2019

F&M BANK

Farmers & Merchants Bank®

California's Strongest, since 1907.

2019 Annual Report

IN THIS TOGETHER
Farmers & Merchants Bank
F&M

State of the Bank

Our Balance Sheet as of 12/31/2019

$7.6 Billion
In Total Assets

$5.8 Billion
In Total Deposits

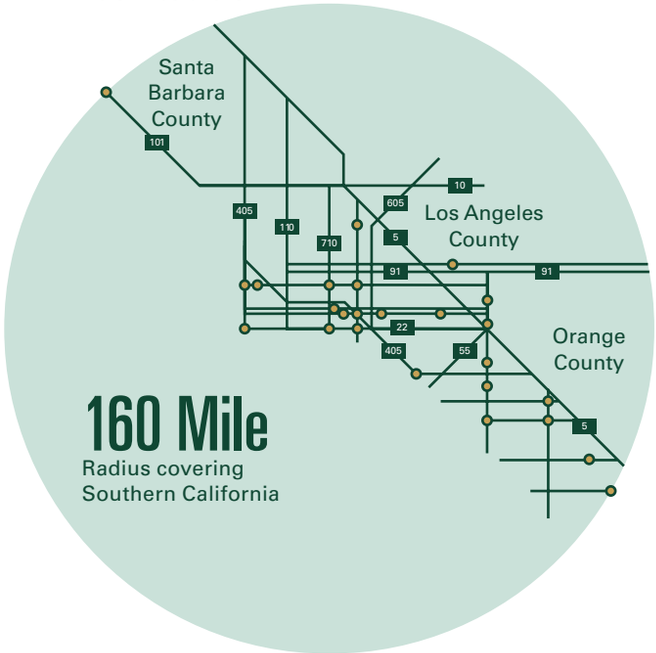
$4.3 Billion
In Total Net Loans

$1 Billion
Total Stockholders' Equity

128,528
Total Shares Outstanding

Our Locations

25 Branches
As of 12/31/2019

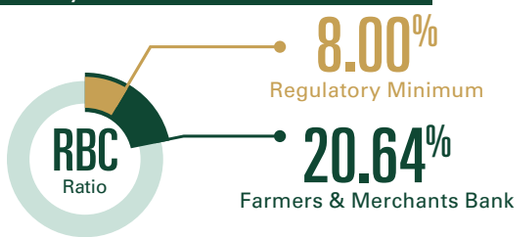


160 Mile
Radius covering
Southern California

Our Services

- Personal Banking
- Commercial Real Estate
- Business Banking
- Mortgages

Our Key Facts



F&M's total risk-based capital (RBC) was 20.64% on 12/31/19, 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.

California's Strongest, IN THIS TOGETHER.

2019

Capital & Reserves as of 12/31/2019

F&M BANK

CAPITAL & RESERVES OVER $1 BILLION

Our Board of Directors

DIRECTORS

DANIEL K. WALKER
CHAIRMAN OF THE BOARD

JoANN M. BOURNE

RICHARD W. DARLING

WALTER M. FLORIE

LAWRENCE J. McLAUGHLIN

CHRISTINE A. SCHEUNEMAN

TIMOTHY M. WILSON

Our Year Highlights

April 2019
Redondo Beach Branch Grand Reopening

June 2019
New Online & Mobile Banking Application Launch

September 2019
New "YES, WE CAN" Campaign Launch

Our Technology

Digital Wallet

Person-to-Person Payments

Mobile Check Deposit

Touch ID

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Our Values

Honesty

Integrity

The Home

The Church

Service Above Self

Board of Directors

Daniel K. Walker

Chairman of the Board
Mr. Walker is the 4th generation CEO of Farmers & Merchants Bank, where he has served in various positions since 1975.

JoAnn M. Bourne

Ms. Bourne is a retired Senior Executive Vice President/Executive Committee member at MUFG Union Bank where she led Global Treasury Management and Commercial Banking during her 30 year career. She was also a member of the US Management Committee for MUFG in the Americas.

Richard W. Darling

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.

Walter M. Florie

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 in the greater Long Beach community and their healthcare needs.

Lawrence J. McLaughlin

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 Texas-based petroleum land leasing company.

Christine A. Scheuneman

Ms. Scheuneman, who became a member of the Bank's Risk and Compliance Committee, is a recently retired partner with the law firm Pillsbury Winthrop Shaw Pittman LLP. She is skilled in national and international retail, as well as commercial and consumer product matters.

Timothy M. Wilson

Mr. Wilson was the 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.

Financial Information

	2019	2018	2017	2016	2015
Diluted Earnings per Common Share	$661	$654	$495	$546	$496
Dividends Declared per Common Share	$123	$121	$119	$119	$119
Net Interest Margin	3.43%	3.45%	3.43%	3.51%	3.63%
Overhead Efficiency Ratio	60.54%	55.98%	62.08%	58.80%	56.62%
Average Assets (Dollars in Millions)	$7,539	$7,222	$6,942	$6,407	$5,804
Total Risk-Based Capital	20.64%	19.89%	19.97%	20.85%	21.33%

Shareholder Letter

Dear Fellow Shareholders:

The economic and lifestyle challenges all of us have faced during the recent months and continue to endure today, have positioned the world in an extraordinary situation that has implications for society, businesses and families alike.

At Farmers & Merchants Bank, we take our responsibility seriously to help our clients and the communities we serve through this challenging period. As part of the Bank's heritage, we continue, as always, to take a cautious approach to all we do.

As the coronavirus epidemic became a pandemic, we immediately put plans in place to minimize health risks and protect our employees, implementing stringent hygienic measures throughout all our locations and allowing our staff to work at home where feasible, while still serving those clients who wish to visit our offices. We continue to encourage clients to do their daily banking via our online solutions and conduct online or phone meetings with us when possible, rather than in-person meetings.

The approximately $19 million in technology investments we made over the past four years – from peer-to-peer payments (P2P) and mobile banking, to digital wallets, fully upgraded operating systems and more – is paying off in a timely manner for the Bank and for everyone we serve.

We are drawing on our safe, secure IT capabilities to serve clients in efficient ways, with no disruption to service, and without sacrificing the F&M human touch and the sensitivity to their needs. Our investments in hardware, processes and people are allowing us to have many of our staff members work safely and remotely from their homes.

We continue to monitor the potential impact of the pandemic to ensure that we are assisting and supporting all of our stakeholders appropriately, including making assessments in individual circumstances, both for consumers and businesses, to see how we can best help them. For some, it is offering deferment of payments, for others it may be temporarily extending or increasing overdraft facilities.

Working around the clock and weekends, F&M proudly and successfully processed and funded more than 4,000 Paycheck Protection Program (PPP) loans, totaling approximately $700 million, to provide needed relief to both new and existing business clients through the Small Business Administration program that was created under the Coronavirus Aid, Relief and Economic Security (CARES) Act.

Financial Overview

Throughout our 113-year history, the F&M management team and board members have maintained a consistent, unwavering policy of financial prudence, adhering to conservative lending and maintaining robust capital ratios. Such policies, which include our prudent credit standards, have served the Bank, our shareholders and our clients well, enabling us to weather difficult economic cycles and maintain the highest degree of responsive, uncompromised service.

The Bank has maintained its profitability since its founding in 1907. The year 2019 was no exception.

Total interest and dividend income for the year ended December 31, 2019 rose to $280.5 million, from $261.0 million reported for 2018. Interest expense for the full 2019 year was $33.0 million versus $21.9 million in 2018.

Net interest income for 2019 increased to $247.5 million, from $239.1 million in 2018. F&M's net interest margin was 3.43% for the year ended December 31, 2019, compared with 3.45% in the previous year.

The Bank's provision for loan losses was $250,000 for the year ended December 31, 2019, compared with a loan loss provision of $2.5 million for the year ended December 31, 2018. The Bank's allowance for loan losses as a percentage of loans outstanding was 1.42% at December 31, 2019, compared with 1.47% at December 31, 2018.

Non-interest income for the full 2019 year totaled $19.3 million, compared with $18.2 million for the full 2018 year. Non-interest expense for the year ended December 31, 2019 was $163.7 million, compared with $146.1 million last year.

The Bank's net income for 2019 was $85.6 million, or $651.50 per diluted share, compared with $85.6 million, or $654.07 per diluted share, for 2018.

Shareholder Letter

Strong Balance Sheet

F&M recorded solid loan growth and again maintained robust liquidity in 2019. At December 31, 2019, net loans grew to $4.34 billion, compared with $4.19 billion at December 31, 2018. Investment securities aggregated $2.88 billion at December 31, 2019, versus $2.78 billion at December 31, 2018.

Deposits, the Bank's primary funding source, grew to $5.83 billion at the end of 2019, from $5.58 billion at December 31, 2018. Non-interest-bearing deposits represented 36.6% of total deposits at December 31, 2019, versus 37.6% a year ago. Total assets advanced to $7.61 billion at the close of 2019 from $7.31 billion at December 31, 2018.

At December 31, 2019, Farmers & Merchants Bank remained "well-capitalized" under all regulatory categories, with a total risk-based capital ratio of 20.64%, a tier 1 risk-based capital ratio of 19.42%, a common equity tier 1 capital ratio of 19.42%, and a tier 1 leverage ratio of 13.99%. The minimum ratios for capital adequacy for a well-capitalized bank are 10.00%, 8.00%, 6.50% and 5.00%, respectively.

During 2019, F&M repurchased 2,400 shares of its common stock at an average price of $8,194.03 per share under a repurchase program that expired at the end of 2019. Expressing continued confidence in the Bank's future, in April 2020, we announced that our Board of Directors approved the authorization of a new stock repurchase program, also in the amount of $20 million. Purchases may be made from time to time through various means, including open market and privately negotiated transactions, or otherwise within applicable laws.

A Productive Year

Our positive financial results notwithstanding, 2019 was a productive year on several operational fronts. We completed our office expansion in Newport Beach, opened a new branch in Redondo Beach, and completed our first full year at our new Santa Barbara location, which became our 25th branch and extended our geographical reach in Southern California. Looking ahead, we acquired properties for branch relocations in Lakewood and Santa Ana and consummated plans to open an office in the North Tustin section of Orange County.

Early in 2019, we were pleased to announce the appointment of two experienced financial executives to our Board of Directors, JoAnn Bourne and Christine Scheuneman. They succeeded William G. Hayter and Timothy W. Jackert, who retired from our board after serving for 31 years and 13 years, respectively.

We are grateful for the many contributions and the day-to-day guidance that our directors and management team provide to F&M. Their collective wisdom and guidance translate to our longstanding history of success and to an institution characterized by strength and stability for each of our stakeholders, and to a client experience where multi-generational relationships form a bond between F&M and the communities we serve.

