



# 2017 ANNUAL REPORT

*Building relationships that fuel  
Southern California's growth*



BANK OF  
SOUTHERN  
CALIFORNIA N.A.







To Our Shareholders:

We are pleased to report that 2017 was another strong year for Bank of Southern California. We were successful in continuing to grow the bank in many key areas: loans, deposits, capital, and new customer relationships.

Financially, in 2017:

- Total bank assets grew to \$480 million, an increase of \$55 million, a gain of 13%
- Total loans increased to \$399 million, an increase of \$66 million, a gain of 20%
- Deposits grew \$30 million in 2017 totaling \$407 million, a gain of 8%
- Net income of \$4 million, a 32% increase over 2016

In addition to growing our balance sheet, we have made progress to expand our Southern California footprint, grow our team of professional bankers, provide an enhanced customer experience, and further deliver upon our core values.

Strategically, during 2017,

- We expanded into Orange County, opening a loan production office in the city of Orange in December 2017. We anticipate opening a permanent Orange County regional office prior to year-end 2018.
- We successfully recruited and onboarded an experienced Commercial Real Estate Lending and SBA Lending Group from a Southern California regional bank in late fourth quarter 2017. The addition of this team enhances the banks' ability to serve the financing needs of businesses throughout Southern California.
- We continued to make a significant investment in technology to enhance our ability to serve our customers more efficiently. In addition, we upgraded the level of security and protection we provide our clients to help safeguard them against online fraud.
- We recognize that our clients expect a seamless and easy experience, so in 2017 we formalized a bank wide initiative and launched a "Customer Experience" program focused on delivering superior service at every interaction a client has with us.
- We also continued to further invest in the communities we serve, through donations, sponsorships, and employee volunteering, supporting over 40 organizations in 2017.

Our efforts and commitment to serving the needs of Southern California businesses earned us recognition as a top-performing organization in several categories.

In 2017, Bank of Southern California was honored as:

- A Super Premier Performing Bank ranking with The Findley Reports, Inc.
- A 5-star superior performance rating by Bauer Financial

- The top small business lender in the medium size bank category in San Diego County based on the largest quantity of SBA 7(a) loans, and the second largest dollar volume of SBA7(a) loans originated by the San Diego District Office of the U.S. Small Business Administration
- A top lender ranked by the total dollar amount of loans originated by the State California Small Business Loan Guarantee Program

These are the highest designations given by these agencies and bank rating companies. Banks who achieve exceptional performance and recognition like these are considered well managed and high performing, and we are honored to be recognized for our efforts.

2017 was undoubtedly a strong year of growth for Bank of Southern California and we are encouraged that 2018 will be another exceptional year with even stronger performance.

For 2018, we have several significant developments already underway,

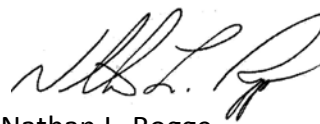
- In February 2018, Bank of Southern California announced the signing of a definitive agreement to acquire Americas United Bank, expanding the banks footprint into the Greater Los Angeles area. This acquisition allows us to enter into a new market and adds four branch locations to our franchise.
- In March 2018 we successfully completed a \$26 million capital offering. A portion of the capital raised will be utilized to complete the Bank's acquisition of Americas United Bank, with the remaining capital to further support organic growth.
- We recently announced the addition of a seasoned and experienced Director of Marketing, and we have dedicated the resources to execute strategic marketing initiatives to increase our brand awareness throughout Southern California.
- We anticipate moving into a permanent full-service regional banking office in Orange County, allowing us to better serve businesses in that region.
- Year-over-year, one thing remains the same at Bank of Southern California: our commitment to our clients. In 2018, we are continuing to make great progress with our "Customer Experience" initiatives, and you have the on-going promise from our entire staff to serve you with excellence and integrity.

In closing, we are fortunate to have shareholders and customers who made the decision to invest and bank with us. We are grateful for your business and for the continuing trust and confidence you place in Bank of Southern California. We believe the best days and years are ahead and thank you for standing alongside us.

Sincerely,



John Farkash  
Chairman of the Board



Nathan L. Rogge  
President and Chief Executive Officer

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**VAVRINEK, TRINE, DAY & CO., LLP**

**Certified Public Accountants**

**VALUE THE** *difference*

## **Independent Auditor's Report**

Board of Directors and Shareholders of  
Bank of Southern California, N.A.

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

We have audited the accompanying financial statements of Bank of Southern California N.A., which are comprised of the statements of financial condition as of December 31, 2017 and 2016, and the related statements of income, comprehensive income, changes in shareholders' equity and cash flows for the years then ended, and the related notes to the financial statements.

### ***Management's Responsibility for the Financial Statements***

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

### ***Auditor's Responsibility***

Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the 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, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

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

### ***Opinion***

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Bank of Southern California N.A. 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.

*Vavrinek, Trine, Day & Co., LLP*

Laguna Hills, CA

March 21, 2018

**BANK OF SOUTHERN CALIFORNIA, N. A.**  
**STATEMENTS OF FINANCIAL CONDITION**  
**December 31, 2017 and 2016**

**ASSETS**

	<u>2017</u>	<u>2016</u>
Cash and Due from Banks	\$ 7,377,883	\$ 6,199,920
Excess Reserves at Federal Reserve Bank	<u>32,500,000</u>	<u>62,370,000</u>
<b>TOTAL CASH AND CASH EQUIVALENTS</b>	<b>39,877,883</b>	<b>68,569,920</b>
Investment Securities Available for Sale	21,494,286	4,543,977
Loans:		
Construction and Land Development	34,055,177	15,182,243
Real Estate - Other:		
1-4 Family Residential	73,811,574	75,173,955
Multifamily Residential	31,770,520	11,575,418
Commercial Real Estate and Other	191,167,394	175,134,665
Commercial and Industrial	66,311,838	53,298,113
Consumer	<u>2,285,391</u>	<u>2,745,483</u>
<b>TOTAL LOANS</b>	<b>399,401,894</b>	<b>333,109,877</b>
Allowance for Loan Losses	<u>( 3,076,022)</u>	<u>( 2,920,030)</u>
<b>NET LOANS</b>	<b>396,325,872</b>	<b>330,189,847</b>
Stock Investments, at Cost	3,259,300	2,850,550
Premises and Equipment	4,556,141	4,226,616
Goodwill and Other Intangibles	1,399,001	1,487,800
Other Real Estate Owned, net	-	235,000
Bank Owned Life Insurance	9,130,769	8,890,867
Accrued Interest and Other Assets	<u>3,468,621</u>	<u>3,086,897</u>
<b>TOTAL ASSETS</b>	<b><u>\$ 479,511,873</u></b>	<b><u>\$ 424,081,474</u></b>

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

**BANK OF SOUTHERN CALIFORNIA, N. A.**  
**STATEMENTS OF FINANCIAL CONDITION**  
**December 31, 2017 and 2016**

**LIABILITIES AND SHAREHOLDERS' EQUITY**

	<u>2017</u>	<u>2016</u>
Deposits:		
Noninterest-Bearing Demand	\$ 123,075,336	\$ 138,082,035
Interest-Bearing NOW Accounts	50,818,615	44,407,279
Money Market and Savings Accounts	148,458,217	129,679,024
Time Deposits Under \$250,000	49,715,180	39,703,115
Time Deposits \$250,000 and Over	<u>35,417,723</u>	<u>25,657,899</u>
<b>TOTAL DEPOSITS</b>	407,485,071	377,529,352
 Federal Home Loan Bank Advances	 20,000,000	 -
Accrued Interest and Other Liabilities	<u>2,329,063</u>	<u>1,931,069</u>
<b>TOTAL LIABILITIES</b>	429,814,134	379,460,421
 Commitments and Contingencies - Notes E and L	 -	 -
Shareholders' Equity:		
Preferred Stock - 10,000,000 Shares Authorized, No Par Value;		
No Shares Issued and Outstanding in 2017 and 2016	-	-
Common Stock - 10,000,000 Shares Authorized, \$5.00 Par Value;		
Issued and Outstanding 5,223,627 in 2017 and 5,140,497 in 2016	26,118,135	25,702,485
Additional Paid-in Capital	18,651,869	17,959,620
Retained Earnings	4,940,426	975,734
Accumulated Other Comprehensive Income (Loss) - Net of Taxes	<u>( 12,691)</u>	<u>( 16,786)</u>
<b>TOTAL SHAREHOLDERS' EQUITY</b>	<u>49,697,739</u>	<u>44,621,053</u>
<b>TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY</b>	<u><u>\$ 479,511,873</u></u>	<u><u>\$ 424,081,474</u></u>

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



**BANK OF SOUTHERN CALIFORNIA, N.A.**  
**STATEMENTS OF INCOME**  
For the Years Ended December 31, 2017 and 2016

	<u>2017</u>	<u>2016</u>
<b>INTEREST INCOME</b>		
Interest and Fees on Loans	\$ 18,181,331	\$ 15,757,800
Interest and Dividends on Investment Securities	722,189	329,594
Interest on Federal Funds Sold and Other Balances	<u>390,602</u>	<u>185,803</u>
<b>TOTAL INTEREST INCOME</b>	19,294,122	16,273,197
<b>INTEREST EXPENSE</b>		
Interest on Savings, NOW and Money Market Accounts	768,888	525,507
Interest on Time Deposits	770,648	593,713
Interest on Other Borrowings	<u>2,318</u>	<u>8,148</u>
<b>TOTAL INTEREST EXPENSE</b>	<u>1,541,854</u>	<u>1,127,368</u>
<b>NET INTEREST INCOME</b>	17,752,268	15,145,829
Provision for Loan Losses	<u>271,000</u>	<u>530,000</u>
<b>NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES</b>	17,481,268	14,615,829
<b>NONINTEREST INCOME</b>		
Service Charges, Fees and Other	1,101,739	935,411
Increase in Cash Surrender Value of Bank Owned Life Insurance	239,902	210,357
Gain (Loss) on Sale of Securities	1,927	( 4,387)
Gain on Sale of Loans	865,378	746,080
Gain on Sale of Other Real Estate Owned	<u>452</u>	<u>49,620</u>
<b>TOTAL NONINTEREST INCOME</b>	<u>2,209,398</u>	<u>1,937,081</u>
<b>NONINTEREST EXPENSE</b>		
Salaries and Employee Benefits	7,482,324	6,955,490
Occupancy and Equipment Expenses	1,650,085	1,528,013
Other Expenses	<u>3,589,565</u>	<u>2,999,156</u>
<b>TOTAL NONINTEREST EXPENSE</b>	<u>12,721,974</u>	<u>11,482,659</u>
<b>INCOME BEFORE INCOME TAXES</b>	6,968,692	5,070,251
Income Tax Expense	<u>3,004,000</u>	<u>2,061,000</u>
<b>NET INCOME</b>	<u>\$ 3,964,692</u>	<u>\$ 3,009,251</u>
<b>NET INCOME PER SHARE - BASIC</b>	<u>\$ 0.76</u>	<u>\$ 0.69</u>
<b>NET INCOME PER SHARE - DILUTED</b>	<u>\$ 0.74</u>	<u>\$ 0.69</u>

