

**BANK OF SAN FRANCISCO ♦ FINANCIAL STATEMENTS**



As of December 31, 2016 and 2015 and for the years then ended  
and independent auditor's report



## INDEPENDENT AUDITOR'S REPORT

Board of Directors  
Bank of San Francisco  
San Francisco, California

**Report on the Financial Statements**

We have audited the accompanying financial statements of Bank of San Francisco (the "Bank"), which comprise the balance sheets as of December 31, 2016 and 2015, and the related statements of income and comprehensive income, changes in shareholders' equity, and cash flows for the years then ended, and the related notes to the financial statements.

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

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

***Auditor's Responsibility***

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

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

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

***Opinion***

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Bank of San Francisco as of December 31, 2016 and 2015, and the results of its operations and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.



Crowe Horwath LLP

San Francisco, California  
March 28, 2017

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Bank of San Francisco  
BALANCE SHEETS  
December 31, 2016 and 2015

	<b>2016</b>	<b>2015</b>
<b>ASSETS</b>		
Cash and due from financial institutions	\$ 4,564,451	\$ 6,599,845
Interest-bearing deposits in banks	40,316,750	27,159,015
Cash and cash equivalents	44,881,201	33,758,860
Term deposits at other financial institutions	245,000	245,000
Loans, net of allowance of \$2,575,000 and \$2,305,000	184,997,803	175,553,629
Federal Home Loan Bank stock, at cost	929,800	707,200
Premises and equipment, net	438,150	553,958
Accrued interest receivable and other assets	2,034,792	2,141,626
Total assets	\$ 233,526,746	\$ 212,960,273
 <b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
Deposits		
Non-interest bearing	\$ 89,342,558	\$ 86,870,567
Interest bearing	120,487,272	108,084,394
Total deposits	209,829,830	194,954,961
Accrued interest payable and other liabilities	971,038	824,835
Total liabilities	\$ 210,800,868	\$ 195,779,796
 Commitments and contingent liabilities		
 Shareholders' equity		
Common stock, no par; 10,000,000 shares authorized; 1,500,675 and 1,236,500 shares issued and outstanding	17,076,547	13,061,340
Retained earnings	5,649,331	4,119,137
Total shareholders' equity	22,725,878	17,180,477
	\$ 233,526,746	\$ 212,960,273

See accompanying notes.

Bank of San Francisco  
STATEMENTS OF INCOME AND COMPREHENSIVE INCOME  
Years ended December 31, 2016 and 2015

	<b>2016</b>	<b>2015</b>
Interest and dividend income		
Loans, including fees	\$ 8,894,837	\$ 7,990,784
Deposits in banks	142,345	52,256
Federal funds sold and other	102,531	68,359
Total interest income	<u>9,139,713</u>	<u>8,111,399</u>
Interest expense		
Deposits	488,776	439,706
Borrowings	3,790	6,861
Total interest expense	<u>492,566</u>	<u>446,567</u>
Net interest income	8,647,147	7,664,832
Provision for loan losses	<u>252,803</u>	<u>244,900</u>
Net interest income after provision for loan losses	8,394,344	7,419,932
Non-interest income		
Service charges on deposits	256,689	236,003
Mortgage broker fees	67,649	10,343
Gains on sale of loans	379,976	444,680
Loan servicing fees	165,598	135,630
Other	8,029	18,448
Total non-interest income	<u>877,941</u>	<u>845,104</u>
Noninterest expense		
Salaries and employee benefits	4,119,337	3,923,119
Occupancy and equipment	843,817	763,451
Data processing	393,320	341,230
Federal deposit insurance	105,046	108,126
Professional Fees	422,048	334,625
Other	791,112	629,070
Total non-interest expense	<u>6,674,680</u>	<u>6,099,621</u>
Income before income taxes	2,597,605	2,165,415
Income tax expense	<u>1,067,411</u>	<u>900,279</u>
Net income	<u>\$ 1,530,194</u>	<u>\$ 1,265,136</u>
Earnings per share:		
Basic	\$ 1.06	\$ 1.02
Comprehensive income	<u>\$ 1,530,194</u>	<u>\$ 1,265,136</u>

See accompanying notes.

Bank of San Francisco  
 STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY  
 Years ended December 31, 2016 and 2015

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	<u>Common Stock</u>		<u>Retained</u>	<u>Total</u>
	<u>Shares</u>	<u>Amount</u>	<u>Earnings</u>	<u>Shareholders'</u> <u>Amount</u>
Balance, January 1, 2015	1,236,500	\$ 13,061,340	\$ 2,854,001	\$ 15,915,341
Net income	-	-	1,265,136	1,265,136
Balance, December 31, 2015	1,236,500	13,061,340	4,119,137	17,180,477
Net income			1,530,194	1,530,194
Issuance of common stock, net of \$145,550 stock offering costs	264,175	4,015,207	-	4,015,207
Balance, December 31, 2016	<u>1,500,675</u>	<u>\$ 17,076,547</u>	<u>\$ 5,649,331</u>	<u>\$ 22,725,878</u>

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See accompanying notes.

Bank of San Francisco  
STATEMENT OF CASH FLOWS  
Years ended December 31, 2016 and 2015

	<b>2016</b>	<b>2015</b>
<b>Cash flows from operating activities</b>		
Net income	\$ 1,530,194	\$ 1,265,136
Adjustments to reconcile net income to net cash from operating activities		
Provision for loan losses	252,803	244,900
Depreciation and amortization of premises and equipment	148,363	143,532
Change in deferred loan origination fees and discount, net	208,960	237,004
Gain on sale of government-guaranteed loans	(379,976)	(444,680)
Deferred income tax benefit	(150,508)	(103,295)
Net change in:		
Accrued interest receivable and other assets	257,342	(493,894)
Accrued interest payable and other liabilities	146,203	14,539
Net cash from operating activities	2,013,381	863,242
<b>Cash flows from investing activities</b>		
Purchase of Federal Home Loan Bank stock	(222,600)	(213,900)
Loan originations and payments, net	(9,525,961)	(28,183,057)
Additions to premises and equipment	(32,555)	(159,771)
Net cash from investing activities	(9,781,116)	(28,556,728)
<b>Cash flows from financing activities</b>		
Net change in demand, NOW, savings deposits	18,112,082	28,700,366
Net change in time deposits	(3,237,213)	8,394,601
Proceeds from issuance of common stock	4,015,207	-
Net cash from financing activities	18,890,076	37,094,967
Net change in cash and cash equivalents	11,122,341	9,401,481
Beginning cash and cash equivalents	33,758,860	24,357,379
Ending cash and cash equivalents	\$ 44,881,201	\$ 33,758,860
Supplemental cash flow information:		
Interest paid	492,356	441,286
Income taxes paid	1,035,000	1,240,000

See accompanying notes.



