



CONSOLIDATED FINANCIAL  
STATEMENTS

AS OF DECEMBER 31, 2018 AND 2017  
AND FOR THE YEARS ENDED  
DECEMBER 31, 2018, 2017 AND 2016  
AND  
INDEPENDENT AUDITOR'S REPORT

## INDEPENDENT AUDITOR'S REPORT

To the Shareholders and Board of Directors  
Avidbank Holdings, Inc. and Subsidiary  
San Jose, California

**Report on the Financial Statements**

We have audited the accompanying consolidated financial statements of Avidbank Holdings, Inc. and Subsidiary, which comprise the consolidated balance sheets as of December 31, 2018 and 2017, and the related consolidated statements of income, comprehensive income, changes in shareholders' equity, and cash flows for each of the years in the three year period ended December 31, 2018, 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 consolidated 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 consolidated 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 consolidated 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 consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated 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 consolidated 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 consolidated 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 consolidated financial statements referred to above present fairly, in all material respects, the financial position of Avidbank Holdings, Inc. and Subsidiary as of December 31, 2018 and 2017, and the results of their operations and their cash flows for each of the years in the three year period ended December 31, 2018 in accordance with accounting principles generally accepted in the United States of America.

*Crowe LLP*  
Crowe LLP

Sacramento, California  
March 19, 2019

**AVIDBANK HOLDINGS, INC. AND SUBSIDIARY**  
**CONSOLIDATED BALANCE SHEETS**

December 31, 2018 and 2017  
(in thousands, except share amounts)

	<b>2018</b>	<b>2017</b>
<b>ASSETS</b>		
Cash and due from banks	\$ 19,252	\$ 10,650
Due from Federal Reserve Bank	8,400	22,710
	27,652	33,360
Total cash and cash equivalents	27,652	33,360
Available-for-sale investment securities	56,491	74,364
Loans, less allowance for loan losses of \$9,758 in 2018 and \$8,297 in 2017	797,581	639,976
Federal Home Loan Bank stock, at cost	3,034	5,130
Property and equipment, net	5,723	5,946
Cash surrender value of Bank-owned life insurance policies	10,890	10,619
Accrued interest receivable and other assets	15,534	13,598
	\$ 916,905	\$ 782,993
Total assets	\$ 916,905	\$ 782,993
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
Deposits:		
Non-interest bearing	\$ 366,851	\$ 275,925
Interest bearing	429,746	370,482
	796,597	646,407
Total deposits	796,597	646,407
Subordinated debt securities, net	11,845	11,761
Federal Home Loan Bank advances	-	30,000
Accrued interest payable and other liabilities	7,947	5,718
	816,389	693,886
Total liabilities	816,389	693,886
Commitments and contingencies (Note 10)		
Shareholders' equity:		
Preferred stock - no par value; \$1,000 liquidation preference; 5,000,000 shares authorized, no shares issued and outstanding at December 31, 2018 and 2017	-	-
Common stock - no par value; 10,000,000 shares authorized; 5,968,148 and 5,893,144 shares issued and outstanding at December 31, 2018 and 2017, respectively	62,234	62,234
Additional paid-in capital	5,778	4,762
Retained earnings	34,053	22,811
Accumulated other comprehensive (loss) income, net of taxes	(1,549)	(700)
	100,516	89,107
Total shareholders' equity	100,516	89,107
Total liabilities and shareholders' equity	\$ 916,905	\$ 782,993

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

**AVIDBANK HOLDINGS, INC. AND SUBSIDIARY**  
**CONSOLIDATED STATEMENTS OF INCOME**  
For the Years Ended December 31, 2018, 2017 and 2016  
(in thousands, except per share amounts)

	<u>2018</u>	<u>2017</u>	<u>2016</u>
Interest income:			
Interest and fees on loans	\$ 39,874	\$ 30,784	\$ 24,036
Interest on taxable investment securities	1,578	1,988	1,834
Interest on Federal funds sold	1,132	581	381
Total interest income	<u>42,584</u>	<u>33,352</u>	<u>26,251</u>
Interest expense:			
Interest on deposits	2,958	1,727	1,135
Interest on borrowings	1,760	1,097	854
Total interest expense	<u>4,718</u>	<u>2,824</u>	<u>1,989</u>
Net interest income	37,866	30,528	24,262
Provision for loan losses	<u>1,612</u>	<u>1,985</u>	<u>813</u>
Net interest income after provision for loan losses	<u>36,254</u>	<u>28,543</u>	<u>23,449</u>
Non-interest income:			
Service charges, fees and other income	1,826	1,189	933
Federal Home Loan Bank stock	318	297	503
Appreciation in cash surrender value of insurance contracts	271	285	315
Other income	-	116	-
Gain from sale of other real estate owned	288	-	-
Gain from life insurance	-	-	1,472
Gain (loss) on sale of investment securities	17	-	(4)
Total non-interest income	<u>2,720</u>	<u>1,887</u>	<u>3,219</u>
Non-interest expenses:			
Salaries and employee benefits	15,102	12,436	9,923
Occupancy and equipment	3,436	3,029	2,200
Other	4,991	4,132	3,670
Total other expenses	<u>23,529</u>	<u>19,597</u>	<u>15,793</u>
Income before provision for income taxes	15,444	10,833	10,875
Provision for income taxes	<u>4,324</u>	<u>5,179</u>	<u>3,612</u>
Net income	<u>\$ 11,120</u>	<u>\$ 5,654</u>	<u>\$ 7,263</u>
Basic income per common share	<u>\$ 1.93</u>	<u>\$ 1.10</u>	<u>\$ 1.61</u>
Diluted income per common share	<u>\$ 1.90</u>	<u>\$ 1.08</u>	<u>\$ 1.56</u>

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

**AVIDBANK HOLDINGS, INC. AND SUBSIDIARY**  
**CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME**  
For the Years Ended December 31, 2018, 2017 and 2016  
(in thousands)

	<u>2018</u>	<u>2017</u>	<u>2016</u>
Net Income	\$ 11,120	\$ 5,654	\$ 7,263
Other Comprehensive Income:			
Unrealized (losses) gains on securities:			
Unrealized holdings (losses) gains	(1,015)	395	(1,485)
Less: reclassification for realized net (gains) losses included in net income	<u>(17)</u>	<u>-</u>	<u>4</u>
Other comprehensive (loss) income, before tax	(1,032)	395	(1,481)
Tax effect	<u>305</u>	<u>(158)</u>	<u>593</u>
Other comprehensive (loss) income	<u>(727)</u>	<u>237</u>	<u>(888)</u>
Total Comprehensive Income	<u>\$ 10,393</u>	<u>\$ 5,891</u>	<u>\$ 6,375</u>

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

**AVIDBANK HOLDINGS, INC. AND SUBSIDIARY**  
**CONSOLIDATED STATEMENT OF CHANGES IN SHAREHOLDERS' EQUITY**  
For the Years Ended December 31, 2018, 2017 and 2016  
(dollars in thousands)

	Common Stock		Additional	Retained	Accumulated Other Comprehensive	Total
	Shares	Amount	Paid-in Capital	Earnings	Income (Loss), Net of Tax	Shareholders' Equity
Balance, January 1, 2016	<u>4,452,853</u>	<u>\$ 42,222</u>	<u>\$ 3,558</u>	<u>\$ 9,894</u>	<u>\$ (49)</u>	<u>\$ 55,625</u>
Net income				7,263		7,263
Other comprehensive loss					(888)	(888)
Stock options exercised, net	193,802		476			476
Restricted stock issued, net	57,642		(194)			(194)
Tax benefit from exercise/vesting of stock awards			846			846
Stock based compensation			381			381
Balance, December 31, 2016	<u>4,704,297</u>	<u>\$ 42,222</u>	<u>\$ 5,067</u>	<u>\$ 17,157</u>	<u>\$ (937)</u>	<u>\$ 63,509</u>
Net income				5,654		5,654
Other comprehensive income					237	237
Issuance of common stock	1,053,242	20,012	(989)			19,023
Stock options exercised, net	50,828		(33)			(33)
Restricted stock issued, net	84,777		(133)			(133)
Stock based compensation			850			850
Balance, December 31, 2017	<u>5,893,144</u>	<u>\$ 62,234</u>	<u>\$ 4,762</u>	<u>\$ 22,811</u>	<u>\$ (700)</u>	<u>\$ 89,107</u>
Net income				11,120		11,120
Reclassification due to adoption of ASU 2018-02				122	(122)	-
Other comprehensive income					(727)	(727)
Stock options exercised, net	44,740		49			49
Restricted stock issued, net	30,264		(18)			(18)
Stock based compensation			985			985
Balance, December 31, 2018	<u>5,968,148</u>	<u>\$ 62,234</u>	<u>\$ 5,778</u>	<u>\$ 34,053</u>	<u>\$ (1,549)</u>	<u>\$ 100,516</u>

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

**AVIDBANK HOLDINGS, INC. AND SUBSIDIARY**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**  
For the Years Ended December 31, 2018, 2017 and 2016  
(in thousands)

	<u>2018</u>	<u>2017</u>	<u>2016</u>
Cash flows from operating activities:			
Net income	\$ 11,120	\$ 5,654	\$ 7,263
Adjustments to reconcile net income to net cash provided by operating activities:			
(Gain) Loss on sale of investment securities	(17)	-	4
Provision for loan losses	1,612	1,985	813
Depreciation, amortization and accretion	1,234	1,384	1,657
Amortization of debt issuance costs	84	84	64
(Decrease) increase in deferred loan origination fees, net	(344)	14	(160)
Earnings on bank-owned life insurance policies	(271)	(285)	(315)
Gain from bank-owned life insurance	-	-	(1,472)
Share based compensation expense	985	850	381
Change in deferred income taxes	1,145	(643)	50
Loss on disposal of fixed assets	48	-	-
(Increase) in accrued interest receivable and other assets	(2,743)	(277)	(4,151)
Decrease in accrued interest payable and other liabilities	2,230	2,245	818
Net cash provided by operating activities	<u>15,083</u>	<u>11,011</u>	<u>4,952</u>
Cash flows used in investing activities:			
Purchase of available-for-sale investment securities	-	-	(52,972)
Proceeds from sales/calls of available-for-sale investment securities	8,238	-	18,936
Proceeds from paydowns/maturities of available-for-sale investment securities	7,898	14,723	11,338
Redemption (purchase) of Federal Home Loan Bank stock	2,096	(756)	(540)
Net increase in loans	(158,873)	(133,450)	(111,914)
Proceeds from Bank-owned life insurance	-	-	3,745
Purchase of premises and equipment	(884)	(5,735)	(102)
Disposal of fixed assets	513	-	-
Net cash used in investing activities	<u>(141,012)</u>	<u>(125,218)</u>	<u>(131,509)</u>
Cash flows from financing activities:			
Net increase in deposits	150,190	78,410	36,253
Net proceeds from issuance of common stock	-	19,023	-
Net proceeds from exercise of stock options	800	908	1,648
Repurchase of common stock	(751)	(941)	(1,172)
Restricted stock issued, net	(18)	(133)	(194)
(Repayment) proceeds from other borrowings	(30,000)	30,000	-
Net cash provided by financing activities	<u>120,221</u>	<u>127,267</u>	<u>36,535</u>
(Decrease) increase in cash and cash equivalents	(5,708)	13,060	(90,022)
Cash and cash equivalents at beginning of period	33,360	20,300	110,322
Cash and cash equivalents at end of year	<u>\$ 27,652</u>	<u>\$ 33,360</u>	<u>\$ 20,300</u>
Supplemental disclosure of cash flow information:			
Cash paid during the year for:			
Interest expense	\$ 4,333	\$ 2,516	\$ 1,954
Income taxes	\$ 4,545	\$ 4,560	\$ 3,810

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

**AVIDBANK HOLDINGS, INC. AND SUBSIDIARY  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

General

Avidbank Holdings, Inc. (the "Company") was incorporated on December 17, 2007 and subsequently obtained approval from the Board of Governors of the Federal Reserve System to operate as a bank holding company. On April 2, 2008, Avidbank (the "Bank") consummated a merger with the Company effected through the exchange of one share of the Company's stock for each share of the Bank's stock. The reorganization represented an exchange of shares between entities under common control, and, as a result, assets and liabilities of the Bank were recognized at their carrying amounts in the accounts of the Company. Subsequent to the reorganization, the Bank continued its operations as previously conducted, but as a wholly-owned subsidiary of the Company.