During 2019, F&M and the Farmers & Merchants Bank Foundation continued to support many non-profit organizations with cash donations. Through the Foundation, the Bank contributed more than $1 million over the course of the past year to organizations that included Aquarium of the Pacific; Big Brothers Big Sisters of Orange; the Roman Catholic Diocese of Orange; Local Initiatives Support Corporation; the Norbertine Community; John Mallinger Charitable Foundation; the Turner Foundation; and Pathways to Independence, among others.

Proceeding into 2020, while the full magnitude of the economic disruption caused by the coronavirus, along with the protracted low interest rate environment, is not possible to assess, we believe these formidable challenges will be mitigated by F&M's financial strength, a dedicated staff at every level of our organization, and our loyal client base.

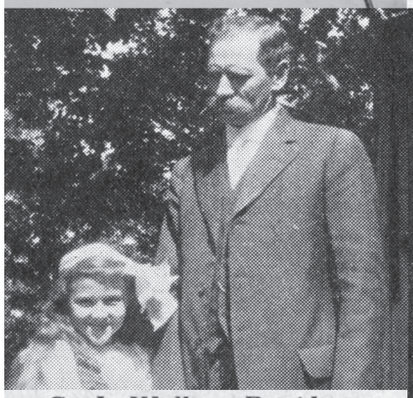
We remain grateful to our Maker and will continue our mission of serving our communities well, helping our business and individual clients who are in need, and striving to achieve value for our shareholders, by an unwavering adherence to our tried and true policies and practices of prudent fiscal management.

Daniel K. Walker
Chairman of the Board and CEO

W. Henry Walker
President

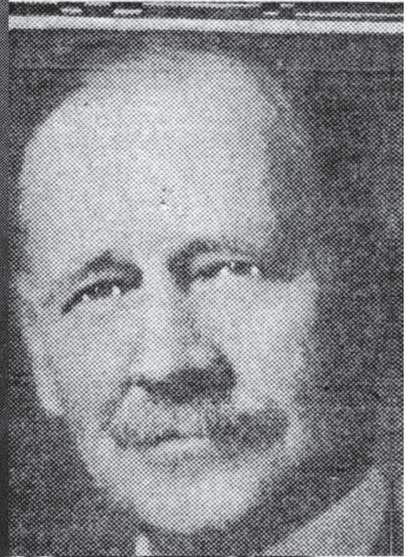
Banker Predicts Good Business and Greater Expansion During 1930

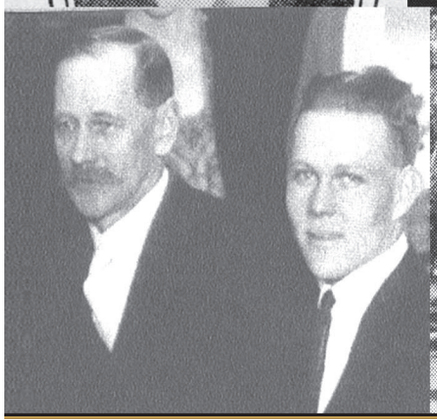
C. J. Walker, president of the Farmers and Merchants bank, believes that Long Beach business conditions will be good in 1930 because of the natural momentum of business, certain industrial expansion and because he is of the opinion that present wage standards will maintain.



C. J. Walker, President of the Board of Directors of The Young Men's Christian Association Receives Keys

Banker Sees Many Reasons for Optimism





CITY NEEDS C. J. WALKER

Long Beach learns with deep, unfeigned, general regret that City Councilman C. J. Walker, acting upon the counsel of his medical advisors, has decided that his health will not permit continuance in office.

Long Beach joins his councilmanic colleagues in the hope that their forthcoming conference with him may eventuate in his reconsideration and his return to participation in their deliberations.

The Press, on the other hand, accepts Mr. Walker's assignment of reason for his action, failing health, at its face value, for he is not the sort of man accustomed to mincing of words. His frank integrity and outspoken veracity are among the personal traits which have exalted him to high level in public

California's Strongest, IN THIS TOGETHER.

BANKER PROVES HE'S GOOD FIREFIGHTER

Gus Walker, president of the Farmers & Merchants Bank, proved yesterday that he is an able fireman as well as a good banker.

Last evening when the fire broke out in the building next to his bank, Walker grabbed a fire hose in the bank building, hauled it to the roof and proceeded to battle the blaze like a veteran fire-eater.

Gus Walker

Banker Honored by Association

G. A. Walker, president of the Farmers & Merchants Bank, today was elected a member of the executive council of the California Bankers' Association for three years at the closing session of the 56th anniversary convention of the Association at Hotel Del Coronado, Coronado.

G. A. WALKER

William A. Marms, vice president of the American Trust Co., of San Francisco, was elected president, succeeding Mark G. McHahon, of Glendale.

Gus A. Walker Elected Head of Clearing House

GUS A. WALKER, president of the Farmers & Merchants Bank, was elected president of the Long Beach Clearing House Association last night, succeeding P. E. Hatch, dean of Long Beach bankers who had served as president of the Clearing House since its organization in 1910. Mr. Hatch recently retired from active banking.

J. R. Davis, vice president and manager of the Long Beach offices of the Bank of America, was re-elected secretary and manager, a position that he has held for 13 years.

Members of the executive committee are Warren A. Harlan, president of the Western Bank; C. C. Jameson, vice president and manager of the Security First National Bank, Mr. Walker and Mr. Davis.

The Clearing House Association, of all Long Beach bankers, has functioned for 35 years. It

GUS A. WALKER

Middough Again Head of Crime Curb Committee

Lorne Middough, Long Beach representative to the State Assembly, was renamed today to the chairmanship of the crime and correction committee of the Assembly; also he was assigned to a committee ordered to investigate charges of brutality at the Preston State School of Industry.

The investigation committee will open its inquiry at the school Monday. It will question O. H. Close, superintendent, suspended by Karl Holton, director of the State Youth Authority. A San Francisco Assemblyman, Edward F. O'Day, chairman of the committee, has said that he found three near-nude youths shivering in unheated cells at the school.

Fred Kraft (R.-San Diego) was named chairman of the committee to handle Gov. Earl Warren's compulsory health insurance plan.

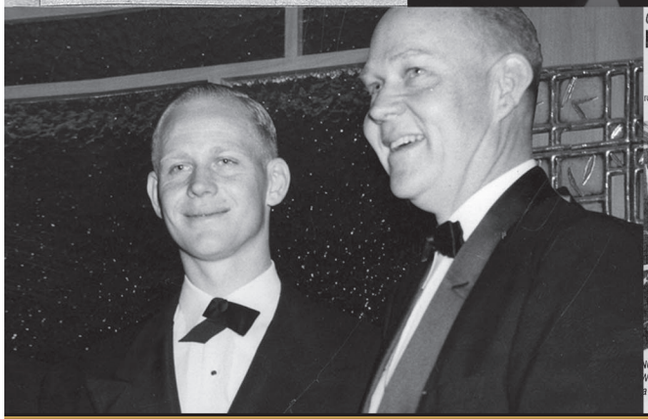
Walter Fourt (R.-Ventura) will be in charge of the Governor's program to maintain state tax rates at present levels.

C. Don Field (R.-Glendale) will head the committee on government efficiency and economy.

Albert Wollenberg (R.-San Francisco) heads the ways and means committee.

Realty Man's Son Missing in Action

Lloyd Leedom, realtor, with offices at 3201 E. Anaheim St., received official notice today tha



CHAIRMAN OF THE BOARD STILL RUNNING THE BUSINESS

F & M's Gus Walker Going Strong At 90

By Mike Fisher
Gazette Staff Writer

At age 90, Gus Walker is not retiring — not in any way.

The chairman of the board of Farmers and Merchants (F&M) Bank of Long Beach continues his daily hands-on management from his balcony office, which overlooks the banking floor.

NOT RETIRING. F&M Bank chairman, 90-year-old Gus Walker, is on the job every day. His office contains memorabilia from his lengthy career. —George Meltvier/Meltvier Photography

Walker spends a typical day at the 301 Pine Ave., F&M headquarters "buying and selling securities," he said, "and changing the balances of correspondent banks so they don't get too high, and we can make them earn us something."

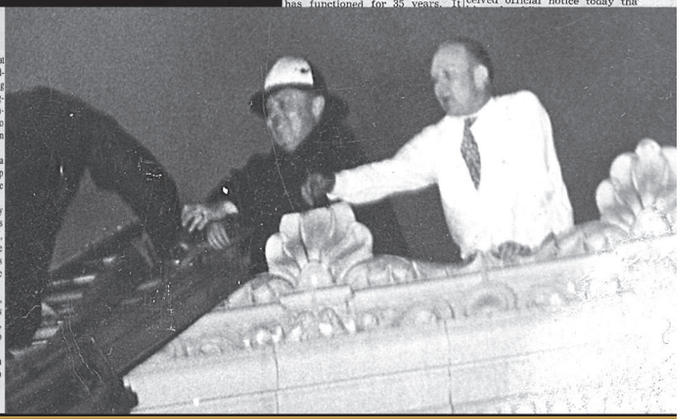
But then again, "if there's a little mopping to do and a mop is close by, then I'll do a little mopping," Walker laughed.

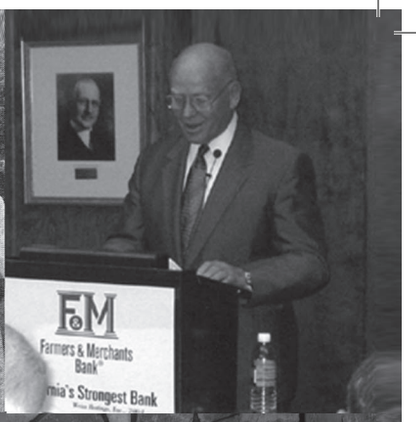
Walker also interviews every new bank employee. He knows everyone who works at F&M, and they know him, a practice learned from C.J. Walker, his father and co-founder of the bank.

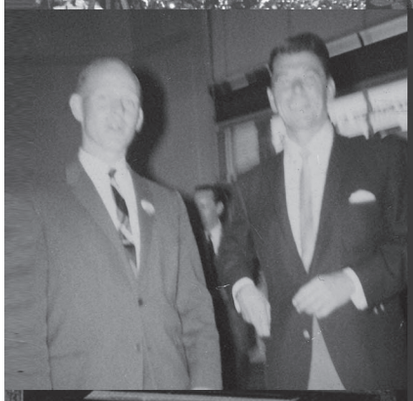
Surrounded by mementos, Walker works adjacent to his father's original roll top desk, and a photo of C.J. hangs just to his left.