Bank of San Francisco  
NOTES TO FINANCIAL STATEMENTS  
December 31, 2016 and 2015

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**NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

General:

Bank of San Francisco (the "Bank") is a state-chartered commercial bank that commenced business on August 1, 2005. The Bank provides a full range of banking services to individuals, businesses and other clients located in its community. A variety of deposit products are offered, including checking, savings, money market and certificates of deposit. The Bank engages in mortgage banking activities and, as such, originates and both brokers and retains in portfolio one-to-four unit residential mortgage loans. The principal market for the Bank's financial services is the greater San Francisco Bay Area. The accounting and reporting policies of the Bank conform with accounting principles generally accepted in the United States of America and prevailing practices within the banking industry.

Subsequent Events

The Bank has evaluated subsequent events for recognition and disclosure through March 28, 2017, which is the date the financial statements were available to be issued. There were no subsequent events requiring accrual or disclosure at December 31, 2016.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions. These estimates and assumptions affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from these estimates because of the inherent subjectivity and inaccuracy of any estimation.

Cash Flows

For the purpose of the statement of cash flows, the Bank considers all highly liquid investments with maturities of three months or less at date of acquisition to be cash equivalents. Cash equivalents include cash, due from banks, interest-bearing deposits in banks and Federal funds sold. Generally, Federal funds are sold for one-day periods.

Term Deposits at Other Financial Institutions

Term deposits at other financial institutions mature one year or less and are carried at cost.

Bank of San Francisco  
NOTES TO FINANCIAL STATEMENTS  
December 31, 2016 and 2015

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**NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES** (Continued)

Loans

Loans that management has the intent and ability to hold for the foreseeable future or until maturity or payoff are reported at the principal balance outstanding, net of deferred loan fees and costs, and an allowance for loan losses. Interest income is accrued on the unpaid principal balance. Loan origination fees, net of certain direct origination costs, are deferred and recognized in interest income using the level-yield method without anticipating prepayments.

Interest income on mortgage and commercial loans is discontinued at the time the loan is 90 days delinquent unless the loan is well-secured and in process of collection. Consumer loans are typically charged off no later than 120 days past due for closed end credit and 180 days for revolving credits. Past due status is based on the contractual terms of the loan. In all cases, loans are placed on nonaccrual or charged-off at an earlier date if collection of principal or interest is considered doubtful. Nonaccrual loans and loans past due 90 days still on accrual include both smaller balance homogeneous loans that are collectively evaluated for impairment and individually classified impaired loans. A loan is moved to non-accrual status in accordance with the Bank's policy, typically after 90 days of non-payment.

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

Concentration of Credit Risk

The Bank grants real estate mortgage, real estate construction, commercial and consumer loans to clients primarily in its principal market. Although management continues to diversify the Bank's loan portfolio, a noteworthy portion of the portfolio is secured by real estate, both commercial and residential real estate.

In management's judgment, a concentration of loans exists in real estate related loans with approximately 65% and 60% of the Bank's loans being real estate related at December 31, 2016 and 2015. A substantial decline in the performance of the economy in general or a continuing decline in real estate values in the Bank's primary market area, in particular, could have an adverse impact on the collectability, increase the level of real estate related nonperforming loans, or have other adverse effects which alone or in the aggregate could have a material adverse effect on the financial condition of the Bank.

Bank of San Francisco  
NOTES TO FINANCIAL STATEMENTS  
December 31, 2016 and 2015

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**NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES** (Continued)

Concentration of Credit Risk (Continued)

Personal and business income represents the primary source of repayment for a majority of these loans.

In addition, management believes that there is a concentration of loans to dental professionals with approximately 17% and 23%, respectively, of the Bank's loans being dental related at December 31, 2016 and 2015. The loans are considered commercial purpose loans and are included in the commercial and industrial loan segment. The loans provide funding for the acquisition of existing dental practices and may also provide funds for working capital and new equipment. Debt coverage is primarily provided by the cash flow of the practice. The loans are generally collateralized by the assets of the practice and further supported by life and disability insurance on the borrower. In general, a weak economy, high unemployment rates and lower insurance reimbursement rates, in particular, could have an adverse impact on the ability of the practices to generate cash flow to service debt.

Allowance for Loan Losses

The allowance for loan losses is an estimate of probable credit losses in the Bank's loan portfolio as of the balance-sheet date. The allowance is established through a provision for loan losses which is charged to expense. Additions to the allowance are expected in order to maintain the total allowance at a level management believes is adequate after loan growth and any potential credit losses. Credit exposures determined to be uncollectible are charged against the allowance. Cash received on previously charged off amounts is recorded as a recovery to the allowance. The overall allowance consists of two primary components, specific reserves related to impaired loans and general reserves for inherent losses related to loans that are not impaired. The Bank maintains a separate allowance for each portfolio segment (loan type). The Bank does not identify separate loan classes below the portfolio segments. These major portfolio segments include construction and land loans, residential real estate loans, commercial real estate loans, commercial and industrial loans, consumer loans and other loans.

The allowance for loan losses attributable to each portfolio segment, which includes both impaired loans and loans that are not impaired, is combined to determine the Bank's overall allowance, which is included on the balance sheet.

The Bank assigns a risk rating to all loans and periodically performs detailed reviews of all such loans over a certain threshold to identify credit risks and to assess the overall collectability of the portfolio. These risk ratings are also subject to examination by independent specialists engaged by the Bank and the Bank's regulators.

Bank of San Francisco  
NOTES TO FINANCIAL STATEMENTS  
December 31, 2016 and 2015

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**NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES** (Continued)

Allowance for Loan Losses (Continued)

During these internal reviews, management monitors and analyzes the financial condition of borrowers and guarantors, trends in the industries in which borrowers operate and the fair values of collateral securing these loans. The Bank analyzes loans individually by classifying the loans as to credit risk. These credit quality indicators are used to assign a risk rating to each individual loan. The risk ratings can be grouped into five major categories, defined as follows:

**Pass** – A pass loan is a credit with no existing or known potential weaknesses deserving of management's close attention.

**Special Mention** – A special mention loan has potential weaknesses that deserve management's close attention. If left uncorrected, these potential weaknesses may result in deterioration of the repayment prospects for the loan or in the Bank's credit position at some future date. Special Mention loans are not adversely classified and do not expose the Bank to sufficient risk to warrant adverse classification.

**Substandard** – A substandard loan is not adequately protected by the current net worth and paying capacity of the borrower or the value of the collateral pledged, if any. Loans classified as substandard have a well-defined weakness or weaknesses that jeopardize the liquidation of the debt. Well defined weaknesses include a project's lack of marketability, inadequate cash flow or collateral support, failure to complete construction on time or a project's failure to fulfill economic expectations. They are characterized by the distinct possibility that the Bank will sustain some loss if the deficiencies are not corrected.

**Doubtful** – Loans classified doubtful have all the weaknesses inherent in those classified as substandard with the added characteristic that the weaknesses make collection or liquidation in full, on the basis of currently known facts, conditions and values, highly questionable and improbable.

