FIRST NATIONAL BANK ALASKA
Anchorage, Alaska

FINANCIAL STATEMENTS
December 31, 2016 and 2015

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Crowe Horwath LLP
Independent Member Crowe Horwath International

INDEPENDENT AUDITOR'S REPORT

The Board of Directors and Shareholders
First National Bank Alaska
Anchorage, Alaska

Report on the Financial Statements

We have audited the accompanying financial statements of First National Bank Alaska, which comprise the statements of financial condition as of December 31, 2016 and 2015, and the related statements of income, comprehensive income, cash flows, and changes in shareholders' equity for the years then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

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

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

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

(Continued)

Opinion

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

Report on Other Legal and Regulatory Requirements

We also have audited in accordance with auditing standards generally accepted in the United States of America, First National Bank Alaska's internal control over financial reporting as of December 31, 2016, based on criteria established in the 2013 Internal Control – Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) relevant to reporting objectives for the express purpose of meeting the regulatory requirements of Section 112 of the Federal Deposits Insurance Corporation Improvement Act (FDICIA) and our report dated February 27, 2017 expressed an unqualified opinion.

Crowe Horwath LLP

Crowe Horwath LLP

Oak Brook, Illinois
February 27, 2017

FIRST NATIONAL BANK ALASKA
STATEMENTS OF FINANCIAL CONDITION
December 31, 2016 and 2015
(Dollars in thousands, except per share data)

	2016	2015
ASSETS		
Cash and cash equivalents	$ 79,127	$ 81,278
Securities, available-for-sale	1,745,429	1,832,601
Real estate loans to be sold	12,089	10,418
Loans:		
Commercial and industrial	321,575	294,543
Real estate	1,336,228	1,237,382
Consumer and other	19,792	19,480
Total loans, gross	1,677,595	1,551,405
Less: Allowance for loan losses	16,600	15,150
Total loans, net	1,660,995	1,536,255
Premises and equipment, net	49,236	50,259
Other real estate owned, net	12,222	17,068
Other assets	50,750	41,547
Total assets	$ 3,609,848	$ 3,569,426
LIABILITIES AND SHAREHOLDERS' EQUITY		
Liabilities:		
Deposits:		
Noninterest bearing	$ 1,306,357	$ 1,290,689
Interest bearing:		
Savings	665,791	632,948
NOW	207,270	201,665
Money market	159,044	167,051
Time	137,213	133,269
Total interest bearing	1,169,318	1,134,933
Total deposits	2,475,675	2,425,622
Securities sold under agreements to repurchase	629,966	645,838
Other liabilities	11,472	9,401
Total liabilities	3,117,113	3,080,861
Shareholders' equity:		
Common stock, $100 par value (authorized: 2016 and 2015 – 400,000 shares) (issued and outstanding: 2016 – 317,139; 2015 – 318,433)	31,714	31,843
Surplus	40,000	40,000
Retained earnings	427,264	414,555
Accumulated other comprehensive income (loss)	(6,243)	2,167
Total shareholders' equity	492,735	488,565
Total liabilities and shareholders' equity	$ 3,609,848	$ 3,569,426

See accompanying notes to financial statements.

FIRST NATIONAL BANK ALASKA
STATEMENTS OF INCOME
Years ended December 31, 2016 and 2015
(Dollars in thousands, except per share data)

	2016	2015
Interest income and loan fees:		
Interest and fees on loans:		
Taxable	$ 88,508	$ 84,506
Nontaxable	2,162	2,285
Total interest and fees on loans	90,670	86,791
Interest and dividends on investment securities:		
Taxable	27,646	25,443
Nontaxable	4,345	3,621
Total interest and dividends on investment securities	31,991	29,064
Interest on cash and cash equivalents	390	173
Total interest and loan fee income	123,051	116,028
Interest expense:		
Interest on deposits	847	827
Interest on federal funds purchased and securities sold under agreements to repurchase	961	943
Interest on notes payable, capital lease obligations and other	-	1
Total interest expense	1,808	1,771
Net interest and loan fee income	121,243	114,257
Provision for loan losses	2,422	2,710
Net interest and loan fee income after provision for loan losses	118,821	111,547
Noninterest income:		
Bankcard fees	8,166	9,646
Service charges on deposit accounts	5,723	4,718
Gain on sale of mortgage loans	3,322	2,432
Mortgage loan servicing income	1,817	1,837
Net gains on investment securities	1,404	376
Other noninterest income	7,016	7,178
Total noninterest income	27,448	26,187
Noninterest expense:		
Salaries and employee benefits	51,533	50,756
Occupancy expense, net	8,559	8,318
Furniture and equipment expense	2,182	2,433
Bankcard expenses	2,378	3,557
Other noninterest expense	19,863	19,775
Total noninterest expense	84,515	84,839
Income before taxes	61,754	52,895
Provision for income taxes	20,362	16,770
Net income	$ 41,392	$ 36,125
Earnings per common share	$ 130.35	$ 113.02