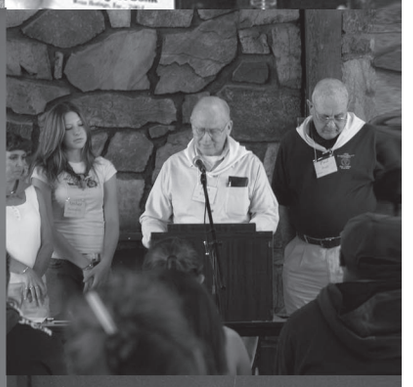
Stuffed animal trophies from Walker's hunting safaris 60 to

(Continued on Page 17)









Ken Walker

KENNETH G. WALKER

CALIFORNIA'S STRONGEST BANK HAS FAMILY TIES

LONG BEACH'S F & M BANK

By William McIlhany

With a net worth-to-assets ratio of 17 percent, almost three times the FDIC guidelines, and enough cash, government bonds and high-grade municipal bonds to cover total deposits of $587 million at the close of 1985, Farmers & Merchants Bank is considered one of California's strongest banks.

The Long Beach-based bank, which has seven branch offices in Orange County, is run by the father-and-son team of Gus Walker, chairman of the board, and Kenneth Walker, president. They attribute the bank's strength — and longevity — to conservative practices.

According to Kenneth Walker, "When you realize that the size of the bank is related to the amount of deposits and these are liabilities, not assets, of the bank, the fiduciary responsibility of management is very clear. We are responsible first to our depositors, second to our stockholders and third to our employees — in that order of priority."

Though native to New York state, the saga of the Walker family begins about 1890 when young C.J. Walker rode horseback from Kansas City to California, following his father and eventually settling in the Long Beach area. Marrying a lady from the Fresno area, Walker founded what grew into a successful contracting business. He built many of the roads in the Long Beach area, as well as the Pacific Electric Railway line from Los Angeles to Long Beach.

In 1913, C.J. Walker founded the Bank of Commerce in Long Beach. Two years later, the bank moved into their present headquarters on Pine Street in Long Beach, a strikingly nostalgic building that transports the visitor back in time in spite of the obvious technology of a modern full service retail bank. Between Gus and Kenneth, they are celebrating a century in the banking business this year.

C.J. Walker's policy of capital accumulation to insure and protect the bank as well as its customers has been faithfully and consistently maintained by two succeeding generations and, according to Kenneth Walker, referring to his children and grandchildren, should they choose to stay in banking, "We're covered for the next two generations."

Fiduciary responsibility exists in all depository institutions — why then have others failed?

"Because they weren't good in their trust responsibilities," Kenneth Walker responded. As to how the bank avoided the bad energy and real estate loans that have crippled other banks, he continued, "You can learn from past experience and history. This bank has been associated with oil production back to the early 1920s, when they first hit oil on Signal Hill.

"My father was a teller at the Long Beach office which handled Shell Oil business. We learned the fundamentals and know how to recognize them. Basically, we're trying to identify real current value in a loan application, the most recent five of their 16 locations. The bank was invited to open their first Orange County branch in Garden Grove 25 years ago, and in the past five years have added branches now covering the Santa Ana, Seal Beach, Fullerton, Orange and San Juan Capistrano areas. It is also interested in finding a location in the Newport-Costa Mesa region.

Kenneth and Gus Walker carry on family banking tradition.

Most bank managers "grew up in the bank in Long Beach," and Garden Grove branch manager Melvin Manker illustrated his commitment to the community by serving as president of the Garden Grove Chamber of Commerce.

Noting that the financing of churches is a source of pride for the bank, Manker added, "The bank does a very fine job and with an amazing amount of churches." Although not limited to the Walkers' denominational preference, Manker added that this trend reflects "a strong family faith that filters through the whole organization."

Gus Walker said that the bank has only lost money on one church project and that was due to an earthquake which destroyed the building.

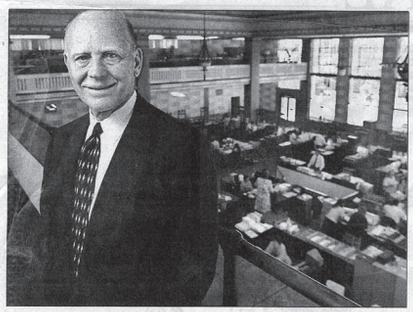
The Walkers are aware that the character and strength of their bank, as well as the continuity of management policy, has been a consequence of their closely managed or closely held corporate organization. A bank that is publicly traded on the stock exchange would be hard pressed to accumulate capital with stockholders clamoring for higher dividends; yet F&M has paid competitive dividends and operates one of the few profitable trust divisions (a separate company) in California.

But wouldn't a bank with such conservative, self-protecting management be more difficult for a borrower to deal with during a time of cash flow problems?

"You might think so," Long Beach real estate developer Dale Neill told the *Business Journal*, "but actually it proved very beneficial for me."

Several years ago Neill's Diversified

National Conference honorees



Ken Walker heads the family business, the Farmers and Merchants Bank. Throughout his career, he has been involved in numerous philanthropic activities.

David Waters / Press-Telegram

Walking the philanthropic walk

Hospital Board Chief

Kenneth G. Walker, executive vice president of Farmers and Merchants Bank, has been elected president of the board of directors of Memorial Hospital of Long Beach.

He succeeds R.J. Munzer.

Walker has twice served terms as vice president on the board and has been a trustee and director for 12 years.

The new president said he will try to see that the hospital invests in the best medical care and that it attains quality patient care through a healthy financial organization.

He stressed however that the hospital must succeed as an efficient operation "without losing personal relationships be-

California's Strongest, IN THIS TOGETHER.

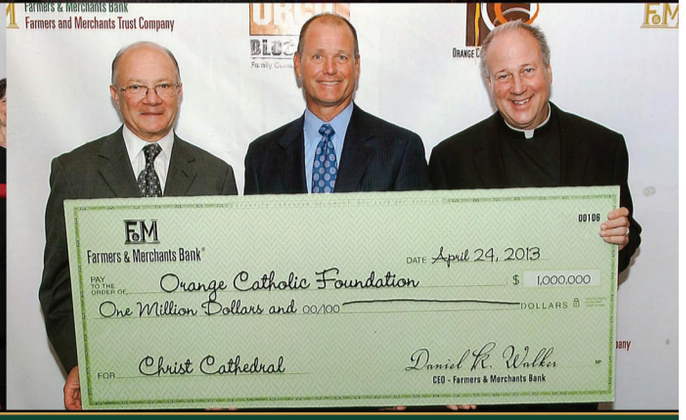
LONG BEACH FIRE DEPT.

Farmers & Merchants Bank
California's Strongest, since 1907.

1234
Farmers & Merchants Bank
$ 20,000
Big Brothers Big Sisters Orange County
Twenty Thousand Dollars and
NO/100

Daniel K. Walker
W. Henry Walker

California's Strongest, since 1907.


Farmers & Merchants Bank
Farmers and Merchants Trust Company
00106
Farmers & Merchants Bank
DATE April 24, 2013
PAY TO THE ORDER OF Orange Catholic Foundation $ 1,000,000
One Million Dollars and 00/100 DOLLARS
FOR Christ Cathedral
Daniel K. Walker
CEO - Farmers & Merchants Bank

California's Strongest, IN THIS TOGETHER.

2019 Financial Report

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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, 2019 and 2018, 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, 2019 and 2018, and the results of its operations and its cash flows for the years then ended in accordance with U.S. generally accepted accounting principles.

California's Strongest, IN THIS TOGETHER.

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, 2019, 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 22, 2020 expressed an unmodified opinion on the effectiveness of the Bank's internal control over financial reporting

KPMG LLP

Irvine, California
April 22, 2020

FARMERS & MERCHANTS BANK OF LONG BEACH
BALANCE SHEETS

	December 31, 2019	December 31, 2018
	(In thousands, except share and per share data)	
Assets		
Cash and due from banks:		
Non-interest-bearing balances	$ 64,556	$ 69,486
Interest-bearing balances	54,309	17,661
Total cash and due from banks	118,865	87,147
Securities available-for-sale, at fair value	150,623	134,008
Securities held-to-maturity, at amortized cost	2,728,583	2,649,460
Loans held for sale	23,301	20,718
Gross loans	4,403,876	4,260,093
Allowance for loan losses	(62,489)	(62,450)
Unamortized deferred loan fees, net	(5,127)	(5,973)
Loans, net	4,336,260	4,191,670
Other real estate owned, net	-	1,724
Investments in FHLB and FRB stock, at cost	20,160	20,690
Premises and equipment, net	108,133	100,478
Deferred tax assets, net	22,213	19,680
Other assets	97,431	82,661
Total assets	**$ 7,605,569**	**$ 7,308,236**
Liabilities and Stockholders' Equity		
Liabilities:		
Deposits:		
Non-interest-bearing deposits	$ 2,135,056	$ 2,098,097
Interest-bearing deposits	3,693,209	3,486,369
Total deposits	5,828,265	5,584,466
Securities sold under repurchase agreements	632,428	609,791
Other borrowings	-	30,000
Other liabilities	61,996	56,106
Total liabilities	6,522,689	6,280,363
Stockholders' equity:		
Common stock, par value $20; authorized 250,000 shares; 128,528 and 130,928 shares issued and outstanding at December 31, 2019 and December 31, 2018, respectively	2,571	2,619
Additional paid-in capital	95,446	112,044
Retained earnings	983,867	914,164
Accumulated other comprehensive income (loss)	996	(954)
Total stockholders' equity	1,082,880	1,027,873
Total liabilities and stockholders' equity	**$ 7,605,569**	**$ 7,308,236**

See accompanying notes to financial statements.

California's Strongest, IN THIS TOGETHER.

FARMERS & MERCHANTS BANK OF LONG BEACH
STATEMENTS OF INCOME

	Years Ended December 31,	
	2019	2018
	(In thousands, except per share data)	
Interest and dividend income:		
Loans	$ 207,294	$ 190,234
Investment securities	68,829	67,034
Investments in FHLB and FRB stock	1,404	1,694
Interest-bearing deposits in financial institutions	2,926	2,035
Total interest and dividend income	280,453	260,997
Interest expense:		
Deposits	22,533	14,202
Securities sold under repurchase agreements	10,378	7,698
Other borrowings	54	41
Total interest expense	32,965	21,941
Net interest income	247,488	239,056
Provision for loan losses	250	2,500
Net interest income after provision for loan losses	247,238	236,556
Non-interest income:		
Service charges on deposit accounts	6,584	5,650
Card income	3,618	3,877
Other real estate owned income	227	-
Other income	8,838	8,639
Total non-interest income	19,267	18,166
Non-interest expense:		
Salaries and employee benefits	99,683	88,463
FDIC and other insurance expense	1,041	2,593
Occupancy expense	11,930	10,195
Software and equipment expense	12,725	10,879
Other real estate owned expense	85	139
Professional and legal services	7,154	5,803
Marketing expense	8,556	5,950
Other expense	22,555	22,076
Total non-interest expense	163,729	146,098
Income before income tax expense	102,776	108,624
Income tax expense	17,204	22,988
Net income	**$ 85,572**	**$ 85,636**
Basic earnings per common share	$ 661.80	$ 654.07
Diluted earnings per common share	$ 661.23	$ 654.07
Basic weighted-average shares outstanding	129,303	130,928
Diluted weighted-average shares outstanding	129,414	130,928

See accompanying notes to financial statements.