**Loss** – Loans classified as loss are considered uncollectible and charged off immediately.

Bank of San Francisco  
NOTES TO FINANCIAL STATEMENTS  
December 31, 2016 and 2015

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**NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)**

Allowance for Loan Losses (Continued)

All segments of loans are considered impaired when, based on current information and events, it is probable that the Bank will be unable to collect all amounts due, including principal and interest, according to the contractual terms of the original agreement. Factors considered by management in determining impairment include payment status, collateral value, and the probability of collecting scheduled principal and interest payments when due. Loans that experience insignificant payment delays and payment shortfalls generally are not classified as impaired. Management determines the significance of payment delays and payment shortfalls on a case-by-case basis, taking into consideration all of the circumstances surrounding the loan and the borrower, including the length of the delay, the reasons for the delay, the borrower's prior payment record, and the amount of the shortfall in relation to the principal and interest owed. Loans determined to be impaired are individually evaluated for impairment.

When a loan is impaired, the Bank measures impairment based on the present value of expected future cash flows discounted at the loan's effective interest rate, except that as a practical expedient, it may measure impairment based on a loan's observable market price, or the fair value of the collateral if the loan is collateral dependent. A loan is collateral dependent if the repayment of the loan is expected to be provided solely by the underlying collateral.

A restructuring of a debt constitutes a troubled debt restructuring (TDR) if the Bank for economic or legal reasons related to the debtor's financial difficulties grants a concession to the debtor that it would not otherwise consider. Restructured workout loans typically present an elevated level of credit risk as the borrowers are not able to perform according to the original contractual terms. Loans that are reported as TDRs are considered impaired and measured for impairment as described above. If a troubled debt restructuring is considered to be a collateral dependent loan, the loan is reported, net, at the fair value of the collateral. For troubled debt restructurings that subsequently default, the Bank determines the amount of reserve in accordance with the accounting policy for the allowance for loan losses.

The general reserve component of the allowance for loan losses also consists of reserve factors that are based on management's assessment of the following for each portfolio segment: (1) inherent credit risk, (2) historical losses and (3) other qualitative factors.

Bank of San Francisco  
NOTES TO FINANCIAL STATEMENTS  
December 31, 2016 and 2015

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**NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)**

Allowance for Loan Losses (Continued)

The historical loss experience is determined by portfolio segment and is based on the actual loss history experienced by the Bank over the last three years. For portfolio segments where the Bank has not experienced any loss, the historical loss factors used are based on average loss factors of a peer group of banks. Other qualitative factors that are considered are economic conditions, unemployment, loan growth, asset quality, staffing and credit policy and loan concentrations. These reserve factors are inherently subjective and are driven by the repayment risk associated with each portfolio segment described below.

**Construction and Land** – Construction and land loans generally possess a higher inherent risk of loss than other real estate portfolio segments. A major risk arises from the necessity to complete projects within specified costs and time lines. Trends in the construction industry significantly impact the credit quality of these loans, as demand drives construction activity. In addition, trends in real estate values significantly impact the credit quality of these loans, as property values determine the economic viability of construction projects.

**Commercial Real Estate** – Commercial real estate loans generally possess a higher inherent risk of loss than other real estate portfolio segments, except construction and land loans. Adverse economic conditions or an overbuilt market impact commercial real estate projects and may result in troubled loans. Trends in vacancy rates of commercial properties impact the credit quality of these loans. High vacancy rates reduce operating revenues and the ability for properties to produce sufficient cash flow to service debt obligations.

**Residential Real Estate** – The degree of risk in residential real estate lending (includes multi-family real estate loans and home equity lines of credit) depends primarily on the loan amount in relation to collateral value, the interest rate and the borrower's ability to repay in an orderly fashion. These loans generally possess a lower inherent risk of loss than other real estate portfolio segments. Economic trends determined by unemployment rates and other key economic indicators are closely correlated to the credit quality of these loans. Weak economic trends indicate that the borrowers' capacity to repay their obligations may be deteriorating.

Bank of San Francisco  
NOTES TO FINANCIAL STATEMENTS  
December 31, 2016 and 2015

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**NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES** (Continued)

Allowance for Loan Losses (Continued)

**Commercial and Industrial** – Commercial and industrial loans generally possess a lower inherent risk of loss than real estate portfolio segments because these loans are generally underwritten to existing cash flows of operating businesses. Debt coverage is provided by business cash flows and economic trends influenced by unemployment rates and other key economic indicators are closely correlated to the credit quality of these loans.

**Consumer** – Consumer loans are comprised mainly of lines or loans to individuals for consumer purposes. Consumer loans generally possess a higher inherent risk than commercial loans because the loans are underwritten based on personal cash flow and assets. Debt coverage is provided by personal cash flows and economic trends influenced by unemployment rates and other key economic indicators are closely correlated to the credit quality of these loans. Weak economic trends indicate that the borrower's capacity to repay their obligations may be deteriorating.

**Other** – Other loans are comprised of lines or loans not included in the other categories, overdrafts on deposit accounts and loans to finance agricultural production and other loans to farmers (not including loans secured by farm land). Overdrafts and other loans possess a high inherent risk because of the nonstandard nature of the credit. The loans to finance agricultural production generally possess a higher risk than commercial and industrial loans because the repayment is typically dependent upon the sale of the crops for which the production cost was financed. Trends in the commodities market and economy and weather conditions can significantly impact the credit quality of this portfolio segment, as sale price and crop quality drives the ability to sell the crops produced.

Although management believes the allowance to be adequate, ultimate losses may vary from its estimates. At least quarterly, the Board of Directors and management review the adequacy of the allowance, including consideration of the relative risks in the portfolio, current economic conditions and other factors. If the Board of Directors and management determine that changes are warranted based on those reviews, the allowance is adjusted. In addition, the Bank's primary regulators, the Federal Deposit Insurance Corporation and the California Department of Business Oversight, as an integral part of their examination process, review the adequacy of the allowance. These regulatory agencies may require additions to the allowance based on their judgment about information available at the time of their examinations.



Bank of San Francisco  
NOTES TO FINANCIAL STATEMENTS  
December 31, 2016 and 2015

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**NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES** (Continued)

Allowance for Credit Losses on Off-Balance-Sheet Credit Exposures

The Bank also maintains a separate allowance for off-balance-sheet commitments. Management estimates anticipated losses using historical data and utilization assumptions. The allowance for off-balance-sheet commitments is included in accrued interest payable and other liabilities on the balance sheet.

Servicing Fee Income

Servicing fee income is reported on the statement of income and comprehensive income as "loan servicing fees" and, is recorded for fees earned for servicing the sold portion of SBA guaranteed loans. The fees are based on a contractual percentage of the outstanding principal; or a fixed amount per loan and are recorded as income when earned. Servicing fees totaled \$165,598 and \$135,630 for the years ended December 31, 2016 and 2015, respectively. Late fees and ancillary fees related to loan servicing are not material.

