

CENTRAL VALLEY COMMUNITY BANCORP

Form 10-K

March 14, 2018

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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-K

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended December 31, 2017

OR

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission file number: 000-31977

CENTRAL VALLEY COMMUNITY BANCORP

(Exact name of registrant as specified in its charter)

CALIFORNIA

77-0539125

(State or other jurisdiction of incorporation or organization) (I.R.S. Employer Identification No.)

7100 N. Financial Dr., Suite 101, Fresno, CA

93720

(Address of principal executive offices)

(Zip Code)

559-298-1775

(Registrant's telephone number, including area code)

[None]

(Former name, former address and former fiscal year, if changed since last report)

Securities registered pursuant to Section 12(b) of the Act:

Title of Each Class	Name of Each Exchange on which Registered
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Common Stock, no par value	NASDAQ Capital Market
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Securities registered pursuant to Section 12(g) of the Act: None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.

Yes  No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Exchange Act. Yes  No

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes  No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulations S-T (232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes  No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer," "smaller reporting company," and "emerging reporting company" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer

Accelerated filer

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Non-accelerated filer  (Do not check if a smaller reporting company) Smaller reporting company   
Emerging reporting company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes  No

As of June 30, 2017, the aggregate market value of the registrant's common stock held by non-affiliates of the registrant was \$222,959,000 based on the price at which the stock was last sold on June 30, 2017.

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

Common Stock, Par Value Outstanding at March 8, 2018

13,751,287 shares

**DOCUMENTS INCORPORATED BY REFERENCE**

Portions of the Registrant's definitive proxy statement to be filed with the Securities and Exchange Commission pursuant to Regulation 14A in connection with the 2018 Annual Meeting of Shareholders to be held on May 16, 2018 are incorporated by reference into Part III of this Report. The proxy statement will be filed with the Securities and Exchange Commission not later than 120 days after the Registrant's fiscal year ended December 31, 2017.

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PART I

ITEM 1 - DESCRIPTION OF BUSINESS

General

Central Valley Community Bancorp is a bank holding company registered under the Bank Holding Company Act of 1956, as amended (the “Company”). The Company was incorporated on February 7, 2000 as a California corporation, for the purpose of becoming the holding company for Central Valley Community Bank (the “Bank”), formerly known as Clovis Community Bank, a California state chartered bank, through a corporate reorganization. In the reorganization, the Bank became the wholly-owned subsidiary of the Company, and the shareholders of the Bank became the shareholders of the Company. The Company made a decision in the first half of 2002 to change the name of its one subsidiary, Clovis Community Bank, to Central Valley Community Bank.

At December 31, 2017, the Bank was our only banking subsidiary. The Bank is a multi-community bank that offers a full range of commercial banking services to small and medium size businesses, and their owners, managers and employees in the central valley area of California. We serve nine contiguous counties in California’s central valley including Fresno County, El Dorado County, Madera County, Merced County, Placer County, Sacramento County, San Joaquin County, Stanislaus County, and Tulare County, and their surrounding areas. We do not currently conduct any operations other than through the Bank. Unless the context otherwise requires, references to “us,” “we,” or “our” refer to the Company and the Bank on a consolidated basis. At December 31, 2017, we had consolidated total assets of approximately \$1,661,655,000. See Items 7 and 8, Management’s Discussion and Analysis of Financial Condition and Results of Operations, and Financial Statements.

Effective October 1, 2017, the Company and Folsom Lake Bank (FLB) completed a merger under which Folsom Lake Bank, with two full-service offices, located in Folsom and Rancho Cordova (Sacramento County), merged with and into the Bank. Effective October 1, 2016, the Company and Sierra Vista Bank (SVB) completed a merger under which Sierra Vista Bank, with three full-service offices, located in Folsom and Fair Oaks (Sacramento County) and Cameron Park (El Dorado County), merged with and into the Bank.

The Company is regulated by the Board of Governors of the Federal Reserve. The Bank is regulated by the California Department of Business Oversight and its primary Federal regulator is the Federal Deposit Insurance Corporation (“FDIC”).

As of March 1, 2018, we had a total of 343 employees and 316 full time equivalent employees, including the employees of the Bank.

The Bank

The Bank was organized in 1979 and commenced business as a California state chartered bank in 1980. The deposits of the Bank are insured by the FDIC up to applicable limits. The Bank is not a member of the Federal Reserve System.

The Bank operates 24 full-service banking offices in Cameron Park, Clovis, Exeter, Fair Oaks, Folsom, Fresno, Kerman, Lodi, Madera, Merced, Modesto, Oakhurst, Prather, Rancho Cordova, Roseville, Sacramento, Stockton, Tracy, and Visalia. The Bank conducts a commercial banking business, which includes accepting demand, savings and time deposits and making commercial, real estate and consumer loans. It also provides domestic and international wire transfer services and provides safe deposit boxes and other customary banking services. The Bank also offers Internet banking. Internet banking consists of inquiry, account status, bill paying, account transfers, and cash management. The Bank does not offer trust services or international banking services and does not currently plan to do so in the near future. The Bank has a Real Estate Division, an Agribusiness Center, and an SBA Lending Division in Fresno. All real estate related transactions are conducted and processed through the Real Estate Division, including interim construction loans for single family residences and commercial buildings. We offer permanent single family residential loans through our mortgage broker services. Our total market share of deposits in Fresno, Madera, and

Tulare counties was 4.88% in 2017 compared to 4.82% in 2016 based on FDIC deposit market share information published as of June 30, 2017. Our total market share in the other counties we operate in (El Dorado, Merced, San Joaquin, Sacramento, and Stanislaus), was less than 1.00% in 2017. We have a diversified loan portfolio. At December 31, 2017, we had total loans of \$900,679,000. Total commercial and industrial loans outstanding were \$100,856,000, total agricultural land and production loans outstanding were \$14,956,000, total real estate construction and other land loans outstanding were \$96,460,000; total other real estate loans outstanding were \$581,007,000, total equity loans and lines of credit were \$76,404,000 and total consumer installment loans outstanding were \$29,637,000. Our loans are collateralized by real estate, listed securities, savings and time deposits, automobiles, inventory, accounts receivable, machinery and equipment.

In addition to acquisitions, we have experienced organic growth by expanding our branch network. Opening new branches provides us with opportunities to expand our loan and deposit base; however, based on past experience, management expects these new offices may initially have a negative impact on earnings until the volume of business grows to cover fixed overhead expenses. The Bank anticipates opening new branches in the future. In February 2017, the Bank established the Real Estate and Agribusiness Center Branch in Fresno, California. The Bank's private banking office in Gold River, California was

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closed in late April 2017. The Bank opened a full-service branch in Roseville, California the same weekend in April 2017. After extensive analysis combined with the rising popularity of online and mobile banking trends, we chose to consolidate the Sunnyside office into our Fresno Downtown office in April 2016. In 2018, we will consolidate two banking offices into branches currently serving the same communities - one in Visalia and one in Folsom. Since August of 1995 the Bank has been a party to an agreement with Investment Centers of America, pursuant to which Investment Centers of America provides Bank customers with access to investment services. In November 2017, the Bank ended its relationship with Investment Centers of America and entered into an agreement with Raymond James Financial Services, Inc. to provide Bank customers with access to investment services. No individual or single group of related accounts is considered material in relation to the Bank's assets or deposits, or in relation to our overall business. Our deposits are attracted from individual and commercial customers. A material portion of our deposits have not been obtained from a single person or a few persons, the loss of any one or more of which would not have a material adverse effect on our business. However, at December 31, 2017 approximately 83.7% of our loan portfolio held for investment consisted of loans secured by real estate, including construction loans, equity loans and lines of credit and commercial loans secured by real estate and 12.9% consisted of commercial loans. See [Item 7](#) — Management's Discussion and Analysis of Financial Condition and Results of Operations. Currently, our business activities are primarily concentrated in Fresno, El Dorado, Madera, Merced, Sacramento, San Joaquin, Stanislaus, and Tulare Counties in California. Consequently, our results of operations and financial condition are dependent upon the general economic trends in our market area and, in particular, the residential and commercial real estate markets. Further, our concentration of operations in this area of California exposes us to greater risk than other banking companies with a wider geographic base.

## Competition

The banking business in California generally, and our primary service area specifically, is highly competitive with respect to both loans and deposits, and is dominated by a relatively small number of major banks with many offices operating over a wide geographic area. Among the advantages such major banks have over us is their ability to finance wide-ranging advertising campaigns and to allocate their investment assets, including loans, to regions of higher yield and demand. Major banks offer certain services such as international banking and trust services which we do not offer directly but which we usually can offer indirectly through correspondent institutions. To compete effectively, we rely substantially on local promotional activity, personal contacts by our officers, directors and employees, referrals by our shareholders, extended hours, personalized service and our reputation in the communities we serve.

In Fresno and Madera Counties, in addition to our 10 full-service branch locations serving the Bank's primary service areas, as of June 30, 2017 there were 141 operating banking and credit union offices in our primary service area, which consists of the cities of Clovis, Fresno, Kerman, Oakhurst, Madera, and Prather, California. Prather does not contain any banking offices other than our office. The June 2017 FDIC Summary of Deposits report indicated the Company had 4.99% of the total deposits held by all depositories in Fresno County and 7.74% in Madera County. In San Joaquin County, in addition to our three full service branch locations, as of June 30, 2017 there were 98 operating banking and credit union offices. The FDIC Summary of Deposits as of June 2017 report indicated the Company had 1.39% of total deposits held by all depositories in San Joaquin County. In Merced County, in addition to our one branch, as of June 30, 2017 there were 28 operating banking and credit union offices in our primary service area. In Sacramento County, in addition to our five branches, as of June 30, 2017 there were 217 operating banking and credit union offices in our primary service area. In Stanislaus County, in addition to our one branch, there were 87 operating banking and credit union offices in our primary service area. In Tulare County, in addition to our four branches there were 54 operating banking and credit union offices in our primary service area. In El Dorado County, in addition to our one branch, there were 39 operating banking and credit union offices in our primary service area. Business activity in our primary service area is oriented toward light industry, small business and agriculture.

By virtue of their greater total capitalization, larger banks have substantially higher lending limits than we do. Legal lending limits to an individual customer are limited to a percentage of our total capital. As of December 31, 2017, the Bank's legal lending limits to individual customers were \$23,783,000 for unsecured loans and \$39,639,000 for unsecured and secured loans combined.

For borrowers desiring loans in excess of the Bank's lending limits, the Bank seeks to make such loans on a participation basis with other financial institutions. Banks also compete with money market funds and other money market instruments, which are not subject to interest rate ceilings. In recent years, increased competition has also developed from specialized finance and non-finance companies that offer wholesale finance, credit card, and other consumer finance services, including on-line banking services and personal finance software. Competition for deposit and loan products remains strong, from both banking and non-banking firms, and affects the rates of those products as well as the terms on which they are offered to customers.

Technological innovation continues to contribute to greater competition in domestic and international financial services markets. Technological innovation has, for example, made it possible for non-depository institutions to offer customers automated transfer payment services that previously have been traditional banking products. In addition, customers



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now expect a choice of several delivery systems and channels, including telephone, mail, home computer, ATMs, remote deposit, mobile banking applications, self-service branches, and in-store branches.

Mergers between financial institutions have placed additional pressure on banks to streamline their operations, reduce expenses, and increase revenues to remain competitive. In addition, competition has intensified due to federal and state interstate banking laws, which permit banking organizations to expand geographically with fewer restrictions than in the past. Such laws allow banks to merge with other banks across state lines, thereby enabling banks to establish or expand banking operations in our market. The competitive environment also is significantly impacted by federal and state legislation, which may make it easier for non-bank financial institutions to compete with us.

## Supervision and Regulation

### GENERAL

Banking is a complex, highly regulated industry. Regulation and supervision by federal and state banking agencies are intended to maintain a safe and sound banking system, protect depositors and the FDIC's insurance fund, and to facilitate the conduct of sound monetary policy. In furtherance of these goals, Congress and the states have created several largely autonomous regulatory agencies and enacted numerous laws that govern banks, bank holding companies and the financial services industry. Consequently, the growth and earnings performance of the Company can be affected not only by management decisions and general economic conditions, but also by the requirements of applicable state and federal statutes, regulations and the policies of various governmental regulatory authorities, including the Federal Reserve, FDIC, the California Department of Business Oversight (DBO) and the Consumer Financial Protection Bureau (CFPB). Furthermore, tax laws administered by the Internal Revenue Service and state taxing authorities, accounting rules developed by the FASB, securities laws administered by the SEC and state securities authorities, anti-money laundering laws enforced by the U.S. Department of the Treasury, or Treasury, and mortgage related rules, including with respect to loan securitization and servicing by the U.S. Department of Housing and Urban Development and agencies such as Fannie Mae and Freddie Mac, also impact our business. The effect of these statutes, regulations, regulatory policies and rules are significant to our financial condition and results of operations. Further, the nature and extent of future legislative, regulatory or other changes affecting financial institutions are impossible to predict with any certainty.

Federal and state banking laws impose a comprehensive system of supervision, regulation and enforcement on the operations of banks, their holding companies and their affiliates. These laws are intended primarily for the protection of the FDIC's Deposit Insurance Fund and bank customers rather than shareholders. Federal and state laws, and the related regulations of the bank regulatory agencies, affect, among other things, the scope of business, the kinds and amounts of investments banks may make, reserve requirements, capital levels relative to operations, the nature and amount of collateral for loans, the establishment of branches, the ability to merge, consolidate and acquire, dealings with insiders and affiliates and the payment of dividends.