The Bank is a California state-chartered institution, headquartered in San Jose, California, and provides financial products and services to customers who are predominately small and middle-market businesses, professionals and individuals residing in Santa Clara, San Mateo and San Francisco Counties.

We have considered all events occurring from December 31, 2018 through March 19, 2019, the date the consolidated financial statements were available for issuance.

Principles of Consolidation

The consolidated financial statements include the accounts of the Company and the accounts of its wholly-owned subsidiary, the Bank. All significant intercompany balances and transactions have been eliminated. The accounting and reporting policies of the Company conform with accounting principles generally accepted in the United States of America and prevailing practices within the banking industry.

Use of Estimates

The preparation of financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions based on available information. 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.

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.

Cash and Cash Equivalents

For the purpose of the statement of cash flows, cash and cash equivalents consist of cash and due from banks and Due from Federal Reserve. Generally, Due from Federal Reserve funds are sold for one day periods. On the statement of cash flows, net cash flows are reported for customer loan and deposit transactions.



**AVIDBANK HOLDINGS, INC. AND SUBSIDIARY**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
(Continued)

**1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES** (Continued)

Investment Securities

Investment securities are classified into the following categories:

- Available-for-sale securities, reported at fair value, with unrealized gains and losses excluded from earnings and reported, net of taxes, as accumulated other comprehensive income within shareholders' equity.
- Held-to-maturity securities, which management has the positive intent and ability to hold, reported at amortized cost, adjusted for the accretion of discounts and amortization of premiums, which are recognized as adjustments to interest income.

Management determines the appropriate classification of its investments at the time of purchase and may only change the classification in certain limited circumstances. All transfers between categories are accounted for at fair value. At December 31, 2018 and 2017, all of the Company's securities were classified as available-for-sale and there were no transfers between categories during those years.

Gains and losses on the sale of securities are computed using the specific identification method on the trade date. Interest earned on investment securities is reported in interest income, net of applicable adjustments for accretion of discounts and amortization of premiums which are accounted for on the level-yield method without anticipation of prepayment. In addition, unrealized losses, if any, that are determined by management to be other than temporary are recognized in earnings in accordance with the methodology described below.

An investment security is impaired when its carrying value is greater than its fair value. Impaired investment securities are evaluated on at least a quarterly basis and more frequently when economic or market conditions warrant such an evaluation to determine whether a decline in their fair value is other than temporary. Management utilizes criteria such as the magnitude and duration of the decline and the intent and ability of the Company to retain its investment in the securities for a period of time sufficient to allow for an anticipated recovery in fair value, in addition to the reasons underlying the decline, to determine whether the loss in value is other than temporary. The term "other than temporary" is not intended to indicate the decline is permanent, but indicates the prospects for a near-term recovery of value are not necessarily favorable, or there is a lack of evidence to support a realizable value equal to or greater than the carrying value of the investment. Once a decline in value is determined to be other than temporary, and management does not intend to sell the security or it is more likely than not the Company will not be required to sell the security before recovery, only the portion of the impairment loss representing credit exposure is recognized as a charge to earnings, with the balance recognized as a charge to other comprehensive income. If management intends to sell the security or it is more likely than not the Company will be required to sell the security before recovering its forecasted cost, the entire impairment loss is recognized as a charge to earnings.

Investment in Federal Home Loan Bank Stock

As a member of the Federal Home Loan Bank System, the Company is required to maintain an investment in the capital stock of the Federal Home Loan Bank (FHLB). The investment is carried at cost and periodically evaluated for impairment based on ultimate recovery of par value. Both cash and stock dividends are reported as income.

**AVIDBANK HOLDINGS, INC. AND SUBSIDIARY**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
(Continued)

**1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES** (Continued)

Loans

Loans are stated at principal balances outstanding net of deferred loan fees and costs, and an allowance for loan losses. Interest is accrued daily based upon outstanding loan balances. However, when a loan is past due 90 days or in the opinion of management, loans are considered to be impaired and the future collectability of interest and principal is in serious doubt, loans are placed on nonaccrual status and the accrual of interest income is suspended. Any interest accrued but unpaid is charged against income. Payments received on loans on nonaccrual status are applied to reduce principal to the extent necessary to ensure collection. Subsequent payments on these loans, or payments received on nonaccrual loans for which the ultimate collectability of principal is not in doubt, are applied first to earned but unpaid interest and then to principal. Loans are returned to accrual status when all the principal and interest amounts contractually due are brought current and future payments are reasonably assured.

Substantially all loan origination fees, commitment fees, direct loan origination costs and purchase premiums and discounts on loans are deferred and recognized as an adjustment of yield, to be amortized to interest income over the contractual term of the loan. The unamortized balance of deferred fees and costs is reported as a component of net loans.

A loan is considered impaired when, based on current information and events, it is probable that the Company will be unable to collect all amounts due (including both principal and interest) in accordance with the contractual terms of the loan agreement. Factors considered by management in determining impairment include payment status, the structure and nature of collateral, if any, 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 the 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. The amount of impairment, if any, on an impaired loan is measured based on the present value of expected future cash flows discounted at the loan's effective rate, except that as a practical expedient, impairment may be measured based upon the loan's observable market price or the fair value of 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.

Allowance for Loan Losses

The allowance for loan losses (the "allowance") is a valuation allowance for probable incurred credit losses. The allowance is established through a provision for loan losses which is charged to expense. Additions to the allowance are expected to maintain the adequacy of the total allowance after credit losses and loan growth. 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 which are individually evaluated for impairment and general reserves for losses related to loans that are collectively evaluated for impairment.

A restructuring of a debt constitutes a troubled debt restructuring (TDR) if the Company for economic or legal reasons related to the borrower's financial difficulties grants a concession to the borrower 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.

**AVIDBANK HOLDINGS, INC. AND SUBSIDIARY**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
(Continued)

**1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES** (Continued)

Allowance for Loan Losses (Continued)

Loans reported as TDRs are considered impaired and measured for impairment as described above. For troubled debt restructurings that subsequently default, the Company determines the amount of reserve in accordance with the accounting policy for the allowance for loan losses.

The determination of the general reserve for loans that are collectively evaluated for impairment is based on estimates made by management, to include, but not limited to, consideration of all historical losses based on a seven-year lookback period by portfolio segment, internal asset classifications, and qualitative factors to include economic trends in the Company's service areas, industry trends, geographic concentrations, estimated collateral values, the Company's underwriting policies, the character of the loan portfolio, and probable losses in the portfolio taken as a whole.

The Company determines a separate allowance for each portfolio segment (loan type). These portfolio segments include commercial, construction (including land and development loans), residential real estate (including home equity lines of credit), commercial real estate, sponsor finance (acquisition loans), asset based and asset based term and consumer loans. The allowance for loan losses attributable to each portfolio segment, which includes both loans individually evaluated for impairment and loans that are collectively evaluated for impairment, are combined to determine the Company's overall allowance, which is included on the consolidated balance sheet.

The Company assigns a risk rating to all loans except pools of homogeneous loans, and periodically performs detailed reviews of all such loans exhibiting variances in expected payment and/or financial performance 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 Company and the Company's regulators. 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. These credit quality indicators are used to assign a risk rating to each individual loan. The risk ratings can be grouped into six major categories, defined as follows:

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

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

Substandard-Non-Impaired – A substandard non-impaired 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 jeopardizing the liquidation of the loan. Well-defined weaknesses include the potential for: lack of marketability, inadequate cash flow or collateral support, failure to complete construction on time or the project's failure to fulfill economic expectations. They are characterized by the distinct possibility that the Company will sustain some loss if the deficiencies are not corrected.

Substandard-Impaired – A substandard loan is impaired when, based on current information and known or anticipated events, it is probable that the lender will be unable to collect all amounts due according to the terms of the original loan agreement. These loans are typically on nonaccrual and have many of the same weaknesses as substandard non-impaired loans.

**AVIDBANK HOLDINGS, INC. AND SUBSIDIARY**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
(Continued)

**1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES** (Continued)

Allowance for Loan Losses (Continued)

Doubtful – Loans classified as 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.

The general reserve component of the allowance for loan losses also consists of reserve factors based on management's assessment of the following for each portfolio segment: (1) inherent credit risk, (2) historical losses and (3) other qualitative factors. These reserve factors are inherently subjective and are driven by the repayment risk associated with each portfolio segment described below:

Commercial – Commercial 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 which are closely correlated to the credit quality of these loans. Asset based commercial loans are advances generally made against receivables to companies generating consistent sales without yet having reached consistent profitability. These companies are subjected to an audit of their receivables and ineligible accounts are excluded from the borrowing base. The Company controls the entire receivables cash flow of the company and advances are made on a portion of eligible receivable balances. Receivables are monitored daily and borrowing capacity is calculated based upon contractual formulas. As a result of these controls, asset based lending loans typically possess less risk than unsecured commercial loans.

Construction – Construction loans, including land and development 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 cost and timelines. 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.

Residential real estate (including home equity lines of credit) – Residential real estate loans are loans made with a residence serving as collateral. These are not typical mortgage loans and may have a variety of reasons for the borrowing including providing funding to a business or paying for large personal expenditures. These loans generally possess a lower inherent risk of loss than commercial real estate and construction loans and are often situations where the borrower is the occupant of the residence. The degree of risk in home equity loans 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. 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.

Commercial real estate – Commercial real estate loans generally possess a higher inherent risk of loss than other real estate portfolio segments, except land and construction loans. Adverse economic developments 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.

**AVIDBANK HOLDINGS, INC. AND SUBSIDIARY**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)**

Allowance for Loan Losses (Continued)

Consumer – Consumer loans are primarily loans to individuals that may be unsecured or secured by collateral other than real estate. The unsecured loans are generally revolving personal lines of credit to established clients. The Company also offers demand deposit lines of credit to certain checking account clients. The high quality of the clients who are offered these products has historically caused this loan product to have less risk of loss than commercial loan products.

Although management believes the allowance to be appropriate, ultimate losses may vary from its estimates. At least quarterly, the Board of Directors reviews 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 changes are warranted based on those reviews, the allowance is adjusted. In addition, the Company's primary regulators, the Federal Reserve Bank, the FDIC 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. The allowance for loan losses at December 31, 2018 and 2017 reflects management's estimate of probable incurred credit losses in the Company's loan portfolio.

Reserve for Undisbursed Loan Commitments

The Company maintains a separate reserve for losses related to undisbursed loan commitments. Management estimates the amount of probable losses by applying the loss factors used in the allowance for loan loss methodology to an estimate of the expected usage of undisbursed lines of credit. This reserve was approximately \$370,000 at December 31, 2018 and 2017, and is included in accrued interest payable and other liabilities on the consolidated balance sheet.

Property and Equipment

Property and equipment are carried at cost less accumulated depreciation. Depreciation is determined using 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 five to ten years. Leasehold improvements are amortized over the life of the asset or the term of the related lease, 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.

