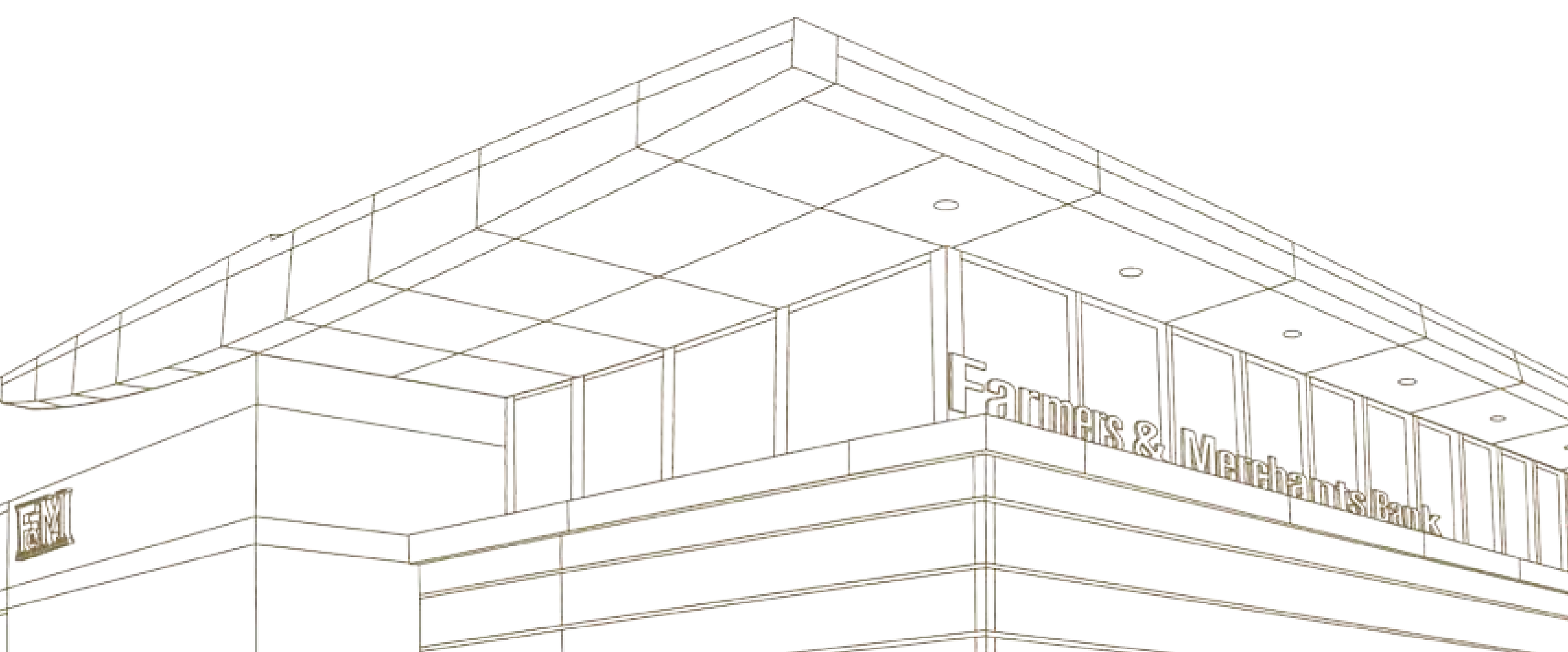
F&M BANK

Farmers & Merchants Bank®

2016 Annual Report

Our Commitment

YESTERDAY. TODAY. TOMORROW.



Farmers & Merchants Bank is one of the STRONGEST banks in the country, as measured by a variety of INDUSTRY STANDARDS, and upholds the PHILOSOPHY of our founder, C.J. Walker.

"Safeguarding our clients' money is a sacred trust."

And GIVING BACK to the community is the WISEST investment a business can make.

Today

Our Balance Sheet as of 12/31/2016

$6.7 Billion
In Total Assets

$5.1 Billion
In Total Deposits

$3.4 Billion
In Total Net Loans

$910.3 Million
Total Stockholders' Equity

130,928
Total Shares Outstanding

Our Locations

24 Offices
In Southern California

302 Pine Avenue
Corporate Headquarters
in Long Beach, California

Our Services

Personal Banking

Credit & Loans

Business Banking

Mobile Banking

Key Facts

F&M's total risk-based capital (RBC) was 20.85% on 12/31/16, more than DOUBLE the federally mandated adequacy levels.

Our Employees

F&M's employee tenure averages more than eight years, which is nearly DOUBLE the median employee tenure.

Honesty Integrity The Home ... Church Service above Self

F&M BANK

Contents

Honesty Integrity The Home The Church Service above Self

VALUES - noun - principles or standards of behavior; one's judgment of what is important in life.

F&M Garden Grove Office Grand Opening
October 1955

Honesty Integrity The Hom… Church Service above Self

F&M BANK

Our Values

Honesty

Integrity

The Home

The Church

Service above Self

Board of Directors

Daniel K. Walker
Chairman of the Board & CEO

Since 2003
Mr. Walker is Chairman of the Board & CEO of Farmers & Merchants Bank, where he has served in various positions since 1975.

Timothy W. Jackert
Board Member

Since 2003
Mr. Jackert served as chief financial officer at Memorial Medical Center Foundation in Long Beach for 38 years.

Richard W. Darling
Board Member

Since 2008
Mr. Darling, who also served as a board member between 1994 and 2007, is the retired president of Bremco Construction, a general contractor specializing in projects for major industrial and commercial corporations.

Lawrence J. McLaughlin
Board Member

Since 1990
Mr. McLaughlin, who formerly was a principal and managing partner of a Los Angeles–based law firm for more than three decades, is now a principal at Megandrew Mineral Co., a Girard, Texas–based petroleum development company.

Walter M. Florie
Board Member

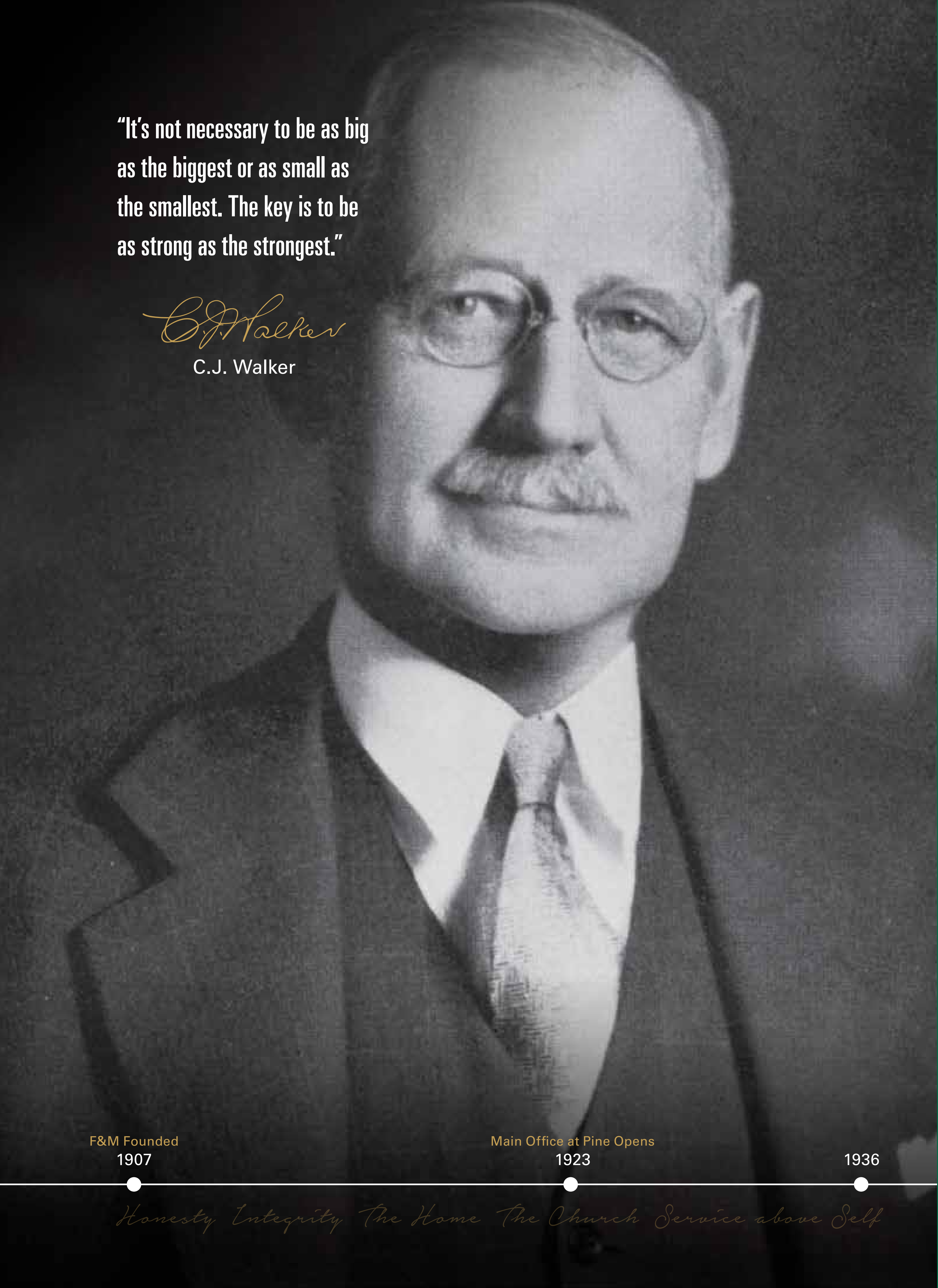
Since 2007
Mr. Florie, who formerly held executive positions at Union Bank for almost three decades, is now president and CEO of the Earl B. and Loraine H. Miller Foundation, an organization focused on children and their healthcare needs in the greater Long Beach community.

Timothy M. Wilson
Board Member

Since 2005
Mr. Wilson is president of Mitchell Land & Improvement Co., a Southern California–based real estate development company where he previously served as executive vice president and chief operating officer.

William G. Hayter
Board Member

Since 1998
Mr. Hayter, who previously served as president of the Pacific Hospital Foundation, director of the Long Beach YMCA, and counsel for the Boy Scouts of America, is a practicing attorney specializing in business, estate planning, and trust administration.



"It's not necessary to be as big as the biggest or as small as the smallest. The key is to be as strong as the strongest."

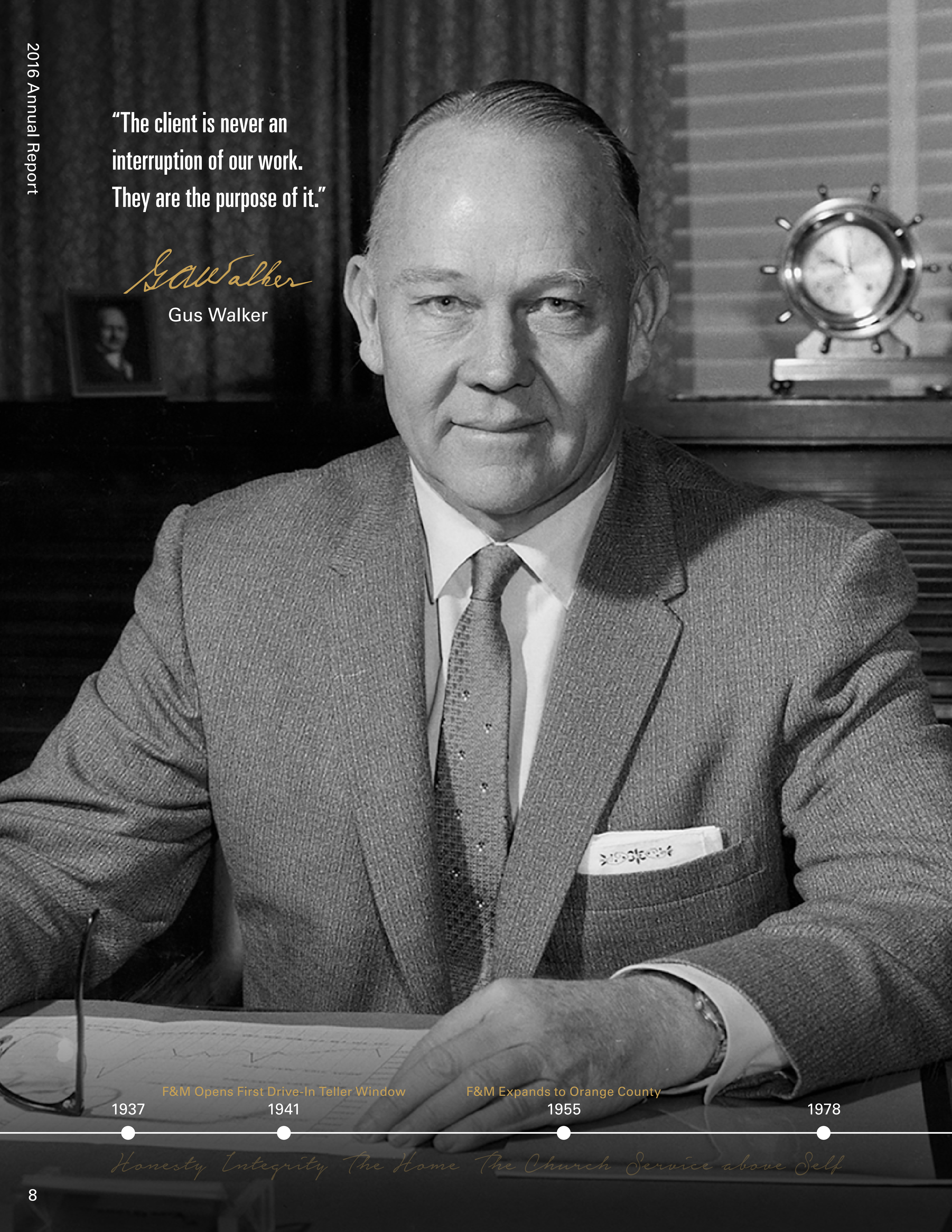
C.J. Walker

F&M Founded
1907

Main Office at Pine Opens
1923

1936

Honesty Integrity The Home The Church Service above Self



"The client is never an interruption of our work. They are the purpose of it."