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

**BANK OF SOUTHERN CALIFORNIA, N.A.**

**STATEMENTS OF COMPREHENSIVE INCOME**  
**For the Years Ended December 31, 2017 and 2016**

	<u>2017</u>	<u>2016</u>
Net Income	\$ 3,964,692	\$ 3,009,251
<b>OTHER COMPREHENSIVE INCOME (LOSS):</b>		
Unrealized Gains (Losses) on Securities Available for Sale:		
Change in Net Unrealized Gain (Loss)	12,503	( 17,235)
Reclassification of (Gain) Loss Recognized in Net Income	<u>( 1,927)</u>	<u>4,387</u>
	10,576	( 12,848)
Income Taxes (Benefit):		
Change in Net Unrealized Gain (Loss)	7,040	( 7,065)
Reclassification of (Gain) Loss Recognized in Net Income	<u>( 559)</u>	<u>1,799</u>
	<u>6,481</u>	<u>( 5,266)</u>
<b>TOTAL OTHER COMPREHENSIVE</b>		
<b>INCOME (LOSS)</b>	<u>4,095</u>	<u>( 7,582)</u>
<b>TOTAL COMPREHENSIVE INCOME</b>	<u><u>\$ 3,968,787</u></u>	<u><u>\$ 3,001,669</u></u>

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

**BANK OF SOUTHERN CALIFORNIA, N.A.**  
**STATEMENT OF CHANGES IN SHAREHOLDERS' EQUITY**  
**For the Years Ended December 31, 2017 and 2016**

	<u>Preferred Stock</u>		<u>Common Stock</u>		<u>Additional</u>	<u>Retained</u>	<u>Accumulated</u>	<u>Total</u>
	<u>Shares</u>	<u>Amount</u>	<u>Shares</u>	<u>Amount</u>	<u>Paid-in</u>	<u>Earnings</u>	<u>Other</u>	<u>Shareholders'</u>
					<u>Capital</u>	<u>(Deficit)</u>	<u>Comprehensive</u>	<u>Equity</u>
							<u>Income (Loss)</u>	
<b>Balance at December 31, 2015</b>	3,050	\$ 3,050,000	4,307,538	\$ 21,537,690	\$ 14,967,606	\$ (2,033,517)	\$ (9,204)	\$ 37,512,575
Vested Restricted Share Award			2,430	12,150	(12,150)			-
Stock-Based Compensation					247,941			247,941
Repurchase of Preferred Stock	(3,050)	(3,050,000)			289,000			(2,761,000)
Issuance of Common Stock, net			823,529	4,117,645	2,461,793			6,579,438
Stock Options Exercised			7,000	35,000	5,430			40,430
Net Income						3,009,251		3,009,251
Other Comprehensive Income (Loss)							(7,582)	(7,582)
<b>Balance at December 31, 2016</b>	-	-	5,140,497	25,702,485	17,959,620	975,734	(16,786)	44,621,053
Vested Restricted Share Award			2,430	12,150	(12,150)			-
Stock-Based Compensation					306,707			306,707
Stock Options Exercised			80,700	403,500	397,692			801,192
Net Income						3,964,692		3,964,692
Other Comprehensive Income (Loss)							4,095	4,095
<b>Balance at December 31, 2017</b>	-	\$ -	5,223,627	\$ 26,118,135	\$ 18,651,869	\$ 4,940,426	\$ (12,691)	\$ 49,697,739

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

**BANK OF SOUTHERN CALIFORNIA, N.A.**  
**STATEMENTS OF CASH FLOWS**  
**For the Years Ended December 31, 2017 and 2016**

	2017	2016
<b>OPERATING ACTIVITIES</b>		
Net Income	\$ 3,964,692	\$ 3,009,251
Adjustments to Reconcile Net Income to Net Cash Provided by Operating Activities:		
Depreciation and Amortization	442,361	473,411
Gain on Sale of Loans	( 865,378)	( 746,080)
Provision for Loan Losses	271,000	530,000
Deferred Tax Benefits	4,000	660,000
(Gain) Loss on Sale of Other Real Estate Owned	( 452)	( 49,620)
Stock-Based Compensation	306,707	247,941
Increase in Cash Surrender Value of Bank Owned Life Insurance	( 239,902)	( 210,357)
(Gain) Loss on Sale of Available for Sale Securities	( 1,927)	4,387
Accretion of Acquired Loans, Net	( 509,130)	( 333,856)
Net Changes in Other Assets and Liabilities	355,807	364,812
<b>NET CASH PROVIDED BY OPERATING ACTIVITIES</b>	<b>3,727,778</b>	<b>3,949,889</b>
<b>INVESTING ACTIVITIES</b>		
Purchase of Available-for-Sale Securities	( 18,581,388)	-
Proceeds from Sale of Available-for-Sale Securities	689,391	1,203,941
Proceeds from Maturities of Available-for-Sale Securities	884,256	987,164
Net Redemption (Purchase) of Stock Investments	( 408,750)	( 363,450)
Purchase of Bank Owned Life Insurance	-	( 4,000,000)
Net (Funding) Repayment of Loans	( 78,995,882)	( 53,811,238)
Proceeds from Sale of Loans	13,657,921	9,261,564
Proceeds from Sale of Other Real Estate Owned	272,560	152,693
Purchases of Premises and Equipment, net of Sales Proceeds	( 694,834)	( 300,537)
<b>NET CASH (USED) BY INVESTING ACTIVITIES</b>	<b>( 83,176,726)</b>	<b>( 46,869,863)</b>
<b>FINANCING ACTIVITIES</b>		
Net Increase in Deposits	29,955,719	79,278,478
Redemption of Preferred Stock	-	( 2,761,000)
(Repayments to) Advances from Federal Home Loan Bank	20,000,000	( 7,500,000)
Proceeds from Common Stock Issued, net of Expenses	801,192	6,619,868
<b>NET CASH PROVIDED BY FINANCING ACTIVITIES</b>	<b>50,756,911</b>	<b>75,637,346</b>
<b>INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS</b>	<b>( 28,692,037)</b>	<b>32,717,372</b>
Cash and Cash Equivalents at Beginning of Year	68,569,920	35,852,548
<b>CASH AND CASH EQUIVALENTS AT THE END OF THE YEAR</b>	<b>\$ 39,877,883</b>	<b>\$ 68,569,920</b>
<b>Supplemental Disclosures of Cash Flow Information:</b>		
Interest Paid	\$ 1,522,358	\$ 1,109,496
Taxes Paid	\$ 3,130,000	\$ 1,300,000
Loans Transferred to Other Real Estate Owned	\$ 145,800	\$ 268,112

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

**BANK OF SOUTHERN CALIFORNIA, N.A.**  
**NOTES TO FINANCIAL STATEMENTS**  
**December 31, 2017 and 2016**

**NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

Nature of Operations

Bank of Southern California, N.A. (the “Bank”) began business operations in December 2001 under the name Ramona National Bank. The name was changed to First Business Bank, N.A. in 2006 and to Bank of Southern California, N.A. in 2010. The Bank operates under a federal charter and its primary regulator is the Office of the Comptroller of the Currency (“OCC”). The Bank is organized as a single operating segment that operates seven full-service offices, including four offices in San Diego County and three in the Coachella Valley of Riverside County. Since December 2010, the Bank has acquired a total of six branches in the Coachella Valley in four separate transactions and has consolidated these into three remaining branches. During 2017, the Bank opened a loan production office in Orange County. The Bank's primary source of revenue is interest earned on loans to clients, who are predominately small and middle-market businesses and individuals. Client deposits are insured by the Federal Deposit Insurance Corporation (“FDIC”) up to the maximum legal limit and the Bank is a member of the Federal Reserve Bank (“FRB”).

Use of Estimates in the Preparation of Financial Statements

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

Subsequent Events

The Bank has evaluated subsequent events for recognition and disclosure through March 21, 2018, the date the financial statements were available to be issued.

Reclassifications

Certain amounts in the 2016 financial statements have been reclassified to conform to the 2017 presentation. The reclassifications have no material effect on shareholders' equity, or net income, as previously reported.

Cash and Cash Equivalents

For purposes of reporting cash flows, cash and cash equivalents include cash and due from banks, excess reserves at the Federal Reserve Bank, and federal funds sold. Excess reserves at the Federal Reserve Bank earn interest, vary in amount every day, and are considered an alternative to federal funds sold. Generally, federal funds are sold for one-day periods.



**BANK OF SOUTHERN CALIFORNIA, N.A.**  
**NOTES TO FINANCIAL STATEMENTS**  
**December 31, 2017 and 2016**

**NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - CONTINUED**

Cash and Due From Banks

Banking regulations require that banks maintain a percentage of their deposits as reserves in cash or on deposit with the Federal Reserve Bank. The Bank's reserve requirement at December 31, 2017 was \$0.

The Bank maintains amounts due from banks, which may exceed federally insured limits. The Bank has not experienced any losses in such accounts.

Investment Securities

Investment securities are classified as held-to-maturity when the Bank has the positive intent and ability to hold the securities to maturity. Investments classified as held-to-maturity securities are carried at amortized cost.

Investments not classified as trading securities nor as held-to-maturity securities are classified as available-for-sale securities and recorded at fair value. Unrealized gains or losses on available-for-sale securities are excluded from net income and reported as an amount net of taxes as a separate component of other comprehensive income included in shareholders' equity. Premiums or discounts on held-to-maturity and available-for-sale securities are amortized or accreted into income using the interest method. Realized gains or losses on sales of held-to-maturity or available-for-sale securities are recorded 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: OTTI related to credit loss, which must be recognized in the income statement and 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. For equity securities, the entire amount of impairment is recognized through earnings. The related write-downs are included in earnings as realized losses. In estimating OTTI losses, management considers: the length of time and the extent to which the fair value has been less than cost, the financial condition and near-term prospects of the issuer, and the intent and ability of the Bank to retain its investment in the issuer for a period of time sufficient to allow for any anticipated recovery in fair value.

**BANK OF SOUTHERN CALIFORNIA, N.A.**  
**NOTES TO FINANCIAL STATEMENTS**  
**December 31, 2017 and 2016**

**NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - CONTINUED**

Stock Investments

Stock investments primarily consist of Federal Reserve Bank stock and Federal Home Loan Bank stock and are carried at cost. Under certain conditions, these stocks may be sold back to the issuing institution at par value or book value. All stock investments are evaluated for impairment based on an estimate of the ultimate recoverability of cost.

Loans

Loans receivable that management has the intent and ability to hold for the foreseeable future or until maturity or payoff are reported at their outstanding unpaid principal balances reduced by any charge-offs and net of any deferred fees or costs on originated loans, or unamortized premiums or discounts on purchased loans. Loan origination fees and certain direct origination costs are capitalized and recognized as an adjustment of the yield of the related loan. Amortization of deferred loan fees is discontinued when a loan is placed on nonaccrual status.