FARMERS & MERCHANTS BANK OF LONG BEACH
STATEMENTS OF COMPREHENSIVE INCOME

	Years Ended December 31,	
	2019	2018
	(In thousands)	
Net income	$ 85,572	$ 85,636
Other comprehensive income (loss), net of tax:		
Unrealized gains (losses) on securities available-for-sale:		
Unrealized holding gains (losses) arising during the period	1,950	(1,041)
Other comprehensive income (loss)	1,950	(1,041)
Comprehensive income	**$ 87,522**	**$ 84,595**

See accompanying notes to financial statements.

California's Strongest, IN THIS TOGETHER.

FARMERS & MERCHANTS BANK OF LONG BEACH
STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY

	Common Stock	Additional Paid-In Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total Stockholders' Equity
			(In thousands)		
Balance, December 31, 2017	**$ 2,619**	**$ 112,044**	**$ 844,370**	**$ 87**	**$ 959,120**
Net income	-	-	85,636	-	85,636
Cash dividends	-	-	(15,842)	-	(15,842)
Other comprehensive loss, net of tax	-	-	-	(1,041)	(1,041)
Balance, December 31, 2018	**$ 2,619**	**$ 112,044**	**$ 914,164**	**$ (954)**	**$ 1,027,873**
Repurchase and retirement of common stock	(48)	(19,618)	-	-	(19,666)
Restricted share units awarded	-	3,020	-	-	3,020
Net income	-	-	85,572	-	85,572
Cash dividends	-	-	(15,869)	-	(15,869)
Other comprehensive income, net of tax	-	-	-	1,950	1,950
Balance, December 31, 2019	**$ 2,571**	**$ 95,446**	**$ 983,867**	**$ 996**	**$ 1,082,880**

See accompanying notes to financial statements.

FARMERS & MERCHANTS BANK OF LONG BEACH
STATEMENTS OF CASH FLOWS

	Years Ended December 31,	
	2019	2018
	(In thousands)	
Cash flows from operating activities:		
Net income	$ 85,572	$ 85,636
Adjustments to reconcile net income to net cash provided by operating activities:		
Net amortization on securities	13,077	19,634
Stock compensation cost	3,020	-
Provision for loan losses	250	2,500
Loans held for sale:		
Originations	(54,850)	(55,552)
Proceeds from sale	53,317	50,808
Gain on sale	(1,050)	(936)
Other real estate owned:		
Gain on sale	(190)	-
Provision	25	-
Amortization of tax credit investments	16,820	11,582
Premises and equipment:		
Gain on sale	(5)	(22)
Depreciation	9,258	7,700
Addition of reserve for losses on unfunded loan commitments	100	400
(Increase) decrease in deferred income tax benefit	(3,378)	1,334
Decrease in other assets	634	3,875
Increase in other liabilities	1,375	2,119
Total adjustments	38,403	43,442
Net cash provided by operating activities	123,975	129,078
Cash flows from investing activities:		
Securities available-for-sale:		
Proceeds from maturities and pay downs	1,121,186	55,802
Purchases	(1,136,026)	(6,338)
Securities held-to-maturity:		
Proceeds from maturities and pay downs	552,064	477,514
Purchases	(643,271)	(486,686)
Net increase in loans held for investment	(144,840)	(361,897)
Proceeds from sale of other real estate owned	1,889	-
Redemption of FHLB stock	530	-
Increase of tax credit investments	(27,782)	(10,730)
Premises and equipment:		
Proceeds from sale	49	93
Purchases	(16,957)	(12,699)
Net cash used in investing activities	(293,158)	(344,941)

California's Strongest, IN THIS TOGETHER.

FARMERS & MERCHANTS BANK OF LONG BEACH
STATEMENTS OF CASH FLOWS

Statements of Cash Flows, continued

	Years Ended December 31,	
	2019	2018
	(In thousands)	
Cash flows from financing activities:		
Net increase in deposits	243,799	193,355
Net increase (decrease) in securities sold under repurchase agreements	22,637	(4,619)
Net (decrease) increase in other borrowings	(30,000)	30,000
Cash dividends paid	(15,869)	(15,842)
Common stock repurchased and retired	(19,666)	-
Net cash provided by financing activities	200,901	202,894
Net increase (decrease) in cash and due from banks	31,718	(12,969)
Cash and cash equivalents at beginning of year	87,147	100,116
Cash and cash equivalents at end of year	**$ 118,865**	**$ 87,147**
Supplemental disclosures of cash flow information:		
Cash paid during the year for:		
Interest expense	$ 22,616	$ 22,140
Income taxes	20,098	15,821
Non-cash investing and financing activities		
Transfers of loans to other real estate owned	$ -	$ 1,724
New commitment to fund tax credit investments	22,127	37,556

See accompanying 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 bank that offers a broad range of banking products and services to individuals, professionals and small to medium-sized businesses. As of December 31, 2019, the Bank operates 25 branches in California's Los Angeles County, Orange County and Santa Barbara County, as well as through robust Online and Mobile Banking platforms. 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") and Federal Home Loan Bank ("FHLB"), the majority of which is immediately available.

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

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

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

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 unaccreted 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, and Federal Reserve Bank ("FRB") Discount Window borrowings.

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 other 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

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

Loans Held for Sale, continued

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, 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 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 original contractual terms. Impaired loans include loans on nonaccrual status or TDR.

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

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 ALL is based upon a continuing review of the portfolio, past loan loss experience, current economic conditions and external conditions that may affect the borrowers' ability to pay and the underlying collateral value of the loans. Loans that are deemed to be uncollectible are charged off and deducted from the ALL. The provision for loan losses and recoveries on loans previously charged off are added to the ALL.

The ALL 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 historical look-back period increased from 13 years at December 31, 2018 to 14 years for the year ended December 31, 2019. This increase maintains the fourth quarter of 2005 as the starting period, which was deemed prudent in order to include loan charge-off experience during the most recent downward economic cycle in the estimation of the ALL. 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," "watch," "special mention," "substandard," or "doubtful" and are defined in general terms as follows:

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

Watch: This is a "Pass" rating; however, loans with this risk rating require a higher level of oversight and management

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: Substandard loans have a high probability of payment default, or they have other well-defined weaknesses. They require more intensive supervision by bank management. Substandard loans are generally characterized by current or expected unprofitable operations, inadequate debt service coverage, inadequate liquidity, or marginal capitalization.

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

Allowance for Loan Losses, continued

Doubtful: A doubtful loan has a high probability of total or substantial loss, but because of specific pending events that may strengthen the loan, its classification as loss is deferred. Doubtful borrowers are usually in default, lack adequate liquidity or capital, and lack the resources necessary to remain an operating entity.

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 the Financial Accounting Standards Board's ("FASB") Accounting Standards 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 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 costs to sell is charged to the ALL 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. Investment in FHLB stock is carried at cost and is 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 FRBSF, the Bank is required to maintain FRB stock 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.

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.

Tax Credit Investments

The Bank invests in limited liability companies and partnerships that make investments in affordable housing projects, renewable energy projects, and new market tax credits, which qualify for federal income tax credits. The Bank's interests are accounted for utilizing the Hypothetical Liquidation at Book Value ("HLBV") method or the proportional amortization method. For investments accounted for using the HLBV method, a calculation is prepared at each balance sheet date to estimate the amount that the Bank would receive if the investment entity was to liquidate all of its assets and distribute that cash to the investors based on the contractually defined liquidation priorities. Investments accounted for using the proportional amortization method are 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.

Borrowings

The Bank utilizes repurchase agreements, federal funds' lines of credit, FRB discount window, 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 unsecured federal funds lines of credit with several correspondent banks, as well as with the FHLB and FRB. These federal funds lines of credit generally mature within one business day. The Bank's available secured borrowing capacity from the FHLB is derived from the loans that are pledged to the FHLB.

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

Revenue Recognition

The Bank accounts for certain of its revenue streams in accordance with ASC 606 – *Revenue from Contracts with Customers*. Revenue from contracts with customers in the scope of Topic 606 is measured based on the consideration specified in the contract with a customer, and excludes amounts collected on behalf of third parties. The Bank recognizes revenue from contracts with customers when it satisfies its performance obligations. The Bank's performance obligations are typically satisfied as services are rendered and payment is generally collected at the time services are rendered, or on a monthly, quarterly or annual basis. The Bank had no material unsatisfied performance obligations as of December 31, 2019 and December 31, 2018.

In certain cases, other parties are involved with providing products and services to our customers. If the Bank is a principal in the transaction (providing goods or services itself), revenues are reported based on the gross consideration received from the customer and any related expenses are reported gross in noninterest expense. If the Bank is an agent in the transaction (arranging for another party to provide goods or services), the Bank reports its net fee or commission retained as revenue. Rebates, waivers, and reversals are recorded as a reduction of revenue either when the revenue is recognized by the Bank or at the time the rebate, waiver, or reversal is earned by the customer.

Card Income consists of interchange fees from merchant bankcards and debit cards, merchant acquirer revenue, and other card related services. Interchange fees are earned by the Bank each time a request for payment is initiated by a customer at a merchant for which the Bank transfers the funds on behalf of the customer. Interchange rates are set by the payment network and are based on purchase volumes and other factors. The Bank is considered an agent of the customer and incurs costs with the payment network to facilitate the interchange with the merchant; therefore, the related payment network expense is recognized as a reduction of card income. The Bank offers rewards and/or rebates to its customers based on card usage. The costs associated with these programs are recognized as a reduction of Card Income.