Gus Walker

F&M Opens First Drive-In Teller Window

F&M Expands to Orange County

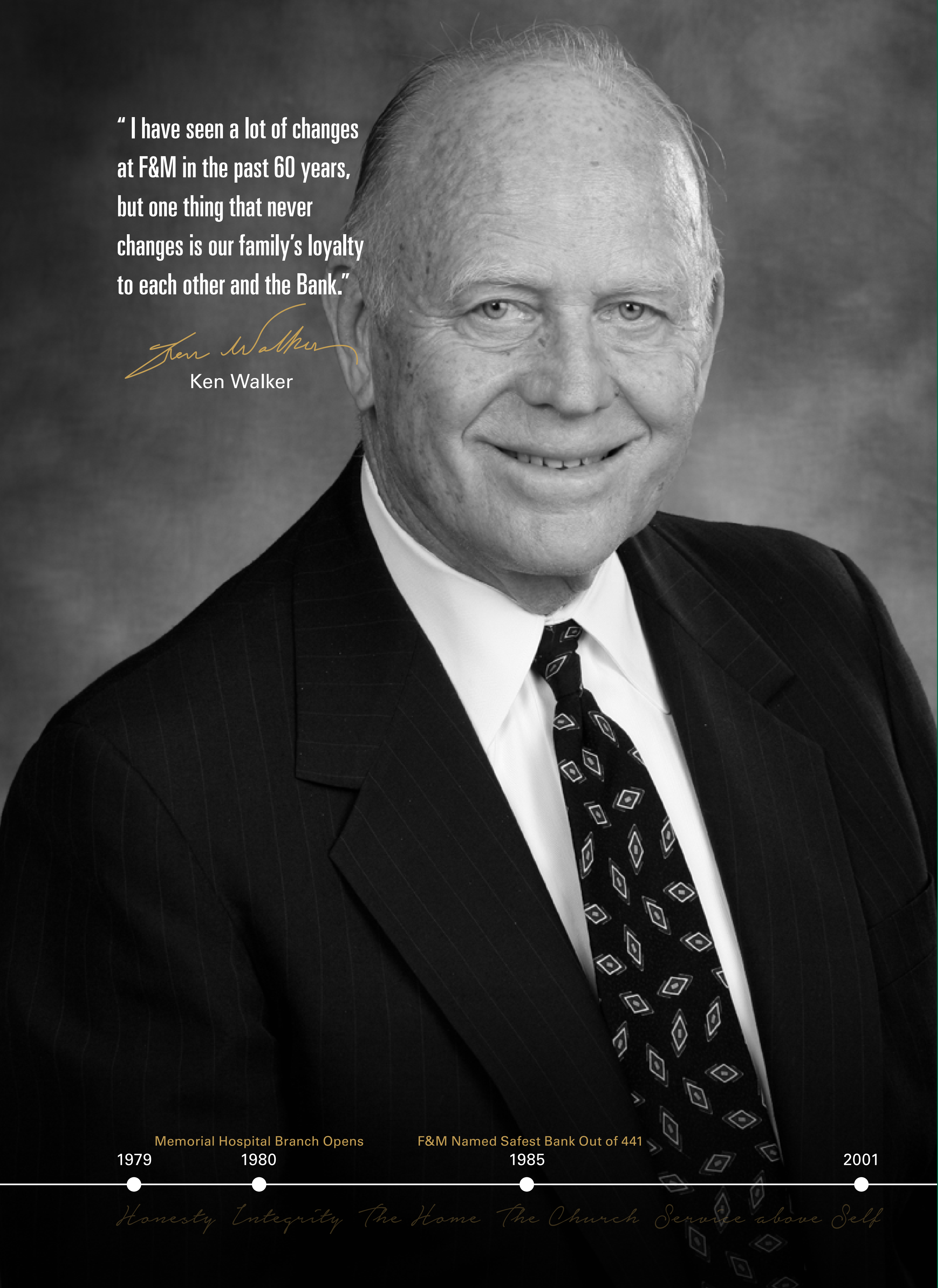
1937

1941

1955

1978

Honesty Integrity The Home The Church Service above Self



"I have seen a lot of changes at F&M in the past 60 years, but one thing that never changes is our family's loyalty to each other and the Bank."

Ken Walker

Memorial Hospital Branch Opens

F&M Named Safest Bank Out of 441

1979 — 1980 — 1985 — 2001

Honesty Integrity The Home The Church Service above Self

Daniel K. Walker
Chairman of the Board & CEO

W. Henry Walker
President

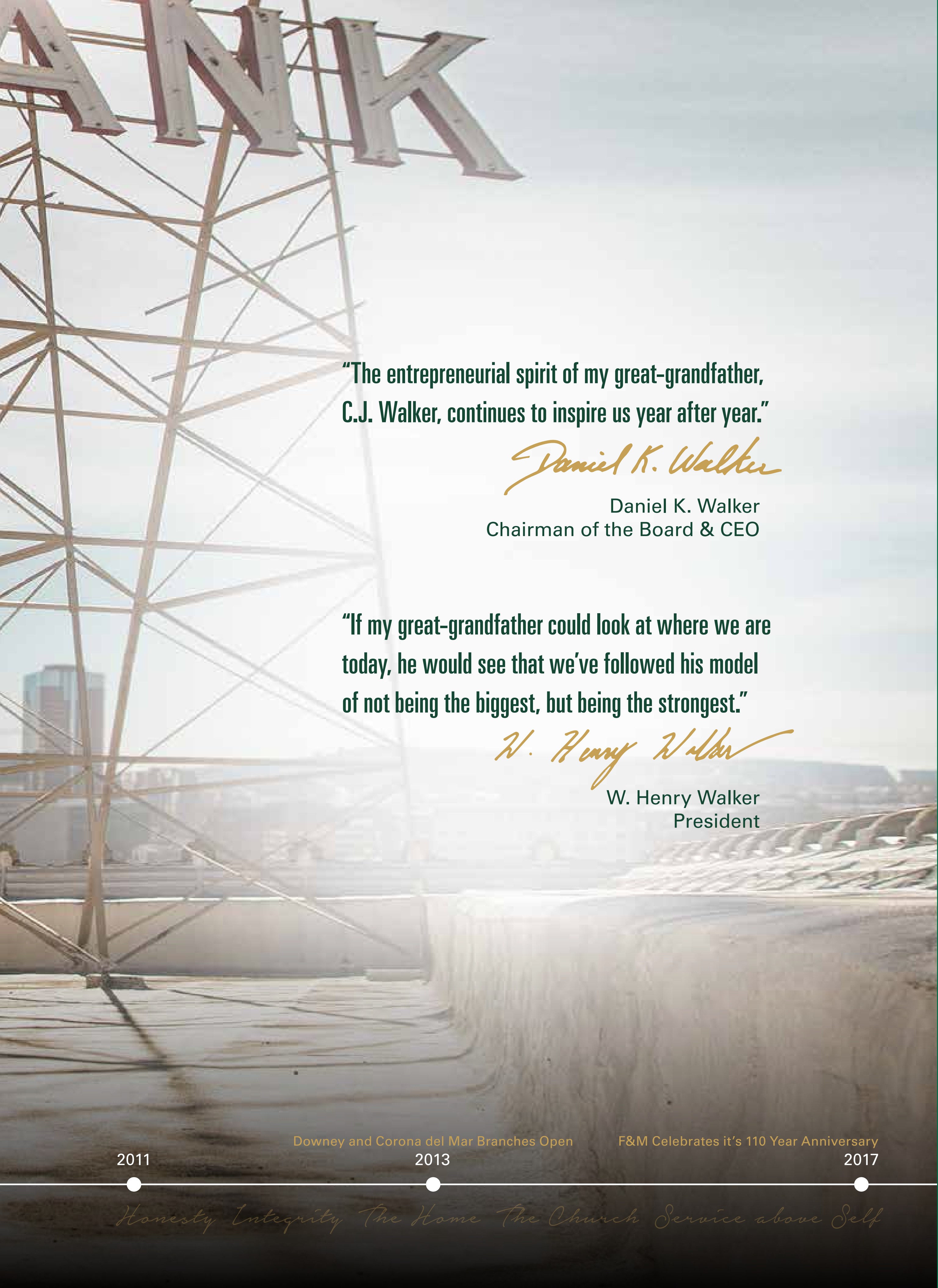
2002

F&M Main Office Is Fully Restored
2005

F&M Customer Care Center Opens
2009

2010

Honesty Integrity The Home The Church Service above Self



"The entrepreneurial spirit of my great-grandfather, C.J. Walker, continues to inspire us year after year."

Daniel K. Walker

Daniel K. Walker
Chairman of the Board & CEO

"If my great-grandfather could look at where we are today, he would see that we've followed his model of not being the biggest, but being the strongest."

W. Henry Walker

W. Henry Walker
President

2011

Downey and Corona del Mar Branches Open
2013

F&M Celebrates it's 110 Year Anniversary
2017

Honesty Integrity The Home The Church Service above Self

Dear Fellow Shareholders

When Farmers & Merchants Bank's founder, C.J. Walker, proclaimed that "safeguarding our clients' money is a sacred trust," he set in motion a philosophy that has resonated throughout the Bank for more than five generations.

Indeed, it is a sacred trust to do business with the community we have been serving since 1907. The foundation upon which that sacred trust is built contains a set of core values, including honesty, integrity, the home, the church, and service above self.

These values are consistent with our commitment to provide high-quality products and services to our clients. It is noteworthy that our commitment to these values parallels our financial health. F&M has been profitable since its inception and has never requested or received any government assistance, including during the 2008–09 recession.

Despite continued fluctuations in the economy, we have maintained our momentum in asset growth, while staying focused on our conservative lending philosophy. Since 2009, F&M has grown total assets nearly 70% to more than $6.7 billion in 2016. F&M has also paid a dividend each year to shareholders for more than a century.

Maintaining Financial Strength

Looking more closely at our financial results in 2016, interest and dividend income rose to $222.8 million from $206.2 million in 2015. Interest expense for the year was $10.3 million, versus $7.6 million in 2015.

Farmers & Merchants' net interest income for 2016 was $212.5 million, versus $198.6 million in 2015. The Bank's net interest margin was 3.51% for the year ended December 31, 2016, compared with 3.63% in the previous year.

In 2016, the Bank did not record a loan loss provision, compared with $2.7 million in loan loss provision recapture in 2015. The Bank's allowance for loan losses as a percentage of loans outstanding was 1.64% at December 31, 2016, compared with 1.73% at December 31, 2015.

Non-interest income for the full 2016 year totaled $25.3 million, essentially in line with non-interest income in 2015.

Non-interest expense for the year ended December 31, 2016, was $143.5 million, compared with $132.7 million in the previous year.

The Bank's net income for 2016 was $71.5 million, or $546.16 per diluted share, compared with $64.9 million, or $496.06 per diluted share, for 2015.

Healthy Balance Sheet

F&M continued to maintain a strong, healthy balance sheet in 2016, while also demonstrating steady loan and deposit growth. In 2016, net loans totaled $3.40 billion, compared with $3.22 billion at December 31, 2015.

The Bank's deposits grew to $5.12 billion at the end of 2016, from $4.70 billion at December 31, 2015. Non-interest-bearing deposits represented 37.7% of total deposits at December 31, 2016, versus 38.9% of total deposits at December 31, 2015.

At December 31, 2016, Farmers & Merchants Bank remained "well capitalized" under all regulatory categories, with a total risk-based capital ratio of 20.85%, a tier 1 risk-based capital ratio of 19.60%, a common equity tier 1 capital ratio of 19.60%, and a tier 1 leverage ratio of 13.62%. The minimum ratios for capital adequacy for a well-capitalized bank are 10.00%, 8.00%, 6.50%, and 5.00%, respectively.

Sacred Trust

Of course, there is a story behind F&M's financial strength that exists in the relationships we form with our clients. The profiles in this annual report demonstrate the passion we have for seeing our clients succeed, as well as the sacred trust that exists between us.

As we move forward in our 110th year of serving Southern California, we remain steadfast in our focus to build and maintain strong relationships with new and existing clients, while growing our lending and deposit base, as well as continuing to contribute to organizations that provide a helping hand to those in need in our community.

On behalf of F&M's Board of Directors and management team, we would like to express our gratitude to our employees for their commitment to the Bank's core values, our shareholders for their continued support, and our clients for their sacred trust.

Daniel K. Walker　　　　W. Henry Walker

Daniel K. Walker
Chairman of the Board
Chief Executive Officer

W. Henry Walker
President

Financial Information

Diluted Earnings per Common Share (in Dollars)	2016 $546	2015 $496	2014 $477	2013 $475	2012 $484
Dividends Declared per Common Share (in Dollars)	2016 $119	2015 $119	2014 $114	2013 $114	2012 $114
Net Interest Margin (in Percents)	2016 3.51%	2015 3.63%	2014 3.50%	2013 3.30%	2012 3.65%
Overhead Efficiency Ratio (in Percents)	2016 58.80%	2015 56.62%	2014 55.21%	2013 51.72%	2012 49.00%
Average Assets (Dollars in Millions)	2016 $6,407	2015 $5,804	2014 $5,452	2013 $5,136	2012 $4,845
Total Risk-Based Capital (in Percents)	2016 20.85%	2015 21.33%	2014 23.59%	2013 26.16%	2012 29.61%

Corporate Profile

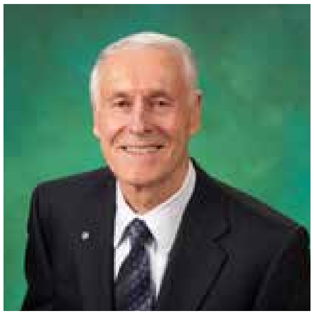
Farmers & Merchants Bank is a full-service, California-state-chartered bank with $6.7 billion in total assets at December 31, 2016. Founded in Long Beach in 1907 by C.J. Walker, the Bank specializes in commercial and small business banking, business loan programs, home loans, and a robust offering of consumer retail banking products, including checking, savings, and youth accounts. With 24 offices located throughout Los Angeles and Orange counties, the Bank is one of California's strongest banks, as demonstrated by several characteristics, including financial performance, heritage, culture, longevity, character, service, and values.

Yesterday, Today, & Tomorrow

This year's annual report features what makes F&M a financial institution above others: personal relationships built with each individual client, yesterday, today, and tomorrow. The values inherent to these relationships are fundamental to the Bank's strength and success in the communities we serve. Our customers inspire us every day, and we will always work toward the success of our clients.