Loans on which the accrual of interest has been discontinued are designated as nonaccrual loans. The accrual of interest on loans is generally discontinued when principal or interest is past due 90 days based on the contractual terms of the loan or earlier when, in the opinion of management, there is reasonable doubt as to collectability. On a case by case basis, loans past due 90 days may remain on accrual, if the loan is well collateralized, actively in process of collection and, in the opinion of management, likely to be paid current within the next payment cycle. When loans are placed on nonaccrual status, all interest previously accrued but not collected is generally reversed against current period interest income. Income on nonaccrual loans is subsequently recognized only to the extent that cash is received and the loan's principal balance is deemed collectible. Interest accruals are resumed on such loans only when they are brought current with respect to interest and principal and when, in the judgment of management, the loans are estimated to be fully collectable as to all principal and interest.

The Bank recognizes interest income on impaired loans based on its existing methods of recognizing interest income on nonaccrual loans.

Purchased Credit Impaired Loans

The Bank purchases groups of loans, some of which have shown evidence of credit deterioration since origination. These purchase credit impaired loans are recorded at the amount paid, such that there is no carryover of the seller's allowance for loan losses. After acquisition, losses are recognized by an increase in the allowance for loan losses.

Such purchased credit impaired loans are accounted for individually or aggregated into pools of loans based on common risk characteristics such as credit score, loan type, and date of origination. The Bank estimates the amount and timing of expected cash flows for each loan or pool, and the expected cash flows in excess of amount paid are recorded as interest income over the remaining life of the loan or pool (accretable yield). The excess of the loan's or pool's contractual principal and interest over expected cash flows is not recorded (nonaccretable difference).

**BANK OF SOUTHERN CALIFORNIA, N.A.**  
**NOTES TO FINANCIAL STATEMENTS**  
**December 31, 2017 and 2016**

**NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - CONTINUED**

Purchased Credit Impaired Loans - Continued

Over the life of the loan or pool, expected cash flows continue to be estimated. If the present value of expected cash flows is less than the carrying amount, a loss is recorded as a provision for loan losses. If the present value of expected cash flows is greater than the carrying amount, it is recognized as part of future interest income.

Allowance for Loan Losses

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

The Bank determines a separate allowance for each portfolio segment. The allowance consists of specific and general reserves. Specific reserves relate to loans that are individually classified as impaired. The Bank considers a loan to be impaired when it is probable that the Bank will be unable to collect all amounts due, principal and interest, according to the contractual terms of the loan agreement. Factors considered in determining impairment include payment status, collateral value and the probability of collecting all amounts when due. Measurement of impairment is based on the expected future cash flows of an impaired loan, which are to be discounted at the loan's effective interest rate, or measured by reference to an observable market value, if one exists, or the fair value of the collateral for a collateral-dependent loan. The Bank selects the measurement method on a loan-by-loan basis except that collateral-dependent loans for which foreclosure is probable are measured at the net realizable value of the collateral. Loans, for which the terms have been modified resulting in a concession, and for which the borrower is experiencing financial difficulties, are considered troubled debt restructurings and classified as impaired with measurement of impairment as described above.

If a loan is impaired, a portion of the allowance is allocated so that the loan is reported, net, at the present value of estimated future cash flows using the loan's existing rate or at the fair value of collateral if repayment is expected solely from the collateral. Troubled debt restructurings are separately identified for impairment disclosures and are measured at the present value of estimated future cash flows using the loan's effective rate at inception. If a troubled debt restructuring is considered to be a collateral dependent loan, the loan is reported, net, at the fair value of the collateral. For troubled debt restructurings that subsequently default, the Bank determines the amount of reserve in accordance with the accounting policy for the allowance for loan losses.

General reserves cover non-impaired loans and are based on historical loss rates for each portfolio segment, adjusted for the effects of qualitative or environmental factors that are likely to cause estimated credit losses as of the evaluation date to differ from the portfolio segment's historical loss experience.

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**NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - CONTINUED**

Allowance for Loan Losses - Continued

The Bank reviews the historical loss rates for each portfolio segment and utilizes peer loss rates when the Bank does not have sufficient historical experience or otherwise feels historical experience is not indicative of the current loan portfolio. Qualitative factors include consideration of the following: changes in lending policies and procedures; changes in economic conditions, changes in the nature and volume of the portfolio; changes in the experience, ability and depth of lending management and other relevant staff; changes in the volume and severity of past due, nonaccrual and other adversely graded loans; changes in the loan review system; the existence and effect of any concentrations of credit; the effect of other external factors such as competition and legal and regulatory requirements; the quality and effectiveness of the risk rating system; and the quality of regulatory and other external credit reviews.

Portfolio segments identified by the Bank include construction and land development, real estate, commercial and industrial and consumer loans. Relevant risk characteristics for these portfolio segments generally include debt to income ratios or debt service coverage, credit scores, collateral type and loan-to-value ratios and financial performance.

Allowance for Credit Losses on Off-Balance Sheet Credit Exposures

The Bank also maintains a separate allowance for off-balance sheet commitments. Management estimates anticipated losses using historical data and utilization assumptions. The allowance for off-balance sheet commitments totaled \$50,000 at December 31, 2017 and 2016 and is included in other liabilities on the statements of financial condition.

Other Real Estate Owned

Real estate acquired through foreclosure or deed in lieu of foreclosure is recorded at fair value at the date legal title is transferred, establishing a new cost basis by a charge to the allowance for loan losses, if necessary. Other real estate owned is carried at the lower of the Bank's carrying value of the property or its fair value, less estimated carrying costs and costs of disposition. Fair value is based on current appraisals less estimated selling costs. Any subsequent write-downs are charged against operating expenses and recognized as a valuation allowance. Operating expenses of such properties, net of related income, and gains and losses on their disposition are included in other operating expenses.

Bank Owned Life Insurance

Bank owned life insurance is recorded at the amount that can be realized under insurance contracts at the date of the statement of financial condition, which is the cash surrender value adjusted for other charges or other amounts due that are probable at settlement.

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**NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - CONTINUED**

Transfers of Financial Assets

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

Loan Sales and Servicing of Financial Assets

The Bank originates SBA loans that may be sold in the secondary market. Servicing rights are recognized separately when they are acquired through sale of loans. Servicing rights are initially recorded at fair value with the income statement effect recorded in gain on sale of loans. Fair value is based on a valuation model that calculates the present value of estimated future cash flows from the servicing assets. The valuation model uses assumptions that market participants would use in estimating cash flows from servicing assets, such as the cost to service, discount rates and prepayment speeds. The Bank compares the valuation model inputs and results to published industry data in order to validate the model results and assumptions. Servicing assets are subsequently measured using the amortization method which requires servicing rights to be amortized into noninterest income in proportion to, and over the period of, the estimated future net servicing income of the underlying loans.

Servicing assets are evaluated for impairment based upon the fair value of the rights as compared to the carrying amount. Impairment is determined by stratifying rights into groupings based on predominant risk characteristics, such as interest rate, loan type and investor type. For purposes of measuring impairment, the Bank has identified each servicing asset with the underlying loan being serviced. A valuation allowance is recorded where the fair value is below the carrying amount of the asset. If the Bank later determines that all or a portion of the impairment no longer exists for a particular grouping, a reduction of the allowance may be recorded as an increase in income. The fair values of servicing rights are subject to significant fluctuations as a result of changes in estimated and actual prepayments speeds and changes in the discount rates.

Servicing fee income, which is reported on the income statement with service charges, fees and other income, is recorded for fees earned for servicing loans. The fees are based on a contractual percentage of the outstanding principal and recorded as income when earned. The amortization of servicing rights and changes in the valuation allowance are netted against loan servicing income.

Premises and Equipment

Land is carried at cost. Premises and equipment are carried at cost less accumulated depreciation and amortization. Depreciation is computed using the straight-line method over the estimated useful lives, which ranges from three to seven years for furniture and equipment and fifty-five years for premises. Leasehold improvements are amortized using the straight-line method over the estimated useful lives of the improvements or the remaining lease term, whichever is shorter. Expenditures for betterments or major repairs are capitalized and those for ordinary repairs and maintenance are charged to operations as incurred.



**BANK OF SOUTHERN CALIFORNIA, N.A.**  
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**NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - CONTINUED**

Employee Benefit Plan

The Bank has a retirement savings 401(k) plan in which substantially all employees may participate. Pursuant to the Bank's safe harbor election, matching contributions up to 4.0% of salary are made to the plan. Total contribution expense for the plan was \$161,101 in 2017 and \$149,025 in 2016.

Advertising Costs

The Bank expenses the costs of advertising in the period incurred.

Income Taxes

Deferred income taxes are computed using the asset and liability method, which recognizes a liability or asset representing the tax effects, based on current tax law, of future deductible or taxable amounts attributable to events that have been recognized in the consolidated financial statements. A valuation allowance is established to reduce the deferred tax asset to the level at which it is "more likely than not" that the tax asset or benefits will be realized. Realization of tax benefits of deductible temporary differences and operating loss carryforwards depend on having sufficient taxable income of an appropriate character within the carryforward periods.

The Bank has adopted guidance issued by the Financial Accounting Standards Board ("FASB") that clarifies the accounting for uncertainty in tax positions taken or expected to be taken on a tax return and provides that the tax effects from an uncertain tax position can be recognized in the financial statements only if, based on its merits, the position is more likely than not to be sustained on audit by the taxing authorities. Management believes that all tax positions taken to date are highly certain and, accordingly, no accounting adjustment has been made to the financial statements. Interest and penalties related to uncertain tax positions are recorded as part of income tax expense.

Preferred Stock

On April 10, 2009, the Bank issued 2,211 shares of the Bank's Fixed Rate Non-Cumulative Perpetual Preferred Stock, Series A and 111 shares of the Bank's Fixed Rate Non-Cumulative Perpetual Preferred Stock, Series B, with an aggregate redemption price of \$2,322,000.

On December 11, 2009, the Bank issued 2,032 shares of the Bank's Fixed Rate Non-Cumulative Perpetual Preferred Stock, Series C with a redemption price of \$2,032,000.

In December 2012, pursuant to an auction by the U.S. Treasury, the Bank redeemed 553 shares of Series A, 51 shares of Series B, and 700 shares of Series C, for an aggregate redemption price of \$1,201,601, and all remaining Preferred Stock was sold by the U.S. Treasury to independent investors. During 2016, the Bank redeemed the remaining 3,050 shares of Preferred Stock for an aggregate redemption price of \$2,761,000.

**BANK OF SOUTHERN CALIFORNIA, N.A.**  
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**NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - CONTINUED**

Comprehensive Income

Changes in unrealized gains and losses on available-for-sale securities is the only component of accumulated other comprehensive income for the Bank. The amount reclassified out of other accumulated comprehensive income related to gains and losses on available-for-sale securities was a gain of \$1,927 for 2017 and a loss of \$4,387 for 2016, with the related tax effect of \$559 and (\$1,799), respectively.