This supervisory and regulatory framework subjects banks and bank holding companies to regular examination by their respective regulatory agencies, which results in examination reports and ratings that, while not publicly available, can affect the conduct and growth of their businesses. These examinations consider not only compliance with applicable laws and regulations, but also capital levels, asset quality and risk, management ability and performance, earnings, liquidity, and various other factors. The regulatory agencies have broad discretion to impose restrictions and limitations on the operations of a regulated entity where the agencies determine, among other things, that such operations are unsafe or unsound, fail to comply with applicable law or are otherwise inconsistent with laws and regulations or with the supervisory policies of these agencies.

The following is a summary of the material elements of the supervisory and regulatory framework applicable to the Company and its bank subsidiary. It does not describe all of the statutes, regulations and regulatory policies that apply, nor does it restate all of the requirements of those that are described. The descriptions are qualified in their entirety by reference to the particular statutory and regulatory provision.

## BANK HOLDING COMPANY REGULATION

The Company, as a bank holding company, is subject to regulation under the Bank Holding Company Act of 1956, as amended (“BHC Act”), and is subject to the supervision and examination of the Board of Governors. Pursuant to the BHC Act, we are required to obtain the prior approval of the Board of Governors before we may acquire all or substantially all of the assets of any bank, or ownership or control of voting shares of any bank if, after giving effect to such acquisition, we would own or control, directly or indirectly, more than five percent of such bank.

Under the BHC Act, we may not engage in any business other than managing or controlling banks or furnishing services to our subsidiaries that the Board of Governors deems to be so closely related to banking as to be a proper incident to banking. Bank holding companies that qualify and elect to be treated as “financial holding companies” may engage in a broad range of additional activities that are (i) financial in nature or incidental to such financial activities or (ii) complementary to a

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financial activity and do not pose a substantial risk to the safety and soundness of depository institutions or the financial system generally. These activities include securities underwriting and dealing, insurance underwriting and making merchant banking investments. We have not elected to be treated as a financial holding company and currently have no plans to make a financial holding company election.

We are also prohibited, with certain exceptions, from acquiring direct or indirect ownership or control of more than five percent of the voting shares of any company unless the company is engaged in banking activities or the Board of Governors determines that the activity is so closely related to banking to be a proper incident to banking. The Board of Governors' approval must be obtained before the shares of any such company can be acquired and, in certain cases, before any approved company can open new offices.

The BHC Act and regulations of the Board of Governors also impose certain constraints on the redemption or purchase by a bank holding company of its own shares of stock.

Our earnings and activities are affected by legislation, by actions of regulators, and by local legislative and administrative bodies and decisions of courts in the jurisdictions in which both the Company and the Bank conduct business. For example, these include limitations on the ability of the Bank to pay dividends to the Company and the ability of the Company to pay dividends to its shareholders. It is the policy of the Board of Governors that bank holding companies should pay cash dividends on common stock only out of income available over the past year and only if prospective earnings retention is consistent with the organization's expected future needs and financial condition. The policy provides that bank holding companies should not maintain a level of cash dividends that undermines the bank holding company's ability to serve as a source of strength to its banking subsidiaries. Various federal and state statutory provisions limit the amount of dividends that subsidiary banks can pay to their holding companies without regulatory approval. In addition to these explicit limitations, the federal regulatory agencies are authorized to prohibit a banking subsidiary or bank holding company from engaging in an unsafe or unsound banking practice. Depending upon the circumstances, the agencies could take the position that paying a dividend would constitute an unsafe or unsound banking practice.

In addition, banking subsidiaries of bank holding companies are subject to certain restrictions imposed by federal law in dealings with their holding companies and other affiliates. Transactions between affiliates are subject to Sections 23A and 23B of the Federal Reserve Act. Regulation W codifies interpretive guidance with respect to affiliate transactions. Subject to certain exceptions set forth in the Federal Reserve Act and Regulation W, a bank can make a loan or extend credit to an affiliate, purchase or invest in the securities of an affiliate, purchase assets from an affiliate, accept securities of an affiliate as collateral security for a loan or extension of credit to any person or company, issue a guarantee, or accept letters of credit on behalf of an affiliate only if the aggregate amount of the above transactions of such subsidiary does not exceed 10 percent of such subsidiary's capital stock and surplus on a per affiliate basis or 20 percent of such subsidiary's capital stock and surplus on an aggregate affiliate basis. Such transactions must be on terms and conditions that are consistent with safe and sound banking practices and on terms that are not more favorable than those provided to a non-affiliate. A bank and its subsidiaries generally may not purchase a "low-quality asset," as that term is defined in the Federal Reserve Act, from an affiliate. Such restrictions also generally prevent a holding company and its other affiliates from borrowing from a banking subsidiary of the holding company unless the loans are secured by collateral.

A holding company and its banking subsidiaries are prohibited from engaging in certain tie-in arrangements in connection with any extension of credit, sale or lease of property or provision of services. For example, with certain exceptions a bank may not condition an extension of credit on a customer obtaining other services provided by it, a holding company or any of its other bank affiliates, or on a promise by the customer not to obtain other services from a competitor.

The Board of Governors has cease and desist powers over parent bank holding companies and non-banking subsidiaries where actions of a parent bank holding company or its non-financial institution subsidiaries represent an unsafe or unsound practice or violation of law. The Board of Governors has the authority to regulate debt obligations (other than commercial paper) issued by bank holding companies by imposing interest ceilings and reserve requirements on such debt obligations.

We are also a bank holding company within the meaning of Section 3700 of the California Financial Code. As such, we and our subsidiaries are subject to examination by the California Department of Business Oversight (DBO). Further, we are required by the Board of Governors to maintain certain capital levels. See “Capital Standards.”

#### REGULATION OF THE BANK

Banks are extensively regulated under both federal and state law. The Bank, as a California state-chartered bank, is subject to primary supervision, regulation and periodic examination by the DBO and the FDIC. The Bank is not a member of the Federal Reserve System, but is nevertheless subject to certain regulations of the Board of Governors. If, as a result of an examination of a bank, the FDIC should determine that the financial condition, capital resources, asset quality, earnings prospects, management, liquidity, or other aspects of the Bank’s operations are unsatisfactory or that the Bank or its management is violating or has violated any law or regulation, various remedies are available to the FDIC. Such remedies include the power to enjoin “unsafe or unsound” practices, to require affirmative action to correct any conditions resulting from any violation or practice, to issue an administrative order that can be judicially enforced, to direct an increase in

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capital, to restrict the growth of the Bank, to assess civil monetary penalties, to remove officers and directors, and ultimately to terminate the Bank's deposit insurance, which for a California chartered bank would result in a revocation of the Bank's charter. The DBO has many of the same remedial powers.

The Bank is a member of the FDIC, which currently insures customer deposits in each member bank to a maximum of \$250,000 per depositor. For this protection, the Bank is subject to the rules and regulations of the FDIC, and, as is the case with all insured banks, may be required to pay a semi-annual statutory assessment. All of a depositor's accounts at an insured depository institution, including all non-interest bearing transactions accounts, will be insured by the FDIC up to the standard maximum deposit insurance amount of (\$250,000) for each deposit insurance ownership category. Various requirements and restrictions under the laws of the State of California and the United States affect the operations of the Bank. State and federal statutes and regulations relate to many aspects of the Bank's operations, including standards for safety and soundness, reserves against deposits, interest rates payable on deposits, loans, investments, mergers and acquisitions, borrowings, dividends, locations of branch offices, fair lending requirements, Community Reinvestment Act activities, and loans to affiliates.

**Depositor Preference.** In the event of the "liquidation or other resolution" of an insured depository institution, the claims of depositors of the institution, including the claims of the FDIC as subrogee of insured depositors, and certain claims for administrative expenses of the FDIC as a receiver, will have priority over other general unsecured claims against the institution. If an insured depository institution fails, insured and uninsured depositors along with the FDIC, will have priority in payment ahead of unsecured, non-deposit creditors including the parent bank holding company with respect to any extensions of credit they have made to such insured depository institution.

**Brokered Deposit Restrictions.** Well-capitalized institutions are not subject to limitations on brokered deposits, while an adequately capitalized institution is able to accept, renew or roll over brokered deposits only with a waiver from the FDIC and subject to certain restrictions on the yield paid on such deposits. Undercapitalized institutions are generally not permitted to accept, renew, or roll over brokered deposits. The Bank is eligible to accept brokered deposits without limitations.

**Loans to Directors, Executive Officers and Principal Shareholders.** The authority of the Bank to extend credit to its directors, executive officers and principal shareholders, including their immediate family members and corporations and other entities that they control, is subject to substantial restrictions and requirements under Sections 22(g) and 22(h) of the Federal Reserve Act and Regulation O promulgated thereunder, as well as the Sarbanes- Oxley Act of 2002. These statutes and regulations impose specific limits on the amount of loans the Bank may make to directors and other insiders, and specified approval procedures must be followed in making loans that exceed certain amounts. In addition, all loans the Bank makes to directors and other insiders must satisfy the following requirements:

- the loans must be made on substantially the same terms, including interest rates and collateral, as prevailing at the time for comparable transactions with persons not affiliated with the Bank;
- the Bank must follow credit underwriting procedures at least as stringent as those applicable to comparable transactions with persons who are not affiliated with the Bank; and
- the loans must not involve a greater than normal risk of non-payment or include other features not favorable to the Bank.

Furthermore, the Bank must periodically report all loans made to directors and other insiders to the bank regulators, and these loans are closely scrutinized by the regulators for compliance with Sections 22(g) and 22(h) of the Federal Reserve Act and Regulation O. Each loan to directors or other insiders must be pre-approved by the Bank's board of directors with the interested director abstaining from voting.

## PAYMENT OF DIVIDENDS

## THE COMPANY

Our shareholders are entitled to receive dividends when and as declared by our Board of Directors, out of funds legally available, subject to the dividends preference, if any, on preferred shares that may be outstanding, and also subject to the restrictions of the California Corporations Code.

The principal source of cash revenue to the Company is dividends received from the Bank. The Bank's ability to make dividend payments to the Company is subject to state and federal regulatory restrictions.

#### THE BANK

Dividends payable by the Bank to the Company are restricted under California law to the lesser of the Bank's retained earnings, or the Bank's net income for the latest three fiscal years, less dividends paid during that period, or, with the approval of the DBO, to the greater of the retained earnings of the Bank, the net income of the Bank for its last fiscal year or the net income of the Bank for its current fiscal year.

In addition to the regulations concerning minimum uniform capital adequacy requirements described below, the FDIC has established guidelines regarding the maintenance of an adequate allowance for credit losses. Therefore, the future payment

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of cash dividends by the Bank will generally depend, in addition to regulatory constraints, upon the Bank's earnings during any fiscal period, the assessment of the Board of Directors of the capital requirements of the Bank and other factors, including the maintenance of an adequate allowance for credit losses.

**REGULATORY CAPITAL REQUIREMENTS**

The federal banking agencies have risk-based capital adequacy requirements intended to provide a measure of capital adequacy that reflects the perceived degree of risk associated with a banking organization's operations, both for transactions reported on the balance sheet as assets and for transactions, such as letters of credit and recourse arrangements, that are recorded as off-balance sheet items. In 2013, the bank regulatory agencies issued final rules (the "Basel III Capital Rules") establishing a new comprehensive capital framework for U.S. banking organizations. The Basel III Capital Rules implement the Basel Committee's December 2010 framework for strengthening international capital standards and certain provisions of the Dodd-Frank Act. The Basel III Capital Rules became effective on January 1, 2015.

The Basel III Capital Rules require the Bank to comply with several minimum capital standards. The Bank must maintain a Tier 1 leverage ratio of at least 4.0%; a common equity Tier 1, which we refer to as CET1, to risk-weighted assets of 4.5%; a Tier 1 capital (that is, CET1 plus Additional Tier 1 capital) to risk-weighted assets of at least 6.0% and a total capital (that is, Tier 1 capital plus Tier 2 capital) to risk-weighted assets of at least 8.0%. CET1 capital is generally defined as common stockholders' equity and retained earnings. Tier 1 capital is generally defined as CET1 and Additional Tier 1 capital. Additional Tier 1 capital generally includes certain noncumulative perpetual preferred stock and related surplus and minority interests in equity accounts of consolidated subsidiaries. Total capital includes Tier 1 capital (CET1 capital plus Additional Tier 1 capital) and Tier 2 capital. Tier 2 capital is comprised of capital instruments and related surplus meeting specified requirements, and may include cumulative preferred stock and long-term perpetual preferred stock, mandatory convertible securities, intermediate preferred stock and subordinated debt. Also included in Tier 2 capital is the allowance for loan loss limited to a maximum of 1.25% of risk-weighted assets and, for institutions that have exercised an opt-out election regarding the treatment of Accumulated Other Comprehensive Income ("AOCI"), up to 45% of net unrealized gains on available-for-sale equity securities with readily determinable fair market values. Institutions that have not exercised the AOCI opt-out have AOCI incorporated into CET1 capital (including unrealized gains and losses on available-for-sale securities). We exercised the opt-out election regarding the treatment of AOCI in part to avoid significant variations in our capital levels resulting from changes in the fair value of our available-for-sale investment securities portfolio as interest rates fluctuate. The calculation of all types of regulatory capital is subject to deductions and adjustments specified in the regulations. The Basel III Capital Rules provide for a number of deductions from and adjustments to CET1. These include, for example, the requirement that (i) mortgage servicing rights, (ii) deferred tax assets arising from temporary differences that could not be realized through net operating loss carrybacks, and (iii) significant investments in non-consolidated financial entities be deducted from CET1 to the extent that any one such category exceeds 10% of CET1 or all such items, in the aggregate, exceed 15% of CET1. Implementation of the deductions and other adjustments to CET1 began on January 1, 2015 and would be phased-in over a four-year period (beginning at 40% on January 1, 2015 and an additional 20% per year thereafter).