Bank-Owned Life Insurance

The Company has purchased life insurance policies on certain current employees and former key executives. Bank-owned life insurance is recorded at the amount that can be realized under the insurance contract at the balance sheet date, which is the cash surrender value adjusted for other charges or other amounts due that are probable at settlement.

**AVIDBANK HOLDINGS, INC. AND SUBSIDIARY**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
(Continued)

**1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES** (Continued)

Income Taxes

Deferred tax assets and liabilities are recognized for the tax consequences of temporary differences between the reported amount of assets and liabilities and their tax bases. Deferred tax assets and liabilities are adjusted for the effects of changes in tax laws and rates on the date of enactment. The determination of the amount of deferred income tax assets, which are more likely than not to be realized, is primarily dependent on projections of future earnings, which are subject to uncertainty and estimates that may change given economic conditions and other factors. The recognition of deferred income tax assets is assessed and a valuation allowance is recorded if it is "more likely than not" that all or a portion of the deferred tax assets will not be realized. "More likely than not" is defined as greater than a 50% chance. All available evidence, both positive and negative, is considered to determine whether, based on the weight of that evidence, a valuation allowance is needed.

The Company 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 tax benefit that is more than fifty percent likely of being realized upon settlement with the applicable taxing authority. The portion of the benefits associated with tax positions taken that exceeds the amount measured as described above, if any, is reflected as a liability for unrecognized tax benefits in the accompanying consolidated balance sheet along with any associated interest and penalties that would be payable to the taxing authorities upon examination. Interest expense and penalties associated with unrecognized tax benefits, if any, are included in the provision for income taxes in the statement of operations. The Company did not have any uncertain income tax positions and has not accrued for any interest or penalties as of December 31, 2018 and 2017.

Stock-Based Compensation

Compensation cost is recognized for stock options and restricted stock awards based on the fair value of these awards at the date of grant. A Black-Scholes model is utilized to estimate the fair value of stock options, while the market price of the Company's common stock at the date of grant is used for restricted stock awards. Compensation cost is recognized over the required service period, generally defined as the vesting period. For awards with graded vesting, compensation cost is recognized on a straight-line basis over the requisite service period for the entire award.

The Company reports the cash flows resulting from the tax benefits resulting from tax deductions in excess of the compensation cost recognized for options (excess tax benefits) as a cash flow from financing in the statement of cash flows. There were no excess tax benefits for the years ended December 31, 2018 or 2017.

Earnings Per Common Share

Basic earnings per share (EPS) is computed by dividing income available to common shareholders by the weighted-average number of common shares outstanding for the period. Diluted EPS reflects the potential dilution that could occur if securities or other contracts to issue common stock, such as stock options, result in the issuance of common stock which share in the earnings of the Company. The treasury stock method is applied to determine the dilutive effect of stock options in computing diluted EPS. Earnings and dividends per share are restricted for all stock splits and stock dividends through date of issuance of the financial statements.

**AVIDBANK HOLDINGS, INC. AND SUBSIDIARY**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
(Continued)

**1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES** (Continued)

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. Unrealized gains and losses on the Company's available-for-sale investment securities are included in other comprehensive income. The components of accumulated other comprehensive income are presented in the statement of changes in shareholders' equity.

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 are any such matters that will have a material effect on the financial statements.

Impact of New Accounting Pronouncements

In May 2014, the Financial Accounting Standard Board (FASB) issued Accounting Standard Update (ASU) 2014-9 (ASU 2014-09), Revenue from Contracts with Customers. The core principle of ASU 2014-09 is that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. The guidance also specifies the accounting for some costs to obtain or fulfill a contract with a customer, as well as enhanced disclosure requirements. In August 2015, the FASB issued ASU 2015-14 which deferred the effective date of ASU 2014-09 to fiscal years, and interim reporting periods within those fiscal years, beginning after December 15, 2017. In March 2016, the FASB issued ASU 2016-08 which clarified the revenue recognition implementation guidance on principal versus agent considerations and is effective during the same period as ASU 2014-09. In April 2016, the FASB issued ASU 2016-10 which clarified the revenue recognition guidance regarding the identification of performance obligations and the licensing implementation and is effective during the same period as ASU 2014-09. In May 2016, the FASB issued ASU 2016-12 which narrowly amended the revenue recognition guidance regarding collectability, noncash consideration, presentation of sales tax and transition. ASU 2016-12 is effective during the same period as ASU 2014-09.

The Company adopted ASU 2014-09 on 1/1/2018. The majority of the Company's revenue consists of net interest income on financial assets and financial liabilities, which is explicitly excluded from the scope of ASU 2014-09. The Company has completed its analysis for determining the extent ASU 2014-09 will affect its noninterest income, primarily in the area of fees and service charges on deposit accounts. Based on the analysis performed, the Company did not have a material change in the timing or measurement of revenues related to noninterest income as such, adoption of the standard did not have a material impact on the Company's consolidated financial statements and related disclosures.

**AVIDBANK HOLDINGS, INC. AND SUBSIDIARY**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
(Continued)

**1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)**

Impact of New Accounting Pronouncements (Continued)

In January 2016, the FASB amended existing guidance that investments (except those accounted for under the equity method of accounting, or those that result in consolidation of the investee) be measured at fair value with changes in fair value recognized in net income. It requires public business entities to use the exit price notion when measuring the fair value of financial instruments for disclosure purposes. It requires separate presentation of financial assets and financial liabilities by measurement category and form of financial asset (i.e., securities or loans and receivables). It eliminates the requirement for public business entities to disclose the method(s) and significant assumptions used to estimate the fair value that is required to be disclosed for financial instruments measured at amortized cost. These amendments are effective for public business entities for fiscal years beginning after December 31, 2017, including interim periods within those fiscal years. The standard was effective for the Company on January 1, 2018 and resulted in the use of an exit price rather than an entrance price to determine the fair value of financial instruments not measured at fair value on a non-recurring basis in the consolidated balance sheets. See fair value disclosures in Note 16.

In February 2016, the FASB issued ASU No. 2016-02, "Leases." Under the new guidance, lessees will be required to recognize the following for all leases (with the exception of short-term leases): 1) a lease liability, which is the present value of a lessee's obligation to make lease payments, and 2) a right-of-use asset, which is an asset that represents the lessee's right to use, or control the use of, a specified asset for the lease term. Lessor accounting under the new guidance remains largely unchanged as it is substantially equivalent to existing guidance for sales-type leases, direct financing leases, and operating leases. Other limited changes were made to align lessor accounting with the lessee accounting model and the new revenue recognition standard. All entities will classify leases to determine how to recognize lease-related revenue and expense. Quantitative and qualitative disclosures will be required by lessees and lessors to meet the objective of enabling users of financial statements to assess the amount, timing, and uncertainty of cash flows arising from leases. The intention is to require enough information to supplement the amounts recorded in the financial statements so that users can understand more about the nature of an entity's leasing activities. ASU No. 2016-02 is effective for interim and annual reporting periods beginning after December 15, 2018; early adoption is permitted.

All entities are required to use a modified retrospective approach for leases that exist or are entered into after the beginning of the earliest comparative period in the financial statements. They have the option to use certain relief; full retrospective application is prohibited. The Company has determined that the provisions of ASU No. 2016-02 will result in an increase in assets of approximately \$14.2 million to recognize the present value of the lease obligations with a corresponding increase in liabilities, however, the Company does not expect this to have a material impact on the Company's results of operations or cash flows.

In June 2016, the FASB issued ASU No. 2016-13, "Measurement of Credit Losses on Financial Instruments." This ASU significantly changes how entities will measure credit losses for most financial assets and certain other instruments that aren't measured at fair value through net income. In issuing the standard, the FASB is responding to criticism that today's guidance delays recognition of credit losses. The standard will replace today's "incurred loss" approach with an "expected loss" model. The new model, referred to as the current expected credit loss ("CECL") model, will apply to: (1) financial assets subject to credit losses and measured at amortized cost, and (2) certain off-balance sheet credit exposures. This includes, but is not limited to, loans, leases, held-to-maturity securities, loan commitments, and financial guarantees. The CECL model does not apply to available-for-sale ("AFS") debt securities. For AFS debt securities with unrealized losses, entities will measure credit losses in a manner similar to what they do today, except that the losses will be recognized as allowances rather than reductions in the amortized cost of the securities.



**AVIDBANK HOLDINGS, INC. AND SUBSIDIARY**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
(Continued)

**1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)**

Impact of New Accounting Pronouncements (Continued)

As a result, entities will recognize improvements to estimated credit losses immediately in earnings rather than as interest income over time, as they do today. The ASU also simplifies the accounting model for purchased credit-impaired debt securities and loans. ASU 2016-13 also expands the disclosure requirements regarding an entity's assumptions, models, and methods for estimating the allowance for loan and lease losses. In addition, entities will need to disclose the amortized cost balance for each class of financial asset by credit quality indicator, disaggregated by the year of origination. ASU No. 2016-13 is effective for interim and annual reporting periods beginning after December 15, 2020 for the Company; early adoption is permitted for interim and annual reporting periods beginning after December 15, 2018. Entities will apply the standard's provisions as a cumulative-effect adjustment to retained earnings as of the beginning of the first reporting period in which the guidance is effective (i.e., modified retrospective approach). While the Company is currently evaluating the provisions of ASU No. 2016-13 to determine the potential impact the new standard will have on the Company's Consolidated Financial Statements, it has taken steps to prepare for the implementation when it becomes effective, such as forming an internal task force, gathering pertinent data, consulting with outside professionals, evaluating its current IT systems and implementing specialized software. The Company is still evaluating what impact ASU 2016-13 will have on the consolidated financial statements.

On February 14, 2018, the FASB issued ASU 2018-02, Reclassification of Certain Tax Effects From Accumulated Other Comprehensive Income. The ASU amends ASC 220, Income Statement — Reporting Comprehensive Income, to "allow a reclassification from accumulated other comprehensive income to retained earnings for stranded tax effects resulting from the Tax Cuts and Jobs Act." The ASU is effective for all entities for fiscal years beginning after December 15, 2018, and interim periods within those fiscal years. The Company adopted ASU 2018-02 for the year beginning 01/01/2018. There was no material impact on the Company's results of operations or cash flows as a result of adoption.

**AVIDBANK HOLDINGS, INC. AND SUBSIDIARY**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
(Continued)

**2. AVAILABLE-FOR-SALE INVESTMENT SECURITIES**

The amortized cost and estimated fair value of available-for-sale investment securities at December 31, 2018 and 2017 consisted of the following: (in thousands)

	2018			Estimated Fair Value
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	
Debt securities:				
U.S. Agencies	\$ 2,389	\$ -	\$ (56)	\$ 2,333
Residential Mortgage-Backed Securities	50,131	-	(2,106)	48,025
Corporate Debt Securities	6,170	-	(37)	6,133
	<u>58,690</u>	<u>-</u>	<u>(2,199)</u>	<u>56,491</u>
Total debt securities	<u>\$ 58,690</u>	<u>\$ -</u>	<u>\$ (2,199)</u>	<u>\$ 56,491</u>

	2017			Estimated Fair Value
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	
Debt securities:				
U.S. Agencies	\$ 3,034	\$ -	\$ (81)	\$ 2,953
U.S. Govt. Sponsored Agencies	-	-	-	-
Residential Mortgage-Backed Securities	57,934	11	(1,255)	56,690
Corporate Debt Securities	14,563	158	-	14,721
	<u>75,531</u>	<u>169</u>	<u>(1,336)</u>	<u>74,364</u>
Total debt securities	<u>\$ 75,531</u>	<u>\$ 169</u>	<u>\$ (1,336)</u>	<u>\$ 74,364</u>

Net unrealized losses on available-for-sale investment securities totaling \$2,199,000 were recorded as accumulated other comprehensive income, net of tax benefits of \$650,000, within shareholders' equity at December 31, 2018 and net unrealized losses on available-for-sale investment securities totaling \$1,167,000 were recorded as accumulated other comprehensive income, net of tax benefits of \$345,000, within shareholders' equity at December 31, 2017.