Financial Instruments

In the ordinary course of business, the Bank has entered into off-balance sheet financial instruments consisting of commitments to extend credit, commercial letters of credit, and standby letters of credit. The Bank is a contingent obligor under a letter of credit issued on its behalf to secure certain lease obligations. Such financial instruments are recorded in the financial statements when they are funded or related fees are incurred or received.

Disclosure about Fair Value of Financial Instruments

The Bank's estimated fair value amounts have been determined using available market information and appropriate valuation methods. However, considerable judgment is required to develop the estimates of fair value. Accordingly, the estimates are not necessarily indicative of the amounts the Bank could have realized in a current market exchange. The use of different market assumptions and/or estimation methods may have a material effect on the estimated fair value amounts.

Earnings Per Share ("EPS")

Earnings per share present the net income or loss per common share, after consideration of the preferred shareholders interest in the net income or loss. Basic EPS excludes dilution and is computed by dividing income available to common shareholders by the weighted-average number of common shares outstanding for the period. Diluted EPS reflects the potential dilution that could occur if securities or other contracts to issue common stock were exercised or converted into common stock or resulted in the issuance of common stock that then shared in the earnings of the entity.

Goodwill

Goodwill is the excess purchase price over the fair value of all identifiable assets and liabilities acquired. Current accounting standards require that goodwill be reviewed for impairment at least annually. The Bank has performed a qualitative assessment for potential impairment as of December 31, 2017, and as a result of that assessment has determined that there has been no impairment to the goodwill that was recorded as a result of business combinations in 2010 and 2014.

**BANK OF SOUTHERN CALIFORNIA, N.A.**  
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**NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - CONTINUED**

Intangible Asset

As a result of three acquisitions completed in 2010 and 2014, each of which included branch offices in the Coachella Valley, the Bank has recorded core deposit intangibles totaling \$1,126,902. The core deposit intangibles are being amortized over periods of seven to nine years. Amortization expense for the periods ending December 31, 2017 and 2016 was \$88,799 and \$148,991, respectively. Accumulated amortization as of December 31, 2017 and 2016 was \$727,721 and \$638,922. Future estimated amortization expense for each of the next five years is as follows:

2018	\$	68,735
2019	\$	68,735
2020	\$	68,735
2021	\$	68,735
2022	\$	68,735

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 the 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.

Stock-Based Compensation

The Bank recognizes the cost of employee services received in exchange for awards of stock options and restricted stock grants, or other equity instruments, based on the grant-date fair value of those awards. This cost is recognized over the period which an employee is required to provide services in exchange for the award, generally the vesting period.

In March 2016, the FASB issued ASU 2016-09, *Improvements to Employee Share-Based Payment Accounting (Topic 718)* and the Company adopted this new standard in the current year. ASU 2016-09 includes provisions intended to simplify various aspects related to how share-based payments are accounted for and presented in the financial statements. Under ASU 2016-09, excess tax benefits and certain tax deficiencies are no longer recorded in additional paid-in capital ("APIC"). Instead, all excess tax benefits and tax deficiencies are recorded as income tax expense or benefit in the income statement. ASU 2016-09 also permits an accounting policy election, which the Company invoked, to account for forfeitures as they occur rather than estimating cost based on the number of awards that are expected to vest.

See Note M for additional information on the Company's stock option plan.

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**NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - CONTINUED**

Fair Value Measurement

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

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

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

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

See Note P for more information and disclosures relating to the Bank's fair value measurements.

New Accounting Standards Not Yet Effective

In May 2014, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") No. 2014-09, *Revenue from Contracts with Customers (Topic 606)*. This Update requires an entity to recognize revenue as performance obligations are met, in order to reflect the transfer of promised goods or services to customers in an amount that reflects the consideration the entity is entitled to receive for those goods or services. The following steps are applied in the updated guidance: (1) identify the contract(s) with a customer; (2) identify the performance obligations in the contract; (3) determine the transaction price; (4) allocate the transaction price to the performance obligations in the contract; and (5) recognize revenue when, or as, the entity satisfies a performance obligation. These amendments are effective for public business entities for annual reporting periods beginning after December 15, 2017, including interim periods within that reporting period and one year later for nonpublic business entities. Early adoption is permitted only as of annual reporting periods beginning after December 15, 2016, including interim reporting periods within that period. The Bank does not expect ASU 2014-09 to have a material impact on its financial statements and disclosures.

In January 2016, the FASB issued ASU 2016-01, *Financial Instruments-Overall: Recognition and Measurement of Financial Assets and Financial Liabilities (Subtopic 825-10)*. Changes made to the current measurement model primarily affect the accounting for equity securities and readily determinable fair values, where changes in fair value will impact earnings instead of other comprehensive income. The accounting for other financial instruments, such as loans, investments in debt securities, and financial liabilities is largely unchanged. The Update also changes the presentation and disclosure requirements for financial instruments including a requirement that public business entities use exit price when measuring the fair value of financial instruments measured at amortized cost for disclosure purposes. This Update is

**BANK OF SOUTHERN CALIFORNIA, N.A.**  
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**NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - CONTINUED**

New Accounting Standards Not Yet Effective - Continued

generally effective for public business entities in fiscal years beginning after December 15, 2017, including interim periods within those fiscal years and one year later for nonpublic business entities. The Bank does not expect ASU 2016-01 to have a material impact on its financial statements and disclosures.

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

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



**BANK OF SOUTHERN CALIFORNIA, N.A.**  
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**NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - CONTINUED**

New Accounting Standards Not Yet Effective – Continued

In January 2017, the FASB issued ASU No. 2017-04, *Intangibles – Goodwill and Other (Topic 350): Simplifying the Accounting for Goodwill Impairment*. This guidance removes Step 2 of the goodwill impairment test, which requires a hypothetical purchase price allocation, and goodwill impairment will simply be the amount by which a reporting unit's carrying value exceeds its fair value, not to exceed the carrying amount of goodwill. All other goodwill impairment guidance will remain largely unchanged. Entities will continue to have the option to perform a qualitative assessment to determine if a quantitative impairment test is necessary. The amendments in this Update are required for public business entities and other entities that have goodwill reported in their financial statements and have not elected the private company alternative for the subsequent measurement of goodwill. ASU No. 2017-04 is effective for interim and annual reporting periods beginning after December 15, 2020 for public business entities who are not SEC filers and one year later for all other entities. The Bank is currently evaluating the effects of ASU 2017-04 on its financial statements and disclosures.

**BANK OF SOUTHERN CALIFORNIA, N.A.**  
**NOTES TO FINANCIAL STATEMENTS**  
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**NOTE B - INVESTMENT SECURITIES**

Investment securities have been classified in the statements of financial condition according to management's intent. The carrying amount of investment securities available for sale and their approximate fair values at December 31 were as follows:

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
<b>December 31, 2017</b>				
U.S. Government and Agency:				
Mortgage-Backed Securities	\$ 6,214,918	\$ 880	\$( 34,095)	\$ 6,181,703
Collateralized Mortgage Obligations	1,028,196	305	( 3,030)	1,025,471
Taxable Municipals	11,211,159	37,530	( 13,998)	11,234,691
Tax Exempt Bank-Qualified Municipals	3,057,887	4,589	( 10,055)	3,052,421
	<u>\$21,512,160</u>	<u>\$ 43,304</u>	<u>\$( 61,178)</u>	<u>\$ 21,494,286</u>
<b>December 31, 2016</b>				
U.S. Government and Agency:				
Mortgage-Backed Securities	\$ 2,198,514	\$ 1,207	\$( 22,972)	\$ 2,176,749
Collateralized Mortgage Obligations	1,367,404	-	( 7,006)	1,360,398
Taxable Municipals	1,006,508	322	-	1,006,830
	<u>\$ 4,572,426</u>	<u>\$ 1,529</u>	<u>\$( 29,978)</u>	<u>\$ 4,543,977</u>

The amortized cost and estimated fair value of all investment securities as of December 31, 2017 by contractual maturities are shown below. Expected maturities may differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

	Amortized Cost	Available-for-Sale Fair Value
Due in One Year or Less	\$ 772,971	\$ 766,062
Due from One Year to Five Years	5,664,547	5,655,091
Due from Five to Ten Years	13,523,396	13,525,090
Due after Ten Years	1,551,246	1,548,043
	<u>\$ 21,512,160</u>	<u>\$ 21,494,286</u>

**BANK OF SOUTHERN CALIFORNIA, N.A.**  
**NOTES TO FINANCIAL STATEMENTS**  
**December 31, 2017 and 2016**

**NOTE B - INVESTMENT SECURITIES - CONTINUED**

The gross unrealized loss and related estimated fair value of investment securities that have been in a continuous loss position for less than twelve months and over twelve months at December 31, 2017 and 2016 are as follows:

	Less than Twelve Months		Over Twelve Months		Total	
	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value
<b>December 31, 2017:</b>						
Mortgage-Backed Securities	\$ ( 14,074)	\$ 4,544,759	\$ ( 20,021)	\$ 1,600,463	\$ ( 34,095)	\$ 6,145,222
Collateralized Mortgage Obligations	-	-	( 3,030)	713,181	( 3,030)	713,181
Taxable Municipals	( 10,861)	3,583,934	( 3,137)	531,705	( 13,998)	4,115,639
Tax Exempt Bank-Qualified Municipals	( 10,055)	2,371,196	-	-	( 10,055)	2,371,196
	<u>\$ ( 34,990)</u>	<u>\$10,499,889</u>	<u>\$ ( 26,188)</u>	<u>\$ 2,845,349</u>	<u>\$ ( 61,178)</u>	<u>\$ 13,345,238</u>
<b>December 31, 2016:</b>						
Mortgage-Backed Securities	\$ ( 4,149)	\$ 284,350	\$ ( 18,823)	\$ 1,826,336	\$ ( 22,972)	\$ 2,110,686
Collateralized Mortgage Obligations	( 7,006)	1,360,398	-	-	( 7,006)	1,360,398
	<u>\$ ( 11,155)</u>	<u>\$ 1,644,748</u>	<u>\$ ( 18,823)</u>	<u>\$ 1,826,336</u>	<u>\$ ( 29,978)</u>	<u>\$ 3,471,084</u>

As of December 31, 2017, there were ten investment securities that had been in a continual loss position for over twelve months. At December 31, 2016, there were six investment securities that had been in a continuous loss position for over twelve months. Management evaluates investment securities for other-than-temporary impairment taking into consideration the extent and length of time the fair value has been less than cost, the financial condition of the issuer and whether the Bank has the intent and ability to retain the investment for a period of time sufficient to allow for any anticipated recovery in fair value. As of December 31, 2017, no unrealized losses are deemed to be other-than-temporary.

The Bank had gross gains on early redemption of investment securities of \$1,927 for the year ended 2017. For the year ended December 31, 2016, the Bank had gross gains of \$3,828 and losses of \$8,215 for sales of investments.

The Bank may pledge investment securities to collateralize credit lines, secure public deposits, and for other purposes as permitted or required by law. Investment securities carried at approximately \$7,149,000 and \$3,537,000 at December 31, 2017 and 2016, respectively, were pledged to secure credit facilities at the Federal Home Loan Bank of San Francisco ("FHLB").