In addition to establishing the minimum regulatory capital requirements, the Basel III Capital Rules limit capital distributions and certain discretionary bonus payments to management if an institution does not hold a "capital conservation buffer" consisting of an additional 2.5% of CET1, on top of the minimum risk-weighted asset ratios. The capital conservation buffer is designed to absorb losses during periods of economic stress. The capital conservation buffer requirement is being phased in over a four-year period beginning on January 1, 2016 at 0.625%, increasing by 0.625% each January 1 until it reaches 2.5% on January 1, 2019.

In 2018, banking organizations, including the Company and the Bank, are required to maintain a CET1 capital ratio of at least 6.375%, a Tier 1 capital ratio of at least 7.875%, and a total capital ratio of at least 9.875% to avoid limitations on capital distributions and certain discretionary incentive compensation payments. When fully phased-in on January 1, 2019, The Company and the Bank will be required to meet minimum Tier 1 leverage ratio of 4.0%, a minimum

CET1 to risk-weighted assets of 4.5% (7% with the capital conservation buffer), a Tier 1 capital to risk-weighted assets of 6.0% (8.5% including the capital conservation buffer) and a minimum total capital to risk-weighted assets of 8.0% (10.5% including the capital conservation buffer).

In determining the amount of risk-weighted assets for purposes of calculating risk-based capital ratios, a bank's assets, including certain off-balance sheet assets (e.g., recourse obligations, direct credit substitutes, residual interests), are multiplied by a risk weight factor assigned by the regulations based on perceived risks inherent in the type of asset. As a result, higher levels of capital are required for asset categories believed to present greater risk. For example, a risk weight of 0% is assigned to cash and U.S. government securities, a risk weight of 50% is generally assigned to prudently underwritten first lien 1- 4 family residential mortgages, a risk weight of 100% is assigned to commercial and consumer loans, a risk weight of 150% is assigned to certain past due loans and a risk weight of between 0% to 600% is assigned to permissible equity interests, depending on certain specified factors. The Basel III Capital Rules increased the risk weights for a variety of asset classes,



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including certain commercial real estate mortgages. Additional aspects of the Basel III Capital Rules' risk weighting requirements that are relevant to the Company and the Bank include:

- assigning exposures secured by single-family residential properties to either a 50% risk weight for first-lien mortgages that meet prudent underwriting standards or a 100% risk weight category for all other mortgages;
- providing for a 20% credit conversion factor for the unused portion of a commitment with an original maturity of one year or less that is not unconditionally cancellable (increased from 0% under the previous risk-based capital rules);
- assigning a 150% risk weight to all exposures that are nonaccrual or 90 days or more past due (increased from 100% under the previous risk-based capital rules), except for those secured by single-family residential properties, which will be assigned a 100% risk weight, consistent with the Basel I risk-based capital rules;
- applying a 150% risk weight instead of a 100% risk weight for certain high volatility CRE acquisition, development and construction loans; and
- applying a 250% risk weight to the portion of mortgage servicing rights and deferred tax assets arising from temporary differences that could not be realized through net operating loss carrybacks that are not deducted from CET1 capital (increased from 100% under the previous Basel I risk-based capital rules).

As of December 31, 2017, the Company's and the Bank's capital ratios exceeded the minimum capital adequacy guideline percentage requirements of the federal banking agencies for "well capitalized" institutions under the Basel III Capital Rules on a fully phased-in basis.

## USA PATRIOT ACT

On October 26, 2001, President Bush signed the Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism (USA PATRIOT) Act of 2001. The USA PATRIOT Act also made significant changes to the Bank Secrecy Act. Under the USA PATRIOT Act, financial institutions are subject to prohibitions against specified financial transactions and account relationships as well as enhanced due diligence and of identifying customers when establishing new relationships and standards in their dealings with foreign financial institutions and foreign customers. For example, the enhanced due diligence policies, procedures, and controls generally require financial institutions to take reasonable steps:

- \* To conduct enhanced scrutiny of account relationships to guard against money laundering and report any suspicious transaction;
- \* To ascertain the identity of the nominal and beneficial owners of, and the source of funds deposited into, each account as needed to guard against money laundering and report any suspicious transactions;
- \* To ascertain for any foreign bank, the shares of which are not publicly traded, the identity of the owners of the foreign bank, and the nature and extent of the ownership interest of each such owner; and
- \* To ascertain whether any foreign bank provides correspondent accounts to other foreign banks and, if so, the identity of those foreign banks and related due diligence information.

Under the USA PATRIOT Act, financial institutions are to establish anti-money laundering programs to enhance their Bank Secrecy Act program. The USA PATRIOT Act sets forth minimum standards for these programs, including:

- \* The development of internal policies, procedures, and controls;
- \* The designation of a compliance officer;
- \* An ongoing employee training program; and
- \* An independent audit function to test the programs.

Bank management believes that the Bank is currently in compliance with the US PATRIOT Act.

## OFFICE OF FOREIGN ASSETS CONTROL REGULATION

The U.S. Treasury Department's Office of Foreign Assets Control ("OFAC"), administers and enforces economic and trade sanctions against targeted foreign countries and regimes under authority of various laws, including designated

foreign countries, nationals and others. OFAC publishes lists of specially designated targets and countries. The Company and the Bank are responsible for, among other things, blocking accounts of and transactions with such targets and countries, prohibiting unlicensed trade and financial transactions with them and reporting blocked transactions after their occurrence. Failure to comply with these sanctions could have serious legal and reputational consequences, including causing applicable bank regulatory authorities not to approve merger or acquisition transactions when regulatory approval is required or to prohibit such transactions even if approval is not required.

#### SAFEGUARDING OF CUSTOMER INFORMATION AND PRIVACY

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The Federal Reserve and other bank regulatory agencies have adopted guidelines for safeguarding confidential, personal customer information. These guidelines require financial institutions to create, implement and maintain a comprehensive written information security program designed to ensure the security and confidentiality of customer information, protect against any anticipated threats or hazards to the security or integrity of such information and protect against unauthorized access to or use of such information that could result in substantial harm or inconvenience to any customer. The Bank has adopted a customer information security program to comply with such requirements.

Financial institutions are also required to implement policies and procedures regarding the disclosure of nonpublic personal information about consumers to non-affiliated third parties. In general, financial institutions must provide explanations to consumers on policies and procedures regarding the disclosure of such nonpublic personal information and, except as otherwise required by law, prohibits disclosing such information. The Bank has implemented privacy policies addressing these restrictions which are distributed regularly to all existing and new customers of the Bank.

## COMMUNITY REINVESTMENT ACT

The Community Reinvestment Act (CRA) is intended to encourage insured depository institutions, while operating safely and soundly, to help meet the credit needs of their communities. The CRA specifically directs the federal bank regulatory agencies, in examining insured depository institutions, to assess their record of helping to meet the credit needs of their entire community, including low- and moderate-income neighborhoods, consistent with safe and sound banking practices. The CRA further requires the agencies to take a financial institution's record of meeting its community credit needs into account when evaluating applications for, among other things, domestic branches, consummating mergers or acquisitions or holding company formations. The federal banking agencies have adopted regulations which measure a bank's compliance with its CRA obligations on a performance based evaluation system. This system bases CRA ratings on an institution's actual lending service and investment performance rather than the extent to which the institution conducts needs assessments, documents community outreach or complies with other procedural requirements. The ratings range from "outstanding" to a low of "substantial noncompliance." The Bank had a CRA rating of "satisfactory" as of its most recent regulatory examination.

## CONSUMER PROTECTION LAWS AND REGULATIONS

The bank regulatory agencies are focusing greater attention on compliance with consumer protection laws and their implementing regulations. Examination and enforcement have become more intense in nature, and insured institutions have been advised to monitor carefully compliance with such laws and regulations. The Bank is subject to many federal consumer protection statutes and regulations, some of which are discussed below.

The Equal Credit Opportunity Act (ECOA) generally prohibits discrimination in any credit transaction, whether for consumer or business purposes, on the basis of race, color, religion, national origin, sex, marital status, age, receipt of income from public assistance programs, or good faith exercise of any rights under the Consumer Credit Protection Act.

The Truth in Lending Act (TILA) is designed to ensure that credit terms are disclosed in a meaningful way so that consumers may compare credit terms more readily and knowledgeably. As a result of the TILA, all creditors must use the same credit terminology to express rates and payments, including the annual percentage rate, the finance charge, the amount financed, the total of payments and the payment schedule, among other things.

The Fair Housing Act (FH Act) regulates many practices, including making it unlawful for any lender to discriminate in its housing-related lending activities against any person because of race, color, religion, national origin, sex, handicap or familial status. A number of lending practices have been found by the courts to be, or may be considered, illegal under the FH Act, including some that are not specifically mentioned in the FH Act itself.

The Home Mortgage Disclosure Act (HMDA) grew out of public concern over credit shortages in certain urban neighborhoods and provides public information that will help show whether financial institutions are serving the housing credit needs of the neighborhoods and communities in which they are located. The HMDA also includes a "fair lending" aspect that requires the collection and disclosure of data about applicant and borrower characteristics as a

way of identifying possible discriminatory lending patterns and enforcing anti-discrimination statutes.

Finally, the Real Estate Settlement Procedures Act (RESPA) requires lenders to provide borrowers with disclosures regarding the nature and cost of real estate settlements. Also, RESPA prohibits certain abusive practices, such as kickbacks, and places limitations on the amount of escrow accounts. Penalties under the above laws may include fines, reimbursements and other civil money penalties.

Due to heightened regulatory concern related to compliance with the CRA, TILA, FH Act, ECOA, HMDA and RESPA generally, the Bank may incur additional compliance costs or be required to expend additional funds for investments in its local community.

CONSUMER FINANCIAL PROTECTION BUREAU

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Dodd-Frank created a new, independent federal agency, the Consumer Financial Protection Bureau (CFPB), which was granted broad rulemaking, supervisory and enforcement powers under various federal consumer financial protection laws. The CFPB is also authorized to engage in consumer financial education, track consumer complaints, request data and promote the availability of financial services to underserved consumers and communities. Although all institutions are subject to rules adopted by the CFPB and examination by the CFPB in conjunction with examinations by the institution's primary federal regulator, the CFPB has primary examination and enforcement authority over institutions with assets of \$10 billion or more. The FDIC has primary responsibility for examination of the Bank and enforcement with respect to federal consumer protection laws so long as the Bank has total consolidated assets of less than \$10 billion, and state authorities are responsible for monitoring our compliance with all state consumer laws. The CFPB also has the authority to require reports from institutions with less than \$10 billion in assets, such as the Bank, to support the CFPB in implementing federal consumer protection laws, supporting examination activities, and assessing and detecting risks to consumers and financial markets.

The consumer protection provisions of Dodd-Frank and the examination, supervision and enforcement of those laws and implementing regulations by the CFPB have created a more intense and complex environment for consumer finance regulation. The CFPB has significant authority to implement and enforce federal consumer finance laws, including the Truth in Lending Act, the Equal Credit Opportunity Act and new requirements for financial services products provided for in Dodd-Frank, as well as the authority to identify and prohibit unfair, deceptive or abusive acts and practices. The review of products and practices to prevent such acts and practices is a continuing focus of the CFPB, and of banking regulators more broadly. The ultimate impact of this heightened scrutiny is uncertain but could result in changes to pricing, practices, products and procedures. It could also result in increased costs related to regulatory oversight, supervision and examination, additional remediation efforts and possible penalties. In addition, Dodd-Frank provides the CFPB with broad supervisory, examination and enforcement authority over various consumer financial products and services, including the ability to require reimbursements and other payments to customers for alleged legal violations and to impose significant penalties, as well as injunctive relief that prohibits lenders from engaging in allegedly unlawful practices. The CFPB also has the authority to obtain cease and desist orders providing for affirmative relief or monetary penalties. Dodd-Frank does not prevent states from adopting stricter consumer protection standards. State regulation of financial products and potential enforcement actions could also adversely affect our business, financial condition or results of operations.

## DEPOSIT INSURANCE

The FDIC is an independent federal agency that insures deposits up to prescribed statutory limits of federally insured banks and savings institutions and safeguards the safety and soundness of the banking and savings industries. The FDIC insures the Bank's customer deposits through the Deposit Insurance Fund (the "DIF") up to prescribed limits for each depositor. Pursuant to Dodd-Frank, the maximum deposit insurance amount was increased to \$250,000. The amount of FDIC assessments paid by each DIF member institution is based on its relative risk of default as measured by regulatory capital ratios and other supervisory factors.

The Bank is subject to deposit insurance assessments to maintain the DIF. In October 2010, the FDIC adopted a revised restoration plan to ensure that the DIF's designated reserve ratio ("DRR") reaches 1.35% of insured deposits by September 30, 2020, the deadline mandated by Dodd-Frank. However, financial institutions like the Bank with assets of less than \$10 billion are exempted from the cost of this increase. The restoration plan proposed an increase in the DRR to 2% of estimated insured deposits as a long-term goal for the fund. The FDIC also proposed future assessment rate reductions in lieu of dividends when the DRR reaches 1.5% or greater.