Transfers of Financial Assets

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

Premises and Equipment

Bank premises and equipment are carried at cost, less accumulated depreciation. Depreciation is determined using principally the straight-line method over the estimated useful lives of the related assets. The useful lives of furniture, fixtures and equipment are estimated to be three to seven years. Leasehold improvements are amortized over the useful life of the asset or the term of the related lease, including expected renewal periods, whichever is shorter.

When assets are sold or otherwise disposed of, the cost and related accumulated depreciation or amortization are removed from the accounts, and any resulting gain or loss is recognized in income for the period. The cost of maintenance and repairs is charged to expense as incurred. The Bank evaluates premises and equipment for financial impairment as events or changes in circumstances indicate that the carrying amount of such assets may not be fully recoverable.



Bank of San Francisco  
NOTES TO FINANCIAL STATEMENTS  
December 31, 2016 and 2015

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**NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES** (Continued)

Federal Home Loan Bank (FHLB) Stock

The Bank is a member of the FHLB system. Members are required to own a certain amount of stock based on the level of borrowings and other factors, and may invest in additional amounts. FHLB stock is carried at cost, classified as a restricted security, and periodically evaluated for impairment based on ultimate recovery of par value. Both cash and stock dividends are reported as income.

Loan Commitments and Related Financial Instruments

Financial instruments include off-balance sheet credit instruments, such as commitments to make loans and standby letters of credit, issued to meet client financing needs. The face amount for these items represents the exposure to loss, before considering client collateral or ability to repay. Such financial instruments are recorded when they are funded.

Income Taxes

Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases and tax credit carryforwards. Deferred tax assets and liabilities are measured using enacted tax rates which are expected to be applied 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. A valuation allowance is recognized if, based on the weight of available evidence, management believes it is more likely than not that some portion or all of the deferred tax assets will not be realized.

The Bank considers all tax positions recognized in its financial statements for the likelihood of realization. When tax returns are filed, it is highly certain that some positions taken would be sustained upon examination by the taxing authorities, while others are subject to uncertainty about the merits of the position taken or the amount of the position that would be ultimately sustained. The benefit of a tax position is recognized in the financial statements in the period during which, based on all available evidence, management believes it is more likely than not that the position will be sustained upon examination, including the resolution of appeals or litigation processes, if any.

Tax positions taken are not offset or aggregated with other positions. Tax positions that meet the more-likely-than-not recognition threshold are measured as the largest amount of the tax benefit that is more than 50 percent likely to being realized upon settlement with the applicable taxing authority.

Bank of San Francisco  
NOTES TO FINANCIAL STATEMENTS  
December 31, 2016 and 2015

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**NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES** (Continued)

Income Taxes (Continued)

The portion of the benefits associated with the tax positions taken that exceeds the amount measured as described above is reflected as a liability for unrecognized tax benefits in the accompanying balance sheet along with any associated interest and penalties associated with unrecognized tax benefits, if any, are classified as income tax expense in the statement of operations. The interest and penalties included in the unrecognized tax benefits are not material. If the \$28,269 of unrecognized income tax benefits is recognized, there would not be a material impact on the annual effective tax rate. The Bank does not anticipate any significant changes with respect to unrecognized tax benefits within the next 12 months.

Retirement Plans

Employee 401(k) plan expense is the amount of matching contributions and cost of services related to maintaining the plan.

Earnings Per Common Share

Earnings per share (EPS) is computed by dividing net income available to common shareholders by the weighted-average number of common shares outstanding for the period. Diluted EPS, if applicable, reflects the potential dilution that could occur if securities or other contracts to issue common stock, such as stock options and restricted stock, result in the issuance of common stock which shares in the earnings of the Bank. No stock options or restricted stock were outstanding as of December 31, 2016 and 2015, therefore the Bank does not report diluted EPS.

Comprehensive Income

Comprehensive income is a more inclusive financial reporting methodology that includes disclosure of other comprehensive income that historically has not been recognized in the calculation of net income. For the periods presented, the Bank's only element of comprehensive income was the net income from operations.

Loss Contingencies

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

Bank of San Francisco  
NOTES TO FINANCIAL STATEMENTS  
December 31, 2016 and 2015

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**NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES** (Continued)

Restrictions on Cash

Federal Reserve Board (FRB) regulations require the Bank to maintain reserve balances on deposit with the Federal Reserve Bank. The amount of reserve balances required at the Federal Reserve Bank as of December 31, 2016 and 2015 was \$2,349,000 and \$1,955,000, respectively.

Dividend Restriction

The California Financial Code restricts the total dividend payment of any state banking association in any calendar year to the lesser of (1) the bank's retained earnings or (2) the bank's net income for its last three fiscal years, less distributions made to shareholders during the same three-year period. At December 31, 2016, \$3,864,955 was free of restrictions.

Fair Value of Financial Instruments

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

Reclassifications

Some items in the prior year financial statements were reclassified to conform to the current presentation. Reclassifications had no effect on prior year net income or shareholders' equity.

Adoption of New Accounting Standards

In May 2014, the FASB amended existing guidance related to revenue from contracts with clients. This amendment supersedes and replaces nearly all existing revenue recognition guidance, including industry-specific guidance, establishes a new control-based revenue recognition model, changes the basis for deciding when revenue is recognized over time or at a point in time, provides new and more detailed guidance on specific topics and expands and improves disclosures about revenue. In addition, this amendment specifies the accounting for some costs to obtain or fulfill a contract with a client. These amendments are effective for annual reporting periods beginning after December 15, 2018, and interim periods within annual periods beginning after December 15, 2019.

Bank of San Francisco  
NOTES TO FINANCIAL STATEMENTS  
December 31, 2016 and 2015

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**NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES** (Continued)

Adoption of New Accounting Standards (Continued)

Early application is permitted only as of annual reporting periods beginning after December 15, 2016, and interim reporting periods within annual reporting periods beginning one year after the annual reporting period in which the entity first applies the guidance of ASU 2014-09. The amendments should be applied retrospectively to all periods presented or retrospectively with the cumulative effect recognized at the date of the initial application. The Bank is currently evaluating the impact of this new accounting standard on the financial statements.

In January 2016, the FASB issued ASU 2016-01, Recognition and Measurement of Financial Assets and Financial Liabilities (Subtopic 825-10). This update was issued to enhance the reporting model for financial instruments to provide users of financial statements with more decision-useful information. This Update contains several provisions, including but not limited to 1) require equity investments, with certain exceptions, to be measured at fair value with changes in fair value recognized in net income; 2) simplify the impairment assessment of equity investments without readily determinable fair values by requiring a qualitative assessment to identify impairment; 3) eliminated the requirement to disclose the method(s) and significant assumptions used to estimate fair value; and 4) require separate presentation of financial assets and liabilities by measurement category and form of financial asset on the balance sheet or the accompanying notes to the financial statements. The Update is effective for annual reporting periods beginning after December 15, 2018. The Bank early adopted the provision allowing elimination of the financial instruments table. The Bank is currently evaluating the impact the remaining provisions of this Update will have on its financial statements.