**BANK OF SOUTHERN CALIFORNIA, N.A.**  
**NOTES TO FINANCIAL STATEMENTS**  
**December 31, 2017 and 2016**

**NOTE C - STOCK INVESTMENTS, at COST**

As a member of the FRB System, the Bank must hold FRB stock in an amount equal to 3% of the Bank's common stock and additional paid-in capital. An investment in the equity stock of the FHLB of San Francisco is required for membership; the required investment is a function of the Bank's outstanding mortgage assets and outstanding advances from the FHLB.

The table below summarizes the Bank's stock investments at December 31:

	2017	2016
Federal Reserve Bank	\$ 1,336,800	\$ 1,110,650
Federal Home Loan Bank	1,862,500	1,679,900
Other Stock Investments	60,000	60,000
	<u>\$ 3,259,300</u>	<u>\$ 2,850,550</u>

**NOTE D - LOANS**

The Bank's loan portfolio consists primarily of loans to borrowers within its markets of San Diego County, California and the Coachella Valley of California. Although the Bank seeks to avoid concentrations of loans to a single industry or based upon a single class of collateral, real estate and real estate associated businesses are among the principal industries in the Bank's market area. The Bank's loan portfolio concentration in real estate secured credit at December 31, 2017 was 83%.

The Bank has originated loans that it services for others, including loans partially-guaranteed by the SBA, some of which have been sold in the secondary market, as well as commercial real estate loans for investors and other participating financial institutions. The portfolio of loans serviced for other parties was approximately \$34,741,000 at December 31, 2017 and \$25,556,000 at December 31, 2016.

The Bank has pledged loans with a carrying value of \$106,924,000 to collateralize credit facilities at the FHLB of San Francisco and the FRB as of December 31, 2017.

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

	2017	2016
Beginning Balance	\$ 2,920,030	\$ 2,426,829
Provision for Loan Losses	271,000	530,000
Recoveries on Loans Charged Off	220,115	7,396
	3,411,145	2,964,225
Less Loans Charged Off	( 335,123)	( 44,195)
Ending Balance	<u>\$ 3,076,022</u>	<u>\$ 2,920,030</u>

**BANK OF SOUTHERN CALIFORNIA, N.A.**  
**NOTES TO FINANCIAL STATEMENTS**  
**December 31, 2017 and 2016**

**NOTE D - LOANS - CONTINUED**

A summary of allowance of loan losses and loan balance disclosed by portfolio segment and also by loans individually evaluated and loans collectively evaluated for impairment as of December 31, 2017 and 2016 and for the years then ended follows:

	Construction and Land Development	Real Estate - Other	Commercial & Industrial	Consumer	Total
<b>December 31, 2017</b>					
Allowance for Loan Losses:					
Beginning of Year	\$ 146,536	\$ 2,267,430	\$ 489,472	\$ 16,592	2,920,030
Provisions	182,920	(166,351)	273,298	(18,867)	271,000
Charge-offs	-	(19,070)	(316,053)	-	(335,123)
Recoveries	-	48,201	157,619	14,295	220,115
End of Year	<u>\$ 329,456</u>	<u>\$ 2,130,210</u>	<u>\$ 604,336</u>	<u>\$ 12,020</u>	<u>\$ 3,076,022</u>
Specific Reserves	\$ -	\$ -	\$ 59,779	\$ -	\$ 59,779
General Reserves	<u>329,456</u>	<u>2,130,210</u>	<u>544,557</u>	<u>12,020</u>	<u>3,016,243</u>
	<u>\$ 329,456</u>	<u>\$ 2,130,210</u>	<u>\$ 604,336</u>	<u>\$ 12,020</u>	<u>\$ 3,076,022</u>
Loans Evaluated for Impairment:					
Individually	\$ -	\$ 235,048	\$ 458,306	\$ -	\$ 693,354
Collectively	<u>34,055,177</u>	<u>296,514,440</u>	<u>65,853,532</u>	<u>2,285,391</u>	<u>398,708,540</u>
	<u>\$ 34,055,177</u>	<u>\$ 296,749,488</u>	<u>\$ 66,311,838</u>	<u>\$ 2,285,391</u>	<u>\$ 399,401,894</u>
<b>December 31, 2016</b>					
Allowance for Loan Losses:					
Beginning of Year	\$ 139,915	\$ 1,712,136	\$ 554,384	\$ 20,394	2,426,829
Provisions	5,901	592,813	(64,912)	(3,802)	530,000
Charge-offs	-	(44,195)	-	-	(44,195)
Recoveries	720	6,676	-	-	7,396
End of Year	<u>\$ 146,536</u>	<u>\$ 2,267,430</u>	<u>\$ 489,472</u>	<u>\$ 16,592</u>	<u>\$ 2,920,030</u>
Specific Reserves	\$ -	\$ -	\$ 8,406	\$ -	\$ 8,406
General Reserves	<u>146,536</u>	<u>2,267,430</u>	<u>481,066</u>	<u>16,592</u>	<u>2,911,624</u>
	<u>\$ 146,536</u>	<u>\$ 2,267,430</u>	<u>\$ 489,472</u>	<u>\$ 16,592</u>	<u>\$ 2,920,030</u>
Loans Evaluated for Impairment:					
Individually	\$ -	\$ 628,520	\$ 134,703	\$ -	\$ 763,223
Collectively	<u>15,182,243</u>	<u>261,255,518</u>	<u>53,163,410</u>	<u>2,745,483</u>	<u>332,346,654</u>
	<u>\$ 15,182,243</u>	<u>\$ 261,884,038</u>	<u>\$ 53,298,113</u>	<u>\$ 2,745,483</u>	<u>\$ 333,109,877</u>

**BANK OF SOUTHERN CALIFORNIA, N.A.**  
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**NOTE D - LOANS - CONTINUED**

The Bank's methodology for estimating the allowance for loan losses results in a range of potential reserves, including an estimate primarily based on the Bank's historical loss factors for collective impairment and also a high and low range based on analysis of peer data for collective impairment factors.

The Bank categorizes loans using risk ratings based on relevant information about the ability of borrowers to service their debt such as current financial information, historical payment experience, collateral adequacy, credit documentation, and current economic trends, among other factors. Larger, non-homogeneous loans such as commercial real estate and commercial and industrial loans are analyzed individually for risk rating assessment. This analysis is performed on an ongoing basis as new information is obtained. The Bank uses the following definitions for risk ratings:

**Pass** - Loans classified as pass include loans not meeting the risk ratings defined below.

**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 obligor 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.

**Impaired** - A loan is considered 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. Additionally, all loans classified as troubled debt restructurings are considered impaired.

**BANK OF SOUTHERN CALIFORNIA, N.A.**  
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**NOTE D - LOANS - CONTINUED**

Based on the most recent analysis performed, the risk category of loans by class of loans as of December 31, 2017 and 2016 follows:

	Pass	Special Mention	Substandard	Impaired	Total
<b>December 31, 2017</b>					
Construction and Land Development	\$ 34,019,974	\$ -	\$ 35,203	\$ -	\$ 34,055,177
Real Estate -Other:					
1-4 Family Residential	73,315,999	-	294,694	200,881	73,811,574
Multifamily Residential	31,770,520	-	-	-	31,770,520
Commercial Real Estate and Other	191,021,454	111,773	-	34,167	191,167,394
Commercial and Industrial	65,155,720	347,763	350,049	458,306	66,311,838
Consumer	2,285,391	-	-	-	2,285,391
	<u>\$ 397,569,058</u>	<u>\$ 459,536</u>	<u>\$ 679,946</u>	<u>\$ 693,354</u>	<u>\$ 399,401,894</u>
	Pass	Special Mention	Substandard	Impaired	Total
<b>December 31, 2016</b>					
Construction and Land Development	\$ 15,079,856	\$ 102,387	\$ -	\$ -	\$ 15,182,243
Real Estate -Other:					
1-4 Family Residential	74,213,257	-	678,076	282,622	75,173,955
Multifamily Residential	11,575,418	-	-	-	11,575,418
Commercial Real Estate and Other	172,994,713	152,920	1,641,134	345,898	175,134,665
Commercial and Industrial	52,919,824	226,129	17,457	134,703	53,298,113
Consumer	2,745,483	-	-	-	2,745,483
	<u>\$ 329,528,551</u>	<u>\$ 481,436</u>	<u>\$ 2,336,667</u>	<u>\$ 763,223</u>	<u>\$ 333,109,877</u>



**BANK OF SOUTHERN CALIFORNIA, N.A.**  
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**NOTE D - LOANS - CONTINUED**

A summary of past due loans, loans still accruing over 90 days and nonaccrual loans as of December 31, 2017 and 2016 follows:

	Still Accruing		
	30-89 Days	Over 90 Days	
	Past Due	Past Due	Nonaccrual
<b>December 31, 2017</b>			
Construction and Land Development	\$ -	\$ 35,203	\$ -
Real Estate:			
1-4 Family Residential	2,065,432	633,488	200,881
Multifamily Residential	-	-	-
Commercial Real Estate and Other	-	-	34,167
Commercial and Industrial	68,467	-	458,306
Consumer	300	-	-
	<u>\$ 2,134,199</u>	<u>\$ 668,691</u>	<u>\$ 693,354</u>
<b>December 31, 2016</b>			
Construction and Land Development	\$ -	\$ -	\$ -
Real Estate:			
1-4 Family Residential	158,583	195,636	282,622
Multifamily Residential	-	-	-
Commercial Real Estate and Other	-	-	345,898
Commercial and Industrial	-	-	134,703
Consumer	-	-	-
	<u>\$ 158,583</u>	<u>\$ 195,636</u>	<u>\$ 763,223</u>

**BANK OF SOUTHERN CALIFORNIA, N.A.**  
**NOTES TO FINANCIAL STATEMENTS**  
**December 31, 2017 and 2016**

**NOTE D - LOANS - CONTINUED**

Below is a summary of the Bank's recorded investment in impaired loans disclosed by loan type outstanding at December 31, 2017:

<b>December 31, 2017</b>	<u>Unpaid Principal Balance</u>	<u>Recorded Investment</u>	<u>Related Allowance</u>	<u>Average Recorded Investment</u>	<u>Interest Income Recognized</u>
<b>With no Related Allowance Recorded</b>					
Construction and Land Development	\$ -	\$ -	\$ -	\$ -	\$ -
Real Estate:					
1-4 Family Residential	266,121	200,881	-	209,147	3,520
Multifamily Residential	-	-	-	-	-
Commercial Real Estate and Other	46,071	34,167	-	37,090	-
Commercial and Industrial	242,416	79,683	-	87,932	-
Consumer	-	-	-	-	-
<b>With an Allowance Recorded</b>					
Construction and Land Development	-	-	-	-	-
Real Estate:					
1-4 Family Residential	-	-	-	-	-
Multifamily Residential	-	-	-	-	-
Commercial Real Estate and Other	-	-	-	-	-
Commercial and Industrial	595,483	378,623	59,779	549,067	-
Consumer	-	-	-	-	-
	<u>\$ 1,150,091</u>	<u>\$ 693,354</u>	<u>\$ 59,779</u>	<u>\$ 883,236</u>	<u>\$ 3,520</u>