Proceeds from the sale or calls of available-for-sale investment securities totaled \$8,238,000 for the year ended December 31, 2018 with gross recognized gains of \$17,000. There were no sales or calls of available-for-sale investment securities during 2017.

**AVIDBANK HOLDINGS, INC. AND SUBSIDIARY**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
(Continued)

**2. AVAILABLE-FOR-SALE INVESTMENT SECURITIES (Continued)**

Investment securities with unrealized losses at December 31, 2018 and December 31, 2017 are summarized and classified according to the duration of the loss period as follows: (in thousands)

	2018					
	Less than 12 Months		12 Months or More		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Debt securities:						
U.S. Treasuries and Agencies	\$ -	\$ -	\$ 2,333	\$ (56)	\$ 2,333	\$ (56)
Residential Mortgage-Backed Securities	-	-	48,025	(2,106)	48,025	(2,106)
Corporate Debt Securities	6,133	(37)	-	-	6,133	(37)
<b>Total debt securities</b>	<b>\$ 6,133</b>	<b>\$ (37)</b>	<b>\$ 50,358</b>	<b>\$ (2,162)</b>	<b>\$ 56,491</b>	<b>\$ (2,199)</b>

	2017					
	Less than 12 Months		12 Months or More		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Debt securities:						
U.S. Agencies	\$ -	\$ -	\$ 2,953	\$ (81)	\$ 2,953	\$ (81)
Residential Mortgage-Backed Securities	9,340	(4)	45,784	(1,251)	55,124	(1,255)
<b>Total debt securities</b>	<b>\$ 9,340</b>	<b>\$ (4)</b>	<b>\$ 48,737</b>	<b>\$ (1,332)</b>	<b>\$ 58,077</b>	<b>\$ (1,336)</b>

Residential Mortgage-Backed Securities - At December 31, 2018, the Company held one corporate bond investment security which was in a loss position for less than 12 months and six residential mortgage-backed securities, one collateralized mortgage obligation and one Small Business Administration (SBA) backed security, all of which were in a loss position for more than 12 months. Management believes the unrealized losses on the Company's investments in residential mortgage-backed, collateralized mortgage obligation and SBA backed securities were caused by interest rate changes. The contractual cash flows of those investments are guaranteed or supported by an agency or sponsored entity of the U.S. Government. Accordingly, it is expected that the securities would not be settled at a price less than the amortized cost of the Company's investment. Because the decline in market value is attributable to changes in interest rates and not credit quality, and because the Company does not intend to sell, and it is more likely than not that it will not be required to sell those investments until a recovery of fair value, which may be maturity, the Company does not consider those investments to be other-than-temporarily impaired at December 31, 2018.

**AVIDBANK HOLDINGS, INC. AND SUBSIDIARY**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
(Continued)

**2. AVAILABLE-FOR-SALE INVESTMENT SECURITIES (Continued)**

The amortized cost and estimated fair value of available-for-sale investment securities at December 31, 2018 by contractual maturity are shown below. Expected maturities will differ from contractual maturities because the issuers of the securities may have the right to call or prepay obligations with or without call or prepayment penalties. (in thousands)

	2018	
	Amortized Cost	Fair Value
Within one year	\$ -	\$ -
One to five years	6,170	6,133
Five to ten years	-	-
Beyond ten years	2,389	2,333
	8,559	8,466
Investment securities not due at a single maturity date: residential mortgage-backed securities	50,131	48,025
	\$ 58,690	\$ 56,491

No securities were pledged to the Federal Reserve for discount window borrowing at December 31, 2018 or December 31, 2017. No Investment securities were pledged to secure public deposits at December 31, 2018 or December 31, 2017.

**AVIDBANK HOLDINGS, INC. AND SUBSIDIARY**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
(Continued)

**3. LOANS**

Outstanding loans are summarized below: (in thousands)

	December 31	
	2018	2017
Commercial	\$ 289,747	\$ 239,240
Construction	162,960	143,586
Residential real estate	24,853	21,663
Commercial real estate	329,368	243,712
Consumer	1,107	1,112
	<u>808,035</u>	<u>649,313</u>
Total outstanding loans	808,035	649,313
Deferred loan origination fees, net	(696)	(1,040)
Allowance for loan losses	<u>(9,758)</u>	<u>(8,297)</u>
Total loans net of allowance for loan losses	<u>\$ 797,581</u>	<u>\$ 639,976</u>

Salaries and employee benefits totaling \$2,344,000, \$2,401,000 and \$1,874,000 have been deferred as loan origination costs for the years ended December 31, 2018, 2017 and 2016, respectively.

From time to time, the Bank pledges loans as collateral under a short-term borrowing arrangement through the Discount Window of the Federal Reserve Bank. The bank has pledged a total of \$217 million of loans for borrowing capacity of \$116 million at December 31, 2018. The bank had no borrowings outstanding as of December 31, 2018 (Note 8). The Bank has entered into a blanket lien agreement providing for the pledging of Call Report loan categories for borrowing capacity with the Federal Home Loan Bank. The bank has pledged a total of \$582 million of loans for borrowing capacity of \$287 million at December 31, 2018 (Note 8). The bank had no borrowings outstanding as of December 31, 2018 (Note 8).

**4. ALLOWANCE FOR LOAN LOSSES**

Changes in the allowance for loan losses during the years ended December 31, 2018, 2017 and 2016 were as follows: (in thousands)

	2018	2017	2016
Balance, beginning of year	\$ 8,297	\$ 6,244	\$ 5,394
Provision charged to operations	1,612	1,985	813
Losses charged to allowance	(151)	-	-
Recoveries	-	68	37
	<u>9,758</u>	<u>8,297</u>	<u>6,244</u>
Balance, end of year	<u>\$ 9,758</u>	<u>\$ 8,297</u>	<u>\$ 6,244</u>

**AVIDBANK HOLDINGS, INC. AND SUBSIDIARY**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
(Continued)

**4. ALLOWANCE FOR LOAN LOSSES** (Continued)

Allocation of the Allowance for Loan Losses by Portfolio Segment and Impairment Methodology as of and for the years ended December 31, 2018 and 2017: (in thousands)

	Commercial	Construction	Residential Real Estate	Commercial Real Estate	Consumer	Total
Allowance for loan losses:						
Balance, at January 1, 2017	\$ 2,570	\$ 1,434	\$ 121	\$ 2,090	\$ 29	\$ 6,244
Provision for loan losses	1,015	522	(3)	507	(56)	1,985
Loans charged-off	-	-	-	-	-	-
Recoveries	26	-	-	-	42	68
<hr/>						
Balance, at December 31, 2017	\$ 3,611	\$ 1,956	\$ 118	\$ 2,597	\$ 15	\$ 8,297
Provision for loan losses	752	(64)	43	891	(10)	1,612
Loans charged-off	(151)	-	-	-	-	(151)
Recoveries	-	-	-	-	-	-
<hr/>						
Balance, at December 31, 2018	\$ 4,212	\$ 1,892	\$ 161	\$ 3,488	\$ 5	\$ 9,758

**AVIDBANK HOLDINGS, INC. AND SUBSIDIARY**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
(Continued)

**4. ALLOWANCE FOR LOAN LOSSES** (Continued)

December 31, 2018	Commercial	Construction	Residential Real Estate	Commercial Real Estate	Consumer	Total
<u>Allowance for loan losses:</u>						
Ending balance	\$ 4,212	\$ 1,892	\$ 161	\$ 3,488	\$ 5	\$ 9,758
Ending balance: individually evaluated for impairment	\$ 461	\$ -	\$ -	\$ -	\$ -	\$ 461
Ending balance: collectively evaluated for impairment	\$ 3,751	\$ 1,892	\$ 161	\$ 3,488	\$ 5	\$ 9,297
<u>Loans:</u>						
Ending balance	\$ 289,747	\$ 162,960	\$ 24,853	\$ 329,368	\$ 1,107	\$ 808,035
Ending balance: individually evaluated for impairment	\$ 1,689	\$ -	\$ -	\$ -	\$ -	\$ 1,689
Ending balance: collectively evaluated for impairment	\$ 288,058	\$ 162,960	\$ 24,853	\$ 329,368	\$ 1,107	\$ 806,346

**AVIDBANK HOLDINGS, INC. AND SUBSIDIARY**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

(Continued)  
(dollars in thousands)

**4. ALLOWANCE FOR LOAN LOSSES** (Continued)

December 31, 2017	Commercial	Construction	Residential Real Estate	Commercial Real Estate	Consumer	Total
<u>Allowance for loan losses:</u>						
Ending balance	\$ 3,611	\$ 1,956	\$ 118	\$ 2,597	\$ 15	\$ 8,297
Ending balance: individually evaluated for impairment	\$ 614	\$ -	\$ -	\$ 97	\$ 13	\$ 711
Ending balance: collectively evaluated for impairment	\$ 3,010	\$ 1,956	\$ 118	\$ 2,500	\$ 2	\$ 7,586
<u>Loans:</u>						
Ending balance	\$ 239,240	\$ 143,586	\$ 21,663	\$ 243,712	\$ 1,112	\$ 649,313
Ending balance: individually evaluated for impairment	\$ 4,353	\$ -	\$ -	\$ 704	\$ 94	\$ 5,151
Ending balance: collectively evaluated for impairment	\$ 234,887	\$ 143,586	\$ 21,663	\$ 243,008	\$ 1,018	\$ 644,162



**AVIDBANK HOLDINGS, INC. AND SUBSIDIARY**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
(Continued)

**4. ALLOWANCE FOR LOAN LOSSES** (Continued)

Commercial Credit Exposure

Credit Risk Profile by Internally Assigned Grade as of December 31, 2018 (in thousands)

	Commercial	Construction	Residential Real Estate	Commercial Real Estate	Consumer	Total
Grade:						
Pass	\$ 279,823	\$ 160,785	\$ 24,434	\$ 329,368	\$ 1,107	\$ 795,518
Special Mention	8,235	2,175	-	-	-	10,410
Substandard-Non-Impaired	-	-	419	-	-	419
Substandard-Impaired	1,689	-	-	-	-	1,689
Total	<u>\$ 289,747</u>	<u>\$ 162,960</u>	<u>\$ 24,853</u>	<u>\$ 329,368</u>	<u>\$ 1,107</u>	<u>\$ 808,035</u>

Commercial Credit Exposure

Credit Risk Profile by Internally Assigned Grade as of December 31, 2017 (in thousands)

	Commercial	Construction	Residential Real Estate	Commercial Real Estate	Consumer	Total
Grade:						
Pass	\$ 226,864	\$ 142,241	\$ 21,374	\$ 239,604	\$ 1,019	\$ 631,103
Special Mention	6,523	1,345	-	3,405	-	11,272
Substandard-Non-Impaired	1,500	-	289	-	-	1,789
Substandard-Impaired	4,353	-	-	704	94	5,151
Total	<u>\$ 239,240</u>	<u>\$ 143,586</u>	<u>\$ 21,663</u>	<u>\$ 243,712</u>	<u>\$ 1,112</u>	<u>\$ 649,313</u>