In February, 2016 the FASB issued ASU 2016-02, Leases (Topic 842). ASU 2016-02 requires lessees and lessors to classify leases as either capital leases or operating leases. ASU 2016-02 also requires lessees to recognize assets and liabilities for all leases with the exception of short term leases. There are new disclosure requirements for these leases which will provide users of financial statements with information to understand the amount, timing, and uncertainty of cash flows arising from leases. ASU 2016-02 will become effective for fiscal years beginning after December 15, 2019, and interim periods within fiscal years beginning after December 15, 2020. Early adoption is permitted. The Bank will be assessing the impact of ASU 2016-02 over the next several years. The Bank has \$2,900,000 of lease commitments as of December 31, 2016. (See Note 6).

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**NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES** (Continued)

Adoption of New Accounting Standards (Continued)

In June 2016, FASB issued ASU 2016-13, Financial Instruments-Credit Losses (Topic 326). This guidance is to replace the incurred loss model with an excepted loss model, which is referred to as the current expected credit loss (CECL) model. The CECL model is applicable to the measurement of credit losses on financial assets measured at amortized cost, including loan receivables, held-to-maturity debt securities, and reinsurance receivables. It also applies to off-balance sheet credit exposures not accounted for as insurance (loan commitments, standby letters of credit, financial guarantees, and other similar instruments) and net investment in leases recognized by a lessor. The standard will be effective for fiscal years beginning after December 15, 2020, and interim periods within the fiscal years beginning after December 15, 2021. Early adoption is permitted. The Bank will be assessing the impact of this new accounting standard over the next several years but anticipates that it will lead to an increase in the allowance for loan losses.

**NOTE 2 - FAIR VALUE**

Fair value is the exchange price that would be received for an asset or paid to transfer a liability (exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. There are three levels of inputs that may be used to measure fair values:

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

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

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

There are no assets or liabilities measured on a recurring and non-recurring basis as of December 31, 2016 and 2015.

Bank of San Francisco  
NOTES TO FINANCIAL STATEMENTS  
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**NOTE 3- FEDERAL HOME LOAN BANK STOCK**

As a member of the Federal Home Loan Bank of San Francisco (FHLB), the Bank is required to own capital stock in an amount specified by regulation. At December 31, 2016 and 2015, the Bank owned 9,298 and 7,072 shares, respectively, of \$100 par value FHLB stock. The stock is carried at cost and is redeemable at par at the discretion of the FHLB. The amount of stock required to be held is adjusted periodically based on a determination made by the FHLB.

**NOTE 4 – LOANS RECEIVABLE**

Outstanding loans at December 31, 2016, and 2015, were as follows:

	December 31,	
	2016	2015
Loans secured by real estate:		
Commercial	\$ 46,266,576	\$ 53,953,810
Residential	70,977,426	52,071,195
Construction and land	4,550,837	1,906,985
Total real estate	<u>121,794,839</u>	<u>107,931,990</u>
Commercial and industrial	66,406,767	70,371,454
Consumer	330,577	310,186
Other	12,527	7,946
Total outstanding loans	<u>188,544,710</u>	<u>178,621,576</u>
Deferred loan origination fees and discount, net	(971,907)	(762,947)
Allowance for loan losses	<u>(2,575,000)</u>	<u>(2,305,000)</u>
Net outstanding loans	<u>\$ 184,997,803</u>	<u>\$ 175,553,629</u>

Salaries and employee benefits totaling \$339,285 and \$363,505 were deferred as loan origination costs for the years ended December 31, 2016 and 2015, respectively.

Certain loans have been pledged to secure borrowing arrangements (see Note 14).

Bank of San Francisco  
 NOTES TO FINANCIAL STATEMENTS  
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**NOTE 5 – ALLOWANCE FOR LOAN LOSSES**

The following table presents the activity in the allowance for loan losses by portfolio segment for the years ending December 31, 2016 and 2015:

	Commercial Real Estate	Residential Real Estate	Construction and Land	Commercial & Industrial	Consumer Loans	Other Loans	Totals
December 31, 2016							
Allowance for Loan Losses:							
Beginning balance	\$ 664,423	\$ 668,432	\$ 20,872	\$ 947,708	\$ 3,473	\$ 92	\$ 2,305,000
Provision for loan losses	(60,097)	333,014	31,335	(92,798)	277	41,072	252,803
Loans charged-off	-	-	-	-	-	(41,007)	(41,007)
Recoveries	15,716	-	-	42,488	-	-	58,204
Total Ending Allowance Balance	\$ 620,042	\$ 1,001,446	\$ 52,207	\$ 897,398	\$ 3,750	\$ 157	\$ 2,575,000
December 31, 2015							
Allowance for Loan Losses:							
Beginning balance	\$ 778,275	\$ 347,226	\$ 20,504	\$ 924,458	\$ 12,845	\$ 1,692	\$ 2,085,000
Provision for loan losses	(161,836)	321,206	368	96,134	(9,372)	(1,600)	244,900
Loans charged-off	-	-	-	(76,167)	-	-	(76,167)
Recoveries	47,984	-	-	3,283	-	-	51,267
Total Ending Allowance Balance	\$ 664,423	\$ 668,432	\$ 20,872	\$ 947,708	\$ 3,473	\$ 92	\$ 2,305,000

Bank of San Francisco  
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**NOTE 5 – ALLOWANCE FOR LOAN LOSSES (Continued)**

The following table presents the balance in the allowance for loan losses and the recorded investment in loans by portfolio segment and based on the impairment method as of December 31, 2016 and 2015:

	Commercial Real Estate	Residential Real Estate	Construction and Land	Commercial & Industrial	Consumer Loans	Other Loans	Totals
December 31, 2016							
Allowance for Loan Losses:							
Collectively evaluated for impairment	\$ 620,042	\$ 1,001,446	\$ 52,207	\$ 897,398	\$ 3,750	\$ 157	\$ 2,575,000
Total Ending Allowance Balance	\$ 620,042	\$ 1,001,446	\$ 52,207	\$ 897,398	\$ 3,750	\$ 157	\$ 2,575,000
Loans:							
Individually evaluated for impairment	\$ -	\$ -	\$ -	\$ 70,797	\$ -	\$ -	\$ 70,797
Collectively evaluated for impairment	46,266,576	70,977,426	4,550,837	66,335,970	330,577	12,527	188,473,913
Total Ending Loans Balance	\$ 46,266,576	\$ 70,977,426	\$ 4,550,837	\$ 66,406,767	\$ 330,577	\$ 12,527	\$ 188,544,710
December 31, 2015							
Allowance for Loan Losses:							
Collectively evaluated for impairment	\$ 664,423	\$ 668,432	\$ 20,872	\$ 947,708	\$ 3,473	\$ 92	\$ 2,305,000
Total Ending Allowance Balance	\$ 664,423	\$ 668,432	\$ 20,872	\$ 947,708	\$ 3,473	\$ 92	\$ 2,305,000
Loans:							
Collectively evaluated for impairment	53,953,810	52,071,195	1,906,985	70,371,454	310,186	7,946	178,621,576
Total Ending Loans Balance	\$ 53,953,810	\$ 52,071,195	\$ 1,906,985	\$ 70,371,454	\$ 310,186	\$ 7,946	\$ 178,621,576

Continued



Bank of San Francisco  
 NOTES TO FINANCIAL STATEMENTS  
 December 31, 2016 and 2015

**NOTE 5 – ALLOWANCE FOR LOAN LOSSES (Continued)**

There was one impaired loan at December 31, 2016 for \$70,797 with no specific reserve allocated. There were no impaired loans at December 31, 2015. The total interest income recognized and the cash-basis interest income recognized during the period that impaired loans were outstanding during the year ended December 31, 2016 and 2015 was not significant.