Nature of Goods and Services

Substantially all of the Bank's revenue, such as interest income on loans, investment securities, and interest-earning deposits in financial institutions, is specifically out-of-scope of Topic 606. For the revenue that is in-scope, the following is a description of principal activities, separated by the timing of revenue recognition, from which the Bank generates its revenue from contracts with customers:

Revenue earned at a point in time: Examples of revenue earned at a point in time are ATM transaction fees, wire transfer fees, NSF fees, and merchant and debit card interchange fees. Revenue is generally derived from transactional information accumulated by our systems and is recognized as revenue immediately as the transactions occur or upon providing the service to complete the customer's transaction. The Bank is the principal in each of these contracts with the exception of merchant and debit card interchange fees, in which case the Bank is acting as the agent and records revenue net of expenses paid to the principal.

Revenue earned over time: The Bank earns certain revenue from contracts with customers as services are rendered on a monthly, quarterly or annual basis. Examples of this type of revenue are deposit account service fees, HELOC fees, letter of credit, and safe deposit box fees. Account service fees are recognized on a monthly basis. Revenue is primarily based on services rendered on the number and type of transactions. Revenue is recorded in the same period as the related transactions occur or services are rendered to the customer.

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

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 determines if a contract is a lease at inception. The Bank's operating leases are included within right-of-use ("ROU") assets and lease liabilities on the balance sheet. The ROU asset is based on the operating lease liabilities adjusted for any prepaid or deferred rent.

ROU assets represent our right to use an underlying asset for the lease term and lease liabilities represent our obligation to make lease payments arising from the lease. ROU assets and lease liabilities are recognized at the commencement date based on the present value of lease payments over the lease term. As most of our leases do not provide an implicit rate, the Bank uses its incremental borrowing rate, which is the rate incurred to borrow on a collateralized basis over a similar term and amount equal to the lease payments in a similar economic environment, at commencement date in determining the present value of lease payment. Many of the Bank's lease agreements include options to extend the lease, which the Bank does not include in its minimum lease terms unless they are reasonably certain to be exercised. Rental expense for lease payments related to operating leases is recognized on a straight-line basis over the lease term.

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

Long Term Compensation

The Bank grants restricted share units ("RSUs"), which include service conditions for vesting. Compensation expense for these time-based awards is calculated based on the fair value of the award at the closing price of the Bank's stock on the date of the grant.

Compensation expense is amortized on a straight-line basis over the requisite service period for the entire award. As stock-based compensation expense is estimated based on awards ultimately expected to vest, it is reduced by the expense related to awards expected to be forfeited. Forfeitures are estimated at the time of grant and are reviewed periodically for reasonableness. If the estimated forfeitures are revised, a cumulative effect of changes in estimated forfeitures for current and prior periods is recognized in compensation expense in the period of change.

Market conditions subsequent to the grant date have no impact on the amount of compensation expense the Bank will recognize over the life of the award.

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 ALL 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.

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

Income Taxes

Income taxes are accounted for under the asset and liability method. Under this method, the deferred tax assets and liabilities ("DTA/DTL") 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 income tax expense. The Bank also evaluates existing valuation allowances periodically to determine if sufficient evidence exists to support an increase or reduction in the allowance.

Tax positions that are uncertain but meet a more-likely-than-not recognition threshold, are initially and subsequently measured as the largest amount of tax benefit that has a greater than 50% likelihood of being realized upon settlement with a taxing authority that has full knowledge of all relevant information. The determination of whether or not a tax position meets the more likely than not recognition threshold considers the facts, circumstances, and information available at the reporting date and is subject to management's judgment. The Bank recognizes interest and penalties related to tax positions as part of income tax expense.

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 net income available to common stockholders by the weighted-average number of common shares outstanding during each period. Diluted EPS is computed by dividing net income available to common stockholders by the weighted-average number of common shares outstanding during each period, plus common share equivalents calculated for RSUs outstanding using the treasury stock method.

Recent Accounting Standards

In February 2016, the FASB issued Accounting Standards Update ("ASU") 2016-02, *Leases (Topic 842).* ASU 2016-02 requires lessees to recognize all leases with terms 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. The Bank has elected to apply the "package" of practical expedients in its transition to Topic

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

Recent Accounting Standards, continued

842 and use of the hindsight to determine the lease term, which permits the Bank not to reassess under the new standard our prior conclusions about lease identification, lease classification and initial direct costs. The Bank adopted the new lease standard on January 1, 2019 using the transition method, which the Bank recognized a cumulative effect adjustment to the opening balance sheet in the period of adoption, whereby comparative period is not restated. The Bank has elected to exclude short term leases with contractual terms less than one year from the initial measurement of the lease liability and ROU asset. In transition to Topic 842, the Bank initially recorded lease liabilities of $10.4 million and ROU assets of $10.1 million. There was no cumulative effect adjustment recorded to the retained earning upon adoption. There was no impact to the Statements of Income. Please refer to Note 11 – Leases for additional information related to the Bank's leases.

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 established a CECL Committee in 2017 to develop, implement and review the adoption of ASU 2016-13. In 2018, the Bank established an implementation plan, selected a software solution, reached preliminary accounting decisions on various matters and initiated the implementation phase of the project. In 2019, the Bank implemented the new software solution, which will be utilized to calculate required reserve under CECL. The Bank continues to develop and document the new expected loss model with supportable assumptions and address data and reporting requirements. The Bank expects to begin parallel calculations, testing, and sensitivity analysis on its initial modeling assumptions and results in 2020. ASU 2016-13 is effective for fiscal years beginning after December 15, 2022. The Bank is evaluating the impact of this ASU on its financial statements and related disclosures.

In August 2018, the FASB issued ASU 2018-13, *Fair Value Measurement (Topic 820): Disclosure Framework – Changes to the Disclosure Requirements for Fair Value Measurement*. This update targets improvements in the effectiveness of disclosure requirements for recurring and nonrecurring fair value measurements. The standard removes, modifies, and adds certain disclosure requirements, and is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2019. Adoption of ASU 2018-13 is not expected to have a significant impact on the Bank's 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, 2019				
US Treasury	$ 49,985	$ 5	$ -	$ 49,990
SBA pool securities	4,892	314	-	5,206
Mortgage-backed securities	57,168	658	-	57,826
State and municipal securities	37,164	437	-	37,601
Total securities available-for-sale	$ 149,209	$ 1,414	$ -	$ 150,623
As of December 31, 2018				
US Treasury	$ -	$ -	$ -	$ -
SBA pool securities	5,027	117	-	5,144
Mortgage-backed securities	66,980	82	(1,604)	65,458
State and municipal securities	63,355	291	(240)	63,406
Total securities available-for-sale	$ 135,362	$ 490	$ (1,844)	$ 134,008

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, 2019		
Due in 1 year or less	$ 63,367	$ 63,446
Due after 1 year through 5 years	18,719	18,998
Due after 5 years through 10 years	10,529	10,691
Due after 10 years	56,594	57,488
	$ 149,209	$ 150,623
As of December 31, 2018		
Due in 1 year or less	$ 24,744	$ 24,723
Due after 1 year through 5 years	30,889	31,125
Due after 5 years through 10 years	15,186	15,026
Due after 10 years	64,543	63,134
	$ 135,362	$ 134,008

The Bank did not sell any securities available-for-sale during 2019 and 2018.

NOTE 2 – Securities Available-for-Sale, continued

As of December 31, 2019, the amortized cost of state and municipal securities available-for-sale with unrealized losses totaled $2.2 million and the aggregate amount of unrealized losses totaled only $419 dollars. The following table shows the fair value and the gross unrealized losses on securities available-for-sale aggregated by investment category and the length of time that the individual securities have been in a continuous unrealized loss position as of December 31, 2018:

	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, 2018						
Mortgage-backed securities	$ 14,723	$ (320)	$ 46,715	$ (1,284)	$ 61,438	$ (1,604)
State and municipal securities	8,713	(29)	29,885	(211)	38,598	(240)
Total temporarily impaired securities	$ 23,436	$ (349)	$ 76,600	$ (1,495)	$ 100,036	$ (1,844)

The number of securities available-for-sale with unrealized losses less than 12 months and 12 months or longer was 4 and 7, respectively, for the year ended December 31, 2019, and 50 and 230, respectively, for the year ended December 31, 2018. Whenever the cost of a security exceeds its fair value, management evaluates, among other factors, general market conditions, 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, 2019 and 2018, 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.

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

	Before-Tax Amount	Tax (Expense) Benefit	Net-of-Tax Amount
		(In thousands)	
Year ended December 31, 2019			
Unrealized gains on securities:			
Unrealized holding gains arising during period	$ 2,768	$ (818)	$ 1,950
Other comprehensive income	$ 2,768	$ (818)	$ 1,950
Year ended December 31, 2018			
Unrealized losses on securities:			
Unrealized holding losses arising during period	$ (1,504)	$ 463	$ (1,041)
Other comprehensive loss	$ (1,504)	$ 463	$ (1,041)

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, 2019				
SBA pool securities	$ 98,178	$ 3,141	$ (109)	$ 101,210
Mortgage-backed securities	2,265,208	25,392	(1,061)	2,289,539
State and municipal securities	208,699	2,485	(274)	210,910
Collateralized mortgage obligations	156,498	4,342	(52)	160,788
Total securities held-to-maturity	$ 2,728,583	$ 35,360	$ (1,496)	$ 2,762,447
As of December 31, 2018				
SBA pool securities	$ 80,263	$ 1,332	$ (140)	$ 81,455
Mortgage-backed securities	2,041,099	3,045	(45,318)	1,998,826
State and municipal securities	381,797	2,108	(1,244)	382,661
Collateralized mortgage obligations	146,301	2,444	(681)	148,064
Total securities held-to-maturity	$ 2,649,460	$ 8,929	$ (47,383)	$ 2,611,006

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, 2019		
Due in 1 year or less	$ 87,742	$ 88,030
Due after 1 year through 5 years	115,025	117,315
Due after 5 years through 10 years	575,891	586,332
Due after 10 years	1,949,925	1,970,770
	$ 2,728,583	$ 2,762,447
As of December 31, 2018		
Due in 1 year or less	$ 163,460	$ 163,585
Due after 1 year through 5 years	192,036	193,355
Due after 5 years through 10 years	683,002	678,452
Due after 10 years	1,610,962	1,575,614
	$ 2,649,460	$ 2,611,006

There were no sales or transfers of securities held-to-maturity in 2019 or 2018.