Daniel K. Walker
Chairman of the Board
Chief Executive Officer

W. Henry Walker
President



John W.H. Hinrichs
Executive Vice President,
Chief Financial Officer

Phillip J. Bond
Executive Vice President,
Chief Credit Officer

Melissa Lanfre
Executive Vice President,
Chief Operating Officer

Honesty

"The value of honesty and simply doing what's right for our customers are big reasons why Farmers & Merchants Bank has such a strong history of success. The Bank's values and history are reasons why I choose to work at F&M. I enjoy working for an organization that mirrors what's important to me. We continually look for ways to improve on what we do and giving back to the community."

Thuy Moesta – Branch Manager, Belmont Shore

Honesty *Integrity* *The Home* *The Church* *Service above Self*

Integrity

"I'm in the specialty coffee business, and having integrity is very important when it comes to serving customers a high-quality product. The same rules apply when it comes to banking with Farmers & Merchants Bank. They give me advice and speak to me as a friend, not a bank that would try to nickel and dime you."

Mike Sheldrake – Owner of Polly's Gourmet Coffee

Honesty *Integrity* *The Home* *The Church* *Service above Self*

Service above Self

"Farmers & Merchants Bank's genuine commitment to helping its clients has been the foundation of my banking career. Because of the Bank's culture of putting its clients first and service above self, I have experienced the benefits and success of growing banking relationships by focusing on providing excellent service."

Kourosh Davatolhagh – Relationship Manager, East Long Beach

The Church

"Valuing the Church is about being a good steward of the community, and that is a very inviting characteristic of Farmers & Merchants Bank. It is rare for a bank to care about the well-being of its community, and F&M's customer service makes you feel like a valued member of the community, not just another depositor."

Dr. E.M. Williams – Pastor at St. Luke Holy Baptist Church

Honesty Integrity The Home The Church Service above Self

Honesty

“The value of honesty resonates with me as a branch manager at Farmers & Merchants Bank because I know the Bank is truly doing what is in our clients’ best interest. My parents taught me early on that honesty is always the best policy, and that is certainly an important value when working with our clients at F&M, especially first-time homebuyers.”

Lynette Dyer – Branch Manager, Rossmoor

Honesty Integrity The Home The Church Service above Self

The Home

"The words 'homebuying' and 'easy' are never used in the same sentence—that was, until we recently financed our new home with the help of Farmers & Merchants Bank. The Bank gave us the guidance we needed, and knowing we have a relationship built on trust makes all of the difference."

Brandon Ball – Recent Homebuyer


Honesty
Integrity
Church
Service above Self

2016 Financial Report

KPMG LLP
Suite 700
20 Pacifica
Irvine, CA 92618-3391

Independent Auditors' Report

The Board of Directors
Farmers & Merchants Bank of Long Beach:

Report on the Financial Statements

We have audited the accompanying financial statements of Farmers & Merchants Bank of Long Beach (the Bank), which comprise the balance sheets as of December 31, 2016 and 2015, and the related statements of income, comprehensive income, changes in stockholders' 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 U.S. generally accepted accounting principles; 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.

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

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

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Farmers & Merchants Bank of Long Beach as of December 31, 2016 and 2015, and the results of its operations and its cash flows for the years then ended in accordance with U.S. generally accepted accounting principles.

Report on Internal Control over Financial Reporting

We also have audited, in accordance with auditing standards generally accepted in the United States of America, the Bank's internal control over financial reporting as of December 31, 2016, based on criteria established in *Internal Control – Integrated Framework (2013)* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO), and our report dated April 19, 2017, expressed an unmodified opinion on the effectiveness of the Bank's internal control over financial reporting.

KPMG LLP

Irvine, California
April 19, 2017

Farmers & Merchants Bank of Long Beach
Balance Sheets

	December 31, 2016	December 31, 2015
	(In thousands, except share and per share data)	
Assets		
Cash and due from banks:		
Non-interest-bearing balances	$ 63,797	$ 64,742
Interest-bearing balances	84,918	103,278
Total cash and due from banks	148,715	168,020
Securities available-for-sale, at fair value	182,320	206,649
Securities held-to-maturity, at amortized cost	2,762,877	2,363,383
Loans held for sale	6,080	3,168
Gross loans	3,466,382	3,278,852
Allowance for loan losses	(56,867)	(56,670)
Unamortized deferred loan fees, net	(5,314)	(4,139)
Loans, net	3,404,201	3,218,043
Other real estate owned, net	791	1,351
Investments in FHLB and FRB stock, at cost	20,690	20,690
Premises and equipment, net	87,775	86,781
Deferred tax assets, net	30,281	27,892
Other assets	85,328	57,623
Total assets	**$ 6,729,058**	**$ 6,153,600**
Liabilities and Stockholders' Equity		
Liabilities:		
Deposits:		
Non-interest-bearing deposits	$ 1,931,931	$ 1,824,516
Interest-bearing deposits	3,191,026	2,865,450
Total deposits	5,122,957	4,689,966
Securities sold under repurchase agreements	540,035	572,915
Other borrowings	100,000	-
Other liabilities	55,753	35,388
Total liabilities	5,818,745	5,298,269
Stockholders' equity:		
Common stock, par value $20; authorized 250,000 shares; issued and outstanding 130,928 shares	2,619	2,619
Additional paid-in capital	112,044	112,044
Retained earnings	795,187	739,259
Accumulated other comprehensive income	463	1,409
Total stockholders' equity	910,313	855,331
Total liabilities and stockholders' equity	**$ 6,729,058**	**$ 6,153,600**

See accompanying notes to financial statements.

Farmers & Merchants Bank of Long Beach

Statements of Income

	Years Ended December 31, 2016	2015
	(In thousands, except per share data)	
Interest and dividend income:		
Loans	$ 161,742	$ 149,424
Investment securities	57,823	53,527
Investments in FHLB and FRB stock	2,305	2,864
Interest-bearing deposits in financial institutions	963	412
Total interest and dividend income	222,833	206,227
Interest expense:		
Deposits	8,452	6,468
Securities sold under repurchase agreements	1,877	1,144
Other borrowings	5	6
Total interest expense	10,334	7,618
Net interest income	212,499	198,609
Provision for loan losses	-	(2,700)
Net interest income after provision for loan losses	212,499	201,309
Non-interest income:		
Service charges on deposit accounts	3,930	4,035
Other real estate owned income	27	1,454
Merchant bankcard income	10,298	9,722
Other income	11,033	10,069
Total non-interest income	25,288	25,280
Non-interest expense:		
Salaries and employee benefits	77,190	77,153
FDIC and other insurance expense	2,963	3,238
Occupancy expense	10,433	8,843
Software and equipment expense	7,337	7,353
Other real estate owned expense	(62)	704
Merchant bankcard expense	8,040	8,039
Professional and legal services	5,649	4,602
Marketing expense	6,396	5,504
Other expense	25,587	17,297
Total non-interest expense	143,533	132,733
Income before income tax expense	94,254	93,856
Income tax expense	22,746	28,908
Net income	**$ 71,508**	**$ 64,948**
Basic and diluted earnings per common share	$ 546.16	$ 496.06

See accompanying notes to financial statements.

Farmers & Merchants Bank of Long Beach

Statements of Comprehensive Income

	Years Ended December 31,	
	2016	2015
	(In thousands)	
Net income	$ 71,508	$ 64,948
Other comprehensive loss, net of tax:		
Unrealized losses on securities available-for-sale:		
Unrealized holding losses arising during the period	(946)	(597)
Other comprehensive loss	(946)	(597)
Comprehensive income	**$ 70,562**	**$ 64,351**

See accompanying notes to financial statements.

Farmers & Merchants Bank of Long Beach
Statements of Changes in Stockholders' Equity

	Common Stock	Additional Paid-In Capital	Retained Earnings	Accumulated Other Comprehensive Income	Total Stockholders' Equity
		(In thousands)			
Balance, December 31, 2014	**$ 2,619**	**$ 112,044**	**$ 689,892**	**$ 2,006**	**$ 806,561**
Net income	-	-	64,948	-	64,948
Cash dividends	-	-	(15,581)	-	(15,581)
Other comprehensive loss, net of tax	-	-	-	(597)	(597)
Balance, December 31, 2015	**$ 2,619**	**$ 112,044**	**$ 739,259**	**$ 1,409**	**$ 855,331**
Net income	-	-	71,508	-	71,508
Cash dividends	-	-	(15,580)	-	(15,580)
Other comprehensive loss, net of tax	-	-	-	(946)	(946)
Balance, December 31, 2016	**$ 2,619**	**$ 112,044**	**$ 795,187**	**$ 463**	**$ 910,313**

See accompanying notes to financial statements.

Farmers & Merchants Bank of Long Beach

Statements of Cash Flows

	Years Ended December 31, 2016	2015
	(In thousands)	
Cash flows from operating activities:		
Net income	$ 71,508	$ 64,948
Adjustments to reconcile net income to net cash provided by operating activities:		
Net amortization on securities	24,066	20,152
Provision for loan losses	-	(2,700)
Originations of loans held for sale	(93,115)	(72,158)
Proceeds from sale of loans held for sale	91,846	71,833
Gain on sale of loans held for sale	(1,643)	(1,092)
Gain on sale of other real estate owned	(15)	(1,191)
Addition of reserve for other real estate owned	-	121
Amortization of tax credit investments	18,880	10,958
Depreciation of bank premises and equipment	7,148	5,859
Addition of reserve for losses on unfunded loan commitments	600	700
Increase in deferred income tax benefit	(1,692)	(3,786)
Increase in other assets	(11,456)	(2,355)
(Decrease) Increase in other liabilities	(3,185)	10,067
Total adjustments	31,434	36,408
Net cash provided by operating activities	102,942	101,356
Cash flows from investing activities:		
Securities available-for-sale:		
Proceeds from maturities and pay downs	76,804	74,303
Purchases	(59,276)	(71,855)
Securities held-to-maturity:		
Proceeds from maturities and pay downs	405,833	330,576
Purchases	(824,224)	(700,952)
Net increase in loans held for investment	(186,158)	(410,665)
Proceeds on sale of loans held for investment	-	151,627
Gain on sale of loans held for investment	-	(155)
Proceeds from sale of other real estate owned	575	3,125
Redemption of FHLB and FRB stock	-	7,750
Increase of tax credit investments	(12,190)	(2,869)
Purchases of bank premises and equipment	(8,142)	(7,638)
Net cash used in investing activities	(606,778)	(626,753)

Farmers & Merchants Bank of Long Beach
Statements of Cash Flows

Statement of Cash Flows, continued

	Years Ended December 31, 2016	2015
	(In thousands)	
Cash flows from financing activities:		
Net increase in deposits	432,991	489,693
Net (decrease) increase in securities sold under repurchase agreements	(32,880)	26,157
Net increase in other borrowings	100,000	-
Cash dividends paid	(15,580)	(15,581)
Net cash provided by financing activities	484,531	500,269
Net decrease in cash and due from banks	(19,305)	(25,128)
Cash and cash equivalents at beginning of year	168,020	193,148
Cash and cash equivalents at end of year	**$ 148,715**	**$ 168,020**
Supplemental disclosures of cash flow information:		
Cash paid during the year for:		
Interest expense	$ 8,524	$ 6,522
Income taxes	29,719	28,743
Non-cash investing and financing activities:		
New commitment to fund tax credit investments	$ 28,103	$ -

See accompanying notes to financial statements.

Farmers & Merchants Bank of Long Beach
Notes to Financial Statements

NOTE 1 – NATURE OF OPERATIONS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Farmers & Merchants Bank of Long Beach (the "Bank" or "FMB") was founded in 1907 as a California state-chartered community bank that offers a broad range of banking products and services to individuals, professionals, and small to medium-sized businesses. The Bank operates 24 branches in California's Los Angeles County and Orange County as of December 31, 2016. As a full-service commercial bank, FMB offers a broad range of banking products and services, including accepting demand, money market, savings, and time deposits; originating loans, including commercial real estate loans, construction loans, and commercial business loans; and providing other business-oriented banking products and services. The Bank also provides financing for residential loans, including single-family and multifamily loans.

The Bank's operations, like those of other financial institutions operating in Southern California, are significantly influenced by economic conditions in Southern California, including local economies, the strength of the real estate market, and the fiscal and regulatory policies of the federal and state governments and the regulatory authorities that govern financial institutions.

Basis of Financial Statement Presentation

The financial statements are prepared in accordance with accounting principles generally accepted in the United States of America ("U.S. GAAP") and conform to general practices within the banking industry. The policies that materially affect the determination of balance sheets, statements of income, and cash flow are summarized below.

Use of Estimates

In preparing the financial statements, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities as of the date of the balance sheet and income statement for the year. Material estimates that are particularly susceptible to significant change in the near term relate to the determination of the allowance for loan losses, the fair value of securities available-for-sale, the reserve for other real estate owned, realization of deferred tax assets, and the fair value of financial instruments. Actual results could differ from those estimates.

Reclassifications

Certain prior year amounts have been reclassified to conform to the current year's presentation. These reclassifications did not affect previously reported net income.

Cash and Due from Banks

For purposes of the statements of cash flows, cash and cash equivalents consist of cash and due from banks, which comprise non-interest-bearing balances and interest-bearing balances. Interest-bearing balances represent cash held at the Federal Reserve Bank of San Francisco ("FRBSF"), the majority of which is immediately available.

NOTE 1 – Nature of Operations and Summary of Significant Accounting Policies, continued

Securities Available-for-Sale and Securities Held-to-Maturity

At the time of purchase, the Bank classifies its securities into one of two categories: available-for-sale and held-to-maturity. If the Bank has the ability and positive intent at the time of purchase to hold securities until maturity, they are classified as held-to-maturity. All securities not identified as held-to-maturity are classified as available-for-sale. Securities held-to-maturity are recorded at cost, adjusted for the amortization of premiums and accretion of discounts on a level-yield basis. Securities available-for-sale are carried at estimated fair value with unrealized holding gains and losses, net of the related tax effect, excluded from income and reported as a separate component of stockholders' equity identified as accumulated other comprehensive income until realized.