**AVIDBANK HOLDINGS, INC. AND SUBSIDIARY**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
(Continued)

**4. ALLOWANCE FOR LOAN LOSSES** (Continued)

Past Due and Nonaccrual Loan Detail as of December 31, 2018  
(in thousands)

	30-89 Days Past Due	90 Days and Still Accruing	Nonaccrual	Total Past Due	Current	Total
Commercial	\$ -	\$ -	\$ 1,689	\$ 1,689	\$ 288,058	\$ 289,747
Construction	-	-	-	-	162,960	162,960
Residential Real Estate	-	-	-	-	24,853	24,853
Commercial Real Estate	-	-	-	-	329,368	329,368
Consumer	-	-	-	-	1,107	1,107
<b>Total</b>	<b>\$ -</b>	<b>\$ -</b>	<b>\$ 1,689</b>	<b>\$ 1,689</b>	<b>\$ 806,346</b>	<b>\$ 808,035</b>

Past Due and Nonaccrual Loan Detail as of December 31, 2017  
(in thousands)

	30-89 Days Past Due	90 Days and Still Accruing	Nonaccrual	Total Past Due	Current	Total
Commercial	\$ -	\$ -	\$ 4,353	\$ 4,353	\$ 234,887	\$ 239,240
Construction	-	-	-	-	143,586	143,586
Residential Real Estate	-	-	-	-	21,663	21,663
Commercial Real Estate	-	-	704	704	243,008	243,712
Consumer	-	-	94	94	1,018	1,112
<b>Total</b>	<b>\$ -</b>	<b>\$ -</b>	<b>\$ 5,151</b>	<b>\$ 5,151</b>	<b>\$ 644,162</b>	<b>\$ 649,313</b>

**AVIDBANK HOLDINGS, INC. AND SUBSIDIARY**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
(Continued)

**4. ALLOWANCE FOR LOAN LOSSES** (Continued)

Impaired Loan Detail with a Related Allowance as of December 31, 2018 (in thousands)

	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized	Interest Income Recognized on a Cash Basis
Commercial	\$ 1,740	\$ 1,689	\$ 461	\$ 1,716	\$ 69	\$ -
Construction	-	-	-	-	-	-
Residential Real Estate	-	-	-	-	-	-
Commercial Real Estate	-	-	-	-	-	-
Consumer	-	-	-	-	-	-
<b>Total</b>	<b>\$ 1,740</b>	<b>\$ 1,689</b>	<b>\$ 461</b>	<b>\$ 1,716</b>	<b>\$ 69</b>	<b>\$ -</b>

Impaired Loan Detail with a Related Allowance as of December 31, 2017 (in thousands)

	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized	Interest Income Recognized on a Cash Basis
Commercial	\$ 4,555	\$ 4,353	\$ 601	\$ 4,475	\$ -	\$ -
Construction	-	-	-	-	-	-
Residential Real Estate	-	-	-	-	-	-
Commercial Real Estate	727	704	97	733	-	-
Consumer	98	94	13	109	-	-
<b>Total</b>	<b>\$ 5,380</b>	<b>\$ 5,151</b>	<b>\$ 711</b>	<b>\$ 5,317</b>	<b>\$ -</b>	<b>\$ -</b>

The recorded investment in loans includes accrued interest receivable and loan origination fees, net. For purposes of this disclosure, the unpaid principal balance is not reduced for any related loan loss allowance.

As of December 31, 2018, the Company had no recorded investment in troubled debt restructuring. In 2017, the Company recorded an investment in troubled debt restructurings of \$446,000. The Company allocated \$62,000 of specific reserves for that loan at December 31, 2017. The Company has not committed to lend any additional amounts on loans identified as troubled debt restructurings.

**AVIDBANK HOLDINGS, INC. AND SUBSIDIARY**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
(Continued)

**5. PROPERTY AND EQUIPMENT**

Property and equipment consisted of the following: (in thousands)

	December 31,	
	2018	2017
Leasehold improvements	\$ 5,481	\$ 5,766
Furniture and equipment	1,859	1,335
Computer equipment	2,969	2,764
	<hr/>	<hr/>
Gross property and equipment	10,309	9,865
Less accumulated depreciation and amortization	4,586	3,919
	<hr/>	<hr/>
Property and equipment, net	<u>\$ 5,723</u>	<u>\$ 5,946</u>

Depreciation included in occupancy and equipment expense totaled \$1,227,000, \$383,000 and \$368,000 for the years ended December 31, 2018, 2017 and 2016, respectively.

**6. INTEREST-BEARING DEPOSITS**

Interest-bearing deposits consisted of the following: (in thousands).

	December 31,	
	2018	2017
NOW accounts	\$ 25,377	\$ 16,555
Savings	8,078	9,822
Money market	259,107	233,375
Time, \$250,000 or more	116,621	81,619
Other time	20,563	29,111
	<hr/>	<hr/>
Total interest-bearing deposits	<u>\$ 429,746</u>	<u>\$ 370,482</u>

**AVIDBANK HOLDINGS, INC. AND SUBSIDIARY**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
(Continued)

**6. INTEREST-BEARING DEPOSITS (Continued)**

Time deposits that meet or exceed the FDIC insurance limit of \$250,000 at year-end 2018 and 2017 were \$116,621,000 and \$81,619,000.

Scheduled maturities of time deposits for the next five years were as follows: (in thousands)

Year Ending <u>December 31,</u>	
2019	\$ 117,633
2020	12,413
2021	4,164
2022 and after	2,974
Total time deposits	<u>\$ 137,184</u>

Interest expense recognized on interest-bearing deposits for the years ended December 31, 2018, 2017 and 2016 consisted of the following: (in thousands)

	<u>2018</u>	<u>2017</u>	<u>2016</u>
NOW accounts	\$ 57	\$ 36	\$ 32
Savings	17	16	17
Money market	814	544	522
Time, \$250,000 or more	1,787	856	552
Other time	<u>283</u>	<u>275</u>	<u>12</u>
Total interest on deposits	<u>\$ 2,958</u>	<u>\$ 1,727</u>	<u>\$ 1,135</u>

At December 31, 2018 the Company had two deposit relationships that exceeded 5% of total deposits. At \$44.3 million and \$44.0 million, they represented 5.6% and 5.5% of total deposits, respectively. At December 31, 2017 the Company had no deposit relationships that exceeded 5% of total deposits.

**AVIDBANK HOLDINGS, INC. AND SUBSIDIARY**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
(Continued)  
(dollars in thousands)

**7. INCOME TAXES**

The provision for income taxes for the years ended December 31, 2018, 2017 and 2016 consisted of the following: (in thousands)

2018	Federal	State	Total
Current	\$ 1,936	\$ 1,243	\$ 3,179
Deferred	811	334	1,145
	<u>\$ 2,747</u>	<u>\$ 1,577</u>	<u>\$ 4,324</u>
Provision for income taxes			
	<u>\$ 2,747</u>	<u>\$ 1,577</u>	<u>\$ 4,324</u>
2017	Federal	State	Total
Current	\$ 3,569	\$ 1,191	\$ 4,760
Deferred	461	(42)	419
	<u>\$ 4,030</u>	<u>\$ 1,149</u>	<u>\$ 5,179</u>
Provision for income taxes			
	<u>\$ 4,030</u>	<u>\$ 1,149</u>	<u>\$ 5,179</u>
2016	Federal	State	Total
Current	\$ 2,713	\$ 849	\$ 3,562
Deferred	54	(4)	50
	<u>\$ 2,767</u>	<u>\$ 845</u>	<u>\$ 3,612</u>
Provision for income taxes			
	<u>\$ 2,767</u>	<u>\$ 845</u>	<u>\$ 3,612</u>

**AVIDBANK HOLDINGS, INC. AND SUBSIDIARY**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

(Continued)  
(dollars in thousands)

**7. INCOME TAXES** (Continued)

Deferred tax assets (liabilities) at December 31, 2018 and 2017 consisted of the following: (in thousands)

	2018	2017
Deferred tax assets:		
Allowance for loan losses	\$ 2,994	\$ 2,434
State tax	384	259
Fixed assets	-	33
Deferred rent	231	-
Accrued expenses	832	762
Other	87	22
Unrealized loss on available for sale investment securities	650	335
Share-base compensation	446	172
Total deferred tax assets	\$ 5,624	\$ 4,017
Deferred tax liabilities:		
Other	\$ (376)	\$ (453)
Fixed assets	(82)	-
Loan origination costs	(821)	(679)
Total deferred tax liabilities	(1,279)	(1,132)
Net deferred tax asset	\$ 4,345	\$ 2,885

**AVIDBANK HOLDINGS, INC. AND SUBSIDIARY**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
(Continued)  
(dollars in thousands)

**7. INCOME TAXES** (Continued)

The provision for income taxes differs from amounts computed by applying the statutory Federal income tax rate to income before income taxes. The effects of these differences are as follows:

	Years Ended December 31,					
	2018		2017		2016	
	Amount	Rate %	Amount	Rate %	Amount	Rate %
Federal income tax expense, at statutory rate	\$ 3,243	21.0%	\$ 3,678	34.0%	\$ 3,697	34.0%
State franchise tax expense, net of Federal tax expense	1,246	8.1%	759	7.0%	558	5.1%
Share-based compensation	(110)	-0.7%	(246)	-2.2%	(15)	-0.1%
Tax-exempt income from life insurance policies	(57)	-0.4%	(97)	-0.9%	(107)	-1.0%
Life insurance - death benefit	-	0.0%	-	0.0%	(500)	-4.6%
Meals and Entertainment	21	0.1%	13	0.1%	17	0.2%
Low Income Housing Credit	(68)	-0.4%	(96)	-0.9%	(100)	-0.9%
Change in tax rate	-	0.0%	1,101	10.2%	-	-
Other	49	0.3%	67	0.6%	62	0.5%
Total income tax expense	\$ 4,324	28.0%	\$ 5,179	47.9%	\$ 3,612	33.2%

The total amount of unrecognized tax benefits, related to potentially uncertain tax positions, including interest and penalties, at December 31, 2018 or 2017, was not considered significant for disclosure purposes. The amount of tax benefits that would impact the effective rate, if recognized, is not expected to be material. In 2017 the Company incurred an additional \$1.1 million in income tax expense and a corresponding reduction to our deferred tax asset due to a reduction in the federal income tax rate resulting from the Tax Cuts and Job Act of 2017. The Company does not anticipate any significant changes with respect to unrecognized tax benefits within the next twelve months.

Status of Open Tax Years

The Company is subject to U.S. Federal income tax as well as California state income tax. Federal income tax returns for 2015 through 2017 and California income tax returns for 2014 through 2017 are currently open for Federal or state income tax examinations.



**AVIDBANK HOLDINGS, INC. AND SUBSIDIARY**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
(Continued)

**8. SUBORDINATED DEBT AND OTHER BORROWING ARRANGEMENTS**

On November 12, 2015, the Company issued \$12,000,000 in ten-year, fixed-to-floating rate subordinated notes to certain qualified institutional accredited investors. The subordinated notes have a maturity date of November 15, 2025 and bear interest at the rate of 6.875% per annum, payable semiannually, for the first five years of the term, and then at a variable rate that will reset quarterly to a level equal to the then current 3-month LIBOR plus 536.7 basis points over the remainder of the term. The notes are redeemable after five years subject to satisfaction of certain conditions. The indebtedness evidenced by the subordinated notes, including principal and interest, is unsecured and subordinate and junior to general and secured creditors and depositors. On the balance sheet the subordinated notes are carried net of debt issuance costs of \$422,000 less accumulated depreciation of \$267,000 as of December 31, 2018.