See accompanying notes to financial statements.

FIRST NATIONAL BANK ALASKA
STATEMENTS OF COMPREHENSIVE INCOME
Years ended December 31, 2016 and 2015
(Dollars in thousands)

	2016	2015
Net income	$ 41,392	$ 36,125
Other comprehensive loss –		
Unrealized losses on securities:		
Unrealized holding gains (losses) arising during the period, net of tax effect of $5,293 and $17 in 2016 and 2015, respectively	(7,583)	(23)
Reclassification adjustment for gains included in net income, net of tax effect of $577 and $154 in 2016 and 2015, respectively	(827)	(222)
Other comprehensive loss	(8,410)	(245)
Comprehensive Income	$ 32,982	$ 35,880

See accompanying notes to financial statements.

FIRST NATIONAL BANK ALASKA
STATEMENTS OF CASH FLOWS
Years ended December 31, 2016 and 2015
(Dollars in thousands)

	2016	2015
Cash flows from operating activities		
Net income	$ 41,392	$ 36,125
Adjustments to reconcile net income to net cash provided by operating activities:		
Amortization of premium on investment securities, net	13,800	12,383
Loss from equity method investment	1,377	804
Depreciation, accretion and amortization	5,522	5,737
Provision for loan losses	2,422	2,710
Deferred taxes	(624)	(181)
Gain on sale of mortgage loans	(3,322)	(2,432)
Net gain on the sales of other real estate owned	(184)	(293)
Valuation adjustment on other real estate owned	2,490	272
Net loss on the sale of premises and equipment	(7)	224
Net gain on disposition of investment securities	(1,404)	(376)
Real estate loans to be sold-originated	(190,046)	(144,665)
Real estate loans to be sold-shipped	190,208	146,535
Net increase in other assets	(3,940)	(2,079)
Net increase in other liabilities	2,157	716
Net cash provided by operating activities	59,841	55,480
Cash flows from investing activities		
Proceeds from calls and maturities of securities, available-for-sale	473,536	355,138
Proceeds from sales of securities, available-for-sale	94,120	203,268
Purchase of securities, available-for-sale	(507,161)	(659,992)
Net purchases of Federal Home Loan Bank stock	(308)	(2,440)
Net redemptions of Federal Reserve Bank stock	7	-
Net increase in loans	(95,405)	(144,012)
Purchase of participation loans	(31,516)	(29,028)
Proceeds from sales of premises and equipment	13	8
Purchase of land, premises and equipment	(2,708)	(10,965)
Improvements to other real estate owned	(225)	(3,074)
Proceeds from sales of other real estate owned	2,339	743
Net cash used in investing activities	(67,308)	(290,354)
Cash flows from financing activities		
Net increase in total deposits	50,053	222,390
Net increase (decrease) in securities sold under agreements to repurchase	(15,872)	17,562
Payments on notes and capital leases	(53)	(53)
Dividends paid	(26,977)	(15,973)
Retirement of common stock	(1,835)	(3,165)
Net cash provided by financing activities	5,316	220,761
Decrease in cash and cash equivalents	(2,151)	(14,113)
Cash and cash equivalents, January 1	81,278	95,391
Cash and cash equivalents, December 31	$ 79,127	$ 81,278

(Continued)

FIRST NATIONAL BANK ALASKA
STATEMENTS OF CASH FLOWS
Years ended December 31, 2016 and 2015
(Dollars in thousands)

	2016	2015
Supplemental disclosures of cash flow information:		
Cash paid during the year for interest	$ 1,795	$ 1,779
Cash paid during the year for income taxes	22,442	15,970
Noncash investing and financing activities:		
Transfer of loans to other real estate owned	$ 546	$ 424
Bank financed sales of other real estate owned	786	451
Transfer of land held for Bank premises to other real estate owned	-	546

See accompanying notes to financial statements.