Transfers of securities between categories, if any, are recorded at fair value at the date of the transfer. Unrealized holding gains or losses included in the separate component of equity for securities transferred from available-for-sale to held-to-maturity would be maintained and amortized into income over the remaining life of the security as an adjustment to the yield in a manner consistent with the amortization of premium or accretion of discount on the associated security.

If a decline in market value of any security held-to-maturity or available-for-sale below cost is deemed other-than-temporary, the security is written down to its fair value, which becomes the new cost basis, and an impairment loss is recognized. In estimating other-than-temporary impairment losses, management considers, among other things, (i) the length of time and the extent of which the fair value has been less than cost, (ii) the financial condition and near-term prospects of the issuer, and (iii) 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. Any impairment on securities the Bank intends, or is more likely than not required to sell, is recognized in earnings as the entire difference between the amortized cost and its fair value. Any impairment on securities the Bank does not intend, or is not required to sell before recovery, is separated into an amount representing the credit loss, which is recognized in earnings, and the amount related to all other factors, which is recognized in other comprehensive income. The new cost basis is not changed for subsequent recoveries in fair value.

Premiums and discounts are amortized and accreted over the life of the related security as an adjustment to yield using the interest method. Unamortized premiums and un-accreted discounts are recognized as a component of gain or loss on sale upon disposition of the related security. Interest income is recognized when earned. Realized gains and losses on the sale of securities available-for-sale are included in non-interest income as gain (loss) on sale of securities using the specific-identification method.

The Bank's security portfolio is managed to meet our liquidity needs through proceeds from scheduled maturities and is also utilized for pledging requirements for deposits of state and local subdivisions, securities sold under repurchase agreements, Federal Home Loan Bank ("FHLB") Advances, and Federal Reserve Bank ("FRB") Discount Window borrowings.

NOTE 1 – Nature of Operations and Summary of Significant Accounting Policies, continued

Loans Held for Sale

Loans held for sale are carried at the lower of cost or fair value. Origination fees on loans held for sale, net of certain costs of processing and closing the loans, are deferred until the time of sale and are included in the computation of the gain or loss from the sale of the related loans. Gains and losses are recorded in non-interest income based on the difference between sales proceeds, net of sales commissions, and carrying value.

The Bank will occasionally transfer loans from held for investment to held for sale. Upon transfer, any associated allowance for loan losses is charged off and the carrying value of the loan is adjusted to the lower of cost or estimated fair value. Gains or losses on the sale of these loans are recorded in non-interest income.

Loans

Loans that the Bank has the intent and ability to hold for the foreseeable future, or until maturity, are reported at the principal amounts outstanding, net of the allowance for loan losses and unamortized deferred net loan fees or costs. Nonrefundable fees and direct costs associated with the origination or purchase of loans are deferred and netted against outstanding loan balances. The deferred net loan fees and costs are recognized in interest income on an effective yield basis over the contractual loan term. Interest income on loans is recorded on an accrual basis in accordance with the terms of the respective loan.

Nonaccrual Loans

Loans on which the accrual of interest has been discontinued are designated as nonaccrual loans. The accrual of interest on loans is discontinued when interest or principal payments are past due 90 days or when, in the opinion of management, there is a reasonable doubt as to collectability in the normal course of business. When loans are placed on nonaccrual status, all interest previously accrued but not collected is reversed against current period interest income, and all interest received on nonaccrual loans will be applied to principal. Loans are restored to accrual status when principal and interest are brought fully current and when, in the opinion of management, such loans are deemed fully collectible as to both principal and interest. The accrual of interest on loans that are more than 90 days past due may continue if the loans are well secured and in the process of collection, and management deems it appropriate.

Troubled Debt Restructured Loans

A loan is classified as a troubled debt restructured loan ("TDR") when a borrower is experiencing financial difficulties that lead to a restructuring of the loan, and the Bank grants concessions to the borrower in the restructuring that are not insignificant, or that it would not otherwise consider for market participants with similar risk characteristics. These concessions may include interest rate reductions, principal forgiveness, extension of maturity date and other actions intended to minimize potential losses. TDR loans may be excluded from restructured loan disclosures in years subsequent to the restructuring if the loans

NOTE 1 – Nature of Operations and Summary of Significant Accounting Policies, continued

Troubled Debt Restructured Loans, continued

are in compliance with their modified terms and the modifications were made at market rates for borrowers with similar risk characteristics. Generally, a nonaccrual loan that is restructured remains on nonaccrual for a period of six months to demonstrate that the borrower can meet the restructured terms. However, the borrower's performance prior to restructuring, or other significant events at the time of restructuring may be considered in assessing whether the borrower can meet the new terms and may result in the loan being returned to accrual status after a shorter performance period. If the borrower's performance under the new terms is not reasonably assured, the loan remains classified as a nonaccrual loan.

Impaired Loans

Loans are considered impaired when it is probable that the Bank will be unable to collect all amounts due according to the contractual terms. Impaired loans include loans on nonaccrual status and restructured loans. If the loan is collateral-dependent, the amount of impairment is measured against the estimated fair value of the loan's underlying collateral, less estimated selling costs, including senior obligations such as delinquent property taxes. If the loan is not collateral-dependent, the Bank measures impairment based on the present value of expected future cash flows discounted at the loan's original effective interest rate. The impairment amount on a collateral-dependent loan is charged-off to the allowance for loan losses and the impairment amount of a loan that is not collateral-dependent is set up as a specific loan loss allowance.

Allowance for Loan Losses

The allowance for loan losses ("ALL") is maintained at a level deemed appropriate by the Bank to adequately provide for known and inherent risks in the loan portfolio at the balance sheet date. The allowance is based upon a continuing review of the portfolio, past loan loss experience, current economic conditions and external conditions which may affect the borrowers' ability to pay, and the underlying collateral value of the loans. Loans which are deemed to be uncollectible are charged off and deducted from the allowance. The provision for loan losses and recoveries on loans previously charged off are added to the allowance.

The allowance for loan losses consists of two components: a general allowance for loans not considered impaired and a specific allowance for loans determined to be impaired.

The methodology the Bank uses to estimate the general allowance component of our ALL is the classification migration methodology, which considers both objective and subjective criteria. The objective criteria uses the Bank's actual historical loan charge-off experience on pools of similar loans to establish loss rates that are applied to the Bank's current loan balances to estimate inherent credit losses. The estimation of the ALL at December 31, 2016, considered actual historical loan charge-off experience over an 11-year period starting with the fourth quarter of 2005. The estimation of the ALL at December 31, 2015, considered actual historical loan charge-off experience over a 10-year period starting with the fourth quarter of 2005. The increase in the historical look-back period from 10 years at December 31, 2015, to

NOTE 1 – Nature of Operations and Summary of Significant Accounting Policies, continued

Allowance for Loan Losses, continued

11 years at December 31, 2016, was deemed prudent in order to include loan charge-off experience during the most recent downward economic cycle in the estimation of the allowance for loan losses. This time frame also provides a reasonable period for migration. The Bank recognizes that the estimation of the ALL is sensitive to the assigned credit risk ratings and loss rates at any given point in time. To ensure the accuracy of our credit risk ratings, an independent credit review function assesses the ratings assigned to loans on an ongoing basis.

The subjective criteria considered when establishing the loss rates include, but are not limited to the following:

- current economic trends and forecasts;
- the loan portfolio composition and any loan concentrations;
- the Bank's current lending policies;
- the volume and nature of new loan originations; and
- the loan portfolio's credit performance trends.

The credit risk ratings assigned to every loan are either "pass," "special mention," "substandard," or "doubtful" and defined as follows:

Pass: Loans classified as pass are expected to be fully collected.

Special Mention: Loans classified as special mention have a potential weakness that requires management's attention. If not addressed, these potential weaknesses may result in further deterioration in the borrower's ability to repay the loan.

Substandard: Loans classified as substandard have a well-defined weakness or weaknesses that jeopardize the collection of the debt. They are characterized by the possibility that the Bank will sustain some loss if the weaknesses are not corrected.

Doubtful: Loans classified as doubtful have all the weaknesses of those classified as substandard, with the additional trait that the weaknesses make collection or repayment in full highly questionable and improbable.

In addition, management may refer to the loans classified as "substandard" and "doubtful" together as "classified loans." For additional information on classified loans, see Note 4, *Loans and Allowance for Loan Losses.*

The methodology the Bank uses to estimate the specific allowance for loans determined to be impaired complies with Accounting Standard Codification ("ASC") Section 310-10-35. If the loan is collateral-dependent, the amount of impairment is measured against the estimated fair value of the loan's underlying collateral, less estimated selling costs, including senior obligations such as delinquent property taxes. If the loan is not collateral-dependent, the Bank measures impairment based on the present value

NOTE 1 – Nature of Operations and Summary of Significant Accounting Policies, continued

Allowance for Loan Losses, continued

of expected future cash flows discounted at the loan's effective interest rate. The impairment amount on a collateral-dependent loan is charged-off to the allowance, and the impairment amount of a loan that is not collateral-dependent is set up as a specific allowance.

Other Real Estate Owned

Other real estate owned ("OREO") represents the collateral acquired through foreclosure in full or partial satisfaction of the related loan and is recorded at the fair value as established by a current appraisal, adjusted for estimated selling costs. The excess of the carrying amount of a loan over the fair value of real estate acquired less cost to sell is charged to the allowance for loan losses at the date of transfer. OREO values are reviewed on an ongoing basis, and any decline in value is charged against OREO expense, along with operating expenses of such properties. Subsequent increases in the fair value of the asset less selling costs reduce the OREO valuation allowance, but not below zero, and are credited to noninterest expense. Income on OREO and gains and losses on their disposition are included in OREO income.

Investment in Federal Home Loan Bank Stock

As a member of the FHLB of San Francisco, the Bank is required to own common stock in the FHLB of San Francisco, which is based upon the Bank's membership asset value and/or borrowing levels. Investments in FHLB stock are carried at cost and are expected to be redeemed at par. Investment in FHLB stock is evaluated regularly for impairment. Cash dividends are accrued and reported as dividend income.

Investment in Federal Reserve Bank Stock

As a member of the FRB of San Francisco, the Bank is required to maintain stock in the FRB of San Francisco, based on a specified ratio relative to our capital. FRB stock is carried at cost and may be sold back to the FRB at its carrying value. Investment in FRB stock is evaluated regularly for impairment. Cash dividends are accrued and reported as dividend income.

Tax Credit Investments

The Bank invests in limited liability companies and partnerships that make investments in affordable housing projects, new market tax credits, and renewable energy projects, which qualify for federal or state income tax credits. The Bank's interests are accounted for utilizing the cost method or the proportional amortization method. Investments accounted for using the cost method are being amortized over the life of the related tax credit investments as a component of noninterest expense; meanwhile, those accounted for using the proportional amortization method are being amortized in proportion to the expected total tax benefits as a component of current tax expense. The investments are reviewed for impairment on an annual basis or on an interim basis if an event occurs that would trigger potential impairment.

NOTE 1 – Nature of Operations and Summary of Significant Accounting Policies, continued

Premises and Equipment

Premises and equipment are stated at cost, less accumulated depreciation and amortization. Land is not depreciated. Depreciation is computed on a straight-line method based on the estimated useful lives of the assets:

Type	Estimated Useful Life
Buildings	20 to 39 years
Building improvements	15 to 39 years
Furniture, fixtures, and equipment	3 to 7 years
Leasehold improvements	Shorter of useful lives or the terms of the lease

Construction in progress is carried at cost and includes land acquisition, architectural fees, general contractor fees, and other costs related directly to the construction of a property. Maintenance and repairs are charged to expense.

The Bank reviews its long-lived assets for impairment annually or when events or circumstances indicate that the carrying amount of these assets may not be recoverable. When impairment is indicated for an asset, the amount of impairment loss is the excess of the net book value over its fair value.

Borrowings

The Bank utilizes repurchase agreements, Federal Funds, and FHLB advances to manage its liquidity position. The repurchase agreements are treated as collateralized financing transactions and the obligations to repurchase securities sold are reflected as a liability in the accompanying balance sheets. The collateral securities underlying the agreements remain in the applicable asset accounts. The Bank has established federal funds with several correspondent banks, as well as with the FHLB and FRB. These federal funds generally mature within one business day. The Bank's available collateral borrowing capacity from the FHLB is derived from the loans and securities that are pledged to the FHLB.

Operating Leases

The Bank enters into a variety of lease contracts, as lessee, generally for premises and equipment. Lease contracts that do not transfer substantially all of the benefits and risks of ownership and do not meet the accounting requirements for capital lease classification are treated as operating leases. The Bank accounts for the payments of rent on these contracts on a straight-line basis over the lease term. At inception of the lease term, any periods for which no rents are paid and/or escalation clauses are stipulated in the lease contract are included in the determination of the rent expense and recognized ratably over the lease term.

The Bank also enters into a variety of lease contracts, as lessor, for Bank-owned properties or, as sub-lessee, for properties leased by the Bank. The Bank accounts for lease income on an accrual basis.

NOTE 1 – Nature of Operations and Summary of Significant Accounting Policies, continued

Reserve for Losses on Unfunded Loan Commitments

The Bank maintains a reserve for losses on unfunded loan commitments to absorb losses inherent in those commitments upon funding. The commitments include unfunded loan commitments, standby letters of credit, and commercial lines of credit. The Bank's methodology for assessing the appropriateness of this allowance is the same as that used for the allowance for loan losses, and incorporates an assumption based upon historical information of likely utilization. The reserve for losses on unfunded loan commitments is classified as other liabilities and the change in this reserve is recognized in noninterest expense.

Income Taxes

Income taxes are accounted for under the asset and liability method. Under this method, the deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between financial statement carrying amounts of existing assets and liabilities and their respective tax basis. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date. Deferred tax assets and liabilities in the same jurisdiction are grouped together and reported net on the balance sheets.

On an ongoing basis, management evaluates the deferred tax assets to determine if the tax benefits are expected to be realized in future periods. To the extent that the benefit of a deferred tax asset is not more likely than not to be realized, a valuation allowance is established with a corresponding charge through the provision for income taxes. The Bank also evaluates existing valuation allowances periodically to determine if sufficient evidence exists to support an increase or reduction in the allowance. The Bank recognizes interest and penalties related to tax positions as part of its provision for income taxes.