The Company had unsecured Federal Funds lines of credit totaling \$11,000,000 with its correspondent banks at December 31, 2018 and December 31, 2017. There were no borrowings outstanding under these agreements at December 31, 2018 and 2017.

The Company has a short-term borrowing arrangement with the Federal Reserve Bank through the Discount Window. The Company currently has a blanket lien on certain loans to secure borrowings. The borrowing capacity under the agreement varies depending on the amount of loans pledged. There were no borrowings outstanding under the agreement at December 31, 2018 or 2017.

As a member of the Federal Home Loan Bank (FHLB) of San Francisco, the Bank is eligible to use the FHLB's facilities for short and long term borrowing. Borrowing capacity is based on the amount of stock ownership in the FHLB and all borrowings are based on pledged assets or a blanket lien against certain Call Report loan categories. At December 31, 2017 there were \$30 million in open ended advances outstanding. There were no borrowings outstanding from the FHLB at December 31, 2018. The borrowing capacity at December 31, 2018 was \$287,000,000 based on a blanket lien based on Call Report loan categories.

**9. COMMITMENTS AND CONTINGENCIES**

Operating Leases

The Company leases its branch and its administrative offices in San Jose under a noncancellable operating lease. The lease expires in 2027 and has one five-year renewal option. The Company also leases office space for a branch office in Palo Alto and loan production offices in Redwood City and San Francisco, California. The Palo Alto branch office lease expires in 2027 and has one five year renewal option. The Redwood City loan production office lease expires in 2019 and has one three-year renewal option. The San Francisco loan production office lease expires in 2023 and has one three-year renewal option.

**AVIDBANK HOLDINGS, INC. AND SUBSIDIARY**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
(Continued)

**9. COMMITMENTS AND CONTINGENCIES (continued)**

The following is a schedule by year of future minimum rental payments required under operating leases that have initial or remaining noncancellable lease terms in excess of one year as of December 31, 2018: (in thousands)

<u>December 31,</u>	<u>Leases</u>
2019	\$ 1,952
2020	1,891
2021	1,948
2022	2,006
Thereafter	<u>8,909</u>
	<u>\$ 16,706</u>

Net rent expense included in occupancy and equipment expense totaled \$2,207,000, \$1,925,000, and \$1,361,000 for the years ended December 31, 2018, 2017 and 2016, respectively. The Company recognized no sublease income for the years ended December 31, 2018 or 2017. Sublease income totaled \$6,000 for the year ended December 31, 2016.

Federal Reserve Requirements

Banks are required to maintain reserves with the Federal Reserve Bank equal to a percentage of their reservable deposits. The amount of such reserve balances required at December 31, 2018 was \$4,535,000.

Financial Instruments With Off-Balance-Sheet Risk

The Company 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 customers 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 Company'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 Company uses the same credit policies in making commitments and standby letters of credit as it does for loans included on the balance sheet.

The following financial instruments represent off-balance-sheet credit risk: (in thousands)

	<u>December 31,</u>	
	<u>2018</u>	<u>2017</u>
Commitments to extend credit	\$ 284,539	\$ 283,544
Standby letters of credit	\$ 8,849	\$ 6,261

**AVIDBANK HOLDINGS, INC. AND SUBSIDIARY**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
(Continued)

**9. COMMITMENTS AND CONTINGENCIES (continued)**

Commitments to extend credit consist primarily of unfunded single-family residential and commercial real estate construction loans and commercial revolving lines of credit. Construction loans are established under standard underwriting guidelines and policies and are secured by deeds of trust, with disbursements made over the course of construction. Commercial revolving lines of credit have a high degree of industry diversification. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Since many of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements.

Standby letters of credit are generally secured and are issued by the Bank to guarantee the performance of a customer 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 customers. The fair value of the liability related to these standby letters of credit, which represents the fees received for issuing the guarantees, was not significant at December 31, 2018 and 2017. The Company recognizes these fees as revenue over the term of the commitment or when the commitment is used.

Significant Concentrations of Credit Risk

The Company grants real estate mortgage, real estate construction, commercial and consumer loans primarily to customers in the California counties of San Mateo, San Francisco and Santa Clara. Although the Company has a diversified loan portfolio, a substantial portion of its portfolio is secured by commercial and residential real estate. Management believes the loans within this concentration have no more than the normal risk of collectability. However, a substantial decline in real estate values in the Company's primary market area could have an adverse impact on the collectability of these loans. Personal and business income represent the primary sources of repayment for a majority of these loans and management believes the risks presented by the concentration are further mitigated by diversification of property types within the Company's real estate portfolio and by conservative underwriting.

At December 31, 2018, in management's judgment, a concentration of loans existed in construction and real estate related loans. At that date, approximately 64% of the Company's loans were construction and real estate related, representing 20.2% and 43.8% of total outstanding loans, respectively.

At December 31, 2017, in management's judgment, a concentration of loans existed in construction and real estate related loans. At that date, approximately 63.1% of the Company's loans were construction and real estate related, representing 22.1% and 41.0% of total outstanding loans, respectively.

Contingencies

The Company is subject to legal proceedings and claims which arise in the ordinary course of business. In the opinion of management, the amount of ultimate liability with respect to such actions will not materially affect the consolidated financial position or results of operations of the Company.

**AVIDBANK HOLDINGS, INC. AND SUBSIDIARY**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

(Continued)

**10. SHAREHOLDERS' EQUITY**

Dividends

The Company's ability to pay cash dividends is dependent on dividends paid to it by the Bank, if any, and limited by California law. Under California law, the holders of common stock of the Company are entitled to receive dividends when and as declared by the Board of Directors, out of funds legally available, subject to certain restrictions. California General Corporation Law prohibits the Company from paying dividends on its common stock unless: (i) its retained earnings, immediately prior to the dividend payment, equals or exceeds the amount of the dividend or (ii) immediately after giving effect to the dividend, the sum of the Company's assets (exclusive of goodwill and deferred charges) would be at least equal to 125% of its liabilities (not including deferred taxes, deferred income and other deferred liabilities) and the current assets of the Company would be at least equal to its current liabilities, or, if the average of its earnings before taxes on income and before interest expense for the two preceding fiscal years was less than the average of its interest expense for the two preceding fiscal years, at least equal to 125% of its current liabilities.

Dividends paid from the Bank to the Company are restricted under certain Federal laws and regulations governing banks. In addition, the California Financial Code restricts the total dividend payment of any bank in any one 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, without the prior approval of the California Department of Business Oversight. At December 31, 2018, \$26,034,000 was free of such restrictions.

Common Stock Offering

On July 13, 2017 the Company issued 1,053,242 shares of its common stock totaling \$19,023,000, net of issuance costs of \$989,000 for general corporate purposes.

**AVIDBANK HOLDINGS, INC. AND SUBSIDIARY**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
(Continued)

**10. SHAREHOLDERS' EQUITY (Continued)**

Earnings Per Common Share

A reconciliation of the numerators and denominators of the basic and diluted earnings per common share computations for the years ended December 31, 2018, 2017 and 2016 is shown below:

(\$ in thousands, except the per share amounts)

	Net Income	Net Income Available to Common Shareholders	Weighted Average Number of Shares Outstanding	Per Share Amount
<u>December 31, 2018</u>				
Basic income per common share	\$ 11,120	\$ 11,120	5,751,400	<u>\$ 1.93</u>
Effect of dilutive options			115,001	-
Diluted income per common share	<u>\$ 11,120</u>	<u>\$ 11,120</u>	<u>5,866,401</u>	<u>\$ 1.90</u>
<u>December 31, 2017</u>				
Basic income per common share	\$ 5,654	\$ 5,654	5,138,604	<u>\$ 1.10</u>
Effect of dilutive options			104,441	-
Diluted income per common share	<u>\$ 5,654</u>	<u>\$ 5,654</u>	<u>5,243,045</u>	<u>\$ 1.08</u>
<u>December 31, 2016</u>				
Basic income per common share	\$ 7,263	\$ 3,681	4,521,392	<u>\$ 1.61</u>
Effect of dilutive options			135,321	-
Diluted income per common share	<u>\$ 7,263</u>	<u>\$ 3,681</u>	<u>4,656,713</u>	<u>\$ 1.56</u>

There were no options excluded from the calculation of diluted earnings per share in 2018, 2017 and 2016.

**AVIDBANK HOLDINGS, INC. AND SUBSIDIARY**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
(Continued)

**10. SHAREHOLDERS' EQUITY (Continued)**

Regulatory Capital

Banks and bank holding companies 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 Company on January 1, 2015 with full compliance with all of the requirements being phased in over a multi-year schedule, and fully phased in by January 1, 2019. Under the Basel III rules, the Company must hold a capital conservation buffer above the adequately capitalized risk-based capital ratios. The capital conservation buffer is being phased in from 0.0% for 2015 to 2.50% by 2019. The capital conservation buffer for 2018 is 1.875% and for 2017 is 1.25%. The net unrealized gain or loss on available for sale securities is not included in computing regulatory capital. Management believes as of December 31, 2018, the Company and the Bank meet all capital adequacy requirements to which they are subject.

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 2018 and 2017, 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.

**AVIDBANK HOLDINGS, INC. AND SUBSIDIARY**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
(Continued)

**10. SHAREHOLDERS' EQUITY** (Continued)

Regulatory Capital (Continued)

Actual and required capital amounts (in thousands) and ratios, exclusive of the capital conservation buffer are presented below at December 31, 2018 and 2017:

	2018		2017	
	Amount	Ratio	Amount	Ratio
<u>Leverage Ratio</u>				
Avidbank	\$ 105,370	11.19%	\$ 84,337	10.76%
Minimum requirement for "Well-Capitalized" institution	\$ 47,062	5.00%	\$ 39,199	5.00%
Minimum regulatory requirement	\$ 37,649	4.00%	\$ 31,360	4.00%
<u>Common Equity Tier I</u>				
Avidbank	\$ 105,370	10.74%	\$ 84,337	10.07%
Minimum requirement for "Well-Capitalized" institution	\$ 58,868	6.00%	\$ 50,273	6.00%
Minimum regulatory requirement	\$ 44,151	4.50%	\$ 37,705	4.50%
<u>Tier 1 Risk-Based Capital Ratio</u>				
Avidbank	\$ 105,370	10.74%	\$ 84,337	10.07%
Minimum requirement for "Well-Capitalized" institution	\$ 78,490	8.00%	\$ 67,031	8.00%
Minimum regulatory requirement	\$ 58,868	6.00%	\$ 50,273	6.00%
<u>Total Risk-Based Capital Ratio</u>				
Avidbank	\$ 115,497	11.77%	\$ 93,004	11.10%
Minimum requirement for "Well-Capitalized" institution	\$ 98,113	10.00%	\$ 83,788	10.00%
Minimum regulatory requirement	\$ 78,490	8.00%	\$ 67,031	8.00%

**AVIDBANK HOLDINGS, INC. AND SUBSIDIARY**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
(Continued)

**11. SHARE-BASED PAYMENT**

Equity Incentive Awards

Under the 2013 Equity Incentive Plan, the Company is able to provide stock-based awards to employees, directors, and contractors. Awards under the 2013 Equity Incentive Plan may be in the form of, but not limited to, the following: stock options, restricted stock or units, performance based shares or units, and other stock-based awards as determined by the Board of Directors. The 2013 Equity Incentive Plan specifies that the option price may not be less than the fair market value of the stock at the date the option is granted, and that the stock must be paid for in full at the time the option is exercised. All options expire on a date determined by the Board of Directors, but not later than five years from the date of grant. Upon grant, options vest ratably over a four year period.

There were no options granted in 2018 and 2017. As of December 31, 2018, there were 397,254 remaining shares available to be granted as options or restricted stock among other forms of equity compensation under the 2013 Equity Incentive Plan.



