	$ 141,325	$ 141,325	$ -	$ -
U.S. government-sponsored enterprises	717,999	-	717,999	-
States and political subdivisions	328,279	-	328,279	-
Mortgage-backed securities – residential	2,752	-	2,752	-
Mortgage-backed securities – commercial	79,270	-	79,270	-
Corporate bonds	320,819	-	320,819	-
Securities total	$ 1,590,444	$ 141,325	$ 1,449,119	$ -
2016				
Securities:				
U.S. Treasury securities	$ 226,735	$ 226,735	$ -	$ -
U.S. government-sponsored enterprises	909,330	-	909,330	-
States and political subdivisions	294,197	-	294,197	-
Mortgage-backed securities – residential	3,609	-	3,609	-
Corporate bonds	311,558	-	311,558	-
Securities total	$ 1,745,429	$ 226,735	$ 1,518,694	$ -

For investment securities, where quoted prices are available in an active market for identical securities they are classified within Level 1 of the valuation hierarchy. If quoted market prices are not available, then fair values are estimated by using pricing models and quoted prices of securities with similar characteristics and securities are classified as Level 2.

Where there is limited activity or less transparency around inputs to the valuation, investment securities are classified within Level 3 of the valuation hierarchy. No securities were classified as Level 3 during 2017 and 2016.

The majority of the Bank's investments are in high-quality short term U.S. Treasury, U.S. government-sponsored enterprise bonds where the fair values are determined by the Bank's pricing service using quoted prices of similar securities. As of December 31, 2017 the Bank had no investments in Fannie Mae or Freddie Mac common or preferred stock.

(Dollars in thousands except per share data)

NOTE 16 - ESTIMATED FAIR VALUE OF FINANCIAL INSTRUMENTS (Continued)

Assets measured at fair value on a nonrecurring basis:

	Total	Quoted Prices in Active Markets For Identical Assets Level 1	Significant Other Observable Inputs Level 2	Significant Unobservable Inputs Level 3
December 31, 2017				
Loans – Real estate	$ 5,956	$ -	$ -	$ 5,956
Other real estate owned – Construction and development	6,403	-	-	6,403
Total	$ 13,904	$ -	$ -	$ 13,904
December 31, 2016				
Loans – Real estate	$ 4,806	$ -	$ -	$ 4,806
Other real estate owned – Construction and development	7,671	-	-	7,671
Total	$ 14,562	$ -	$ -	$ 14,562

The fair value of impaired residential real estate loans is based on the value of the collateral securing those loans and is determined using the sale or market comparison. The market comparison evaluates the sales price of similar properties in the same market area. Impaired loans that are measured for impairment using the fair value of the collateral for collateral dependent loans resulted in an additional provision for loan losses of $739 and $350 for the years ended December 31, 2017 and 2016, respectively.

The fair value of other real estate owned is based upon the current appraised values of the properties. Appraisals are obtained at least annually and reductions in value are recorded as a valuation loss through a charge to expense. Other real estate owned measured at fair value less costs to sell resulted in write-downs of $701 and $2,022 for the years ended December 31, 2017 and 2016, respectively.

(Dollars in thousands except per share data)

NOTE 16 - ESTIMATED FAIR VALUE OF FINANCIAL INSTRUMENTS (Continued)

The following table presents quantitative information about level 3 fair value measurements for financial instruments measured at fair value on a nonrecurring basis at December 31, 2017 and 2016:

December 31, 2017	Fair value	Valuation Technique	Unobservable Input	Range (Weighted Average)
Loans – Real estate	$ 5,956	Sales comparison approach	Adjustment for differences between the comparable sales	-0.16% to -38.57% (-6.05%)
Other real estate owned – Construction and development	$ 6,403	Sales comparison approach	Adjustment for differences between the comparable sales	0.24% to -9.33% (-5.07%)

December 31, 2016	Fair value	Valuation Technique	Unobservable Input	Range (Weighted Average)
Loans – Real estate	$ 4,806	Sales comparison approach	Adjustment for differences between the comparable sales	-0.21% to -51.58% (-3.21%)
Other real estate owned – Construction and development	$ 7,671	Sales comparison approach	Adjustment for differences between the comparable sales	-3.27% to -12.57% (-6.26%)

ASC Topic 825 provides an option to selectively report financial assets and financial liabilities at fair value and establishes presentation and disclosure requirements. The Bank did not elect the fair value option for any additional financial assets or liabilities as of December 31, 2017. The Bank may adopt this guidance for financial assets and liabilities in the future as permitted under the guidance.