Comprehensive Income

Other comprehensive income refers to revenues, expenses, and gains and losses that are included in comprehensive income but are excluded from net income because they have been recorded directly in equity. The Bank's comprehensive income consists of net income and net unrealized gains (losses) on securities available-for-sale, arising during the period, and is presented in the statements of comprehensive income.

Earnings Per Share Data

Basic earnings per share ("EPS") is computed by dividing income available to common stockholders by the weighted average number of common shares outstanding for the period.

NOTE 1 – Nature of Operations and Summary of Significant Accounting Policies, continued

Recent Accounting Standards

In May 2014, the FASB issued ASU 2014-09, *Revenue from Contracts with Customers (Topic 606).* The new guidance replaces existing revenue recognition guidance for contracts to provide goods or services to customers. ASU 2014-09 clarifies the principles for recognizing revenue and replaces nearly all existing revenue recognition guidance in U.S. GAAP. Quantitative and qualitative disclosures regarding the nature, amount, timing, and uncertainty of revenue and cash flows arising from contracts with customers are also required. ASU 2014-09, as amended by ASU 2015-14, ASU 2016-08, ASU 2016-10, and ASU 2016-12, is effective for fiscal years beginning after December 15, 2018, and is applied on either a modified retrospective or full retrospective basis. The Bank's revenue is mainly composed of net interest income on financial assets and financial liabilities, which is explicitly excluded from the scope of ASU 2014-09, and non-interest income. Nonetheless, the Bank is evaluating the effect that ASU 2014-09 will have on the related accounting policies, noninterest income, and its financial statements and related disclosures. The Bank does not expect these changes to have a material impact on its financial statements and related disclosures.

In January 2016, the FASB issued ASU 2016-01, *Financial Instruments – Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities*. ASU 2016-01 amends the guidance in U.S. GAAP on the accounting for equity investments, financial liabilities under the fair value option, and the presentation and disclosure requirements of financial instruments. ASU 2016-01 is effective for fiscal years beginning after December 15, 2018. The Bank does not expect the provisions of ASU 2016-01 to have a material impact on its financial statements and related disclosures.

In February 2016, the FASB issued ASU 2016-02, *Leases (Topic 842)*. ASU 2016-02 requires lessees to recognize all leases longer than 12 months on the balance sheet as lease assets and lease liabilities and provide quantitative and qualitative disclosures regarding key information about leasing arrangements. Lessor accounting remains substantially similar to current U.S. GAAP. ASU 2016-02 is effective for fiscal years beginning after December 15, 2019, and mandates a modified retrospective transition method. The Bank is evaluating the effect that ASU 2016-02 will have on its financial statements and related disclosures.

In June 2016, the FASB issued ASU 2016-13, *Financial Instruments – Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments*. ASU 2016-13 will significantly change the way entities recognize impairment of many financial assets, including available-for sale and held-to-maturity debt securities and loans. For available-for-sale debt securities with unrealized losses, ASU 2016-13 does not change the measurement method of credit losses, except that the losses will be recognized as allowances rather than reductions in the amortized cost of the securities. Currently, the impairment model is based on incurred losses, and investments are recognized as impaired when there is no longer an assumption that future cash flows will be collected in full under the originally contracted terms. Under the current expected credit loss (CECL) model, the new standard requires immediate recognition of estimated credit losses expected to occur over the remaining life of the asset. The Bank will establish a CECL Committee in 2017 to develop, implement, and review the CECL model. ASU 2016-13 is effective for fiscal years beginning after December 15, 2020. The Bank is evaluating the effect that ASU 2016-13 will have on its financial statements and related disclosures.

NOTE 1 – Nature of Operations and Summary of Significant Accounting Policies, continued

Recent Accounting Standards, continued

In August 2016, the FASB issued ASU 2016-15, *Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments.* ASU 2016-15 provides guidance on the classification of certain cash receipts and payments on the statement of cash flows in order to reduce diversity in practice. ASU 2016-15 is effective for fiscal years beginning after December 15, 2018. The Bank does not expect the adoption of this guidance to have a material impact on its financial statements and related disclosures.

NOTE 2 – SECURITIES AVAILABLE-FOR-SALE

The following table presents an analysis of the securities available-for-sale portfolio:

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
	(In thousands)			
As of December 31, 2016				
Mortgage-backed securities	$ 24,192	$ 517	$ (136)	$ 24,573
State and municipal securities	157,328	903	(484)	157,747
Collateralized mortgage obligations	-	-	-	-
Total securities available-for-sale	$ 181,520	$ 1,420	$ (620)	$ 182,320
As of December 31, 2015				
Mortgage-backed securities	$ 32,528	$ 869	$ (52)	$ 33,345
State and municipal securities	171,367	1,692	(80)	172,979
Collateralized mortgage obligations	322	3	-	325
Total securities available-for-sale	$ 204,217	$ 2,564	$ (132)	$ 206,649

The following table presents a summary of the estimated maturities of securities available-for-sale based on amortized cost and estimated fair value:

	Amortized Cost	Fair Value
	(In thousands)	
As of December 31, 2016		
Due in 1 year or less	$ 64,025	$ 63,986
Due after 1 year through 5 years	82,205	82,603
Due after 5 years through 10 years	18,972	19,553
Due after 10 years	16,318	16,178
	$ 181,520	$ 182,320

NOTE 2 – Securities Available-for-Sale, continued

	Amortized Cost	Fair Value
	(In thousands)	
As of December 31, 2015		
Due in 1 year or less	$ 60,346	$ 60,421
Due after 1 year through 5 years	93,189	94,097
Due after 5 years through 10 years	30,099	31,540
Due after 10 years	20,583	20,591
	$ 204,217	$ 206,649

The Bank did not sell any securities during 2016 and 2015.

The following table shows the gross unrealized losses on securities available-for-sale and the related fair value, aggregated by investment category and the length of time that individual securities have been in a continuous unrealized loss position:

	Less Than 12 Months		12 Months or Longer		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
			(In thousands)			
As of December 31, 2016						
Mortgage-backed securities	13,782	(136)	-	-	13,782	(136)
State and municipal securities	119,119	(481)	1,330	(3)	120,449	(484)
Total temporarily impaired securities	$ 132,901	$ (617)	$ 1,330	$ (3)	$ 134,231	$ (620)
As of December 31, 2015						
Mortgage-backed securities	13,817	(52)	-	-	13,817	(52)
State and municipal securities	46,946	(79)	226	(1)	47,172	(80)
Total temporarily impaired securities	$ 60,763	$ (131)	$ 226	$ (1)	$ 60,989	$ (132)

The unrealized losses are primarily attributable to declining market prices caused by a rising interest rate environment. The number of securities available-for-sale with unrealized losses less than 12 months and 12 months or longer was 1,123 and 8, respectively, for the year ended December 31, 2016, and 296 and 2, respectively, for the year ended December 31, 2015. Whenever the cost of a security exceeds its fair value, management evaluates, among other factors, general market conditions, as well as the duration and extent to which cost is more than fair value. Management believes that securities available-for-sale in an unrealized loss position at December 31, 2016 and 2015, respectively, had a loss position that was temporary in nature, and therefore no impairment losses were recognized in the income statements. Because the Bank has the ability and intent to hold these investments until a market price recovery or maturity, these securities available-for-sale are not considered other-than-temporarily impaired.

NOTE 2 – Securities Available-for-Sale, continued

The following represents the related tax effect allocated to each component of other comprehensive income at the dates indicated:

	Before-Tax Amount	Tax (Expense) Benefit	Net-of-Tax Amount
		(In thousands)	
Year ended December 31, 2016			
Unrealized losses on securities:			
Unrealized holding losses arising during period	$ (1,632)	$ 686	$ (946)
Other comprehensive loss	$ (1,632)	$ 686	$ (946)
Year ended December 31, 2015			
Unrealized losses on securities:			
Unrealized holding losses arising during period	$ (1,031)	$ 434	$ (597)
Other comprehensive loss	$ (1,031)	$ 434	$ (597)

NOTE 3 – SECURITIES HELD-TO-MATURITY

The following table presents an analysis of the securities held-to-maturity portfolio:

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
		(In thousands)		
As of December 31, 2016				
U.S. Government agency and U.S. Government sponsored enterprise debt securities	$ 13,941	$ 33	$ (43)	$ 13,931
Mortgage-backed securities	2,174,471	13,993	(23,616)	2,164,848
State and municipal securities	533,537	8,607	(1,959)	540,185
Collateralized mortgage obligations	40,190	277	(287)	40,180
Corporate debt securities	738	11	-	749
Total securities held-to-maturity	$ 2,762,877	$ 22,921	$ (25,905)	$ 2,759,893
As of December 31, 2015				
U.S. Government agency and U.S. Government sponsored enterprise debt securities	$ 19,528	$ 45	$ (45)	$ 19,528
Mortgage-backed securities	1,876,718	22,044	(5,132)	1,893,630
State and municipal securities	411,250	14,445	(151)	425,544
Collateralized mortgage obligations	55,133	379	(303)	55,209
Corporate debt securities	754	7	-	761
Total securities held-to-maturity	$ 2,363,383	$ 36,920	$ (5,631)	$ 2,394,672

NOTE 3 – Securities Held-to-Maturity, continued

The following table is a summary of the estimated maturities of securities held-to-maturity based on amortized cost and estimated fair value:

	Amortized Cost	Fair Value
	(In thousands)	
As of December 31, 2016		
Due in 1 year or less	$ 49,092	$ 49,171
Due after 1 year through 5 years	374,460	380,431
Due after 5 years through 10 years	398,359	409,580
Due after 10 years	1,940,966	1,920,711
	$ 2,762,877	$ 2,759,893
As of December 31, 2015		
Due in 1 year or less	$ 19,678	$ 19,771
Due after 1 year through 5 years	201,008	209,057
Due after 5 years through 10 years	386,501	403,680
Due after 10 years	1,756,196	1,762,164
	$ 2,363,383	$ 2,394,672

There were no sales or transfers of securities held-to-maturity in 2016 or 2015.

The following table shows the gross unrealized losses on securities held-to-maturity and the related fair value, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position:

	Less Than 12 Months		12 Months or Longer		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
			(In thousands)			
As of December 31, 2016						
U.S. Government agency and U.S. Government sponsored enterprise debt securities	$ 4,737	$ (43)	$ -	$ -	$ 4,737	$ (43)
Mortgage-backed securities	1,565,522	(23,616)	-	-	1,565,522	(23,616)
State and municipal securities	249,786	(1,944)	918	(15)	250,704	(1,959)
Collateralized mortgage obligations	27,582	(287)	-	-	27,582	(287)
Total temporarily impaired securities	$ 1,847,627	$ (25,890)	$ 918	$ (15)	$ 1,848,545	$ (25,905)

NOTE 3 – Securities Held-to-Maturity, continued

	Less Than 12 Months		12 Months or Longer		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
	(In thousands)					
As of December 31, 2015						
U.S. Government agency and U.S. Government sponsored enterprise debt securities	$ 5,202	$ (45)	$ -	$ -	$ 5,202	$ (45)
Mortgage-backed securities	905,584	(5,132)	26	-	905,610	(5,132)
State and municipal securities	33,017	(117)	2,443	(34)	35,460	(151)
Collateralized mortgage obligations	35,196	(242)	2,619	(61)	37,815	(303)
Total temporarily impaired securities	$ 978,999	$ (5,536)	$ 5,088	$ (95)	$ 984,087	$ (5,631)

The Bank's held-to-maturity portfolio is primarily composed of mortgage-backed securities issued or guaranteed by FNMA (Fannie Mae) or GNMA (Ginnie Mae). The unrealized losses are primarily attributable to declining market prices caused by faster-than-expected prepayments and a rising interest rate environment. The number of securities held-to-maturity with unrealized losses less than 12 months and 12 months or longer was 851 and 3, respectively, for the year ended December 31, 2016, and 298 and 11, respectively, for the year ended December 31, 2015. Management believes that securities held-to-maturity in an unrealized loss position as December 31, 2016 and 2015, respectively, had a loss position that was temporary in nature, and therefore no impairment losses were recognized in the statements of income. Because the Bank has the ability and intent to hold these investments until maturity, these securities held-to-maturity are not considered other-than-temporarily impaired.

Total securities with a carrying value of approximately $1.19 billion for both December 31, 2016, and December 31, 2015, were pledged to secure securities sold under repurchase agreements, public deposits, FRB's daylight overdraft, FHLB's advance line, and for other purposes required by law.

Interest income on tax-exempt securities was $10.3 million for the year ended December 31, 2016, and $10.5 million for the year ended December 31, 2015.

NOTE 4 – LOANS AND ALLOWANCE FOR LOAN LOSSES

The loan portfolio is composed mainly of credit extended to borrowers in Southern California with the majority of loans secured by real estate, even though a substantial amount of the Bank's loans are intended for business purposes. There is no concentration of loans to borrowers in a specific industry within the loan portfolio. Loans are generally expected to be paid off from the operating cash flow of the borrowers, through refinancing by another lender, or through sale by the borrowers of the secured collateral.

NOTE 4 – Loans and Allowance for Loan Losses, continued

The following is the presentation of the loan portfolio, separated into the same loan segments utilized in the estimation of the ALL:

	December 31, 2016	December 31, 2015
	(In thousands)	
Commercial & industrial	$ 118,364	$ 126,829
Construction	361,133	300,549
Commercial real estate	2,111,355	2,114,554
Residential mortgage	719,666	591,550
Equity lines	126,009	119,509
Installment and other loans	29,855	25,861
Gross loans	3,466,382	3,278,852
Less: Allowance for loan losses	(56,867)	(56,670)
Unamortized deferred loan fees, net	(5,314)	(4,139)
Loans, net	$ 3,404,201	$ 3,218,043
Loans held for sale	6,080	3,168
Total loans receivable, net	$ 3,410,281	$ 3,221,211

Total loans with a balance of $673.1 million and $580.6 million at December 31, 2016, and December 31, 2015, respectively, were pledged to secure the Bank's FHLB advance line.