FIRST NATIONAL BANK ALASKA
STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY
Years ended December 31, 2016 and 2015
(Dollars in thousands, except per share data)

	Common Stock ($100 Par Value)	Surplus	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total Shareholders' Equity
Balance, January 1, 2015	$ 32,052	$ 40,000	$ 397,359	$ 2,412	$ 471,823
Net income	-	-	36,125	-	36,125
Other comprehensive loss, net of tax	-	-	-	(245)	(245)
Dividends declared - $50 per share	-	-	(15,973)	-	(15,973)
Retirement of common stock (2,083 shares)	(209)	-	(2,956)	-	(3,165)
Balance, December 31, 2015	31,843	40,000	414,555	2,167	488,565
Net income	-	-	41,392	-	41,392
Other comprehensive loss, net of tax	-	-	-	(8,410)	(8,410)
Dividends declared - $85 per share	-	-	(26,977)	-	(26,977)
Retirement of common stock (1,294 shares)	(129)	-	(1,706)	-	(1,835)
Balance, December 31, 2016	$ 31,714	$ 40,000	$ 427,264	$ (6,243)	$ 492,735

See accompanying notes to financial statements.

NOTE 1 - SIGNIFICANT ACCOUNTING AND REPORTING POLICIES

First National Bank Alaska (the Bank) is a full service commercial bank operated as a single segment, and as such, its principal activities include the receiving and lending of money. Additionally, the Bank provides trust banking services, escrow and contract collection services, bankcard services, and safe deposit box facilities. These services are for business, industry, and individuals primarily within the State of Alaska. Banking services are provided from 30 branches throughout Alaska. The accounting and reporting policies of the Bank conform with U.S. generally accepted accounting principles and the prevailing practices within the banking industry. Significant accounting and reporting policies are summarized below.

Subsequent Events: The Bank has evaluated subsequent events for recognition and disclosure through February 27, 2017, which is the date the financial statements were available to be issued.

Estimates: Use of accounting estimates in the preparation of financial statements, in order to conform with U.S. generally accepted accounting principles, requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Cash and Cash Equivalents: Cash and cash equivalents include cash and due from banks and overnight federal funds sold. Net cash flows are reported for customer loan and deposit transactions, securities sold under agreements to repurchase and federal funds purchased.

Securities, Available-for-Sale: Securities, available-for-sale are classified at the time of acquisition. The available-for-sale classification includes debt and marketable equity securities which are carried at estimated fair value. Unrealized holding gains or losses on securities, available-for-sale are included in other comprehensive income and as a separate component of shareholders' equity. Amortization of premiums and accretion of discounts are recognized using the level yield method. Realized gains and losses on sales of securities are computed using the specific identification method.

Management evaluates securities for other-than-temporary impairment (OTTI) on at least a quarterly basis, and more frequently when economic or market conditions warrant such an evaluation. For securities in an unrealized loss position, management considers the extent and duration of the unrealized loss, and the financial condition and near-term prospects of the issuer. Management also assesses whether it intends to sell, or it is more likely than not that it will be required to sell, a security in an unrealized loss position before recovery of its amortized cost basis. If either of the criteria regarding intent or requirement to sell is met, the entire difference between amortized cost and fair value is recognized as impairment through earnings. For debt securities that do not meet the aforementioned criteria, the amount of impairment is split into two components as follows: 1) OTTI related to credit loss, which must be recognized in the income statement and 2) OTTI related to other factors, which is recognized in other comprehensive income. The credit loss is defined as the difference between the present value of the cash flows expected to be collected and the amortized cost basis.

(Continued)

NOTE 1 - SIGNIFICANT ACCOUNTING AND REPORTING POLICIES (Continued)

Real Estate Loans to be Sold: Real estate loans to be sold are carried at the lower of cost or fair value in the aggregate. The Bank records and holds for sale one-to-four family and multifamily real estate loans which are originated pursuant to investor programs. Net unrealized losses, if any, are recognized through a valuation allowance by charges to other noninterest expense.