**AVIDBANK HOLDINGS, INC. AND SUBSIDIARY**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
(Continued)

**11. SHARE-BASED PAYMENT (Continued)**

Stock Options (Continued)

A summary of option activity under the Plan for the years ended December 31, 2018 and 2017 follows:

	Number of Stock Options Outstanding	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term ( in Years)	Aggregate Intrinsic Value
Options outstanding at January 1, 2017	185,275	\$ 9.85	1.28 years	\$ 1,527,738
Options granted	-	\$ -		
Options exercised	(99,375)	9.15		
Options forfeited	(250)	10.50		
Options outstanding at December 31, 2017	85,650	\$ 10.68	0.98 years	\$ 1,136,993
Options granted	-	\$ -		
Options exercised	(75,650)	10.57		
Options forfeited	-	-		
Options outstanding at December 31, 2018	10,000	\$ 10.57	0.81 years	\$ 95,500
Options vested or expected to vest at December 31, 2018	10,000	\$ 10.57	0.81 years	\$ 95,500
Options exercisable at December 31, 2018	10,000	\$ 10.57	0.81 years	\$ 95,500

The Company determines the fair value of options on the date of grant using a Black-Scholes option pricing model that uses assumptions based on expected option life, the level of estimated forfeitures, expected stock volatility and the risk-free interest rate. Stock volatility is based on the historical volatility of the Company's stock. The risk-free rate is based on the U.S. Treasury yield curve and the expected term of the options. There were no options granted in 2018 or 2017.

**AVIDBANK HOLDINGS, INC. AND SUBSIDIARY**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
(Continued)

**11. SHARE-BASED PAYMENT (Continued)**

Stock Options (Continued)

Options in the amount of 75,650 were exercised in 2018 with cash proceeds received of \$799,825. In addition, 30,910 shares were net settled for \$480,372 as part of net exercises of options. Options in the amount of 99,375 were exercised in 2017 with cash proceeds received of \$908,790. In addition, 48,547 shares were net settled for \$941,333 as part of net exercises of options. Options in the amount of 300,875 were exercised in 2016 with cash proceeds received of \$2,108,850. The intrinsic value of options exercised in 2018, 2017 and 2016 was \$1,037,535, \$1,061,591 and \$2,404,804, respectively. The tax benefit recognized from stock option exercises in 2018 was \$480,690 and in 2017 was \$244,657.

A summary of the status of the Company's non-vested options as of December 31, 2018 and changes during the year ended December 31, 2018, is presented below:

	Options	Weighted Average Exercise Price
Non-vested options		
Non-vested at January 1, 2018	2,500	\$ 11.45
New options granted	-	-
Vested	(2,500)	11.45
Forfeited	-	-
	<u>-</u>	<u>-</u>
Non-vested at December 31, 2018	<u>-</u>	<u>\$ -</u>

As of December 31, 2018, there was no unrecognized compensation cost related to non-vested stock option awards.

**AVIDBANK HOLDINGS, INC. AND SUBSIDIARY**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
(Continued)

**11. SHARE-BASED PAYMENT (Continued)**

Restricted Common Stock Awards

The 2013 Equity Incentive Plan provides for the issuance of restricted stock to directors and officers. Restricted common stock grants typically vest over a three-year period. Restricted common stock (all of which are shares of our common stock) is subject to forfeiture if employment terminates prior to vesting. The cost of these awards is recognized over the vesting period of the awards based on the fair value of our common stock on the date of the grant.

The following table summarizes restricted stock activity for the year ended December 31, 2018:

	Shares	Weighted Average Grant Date Fair Value
Non-vested shares at January 1, 2018	165,276	\$ 17.15
Granted	61,325	24.35
Vested	(3,395)	12.45
Forfeited	(30,352)	18.12
Non-vested shares at December 31, 2018	<u>192,854</u>	<u>\$ 19.37</u>

During the year ended December 31, 2018, 61,325 shares of restricted common stock were granted from the 2013 Equity Incentive Plan. Offsetting the 61,325 grants were 709 shares withheld to cover taxes, in addition to 30,352 shares forfeited due to terminations that resulted in net restricted stock issued of 30,264 shares. The restricted common stock had a weighted average fair value of \$24.35 per share on the date of grant. The restricted shares granted have a three-year cliff vesting period, with all shares vesting on the three year anniversary date.

As of December 31, 2018, there were 192,854 shares of restricted stock that were nonvested and expected to vest. Share-based compensation cost charged against income for restricted stock awards was \$980,867, \$823,726, and \$337,492 for the years ended December 31, 2018, 2017 and 2016, respectively.

As of December 31, 2018, there was \$1,779,539 of total unrecognized compensation cost related to nonvested restricted common stock. Restricted stock compensation expense is recognized on a straight-line basis over the vesting period. This cost is expected to be recognized over a weighted average remaining period of 1.8 years and will be adjusted for subsequent changes in estimated forfeitures.

**AVIDBANK HOLDINGS, INC. AND SUBSIDIARY**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
(Continued)

**12. EMPLOYEE 401(k) PROFIT SHARING PLAN**

The Company has a 401(k) profit sharing plan. All employees 21 years of age or older become eligible to participate in the plan on the first day of the month following employment with the Bank. Eligible employees may elect to make tax deferred contributions of their salary up to the maximum amount allowed by law. The Bank may make additional contributions to the plan at the discretion of the Board of Directors. Bank contributions vest at a rate of 25% annually for all employees. Bank contributions for the years ended December 31, 2018, 2017 and 2016 totaled \$290,000, \$250,000 and \$211,000, respectively.

**13. RELATED PARTY TRANSACTIONS**

During the normal course of business, the Company enters into transactions with related parties, including directors and officers. The following is a summary of the aggregate activity involving related party borrowers during 2018: (in thousands)

Balance, January 1, 2018	\$ 150
Additions	120
Amounts repaid	<u>(150)</u>
Balance, December 31, 2018	<u>\$ 120</u>
Undisbursed commitments to related parties, December 31, 2018	<u>\$ 35</u>

**AVIDBANK HOLDINGS, INC. AND SUBSIDIARY**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
(Continued)

**14. OTHER EXPENSES**

Other expenses for the years ended December 31, 2018, 2017 and 2016 consisted of the following:  
(in thousands)

	<u>2018</u>	<u>2017</u>	<u>2016</u>
Data processing	\$ 1,117	\$ 939	\$ 854
Advertising and marketing	526	324	390
Supplies and printing	55	45	51
Professional fees	512	323	394
Legal fees	241	37	(56)
Director's fees and expenses	430	403	312
Insurance and bonding	99	77	86
FDIC and DBO assessments	764	728	488
Credit reports and appraisals	70	32	32
Correspondent bank charges	509	425	425
Other	668	799	694
	<u>668</u>	<u>799</u>	<u>694</u>
Total other expenses	<u>\$ 4,991</u>	<u>\$ 4,132</u>	<u>\$ 3,670</u>

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Continued)

### 15. FAIR VALUE

The Company discloses the fair value of financial instruments for which it is practicable to estimate that value. Although management uses its best judgment in estimating fair value, there are inherent weaknesses in any estimates that are made at a discrete point in time based on relevant market data, information about the financial instruments, and other factors. Estimates of fair value of instruments without quoted market prices are subjective in nature and involve various assumptions and estimates that are matters of judgment. Changes in the assumptions used could significantly affect these estimates.

#### *Fair Value Hierarchy*

The Bank groups its assets and liabilities measured at fair value in three levels, based on the markets in which the assets and liabilities are traded and the reliability of the assumptions used to determine fair value. Valuations within these levels are based upon:

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.

Management monitors the availability of observable market data to assess the appropriate classification of financial instruments within the fair value hierarchy. Changes in economic conditions or model-based valuation techniques may require the transfer of financial instruments from one fair value level to another. In such instances, the transfer is reported at the beginning of the reporting period.

Management evaluates the significance of transfers between levels based upon the nature of the financial instrument and size of the transfer relative to total assets, total liabilities or total earnings.

Methods and assumptions used to estimate the fair value of each major classification of financial instruments were:

Cash and cash equivalents and Federal Funds sold: The current carrying amount approximates estimated fair value resulting in a Level 1 classification.

FHLB stock: It is not practical to determine the fair value of FHLB stock due to restrictions placed on its transferability.

Available-for-sale investment securities and interest-bearing deposits in other banks: For available-for-sale investment securities and interest-bearing deposits in other banks, fair values are based on quoted market prices, where available (Level 1 classification). If quoted market prices are not available, fair values are estimated using quoted market prices for similar securities and deposits and indications of value provided by brokers (Level 2 classification).

**AVIDBANK HOLDINGS, INC. AND SUBSIDIARY**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
(Continued)

**15. FAIR VALUE** (Continued)

Loans — Fair values of loans are estimated as follows: For variable rate loans that reprice frequently and with no significant change in credit risk, fair values are based on carrying values resulting in a Level 3 classification. Fair values for other loans are estimated using discounted cash flow analyses, using interest rates currently being offered for loans with similar terms to borrowers of similar credit quality resulting in a Level 3 classification. Impaired loans are initially valued at the lower of cost or fair value. Impaired loans carried at fair value generally receive specific allocations of the allowance for credit losses. For collateral dependent real estate loans, fair value is commonly based on recent real estate appraisals. These appraisals may utilize a single valuation approach or a combination of approaches including comparable sales and the income approach. Adjustments are routinely made in the appraisal process by the independent appraisers to adjust for differences between the comparable sales and income data available. Such adjustments are usually significant and typically result in a Level 3 classification of the inputs for determining fair value. Non-real estate collateral may be valued using an appraisal, net book value per the borrower's financial statements, or aging reports, adjusted or discounted based on management's historical knowledge, changes in market conditions from the time of the valuation, and management's expertise and knowledge of the client and client's business, resulting in a Level 3 fair value classification. Impaired loans are evaluated on a quarterly basis for additional impairment and adjusted accordingly. The estimated fair values of financial instruments disclosed above as of December 31, 2018 follow the guidance in ASU 2016-01 which prescribes an "exit price" approach in estimating and disclosing fair value of financial instruments incorporating discounts for credit, liquidity, and marketability factors. The fair values shown as of December 31, 2017 use an "entry price" approach.

The carrying amounts of accrued interest receivable and payable are consistent with the asset/liability they are associated with.

Customer deposits: The fair values disclosed for demand deposits (e.g., interest and non-interest checking, passbook savings, and certain types of money market accounts) are, by definition, equal to the amount payable on demand at the reporting date (i.e., their carrying amount) resulting in a Level 1 classification. The carrying amounts of variable rate, fixed-term money market accounts and certificates of deposit approximate their fair values at the reporting date resulting in a Level 2 classification. Fair values for fixed rate certificates of deposit are estimated using a discounted cash flows calculation that applies interest rates currently being offered on certificates to a schedule of aggregated expected monthly maturities on time deposits resulting in a Level 2 classification. The intangible value of long term relationships with depositors is not taken into account in estimating the fair values disclosed. Management believes that the Bank's non-term accounts, as a continuing source of less costly funds, provide significant additional value to the Bank that is not reflected below. The fair value of deposits with a stated maturity is based on the present value of contractual cash flows discounted by the replacement rates for securities with similar remaining maturities.

Other borrowings: The carrying amounts of other borrowings generally mature within thirty days and therefore approximate their fair values resulting in a Level 1 classification.

Subordinated Debt: The fair values of the Company's Subordinated Debentures are estimated using discounted cash flow analyses based on the current borrowing rates for similar types of borrowing arrangements resulting in a Level 3 classification.