Nonaccrual and Past Due Loans

Loans are tracked by the numbers of days borrower payments are past due. The following tables present an aging analysis of nonaccrual and past due loans, segregated by loan segment:

	As of December 31, 2016					
	30 - 59 Days Past Due	60 - 89 Days Past Due	90 Days & Over Still Accruing	Nonaccrual	Current	Total
	(In thousands)					
Loan Segment						
Commercial & industrial	$ 80	$ -	$ -	$ -	$ 118,284	$ 118,364
Construction	-	-	-	-	361,133	361,133
Commercial real estate	24	-	-	774	2,110,557	2,111,355
Residential mortgage	-	-	-	705	718,961	719,666
Equity lines	454	-	-	267	125,288	126,009
Installment and other loans	-	17	49	-	29,789	29,855
Gross loans	**$ 558**	**$ 17**	**$ 49**	**$ 1,746**	**$ 3,464,012**	**$ 3,466,382**

NOTE 4 – Loans and Allowance for Loan Losses, continued

Nonaccrual and Past Due Loans, continued

	As of December 31, 2015					
	30 - 59 Days Past Due	60 - 89 Days Past Due	90 Days & Over Still Accruing	Nonaccrual	Current	Total
	(In thousands)					
Loan Segment						
Commercial & industrial	$ -	$ -	$ -	$ -	$ 126,829	$ 126,829
Construction	-	-	-	-	300,549	300,549
Commercial real estate	100	-	-	1,685	2,112,769	2,114,554
Residential mortgage	1,740	-	-	705	589,105	591,550
Equity lines	2,256	845	-	418	115,990	119,509
Installment and other loans	-	4	-	-	25,857	25,861
Gross loans	$ 4,096	$ 849	$ -	$ 2,808	$ 3,271,099	$ 3,278,852

The following is a summary of selected information related to the nonaccrual loans outstanding as of December 31, 2016 and 2015, and the related contractual interest income foregone for the years indicated:

	2016	2015
	(In thousands)	
Nonaccrual loans		
Outstanding balance	$ 1,746	$ 2,808
Average balance	2,033	3,283
Interest income recorded	14	16
Interest income foregone	85	124

Credit Quality

Loans are risk rated based on analysis of the current state of the borrower's credit quality. The analysis of credit quality includes review of all sources of repayment, the borrower's current payment performance/ delinquency, the borrower's current financial and liquidity status, and all other relevant information. The following tables present the credit risk rating categories for each loan segment as of the dates indicated. Nonclassified loans are those with a credit risk rating of either pass or special mention, while classified loans are those with a credit risk rating of either substandard or doubtful.

NOTE 4 – Loans and Allowance for Loan Losses, continued

Credit Quality, continued

	December 31, 2016			December 31, 2015		
	Nonclassified	Classified	Total	Nonclassified	Classified	Total
	(In thousands)					
Commercial & industrial	$ 115,723	$ 2,641	$ 118,364	$ 124,454	$ 2,375	$ 126,829
Construction	358,733	2,400	361,133	300,549	-	300,549
Commercial real estate	2,101,519	9,836	2,111,355	2,093,493	21,061	2,114,554
Residential mortgage	714,599	5,067	719,666	589,895	1,655	591,550
Equity lines	124,800	1,209	126,009	115,193	4,316	119,509
Installment and other loans	29,855	-	29,855	25,861	-	25,861
Total	**$ 3,445,229**	**$ 21,153**	**$ 3,466,382**	**$ 3,249,445**	**$ 29,407**	**$ 3,278,852**

Troubled Debt Restructured Loans

Included in the Bank's loan portfolio are TDRs, which are loans that have been modified due to deterioration in the financial condition of the borrower, and the Bank has granted concessions to the borrower that it would not otherwise consider. The total amount of TDRs was $5.4 million at December 31, 2016, and $8.6 million at December 31, 2015.

The following tables present TDRs as of each year end that were modified as TDRs during the year in each respective period.

	For the Year Ended December 31, 2016						
						TDRs That Subsequently Defaulted	
	No. of Contracts	Pre-modification Outstanding Recorded Investment	Post-modification Outstanding Recorded Investment	Charge-offs During Modification	Allocated Reserve	No. of Contracts	Recorded Investment
	(In thousands)						
Loan Segment							
Construction	1	$ 1,900	$ 1,900	$ -	$ -	-	$ -
Commercial real estate	-	-	-	-	-	-	-
Residential mortgage	1	1,410	1,410	-	-	-	-
Total	**2**	**$ 3,310**	**$ 3,310**	**$ -**	**$ -**	**-**	**$ -**

NOTE 4 – Loans and Allowance for Loan Losses, continued

Troubled Debt Restructured Loans, continued

	For the Year Ended December 31, 2015						
	No. of Contracts	Pre-modification Outstanding Recorded Investment	Post-modification Outstanding Recorded Investment	Charge-offs During Modification	Allocated Reserve	TDRs That Subsequently Defaulted: No. of Contracts	TDRs That Subsequently Defaulted: Recorded Investment
				(In thousands)			
Loan Segment							
Construction	-	$ -	$ -	$ -	$ -	-	$ -
Commercial real estate	1	2,561	2,561	-	-	-	-
Residential mortgage	-	-	-	-	-	-	-
Total	1	$ 2,561	$ 2,561	$ -	$ -	-	$ -

Accruing TDRs

A summary of accruing TDRs by concession type and by loan segment is shown below for each year end.

	Principal Deferral	Rate Reduction	Combination of Such Concession	Total
		(In thousands)		
As of December 31, 2016				
Loan Segment				
Construction	$ 2,400	$ -	$ -	$ 2,400
Commercial real estate	229	-	768	997
Residential mortgage	1,410	-	-	1,410
Total loans	$ 4,039	$ -	$ 768	$ 4,807
As of December 31, 2015				
Loan Segment				
Construction	$ -	$ -	$ -	$ -
Commercial real estate	3,455	792	2,212	6,459
Residential mortgage	448	-	-	448
Total loans	$ 3,903	$ 792	$ 2,212	$ 6,907

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Notes to Financial Statements

NOTE 4 – Loans and Allowance for Loan Losses, continued

Nonaccrual TDRs

A summary of nonaccrual TDRs by concession type and by loan segment is shown below for each year end.

	Principal Deferral	Rate Reduction	Forgiveness of Principal	Combination of Such Concession	Total
			(In thousands)		
As of December 31, 2016					
Loan Segment					
Commercial real estate	$ -	$ -	$ -	$ 617	$ 617
Total loans	**$**	**$ -**	**$ -**	**$ 617**	**$ 617**
As of December 31, 2015					
Loan Segment					
Commercial real estate	$ 998	$ -	$ -	$ 687	$ 1,685
Total loans	**$ 998**	**$ -**	**$ -**	**$ 687**	**$ 1,685**

Impaired Loans

Nonaccrual loans and performing restructured loans are considered impaired loans for reporting purposes. For the indicated periods, the following tables contain an analysis of impaired loans by segment:

	As of December 31, 2016						
	Unpaid Principal Balance	Recorded Investment with No ALL	Recorded Investment with ALL	Related ALL	Total	Average Recorded Investment	Interest Income Recognized
				(In thousands)			
Loan Segment							
Commercial & industrial	$ -	$ -	$ -	$ -	$ -	$ -	$ -
Construction	2,400	2,400	-	-	2,400	1,291	146
Commercial real estate	2,085	1,771	-	-	1,771	4,085	58
Residential mortgage	2,115	2,115	-	-	2,115	2,002	57
Equity lines	316	266	-	-	266	357	12
Total	**$ 6,916**	**$ 6,552**	**$ -**	**$ -**	**$ 6,552**	**$ 7,735**	**$ 273**

NOTE 4 – Loans and Allowance for Loan Losses, continued

Impaired Loans, continued

	As of December 31, 2015						
	Unpaid Principal Balance	Recorded Investment with No ALL	Recorded Investment with ALL	Related ALL	Total	Average Recorded Investment	Interest Income Recognized
	(In thousands)						
Loan Segment							
Commercial & industrial	$ -	$ -	$ -	$ -	$ -	$ 27	$ -
Construction	-	-	-	-	-	-	-
Commercial real estate	8,565	5,931	2,212	98	8,045	7,218	326
Residential mortgage	1,227	1,153	-	-	1,153	725	24
Equity lines	502	418	-	-	418	514	1
Total	**$ 10,294**	**$ 7,502**	**$ 2,212**	**$ 98**	**$ 9,616**	**$ 8,484**	**$ 351**

The following table segregates the major loan categories between those loans that were individually evaluated for impairment and those loans that were collectively evaluated for impairment.

	December 31, 2016			December 31, 2015		
	Individually Evaluated for Impairment	Collectively Evaluated for Impairment	Total	Individually Evaluated for Impairment	Collectively Evaluated for Impairment	Total
	(In thousands)					
Loan Segment						
Commercial & industrial	$ -	$ 118,364	$ 118,364	$ -	$ 126,829	$ 126,829
Construction	2,400	358,733	361,133	-	300,549	300,549
Commercial real estate	1,771	2,109,584	2,111,355	8,143	2,106,411	2,114,554
Residential mortgage	2,115	717,551	719,666	1,153	590,397	591,550
Equity lines	266	125,743	126,009	418	119,091	119,509
Installment and other loans	-	29,855	29,855	-	25,861	25,861
Total	**$ 6,552**	**$ 3,459,830**	**$ 3,466,382**	**$ 9,714**	**$ 3,269,138**	**$ 3,278,852**

NOTE 4 – Loans and Allowance for Loan Losses, continued

Allowance for Loan Losses

The following table summarizes ALL activity by loan segment for each year ended:

	Commercial & Industrial	Construction	Commercial Real Estate	Residential Mortgage	Equity Lines	Installment and Other Loans	Total
				(In thousands)			
December 31, 2014	$ 757	$ 7,572	$ 22,554	$ 17,721	$ 490	$ 1,710	$ 50,804
Provision	(4,784)	6,342	8,841	(12,231)	339	(1,207)	(2,700)
Charge-Off	(18)	-	-	-	-	(157)	(175)
Recoveries	5,458	195	772	1,898	106	312	8,741
December 31, 2015	$ 1,413	$ 14,109	$ 32,167	$ 7,388	$ 935	$ 658	$ 56,670
Provision	304	206	(84)	(481)	128	(73)	-
Charge-Off	-	-	-	-	(142)	(206)	(348)
Recoveries	19	85	166	36	12	227	545
December 31, 2016	$ 1,736	$ 14,400	$ 32,249	$ 6,943	$ 933	$ 606	$ 56,867
The ending ALL balance is composed of amounts applicable to loans:							
Individually evaluated for impairment	$ -	$ -	$ -	$ -	$ -	$ -	$ -
Collectively evaluated for impairment	$ 1,736	$ 14,400	$ 32,249	$ 6,943	$ 933	$ 606	$ 56,867

Reserve allocations for loan losses by loan category can shift year to year based on changes to outstanding loan balances, other factors such as charge-offs and recoveries, and enhancements to the ALL methodology.

Reserve for Unfunded Loan Commitments

Activities in the reserve for unfunded loan commitments included in other liabilities in the accompanying balance sheets for the years ended December 31, 2016 and 2015 were as follows:

	December 31, 2016	December 31, 2015
	(In thousands)	
Balance, beginning of year	$ 3,400	$ 2,700
Addition	600	700
Balance, end of year	$ 4,000	$ 3,400

NOTE 5 – OTHER REAL ESTATE OWNED

At December 31, 2016 and 2015, the carrying value of OREO was $0.8 million and $1.4 million, net of reserve for OREO of $0.6 million and $0.6 million, respectively. The following tables summarize the net carrying value of OREO by property type at the dates indicated:

	December 31,	
	2016	2015
	(In thousands)	
Construction and land development	791	1,351
Total OREO, net	$ 791	$ 1,351

The components of OREO income and expense for the years indicated are as follows:

	2016	2015
	(In thousands)	
Rental income	$ 13	$ 263
Net gain on sale	14	1,191
Total OREO income	27	1,454
Operating and maintenance expense	(62)	583
Reduction of reserve for OREO	-	121
Total OREO expense	(62)	704
OREO income, net	$ 89	$ 750

NOTE 6 – TAX CREDIT INVESTMENTS

The Bank has invested in certain limited liability companies and partnerships that make investments in affordable housing projects, new market tax credits, and renewable energy projects for the purpose of utilizing the tax credits these investments generate. The Bank is not the primary beneficiary of these partnerships and has no control over the operations; therefore, it is not required to consolidate these entities on its financial statements.

The Bank's tax credit investments totaled $50.7 million and $34.5 million at December 31, 2016 and December 31, 2015, respectively, and are included in other assets on the balance sheets. Unfunded commitments related to these tax credit investments totaled $31.9 million and $9.0 million at December 31, 2016 and December 31, 2015, respectively, and are included in other liabilities on the balance sheets.

The Bank's usage of federal tax credits totaled $20.4 million for 2016 and $11.8 million for 2015. The Bank's remaining tax credits to be utilized over a multiple-year period approximated $36.3 million and $33.1 million at December 31, 2016 and December 31, 2015, respectively. Under the proportional amortization method, the amortization of the investment recognized as a component of income tax expenses for the years ended December 31, 2016 and 2015 was $2.7 million and $2.5 million, respectively.

Farmers & Merchants Bank of Long Beach

Notes to Financial Statements

NOTE 7 – PREMISES AND EQUIPMENT

The following is a summary of premises and equipment as of the dates indicated:

	December 31, 2016	December 31, 2015
	(In thousands)	
Land	$ 35,625	$ 35,625
Buildings and building improvements	65,231	63,400
Furniture, fixtures, and equipment	29,480	27,228
Leasehold improvements	2,832	2,832
Construction in progress	8,953	5,809
	$ 142,121	$ 134,894
Less accumulated depreciation and amortization	(54,346)	(48,113)
	$ 87,775	$ 86,781

Depreciation and amortization expense was $7.1 million in 2016 and $5.9 million in 2015.

The Bank is committed under a number of operating leases for premises. Most of the leases require that the Bank pay property taxes, insurance, and other operating expenses applicable to the leased premises in addition to the monthly lease payments. Lease expense for the years ended December 31, 2016 and 2015 was $1.4 million and $1.4 million, respectively.

The following table presents future annual minimum lease commitments as of December 31, 2016:

Year Ending December 31,	Commitments
	(In thousands)
2017	$ 1,237
2018	819
2019	743
2020	755
2021	763
Thereafter	$ 3,576

Total lease income for the years ended December 31, 2016 and 2015 was $2.1 million and $1.9 million, respectively. The following table presents future annual lease income payments to be received under operating leases with terms in excess of one year as of December 31, 2016:

Year Ending December 31,	Commitments
	(In thousands)
2017	$ 1,791
2018	1,278
2019	1,029
2020	627
2021	315
Thereafter	$ 128

NOTE 7 – Premises and Equipment, continued

Management expects that in the normal course of business, leases that expire will be renewed or replaced by other leases.