Loans: The Bank grants real estate, commercial, and consumer loans to customers. A substantial portion of the loan portfolio is represented by real estate loans throughout Alaska. The ability of the Bank's debtors to honor their contracts is dependent upon real estate and general economic conditions.

Loans that management has the intent and ability to hold for the foreseeable future, or until maturity or pay-off, generally are reported at their outstanding unpaid principal balances adjusted for charge-offs and any deferred fees or costs on originated loans. Interest income is accrued on the unpaid principal balance. Loan origination fees, net of certain direct origination costs, are deferred and recognized as an adjustment of the related loan yield using the effective interest method.

The accrual of interest on all classes of real estate and commercial loans is normally discontinued at the time a loan is 90 days delinquent. Past due status is based on the contractual terms of the loan. All classes within consumer and other loans are typically charged off no later than 120 days delinquent. In all cases, loans are placed on nonaccrual or charged off at an earlier date if collection of principal or interest is considered doubtful.

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

Allowance for Loan Losses: The allowance for loan losses is a valuation allowance for probable incurred credit losses. The allowance for loan losses is established as losses are estimated to have occurred through a provision for loan losses charged to earnings. Loan losses are charged against the allowance when management believes the uncollectability of a loan balance is confirmed. Subsequent recoveries, if any, are credited to the allowance.

The allowance consists of specific and general components. The specific component relates to loans that are individually classified as impaired when, based on current information and events, it is probable that the Bank will be unable to collect all amounts due according to the contractual terms of the loan agreement. Loans for which the terms have been modified resulting in a concession, and for which the borrower is experiencing financial difficulties, are considered troubled debt restructurings and classified as impaired.

The general component is evaluated on a regular basis by management and is based upon management's periodic review of the collectability of non-impaired loans in light of historical loss experience, the nature and volume of the loan portfolio, adverse situations that may affect the borrower's ability to repay, estimated value of any underlying collateral and prevailing economic conditions. The historical loss experience is determined by portfolio segment and is based on the actual loss history of the Bank over the most recent 3, 5 or 7 years for consumer, commercial and real estate loans, respectively. The actual loss experience is supplemented with other qualitative factors based on the risks present for each portfolio segment.

(Continued)

NOTE 1 - SIGNIFICANT ACCOUNTING AND REPORTING POLICIES (Continued)

Management considers the following when assessing the risk of the loan portfolio segments:

Commercial and Industrial loans – are dependent on the strength of the industries of the related borrowers and the success of their businesses. Commercial loans are advanced for equipment purchases, to provide working capital or meet other financing needs of business enterprises. These loans may be secured by accounts receivable, inventory, equipment or other business assets. At the time of origination, financial information is obtained from the borrower to evaluate ability to repay the loans.

Real estate loans are considered by loan portfolio class as follows:

Commercial and Construction/Development loans – are dependent on the industries tied to these loans as well as the local real estate market. The loans are secured by the real estate, appraisals or other external valuations are obtained to support the loan amount. An evaluation of the project’s cash flows is performed to evaluate the borrower’s ability to repay the loan at the time of origination.

1-4 and multifamily residential loans – are affected by the local residential real estate market, the local economy, and, for variable rate mortgages, movement in indices tied to these loans. At the time of origination the Bank evaluates the borrower’s repayment ability through a review of credit scores and debt to income ratios. Appraisals or other external valuations are obtained to support the loan amount. Multifamily real estate loans are dependent on the industries tied to these loans as well as the local real estate market for the particular property segments. Appraisals or other external valuations are obtained to support the loan amount. An evaluation of the project’s cash flows is performed to evaluate the borrower’s ability to repay the loan at the time of origination.

Consumer and other loans – are dependent on local economies. Consumer loans are generally secured by consumer assets, but may be unsecured. At the time of origination, the Bank evaluates the borrower’s repayment ability through a review of credit scores and an evaluation of debt to income ratios.

This evaluation is inherently subjective as it requires estimates that are susceptible to significant revision as more information becomes available. While management does not expect a substantial decline in real estate values and economic conditions in Alaska, a decline in these values or economic activities could have an impact on the value of collateral securing the loans as well as the ability for the repayment of loans resulting in a higher allowance for loan losses in the future.