NOTE 17 - CREDIT ARRANGEMENTS

The Bank had a committed line of credit, secured by investment securities, of $64,540 and $65,733 from the Federal Reserve Bank at a rate of 2.00% and 1.25% as of December 31, 2017 and 2016, respectively. In addition, the Bank also had federal funds arrangements available from unaffiliated banks totaling $80,000 at a rate estimated at 1.64 – 2.00% and 0.64 – 0.70% as of December 31, 2017 and 2016 respectively. There were no outstanding balances against these lines of credit as of December 31, 2017 or 2016.

(Dollars in thousands except per share data)

NOTE 18 - COMMITMENTS AND CONTINGENCIES

The Bank is party to financial instruments with off-balance-sheet risk in the normal course of business to meet the financing needs of its customers. These instruments include standby letters of credit, loan commitments, subscriptions for the purchase of stock in the Federal Reserve Bank, and commitments to purchase and sell securities. The credit and market risks involved in issuing letters of credit and loan commitments are essentially the same as those involved in extending loans to customers. Such transactions are made under the same terms, including interest rates and collateral, as those prevailing at the same time for comparable on-balance-sheet transactions.

To reduce credit risk, related to the use of credit-related financial instruments, the Bank might deem it necessary to obtain collateral. The amount and nature of the collateral obtained is based on the Bank's credit evaluation of the customer. Collateral varies but may include cash, securities, accounts receivable, inventory, premises and equipment, and real estate.

Amounts of off-balance-sheet commitments as of December 31,

	2017	2016
Loan commitments	$ 516,528	$ 551,844
Bankcard commitments	67,108	67,288
Commitments to fund mortgage loans to be sold	39,996	37,774
Total loan commitments	$ 623,632	$ 656,906
Commitments at fixed interest rates	$ 245,698	$ 309,390
Commitments at variable interest rates	377,934	347,516
Total loan commitments	$ 623,632	$ 656,906
Standby and commercial letters of credit	$ 7,379	$ 8,406
Subscriptions to purchase Federal Reserve Bank stock	2,151	2,155

Commitments to make loans are generally made for periods of 90 days or less. At December 31, 2017, the fixed rate loan commitments have interest rates ranging from 2.27% to 16.50%.

NOTE 19 - REGULATORY MATTERS

The Bank is subject to various regulatory capital requirements administered by the federal banking agencies. Failure to meet minimum capital requirements can initiate certain mandatory - and possible additional discretionary - actions by regulators that, if undertaken, could have a direct material effect on the Bank's financial statements.

The directors of the Bank may declare and pay dividends as frequently and of such amount of undivided profits as they judge prudent, subject to certain restrictions on capital accounts as defined in Federal banking regulations.

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 regulatory accounting practices. The 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 Bank 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 Bank 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% for 2015 to 2.50% by 2019. The capital conservation buffer for 2017 is 1.25%. The net unrealized gain or loss on available for sale securities is not included in computing regulatory capital. Management believes, as of December 31, 2017, that the Bank meets all capital adequacy requirements to which it is subject.

As of December 31, 2017, the most recent notifications from the Comptroller of the Currency (OCC) categorized the Bank as well capitalized under the regulatory framework for prompt corrective action for both 2017 and 2016. To be categorized as well capitalized, the Bank is required to maintain minimum total risk-based, Common Tier I, Tier I risk-based, 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 institution's category.

(Dollars in thousands except per share data)

NOTE 19 - REGULATORY MATTERS (Continued)

The Bank's actual amounts and ratios at December 31, 2017 and 2016 are as follows:

	Actual		Minimum Requirement for Capital Adequacy Purposes Plus Fully Phased In Capital Conservation Buffer		Minimum Requirement to Be Well Capitalized Under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
2017						
Total capital (to risk-weighted assets)	$ 525,018	20.01%	$275,435	10.50%	$262,319	10.00%
Tier I capital (to risk-weighted assets)	505,043	19.25%	222,971	8.50%	209,855	8.00%
Common Tier I (CET1)	505,403	19.25%	183,623	7.00%	170,507	6.50%
Tier I capital (to average assets)	505,043	13.48%	149,886	4.00%	187,358	5.00%
2016						
Total capital (to risk-weighted assets)	$ 516,478	20.60%	$263,232	10.50%	$ 250,696	10.00%
Tier I capital (to risk-weighted assets)	498,978	19.90%	213,093	8.50%	200,557	8.00%
Common Tier I (CET1)	498,978	19.90%	175,488	7.00%	162,953	6.50%
Tier I capital (to average assets)	498,978	13.57%	147,039	4.00%	183,798	5.00%

The Bank's principal source of funds for dividend payments is net income and cash provided by operations. Banking regulations limit the amount of dividends that may be paid without prior approval of the OCC. Under these regulations, the amount of dividends that may be paid in any calendar year is subject to the current year's net profits (net income less dividends paid), combined with the retained net profits of the preceding two years, subject to the minimum requirements for capital adequacy in the table above. The maximum dividend that can be paid as of December 31, 2017 is $39,283 without OCC approval.