We are generally unable to control the amount of premiums that we are required to pay for FDIC insurance. If there are additional bank or financial institution failures or if the FDIC otherwise determines, we may be required to pay even higher FDIC premiums than the recently increased levels. These announced increases and any future increases in FDIC insurance premiums may have a material and adverse effect on our earnings and could have a material adverse effect on the value of or market for our common stock.

In addition to DIF assessments, banks must pay quarterly assessments that are applied to the retirement of Financing Corporation (“FICO”) bonds issued in the 1980’s to assist in the recovery of the savings and loan industry. The FICO assessment amount fluctuates quarterly, but was 0.00115% of average total assets less average tangible equity for the third quarter of 2017. As of the date of this report, the Company had not received the FICO assessment for the fourth quarter of 2017. Those assessments will continue until the Financing Corporation bonds mature in 2019.

The FDIC may terminate a depository institution’s deposit insurance upon a finding that the institution’s financial condition is unsafe or unsound or that the institution has engaged in unsafe or unsound practices that pose a risk to the DIF or that may prejudice the interest of the bank’s depositors. The termination of deposit insurance for a bank would also result in the revocation of the bank’s charter by the DBO.

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CALIFORNIA FINANCIAL INFORMATION PRIVACY ACT/FAIR CREDIT REPORTING ACT

In 1970, the Federal Fair Credit Reporting Act (the FCRA) was enacted to insure the confidentiality, accuracy, relevancy and proper utilization of consumer credit report information. Under the framework of the FCRA, the United States has developed a highly advanced and efficient credit reporting system. The information contained in that broad system is used by financial institutions, retailers and other creditors of every size in making a wide variety of decisions regarding financial transactions. Employers and law enforcement agencies have also made wide use of the information collected and maintained in databases made possible by the FCRA. The FCRA affirmatively preempts state law in a number of areas, including the ability of entities affiliated by common ownership to share and exchange information freely, and the requirements on credit bureaus to reinvestigate the contents of reports in response to consumer complaints, among others.

The California Financial Information Privacy Act, which was enacted in 2003, requires a financial institution to provide specific information to a consumer related to the sharing of that consumer's nonpublic personal information. The Act allows a consumer to direct the financial institution not to share his or her nonpublic personal information with affiliated or nonaffiliated companies with which a financial institution has contracted to provide financial products and services, and requires that permission from each such consumer be acquired by a financial institution prior to sharing such information.

The FACT Act, (Fair and Accurate Credit Transaction Act) became law in 2003, effectively extending and amending provisions of the Fair Credit Reporting Act (FCRA). The FACT Act created many new responsibilities for consumer reporting agencies and users of consumer reports. It contains many new consumer disclosure requirements as well as provisions to address identity theft.

OTHER PENDING AND PROPOSED LEGISLATION

Other legislative and regulatory initiatives which could affect the Company and the Bank and the banking industry in general may be proposed or introduced before the United States Congress, the California legislature and other governmental bodies in the future. Such proposals, if enacted, may further alter the structure, regulation and competitive relationship among financial institutions, and may subject the Company or the Bank to increased regulation, disclosure and reporting requirements. In addition, the various banking regulatory agencies often adopt new rules and regulations to implement and enforce existing legislation. It cannot be predicted whether, or in what form, any such legislation or regulations may be enacted or the extent to which the business of the Company or the Bank would be affected thereby.

Many aspects of the Dodd-Frank Act are subject to continued rulemaking and will take effect over several years, making it difficult to anticipate the overall financial impact on us. Although the reforms primarily target systemically important financial service providers, the Dodd-Frank Act's influence has and is expected to continue to filter down in varying degrees to smaller institutions over time. We will continue to evaluate the effect of the Dodd-Frank Act; however, in many respects, the ultimate impact of the Dodd-Frank Act will not be fully known for years, and no current assurance may be given that the Dodd-Frank Act, or any other new legislative changes, will not have a negative impact on the results of operations and financial condition of the Company and the Bank.

ADDITIONAL INFORMATION

Copies of the annual report on Form 10-K for the year ended December 31, 2017 may be obtained without charge upon written request to Dave Kinross, Chief Financial Officer, at the Company's administrative offices, 7100 N. Financial Dr., Suite 101, Fresno, CA 93720. The Form 10-K is available on our website: [www.cvcb.com](http://www.cvcb.com). Inquiries regarding Central Valley Community Bancorp's accounting, internal controls or auditing concerns should be directed to Steven D. McDonald, chairman of the Board of Directors' Audit Committee, at [steve.mcdonald@cvcb.com](mailto:steve.mcdonald@cvcb.com) or anonymously at [www.ethicspoint.com](http://www.ethicspoint.com) or EthicsPoint, Inc. at 1-866-294-9588.

General inquiries about Central Valley Community Bancorp or Central Valley Community Bank should be directed to LeAnn Ruiz, Assistant Corporate Secretary at 1-800-298-1775.

#### ITEM 1A - RISK FACTORS

An investment in our common stock is subject to risks inherent to our business. The material risks and uncertainties that management believes may affect our business are described below. Before making an investment decision, you should carefully consider the risks and uncertainties described below together with all of the other information included or incorporated by reference in this Annual Report. The risks and uncertainties described below are not the only ones facing our business. Additional risks and uncertainties that management is not aware of or focused on or that management currently deems immaterial may also impair our business operations. This Annual Report is qualified in its entirety by these risk factors.



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If any of the following risks actually occur, our financial condition and results of operations could be materially and adversely affected. If this were to happen, the value of our common stock could decline significantly, and you could lose all or part of your investment.

Worsening economic conditions could adversely affect our business.

The Bank conducts banking operations principally in California's Central Valley. As a result, our financial condition, results of operations and cash flows are subject to changes in the economic conditions in California's Central Valley. Our business results are dependent in large part upon the business activity, population, income levels, deposits and real estate activity in the Central Valley, and adverse economic conditions could have a material adverse effect upon us. In addition, the Central Valley remains largely dependent on agriculture. A downturn in agriculture and agricultural related business could indirectly and adversely affect our results of operations and financial condition. We can provide no assurance that economic conditions in the United States in general and in the State of California and within our operating markets will not further deteriorate or that such deterioration will not materially and adversely affect us. A further deterioration in economic conditions locally, regionally or nationally could result in a further economic downturn in the Central Valley with the following consequences, any of which could further adversely affect our business:

- loan delinquencies and defaults may increase;
- problem assets and foreclosures may increase;
- demand for our products and services may decline;
- low cost or noninterest bearing deposits may decrease;
- collateral for loans may decline in value, in turn reducing customers' borrowing power, and reducing the value of assets and collateral as sources of repayment of existing loans;
- foreclosed assets may not be able to be sold;
- volatile securities market conditions could adversely affect valuations of investment portfolio assets; and
- reputational risk may increase due to public sentiment regarding the banking industry.

Governmental monetary policies and intervention to stabilize the U.S. financial system may affect our business and are beyond our control.

The business of banking is affected significantly by the fiscal and monetary policies of the Federal government and its agencies. Such policies are beyond our control. We are particularly affected by the policies established by the Federal Reserve Board in relation to the supply of money and credit in the United States. The instruments of monetary policy available to the Federal Reserve Board can be used in varying degrees and combinations to directly affect the availability of bank loans and deposits, as well as the interest rates charged on loans and paid on deposits, and this can and does have a material effect on our business.

Tightening of credit markets and liquidity risk could adversely affect our business, financial condition and results of operations.

A tightening of the credit markets or any inability to obtain adequate funds for continued loan growth at an acceptable cost could adversely affect our asset growth and liquidity position and, therefore, our earnings capability. In addition to core deposit growth, maturity of investment securities and loan and lease payments, we also rely on alternative funding sources including unsecured borrowing lines with correspondent banks, secured borrowing lines with the Federal Home Loan Bank of San Francisco and the Federal Reserve Bank of San Francisco, and public time certificates of deposits. Our ability to access these sources could be impaired by deterioration in our financial condition as well as factors that are not specific to us, such as a disruption in the financial markets or negative views and expectations for the financial services industry or serious dislocation in the general credit markets. In the event such a disruption should occur, our ability to access these sources could be adversely affected, both as to price and availability, which would limit or potentially raise the cost of the funds available to us.



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Because a significant portion of our loan portfolio is comprised of real estate loans, negative changes in the economy affecting real estate values and liquidity could impair the value of collateral securing our real estate loans and result in loan and other losses.

At December 31, 2017, \$754 million, or 83.70% of our total loan and lease portfolio, consisted of real estate related loans. The real estate securing our loan portfolio is concentrated in California. The market value of real estate can fluctuate significantly in a short period of time as a result of market conditions in the geographic area in which the real estate is located. As a result, adverse developments affecting real estate values in our market areas could increase the credit risk associated with our real estate loan portfolio. The market value of real estate can fluctuate significantly in a short period of time as a result of market conditions in the geographic area in which the real estate is located. Real estate values and real estate markets are generally affected by changes in national, regional or local economic conditions, the rate of unemployment, fluctuations in interest rates and the availability of loans to potential purchasers, changes in tax laws and other governmental statutes, regulations and policies and acts of nature, such as earthquakes and natural disasters. Adverse changes affecting real estate values and the liquidity of real estate in one or more of our markets could increase the credit risk associated with our loan portfolio, significantly impair the value of property pledged as collateral on loans and affect our ability to sell the collateral upon foreclosure without a loss or additional losses, which could result in losses that would adversely affect profitability. Such declines and losses would have a material adverse impact on our business, results of operations and growth prospects. In addition, if hazardous or toxic substances are found on properties pledged as collateral, the value of the real estate could be impaired. If we foreclose on and take title to such properties, we may be liable for remediation costs, as well as for personal injury and property damage. Environmental laws may require us to incur substantial expenses to address unknown liabilities and may materially reduce the affected property's value or limit our ability to use or sell the affected property.

Supervisory guidance on commercial real estate concentrations could restrict our activities and impose financial requirements or limits on the conduct of our business.

As a part of their regulatory oversight, the federal regulators have issued the CRE Concentration Guidance on sound risk management practices with respect to a financial institution's concentrations in commercial real estate lending activities. These guidelines were issued in response to the agencies' concerns that rising commercial real estate, or CRE, concentrations might expose institutions to unanticipated earnings and capital volatility in the event of adverse changes in the commercial real estate market. Existing guidance reinforces and enhances existing regulations and guidelines for safe and sound real estate lending by providing supervisory criteria, including numerical indicators to assist in identifying institutions with potentially significant commercial real estate loan concentrations that may warrant greater supervisory scrutiny. The guidance does not limit banks' commercial real estate lending, but rather guides institutions in developing risk management practices and levels of capital that are commensurate with the level and nature of their commercial real estate concentrations. The CRE Concentration Guidance identifies certain concentration levels that, if exceeded, will expose the institution to additional supervisory analysis with regard to the institution's CRE concentration risk. The CRE Concentration Guidance is designed to promote appropriate levels of capital and sound loan and risk management practices for institutions with a concentration of CRE loans. In general, the CRE Concentration Guidance establishes the following supervisory criteria as preliminary indications of possible CRE concentration risk: (i) the institution's total construction, land development and other land loans represent 100% or more of total risk-based capital; or (ii) total CRE loans as defined in the regulatory guidelines represent 300% or more of total risk-based capital, and the institution's CRE loan portfolio has increased by 50% or more during the prior 36-month period. Pursuant to the CRE Concentration Guidelines, loans secured by owner occupied commercial real estate are not included for purposes of CRE Concentration calculation. We believe that our underwriting policies, management information systems, independent credit administration process, and monitoring of real estate loan concentrations are currently sufficient to address the CRE Concentration Guidance.

If our allowance for credit losses is not sufficient to cover actual loan losses, our earnings could decrease.

Our loan customers may not repay their loans according to the terms of these loans, and the collateral securing the payment of these loans may be insufficient to assure repayment. We may experience significant credit losses that

could have a material adverse effect on our operating results. We make various assumptions and judgments about the collectability of our loan portfolio, including the creditworthiness of our borrowers and the value of the real estate and other assets serving as collateral for the repayment of many of our loans. We maintain an allowance for loan losses for probable incurred losses in our loan portfolio. The allowance is established through a provision for loan losses based on management's evaluation of the risks inherent in the loan portfolio and the general economy. The allowance is also appropriately increased for new loan growth. The allowance is based upon a number of factors, including the size of the loan portfolio, asset classifications, economic trends, industry experience and trends, industry and geographic concentrations, estimated collateral values, management's assessment of the credit risk inherent in the portfolio, historical loan loss experience and loan underwriting policies. The allowance is only an estimate of the probable incurred losses in the loan portfolio and may not represent actual losses realized over time, either of losses in excess of the allowance or of losses less than the allowance. If our assumptions prove to be incorrect, our current allowance may not be sufficient to cover future loan losses and adjustments may be necessary to allow for different economic conditions or adverse developments in our loan portfolio.

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Our bank regulatory agencies will periodically review our allowance for loan losses and the value attributed to nonaccrual loans or to real estate acquired through foreclosure and may require us to adjust our determination of the value for these items. These adjustments may adversely affect our business, financial condition and results of operations.

Non-performing assets take significant time to resolve and adversely affect our results of operations and financial condition.