NOTE 8 – DEPOSITS

The following table presents the components of deposits as of the dates indicated:

	December 31, 2016	December 31, 2015
	(In thousands)	
Non-interest-bearing checking	$ 1,931,931	$ 1,824,516
Interest-bearing checking	868,380	645,125
Money market accounts	793,021	758,194
Savings deposits	667,648	618,726
Total core deposits	$ 4,260,980	$ 3,846,561
Time deposits:		
$250,000 or less	$ 441,120	$ 436,523
Greater than $250,000	420,857	406,882
Total time deposits	861,977	843,405
Total deposits	$ 5,122,957	$ 4,689,966

As of December 31, 2016, the maturity distribution of the Bank's time deposits was as follows:

Year of Maturity	$250,000 or Less	Greater Than $250,000	Total
	(In thousands)		
2017	$ 302,442	$ 279,549	$ 581,991
2018	36,961	73,889	110,850
2019	14,128	12,056	26,184
2020	48,693	32,373	81,066
2021	38,896	22,990	61,886
	$ 441,120	$ 420,857	$ 861,977

NOTE 9 – SECURITIES SOLD UNDER REPURCHASE AGREEMENTS

Substantially all repurchase agreements have open-ended maturities, where either the customer or the Bank may terminate a repurchase agreement at any time upon written notice. All outstanding balances and pledged securities are rebalanced and interest rates reset daily to reflect market movement.

NOTE 9 – Securities Sold Under Repurchase Agreements, continued

The following table summarizes information about securities sold under repurchase agreements outstanding as of the periods indicated:

	December 31,			
	2016		2015	
	(In thousands)			
Securities sold under repurchase agreements	$	540,035	$	572,915
Weighted average interest rate		0.39%		0.20%
Securities underlying repurchase agreements	$	647,808	$	643,175
Fair value of securities underlying repurchase agreements	$	651,434	$	652,967

The securities underlying these agreements are held by a custodian bank until the maturity of the agreement. The identical securities will be repurchased by the Bank. The following table summarizes securities sold under repurchase agreements' activity during the periods 2016 and 2015, respectively:

	2016		2015	
	(In thousands)			
Average outstanding	$	573,371	$	563,535
Weighted average interest rate		0.33%		0.20%
Maximum amounts outstanding	$	642,214	$	634,334

NOTE 10 – OTHER BORROWINGS

The Bank's available borrowing capacity from federal funds facilities amounted to $579.6 million and $558.0 million as of December 31, 2016 and 2015, respectively. The Bank's available collateral borrowing capacity for FHLB advances totaled $394.1 million and $383.0 million as of December 31, 2016 and 2015, respectively.

The following table summarizes information about FHLB advances as of the periods indicated:

	December 31,			
	2016		2015	
	(In thousands)			
FHLB advances outstanding at year-end	$	100,000	$	-
Weighted average rate on outstanding at year-end		0.55%		-
Highest month-end balance	$	100,000	$	60,000
Average amount outstanding	$	874	$	3,452
Weighted average rate	$	0.59%	$	0.15%

NOTE 11 - INCOME TAXES

The provision for income taxes for the years ended December 31, 2016 and 2015 is composed of the following:

	2016	2015
	(In thousands)	
Current income taxes:		
Federal	$ 12,047	$ 21,111
State	12,391	11,583
Total current income tax expense	24,438	32,694
Deferred income taxes:		
Federal	(343)	(2,708)
State	(1,349)	(1,078)
Total deferred income tax benefit	(1,692)	(3,786)
Total income tax expense	$ 22,746	$ 28,908

Significant temporary differences that give rise to the deferred tax assets and liabilities as of December 31, 2016 and December 31, 2015 are as follows:

	2016	2015
	(In thousands)	
Deferred tax assets		
Allowance for loan losses	$ 27,902	$ 27,536
Reserve for OREO	261	301
Tax credit investments – state tax basis difference	5,473	3,822
Capital loss carry forward	687	681
State income taxes	1,116	1,621
Accrued employee compensation	1,664	1,241
Premises and equipment depreciation and amortization	1,935	874
Other, net	1,700	1,912
Gross deferred tax assets	$ 40,738	$ 37,988
Valuation allowance	(4,721)	(3,987)
Deferred tax assets, net of valuation allowance	$ 36,017	$ 34,001
Deferred tax liabilities		
Unrealized gain on securities available-for-sale	336	1,022
Tax credit investments - federal tax basis difference	5,365	5,052
Other	35	35
Gross deferred tax liabilities	$ 5,736	$ 6,109
Net deferred tax assets	$ 30,281	$ 27,892

NOTE 11 – Income Taxes, continued

The federal tax rate was 35% for 2016 and 2015. The difference between the effective tax rate in the financial statements and the federal income tax rate is attributed to the following:

	2016	2015
Federal income tax rate	35.0%	35.0%
State income taxes, net of federal benefit	6.9%	6.7%
Tax-exempt interest income	(4.2%)	(3.9%)
Tax credits	(16.6%)	(9.0%)
Amortization – low-income housing investment	2.8%	2.7%
Other	0.2%	(0.7%)
	24.1%	30.8%

The lower effective tax rate during the year ended December 31, 2016, compared to the same period in 2015 was attributable to additional tax credit that was recognized from an investment in a qualified renewable energy project during the year ended December 31, 2016. The Bank recognized a federal investment tax credit of $8.4 million, as well as income tax benefits related to the recognition of the losses on this investment during the year ended December 31, 2016. The Bank uses the flow-through income statement method to account for the tax credit earned on the investment in the renewable energy project. Under this method, the tax credit is recognized as a reduction to income tax expense, and the book-tax difference in the basis of the investment is recognized as tax expense in the year the credit is earned.

In assessing the realization of deferred tax assets, management considers whether it is more likely than not that some portion or all of the deferred tax assets will not be realized. The ultimate realization of deferred tax assets is dependent on the generation of future taxable income during the periods in which those temporary differences become deductible. Based upon our taxpaying history and estimates of taxable income over the years in which the items giving rise to the deferred tax assets are deductible, management believes it is more likely than not that the Bank will realize the benefits of these deductible differences, with the exception of the deferred tax assets related to certain state tax basis differences arising from new market tax credit investments. A valuation allowance has been provided for expected capital losses in California, since management believes it is more likely than not that these losses will not be utilized.

ASC 740-10, *Accounting for Uncertainty in Income Taxes* requires that all tax positions be assessed and to the extent the position is more likely than not to be sustained on its technical merits, a benefit be recognized based on the greatest amount that is more likely than not to be sustained. Management's evaluation of tax positions was performed for those tax years which remain open to audit. As of December 31, 2016, all tax years subsequent to 2012 and 2008 for federal and state purposes respectively remain open to examination. The Bank may, from time to time, be assessed interest or penalties by taxing authorities, although any such assessments historically have been minimal and immaterial to our financial results. Unrecognized tax benefit primarily includes state exposures from California Enterprise Zone interest deductions. The Bank does not anticipate any material change in the total amount of unrecognized tax benefits to occur within the next 12 months.

NOTE 12 – EARNINGS PER SHARE

As of December 31, 2016 and 2015, there were no securities or other contracts to issue common stock. The table below is a reconciliation of the numerators and denominators used in the calculation of basic and diluted EPS for the years ended December 31, 2016 and 2015.

	2016	2015
	(In thousands, except share and per share data)	
Basic and diluted earnings per share:		
Net income available to common stockholders	$ 71,508	$ 64,948
Weighted average number of common shares outstanding	130,928	130,928
Weighted basic and diluted earnings per common share	$ 546.16	$ 496.06

NOTE 13 – COMMITMENTS AND CONTINGENCIES

Commitments to Extend Credit

In the normal course of business, the Bank has various outstanding commitments to extend credit that are not reflected in the accompanying financial statements. While the Bank does not anticipate material losses as a result of these transactions, commitments to extend credit are included in determining the appropriate level of the reserve for unfunded loan commitments. Commitments to extend credit are agreements to lend to a customer, provided there is no violation of any condition established in the agreement. Substantially all of the Bank's commitments to extend credit are on a variable rate basis.

Standby letters of credit are conditional commitments issued by the Bank to make payment on behalf of customers when certain specified future events occur. The customer is obligated to reimburse the Bank for any such payment. Most letters of credit expire within one year.

The Bank uses the same credit policies in making commitments to extend credit and in issuing standby letters of credit. Each customer's creditworthiness is evaluated on a case-by-case basis. The amount of collateral obtained is based on management's credit evaluation of the customer.

The following table presents a summary of the Bank's commitments to extend credit as of the dates indicated:

	December 31,	
	2016	2015
	(In thousands)	
Commitments to extend credit	$ 1,230,452	$ 999,114
Financial standby letters of credit	11,079	10,595
Performance standby letters of credit	5,949	6,516
	$ 1,247,480	$ 1,016,225

NOTE 13 – Commitments and Contingencies, continued

Legal Matters

From time to time, the Bank is a defendant or plaintiff in various legal proceedings, including litigation arising in the ordinary course of our business. The outcomes of such legal proceedings and the timing of ultimate resolution are inherently difficult to predict. In accordance with applicable accounting guidance, the Bank establishes an accrued liability for litigation when those matters present loss contingencies that are both probable and estimable. In such cases, there may be an exposure to loss in excess of any amounts accrued. As a matter develops, the Bank, in conjunction with any outside counsel handling the matter, evaluates on an ongoing basis whether such matter presents a loss contingency that is probable and estimable. Once the loss contingency is deemed to be both probable and estimable, the Bank will establish an accrued liability and record a corresponding amount of litigation-related expense. The Bank continues to monitor the matter for further developments that could affect the amount of the accrued liability that has been previously established. Based on current knowledge, management does not believe that loss contingencies arising from pending matters will have a material adverse effect on the financial position or liquidity of the Bank.

NOTE 14 – FAIR VALUE MEASUREMENTS

FASB ASC 820, *Fair Value Measurements and Disclosures*, defines fair value, establishes a framework for measuring fair value including a three-level valuation hierarchy, and expands disclosures about fair value measurements. Fair value is defined as the exchange price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date reflecting assumptions that a market participant would use when pricing an asset or liability. The three-level inputs to measure the fair value of assets and liabilities are as follows:

Level 1 - Quoted prices for identical instruments that are highly liquid, observable, and actively traded in over-the-counter markets. Level 1 financial instruments typically include U.S. Treasury securities.

Level 2 - Quoted prices for similar instruments in active markets; quoted prices for identical or similar instruments in markets that are not active; and model-derived valuations whose inputs are observable and can be corroborated by market data. Level 2 financial instruments typically include U.S. government debt and agency mortgage-backed securities, municipal securities, corporate debt securities, impaired loans, and OREO.

Level 3 - Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities. Level 3 assets and liabilities include financial instruments whose value is determined using pricing models, discounted cash flow methodologies, or similar techniques, as well as instruments for which the determination of fair value requires significant management judgment or estimation. This category typically includes impaired loans and OREO.

NOTE 14 – Fair Value Measurements, continued

The Bank uses the following methodologies to measure the fair value of its financial assets on a recurring and non-recurring basis:

Securities available-for-sale – Other than U.S. Treasury securities, which is a Level 1 measurement, the Bank measures all other securities by using quoted market prices for similar securities or dealer quotes, a Level 2 measurement.

Impaired loans – The Bank does not record loans at fair value on a recurring basis. However, from time to time, nonrecurring fair value adjustments to collateral-dependent impaired loans are recorded based on either current appraised value of the collateral, a Level 2 measurement, or management's judgment and estimation of value reported on appraisals which are adjusted based on recent market trends, a Level 3 measurement. The impaired loans categorized as Level 3 also include loans whose fair values are based on unobservable inputs such as cash flows discounted at the effective loan rate, management's judgment or in the event when current appraised value was higher than the Bank's book balance.

Other real estate owned – The fair value of OREO is generally based on third-party appraisals, which are reviewed and approved by the Bank's Credit Administration Department. OREO measured at fair value based on third-party appraisals or accepted written offers is classified in Level 2 in the fair value hierarchy. In certain circumstances, fair value may be determined using a combination of inputs, including appraised values, broker price opinions, and recent market activity. The weighing of each input in the calculation of fair value is based on management's assumptions regarding market conditions. These assumptions cannot be observed in the market. OREO measured at fair value using non-observable inputs is classified in Level 3 of the fair value hierarchy.

The following table presents the Bank's hierarchy for its assets and liabilities measured at fair value on a recurring and non-recurring basis. These assets and liabilities are reported on the balance sheets at their fair values as of December 31, 2016 and December 31, 2015, respectively:

	As of December 31, 2016			
	Fair Value Measurements Using			Total at
	Level 1	Level 2	Level 3	Fair Value
	(In thousands)			
Assets				
On a recurring basis:				
Securities available-for-sale	$ -	$ 182,320	$ -	$ 182,320
On a non-recurring basis:				
Impaired loans	-	-	-	-
Other real estate owned	-	-	-	-
Total assets	$ -	$ 182,320	$ -	$ 182,320

NOTE 14 – Fair Value Measurements, continued

	As of December 31, 2015			
	Fair Value Measurements Using			Total at
	Level 1	Level 2	Level 3	Fair Value
	(In thousands)			
Assets				
On a recurring basis:				
Securities available-for-sale	$ -	$ 206,649	$ -	$ 206,649
On a non-recurring basis:				
Impaired loans	-	-	2,114	2,114
Other real estate owned	-	1,351	-	1,351
Total assets	$ -	$ 208,000	$ 2,114	$ 210,114

NOTE 15 – FAIR VALUE OF FINANCIAL INSTRUMENTS

Financial instruments are defined under FASB ASC 825-50, *Financial Instruments-Disclosures,* as cash, evidence of an ownership in an entity, or a contract that conveys or imposes on an entity the contractual right or obligation to either receive or deliver cash or another financial instrument. A significant portion of the Bank's assets and liabilities are financial instruments as defined under FASB ASC 825-50.