The following table presents the aging of the recorded investment in past due loans as of December 31, 2016 and 2015 by class of loans:

December 31, 2016	30 - 89 Days Past Due	Greater than 89 Days Past Due	Total Past Due	Loans Not Past Due	Total Loans	Non-accrual loans
Loans secured by real estate:						
Commercial	\$ -	\$ -	\$ -	\$ 46,266,576	\$ 46,266,576	\$ -
Residential	483,585	-	483,585	70,493,841	70,977,426	-
Construction and land	-	-	-	4,550,837	4,550,837	-
Total real estate	\$ 483,585	\$ -	\$ 483,585	\$ 121,311,254	\$ 121,794,839	\$ -
Commercial and industrial						
Consumer	-	-	-	66,406,767	66,406,767	-
Other	-	-	-	330,577	330,577	-
Totals	\$ 483,585	\$ -	\$ 483,585	\$ 188,061,125	\$ 188,544,710	\$ -

Bank of San Francisco  
 NOTES TO FINANCIAL STATEMENTS  
 December 31, 2016 and 2015

**NOTE 5 – ALLOWANCE FOR LOAN LOSSES (Continued)**

December 31, 2015	30 - 89 Days Past Due	Greater than 89 Days Past Due	Total Past Due	Loans Not Past Due	Total Loans	Non-accrual loans
Loans secured by real estate:						
Commercial	\$ -	\$ -	\$ -	\$ 53,953,810	\$ 53,953,810	\$ -
Residential	-	-	-	52,071,195	52,071,195	-
Construction and land	-	-	-	1,906,985	1,906,985	-
Total real estate	\$ -	\$ -	\$ -	\$ 107,931,990	\$ 107,931,990	\$ -
Commercial and industrial	-	-	-	70,371,454	70,371,454	-
Consumer	-	-	-	310,186	310,186	-
Other	-	-	-	7,946	7,946	-
Totals	\$ -	\$ -	\$ -	\$ 178,621,576	\$ 178,621,576	\$ -

There were no loans past due 90 days or more and still accruing interest at December 31, 2016 and 2015.

Based on the most recent analysis performed, the risk category of loans by class of loans is as follows:

December 31, 2016	Pass	Special Mention	Substandard	Doubtful	Total Loans
Loans secured by real estate:					
Commercial	\$ 44,583,444	\$ 1,032,046	\$ 651,086	\$ -	\$ 46,266,576
Residential	70,977,426	-	-	-	70,977,426
Construction and land	4,550,837	-	-	-	4,550,837
Total real estate	120,111,707	1,032,046	651,086	-	121,794,839
Commercial and industrial	63,472,333	2,796,864	137,570	-	66,406,767
Consumer	330,577	-	-	-	330,577
Other	12,527	-	-	-	12,527
Totals	\$ 183,927,144	\$ 3,828,910	\$ 788,656	\$ -	\$ 188,544,710

Continued

Bank of San Francisco  
 NOTES TO FINANCIAL STATEMENTS  
 December 31, 2016 and 2015

**NOTE 5 – ALLOWANCE FOR LOAN LOSSES (Continued)**

December 31, 2015	Pass	Special Mention	Substandard	Doubtful	Total Loans
Loans secured by real estate:					
Commercial	\$ 52,298,708	\$ 1,655,102	\$ -	\$ -	\$ 53,953,810
Residential	52,071,195	-	-	-	52,071,195
Construction and land	1,906,985	-	-	-	1,906,985
Total real estate	106,276,888	1,655,102	-	-	107,931,990
Commercial and industrial	69,634,674	697,843	38,937	-	70,371,454
Consumer	310,186	-	-	-	310,186
Other	7,946	-	-	-	7,946
Totals	<u>\$ 176,229,694</u>	<u>\$ 2,352,945</u>	<u>\$ 38,937</u>	<u>\$ -</u>	<u>\$ 178,621,576</u>

The modification of the terms of loans that result in classification of the loans as troubled debt restructurings include one or a combination of the following: a reduction of the stated interest rate of the loan; an extension of the maturity date at a stated rate of interest lower than the current market rate for new debt with similar risk; or a permanent reduction of the recorded investment in the loan. There was one loan classified as a troubled debt restructuring during the year ending December 31, 2016. The loan was modified to extend the maturity date and reduce payments in the near term along with increasing the interest rate by 1%. The loan is performing as agreed with a balance of \$70,797 as of December 31, 2016. There were no changes to the allowance for loan losses, nor any charge-offs during the year ending December 31, 2016 related to this troubled debt restructuring. During the year ending December 31, 2015, there were not any loans that had their terms modified as troubled debt restructurings.

Bank of San Francisco  
NOTES TO FINANCIAL STATEMENTS  
December 31, 2016 and 2015

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**NOTE 6 - PREMISES AND EQUIPMENT**

Premises and equipment were as follows:

	December 31,	
	2016	2015
Leasehold improvements	\$ 283,465	\$ 279,590
Equipment, furniture and software	952,290	932,157
	1,235,755	1,211,747
Less accumulated depreciation	(797,605)	(657,789)
	\$ 438,150	\$ 553,958

Depreciation and amortization included in occupancy and equipment expense totaled \$148,363 and \$143,532 for the years ended December 31, 2016 and 2015, respectively.

Operating Leases

The Bank leases its only branch and administration office under a non-cancelable operating lease. The lease expires in 2022 and has a renewal option of five years. Rent expense included in occupancy and equipment expense totaled \$499,419 and \$455,178 for the years ended December 31, 2016 and 2015, respectively.

Rent commitments, before considering renewal options that generally are present, were as follows:

	Year Ending December 31,
2017	500,505
2018	512,614
2019	524,723
2020	536,832
2021	548,942
Thereafter	371,344
	\$ 2,994,960

Bank of San Francisco  
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December 31, 2016 and 2015

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**NOTE 7 – INTEREST-BEARING DEPOSITS**

The Bank uses certificates of deposit acquired through the Certificate of Deposit Account Registry Service (CDARS) program to offer its deposit clients full FDIC insurance coverage on their balances by placing them at multiple banks with individual balances not exceeding the FDIC insured limit. In return, the Bank typically receives equal amounts of certificates of deposit through CDARS from other institutions and their clients in reciprocal transactions.