At December 31, 2017, our non-performing loans and leases were 0.32% of total loans and leases compared to 0.29% at December 31, 2016, and 0.40% at December 31, 2015, and our non-performing assets (which include foreclosed real estate) were 0.18% of total assets compared to 0.18% at December 31, 2016. The allowance for credit losses as a percentage of non-performing loans and leases was 305.32% as of December 31, 2017 compared to 427.80% at December 31, 2016. Non-performing assets adversely affect our net income in various ways. We generally do not record interest income on non-performing loans or other real estate owned, thereby adversely affecting our income and increasing our loan administration costs. When we take collateral in foreclosures and similar proceedings, we are required to mark the related asset to the then fair value of the collateral, which may ultimately result in a loss. An increase in the level of non-performing assets increases our risk profile and may impact the capital levels our regulators believe are appropriate in light of the ensuing risk profile, which could result in a request to reduce our level of non-performing assets. When we reduce problem assets through loan sales, workouts, restructurings and otherwise, decreases in the value of the underlying collateral, or in these borrowers' performance or financial condition, whether or not due to economic and market conditions beyond our control, could adversely affect our business, results of operations and financial condition. In addition, the resolution of non-performing assets requires significant commitments of time from management and our directors, which can be detrimental to the performance of their other responsibilities. There can be no assurance that we will not experience future increases in non-performing assets or that the disposition of such non-performing assets will not adversely affect our profitability.

Our focus on lending to small to mid-sized community-based businesses may increase our credit risk.

Commercial real estate and commercial business loans generally are considered riskier than single-family residential loans because they have larger balances to a single borrower or group of related borrowers. Commercial real estate and commercial business loans involve risks because the borrowers' ability to repay the loans typically depends primarily on the successful operation of the businesses or the properties securing the loans. Most of the Bank's commercial real estate and commercial business loans are made to small to medium sized businesses who may have a heightened vulnerability to economic conditions. Moreover, a portion of these loans have been made by us in recent years and the borrowers may not have experienced a complete business or economic cycle. Furthermore, the deterioration of our borrowers' businesses may hinder their ability to repay their loans with us, which could adversely affect our results of operations.

Fluctuations in interest rates could reduce our profitability.

We realize income primarily from the difference between interest earned on loans and securities and the interest paid on deposits and borrowings. We expect that we will periodically experience "gaps" in the interest rate sensitivities of our assets and liabilities, meaning that either our interest-bearing liabilities will be more sensitive to changes in market interest rates than our interest-earning assets, or vice versa. In either event, if market interest rates should move contrary to our position, this "gap" will work against us, and our earnings may be negatively affected.

We are unable to predict fluctuations of market interest rates, which are affected by the following factors outside our control:

- inflation;
- recession;
- competition;
- a rise in unemployment;
- tightening money supply;

international disorder; and  
instability in domestic and foreign financial markets.

Our asset/liability management strategy, which is designed to address the risk from changes in market interest rates and the shape of the yield curve, may not prevent changes in interest rates from having a material adverse effect on our results of operations and financial condition. In recent years, we have shifted our mix of assets from consisting primarily of loans to a more balanced mix of loans and securities. The value of these securities is subject to interest rate risk, which we must monitor and manage successfully in order to prevent declines in value of these assets if interest rates rise in the future.

Additionally, increasing levels of competition in the banking and financial services business may decrease our net interest spread as well as net interest margin by forcing us to offer lower lending interest rates and pay higher deposit interest rates. Although we believe our current level of interest rate sensitivity is reasonable, significant fluctuations in interest rates (such as a sudden and substantial increase in Prime and Overnight Fed Funds rates) as well as increasing competition may require us to increase rates on deposits at a faster pace than the yield we receive on interest earning assets increases. The impact of any sudden and substantial move in interest rates and/or increased competition may have an adverse effect on our

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business, results of operations and financial condition as our net interest income (including the net interest spread and margin) may be negatively impacted.

Furthermore, a sustained decrease in market interest rates could adversely affect our earnings. When interest rates decline borrowers tend to refinance higher-rate, fixed-rate loans to lower rates, prepaying their existing loans. Under those circumstances we would not be able to reinvest those prepayments in assets earning interest rates as high as the rates on the prepaid loans. In addition, our commercial real estate and commercial loans, which carry interest rates that, in general, adjust in accordance with changes in the prime rate, will adjust to lower rates. We are also significantly affected by the level of loan demand available in our market. The inability to make sufficient loans directly affects the interest income we earn. Lower loan demand will generally result in lower interest income realized as we place funds in lower yielding investments.

As a result of the Dodd-Frank Act and recent rulemaking, we are subject to more stringent capital requirements. In July 2013, the U.S. federal banking authorities approved the implementation of the Basel III regulatory capital reforms, or Basel III, and issued rules effecting certain changes required by the Dodd-Frank Act. Basel III is applicable to all U.S. banks that are subject to minimum capital requirements as well as to bank and saving and loan holding companies, other than “small bank holding companies” (generally bank holding companies with consolidated assets of less than \$1.0 billion). Basel III not only increases most of the required minimum regulatory capital ratios, it introduces a new common equity Tier 1 capital ratio and the concept of a capital conservation buffer. Basel III also expands the current definition of capital by establishing additional criteria that capital instruments must meet to be considered additional Tier 1 and Tier 2 capital. In order to be a “well-capitalized” depository institution under the new regime, an institution must maintain a common equity Tier 1 capital ratio of 6.5% or more; a Tier 1 capital ratio of 8% or more; a total capital ratio of 10% or more; and a Tier 1 leverage ratio of 5% or more. The Basel III capital rules became effective as applied to the Company and the Bank on January 1, 2015 with a phase-in period that generally extends through January 1, 2019 for many of the changes.

The failure to meet applicable regulatory capital requirements could result in one or more of our regulators placing limitations or conditions on our activities, including our growth initiatives, or restricting the commencement of new activities, and could affect customer and investor confidence, our costs of funds and FDIC insurance costs, our ability to pay dividends on our common stock, our ability to make acquisitions, and our business, results of operations and financial conditions, generally.

Competition with other financial institutions could adversely affect our profitability.

We face vigorous competition from banks and other financial institutions, including savings institutions, finance companies and credit unions. A number of these banks and other financial institutions have substantially greater resources and lending limits, larger branch systems and a wider array of banking services. To a limited extent, we also compete with other providers of financial services, such as money market mutual funds, brokerage firms, consumer finance companies and insurance companies. This competition may reduce or limit our margins on banking services, reduce our market share and adversely affect our results of operations and financial condition. Additionally, we face competition primarily from other banks in attracting, developing and retaining qualified banking professionals.

Recently, several new banks have opened in our service areas. We are seeing price competition from these new banks, as they work to establish their markets. The existence of competitors, large and small, is a normal and expected part of our operations, but in responding to the particular short-term impact on business of new entrants to the marketplace, we could see a negative impact on revenue and income. Moreover, these near term impacts could be accentuated by the seasonal impact on revenue and income generated by the borrowing and deposit habits of the agricultural community that comprises a significant component of our customer base.

Technology is continually changing and we must effectively implement new technologies.

Our future growth prospects will be highly dependent on our ability to implement changes in technology that affect the delivery of banking services such as the increased demand for computer access to bank accounts and the

availability to perform banking transactions electronically. Our ability to compete will depend upon our ability to continue to adapt technology on a timely and cost-effective basis to meet such demands. In addition, our business and operations could be susceptible to adverse effects from computer failures, communication and energy disruption, and activities such as fraud of unethical individuals with the technological ability to cause disruptions or failures of our data processing system.

If our information systems were to experience a system failure, our business and reputation could suffer. We rely heavily on communications and information systems to conduct our business. The computer systems and network infrastructure we use could be vulnerable to unforeseen problems. Our operations are dependent upon our ability to minimize service disruptions by protecting our computer equipment, systems, and network infrastructure from physical damage due to fire, power loss, telecommunications failure or a similar catastrophic event. We have protective measures in place to prevent or limit the effect of the failure or interruption of our information systems, and will continue to upgrade our security technology and update procedures to help prevent such events. However, if such failures or interruptions were to occur, they could result in damage to our reputation, a loss of customers, increased regulatory scrutiny, or possible exposure to financial liability, any of which could have a material adverse effect on our business, financial condition and results of operations.



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The occurrence of fraudulent activity, breaches or failures of our information security controls or cybersecurity-related incidents could have a material adverse effect on our business, financial condition and results of operations.

As a financial institution we are susceptible to fraudulent activity, information security breaches and cybersecurity-related incidents that may be committed against us or our customers which may result in financial losses or increased costs to us or our customers, disclosure or misuse of our information or our customer information, misappropriation of assets, privacy breaches against our customers, litigation, or damage to our reputation. Such fraudulent activity may take many forms, including check fraud, electronic fraud, wire fraud, on-line banking, phishing, social engineering and other dishonest acts. Information security breaches and cybersecurity-related incidents may include fraudulent or unauthorized access to systems used by us or our customers, denial or degradation of service attacks, and malware or other cyber-attacks. In recent periods, there continues to be a rise in electronic fraudulent activity, security breaches and cyber-attacks within the financial services industry, especially in the commercial banking sector due to cyber criminals targeting commercial bank accounts. Consistent with industry trends we have also experienced an increase in attempted electronic fraudulent activity, security breaches and cybersecurity-related incidents in recent periods. Moreover, in recent periods, several large corporations, including financial institutions and retail companies, have suffered major data breaches, in some cases exposing not only confidential and proprietary corporate information, but also sensitive financial and other personal information of their customers and employees and subjecting them to potential fraudulent activity. Some of our customers may have been affected by these breaches which increase their risks of identity theft, credit card fraud and other fraudulent activity that could involve their accounts with us.

Information pertaining to us and our customers is maintained and transactions are executed on the networks and systems of ours, our customers and certain of our third party partners, such as our online banking or core systems. The secure maintenance and transmission of confidential information as well as execution of transactions over these systems are essential to protect us and our customers against fraud and security breaches and to maintain our customers' confidence. Breaches of information security also may occur, and in infrequent, incidental, cases have occurred, through intentional or unintentional acts by those having access to our systems or our customers' or counterparties' confidential information, including employees. In addition, increases in criminal activity levels and sophistication, advances in computer capabilities, new discoveries, vulnerabilities in third-party technologies (including browsers and operating systems) or other developments could result in a compromise or breach of the technology, processes and controls that we use to prevent fraudulent transactions and to protect data about us, our customers and underlying transactions as well as the technology used by our customers to access our systems.

Although we have developed and continue to invest in systems and processes that are designed to detect and prevent security breaches and cyber-attacks and periodically test our security, our inability to anticipate, or failure to adequately mitigate, breaches of security could result in: losses to us or our customers; our loss of business and/or customers; damage to our reputation; the incurrence of additional expenses; disruption to our business; our inability to grow our online services or other businesses; additional regulatory scrutiny or penalties; or our exposure to civil litigation and possible financial liability - any of which could have a material adverse effect on our business, financial condition and results of operations.

More generally, publicized information concerning security and cyber-related problems could inhibit the use or growth of electronic or web-based applications or solutions as a means of conducting commercial transactions. Such publicity may also cause damage to our reputation as a financial institution. As a result, our business, financial condition and results of operations could be adversely affected.

Our controls over financial reporting and related governance procedures may fail or be circumvented.

Management regularly reviews and updates our internal control over financial reporting, disclosure controls and procedures, and corporate governance policies and procedures. We maintain controls and procedures to mitigate risks such as processing system failures or errors and customer or employee fraud, and we maintain insurance coverage for certain of these risks. Any system of controls and procedures, however well designed and operated, is based in part on certain assumptions and provides only reasonable, not absolute, assurances that the objectives of the system are met.

Events could occur which are not prevented or detected by our internal controls, are not insured against, or are in excess of our insurance limits. Any failure or circumvention of our controls and procedures, or failure to comply with regulations related to controls and procedures, could have an adverse effect on our business.

The current expected credit loss standard established by the Financial Accounting Standards Board will require significant data requirements and changes to methodologies.

In the aftermath of the 2007-2008 financial crises, the Financial Accounting Standards Board, or FASB, decided to review how banks estimate losses in the allowance for loan loss calculation, and it issued the final Current Expected Credit Loss, or CECL, standard on June 16, 2016. Currently, the impairment model used by financial institutions is based on incurred losses, and loans are recognized as impaired when there is no longer an assumption that future cash flows will be collected in full under the originally contracted terms. This model will be replaced by the CECL model that will become effective for the fiscal year beginning after December 15, 2019 in which financial institutions will be required to use historical information, current conditions and reasonable forecasts to estimate the expected loss over the life of the loan. The transition to the CECL model will necessitate significantly greater data requirements and changes to methodologies to accurately account for expected

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losses over the life of a loan. There can be no assurance that we will not be required to increase our reserves and allowance for loan loss as a result of the implementation of CECL.

We have a significant deferred tax asset and cannot assure that it will be fully realized.

Deferred tax assets and liabilities are the expected future tax amounts for the temporary differences between the carrying amounts and tax basis of assets and liabilities computed using enacted tax rates. We regularly assess available positive and negative evidence to determine whether it is more likely than not that our net deferred tax asset will be realized. Realization of a deferred tax asset requires us to apply significant judgment and is inherently speculative because it requires estimates that cannot be made with certainty. At December 31, 2017, we had a net deferred tax asset of \$8.024 million. If we were to determine at some point in the future that we will not achieve sufficient future taxable income to realize our net deferred tax asset, we would be required, under generally accepted accounting principles, to establish a full or partial valuation allowance which would require us to incur a charge to operations for the period in which the determination was made.