A loan is considered impaired when, based on current information and events, it is probable that the Bank will be unable to collect the scheduled payments of principal or interest when due according to the contractual terms of the loan agreement. Factors considered by management in determining impairment include payment status, collateral value, and the probability of collecting scheduled principal and interest payments when due. Loans that experience insignificant payment delays and payment shortfalls generally are not classified as impaired. Management determines the significance of payment delays and payment shortfalls on a case-by-case basis, taking into consideration all of the circumstances surrounding the loan and the borrower, including the length of the delay, the reasons for the delay, the borrower’s prior payment record and the amount of the shortfall in relation to the principal and interest owed. Impairment is measured on a loan by loan basis for commercial and construction loans by either the present value of expected future cash flows discounted at the loan’s effective interest rate or the fair value of the collateral if the loan is collateral dependent. Loans for which the terms have been modified resulting in a concession, and for which the borrower is experiencing financial difficulty, are considered troubled debt restructurings and classified as impaired.

(Continued)

NOTE 1 - SIGNIFICANT ACCOUNTING AND REPORTING POLICIES (Continued)

Troubled debt restructurings are measured at the net present value of estimated future cash flows or where considered to be collateral dependent, the loan is reported, net, at the fair value of the collateral.

Large groups of smaller balance homogeneous loans are collectively evaluated for impairment. Accordingly, the Bank does not separately identify all individual consumer loans for impairment disclosures.

Reserve for Unfunded Commitments: A reserve is established at a level that is considered adequate by management to provide for probable losses associated with commitments to lend funds under existing agreements. Management determines the adequacy of the reserve for unfunded commitments by evaluating the outstanding commitment levels, the expected conversion to loans, historical loss estimates, and other relevant factors. This evaluation is inherently subjective and actual losses may vary from current estimates. Changes in the reserve are reported in earnings in the periods they become known. The reserve for unfunded commitments is included in other liabilities in the accompanying statements of condition.

The recorded liability was $900 and $1,200 at December 31, 2016 and 2015, respectively.

Premises and Equipment: Premises and equipment, including leasehold improvements and software, are stated at cost less accumulated depreciation and amortization. Depreciation on premises and equipment is calculated on a declining balance basis over the estimated useful lives of the assets. The estimated useful life of buildings is 39 years, with some external elements using 15 years. The estimated useful life of software is 3 years and furniture and equipment is 5 to 7 years. Equipment under capital leases is stated at the present value of minimum lease payments. Equipment held under capital leases and leasehold improvements are amortized over the shorter of the lease term or estimated useful life of the asset. Maintenance and repairs are expensed as incurred, while improvements and construction costs are capitalized.

Federal Reserve Bank: This stock is a required holding of capital stock of the Federal Reserve Bank and is carried in other assets in the accompanying statements of condition at cost and periodically evaluated for impairment based on ultimate recovery of par value, ($2,155 and $2,162 as of 2016 and 2015, respectively). Calculation of the stock requirement is based solely on the capital structure of the Bank.

Federal Home Loan Bank Stock: This is a required stock holding of the Federal Home Loan Bank of Des Moines and is carried in other assets in the accompanying statements of condition at cost and periodically evaluated for impairment based on ultimate recovery of par value, ($4,283 and $3,975 as of 2016 and 2015, respectively). The minimum stock requirement is calculated based on the Bank’s assets or qualifying loans, whichever applies.

(Continued)

NOTE 1 - SIGNIFICANT ACCOUNTING AND REPORTING POLICIES (Continued)

Other Real Estate Owned: Consists of properties acquired through foreclosure and is carried at the lower of fair value at acquisition date or current estimated fair value net of disposal costs. Physical possession of residential real estate property collateralizing a consumer mortgage loan occurs when legal title is obtained upon foreclosure or when the borrower conveys all interest in the property to satisfy the loan through completion of a deed in lieu of foreclosure or a similar legal agreement. At the time the property is acquired, it is recorded at estimated fair value less costs to sell, with any difference between this value and the outstanding balance on the loan charged against the allowance for loan losses. Subsequent to foreclosure, costs associated with holding the property are charged to expense as incurred. Subsequent write-downs and gains and losses recognized on the sale of these properties are included in noninterest expense.

Other real estate owned also includes bank premises that were transferred to other real estate owned due to no longer using the premises for Bank purposes and related regulatory requirements for these types of assets. These transfers from premises and equipment are made at the lower of cost or fair value.