Interest bearing deposits were as follows:

	December 31,	
	2016	2015
Savings	\$ 320,968	\$ 1,052,298
Money market	75,295,423	61,817,108
NOW accounts	15,774,492	12,881,386
Time – less than \$100,000	433,354	808,360
Time – \$100,000 or more	17,743,347	20,097,774
Time – CDARS	10,919,688	11,427,468
	<u>\$ 120,487,272</u>	<u>\$ 108,084,394</u>

Time deposits that meet or exceed the FDIC insurance limit of \$250,000 at year-end 2016 and 2015 were \$13,000,000 and \$15,000,000.

Scheduled maturities of time deposits are as follows:

	Year Ending December 31,
2017	28,490,765
2018	<u>605,624</u>
	<u>\$ 29,096,389</u>

Bank of San Francisco  
NOTES TO FINANCIAL STATEMENTS  
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**NOTE 7 – INTEREST-BEARING DEPOSITS (Continued)**

Interest expense on deposits was as follows:

	December 31,	
	2016	2015
Savings	\$ 743	\$ 932
Money market	305,991	274,277
NOW accounts	37,227	44,916
Time – less than \$100,000	2,636	3,788
Time – \$100,000 or more	80,591	50,335
Time – CDARS	61,588	65,458
	<u>\$ 488,776</u>	<u>\$ 439,706</u>

At December 31, 2016 and 2015, the four largest deposit relationships accounted for approximately \$47,000,000, or 23%, and \$48,000,000, or 25% of total deposits, respectively. The loss of these clients could have a material impact on the Bank's operations. However, the majority of these depositors have other business relationships with the Bank, which management believes mitigates the risk of losing these deposits.

In addition, the Bank has a contingent funding plan in place which provides management guidance on courses of action and liquidity options if a liquidity need occurs. Liquidity options include borrowing arrangements with the FHLB and the Bank's correspondent banks (Note 14).

**NOTE 8 - OTHER BENEFIT PLANS**

401(k) Plan

A 401(k) plan was established in 2011. Subject to eligibility requirements, employees may contribute up to 100% of their compensation or the maximum amount allowed by law. A discretionary match equal to 100% of the first 2% of the compensation was contributed for 2016 and 2015. Expenses for 2016 and 2015 totaled \$69,807 and \$72,267, respectively.

Bank of San Francisco  
NOTES TO FINANCIAL STATEMENTS  
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**NOTE 9 - INCOME TAXES**

Income tax expense (benefit) was as follows:

	<u>Federal</u>	<u>State</u>	<u>Total</u>
<u>2016</u>			
Current	\$ 921,292	\$ 296,627	\$ 1,217,919
Deferred	<u>(120,209)</u>	<u>(30,299)</u>	<u>(150,508)</u>
Income tax expense	<u>\$ 801,083</u>	<u>\$ 266,328</u>	<u>\$ 1,067,411</u>
<u>2015</u>			
Current	\$ 751,372	\$ 252,202	\$ 1,003,574
Deferred	<u>(83,215)</u>	<u>(20,080)</u>	<u>(103,295)</u>
Income tax expense	<u>\$ 668,157</u>	<u>\$ 232,122</u>	<u>\$ 900,279</u>

Year-end deferred tax assets and liabilities were due to the following:

	<u>2016</u>	<u>2015</u>
Deferred tax assets:		
Allowance for loan losses	\$ 1,059,726	\$ 948,609
Organization costs	42,650	54,552
State income tax	105,889	84,551
Accrued Expenses	241,442	239,905
Other, net	<u>17,285</u>	<u>16,050</u>
Total deferred tax assets	1,466,992	1,343,667
Deferred tax liabilities:		
Depreciation, net	(65,328)	(106,597)
Deferred loan origination costs	<u>(280,179)</u>	<u>(266,093)</u>
Total deferred tax liabilities	(345,507)	(372,690)
Net deferred tax assets	<u>\$ 1,121,485</u>	<u>\$ 970,977</u>

Management believes that, based on its tax planning strategies, historical taxable income and estimated future taxable income, it is more likely than not the Bank will generate sufficient taxable income to fully utilize the net deferred tax assets. Accordingly, no valuation allowance has been established as of December 31, 2016 and 2015.

The primary difference between the federal statutory tax rate and the tax expense recorded in the financial statements is due to the state income tax.

Bank of San Francisco  
NOTES TO FINANCIAL STATEMENTS  
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**NOTE 9 - INCOME TAXES** (Continued)

The Bank files income tax returns in the United States and California jurisdictions. At December 31, 2016, the Bank had no net operating loss carryforwards (NOLs).

The Bank is no longer subject to tax examination by U.S. Federal taxing authorities for years ended before December 31, 2013 and by state and local taxing authorities for years ended before December 31, 2012.

**NOTE 10 - RELATED-PARTY TRANSACTIONS**

During the normal course of business, the Bank enters into transactions with related parties, including Directors, executive officers and affiliates. The following is a summary of aggregate related party borrowing arrangements at December 31, 2016:

Beginning balance	\$ 154,792
Disbursements	692,000
Amounts repaid	<u>(79,365)</u>
Ending balance	<u><u>\$ 767,427</u></u>
Undisbursed commitments	<u><u>\$ 112,573</u></u>

Deposits

At December 31, 2016 and 2015, the Bank's deposits from related parties totaled approximately \$3,900,000 and \$3,400,000, respectively.

**NOTE 11 - REGULATORY CAPITAL MATTERS**

Banks are subject to regulatory capital requirements administered by federal banking agencies. Capital adequacy guidelines and, additionally for banks, prompt corrective action regulations, involve quantitative measures of assets, liabilities, and certain off-balance-sheet items calculated under regulatory accounting practices. Capital amounts and classifications are also subject to qualitative judgments by regulators. Failure to meet capital requirements can initiate regulatory action. The final rules implementing Basel Committee on Banking Supervision's capital guidelines for U.S. banks (Basel III rules) became effective for the Bank on January 1, 2015 with full compliance with all of the requirements being phased in over a multi-year schedule, and fully phased in by January 1, 2019.



Bank of San Francisco  
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**NOTE 11 - REGULATORY CAPITAL MATTERS** (Continued)

Under Basel III rules, the Bank must hold a capital conservation buffer above the adequately capitalized risk-based capital ratios. The capital conservation buffer is being phased in from 0.0% for 2015 to 2.50% for 2019. The capital conservation buffer for 2016 is 0.625%. The net unrealized gain or loss on available for sales securities is not included in computing regulatory capital. Management believes that the Bank met all their capital adequacy requirements as of December 31, 2016 and 2015.