We may not be successful in raising additional capital needed in the future.

We may need to raise additional capital in the future to provide us with sufficient capital resources and liquidity to meet our commitments and business strategies. Our ability to raise additional capital, if needed, will depend on, among other things, conditions in the capital markets at that time which are outside of our control, and our financial performance. We cannot be assured that such capital will be available to us on acceptable terms or at all. Any occurrence that may limit our access to the capital markets may adversely affect our capital costs and our ability to raise capital. Moreover, if we need to raise capital in the future, we may have to do so when many other financial institutions are also seeking to raise capital and would have to compete with those institutions for investors. An inability to raise additional capital on acceptable terms when needed could have a material adverse effect on our business, results of operations and financial condition.

The effects of changes to FDIC insurance coverage limits are uncertain and increased premiums may adversely affect us.

The Bank's deposits are insured by the Federal Deposit Insurance Corporation (FDIC) up to applicable legal limits. All of a depositor's accounts at an insured depository institution, including all non-interest bearing transactions accounts, will be insured by the FDIC up to the standard maximum deposit insurance amount of (\$250,000) for each deposit insurance ownership category.

Increases in FDIC insurance premiums will add to our cost of operations and could have a significant impact on the Bank. Depending on any future losses that the FDIC insurance fund may suffer due to failed institutions, there can be no assurance that there will not be additional significant premium increases in order to replenish the fund.

On February 7, 2011, the FDIC Board of Directors adopted the final rule, which redefined the deposit insurance assessment base as required by Dodd-Frank, and makes changes to assessment rates, implements Dodd-Frank's Deposit Insurance Fund (DIF) dividend provisions, and revises the risk based assessment system for all large institutions. The final rule redefined the deposit insurance assessment base as average consolidated total assets minus average tangible equity, defined as Tier 1 capital. The rule lowered overall assessment rates in order to generate the same approximate amount of revenue under the new larger base as was raised under the old base. In 2016, the FDIC board of directors approved a final rule revising DIF assessment formulas for community banks with less than \$10 billion in assets that have been FDIC-insured for at least five years. The revised method better reflects risks and helps ensure that banks that take on greater risks pay more for deposit insurance than their less risk counterparts. The method change is revenue-neutral meaning aggregate assessment revenue collected from established small banks is expected to be approximately the same as it would have been using the prior method. Assessments were expected to drop by an average of approximately one-third. The range of initial assessment rates for all institutions declines to between 3 cents and 30 cents per \$100 of the assessment base from between 5 cents and 35 cents.

We have and in the future we may be required to recognize impairment with respect to investment securities, including the FHLB stock we hold.

Our securities portfolio contains whole loan private mortgage-backed securities and currently includes securities with unrecognized losses and securities that have been downgraded to below investment grade by national rating agencies. We may continue to observe declines in the fair market value of these securities. We evaluate the securities portfolio for any other-than-temporary impairment each reporting period, as required by generally accepted accounting principles. Numerous factors, including the lack of liquidity for re-sales of certain securities, the absence of reliable pricing information for securities, adverse changes in the business climate, adverse regulatory actions or unanticipated changes in the competitive environment, could have a negative effect on our securities portfolio and results of operations in future periods. There can be no assurance, however, that future evaluations of the securities portfolio will not require us to recognize further impairment charges with respect to these and other holdings.

In addition, as a condition to membership in the Federal Home Loan Bank of San Francisco (the FHLB), we are required to purchase and hold a certain amount of FHLB stock. Our stock purchase requirement is based, in part, upon the outstanding principal balance of advances from the FHLB. At December 31, 2017, we held stock in the FHLB totaling

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\$6,843,000 as compared to our minimum required stock holding of \$6,335,000. The FHLB stock held by us is carried at cost and is subject to recoverability testing under applicable accounting standards. To date, the FHLB has not discontinued the distribution of dividends on its shares. However, there can be no assurance the FHLB's dividend paying practices will continue. As of December 31, 2017, we did not recognize an impairment charge related to our FHLB stock holdings. There can be no assurance, however, that future negative changes to the financial condition of the FHLB may not require us to recognize an impairment charge with respect to such holdings.

If the goodwill we have recorded in connection with our acquisitions becomes impaired, it could have an adverse impact on our earnings and capital.

At December 31, 2017, we had approximately \$53,777,000 of goodwill on our balance sheet attributable to our acquisitions of the Bank of Madera County in January 2005, Service 1st Bancorp in November 2008, Visalia Community Bank in July 2013, Sierra Vista Bank in October 2016, and Folsom Lake Bank in October 2017. In accordance with generally accepted accounting principles, our goodwill is not amortized but rather evaluated for impairment on an annual basis or more frequently if events or circumstances indicate that a potential impairment exists. Such evaluation is based on a variety of factors, including the quoted price of our common stock, market prices of the common stock of other banking organizations, common stock trading multiples, discounted cash flows, and data from comparable acquisitions. There can be no assurance that future evaluations of goodwill will not result in findings of impairment and write-downs, which could be material.

We may raise additional capital, which could have a dilutive effect on the existing holders of our common stock and adversely affect the market price of our common stock.

We are not restricted from issuing additional shares of common stock or securities that are convertible into or exchangeable for, or that represent the right to receive, common stock. We frequently evaluate opportunities to access the capital markets taking into account our regulatory capital ratios, financial condition and other relevant considerations, and subject to market conditions, we may take further capital actions. Such actions could include, among other things, the issuance of additional shares of common stock in public or private transactions in order to further increase our capital levels above the requirements for a well-capitalized institution established by the Federal bank regulatory agencies as well as other regulatory targets.

The issuance of any additional shares of common stock or securities convertible into or exchangeable for common stock or that represent the right to receive common stock, or the exercise of such securities including, without limitation, securities issued upon exercise of outstanding stock options under our stock option plans, could be substantially dilutive to shareholders of our common stock. With the exception of one major shareholder, holders of our shares of common stock have no preemptive rights that entitle holders to purchase their pro rata share of any offering of shares of any class or series and, therefore, such sales or offerings could result in increased dilution to our shareholders. The market price of our common stock could decline as a result of sales of shares of our common stock or the perception that such sales could occur.

We may not be able to maintain our historical growth rate which may adversely impact our results of operations and financial condition.

We have initiated internal asset growth programs, completed various acquisitions and opened additional offices in the past few years. We may not be able to sustain our historical rate of asset growth or may not even be able to grow at all. We may not be able to obtain the financing necessary to fund additional asset growth and may not be able to find suitable candidates for acquisition. Various factors, such as economic conditions and competition, may impede or prohibit the opening of new branch offices. Further, our inability to attract and retain experienced bankers may adversely affect our internal asset growth. A significant decrease in our historical rate of asset growth may adversely impact our results of operations and financial condition.

We may be unable to complete future acquisitions, and once complete, may not be able to integrate our acquisitions successfully.

Our growth strategy includes our desire to acquire other financial institutions. We may not be able to complete any future acquisitions and, for completed acquisitions, we may not be able to successfully integrate the operations, management, products and services of the entities we acquire. We may not realize expected cost savings or make revenue enhancements. Following each acquisition, we must expend substantial managerial, operating, financial and other resources to integrate these entities. In particular, we may be required to install and standardize adequate operational and control systems, deploy or modify equipment, implement marketing efforts in new as well as existing locations and employ and maintain qualified personnel. Our failure to successfully integrate the entities we acquire into our existing operations may adversely affect our financial condition and results of operations.

We operate in a highly regulated environment and may be adversely affected by changes in federal and local laws and regulations.

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We are subject to extensive regulation, supervision and examination by federal and state banking authorities. Any change in applicable regulations or federal or state legislation could have a substantial impact on us and our operations. Additional legislation and regulations may be enacted or adopted in the future that could significantly affect our powers, authority and operations, which could have a material adverse effect on our financial condition and results of operations. Further, regulators have significant discretion and power to prevent or remedy unsafe or unsound practices or violations of laws by banks and bank holding companies in the performance of their supervisory and enforcement duties. The exercise of this regulatory discretion and power may have a negative impact on us.

The price of our common stock may fluctuate significantly, and this may make it difficult for you to resell shares of common stock owned by you at times or at prices you find attractive.

The stock market and, in particular, the market for financial institution stocks, has experienced significant volatility, which, in recent quarters, has reached unprecedented levels. In some cases, the markets have produced downward pressure on stock prices for certain issuers without regard to those issuers' underlying financial strength. As a result, the trading volume in our common stock may fluctuate more than usual and cause significant price variations to occur. This may make it difficult for you to resell shares of common stock owned by you at times or at prices you find attractive. The low trading volume in our common shares on the NASDAQ Capital Market means that our shares may have less liquidity than other publicly traded companies. We cannot ensure that the volume of trading in our common shares will be maintained or will increase in the future.

The trading price of the shares of our common stock will depend on many factors, which may change from time to time and which may be beyond our control, including, without limitation, our financial condition, performance, creditworthiness and prospects, future sales or offerings of our equity or equity related securities, and other factors identified above in the forward-looking statement discussion under the section titled "Cautionary Statements Regarding Forward-Looking Statements" and below. These broad market fluctuations have adversely affected and may continue to adversely affect the market price of our common stock. Among the factors that could affect our stock price are:

- actual or anticipated quarterly fluctuations in our operating results and financial condition;
- changes in financial estimates or publication of research reports and recommendations by financial analysts or actions taken by rating agencies with respect to our common stock or those of other financial institutions;
- failure to meet analysts' revenue or earnings estimates;
- speculation in the press or investment community generally or relating to our reputation, our market area, our competitors or the financial services industry in general;
- strategic actions by us or our competitors, such as acquisitions, restructurings, dispositions or financings;
- actions by our current shareholders, including sales of common stock by existing shareholders and/or directors and executive officers;
- fluctuations in the stock price and operating results of our competitors;
- future sales of our equity, equity-related or debt securities;
- changes in the frequency or amount of dividends or share repurchases;
- proposed or adopted regulatory changes or developments;
- anticipated or pending investigations, proceedings, or litigation that involves or affects us;
- trading activities in our common stock, including short-selling;
- domestic and international economic factors unrelated to our performance; and
- general market conditions and, in particular, developments related to market conditions for the financial services industry.

A significant decline in our stock price could result in substantial losses for individual shareholders.

ITEM 1B - UNRESOLVED STAFF COMMENTS

Not applicable.

ITEM 2 - DESCRIPTION OF PROPERTY

The Company owns the property on which full-service branch offices are situated at the following California locations: the Clovis Main office in Clovis, the Foothill office in Prather, the Modesto office, the Kerman office, the Floral office in Visalia, and the Exeter office.

All other property is leased by the Company, including the principal executive offices in Fresno. This facility houses the Company's corporate offices, comprised of various departments, including accounting, information services, human resources, real estate department, loan servicing, credit administration, branch support operations, and compliance.



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The Company continually evaluates the suitability and adequacy of the Company's offices and has a program of relocating or remodeling them as necessary to be efficient and attractive facilities. Management believes that its existing facilities are adequate for its present purposes.

Properties owned by the Bank are held without loans or encumbrances. All of the property leased is leased directly from independent parties. Management considers the terms and conditions of each of the existing leases to be in the aggregate favorable to the Company. See Note 12 of the Company's audited Consolidated Financial Statements in Item 8 of this Annual Report.

## ITEM 3 - LEGAL PROCEEDINGS

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 consolidated results of operations of the Company.

None of our directors, officers, affiliates, more than 5% shareholders or any associates of these persons is a party adverse to the Company or the Bank or has a material interest adverse to the Company or the Bank in any material legal proceeding.

## ITEM 4 - MINE SAFETY DISCLOSURES

Not Applicable.

## PART II

ITEM 5 MARKET FOR COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER  
- PURCHASES OF EQUITY SECURITIES

Our common stock is listed for trading on the Nasdaq Capital Market under the ticker symbol CVCY. As of March 8, 2018, we had approximately 1,072 shareholders of record.

The following table shows the high and low sales prices for the common stock for each quarter as reported by The NASDAQ Stock Market and cash dividend payment for each quarter presented.

## Common Stock Prices and Dividends

	Quarter 1 2016	Quarter 2 2016	Quarter 3 2016	Quarter 4 2016	Quarter 1 2017	Quarter 2 2017	Quarter 3 2017	Quarter 4 2017
High	\$ 12.49	\$ 14.64	\$ 16.42	\$ 20.00	\$ 22.44	\$ 23.94	\$ 23.28	\$ 22.75
Low	\$ 9.45	\$ 10.78	\$ 13.30	\$ 13.75	\$ 18.42	\$ 17.62	\$ 18.57	\$ 19.06
Dividends per share	\$ 0.06	\$ 0.06	\$ 0.06	\$ 0.06	\$ 0.06	\$ 0.06	\$ 0.06	\$ 0.06

We paid common share cash dividends of \$0.24 per share in 2017 and 2016. The Company's primary source of income with which to pay cash dividends is dividends from the Bank. The Bank would not pay any dividend that would cause it to be deemed not "well capitalized" under applicable banking laws and regulations. See Note 13 in the audited Consolidated Financial Statements in Item 8 of this Annual Report.