**BANK OF SOUTHERN CALIFORNIA, N.A.**  
**NOTES TO FINANCIAL STATEMENTS**  
**December 31, 2017 and 2016**

**NOTE D - LOANS - CONTINUED**

Below is a summary of the Bank's recorded investment in impaired loans disclosed by loan type outstanding at December 31, 2016:

<b>December 31, 2016</b>	Unpaid Principal Balance	Recorded Investment	Related Allowance	Average Recorded Investment	Interest Income Recognized
<b>With no Related Allowance Recorded</b>					
Construction and Land Development	\$ -	\$ -	\$ -	\$ -	\$ -
Real Estate:					
1-4 Family Residential	317,969	282,622	-	259,858	3,837
Multifamily Residential	-	-	-	-	-
Commercial Real Estate and Other	366,379	345,898	-	350,939	21,642
Commercial and Industrial	321,681	106,683	-	117,933	-
Consumer	-	-	-	-	-
<b>With an Allowance Recorded</b>					
Construction and Land Development	-	-	-	-	-
Real Estate:					
1-4 Family Residential	-	-	-	-	-
Multifamily Residential	-	-	-	-	-
Commercial Real Estate and Other	-	-	-	-	-
Commercial and Industrial	38,800	28,020	8,406	66,686	-
Consumer	-	-	-	-	-
	<u>\$ 1,044,829</u>	<u>\$ 763,223</u>	<u>\$ 8,406</u>	<u>\$ 795,416</u>	<u>\$ 25,479</u>

No additional funds are committed to be advanced on impaired loans. The Bank received income recognized on a cash basis of \$3,520 on impaired loans in 2017 and \$25,479 in 2016. Interest foregone on impaired loans was \$39,308 in 2017 and \$49,168 in 2016. The principal balance of impaired loans that was guaranteed by the SBA was \$204,683 and \$116,327 at December 31, 2017 and 2016, respectively.

The Bank did not have any loans that have been modified in troubled debt restructurings as of December 31, 2017 and December 31, 2016. No loans have been modified during 2017 and 2016.

The balance of unamortized loan origination costs and premiums, net of unamortized fees, included in total loans was \$862,220 and \$902,863 at December 31, 2017 and 2016, respectively. The unamortized purchase discount (premium) on loans acquired at fair value and included in total loans was \$779,260 and \$1,398,208 as of December 31, 2017 and 2016, respectively.

**BANK OF SOUTHERN CALIFORNIA, N.A.**  
**NOTES TO FINANCIAL STATEMENTS**  
**December 31, 2017 and 2016**

**NOTE E - PREMISES AND EQUIPMENT**

A summary of premises and equipment as of December 31 follows:

	<u>2017</u>	<u>2016</u>
Land & Building	\$ 3,451,679	\$ 3,451,679
Leasehold Improvements	1,979,571	1,611,444
Furniture, Fixtures, and Equipment	1,458,548	1,223,887
Computer Equipment	<u>459,971</u>	<u>397,204</u>
	7,349,769	6,684,214
Less Accumulated Depreciation and Amortization	<u>( 2,793,628)</u>	<u>( 2,457,598)</u>
	<u>\$ 4,556,141</u>	<u>\$ 4,226,616</u>

The Bank has entered into leases for its main office and branches, which will expire at various dates through 2022. The leases also include provisions for options to extend the leases. The leases include provisions for periodic rent increases as well as payment by the lessee of certain operating expenses. Rental expense relating to these leases and other short-term rentals was approximately \$804,255 and \$776,007 for the years ended December 31, 2017 and 2016, respectively.

The Bank leases its Ramona banking premises from its principal shareholder, under an operating lease currently expiring on April 30, 2022, with one five-year renewal option. The Bank believes the terms of the lease are no less favorable to the Bank than could have been obtained from unaffiliated third parties. The Bank pays fixed monthly lease payments, which are increased annually by 3%, and its pro rata share of common area operating expenses for the property

At December 31, 2017, the future lease rentals payable under non-cancellable operating lease commitments to related parties and others are as follows:

Years Ending December 31,	<u>Related Party</u>	<u>Others</u>
2018	\$ 36,651	\$ 979,768
2019	37,751	945,861
2020	38,884	972,456
2021	40,050	268,060
2022	13,885	-
Thereafter	<u>-</u>	<u>-</u>
Total	<u>\$ 167,221</u>	<u>\$ 3,166,144</u>

The minimum rental payments shown above are given for the existing lease obligations and are not a forecast of future rental expense.

**BANK OF SOUTHERN CALIFORNIA, N.A.**  
**NOTES TO FINANCIAL STATEMENTS**  
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**NOTE F - DEPOSITS**

At December 31, 2017, the scheduled maturities of time deposits are as follows:

Due in One Year or Less	\$ 70,017,409
Due from One to Three Years	15,071,943
Due over Three Years	43,551
Total Time Deposits	<u>\$ 85,132,903</u>

**NOTE G - BORROWING ARRANGEMENTS**

The Bank has a credit facility with the Federal Home Loan Bank of San Francisco ('FHLB'), under which the Bank may enter borrowing agreements under various terms and conditions, subject to pledging qualifying collateral, such as investment securities and loans. The Bank has investment securities with a carrying value of \$7,149,000 and loans with a carrying value of approximately \$101,603,000 pledged with the FHLB at December 31, 2017. The Bank has outstanding borrowings of \$20,000,000 at December 31, 2017 at an interest rate of 1.41%, which matured January 2, 2018. At December 31, 2016, the Bank had no outstanding borrowings from the FHLB. Available remaining borrowing capacity from the FHLB at December 31, 2017, based upon collateral pledged was approximately \$37,429,000.

The Bank has a \$5,000,000 overnight credit line on an unsecured basis from a correspondent bank. The line is subject to annual review. The Bank had no overnight borrowings under this correspondent line at December 31, 2017 or 2016.

The Bank has credit availability at the Federal Reserve discount window to the extent of collateral pledged. The Bank has pledged loan collateral at December 31, 2017 with a book value of \$5,321,000. The Bank had no discount window borrowings at December 31, 2017 or 2016.

**BANK OF SOUTHERN CALIFORNIA, N.A.**  
**NOTES TO FINANCIAL STATEMENTS**  
**December 31, 2017 and 2016**

**NOTE H - INCOME TAXES**

The Bank is subject to Federal and California franchise tax. Income tax returns for the years ending after December 31, 2013 are open to audit by the Federal authorities and income tax returns for the years ending after December 31, 2012 are open to audit by California authorities.

The income tax expense for the years ended December 31, is comprised of the following:

	2017	2016
Current Taxes Payable:		
Federal	\$ 2,199,343	\$ 1,084,173
State	800,657	316,827
	3,000,000	1,401,000
Deferred Taxes	(238,000)	660,000
Deferred Tax Asset Adjustment for Enacted Change in Tax Rate	242,000	-
Total Expense	<u>\$ 3,004,000</u>	<u>\$ 2,061,000</u>

Income tax expense for 2017 includes a downward adjustment of net deferred tax assets in the amount of \$242,000, recorded as a result of the enactment of H.R. 1 Tax Cuts and Jobs Act on December 22, 2017. The Act reduced the corporate Federal tax rate from 34% to 21% effective January 1, 2018.

A comparison of the federal statutory income tax rates to the Bank's effective income tax rates at December 31 follows:

	2017		2016	
	Amount	Rate	Amount	Rate
Federal Taxes	\$ 2,369,000	34.0%	\$ 1,724,000	34.0%
State Taxes	492,000	7.1%	358,000	7.1%
Tax Impact from Enacted Change in Tax Rate	242,000	3.5%	-	0.0%
Employee Stock Based Comp	47,000	0.7%	42,000	0.8%
Tax Free Income	(104,000)	(1.5%)	(72,000)	(1.4%)
Other	(42,000)	(0.7%)	9,000	0.2%
	<u>\$ 3,004,000</u>	<u>43.1%</u>	<u>\$ 2,061,000</u>	<u>40.7%</u>

**BANK OF SOUTHERN CALIFORNIA, N.A.**  
**NOTES TO FINANCIAL STATEMENTS**  
**December 31, 2017 and 2016**

**NOTE H - INCOME TAXES - CONTINUED**

Deferred taxes are a result of differences between income tax accounting and generally accepted accounting principles with respect to income and expense recognition. The following is a summary of the components of the net deferred tax asset accounts recognized in the accompanying statements of financial condition at December 31:

	<u>2017</u>	<u>2016</u>
Deferred Tax Assets:		
Allowance for Loan Losses	\$ 626,000	\$ 749,000
Stock-Based Compensation	98,000	60,000
Depreciation Differences	-	31,000
California Franchise Tax	169,000	106,000
Deferred Expense Deductions	242,000	318,000
Other	262,000	362,000
	<u>1,397,000</u>	<u>1,626,000</u>
Deferred Tax Liabilities:		
Deferred Loan Costs	( 173,000)	( 224,000)
Acquisition Basis Differences	( 505,000)	( 701,000)
Depreciation Differences	( 41,000)	-
Other	( 34,000)	( 46,000)
	<u>( 753,000)</u>	<u>( 971,000)</u>
Net Deferred Tax Assets	<u>\$ 644,000</u>	<u>\$ 655,000</u>

As of December 31, 2016, the Bank had utilized all net operating loss carryforwards.

**BANK OF SOUTHERN CALIFORNIA, N.A.**  
**NOTES TO FINANCIAL STATEMENTS**  
**December 31, 2017 and 2016**

**NOTE I - OTHER EXPENSES**

Other expenses for the years ended December 31 are comprised of the following:

	<u>2017</u>	<u>2016</u>
Data Processing and Communications	\$ 1,182,376	\$ 1,017,262
Legal, Audit and Professional	327,981	193,895
Merger Related Expenses	-	99,775
Regulatory Assessments	270,938	330,593
Marketing, Advertising and Public Relations	249,188	216,393
Travel, Training and Office	243,092	238,062
Deposit Administration and Online Banking	304,991	338,668
Loan Administration	39,913	50,506
Loan Collections and OREO Expense	533,609	183,670
Insurance and Correspondent Charges	88,289	77,889
Other Expenses	349,188	252,443
	<u>\$ 3,589,565</u>	<u>\$ 2,999,156</u>

**NOTE J - EARNINGS PER SHARE ("EPS")**

The following is a reconciliation of net income and shares outstanding to the income and number of shares used to compute EPS:

	<u>2017</u>		<u>2016</u>	
	Income	Shares	Income	Shares
Net Income as Reported	\$ 3,964,692		\$ 3,009,251	
Weighted-Average Shares Outstanding		<u>5,189,799</u>		<u>4,346,702</u>
<b>Used in Basic EPS</b>	3,964,692	5,189,799	3,009,251	4,346,702
 Dilutive Effect of Outstanding:				
Stock Options	-	170,355	-	-
Restricted Stock Grants	-	3,196	-	3,392
<b>Used in Dilutive EPS</b>	<u>\$ 3,964,692</u>	<u>5,363,350</u>	<u>\$ 3,009,251</u>	<u>4,350,094</u>

At December 31, 2017 and 2016, there were 20,000 and 649,225 stock options, respectively, that were potentially dilutive to earnings per share that were not included in the computation of diluted earnings per share because to do so would have been anti-dilutive.