Prompt corrective action regulations provide five classifications: well capitalized, adequately capitalized, undercapitalized, significantly undercapitalized, and critically undercapitalized, although these terms are not used to represent overall financial condition. If adequately capitalized, regulatory approval is required to accept brokered deposits. If undercapitalized, capital distributions are limited, as is asset growth and expansion, and capital restoration plans are required.

At year-end 2016 and 2015, the most recent regulatory notifications categorized the Bank as "well-capitalized" under the regulatory framework for prompt corrective action. There are no conditions or events since that notification that management believes have changed the institution's category.

Actual and required capital amounts (dollars in thousands) and ratios are presented below at year end.

	2016		2015	
	Amount	Ratio	Amount	Ratio
<u>Total Risk-Based Capital Ratio</u>				
Bank of San Francisco	\$ 24,627	15.1%	\$ 19,133	11.7%
Minimum requirement for "Well-Capitalized" institution under the prompt corrective action provisions	16,330	10.0%	16,317	10.0%
Minimum regulatory requirement	13,064	8.0%	13,054	8.0%
<u>Tier 1 Risk-Based Capital Ratio</u>				
Bank of San Francisco	\$ 22,579	13.8%	\$ 17,090	10.5%
Minimum requirement for "Well-Capitalized" institution under the prompt corrective action provisions	13,064	8.0%	13,054	8.0%
Minimum regulatory requirement	9,798	6.0%	9,790	6.0%

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**NOTE 11 - REGULATORY CAPITAL MATTERS** (Continued)

	2016		2015	
	Amount	Ratio	Amount	Ratio
<u>Common Tier 1 Risk-Based Capital Ratio</u>				
Bank of San Francisco	\$ 22,579	13.8%	\$ 17,090	10.5%
Minimum requirement for "Well-Capitalized" institution under the prompt corrective action provisions	10,615	6.5%	10,606	6.5%
Minimum regulatory requirement	7,349	4.5%	7,343	4.5%
<u>Leverage Ratio</u>				
Bank of San Francisco	\$ 22,579	9.7%	\$ 17,090	8.2%
Minimum requirement for "Well-Capitalized" institution under the prompt corrective action provisions	11,693	5.0%	10,420	5.0%
Minimum regulatory requirement	9,354	4.0%	8,336	4.0%

**NOTE 12 - LOAN COMMITMENTS AND OTHER RELATED ACTIVITIES**

Financial Instruments With Off-Balance-Sheet Risk

The Bank is a party to financial instruments with off-balance-sheet risk in the normal course of business in order to meet the financing needs of its clients and to reduce its own exposure to fluctuations in interest rates. These financial instruments consist of commitments to extend credit and standby letters of credit. These instruments involve, to varying degrees, elements of credit and interest rate risk in excess of the amount recognized on the balance sheet. The Bank's exposure to credit loss in the event of nonperformance by the other party for commitments to extend credit and standby letters of credit is represented by the contractual amount of those instruments. The Bank uses the same credit policies in making commitments and standby letters of credit as it does for loans included on the balance sheet.

Standby letters of credit are conditional commitments issued by the Bank to guarantee the performance or financial obligation of a client to a third party. The credit risk involved in issuing standby letters of credit is essentially the same as that involved in extending loans to clients.

Bank of San Francisco  
NOTES TO FINANCIAL STATEMENTS  
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**NOTE 12 - LOAN COMMITMENTS AND OTHER RELATED ACTIVITIES** (Continued)

The contractual amounts of financial instruments with off-balance sheet risk at year end were as follows (dollars in thousands):

	<u>December 31,</u>	
	<u>2016</u>	<u>2015</u>
Commitments to extend credit	36,926	26,813
Standby letters of credit	778	865

**NOTE 13 - EARNINGS PER SHARE**

The factors used in the earnings per share computation follow:

For the Year Ended	<u>Net Income Available to Common Shareholders</u>	<u>Weighted Average Number of Shares Outstanding</u>	<u>Per Share Amount</u>
<u>December 31, 2016</u>			
Basic earnings per share	<u>\$ 1,530,194</u>	<u>1,447,846</u>	<u>\$ 1.06</u>
<u>December 31, 2015</u>			
Basic earnings per share	<u>\$ 1,265,136</u>	<u>1,236,500</u>	<u>\$ 1.02</u>

**NOTE 14 - BORROWING ARRANGEMENTS**

Correspondent Banks

The Bank could also borrow up to \$6,500,000 under unsecured Federal funds lines of credit with its correspondent banks. There were no amounts outstanding under these borrowing arrangements at December 31, 2016 and 2015.

Bank of San Francisco  
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**NOTE 14 - BORROWING ARRANGEMENTS** (Continued)

Federal Home Loan Bank Advances

At December 31, 2016 and 2015, the Bank's remaining borrowing capacity totaled \$25,000,000 and \$30,000,000, respectively. The Bank has a blanket lien pledge arrangement with the FHLB and various loans totaling approximately \$91,000,000 and \$96,000,000 were specifically identified to secure FHLB borrowings as of December 31, 2016 and 2015, respectively. There were no advances outstanding as of December 31, 2016 and 2015. One letter of credit totaling \$11,000,000 was outstanding as of December 31, 2016 and two letters of credit totaling \$13,200,000 were outstanding as of December 31, 2015. The letter of credit outstanding as of December 31, 2016 matures in 2017 and was issued as collateral to support public funds deposits.

**NOTE 15 - CAPITAL RAISE**

On May 21, 2015, the California Department of Business Oversight issued a stock permit that authorized the Bank to offer and sell up to 525,000 shares of common stock, with a minimum of 255,000 shares at a cash price of \$15.75 per share. The stock permit had an expiration date of November 21, 2015 that was extended to March 21, 2016. The capital raise ended on March 21, 2016. In 2016, the Bank issued 264,175 new shares of common stock and added \$4,015,207 (net of cost) to capital. No shares were issued in 2015.

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## OUR MISSION

Bank of San Francisco's mission is to enhance the success of our communities by providing exceptional service and expertise to support the goals and aspirations of people, businesses, and nonprofits.

## WHO WE ARE

Bank of San Francisco is a progressive community bank that reflects the best of San Francisco and Bay Area culture – flexible, entrepreneurial, and forward thinking. We are a local bank, owned by members of the community, serving Bay Area businesses, nonprofits, individuals, and families.

Bank of San Francisco delivers high-touch, personalized service with agility and accountability. Our advanced technology platform and mobile apps enable our clients to transact in real time. Every client works with their own banker who offers creative, effective solutions based on an intimate understanding of each client's particular needs.

Our team is as diverse as the community we serve, which allows us to understand our clients' unique needs and goals. We invest in our community and employees, encouraging professional development, time off to volunteer, and leadership in local nonprofits of their choice.

We invite you to learn more about Bank of San Francisco and to join our family of successful, community-minded clients.

### BANK OF SAN FRANCISCO

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