Loan Commitments and Related Financial Instruments: This includes off-balance sheet credit instruments, such as commitments to make loans and commercial letters of credit, issued to meet customer financing needs. The face amount for these items represents the exposure to loss, before considering customer collateral or ability to repay. Such financial instruments are recorded when they are funded.

Originated Mortgage Servicing Rights (OMSRs): OMSRs are capitalized based on their fair value when the corresponding loans are sold. The purchased or originated rights to service loans are amortized in relation to the estimated period of net servicing income. The carrying value of mortgage servicing rights (MSRs) is evaluated on a disaggregated basis relative to loans originated in a given quarter for impairment if there are changes in market conditions, payoffs or loan delinquencies. Impairment of MSRs is recognized through a charge to noninterest income when the MSRs' carrying amount exceeds its current fair value. MSRs are included in other assets in the accompanying statements of condition and are amortized into mortgage loan servicing income.

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

Mortgage Loan Servicing Fees: These are based on a percentage of the interest collected and are included in income as related loan payments from mortgagors are collected offset by the amortization of the servicing rights.

Investments in Limited Partnerships: Investments where the underlying assets are qualified affordable housing projects are accounted for using either the cost method or equity method, depending on investment ownership percentage. Under the cost method, the Bank amortizes the excess of the carrying amount of the investment over its estimated residual value during the periods in which tax credits are allocated to the Bank. The amortization is included in other noninterest expense. Under the equity method, the Bank includes its proportionate share of income or loss in other noninterest income or expense.

NOTE 1 - SIGNIFICANT ACCOUNTING AND REPORTING POLICIES (Continued)

Bankcard Fees: These include income from interchange fees on both credit and debit cards, merchant fees earned on credit transactions, and miscellaneous set up and equipment rental fees. The Bank recognizes fee revenue as it is earned and collectability is reasonably assured. Expenses related to rebate reward programs are recorded when earned by cardholders.

Income Taxes: Income taxes are accounted for in accordance with Accounting Standards Codification (ASC) Topic 740. A current income tax asset or liability is recognized for estimated taxes payable or refundable on current year income tax returns. A deferred tax asset or liability is recognized for future tax effects attributable to temporary differences arising between the tax bases of assets or liabilities and their reported amounts in the financial statements. The measurement of current and deferred tax assets and liabilities is based on provisions of enacted tax law. The effect of a change in tax rates on deferred taxes is recognized in income in the period that includes the enactment date. In the event the Bank does not expect to realize future tax benefits, a valuation allowance would be established to reduce the amount of deferred tax assets.

A tax position is recognized as a benefit only if it is “more likely than not” that the tax position would be sustained in a tax examination, with a tax examination being presumed to occur. The amount recognized is the largest amount of tax benefit that is greater than 50% likely of being realized on examination. For tax positions not meeting the “more likely than not” test, no tax benefit is recorded.

The Bank recognizes interest and/or penalties related to income tax matters in income tax expense.

Earnings Per Common Share: These are computed on the basis of the weighted average number of shares outstanding. The weighted average number of shares outstanding were 317,544 and 319,633 for 2016 and 2015, respectively. The Bank does not have any potentially dilutive securities.

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

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

Reclassifications: Reclassifications have been made to conform 2015 financial statement data with the 2016 presentation. Reclassifications had no effect on prior year net income or shareholders’ equity.

(Continued)

NOTE 1 - SIGNIFICANT ACCOUNTING AND REPORTING POLICIES (Continued)

Adoption of New Accounting Standards: In May 2014, the Financial Accounting Standards Board (FASB) amended existing guidance related to revenue from contracts with customers. This amendment supersedes and replaces nearly all existing revenue recognition guidance, including industry-specific guidance, establishes a new control-based revenue recognition model, changes the basis for deciding when revenue is recognized over time or at a point in time, provides new and more detailed guidance on specific topics and expands and improves disclosures about revenue. In addition, this amendment specifies the accounting for some costs to obtain or fulfill a contract with a customer. These amendments are effective for annual periods beginning after December 15, 2017 and must be applied retrospectively. The effects of adopting this standard is still being evaluated by management**.**

In January 2016, the FASB amended existing guidance that requires public business entities to use the exit price notion when measuring the fair value of financial instruments for disclosure purposes. It requires separate presentation of financial assets and financial liabilities by measurement category and form of financial asset (i.e. securities or loans and receivables). It eliminates the requirement for public business entities to disclose the methods and significant assumptions used to estimate the fair value that is required to be disclosed for financial instruments measured at amortized cost. These amendments are effective for public business entities for fiscal years beginning after December 15, 2017. The effects of adopting of this standard is still being evaluated by management.