Commitments to extend credit: The majority of the Bank's commitments to extend credit carry current market interest rates if converted to loans. Because these commitments are generally unassignable by either the Bank or the borrower, they have value only to the Bank and the borrower. The estimated fair value of the Bank's commitments to extend credit, including letters of credit, approximates the recorded deferred fee amounts and was not material at December 31, 2018 or 2017.

**AVIDBANK HOLDINGS, INC. AND SUBSIDIARY**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

(Continued)

(dollars in thousands)

**15. FAIR VALUE** (Continued)

The carrying amounts and estimated fair values of financial instruments, at December 31, 2018 and December 31, 2017 are as follows:

	Carrying Amount	Fair Value Measurements at December 31, 2018 Using:			Total
		Level 1	Level 2	Level 3	
<b>Financial assets:</b>					
Cash and due from banks	\$ 19,252	\$ 19,252	\$ -	\$ -	\$ 19,252
Federal funds sold	8,400	8,400	-	-	8,400
Available-for-sale investment securities	56,491	-	56,491	-	56,491
Loans	797,581	-	-	778,872	778,872
Federal Home Loan Bank stock	3,034	NA	NA	NA	NA
Accrued interest receivable	2,398	-	265	2,133	2,398

<b>Financial liabilities:</b>					
Deposits	796,597	659,413	138,043	-	797,456
Subordinated debt	11,845	-	-	11,845	11,845
Accrued interest payable	733	138	595	-	733

	Carrying Amount	Fair Value Measurements at December 31, 2017 Using:			Total
		Level 1	Level 2	Level 3	
<b>Financial assets:</b>					
Cash and due from banks	\$ 10,650	\$ 10,650	\$ -	\$ -	\$ 10,650
Federal funds sold	22,710	22,710	-	-	22,710
securities	74,364	-	74,364	-	74,364
Loans	639,976	-	-	627,724	627,724
Federal Home Loan Bank stock	5,130	NA	NA	NA	NA
Accrued interest receivable	2,012	-	325	1,687	2,012

<b>Financial liabilities:</b>					
Deposits	646,407	535,678	111,256	-	646,934
Federal Home Loan Bank advances	30,000	30,000	-	-	30,000
Subordinated debt	11,761	-	-	11,761	11,761
Accrued interest payable	428	138	290	-	428



**AVIDBANK HOLDINGS, INC. AND SUBSIDIARY**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
(Continued)

**15. FAIR VALUE** (Continued)

Assets Recorded at Fair Value

The following tables present information about the company's assets and liabilities measured at fair value on a recurring and nonrecurring basis as of December 31, 2018 and December 31, 2017:

*Recurring Basis*

The Company is required or permitted to record the following assets at fair value on a recurring basis as follows: (in thousands)

Description	2018			
	Fair Value	Level 1	Level 2	Level 3
U.S. Treasuries and Agencies	\$ 2,333	\$ -	\$ 2,333	\$ -
U.S. Govt. Sponsored Agencies	-	-	-	-
Residential Mortgage-Backed Securities	48,025	-	48,025	-
Corporate Debt Securities	6,133	-	6,133	-
Available-for-sale securities	<u>\$ 56,491</u>	<u>\$ -</u>	<u>\$ 56,491</u>	<u>\$ -</u>

Description	2017			
	Fair Value	Level 1	Level 2	Level 3
U.S. Treasuries and Agencies	\$ 2,953	\$ -	\$ 2,953	\$ -
U.S. Govt. Sponsored Agencies	-	-	-	-
Residential Mortgage-Backed Securities	56,690	-	56,690	-
Corporate Debt Securities	14,721	-	14,721	-
Available-for-sale securities	<u>\$ 74,364</u>	<u>\$ -</u>	<u>\$ 74,364</u>	<u>\$ -</u>

Fair values for available-for-sale investment securities are based on quoted market prices for similar securities (Level 2). During the years ended December 31, 2018 and December 31, 2017, there were no significant transfers in or out of Levels 1,2 or 3.

**AVIDBANK HOLDINGS, INC. AND SUBSIDIARY**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
(Continued)

**15. FAIR VALUE** (Continued)

Assets Recorded at Fair Value (cont.)

*Non-recurring Basis*

The Company may be required, from time to time, to measure certain assets and liabilities at fair value on a non-recurring basis. These include the following assets and liabilities that are measured at the lower of cost or fair value that were recognized at fair value which was below cost at December 31, 2018 and 2017. (in thousands)

	2018			
	Fair Value	Level 1	Level 2	Level 3
Collateral dependent impaired loans:				
Commercial and industrial	\$ 1,228	\$ -	\$ -	\$ 1,228
Commercial Real Estate	-	-	-	-
Consumer/installment	-	-	-	-
Total collateral dependent impaired loans:	1,228	-	-	1,228
Total assets measured at fair value on a non-recurring basis	<u>\$ 1,228</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 1,228</u>
	2017			
	Fair Value	Level 1	Level 2	Level 3
Collateral dependent impaired loans:				
Commercial and industrial	\$ 3,752	\$ -	\$ -	\$ 3,752
Commercial Real Estate	607	-	-	607
Consumer/installment	81	-	-	81
Total collateral dependent impaired loans:	4,440	-	-	4,440
Total assets measured at fair value on a non-recurring basis	<u>\$ 4,440</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 4,440</u>

**AVIDBANK HOLDINGS, INC. AND SUBSIDIARY**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
(Continued)

**15. FAIR VALUE** (Continued)

Assets Recorded at Fair Value (cont.)

*Non-recurring Basis (cont.)*

At the time a loan is considered impaired, it is valued at the lower of cost or fair value. Impaired loans carried at fair value generally receive specific allocations of the allowance for credit losses. For collateral dependent loans, fair value is commonly based on recent real estate appraisals. These appraisals may utilize a single valuation approach or a combination of approaches including comparable sales and the income approach. Adjustments are routinely made in the appraisal process by the independent appraisers to adjust for differences between the comparable sales and income data available. Such adjustments are usually significant and typically result in a Level 3 classification of the inputs for determining fair value. Non-real estate collateral may be valued using an appraisal, net book value per the borrower's financial statements, or aging reports, adjusted or discounted based on management's historical knowledge, changes in market conditions from the time of the valuation, and management's expertise and knowledge of the client and client's business, resulting in a Level 3 fair value classification. The fair value of impaired loans is based on the fair value of the collateral. Impaired loans were determined to be collateral dependent and categorized as Level 3 due to ongoing real estate market conditions resulting in inactive market data, which in turn required the use of unobservable inputs and assumptions in fair value measurements. Impaired loans evaluated under the discounted cash flow method are excluded from the table above. The discounted cash flow method as prescribed by topic 310 is not a fair value measurement since the discount rate utilized is the loan's effective interest rate which is not a market rate. There were no changes in valuation techniques used during the year ended December 31, 2018.

Appraisals for collateral-dependent impaired loans are performed by certified general appraisers (for commercial properties) or certified residential appraisers (for residential properties) whose qualifications and licenses have been reviewed and verified by the Company. Once received, the assumptions and approaches utilized in the appraisal as well as the overall resulting fair value is compared with independent data sources such as recent market data or industry-wide statistics.

Impaired loans that are measured for impairment using the fair value of the collateral for collateral dependent loans, had a principal balance of \$1,689,000 with a valuation allowance of \$461,000 at December 31, 2018, down to their fair value of \$1,228,000. The valuation allowance represents specific allocations for the allowance for credit losses for impaired loans.

Impaired loans that are measured for impairment using the fair value of the collateral for collateral dependent loans, had a principal balance of \$5,151,000 with a valuation allowance of \$711,000 at December 31, 2017, down to their fair value of \$4,440,000. The valuation allowance represents specific allocations for the allowance for credit losses for impaired loans.

During the years ended December 31, 2018 and December 31, 2017, there were provisions for credit losses recorded related to loans carried at fair value of \$226,000 and \$236,000, respectively. During 2018 there was \$151,000 in charge-offs related to loans carried at fair value, none during 2017.

**AVIDBANK HOLDINGS, INC. AND SUBSIDIARY**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
(Continued)

**16. QUALIFIED AFFORDABLE HOUSING PROJECT INVESTMENTS**

The Company invests in qualified affordable housing projects. At December 31, 2018 and 2017, the balance of the investment for qualified affordable housing projects was \$4,609,000. These balances are reflected in the accrued interest receivable and other assets line on the consolidated balance sheets. Total unfunded commitments related to the investments in qualified affordable housing projects totaled \$139,000 at December 31, 2018 and 2017. The Company expects to fulfill these commitments through the year ending 2024.

During the year ended December 31, 2018 and 2017, the Company recognized amortization expense of \$426,000 and \$429,000, respectively, which was included within income tax expense on the consolidated statements of income.

Additionally, during the years ended December 31, 2018 and 2017, the Company recognized tax credits and other benefits from its investment in affordable housing tax credits of \$97,000 and \$135,000, respectively. During the years ended December 31, 2018, 2017 and 2016, the Company incurred no impairment losses.

## OFFICERS and DIRECTORS

### EXECUTIVE OFFICERS

**Mark D. Mordell**

*Chairman and Chief Executive Officer*

**Steve Leen**

*Executive Vice President and Chief Financial Officer*

**Dori Hamilton**

*Executive Vice President and Chief Banking Officer*

**Kenneth D. Brenner**

*Head of Strategic Relationships*

**Geoffrey Butner**

*Executive Vice President - Chief Credit Officer*

### BANK OFFICERS

**Reisa Babic**

*Senior Vice President - Underwriter/Portfolio Manager*

**Sam Bhaumik**

*Executive Vice President - Venture Lending*

**Nicole L. Bader Edelstein**

*Senior Vice President - Senior Loan Officer*

*Senior Vice President - CRA Officer*

**Tami Benedict**

*Senior Vice President - Operations Manager*

**Jodie Capp**

*Senior Vice President - Relationship Manager*

**Robert Foley**

*Senior Vice President - Northeast Regional Manager*

**Cathe Franklin**

*Senior Vice President and Controller*

**Chris Greene**

*Senior Vice President - Corporate Banking*

**Greg Hickel**

*Senior Vice President - Senior Credit Administrator*

**Johnnie Kamalani**

*Senior Vice President - Reporting Manager*

### DIRECTORS

**Mark D. Mordell, Chairman**

**Bryan C. Polster, Lead Independent Director**

**Kristofer W. Biorn**

**Kenneth D. Brenner**

**Lisa B. Hendrickson**

**Roxy H. Rapp**

**Michael F. Rosinus**

**Robert H. Scott**

**Marc Verissimo**

**Darryl Karmen**

*Senior Vice President - Regional Manager*

**Jon Krogstad**

*Senior Vice President - Group Manager*

*Specialty Finance*

**Joe Maleti**

*Executive Vice President - Commercial Real Estate*

**Fergal J. O'Boyle**

*Executive Vice President - Construction Lending*

**Joan Secoquian**

*Senior Vice President - Relationship Manager*

**Greg Smith**

*Senior Vice President - Corporate Banking*

**Gina Stephens**

*Senior Vice President - BSA Officer*

**An Na Tran**

*Senior Vice President - Corporate Banking*

**Sarah Wesner**

*Senior Vice President - Group Manager*

*Corporate Banking*

Avidbank Holdings, Inc., headquartered in San Jose, California offers innovative financial solutions and services. We specialize in the following markets: commercial & industrial, corporate finance, asset-based lending, real estate construction and commercial real estate lending, and real estate bridge financing.

Avidbank advances the success of our clients by providing them with financial opportunities and serving them as we wish to be served - with mutual effort, ingenuity and trust - creating long-term banking relationships.

**Avidbank**  
**Holdings, Inc.**