**BANK OF SOUTHERN CALIFORNIA, N.A.**  
**NOTES TO FINANCIAL STATEMENTS**  
**December 31, 2017 and 2016**

**NOTE K - RELATED PARTY TRANSACTIONS**

In the ordinary course of business, the Bank has granted loans to certain directors and their related interests with which they are associated. In the Bank's opinion, all loans and loan commitments to such parties are made on substantially the same terms including interest rates, and collateral, as those prevailing at the time for comparable transactions with unrelated clients.

The balance of these loans outstanding and activity in related party loans for the periods ended December 31, 2017 and 2016 follows:

	<u>2017</u>	<u>2016</u>
Balance at Beginning of Year	\$ 4,930,511	\$ 3,304,468
Credit Granted, Including Renewals	-	1,786,262
Repayments	<u>(738,618)</u>	<u>(160,219)</u>
	<u>\$ 4,191,893</u>	<u>\$ 4,930,511</u>

Deposits held by the Bank from directors and their related interests at December 31, 2017 and 2016, amounted to \$10,125,243 and \$7,938,584, respectively.

**NOTE L - COMMITMENTS AND CONTINGENCIES**

In the ordinary course of business, the Bank enters into financial commitments to meet the financing needs of its customers. These financial commitments include commitments to extend credit and standby letters of credit. Those instruments involve to varying degrees, elements of credit and interest rate risk not recognized in the Bank's financial statements.

Commitments to extend credit are agreements to lend to a client as long as there is no violation of any condition established in the contract. Since many of the commitments are expected to expire without being drawn upon, the total amounts do not necessarily represent future cash requirements. The Bank evaluates each client's credit worthiness on a case-by-case basis. Collateral may or may not be required based on management's credit evaluation of the customer. The majority of the Bank's commitments to extend credit and standby letters of credit are secured by real estate.

The Bank's exposure to loan loss in the event of nonperformance on commitments to extend credit and standby letters of credit is represented by the contractual amount of those instruments. The Bank uses the same credit policies in making commitments as it does for loans reflected in the financial statements.

**BANK OF SOUTHERN CALIFORNIA, N.A.**  
**NOTES TO FINANCIAL STATEMENTS**  
**December 31, 2017 and 2016**

**NOTE L - COMMITMENTS AND CONTINGENCIES - CONTINUED**

As of December 31, 2017 and 2016, the Bank had the following outstanding financial commitments whose contractual amount represents potential credit risk to the Bank, and potential financial obligations of the Bank:

	2017	2016
Commitments to Extend Credit	\$ 82,256,359	\$ 69,988,695
Letters of Credit Issued to Customers	930,200	670,000
	<u>\$ 83,186,559</u>	<u>\$ 70,658,695</u>

The Bank evaluates the loss exposure for unfunded commitments to extend credit following the same principles used for the allowance for loan losses, with consideration for experienced utilization rates on client credit lines and the inherently lower risk of unfunded commitments relative to disbursed commitments.

In 2016, the Bank entered into deferred compensation agreements with certain key officers. Under these agreements, the Bank is obligated to provide, upon retirement, a 10 year benefit to the officers. The annual benefits range from \$8,873 to \$175,000. The estimated present value of future benefits to be paid is being accrued over the period from the effective date of the agreements until the expected retirement dates of the participants. The expense incurred for these agreements in 2017 was \$178,156 and \$15,000 in 2016. The Bank is a beneficiary of life insurance policies that have been purchased as a method of financing the benefits under these agreements.

**NOTE M - STOCK-BASED COMPENSATION PLAN**

Under the Bank's 2001 Stock Option Plan (the "2001 Plan"), as amended, stock options were granted to eligible employees and directors. The 2001 Plan terminated November 8, 2011, in accordance with its term; however stock options previously granted under the Plan remain valid in accordance with their terms. Under the terms of the 2001 Plan, officers and key employees were granted either nonqualified or incentive stock options and directors, who were not also an officer or employee, were granted nonqualified stock options. Under the 2001 Plan, stock options were granted at prices not less than 100% of the fair market value of the stock on the date of grant; options granted expired no later than ten years from the date of the grant; and option grants generally vest over five years. The Plan provides for accelerated vesting if there is a change of control, as defined in the Plan.

**BANK OF SOUTHERN CALIFORNIA, N.A.**  
**NOTES TO FINANCIAL STATEMENTS**  
**December 31, 2017 and 2016**

**NOTE M - STOCK-BASED COMPENSATION PLAN - CONTINUED**

In November 2011, the board of directors adopted the Omnibus Equity Incentive Plan (the “Omnibus Plan”) providing for up to 544,907 shares of common stock that could be issued pursuant to awards of stock options, including incentive stock options, and restricted share awards. In 2016, shareholders approved increasing the number of shares authorized shares remaining under the Omnibus Plan to 997,235. The Omnibus Plan provides that any director, employee or consultant of the Bank shall be eligible to be designated a participant in the Omnibus Plan for purposes of receiving awards. The Board has the power to determine the terms of the awards, including the exercise price, the number of shares subject to each award, the vesting and exercisability of the awards and the form of consideration payable upon exercise. Stock options expire no later than ten years from the date of the grant. The Plan provides for accelerated vesting if there is a change of control, as defined in the Plan.

The Bank recognized stock-based compensation cost of \$306,707 and \$247,941 in 2017 and 2016, respectively. The Bank also recognized related tax benefits of approximately \$62,191 in 2017 and \$44,346 in 2016.

The fair value of each option grant is estimated on the date of grant using the Black-Scholes option pricing model. The following table provides the weighted-average assumptions used in the pricing model, and the weighted-average grant date fair value, for option grants made in 2017 and 2016:

	<u>2017</u>	<u>2016</u>
Expected Volatility	26.53%	27.73%
Expected Term (Years)	6.5	6.5
Expected Dividends	None	None
Risk Free Rate	1.92%	1.22%
Weighted-Average Grant Date Fair Value	\$ 3.18	\$ 2.43

Since the Bank’s shares have a very limited volume of historical trades, the expected volatility is based on an index of the historical volatility of similar banks that have a longer trading history at higher volumes. The expected term represents the estimated average period of time that the options remain outstanding. Since the Bank does not have sufficient historical data on the exercise of stock options, the expected term is based on the “simplified” method that measures the expected term as the average of the vesting period and the contractual term. The risk free rate of return reflects the grant date yield on U.S. Treasury bonds with maturities comparable to the expected term of the options.

**BANK OF SOUTHERN CALIFORNIA, N.A.**  
**NOTES TO FINANCIAL STATEMENTS**  
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**NOTE M - STOCK-BASED COMPENSATION - CONTINUED**

A summary of changes in outstanding stock options during 2017 and options exercisable at December 31, 2017 is presented below:

	Shares	Weighted- Average Exercise Price	Weighted- Average Remaining Contractual Term	Aggregate Intrinsic Value
Outstanding at Beginning of Year	649,225	\$ 7.70		
Granted	135,500	\$ 10.24		
Exercised	( 80,700)	\$ 9.93		
Expired	( 75)	\$ 10.00		
Forfeited	( 8,800)	\$ 7.36		
Outstanding at End of Year	<u>695,150</u>	<u>\$ 7.94</u>	<u>7.6 Years</u>	<u>\$3,892,840</u>
Options Exercisable	<u>232,150</u>	<u>\$ 6.95</u>	<u>6.0 Years</u>	<u>\$1,529,869</u>

The intrinsic value of stock options exercised in 2017 is approximately \$208,000.

Additionally, during December 2011, the Bank granted 17,009 shares of restricted stock valued at \$5.35 per share, of which 4,859 shares vested in 2013 and 2,430 shares vested each year from 2014 to 2017. The remaining unvested shares vest in 2018 and will result in stock-based compensation expense of \$13,000 in 2018. The intrinsic value of the shares vested in the year ended December 31, 2017 was \$32,902 and \$20,655 in the year ended December 31, 2016.

As of December 31, 2017, there was \$1,030,028 of total unrecognized compensation cost related to the outstanding stock options and restricted stock that will be recognized over a weighted-average period of approximately 1.65 years as shown below:

2018	\$ 331,014
2019	294,297
2020	248,168
2021	121,529
2022	35,020
	<u>\$ 1,030,028</u>

Future levels of compensation cost recognized related to stock-based compensation awards may be impacted by new awards and/or modifications, repurchases and cancellations of existing awards. Under the terms of the Plan, vested options generally expire ninety days after the director or employee terminates the service affiliation with the Bank.

**BANK OF SOUTHERN CALIFORNIA, N.A.**  
**NOTES TO FINANCIAL STATEMENTS**  
**December 31, 2017 and 2016**

**NOTE N - 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 possibly additional discretionary, actions by regulators that, if undertaken, could have a direct material effect on the Bank's financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Bank must meet specific capital guidelines that involve quantitative measures of the Bank's assets, liabilities, and certain off-balance-sheet items as calculated under 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.

In July, 2013, the federal bank regulatory agencies approved the final rules implementing the Basel Committee on Banking Supervision's capital guidelines for U.S. banks (Basel III rules). The new rules, Basel III, became effective on January 1, 2015, with certain of the requirements 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 0.00% in 2015 to 2.5% 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.

Quantitative measures established by regulation to ensure capital adequacy require the Company and Bank to maintain minimum amounts and ratios (set forth in the table below) of total, Tier 1 and CET1 capital (as defined in the regulations) to risk-weighted assets (as defined), and of Tier 1 capital (as defined) to average assets (as defined). 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 notification from the Office of the Comptroller of the Currency categorized the Bank as "well-capitalized" under the regulatory framework for prompt corrective action.