The amount of future dividends will depend upon our earnings, financial condition, capital requirements and other factors, and will be determined by our board of directors on a quarterly basis. It is Federal Reserve policy that bank holding companies generally pay dividends on common stock only out of income available over the past year, and only if prospective earnings retention is consistent with the organization's expected future needs and financial condition. It is also Federal Reserve policy that bank holding companies not maintain dividend levels that undermine

the holding company's ability to be a source of strength to its banking subsidiaries. Additionally, in consideration of the current financial and economic environment, the Federal Reserve has indicated that bank holding companies should carefully review their dividend policy and has discouraged payment ratios that are at maximum allowable levels unless both asset quality and capital are very strong. Under the federal Prompt Corrective Action regulations, the Federal Reserve or the FDIC may prohibit a bank holding company from paying any dividends if the holding company's bank subsidiary is classified as undercapitalized.

As a holding company, our ability to pay cash dividends is affected by the ability of our bank subsidiary, to pay cash dividends. The ability of the Bank (and our ability) to pay cash dividends in the future and the amount of any such cash dividends is and could be in the future further influenced by bank regulatory requirements and approvals and capital guidelines.

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The decision whether to pay dividends will be made by our board of directors in light of conditions then existing, including factors such as our results of operations, financial condition, business conditions, regulatory capital requirements and covenants under any applicable contractual arrangements, including agreements with regulatory authorities.

The Company has outstanding trust preferred securities from special purpose trust and accompanying subordinated debt. The subordinated debt is senior to our shares of common stock. As a result, we must make payments on the subordinated debt before any dividends can be paid on our common stock. Under the terms of the subordinated debt, we may defer interest payments for up to five years. If the Company should ever defer such interest payments, we would be prohibited from declaring or paying any cash dividends on any shares of our common stock.

For information on the statutory and regulatory limitations on the ability of the Company to pay dividends and on the Bank to pay dividends to Company see “Item 1 - Business - Supervision and Regulation - Dividends.”

**EQUITY COMPENSATION PLAN INFORMATION**

The following chart sets forth information for the year ended December 31, 2017, regarding equity based compensation plans of the Company.

Plan Category	Number of securities to be issued upon exercise of outstanding options, warrants and rights	Weighted-average exercise price of outstanding options, warrants and rights	Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column (a))
	(a)	(b)	(c)
Equity compensation plans approved by security holders	232,870	(1)\$ 9.13	830,760 (2)
Equity compensation plans not approved by security holders	N/A	N/A	N/A
Total	232,870	\$ 9.13	830,760

(1) Under the Central Valley Community Bancorp 2015 Omnibus Incentive Plan (2015 Plan) and the Central Valley Community Bancorp 2005 Omnibus Incentive Plan (2005 Plan), the Company is authorized to issue restricted stock awards. Restricted stock awards are not included in the total in column (a). See Note 14 in the audited Consolidated Financial Statements in Item 8 of this Annual Report.

(2) Includes securities available for issuance of stock options and restricted stock.

At December 31, 2017, there were 63,768 shares of restricted stock issued and outstanding. No options to purchase shares of the Company’s common stock were issued during the years ended December 31, 2017 and 2016 from any of the Company’s stock based compensation plans. During the years ended December 31, 2017 and 2016, zero and 54,650 shares of restricted common stock were granted from outstanding grants under the 2015 and 2005 Plans.

**ITEM 6 - SELECTED CONSOLIDATED FINANCIAL DATA**

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(In thousands, except per-share amounts)	Years Ended December 31,				
	2017	2016	2015	2014	2013
Statements of Income					
Total interest income	\$57,376	\$46,676	\$41,822	\$41,039	\$34,836
Total interest expense	1,137	1,096	1,047	1,156	1,385
Net interest income before provision for credit losses	56,239	45,580	40,775	39,883	33,451
(Reversal of) Provision for credit losses	(1,150 )	(5,850 )	600	7,985	—
Net interest income after provision for credit losses	57,389	51,430	40,175	31,898	33,451
Non-interest income	10,836	9,591	9,387	8,164	7,831
Non-interest expenses	44,406	38,922	36,016	35,338	31,685
Income before provision for (benefit from) income taxes	23,819	22,099	13,546	4,724	9,597
Provision for (benefit from) income taxes	9,793	6,917	2,582	(570 )	1,347
Net income	14,026	15,182	10,964	5,294	8,250
Preferred stock dividends and accretion of discount	—	—	—	—	350
Net income available to common shareholders	\$14,026	\$15,182	\$10,964	\$5,294	\$7,900
Basic earnings per share	\$1.12	\$1.34	\$1.00	\$0.48	\$0.77
Diluted earnings per share	\$1.10	\$1.33	\$1.00	\$0.48	\$0.77
Cash dividends declared per common share	\$0.24	\$0.24	\$0.18	\$0.20	\$0.20
(In thousands)	December 31,				
	2017	2016	2015	2014	2013
Balances at end of year:					
Investment securities, Federal funds sold and deposits in other banks	\$604,801	\$558,132	\$580,544	\$520,511	\$529,398
Net loans	891,901	747,302	588,501	564,280	503,149
Total deposits	1,425,687	1,255,979	1,116,267	1,039,152	1,004,143
Total assets	1,661,655	1,443,323	1,276,736	1,192,183	1,145,635
Shareholders' equity	209,559	164,033	139,323	131,045	120,043
Earning assets	1,505,436	1,319,065	1,173,591	1,074,942	1,042,552
Average balances:					
Investment securities, Federal funds sold and deposits in other banks	\$568,426	\$560,860	\$529,046	\$513,866	\$445,859
Net loans	784,085	636,475	577,784	531,382	444,770
Total deposits	1,284,305	1,144,231	1,065,798	1,006,560	848,493
Total assets	1,491,696	1,321,007	1,222,526	1,157,483	986,924
Shareholders' equity	182,507	154,325	135,062	130,414	119,746
Earning assets	1,364,839	1,210,082	1,112,758	1,052,097	895,330

Data from 2017 reflects the partial year impact of the acquisition of Folsom Lake Bank on October 1, 2017. Data from 2016 reflects the partial year impact of the acquisition of Sierra Vista Bank on October 1, 2016. Data from 2013 reflects the partial year impact of the acquisition of Visalia Community Bank on July 1, 2013.

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ITEM 7 - MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS.

Management's discussion and analysis should be read in conjunction with the Company's audited Consolidated Financial Statements, including the Notes thereto, in Item 8 of this Annual Report.

Certain matters discussed in this report constitute forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. All statements contained herein that are not historical facts, such as statements regarding the Company's current business strategy and the Company's plans for future development and operations, are based upon current expectations. These statements are forward-looking in nature and involve a number of risks and uncertainties. Such risks and uncertainties include, but are not limited to (1) significant increases in competitive pressure in the banking industry; (2) the impact of changes in interest rates; (3) a decline in economic conditions in the Central Valley; (4) the Company's ability to continue its internal growth at historical rates; (5) the Company's ability to maintain its net interest margin; (6) the decline quality of the Company's earning assets; (7) decline in credit quality; (8) changes in the regulatory environment; (9) fluctuations in the real estate market; (10) changes in business conditions and inflation; (11) changes in securities markets (12) risks associated with acquisitions, relating to difficulty in integrating combined operations and related negative impact on earnings, and incurrence of substantial expenses. Therefore, the information set forth in such forward-looking statements should be carefully considered when evaluating the business prospects of the Company.

When the Company uses in this Annual Report the words "anticipate," "estimate," "expect," "project," "intend," "commit," "believe" and similar expressions, the Company intends to identify forward-looking statements. Such statements are not guarantees of performance and are subject to certain risks, uncertainties and assumptions, including those described in this Annual Report. Should one or more of these risks or uncertainties materialize, or should underlying assumptions prove incorrect, actual results may vary materially from those anticipated, estimated, expected, projected, intended, committed or believed. The future results and shareholder values of the Company may differ materially from those expressed in these forward-looking statements. Many of the factors that will determine these results and values are beyond the Company's ability to control or predict. For those statements, the Company claims the protection of the safe harbor for forward-looking statements contained in the Private Securities Litigation Reform Act of 1995. See also the discussion of risk factors in Item 1A, "Risk Factors."

We are not able to predict all the factors that may affect future results. You should not place undue reliance on any forward looking statement, which speaks only as of the date of this Report on Form 10-K. Except as required by applicable laws or regulations, we do not undertake any obligation to update or revise any forward looking statement, whether as a result of new information, future events or otherwise.

## INTRODUCTION

Central Valley Community Bancorp (NASDAQ: CVCY) (the Company) was incorporated on February 7, 2000. The formation of the holding company offered the Company more flexibility in meeting the long-term needs of customers, shareholders, and the communities it serves. The Company currently has one bank subsidiary, Central Valley Community Bank (the Bank) and one business trust subsidiary, Service 1st Capital Trust 1. The Company and Folsom Lake Bank (FLB) completed a merger under which FLB was merged with and into the Bank on October 1, 2017. With the FLB acquisition, the Company added two full service branches, located in Folsom, and Rancho Cordova, California which continue to be operated by the Bank. The Company's market area includes the central valley area from Sacramento, California to Bakersfield, California.

During 2017, we focused on asset quality and capital adequacy due to the uncertainty created by the economy. We also focused on assuring that competitive products and services were made available to our clients while adjusting to the many new laws and regulations that affect the banking industry.

As of December 31, 2017, the Bank operated 24 full-service offices. The Bank has a Real Estate Division, an Agribusiness Center and an SBA Lending Division in Fresno. All real estate related transactions are conducted and processed through the Real Estate Division, including interim construction loans for single family residences and commercial buildings. We offer permanent single family residential loans through our mortgage broker services. The FLB acquisition added total assets, at fair value, of approximately \$196.15 million, \$117.82 million in loans, at fair value, and \$171.95 million in deposits, at fair value, at October 1, 2017. FLB's results of operations have been included in the Company's results of operations beginning October 1, 2017. The one-time pre-tax severance, retention, acquisition and integration costs totaled \$1.83 million for the year ended December 31, 2017.

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### ECONOMIC CONDITIONS

The economy in California's Central Valley was negatively impacted by the economic conditions in California and in our operating markets during the economic downturn of 2007 through 2010. The recession impacted most industries in our market area. Initially, housing values throughout the nation and especially in the Central Valley decreased dramatically, which in turn negatively affected the personal net worth of much of the population in our service area. Over the last several years the economy, as evidenced by the California and Central Valley unemployment rates, and housing prices have shown slow but steady improvement. Housing in the Central Valley continues to be relatively more affordable than the major metropolitan areas in California.

Agriculture and agricultural related businesses remain a critical part of the Central Valley's economy. The Valley's agricultural production is widely diversified, producing nuts, vegetables, fruit, cattle, dairy products, and cotton. The continued future success of agriculture related businesses is highly dependent on the availability of water and is subject to fluctuation in worldwide commodity prices, currency exchanges, and demand. From time to time, California experiences severe droughts, which could significantly harm the business of our customers and the credit quality of the loans to those customers. We closely monitor the water resources and the related issues affecting our customers, and will remain vigilant for signs of deterioration within the loan portfolio in an effort to manage credit quality and work with borrowers where possible to mitigate any losses.

### OVERVIEW

Diluted earnings per share (EPS) for the year ended December 31, 2017 was \$1.10 compared to \$1.33 and \$1.00 for the years ended December 31, 2016 and 2015, respectively. Net income for 2017 was \$14,026,000 compared to \$15,182,000 and \$10,964,000 for the years ended December 31, 2016 and 2015, respectively. The decrease in net income and EPS was primarily driven by the increase in provision for income taxes and increase in non-interest expense, and an increase in provision for credit losses, offset by an increase in net interest income, and an increase in non-interest income in 2017 compared to 2016. Total assets at December 31, 2017 were \$1,661,655,000 compared to \$1,443,323,000 at December 31, 2016.

Return on average equity for 2017 was 7.69% compared to 9.84% and 8.12% for 2016 and 2015, respectively. Return on average assets for 2017 was 0.94% compared to 1.15% and 0.90% for 2016 and 2015, respectively. Total equity was \$209,559,000 at December 31, 2017 compared to \$164,033,000 at December 31, 2016. The increase in equity in 2017 compared to 2016 was primarily driven by the issuance of common stock in connection with the Folsom Lake Bank acquisition, as well as the retention of earnings, net of dividends paid, and an increase in unrealized gains on available-for-sale securities, net of tax, recorded in accumulated other comprehensive income (AOCI).

Average total loans increased \$146,770,000 or 22.70% to \$793,343,000 in 2017 compared to \$646,573,000 in 2016. In 2017, we recorded a reverse provision for credit losses of \$1,150,000 compared to a reverse provision of \$5,850,000 in 2016 and a provision of \$600,000 in 2015. The Company had nonperforming assets consisting of \$2,875,000 in nonaccrual loans and \$70,000 in repossessed assets, totaling \$2,945,000 at December 31, 2017. At December 31, 2016, nonperforming assets totaled \$2,542,000. Net loan loss recoveries for 2017 were \$602,000 compared to \$5,566,000 for 2016 and \$702,000 for 2015. Refer to "Asset Quality" below for further information.

### Key Factors in Evaluating Financial Condition and Operating Performance

In evaluating our financial condition and operating performance, we focus on several key factors including:

- Return to our shareholders;
- Return on average assets;
- Development of revenue streams, including net interest income and non-interest income;
- Asset quality;

- Asset growth;
- Capital adequacy;
- Operating efficiency; and
- Liquidity.

#### Return to Our Shareholders

One measure of our return to our shareholders is the return on average equity (ROE). ROE is a ratio that measures net income divided by average shareholders' equity. Our ROE was 7.69% for the year ended 2017 compared to 9.84% and 8.12% for the years ended 2016 and 2015, respectively.