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NOTE 3 – Securities Held-to-Maturity, continued

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, 2019						
SBA pool securities	$ 28,674	$ (109)	$ -	$ -	$ 28,674	$ (109)
Mortgage-backed securities	173,187	(207)	179,180	(854)	352,367	(1,061)
State and municipal securities	15,622	(92)	20,076	(182)	35,698	(274)
Collateralized mortgage obligations	14,654	(31)	2,151	(21)	16,805	(52)
Total temporarily impaired securities	$ 232,137	$ (439)	$ 201,407	$ (1,057)	$ 433,544	$ (1,496)
As of December 31, 2018						
SBA pool securities	$ -	$ -	$ 10,458	$ (140)	$ 10,458	$ (140)
Mortgage-backed securities	509,841	(6,692)	1,225,080	(38,626)	1,734,921	(45,318)
State and municipal securities	42,838	(220)	128,969	(1,023)	171,807	(1,243)
Collateralized mortgage obligations	9,431	(115)	26,885	(567)	36,316	(682)
Total temporarily impaired securities	$ 562,110	$ (7,027)	$ 1,391,392	$ (40,356)	$ 1,953,502	$ (47,383)

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. The number of securities held-to-maturity with unrealized losses less than 12 months and 12 months or longer was 47 and 67, respectively, for the year ended December 31, 2019, and 372 and 610, respectively, for the year ended December 31, 2018. Management believes that securities held-to-maturity in an unrealized loss position as December 31, 2019 and 2018, 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 $1.50 billion at December 31, 2019, and $1.38 billion at December 31, 2018, were pledged to secure securities sold under repurchase agreements, public deposits, FRB's daylight overdraft, and for other purposes required by law.

Interest income on tax-exempt securities was $6.8 million for the year ended December 31, 2019, and $9.8 million for the year ended December 31, 2018.

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, although 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, 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,	
	2019	2018
	(In thousands)	
Commercial & industrial	$ 177,123	$ 139,376
Construction	434,509	526,011
Commercial real estate	2,872,068	2,712,210
Residential mortgages	808,960	761,669
Equity lines	80,876	92,639
Installment and other loans	30,340	28,188
Gross loans	$ 4,403,876	$ 4,260,093
Less: Allowance for loan losses	(62,489)	(62,450)
Unamortized deferred loan fees, net	(5,127)	(5,973)
Loans, net	$ 4,336,260	$ 4,191,670
Loans held for sale	23,301	20,718
Total loans receivable, net	$ 4,359,561	$ 4,212,388

Total loans with a balance of $686.9 million and $714.2 million at December 31, 2019, and December 31, 2018, respectively, were pledged to secure the Bank's FHLB advance line.

Nonaccrual and Past Due Loans

Loans are tracked by the numbers of days that the borrower's 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, 2019					
	30 - 59 Days Past Due	60 - 89 Days Past Due	90 Days & Over Still Accruing	Nonaccrual	Current	Total
			(In thousands)			
Loan Segment						
Commercial & industrial	$ -	$ -	$ -	$ -	$ 177,123	$ 177,123
Construction	-	-	-	-	434,509	434,509
Commercial real estate	617	-	-	-	2,871,451	2,872,068
Residential mortgages	4,192	-	-	4,077	800,691	808,960
Equity lines	509	-	-	960	79,407	80,876
Installment and other loans	-	30	12	-	30,298	30,340
Gross loans	$ 5,318	$ 30	$ 12	$ 5,037	$ 4,393,479	$ 4,403,876

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NOTE 4 – Loans and Allowance for Loan Losses, continued

Nonaccrual and Past Due Loans, continued

	As of December 31, 2018					
	30 - 59 Days Past Due	60 - 89 Days Past Due	90 Days & Over Still Accruing	Nonaccrual	Current	Total
	(In thousands)					
Loan Segment						
Commercial & industrial	$ 1,776	$ -	$ -	$ -	$ 137,600	$ 139,376
Construction	-	-	-	1,609	524,402	526,011
Commercial real estate	475	-	-	897	2,710,838	2,712,210
Residential mortgages	5,092	849	-	10,847	744,881	761,669
Equity lines	996	-	-	875	90,768	92,639
Installment and other loans	-	33	3	-	28,152	28,188
Gross loans	$ 8,339	$ 882	$ 3	$ 14,228	$ 4,236,641	$ 4,260,093

The following is a summary of selected information related to the nonaccrual loans outstanding as of December 31, 2019 and 2018, and the related contractual interest income foregone for the years indicated:

	2019	2018
	(In thousands)	
Nonaccrual loans		
Outstanding balance	$ 5,037	$ 14,228
Average balance	9,511	14,428
Interest income recorded	122	55
Interest income foregone	48	712

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 table presents 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.

	December 31, 2019			December 31, 2018		
	Nonclassified	Classified	Total	Nonclassified	Classified	Total
	(In thousands)					
Loan Segment						
Commercial & industrial	$ 176,263	$ 860	$ 177,123	$ 136,963	$ 2,413	$ 139,376
Construction	434,509	-	434,509	515,486	10,525	526,011
Commercial real estate	2,858,442	13,626	2,872,068	2,696,181	16,029	2,712,210
Residential mortgages	801,896	7,064	808,960	743,304	18,365	761,669
Equity lines	78,527	2,349	80,876	89,926	2,713	92,639
Installment and other loans	30,340	-	30,340	28,188	-	28,188
Total	$ 4,379,977	$ 23,899	$ 4,403,876	$ 4,210,048	$ 50,045	$ 4,260,093

NOTE 4 – Loans and Allowance for Loan Losses, continued

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 $3.3 million at December 31, 2019, and $4.3 million at December 31, 2018.

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

	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	Recorded Investment
			(In thousands, except number of contracts)				
As of December 31, 2019							
Loan Segment							
Commercial real estate	-	$ -	$ -	$ -	$ -	-	$ -
Residential mortgages	1	825	825	-	-	-	-
Equity lines	3	1,284	1,284	-	-	-	-
Total	4	$ 2,109	$ 2,109	$ -	$ -	-	$ -
As of December 31, 2018							
Loan Segment							
Commercial real estate	1	$ 905	$ 905	$ -	$ -	-	$ -
Residential mortgages	-	-	-	-	-	-	-
Equity lines	1	395	395	-	-	-	-
Total	2	$ 1,300	$ 1,300	$ -	$ -	-	$ -

Accruing TDRs

A summary of accruing TDRs by concession type and by loan segment is shown in the following tables for each year end.

	Principal Deferral	Rate Reduction	Combination of Such Concession	Total
		(In thousands)		
As of December 31, 2019				
Loan Segment				
Construction	$ -	$ -	$ -	$ -
Commercial real estate	-	-	704	704
Residential mortgages	825	-	-	825
Equity lines	1,077	-	-	1,077
Total loans	$ 1,902	$ -	$ 704	$ 2,606

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NOTE 4 – Loans and Allowance for Loan Losses, continued

Accruing TDRs, continued

	Principal Deferral	Rate Reduction	Combination of Such Concession	Total
		(In thousands)		
As of December 31, 2018				
Loan Segment				
Construction	$ 2,200	$ -	$ -	$ 2,200
Commercial real estate	-	-	733	733
Residential mortgages	-	-	-	-
Equity lines	105	-	-	105
Total loans	$ 2,305	$ -	$ 733	$ 3,038

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, 2019					
Loan Segment					
Commercial real estate	$ -	$ -	$ -	$ -	$ -
Equity lines	669	-	-	-	669
Total loans	$ 669	$ -	$ -	$ -	$ 669
As of December 31, 2018					
Loan Segment					
Commercial real estate	$ 897	$ -	$ -	$ -	$ 897
Equity lines	388	-	-	-	388
Total loans	$ 1,285	$ -	$ -	$ -	$ 1,285

NOTE 4 – Loans and Allowance for Loan Losses, continued

Impaired Loans

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

	Unpaid Principal Balance	Recorded Investment with No ALL	Recorded Investment with ALL	Related ALL	Total	Average Recorded Investment	Interest Income Recognized
				(In thousands)			
As of December 31, 2019							
Loan Segment							
Commercial & industrial	$ -	$ -	$ -	$ -	$ -	$ 5	$ -
Construction	-	-	-	-	-	1,820	-
Commercial real estate	704	704	-	-	704	1,292	40
Residential mortgages	4,902	4,902	-	-	4,902	6,220	135
Equity lines	2,087	2,037	-	-	2,037	1,581	83
Total	$ 7,693	$ 7,643	$ -	$ -	$ 7,643	$ 10,918	$ 258
As of December 31, 2018							
Loan Segment							
Commercial & industrial	$ -	$ -	$ -	$ -	$ -	$ -	$ -
Construction	3,950	3,809	-	-	3,809	3,980	141
Commercial real estate	1,634	1,630	-	-	1,630	1,315	76
Residential mortgages	11,075	10,847	-	-	10,847	11,552	-
Equity lines	1,027	980	-	-	980	851	27
Total	$ 17,686	$ 17,266	$ -	$ -	$ 17,266	$ 17,698	$ 244

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

	December 31, 2019			December 31, 2018		
	Individually Evaluated for Impairment	Collectively Evaluated for Impairment	Total	Individually Evaluated for Impairment	Collectively Evaluated for Impairment	Total
			(In thousands)			
Loan Segment						
Commercial & industrial	$ -	$ 177,123	$ 177,123	$ -	$ 139,376	$ 139,376
Construction	-	434,509	434,509	3,809	522,202	526,011
Commercial real estate	704	2,871,364	2,872,068	1,630	2,710,580	2,712,210
Residential mortgages	4,902	804,058	808,960	10,847	750,822	761,669
Equity lines	2,037	78,839	80,876	980	91,659	92,639
Installment and other loans	-	30,340	30,340	-	28,188	28,188
Total	$ 7,643	$ 4,396,233	$ 4,403,876	$ 17,266	$ 4,242,827	$ 4,260,093

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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 Mortgages	Equity Lines	Installment and Other Loans	Total
			(In thousands)				
December 31, 2017	$ 1,505	$ 15,746	$ 35,678	$ 5,717	$ 339	$ 517	$ 59,502
Provision	130	1,229	2,157	(645)	(304)	(67)	2,500
Charge-Offs	-	-	-	-	(10)	(165)	(175)
Recoveries	259	-	-	3	210	151	623
December 31, 2018	$ 1,894	$ 16,975	$ 37,835	$ 5,075	$ 235	$ 436	$ 62,450
Provision	326	(6,080)	4,718	1,109	22	155	250
Charge-Offs	(71)	-	-	-	-	(323)	(394)
Recoveries	7	-	-	-	4	172	183
December 31, 2019	$ 2,156	$ 10,895	$ 42,553	$ 6,184	$ 261	$ 440	$ 62,489
The ending ALL balance is composed of amounts applicable to loans:							
Individually evaluated for impairment	$ -	$ -	$ -	$ -	$ -	$ -	$ -
Collectively evaluated for impairment	$ 2,156	$ 10,895	$ 42,553	$ 6,184	$ 261	$ 440	$ 62,489

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, as well as 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, 2019 and 2018, were as follows:

	December 31, 2019	December 31, 2018
	(In thousands)	
Balance, beginning of year	$ 5,700	$ 5,300
(Subtraction) addition	(100)	400
Balance, end of year	$ 5,600	$ 5,700

NOTE 5 – OTHER REAL ESTATE OWNED

As of December 31, 2019, the Bank had no OREO properties. At December 31, 2018, the Bank had two OREO properties with a carrying value of $1.7 million and no reserve. The following table summarizes the net carrying value of OREO by property type at the dates indicated:

	December 31,	
	2019	2018
	(In thousands)	
Commercial real estate	$ -	$ 1,019
Single-family residence	-	705
Total OREO, net	$ -	$ 1,724

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

	2019	2018
	(In thousands)	
Rental income	$ 37	$ -
Net gain on sale	190	-
Total OREO income	$ 227	-
Operating and maintenance, net	$ 60	$ 139
Addition of reserve for OREO	25	-
Total OREO expense	$ 85	$ 139
OREO income (expense), net	$ 142	$ (139)

NOTE 6 – PREMISES AND EQUIPMENT

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

	December 31,	
	2019	2018
	(In thousands)	
Land	$ 42,030	$ 38,083
Buildings and building improvements	88,927	79,685
Furniture, fixtures and equipment	45,058	41,802
Leasehold improvements	4,640	4,467
Construction in progress	1,095	2,577
	181,750	166,614
Less accumulated depreciation and amortization	(73,617)	(66,136)
Total premises and equipment, net	$ 108,133	$ 100,478

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NOTE 6 – Premises and Equipment, continued

Depreciation and amortization expense was $9.3 million in 2019 and $7.7 million in 2018.

NOTE 7 – TAX CREDIT INVESTMENTS

The Bank has invested in certain limited liability companies and partnerships that make investments in affordable housing projects, new market tax credit projects, 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, the Bank is not required to consolidate these entities on its financial statements.

The Bank's tax credit investments totaled $57.2 million and $51.9 million at December 31, 2019, and December 31, 2018, respectively, and are included in other assets on the balance sheets. Unfunded commitments related to these tax credit investments totaled $25.1 million and $30.7 million at December 31, 2019, and December 31, 2018, respectively, and are included in other liabilities on the balance sheets.

The Bank utilized $17.3 million and $13.1 million of federal tax credits in 2019 and 2018, respectively. At December 31, 2019 and December 31, 2018, these investments are expected to generate approximately $52.2 million and $45.0 million, respectively, of federal tax credits in future years. The Bank records its investment in affordable housing projects using the proportional amortization method. Under the proportional amortization method, the amortization of the investments recognized as a component of income tax expenses for the years ended December 31, 2019 and 2018, were $2.8 million.

NOTE 8 – DEPOSITS

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

	December 31,	
	2019	2018
	(In thousands)	
Non-interest-bearing checking	$ 2,135,056	$ 2,098,097
Interest-bearing checking	1,302,727	1,178,886
Money market accounts	994,141	890,327
Savings deposits	675,383	676,119
Total core deposits	$ 5,107,307	$ 4,843,429
Time deposits:		
$250,000 or less	$ 380,256	$ 402,776
Greater than $250,000	340,702	338,261
Total time deposits	720,958	741,037
Total deposits	$ 5,828,265	$ 5,584,466

NOTE 8 – Deposits, continued

As of December 31, 2019, the maturity distribution of the Bank's time deposits was as follows:

	$250,000 or Less	Greater Than $250,000	Total
		(In thousands)	
2020	$ 266,265	$ 256,408	$ 522,673
2021	59,344	44,249	103,593
2022	24,202	17,084	41,286
2023	19,855	13,844	33,699
2024	10,590	9,117	19,707
	$ 380,256	$ 340,702	$ 720,958

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.

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

	December 31,	
	2019	2018
	(In thousands)	
Securities sold under repurchase agreements	$ 632,428	$ 609,791
Weighted average interest rate	1.42%	1.63%
Securities underlying repurchase agreements	$ 777,058	$ 738,955
Fair value of securities underlying repurchase agreements	$ 787,503	$ 723,794

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 2019 and 2018, respectively:

	2019	2018
	(In thousands)	
Average outstanding	$ 655,214	$ 637,228
Weighted average interest rate	1.58%	1.21%
Maximum amounts outstanding	$ 782,601	$ 727,885

NOTE 10 – OTHER BORROWINGS

The Bank's available borrowing capacity from federal funds lines of credit and FRB discount window amounted to $593.5 million and $616.5 million as of December 31, 2019 and 2018, respectively. The Bank's available secured borrowing capacity for FHLB advances totaled $513.8 million and $481.8 million as of December 31, 2019 and 2018, respectively.

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

	December 31,	
	2019	2018
	(In thousands)	
FHLB advances outstanding at year-end	$ -	$ 30,000
Weighted average rate on outstanding at year-end	-	2.56%
Highest month-end balance	$ 60,000	$ 30,000
Average amount outstanding	$ 2,192	$ 1,740
Weighted average rate	2.47%	2.37%

NOTE 11 – LEASES

The Bank is obligated 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, 2019 and 2018, was $2.0 million and $2.1 million, respectively.

	December 31, 2019
	(In thousands)
Operating lease expense	$ 1,772
Variable lease expense	223
Sublease income	(28)
Net lease cost	$ 1,967
Cash paid for amounts included in the measurements of lease liabilities	$ 1,761
ROU assets obtained in the exchange for lease liabilities	10,098
Balance Sheet:	
Operating lease ROU assets	$ 8,653
Operating lease liabilities	9,048
Operating leases:	
Weighted-average remaining lease term (in years):	5.9
Weighted-average discount rate:	4.01%

NOTE 11 – Leases, continued

The following table presents a maturity analysis of the Bank's operating lease liabilities:

	December 31, 2019 (In thousands)
Maturities of lease liabilities:	
2020	$ 1,808
2021	1,831
2022	1,865
2023	1,476
2024	1,246
Thereafter	1,971
Total lease payments	10,197
Less: imputed interest	1,149
Total lease liability	$ 9,048

Total lease income for the years ended December 31, 2019 and 2018, was $2.8 million and $2.3 million, respectively. The following table presents future annual lease income payments that are expected to be received under operating leases with terms in excess of one year as of December 31, 2019:

	Deccember 31, 2019 (In thousands)
2020	$ 3,001
2021	2,384
2022	1,560
2023	728
2024	446
Thereafter	636
Total lease income	$ 8,755

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

NOTE 12 – 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 accrued expense of $7.8 million and $7.3 million for the profit-sharing plan in 2019 and 2018, respectively. At December 31, 2019 and 2018, no shares of the Bank's stock are held by the plan.

NOTE 13 – LONG TERM INCENTIVE PLAN

Pursuant to the Bank's 2010 Long-term Incentive Plan ("Plan") as amended in 2019, the Bank may issue stock options, share appreciation rights, restricted share units ("RSUs"), deferred share units, performance awards or dividend equivalent rights to certain employees at no cost to the recipient. A total of 6,000 shares

NOTE 13 – Long Term Incentive Plan, continued

are available to grant under the Plan.

In June 2019, the Bank granted 3,825 RSUs to employees which cliff vest after five years of continued employment from the date of the grant. There are a remaining 2,175 shares available for grant. All RSUs are subject to forfeiture until vested.

Compensation costs for these time-based awards are based on the closing price of the Bank's stock at the grant date. Compensation costs are recognized on a straight-line basis from the grant date until the vesting date of each grant. The Bank continues to estimate the total number of awards expected to be forfeited in recognizing compensation expense. RSU compensation costs were $3.0 million for the year ended December 31, 2019. Unrecognized RSU compensation costs totaled $27.2 million as of December 31, 2019 and will be recognized over the next 4.5 years.

The following table presents a summary of the activity for the Bank's time-based RSUs for the year ended December 31, 2019 based on the target amount of awards.

	Shares	Weighted-Average Grant Date Fair Value
Outstanding as of December 31, 2018	-	$ -
Granted	3,825	8,150
Vested	-	-
Forfeited	(50)	8,150
Outstanding as of December 31, 2019	3,775	$ 8,150

The total fair value of the unvested time-based RSUs as of December 31, 2019 was $29.6 million. There are no vested RSUs as of December 31, 2019.

NOTE 14 – INCOME TAXES

The income tax expense attributable to income from continuing operations for the years ended December 31, 2019 and 2018, consists of the following:

	2019	2018
	(In thousands)	
Current income taxes:		
Federal	$ 5,457	$ 10,706
State	15,125	10,948
Total current tax expense	20,582	21,654
Deferred income taxes:		
Federal	(464)	(312)
State	(2,914)	1,646
Total deferred tax (benefit) expense	(3,378)	1,334
Total income tax expense	$ 17,204	$ 22,988

NOTE 14 – Income Taxes, continued

The tax effects of temporary differences that give rise to significant portions of the deferred tax assets and deferred tax liabilities at December 31, 2019 and 2018 are as follows:

	2019	2018
	(In thousands)	
Deferred tax assets		
Allowance for loan losses	$ 21,679	$ 21,699
Tax credit investments — state tax basis difference	4,161	4,785
Capital loss carry forward	4,873	959
State income taxes	599	763
Accrued employee compensation	1,494	478
Premises and equipment depreciation and amortization	221	147
Operating lease liabilities	2,881	-
Other, net	491	614
Gross deferred tax assets	36,399	29,445
Valuation allowance	(6,729)	(5,671)
Deferred tax assets, net of valuation allowance	$ 29,670	$ 23,774
Deferred tax liabilities		
Tax credit investments — federal tax basis difference	$ 2,100	$ 1,581
Loan origination costs	1,648	1,631
Prepaid assets	954	846
Operating lease ROU assets	2,755	-
Other	-	36
Gross deferred tax liabilities	7,457	4,094
Net deferred tax assets	$ 22,213	$ 19,680

The statutory federal income tax rate was 21% for 2019 and 2018. The difference between the effective tax rate in the financial statements and the federal income tax rate is attributed to the following:

	2019	2018
Federal income tax rate	21.0%	21.0%
State income taxes, net of federal benefit	8.6%	8.6%
Tax-exempt interest income	(2.6%)	(2.6%)
Tax credits, net of amortization	(11.1%)	(6.3%)
Other	0.8%	0.4%
	16.7%	21.1%

The lower effective tax rate during the year ended December 31, 2019, compared to the same period in 2018 was primarily due to the availability of more tax credits in 2019 compared to 2018. Available tax credits in 2019 were $17.3 million compared to $11.5 million in 2018.