**BANK OF SOUTHERN CALIFORNIA, N.A.**  
**NOTES TO FINANCIAL STATEMENTS**  
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**NOTE N - REGULATORY MATTERS - CONTINUED**

To be categorized as well-capitalized, the Bank must maintain minimum ratios as set forth in the table below. Management believes, as of December 31, 2017, that the Bank meets all capital adequacy requirements to which it is subject. The following table also sets forth the Bank's actual capital amounts and ratios (dollar amounts in thousands):

	Actual		Amount of Capital Required			
			To be Adequately Capitalized		To be Well-Capitalized under PCA Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
<b>As of December 31, 2017:</b>						
Total Capital (to Risk-Weighted Assets)	\$ 51,700	13.5%	\$ 30,608	8.0%	\$ 38,260	10.0%
Tier 1 Capital (to Risk-Weighted Assets)	48,574	12.7%	22,956	6.0%	30,608	8.0%
CET1 Capital (to Risk-Weighted Assets)	48,574	12.7%	17,217	4.5%	24,869	6.5%
Tier 1 Capital (to Average Assets)	48,574	10.3%	18,805	4.0%	23,507	5.0%
<b>As of December 31, 2016:</b>						
Total Capital (to Risk-Weighted Assets)	\$ 46,600	14.5%	\$ 25,706	8.0%	\$ 32,132	10.0%
Tier 1 Capital (to Risk-Weighted Assets)	43,630	13.6%	19,279	6.0%	25,706	8.0%
CET1 Capital (to Risk-Weighted Assets)	43,630	13.6%	14,459	4.5%	20,886	6.5%
Tier 1 Capital (to Average Assets)	43,630	10.4%	16,781	4.0%	20,976	5.0%

Under federal law, a national bank generally may not pay cash dividends in excess of the bank's net profits, if it would impair the bank's capital, if the bank is in default on the payment of any assessment due to the FDIC, or if the bank has not paid all cumulative dividends on outstanding preferred stock. In addition, unless and until a bank's additional paid in capital account is equal to its common stock account, no dividend can be declared until the bank has carried to its additional paid-in capital account not less than one-tenth of its net profits for the preceding two consecutive half-years (in the case of annual dividends).

**BANK OF SOUTHERN CALIFORNIA, N.A.**  
**NOTES TO FINANCIAL STATEMENTS**  
**December 31, 2017 and 2016**

**NOTE O - FAIR VALUE OF FINANCIAL INSTRUMENTS**

The fair value of a financial instrument is the amount at which the asset or obligation could be exchanged in a current transaction between willing parties, other than in a forced or liquidation sale. Fair value estimates are made at a specific point in time based on relevant market information and information about the financial instrument. These estimates do not reflect any premium or discount that could result from offering for sale at one time the entire holdings of a particular financial instrument. Because no market value exists for a significant portion of the financial instruments, fair value estimates are based on judgments regarding future expected loss experience, current economic conditions, risk characteristics of various financial instruments, and other factors. These estimates are subjective in nature, involve uncertainties and matters of judgment and, therefore, cannot be determined with precision. Changes in assumptions could significantly affect the estimates.

Fair value estimates are based on financial instruments both on and off the balance sheet without attempting to estimate the value of anticipated future business, and the value of assets and liabilities that are not considered financial instruments. Additionally, tax consequences related to the realization of the unrealized gains and losses can have a potential effect on fair value estimates and have not been considered in many of the estimates.

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

Financial Assets

The carrying amounts of cash, deposits due from banks, and interest bearing deposits with banks, including excess reserves at the Federal Reserve Bank, are considered to approximate fair value. The fair values of investment securities are based on quoted market prices for similar securities. The fair value of loans are estimated by discounting estimated future cash flows at an appropriate market rate given the term of the related loans.

Financial Liabilities

The carrying amounts of deposit liabilities payable on demand are considered to approximate fair value. For fixed maturity deposits, fair value is estimated by discounting estimated future cash flows using currently offered rates for deposits of similar remaining maturities. The fair value of long-term debt is based on rates currently available to the Bank for debt with similar terms and remaining maturities.

**BANK OF SOUTHERN CALIFORNIA, N.A.**  
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**NOTE O - FAIR VALUE OF FINANCIAL INSTRUMENTS - CONTINUED**

Off-Balance Sheet Financial Instruments

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

The estimated fair value hierarchy level and estimated fair value of financial instruments at December 31 is summarized as follows:

		2017		2016	
	Fair Value Hierarchy	Carrying Value	Fair Value	Carrying Value	Fair Value
<b>Financial Assets:</b>					
Cash and Due From Banks	Level 1	\$ 7,377,883	\$ 7,377,883	\$ 6,199,920	\$ 6,199,920
Excess Reserves at the Federal Reserve Bank	Level 1	32,500,000	32,500,000	62,370,000	62,370,000
Investment Securities Available for Sale	Level 2	21,494,286	21,494,286	4,543,977	4,543,977
Loans, net	Level 3	396,325,872	393,557,000	330,189,847	328,080,000
FHLB, FRB and Banker's Bank Stock	Level 2	3,259,300	3,259,300	2,850,550	2,850,550
Accrued Interest Receivable	Level 2	1,324,567	1,324,567	972,803	972,803
<b>Financial Liabilities:</b>					
Deposits	Level 2	407,485,071	407,243,000	377,529,352	377,659,000
FHLB Advances	Level 2	20,000,000	20,000,000	-	-
Accrued Interest Payable	Level 2	63,613	63,613	44,117	44,117

**NOTE P - FAIR VALUE MEASUREMENT**

The following is a description of valuation methodologies used for assets and liabilities recorded at fair value:

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

Other Real Estate Owned: Nonrecurring adjustments to certain commercial and residential real estate properties classified as other real estate owned (OREO) are measured at the lower of the carrying amount or fair value, less costs to sell. The fair value of OREO is generally based on recent real estate appraisals or broker opinions, obtained from independent third parties, which are frequently adjusted by management to reflect current conditions and estimated selling costs (Level 3).



**BANK OF SOUTHERN CALIFORNIA, N.A.**  
**NOTES TO FINANCIAL STATEMENTS**  
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**NOTE P - FAIR VALUE MEASUREMENT - CONTINUED**

Appraisals for other real estate owned and collateral dependent loans are performed by certified general appraisers whose qualifications and licenses have been reviewed and verified by the Bank. Once received, a member of the loan department reviews the assumptions and approaches utilized in the appraisal as well as the overall resulting fair value. The Bank also determines what additional adjustments, if any, should be made to the appraisal values on any remaining other real estate owned to arrive at fair value. No significant adjustments to appraised values have been made as a result of this review process at December 31, 2017 or 2016.

The Bank has no liabilities measured and recorded at fair value as of December 31, 2017. The Bank had no assets measured at fair value on a recurring basis using significant unobservable inputs (Level 3) during 2017.

The following table provides the hierarchy and fair value for each major category of asset measured at fair value at December 31, 2017:

	Fair Value Measurements Using			
	Level 1	Level 2	Level 3	Total
<b>Assets measured at fair value on a recurring basis</b>				
Securities Available for Sale	\$ -	\$21,494,286	\$ -	\$21,494,286

The following table provides the hierarchy and fair value for each major category of asset measured at fair value at December 31, 2016:

	Fair Value Measurements Using			
	Level 1	Level 2	Level 3	Total
<b>Assets measured at fair value on a recurring basis</b>				
Securities Available for Sale	\$ -	\$ 4,543,977	\$ -	\$ 4,543,977
<b>Assets measured at fair value on a non-recurring basis</b>				
Other Real Estate Owned	\$ -	\$ -	\$ 235,000	\$ 235,000

**BANK OF SOUTHERN CALIFORNIA, N.A.**  
**NOTES TO FINANCIAL STATEMENTS**  
**December 31, 2017 and 2016**

**NOTE P - FAIR VALUE MEASUREMENT - CONTINUED**

The Bank had no non-recurring Level 3 fair value measurements at December 31, 2017.

Qualitative information about the Bank's non-recurring Level 3 fair value measurements at December 31, 2016 is as follows:

	<u>Fair Value Amount</u>	<u>Valuation Technique</u>	<u>Unobservable Input</u>	<u>Weighted Average Adjustment</u>
Other Real Estate Owned	\$235,000	3rd Party Appraisals	Selling Costs and Management Adjustments	20%

**NOTE R - SUBSEQUENT EVENTS**

On February 21, 2018, the Bank signed a definitive agreement and plan of merger (the "Agreement") whereby Americas United Bank will merge with and into Bank of Southern California. The merger is subject to customary closing conditions, including the receipt of all regulatory approvals and the approval of the shareholders of Americas United Bank and Bank of Southern California, and is expected to close in the third quarter of 2018. Additionally, directors and executive officers of Americas United Bank have entered into agreements committing to vote their shares in favor of the transaction. The transaction is valued at approximately \$44.1 million, based on Bank of Southern California's stock price per share of \$14.75.

Under the terms of the Agreement, Americas United Bank shareholders will receive \$7.00 in cash and 0.4746 shares of Bank of Southern California common stock, or \$14.00 per share, for each share of Americas United Bank common stock that they own as of the closing date of the merger. Americas United Bank had assets of approximately \$235.2 million at December 31, 2017. In order to support the operations of the combined Bank following the merger, Bank of Southern California has received binding commitments from investors pursuant to which it will raise \$20.0 million in common stock.

## Board of Directors

**John Farkash** | Chairman of the Board

**Irwin L. Golds** | CEO and Co-founder of Capitis Real Estate

**Lester Machado, MD, DDS, FRCS (Ed)** | Oral and Maxillofacial Surgeon

**Joseph E. Matranga, C.P.A.** | President and Founder of Matranga & Company, CPA's

**Nathan L. Rogge** | President and CEO, Bank of Southern California

**David J. Volk** | Principal, Castle Creek Capital

## Executive Management

**Nathan L. Rogge** | President and Chief Executive Officer

**James H. Burgess** | Executive Vice President and Chief Financial Officer

**Anthony J. DiVita** | Executive Vice President and Chief Banking Officer

**Pamela C. Isaacson** | Executive Vice President and Chief Administrative Officer

**Robert A. Marshall** | Executive Vice President and Chief Credit Officer

## Office Locations

### Del Mar

12265 El Camino Real, Suite 100

San Diego, CA 92130

Phone: (858) 847-4700

Fax: (858) 847-4701

Manager: Theresa Green

### Carlsbad

3142 Tiger Run Court, Suite 107

Carlsbad, CA 92010

Phone: (760) 599-7044

Fax: (760) 599-7074

Manager: Sandy Apodaca

### Ramona

1315 Main Street

Ramona, CA 92065

Phone: (760) 788-8788

Fax: (760) 789-5576

Manager: Patricia Bell

### Downtown San Diego

1620 5<sup>th</sup> Avenue, Suite 120

San Diego, CA 92101

Phone: (619) 849-5741

Fax: (619) 849-5760

Manager: Irene Zimmerman

### La Quinta

47-000 Washington

La Quinta, CA 92253

Phone: (760) 771-0654

Fax: (760) 771-9548

Manager: Angela Henderson

### Palm Desert

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Palm Desert, CA 92260

Phone: (760) 862-0099

Fax: (760) 862-1866

Manager: Luz Gonzalez

### Rancho Mirage

40101 Monterey Avenue

Building H

Rancho Mirage, CA 92270

Phone: (760) 834-6600

Fax: (760) 771-9548

Manager: Luz Gonzalez

### Orange Loan Production Office

1100 W. Town and Country Road

Suite 1250

Orange, CA 92868

Phone: (714) 352-7473

## Professional Consultants

Vavrinek Trine Day & Co., LLP | Independent Auditor

Duane Morris, L.L.P. | Legal Counsel

## Common Stock Information

**Stock Exchange Listing** | The common stock trades on the OTC Marketplace (OTC Pink) under the symbol BCAL

**Computershare Investor Services** | Transfer Agent