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Our net income for the year ended December 31, 2017 decreased \$1,156,000 compared to 2016 and increased \$4,218,000 in 2016 compared to 2015. During 2017, net income compared to 2016 was negatively impacted by the re-measurement of our deferred tax asset and corresponding increase in tax expense. Also contributing to the decrease was the increase in non-interest expenses, and an increase in the provision for credit losses. These were partially offset by increases in net interest income and increases in non-interest income.

Net interest income increased primarily because of increases in loan and investment income, offset by increases in interest expense on deposits. For 2017, our net interest margin (NIM) increased 32 basis points to 4.41% compared to 2016. Our net interest margin increased as a result of yield changes, asset mix changes, and an increase in average earning assets, partially offset by an increase in interest-bearing liabilities. Net interest income during 2017 was positively impacted by the collection of nonaccrual loans which resulted in a recovery of interest income of approximately \$1,325,000. The recovery was partially offset by reversal of approximately \$12,000 in interest income on loans placed on nonaccrual during the year. Net interest income during 2016 was positively impacted by the collection of nonaccrual loan which resulted in a recovery of interest income of approximately \$657,000. The recovery in 2016 was partially offset by reversal of approximately \$71,000 in interest income on loans put on nonaccrual during the year.

Non-interest income increased 12.98% in 2017 compared to 2016 primarily due to a \$882,000 increase in net realized gains on sales and calls of investment securities, a \$230,000 increase in interchange fees, a \$204,000 increase in service charge income, and a \$294,000 increase in other income, partially offset by a decrease in loan placement fees of \$377,000, and a \$187,000 decrease in Federal Home Loan Bank dividends. The Company also realized \$190,000 tax-free gains related to the collection of life insurance proceeds in 2016, which are included in other non-interest income. In addition, the Company recorded an other-than-temporary impairment loss of \$136,000 during the period ended December 31, 2016.

Non-interest expenses increased in 2017 compared to 2016 primarily due to the SVB and FLB acquisitions. The net increase year over year was a result of increases in salary and employee benefit expenses of \$2,857,000, increase in acquisition and integration expenses of \$46,000, data processing expenses of \$33,000, occupancy and equipment expenses of \$432,000, ATM/Debit card expenses of \$117,000, Internet banking expenses of \$27,000, regulatory assessments of \$10,000, advertising fees of \$62,000, professional services of \$251,000, and amortization of core deposit intangibles of \$85,000. The Company also recognized additional tax expense of \$3,535,000 related to a tax law change enacted in 2017. Basic EPS was \$1.12 for 2017 compared to \$1.34 and \$1.00 for 2016 and 2015, respectively. Diluted EPS was \$1.10 for 2017 compared to \$1.33 and \$1.00 for 2016 and 2015, respectively. The decrease in EPS for 2017 is primarily due to the decrease in net income.

We experienced an increase in capital due to the issuance of common stock as a result of the Folsom Lake Bank acquisition, as well as the retention of earnings, net of dividends paid, and an increase in accumulated other comprehensive income.

### Return on Average Assets

Our return on average assets (ROA) is a ratio that measures our performance compared with other banks and bank holding companies. Our ROA for the year ended 2017 was 0.94% compared to 1.15% and 0.90% for the years ended December 31, 2016 and 2015, respectively. The 2017 decrease in ROA is primarily due to the decrease in net income. Annualized ROA for our peer group was 1.13% at December 31, 2017. Peer group information from SNL Financial data includes bank holding companies in central California with assets from \$600 million to \$3.5 billion.

### Development of Revenue Streams

Over the past several years, we have focused on not only our net income, but improving the consistency of our revenue streams in order to create more predictable future earnings and reduce the effect of changes in our operating environment on our net income. Specifically, we have focused on net interest income through a variety of strategies, including increases in average interest earning assets, and minimizing the effects of the recent interest rate decline on

our net interest margin by focusing on core deposits and managing the cost of funds. Our net interest margin (fully tax equivalent basis) was 4.41% for the year ended December 31, 2017, compared to 4.09% and 4.01% for the years ended December 31, 2016 and 2015, respectively. We experienced an increase in 2017 net interest margin compared to 2016, resulting from the increase in loan and investment yields. The effective tax equivalent yield on total earning assets increased 32 basis points, while the cost of total interest-bearing liabilities decreased slightly to 0.14% for the year ended December 31, 2017. Our cost of total deposits in 2017 and 2016 was 0.08% and 0.09%, respectively, compared to 0.09% for the same period in 2015. Our net interest income before provision for credit losses increased \$10,659,000 or 23.39% to \$56,239,000 for the year ended 2017 compared to \$45,580,000 and \$40,775,000 for the years ended 2016 and 2015, respectively.

Our non-interest income is generally made up of service charges and fees on deposit accounts, fee income from loan placements, appreciation in cash surrender value of bank owned life insurance, and net gains from sales and calls of investment securities. Non-interest income in 2017 increased \$1,245,000 or 12.98% to \$10,836,000 compared to \$9,591,000 in 2016 and \$9,387,000 in 2015. The increase resulted primarily from increases in net realized gains on sales and calls of investment securities, interchange fees, service charge income, and appreciation in cash surrender value of bank owned life insurance,

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partially offset by a decrease in loan placement fees and Federal Home Loan Bank dividends compared to 2016. Customer service charges increased \$204,000 or 7.16% to \$3,053,000 in 2017 compared to \$2,849,000 and \$2,970,000 in 2016 and 2015, respectively. Further detail on non-interest income is provided below.

### Asset Quality

For all banks and bank holding companies, asset quality has a significant impact on the overall financial condition and results of operations. Asset quality is measured in terms of classified and nonperforming loans, and is a key element in estimating the future earnings of a company. Total nonperforming assets were \$2,945,000 and \$2,542,000 at December 31, 2017 and 2016, respectively. Nonperforming assets totaled 0.33% of gross loans as of December 31, 2017 and 0.34% of gross loans as of December 31, 2016. The nonperforming assets for 2017 includes repossessed assets of \$70,000 compared to \$362,000 repossessed assets at December 31, 2016. The Company had no other real estate owned (OREO) at December 31, 2017 or December 31, 2016. Management maintains certain loans that have been brought current by the borrower (less than 30 days delinquent) on nonaccrual status until such time as management has determined that the loans are likely to remain current in future periods.

The ratio of nonperforming loans to total loans was 0.32% as of December 31, 2017 and 0.29% as of December 31, 2016. The allowance for credit losses as a percentage of outstanding loan balance was 0.98% as of December 31, 2017 and 1.23% as of December 31, 2016. The ratio of net recoveries to average loans was 0.08% as of December 31, 2017 and 0.86% as of December 31, 2016.

### Asset Growth

As revenues from both net interest income and non-interest income are a function of asset size, the continued growth in assets has a direct impact in increasing net income and therefore ROE and ROA. The majority of our assets are loans and investment securities, and the majority of our liabilities are deposits, and therefore the ability to generate deposits as a funding source for loans and investments is fundamental to our asset growth. Total assets increased 15.13% during 2017 to \$1,661,655,000 as of December 31, 2017 from \$1,443,323,000 as of December 31, 2016. Total gross loans increased 19.04% to \$900,679,000 as of December 31, 2017, compared to \$756,628,000 at December 31, 2016. Total investment securities and Federal funds sold decreased 0.92% to \$542,721,000 as of December 31, 2017 compared to \$547,764,000 as of December 31, 2016. Total deposits increased 13.51% to \$1,425,687,000 as of December 31, 2017 compared to \$1,255,979,000 as of December 31, 2016. Our loan to deposit ratio at December 31, 2017 was 63.18% compared to 60.24% at December 31, 2016. The loan to deposit ratio of our peers was 77.65% at December 31, 2017. The growth information above includes the results of our acquisition of Folsom Bank which added approximately \$117,815,000 in net loans and \$171,948,000 in deposits during 2017.

### Capital Adequacy

At December 31, 2017, we had a total capital to risk-weighted assets ratio of 14.07%, a Tier 1 risk-based capital ratio of 13.28%, common equity Tier 1 ratio of 12.90%, and a leverage ratio of 9.71%. At December 31, 2016, we had a total capital to risk-weighted assets ratio of 13.72%, a Tier 1 risk-based capital ratio of 12.74%, common equity Tier 1 ratio of 12.48%, and a leverage ratio of 8.75%. At December 31, 2017, on a stand-alone basis, the Bank had a total risk-based capital ratio of 13.74%, a Tier 1 risk based capital ratio of 12.96%, common equity Tier 1 ratio of 12.96%, and a leverage ratio of 9.46%. At December 31, 2016, the Bank had a total risk-based capital ratio of 13.57%, Tier 1 risk-based capital of 12.59% and a leverage ratio of 8.64%. Note 13 of the audited Consolidated Financial Statements provides more detailed information concerning the Company's capital amounts and ratios. As of January 1, 2015, along with other community banking organizations, the Company and the Bank became subject to new capital requirements, and certain provisions of the new rules are being phased in through 2019 under the Dodd-Frank Act and Basel III. As of December 31, 2017, the Company and the Bank met or exceeded all of their capital requirements inclusive of the capital buffer. The Company and the Bank's capital ratios exceeded the regulatory guidelines for a

well-capitalized financial institution under the Basel III regulatory requirements at December 31, 2017.

#### Operating Efficiency

Operating efficiency is the measure of how efficiently earnings before taxes are generated as a percentage of revenue. A lower ratio represents greater efficiency. The Company's efficiency ratio (operating expenses, excluding amortization of intangibles and foreclosed property expense, divided by net interest income plus non-interest income, excluding net gains and losses from sale of securities) was 62.03% for 2017 compared to 64.72% for 2016 and 68.46% for 2015. The improvement in the efficiency ratio in 2017 was due to the growth in revenues outpacing the growth in non-interest expense. The increase in the efficiency ratio in 2016 compared to 2015 was due to the growth in revenues outpacing the growth in non-interest expense.

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The Company's net interest income before provision for credit losses plus non-interest income increased 21.58% to \$67,075,000 in 2017 compared to \$55,171,000 in 2016 and \$50,162,000 in 2015, while operating expenses increased 14.09% in 2017, 8.07% in 2016, and 1.92% in 2015.

## Liquidity

Liquidity management involves our ability to meet cash flow requirements arising from fluctuations in deposit levels and demands of daily operations, which include providing for customers' credit needs, funding of securities purchases, and ongoing repayment of borrowings. Our liquidity is actively managed on a daily basis and reviewed periodically by our management and Directors' Asset/Liability Committee. This process is intended to ensure the maintenance of sufficient funds to meet our needs, including adequate cash flows for off-balance sheet commitments. Our primary sources of liquidity are derived from financing activities which include the acceptance of customer and, to a lesser extent, broker deposits, Federal funds facilities and advances from the Federal Home Loan Bank of San Francisco. We have available unsecured lines of credit with correspondent banks totaling approximately \$40,000,000 and secured borrowing lines of approximately \$234,689,000 with the Federal Home Loan Bank. These funding sources are augmented by collection of principal and interest on loans, the routine maturities and pay downs of securities from our investment securities portfolio, the stability of our core deposits, and the ability to sell investment securities. Primary uses of funds include origination and purchases of loans, withdrawals of and interest payments on deposits, purchases of investment securities, and payment of operating expenses. We had liquid assets (cash and due from banks, interest-earning deposits in other banks, Federal funds sold and available-for-sale securities) totaling \$643,087,000 or 38.70% of total assets at December 31, 2017 and \$586,317,000 or 40.62% of total assets as of December 31, 2016.

## RESULTS OF OPERATIONS

### Net Income

Net income was \$14,026,000 in 2017 compared to \$15,182,000 and \$10,964,000 in 2016 and 2015, respectively. Basic earnings per share was \$1.12, \$1.34, and \$1.00 for 2017, 2016, and 2015, respectively. Diluted earnings per share was \$1.10, \$1.33, and \$1.00 for 2017, 2016, and 2015, respectively. ROE was 7.69% for 2017 compared to 9.84% for 2016 and 8.12% for 2015. ROA for 2017 was 0.94% compared to 1.15% for 2016 and 0.90% for 2015. The decrease in net income for 2017 compared to 2016 can be attributed to an increase in provision for income taxes and an increase in non-interest expense, partially offset by an increase in the provision for credit losses, an increase in net interest income, and an increase in non-interest income. The increase in net income for 2016 compared to 2015 was primarily attributed to a decrease in the provision for credit losses, an increase in net interest income, and an increase in non-interest income, partially offset by an increase in provision for income taxes and an increase in non-interest expense.

### Interest Income and Expense

Net interest income is the most significant component of our income from operations. Net interest income (the interest rate spread) is the difference between the gross interest and fees earned on the loan and investment portfolios and the interest paid on deposits and other borrowings. Net interest income depends on the volume of and interest rate earned on interest-earning assets and the volume of and interest rate paid on interest-bearing liabilities.

The following table sets forth a summary of average balances with corresponding interest income and interest expense as well as average yield and cost information for the periods presented. Average balances are derived from daily balances, and nonaccrual loans are not included as interest-earning assets for purposes of this table.



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SCHEDULE OF AVERAGE BALANCES, AVERAGE YIELDS AND RATES

	Year Ended December 31, 2017		Year Ended December 31, 2016		Year Ended December 31, 2015	
(Dollars in thousands)	Average Interest Income/Expense	Average Interest Rate	Average Interest Income/Expense	Average Interest Rate	Average Interest Income/Expense	Average Interest Rate
ASSETS						