In February 2016, the FASB amended existing guidance that requires lessees recognize the following for all leases (with the exception of short-term leases) at the commencement date (1) A lease liability, which is a lessee's obligation to make lease payments arising from a lease, measured on a discounted basis; and (2) A right-of-use asset, which is an asset that represents the lessee's right to use, or control the use of, a specified asset for the lease term. Under the new guidance, lessor accounting is largely unchanged. Certain targeted improvements were made to align, where necessary, lessor accounting with the lessee accounting model and Topic 606, Revenue from Contracts with Customers. These amendments are effective for annual periods beginning after December 15, 2017. Lessees (for capital and operating leases) and lessors (for sales-type, direct financing, and operating leases) must apply a modified retrospective transition approach for leases existing at, or entered into after, the beginning of the earliest comparative period presented in the financial statements. The modified retrospective approach would not require any transition accounting for leases that expired before the earliest comparative period presented. Lessees and lessors may not apply a full retrospective transition approach. The effects of adopting this standard is still being evaluated by management.

In June 2016, the FASB amended existing guidance to replace the incurred loss model with an expected loss model, which is referred to as the current expected credit loss (CECL) model. The CECL model is applicable to the measurement of credit losses on financial assets measured at amortized cost, including loan receivables, held-to-maturity debt securities, and reinsurance receivables. It also applies to off-balance sheet credit exposures not accounted for as insurance (loan commitments, standby letters of credit, financial guarantees, and other similar instruments) and net investments in leases recognized by a lessor. For debt securities with other-than-temporary impairment, the guidance will be applied prospectively. For all other assets within the scope of CECL, a cumulative-effect adjustment will be recognized in retained earnings as of the beginning of the first reporting period in which the guidance is effective. These amendments are effective for annual periods beginning after December 15, 2020. The effects of adopting of this standard is still being evaluated by management**.**

(Continued)

(Dollars in thousands except per share data)

NOTE 2 - CASH AND CASH EQUIVALENTS

The Bank is required to maintain an average daily reserve balance with the Federal Reserve Bank, or maintain such reserve balance in cash. The average daily reserve balance for the two-week maintenance period which encompassed December 31, 2016 and 2015 was $21,997 and $22,833, respectively.

NOTE 3 - SECURITIES

The amortized cost and fair value of securities, available-for-sale are shown by contractual maturity. Expected maturities may differ from contractual maturities if borrowers have the right to call or prepay obligations with or without call or prepayment penalties. Amortized cost and fair values of securities, available-for-sale by maturity date, as of December 31, 2016:

December 31, 2016	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value
U.S. Treasury securities maturities:				
Within 1 year	$ 31,743	$ 127	$ -	$ 31,870
One to 5 years	164,492	938	195	165,235
Five to 10 years	29,879	-	249	29,630
Total	226,114	1,065	444	226,735
U.S. government-sponsored enterprises maturities:				
Within 1 year	94,079	471	5	94,545
One to 5 years	526,971	2,544	1,756	527,759
Five to 10 years	292,846	459	6,279	287,026
Total	913,896	3,474	8,040	909,330
States and political subdivisions maturities:				
Within 1 year	11,649	2	8	11,643
One to 5 years	169,370	71	1,245	168,196
Five to 10 years	107,132	9	2,622	104,519
After 10 years	10,399	-	560	9,839
Total	298,550	82	4,435	294,197
Mortgage-backed securities: residential	3,632	-	23	3,609
Corporate bonds maturities:				
Within 1 year	25,134	27	3	25,158
One to 5 years	220,751	580	1,479	219,852
Five to 10 years	67,953	67	1,472	66,548
Total	313,838	674	2,954	311,558
Total securities, available-for-sale	$ 1,756,030	$ 5,295	$ 15,896	$ 1,745,429

Within the state and political subdivisions category, the largest concentrations of securities, available-for-sale are held in Texas with 31%, Utah with 29%, and Alaska with 18% of the category.