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

NOTE 14 – Income Taxes, continued

tax assets is dependent on the generation of future taxable income during the periods in which those temporary differences become deductible. Based upon the Bank's 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 and capital loss carryforward in California. California's capital loss carryforward balance at the end of 2019 and 2018 was $45.0 million and $8.9 million, respectively. If unused, these carryforwards will expire as follows; $8.9 million in 2022 and $36.1 million in 2023.

FASB 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 that remain open to audit. As of December 31, 2019, tax years 2016 through 2019 for federal purposes and taxes years 2015 through 2019 for state purposes, 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. The Bank does not have any unrecognized tax benefits as of December 31, 2019.

NOTE 15 – EARNINGS PER SHARE

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, 2019 and 2018.

	2019	2018
	(In thousands, except share and per share data)	
Basic and diluted earnings per share:		
Net income available to common stockholders	$ 85,572	$ 85,636
Basic earnings per common share	$ 661.80	$ 654.07
Diluted earnings per common share	$ 661.23	$ 654.07
Basic weighted-average shares outstanding	129,303	130,928
Diluted weighted-average shares outstanding	129,414	130,928

NOTE 16 – 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.

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 any such payment. Most letters of credit expire within one year.

NOTE 16 – Commitments and Contingencies, continued

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,	
	2019	2018
	(In thousands)	
Commitments to extend credit	$1,558,054	$1,669,926
Financial standby letters of credit	14,868	13,909
Performance standby letters of credit	6,029	6,463
	$1,578,951	$1,690,298

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 outcome 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 17 – 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

NOTE 17 – Fair Value Measurements, continued

instruments typically include U.S. government debt and agency mortgage-backed securities, municipal securities, corporate debt securities, loans held for sale, 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 judgement or estimation. This category typically includes impaired loans and OREO.

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 securities by using quoted market prices for similar securities or dealer quotes, a Level 2 measurement.

Loans held for sale — Loans held for sale are carried at the lower of cost or fair value. The Bank records loans held for sale at fair value based on quoted prices from third party sale analysis, existing sale agreements, or appraisal reports adjusted by sales commission assumption, which is 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 that 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 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 table on the next page 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, 2019 and 2018:

NOTE 17 – Fair Value Measurements, continued

	Fair Value Measurements Using			Total at
	Level 1	Level 2	Level 3	Fair Value
		(In thousands)		
As of December 31, 2019				
Assets				
On a recurring basis:				
Securities available-for-sale	$ 49,990	$100,633	$ -	$ 150,623
Loans held for sale	-	5,612	-	5,612
On a non-recurring basis:				
Impaired loans	-	-	-	-
Other real estate owned	-	-	-	-
Total assets	$ 49,990	$106,245	$ -	$ 156,235
As of December 31, 2018				
Assets				
On a recurring basis:				
Securities available-for-sale	$ -	$134,008	$ -	$ 134,008
Loans held for sale	-	19,813	-	19,813
On a non-recurring basis:				
Impaired loans	-	-	-	-
Other real estate owned	-	-	-	-
Total assets	$ -	$153,821	$ -	$ 153,821

NOTE 18 – 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, 2019 and 2018, 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.

NOTE 18 – Fair Value of Financial Instruments, continued

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 quoted price for similar financial characteristics, commitments outstanding from investors, or book value.

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 with an "exit price concept," 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.

Time Deposits

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.

NOTE 18 – Fair Value of Financial Instruments, continued

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 the fair value of the fees charged to enter into such agreements to be nominal.

The following table presents the carrying and estimated fair value per the fair value hierarchy of financial instruments as of the dates indicated:

	Carrying Value	Level 1	Level 2	Level 3	Estimated Fair Value
			(In thousands)		
As of December 31, 2019					
Financial Assets:					
Cash and due from banks	$ 118,865	$ 118,865	$ -	$ -	$ 118,865
Securities available-for-sale	150,623	49,990	100,633	-	150,623
Securities held-to-maturity	2,728,583	-	2,734,735	27,712	2,762,447
Loans held for sale	23,301	-	23,550	-	23,550
Loans, net of allowance for loan losses	4,336,260	-	-	4,501,231	4,501,231
Investments in FHLB and FRB stock	20,160	-	20,160	-	20,160
Financial Liabilities:					
Time deposits	$ 720,958	-	$ 720,958	-	$ 720,958
Securities sold under repurchase agreements	632,428	-	632,428	-	632,428
FHLB advances	-	-	-	-	-
As of December 31, 2018					
Financial Assets:					
Cash and due from banks	$ 87,147	$ 87,147	$ -	$ -	$ 87,147
Securities available-for-sale	134,008	-	134,008	-	134,008
Securities held-to-maturity	2,649,460	-	2,593,555	17,451	2,611,006
Loans held for sale	20,718	-	20,732	-	20,732
Loans, net of allowance for loan losses	4,191,670	-	-	4,275,651	4,275,651
Investments in FHLB and FRB stock	20,690	-	20,690	-	20,690
Financial Liabilities:					
Time deposits	$ 741,037	-	$ 741,037	-	$ 741,037
Securities sold under repurchase agreements	609,791	-	609,791	-	609,791
FHLB advances	30,000	-	30,000	-	30,000

NOTE 19 – RELATED PARTY TRANSACTIONS

The Bank and Queen City Investments, Inc. (“Queen City”), which is the parent company of 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 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.

NOTE 19 – Related Party Transactions, continued

The Bank leases its Torrance branch location from Queen City, and leased its office space at the Santa Barbara location from the Trust Company. The Trust Company also has leases office space from the Bank at the Long Beach, Laguna Hills and Newport Beach locations. A related party of the Bank has leased office space at the Bank's Rossmoor location.

The table below summarizes all lease activities between the Bank and all related parties. All leases are subject to an ongoing lease agreement:

	2019	2018
	(In thousands)	
Lease payment paid to:		
Queen City Investments, Inc.	$ 292	$ 284
Farmers & Merchants Trust Company	5	10
Lease payment received from:		
Farmers & Merchants Trust Company	197	147
Other related party	-	41

The Bank and the Trust Company have an Employee Leasing agreement whereby the Bank and the Trust Company provide services of various employees between the parties, and will be reimbursed periodically. In 2019 and 2018, the Trust Company paid the Bank a net total of $423 thousand and $354 thousand, respectively, under this agreement.

In addition, the Bank and the Trust Company have entered into various agreements for the exchange of other services, which provide for the periodic settlement between the parties of the differences in the values of respective services provided between each other. Under this arrangement, the Bank provides human resources, payroll services, and IT support to the Trust Company, and the Trust Company provides financial services to the Bank and maintains deposits with the Bank. For the years ended December 31, 2019 and 2018, the Trust Company paid the Bank a total of $52 thousand and $58 thousand, respectively, for the difference between the values of services exchanged between the parties.

At December 31, 2019 and 2018, no loans were outstanding with any related party. At December 31, 2019 and 2018, related-party deposits were $197 million and $159 million, respectively, of which, $193 million and $155 million, respectively, were attributable to Queen City and its subsidiaries.

In the ordinary course of business, the Bank may enter into other transactions with various related parties. Related party transactions not included herein were not material for the years ended December 31, 2019 and 2018.

NOTE 20 – 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 quantitative measures

NOTE 20 – Regulatory Matters, continued

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, 2019, the most recent notification from the FRB 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 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, 2019:								
Total risk-based capital ratio	$1,149,972	20.64%	≥	$ 445,726	8.00%	≥	$ 557,157	10.00%
Tier 1 risk-based capital ratio	1,081,884	19.42%	≥	334,259	6.00%	≥	445,678	8.00%
Common equity tier 1 capital ratio	1,081,884	19.42%	≥	250,694	4.50%	≥	362,114	6.50%
Tier 1 leverage ratio	1,081,884	13.99%	≥	309,331	4.00%	≥	386,663	5.00%
As of December 31, 2018:								
Total risk-based capital ratio	$1,096,976	19.89%	≥	$ 414,217	8.00%	≥	$ 551,521	10.00%
Tier 1 risk-based capital ratio	1,028,827	18.66%	≥	330,813	6.00%	≥	441,083	8.00%
Common equity tier 1 capital ratio	1,028,827	18.66%	≥	248,109	4.50%	≥	358,380	6.50%
Tier 1 leverage ratio	1,028,827	14.04%	≥	293,113	4.00%	≥	366,391	5.00%

NOTE 21– SUBSEQUENT EVENTS

On March 11, 2020, the World Health Organization declared the novel strain of coronavirus (COVID-19) a global pandemic and recommended containment and mitigation measures worldwide. The Bank is closely monitoring the impact of the pandemic on all aspects of its business, including how it will impact its customers, team members, suppliers, and vendors. As of the date these financial statements were issued, April 22, 2020, the Bank has not incurred any significant disruptions. However, the Bank is unable to predict the length and severity of this pandemic, or the extent to which the pandemic may materially impact our financial position, results of operations and cash flows in 2020.

FORWARD-LOOKING STATEMENTS

In addition to the historical information contained herein, this Annual Report may contain forward-looking statements about Farmers & Merchants Bank of Long Beach. Readers of this Annual Report should understand that such forward-looking statements are neither promises nor guarantees and are subject to various risks and uncertainties, many of which are beyond the Bank's control. Such risks and uncertainties could cause actual results and actions to differ materially from those contemplated in such forward-looking statements and the Bank's reported results should not be considered an indication of the Bank's future performance. Factors that could cause or contribute to such differences include, but are not limited to, credit, market, operational, liquidity and interest rate risks associated with the Bank's business and operations, changes in interest rates, changes in general business and economic conditions, changes in banking laws and regulations, loan losses, increases in expenses, changes in rates charged on loans and earned on investments, accounting estimates and judgments, changes in rates on deposits, competition effects, the amount of non-interest income earned, adverse consequences caused by the coronavirus pandemic, as well as other factors. Given these factors, readers should not place undue reliance on any forward-looking statement.

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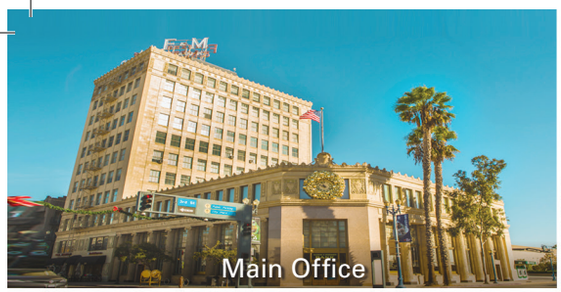
Main Office

Farmers & Merchants Bank
East Long Beach

Farmers & Merchants Bank
Garden Grove

Lakewood

Farmers & Merchants Bank
Bixby Knolls

F&M
Belmont Shore

Los Altos

Memorial Hospital

Lake Forest

Orange

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