The following presents a description of the Bank's financial instruments and the methodologies and assumptions used to estimate their fair value. Much of the information used to determine fair value is highly subjective. When applicable, readily available market information has been utilized. However, for a significant portion of the Bank's financial instruments, active markets may not exist. Therefore, considerable judgments are required in estimating fair value of certain items. The subjective factors include, among other things, the estimated timing and amount of cash flows, risk characteristics, credit quality, and interest rates, all of which are subject to change. Since the fair value is estimated as of December 31, 2016 and 2015, the amounts that will actually be realized could be significantly different.

Cash and Due from Banks

The carrying value of cash and due from banks approximates the fair value because of the short maturity of such assets.

Securities Available-for-Sale and Securities Held-to-Maturity

The Bank used market quotes for similar or identical securities in an actively traded market or management's judgment and estimation to determine the fair values of securities available-for-sale and securities held-to-maturity as disclosed in Notes 2 and 3, respectively. Private Placement Bonds are evaluated with the same methodology that is used in loans.

Loans Held for Sale

Loans held for sale are carried at the lower of aggregate cost or fair value, and are short-term in nature. Fair values are based on commitments outstanding from investors or book value.

NOTE 15 – Fair Value of Financial Instruments, continued

Loans

Fair values were estimated for portfolios of loans with similar financial characteristics. Each loan category was further segmented into fixed and adjustable rate interest terms, by performing and nonperforming categories, and credit quality. The fair value of performing loans was calculated by discounting scheduled cash flows through the estimated maturity using estimated market discount rates that reflect the credit and interest rate risk inherent in the loan. The entire allowance for loan losses was deducted from the loan portfolio. Accordingly, they are considered to be carried at fair value as the allowance for loan losses represents the estimated discount for credit risk for the applicable loans.

Investments in FHLB and FRB Stock

Investments in FHLB and FRB stock are carried at cost. Ownership of stock is restricted to member banks and the securities do not have a readily determinable market value. Purchases and sales of these securities are at par value with the issuers; hence, the fair value is equal to the carrying value.

Deposits

The fair value of demand deposits, savings, and money market saving accounts represents the amount payable on demand at the reporting date. For fixed maturity time deposits, the fair value was estimated by discounting expected cash flows by the current offering rates of term deposits with similar maturities; however, since the bank's current interest rate is approximately at market, fixed maturity time deposits were determined to approximate the carrying value.

Securities Sold Under Repurchase Agreements

The fair value of securities sold under agreements to repurchase approximates carrying value due to the terms and nature of the obligations. Interest rates will reset daily according to the market movement.

Other Borrowings

The fair value of other borrowings approximates carrying value due to the terms and nature of the obligations. The borrowings are generally short term.

Off-Balance Sheet Financial Instruments

As the standby letters of credit and commitments to lend have terms that are consistent with current market terms, the Bank estimates that the fair value of the fees charged to enter into such agreements to be nominal.

Farmers & Merchants Bank of Long Beach
Notes to Financial Statements

NOTE 15 – Fair Value of Financial Instruments, continued

The following tables present the carrying and estimated fair value per the fair value hierarchy of certain financial instruments at the dates indicated:

	Carrying Value	Level 1	Level 2 (In thousands)	Level 3	Estimated Fair Value
As of December 31, 2016					
Financial Assets:					
Cash and due from banks	$ 148,715	$ 148,715	$ -	$ -	$ 148,715
Securities available-for-sale	182,320	-	182,320	-	182,320
Securities held-to-maturity	2,762,877	-	2.718,818	41,075	2,759,893
Loans held for sale	6,080	-	6,217	-	6,217
Loans, net of allowance for loan losses	3,404,201	-	-	3,501,867	3,501,867
Investments in FHLB and FRB stock	20,690	-	20,690	-	20,690
Financial Liabilities:					
Deposits:					
Non-interest-bearing deposits	$ 1,931,931	$ -	$ 1,931,931	$ -	$ 1,931,931
Interest-bearing deposits	868,380	-	868,380	-	868,380
Savings and money market deposits	1,460,669	-	1,460,669	-	1,460,669
Time deposits	861,977	-	861,977	-	861,977
Securities sold under repurchase agreements	540,035	-	540,035	-	540,035
FHLB advances	100,000	-	100,000	-	100,000
As of December 31, 2015					
Financial Assets:					
Cash and due from banks	$ 168,020	$ 168,020	$ -	$ -	$ 168,020
Securities available-for-sale	206,649	-	206,649	-	206,649
Securities held-to-maturity	2,363,383	-	2,337,227	57,445	2,394,672
Loans held for sale	3,168	-	3,168	-	3,168
Loans, net of allowance for loan losses	3,218,043	-	-	3,364,712	3,364,712
Investments in FHLB and FRB stock	20,690	-	20,690	-	20,690
Financial Liabilities:					
Deposits:					
Non-interest-bearing deposits	$ 1,824,516	$ -	$ 1,824,516	$ -	$ 1,824,516
Interest-bearing deposits	645,125	-	645,125	-	645,125
Savings and money market deposits	1,376,920	-	1,376,920	-	1,376,920
Time deposits	843,405	-	843,405	-	843,405
Securities sold under repurchase agreements	572,915	-	572,915	-	572,915
FHLB advances	-	-	-	-	-

NOTE 16 – RELATED PARTY TRANSACTIONS

The Bank and Queen City Investments, Inc. ("Queen City"), which is the parent company of the Farmers & Merchants Trust Company of Long Beach (the "Trust Company"), are considered affiliated parties as significant percentages of the outstanding shares of the Bank and Queen City are held by common shareholders, including by certain executive officers and/or directors of the Bank. In addition, certain executive and other officers of the Bank served as officers and/or directors of Queen City and/or its subsidiaries, including the Trust Company.

The Bank and the Trust Company have entered into an Employee Leasing Agreement whereby the Bank provides the Trust Company with the services of various Bank employees and in return the Trust Company pays fees to the Bank for such employee services. In 2016 and 2015, the Trust Company paid the Bank $341,000 and $269,000, respectively, under this arrangement. In addition, the Bank and the Trust Company have entered into an Exchange of Services Agreement for the exchange of various other services, which agreement provides for the periodic settlement between the parties of the differences in the values of respective services provided by one party to the other. Under this arrangement, the Bank provides human resources and payroll services to the Trust Company, and the Trust Company provides financial services to the Bank and maintains deposits with the Bank. In 2016, the Bank paid the Trust Company $46,000 for the difference between the values of services exchanged between the parties in 2015 and 2016, and in 2015 the Bank paid the Trust Company $66,000 for the difference between the values of services exchanged between the parties in 2014.

The Bank has also leased the Torrance branch location from Queen City, which is subject to an ongoing lease agreement. The Bank paid $270,000 and $292,000, respectively, in lease expense for each of the years ended December 31, 2016 and 2015.

At December 31, 2016 and December 31, 2015, no loans were outstanding with any related party. At December 31, 2016 and December 31, 2015, related-party deposits were $143 million and $99 million, respectively, of which, $134 million and $91 million, respectively, were attributable to Queen City and its subsidiaries.

NOTE 17 – PROFIT-SHARING PLAN

The Bank has a noncontributory profit-sharing plan in which employees are eligible to participate at year-end if they have been employed for at least 1,000 hours during the year. The Bank contributed $6.2 million and $5.7 million to the profit-sharing plan in 2016 and 2015, respectively. At December 31, 2016 and December 31, 2015, no shares of the Bank's stock are held by the trust created by the plan.

NOTE 18 – REGULATORY MATTERS

The Bank is subject to various regulatory capital requirements administered by the federal and state 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

NOTE 18 – Regulatory Matters, continued

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, common equity, and other factors.

As of December 31, 2016, the most recent notification from the Federal Reserve Bank categorized the Bank as well capitalized under the regulatory framework for prompt corrective action. To be categorized as well capitalized, the Bank must maintain minimum total risk-based, Tier 1 risk-based, Tier 1 common equity, and Tier 1 leverage ratios as set forth in the following table. There are no conditions or events since the notification that management believes have changed the institution's category.

The Bank's actual regulatory capital amounts and ratios are also presented in the following table.

	Actual		Minimum Capital Requirements		To Be Well Capitalized Under Prompt Corrective Action Provisions	
	Amount	Rate	Amount	Rate	Amount	Rate
			(Dollars in thousands)			
As of December 31, 2016:						
Total risk-based capital ratio	$ 967,919	20.85%	≥ $ 371,420	≥ 8.0%	≥ $ 464,275	≥ 10.0%
Tier 1 risk-based capital ratio	909,850	19.60%	≥ 278,565	≥ 6.0%	≥ 371,420	≥ 8.0%
Common equity tier I capital ratio	909,850	19.60%	≥ 208,924	≥ 4.5%	≥ 301,779	≥ 6.5%
Tier 1 leverage ratio	909,850	13.62%	≥ 267,307	≥ 4.0%	≥ 334,133	≥ 5.0%

	Actual		Minimum Capital Requirements		To Be Well Capitalized Under Prompt Corrective Action Provisions	
	Amount	Rate	Amount	Rate	Amount	Rate
			(Dollars in thousands)			
As of December 31, 2015:						
Total risk-based capital ratio	$ 907,089	21.33%	≥ $ 340,164	≥ 8.0%	≥ 425,205	≥ 10.0%
Tier 1 risk-based capital ratio	853,852	20.08%	≥ 255,123	≥ 6.0%	≥ 340,164	≥ 8.0%
Common equity tier I capital ratio	853,852	20.08%	≥ 191,342	≥ 4.5%	≥ 276,384	≥ 6.5%
Tier 1 leverage ratio	853,852	14.02%	≥ 243,677	≥ 4.0%	≥ 304,596	≥ 5.0%

NOTE 19 – SUBSEQUENT EVENTS

The Bank has evaluated events that have occurred subsequent to December 31, 2016, and through April 19, 2017, the date that these financial statements were issued. There have been no subsequent events that have occurred during the period that would require recognition in the financial statements or its disclosure in 2016.

Corporate Information

Board of Directors

Daniel K. Walker, Chairman of the Board
Richard W. Darling
Walter M. Florie
William G. Hayter
Timothy W. Jackert
Lawrence J. McLaughlin
Timothy M. Wilson

Principal Officers

Daniel K. Walker, Chairman of the Board & CEO
W. Henry Walker, President
Kenneth G. Walker, President, Main Office
John W.H. Hinrichs, Chief Financial Officer
Phillip J. Bond, Chief Credit Officer
Melissa Lanfre, Chief Operating Officer

Auditor

KPMG LLP
20 Pacifica, Suite 700
Irvine, CA 92618

Legal Counsel

Paul, Hastings, Janofsky & Walker LLP
695 Town Center Drive, 17th Floor
Costa Mesa, CA 92626

Investor Relations

PondelWilkinson Inc.
1880 Century Park East, Suite 350
Los Angeles, CA 90067

Transfer Agent

American Stock Transfer & Trust Company
6201 15th Ave.
Brooklyn, NY 11219

Securities Listing

Farmers & Merchants Bank's common stock is traded on the OTC Markets system (OTCQB) under the symbol FMBL.

Corporate Headquarters

302 Pine Ave.
Long Beach, CA 90802

Certain statements in this annual report may be forward-looking statements. Readers of this annual report should understand that all such forward-looking statements are inherently subject to risk and uncertainties, some of which cannot be predicted or quantified. Future events and actual results could differ materially from those set forth in, contemplated by or underlying such forward-looking statements, and the Bank's actual results or outcomes could differ materially from those anticipated.

Office Locations

Main – Long Beach
302 Pine Ave.
Long Beach, CA 90802
(562) 437-0011
Since 1907

Belmont Shore
4827 E. Second St.
Long Beach, CA 90803
(562) 621-1430
Since 1971

Bixby Knolls
4545 California Ave.
Long Beach, CA 90807
(562) 984-3600
Since 1970

Corona del Mar
2421 E. Coast Hwy.
Corona del Mar, CA 92625
(949) 723-1804
Since 2013

Downey
9001 Firestone Blvd.
Downey, CA 90241
(562) 334-1836
Since 2013

East Long Beach
3140 E. Anaheim St.
Long Beach, CA 90804
(562) 621-1400
Since 1921

Fullerton
315 N. Harbor Blvd.
Fullerton, CA 92832
(714) 578-1945
Since 1985

Garden Grove
10422 Garden Grove Blvd.
Garden Grove, CA 92843
(714) 590-3880
Since 1955

Huntington Beach
7125 Yorktown Ave.
Huntington Beach, CA 92648
(714) 465-3131
Since 2004

Laguna Hills
24300 Paseo de Valencia
Laguna Hills, CA 92653
(949) 340-3150
Since 2004

Lake Forest
23772 Rockfield Blvd.
Lake Forest, CA 92630
(949) 460-7900
Since 1981

Lakewood
5101 Lakewood Blvd.
Lakewood, CA 90712
(562) 602-8378
Since 1966

Los Altos
2302 Bellflower Blvd.
Long Beach, CA 90815
(562) 799-7271
Since 1973

Memorial Hospital
2801 Atlantic Ave.
Long Beach, CA 90806
(562) 989-7862
Since 1981

Newport Beach
4695 MacArthur Ct., Ste. 130
Newport Beach, CA 92660
(949) 241-8280
Since 2006

Orange
1220 E. Katella Ave.
Orange, CA 92867
(714) 288-8450
Since 1981

Redondo Beach
1304 S. Pacific Coast Hwy.
Redondo Beach, CA 90277
(310) 802-7560
Since 2015

Rolling Hills Estates
27525 Indian Peak Road
Rolling Hills Estates, CA 90274
(310) 491-1711
Since 2001

Rossmoor
12535 Seal Beach Blvd.
Seal Beach, CA 90740
(562) 799-2002
Since 1985

San Clemente
621 N. El Camino Real
San Clemente, CA 92672
(949) 373-2470
Since 2006

San Juan Capistrano
31873 Del Obispo St.
San Juan Capistrano, CA 92675
(949) 488-8550
Since 1985

Santa Ana
1750 E. 17th St.
Santa Ana, CA 92705
(714) 564-1750
Since 1985

Torrance
22400 Hawthorne Blvd.
Torrance, CA 90505
(310) 265-3200
Since 2003

Tustin
2691 Park Ave.
Tustin, CA 92782
(714) 824-3070
Since 2007

F&M