(Continued)

(Dollars in thousands except per share data)

NOTE 3 - SECURITIES (Continued)

Gross unrealized losses on investment securities and the fair value of the related securities, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position, at December 31, 2016, were as follows:

	Less Than 12 Months		12 Months or More		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
2016						
Available-for-sale:						
U.S. Treasury	$ 19,691	$ 316	$ 34,835	$ 128	$ 54,526	$ 444
U.S. government-sponsored enterprises	254,849	7,417	197,154	623	452,003	8,040
States and political subdivisions	202,092	4,165	32,292	270	234,384	4,435
Mortgage-backed - residential	-	-	3,609	23	3,609	23
Corporate bonds	134,243	2,731	58,322	223	192,565	2,954
Total	$ 610,875	$ 14,629	$ 326,212	$ 1,267	$ 937,087	$ 15,896

The unrealized holding losses on investments are the result of increasing interest rates. The contractual terms of these investments do not permit the issuer to redeem the securities at a price less than par, or at a time in which the securities amortized cost would be less than par. Unrealized losses on U.S. Treasury, U.S. government-sponsored enterprises, states and political subdivisions and corporate bonds have not been recognized into income because the issuer(s) bonds are of high credit quality, management does not intend to sell and it is likely that management will not be required to sell the securities prior to their anticipated recovery, and the decline in fair value is largely due to changes in interest rates and other market conditions. The fair value is expected to recover as the bonds approach maturity.

At December 31, 2016, all of the mortgage-backed securities held by the Bank were issued by U.S. government corporations (Ginnie Mae) or U.S. government-sponsored entities (Fannie Mae and Freddie Mac), institutions which the government has affirmed its commitment to support. Because the decline in fair value is attributable to changes in interest rates and illiquidity, and not credit quality, and because the Bank does not have the intent to sell these mortgage-backed securities and it is likely that it will not be required to sell the securities before their anticipated recovery, the Bank does not consider these securities to be other-than-temporarily impaired.

(Continued)

(Dollars in thousands except per share data)

NOTE 3 - SECURITIES (Continued)

The amortized cost and fair value of securities, available-for-sale are shown by contractual maturity. Amortized cost and fair values of securities, available-for-sale by maturity date, as of December 31, 2015:

	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value
December 31, 2015				
U.S. Treasury securities maturities:				
Within 1 year	$ 20,073	$ 165	$ -	$ 20,238
One to 5 years	160,833	1,078	20	161,891
Five to 10 years	45,095	71	185	44,981
Total	226,001	1,314	205	227,110
U.S. government-sponsored enterprises maturities:				
Within 1 year	84,999	120	26	85,093
One to 5 years	733,983	3,747	2,728	735,002
Five to 10 years	309,014	698	1,248	308,464
Total	1,127,996	4,565	4,002	1,128,559
States and political subdivisions maturities:				
Within 1 year	11,208	49	1	11,256
One to 5 years	128,229	502	78	128,653
Five to 10 years	117,149	1,618	7	118,760
Total	256,586	2,169	86	258,669
Mortgage-backed securities: residential	5,116	-	72	5,044
Corporate bonds maturities:				
Within 1 year	29,588	101	7	29,682
One to 5 years	130,090	431	349	130,172
Five to 10 years	53,545	165	345	53,365
Total	213,223	697	701	213,219
Total securities, available-for-sale	$ 1,828,922	$ 8,745	$ 5,066	$ 1,832,601

Within the state and political subdivisions category, the largest concentrations of securities, available-for-sale are held in Texas with 35%, Utah with 29%, and Alaska with 21% of the category.

(Continued)

(Dollars in thousands except per share data)

NOTE 3 - SECURITIES (Continued)

Gross unrealized losses on investment securities and the fair value of the related securities, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position, at December 31, 2015, were as follows:

	Less Than 12 Months		12 Months or More		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
2015						
Available-for-sale:						
U.S. Treasury	$ 54,325	$ 205	$ -	$ -	$ 54,325	$ 205
U.S. government-sponsored enterprises	243,633	$ 1,509	$ 323,325	$ 2,493	$ 566,958	$ 4,002
States and political subdivisions	15,917	44	27,185	42	43,102	86
Mortgage-backed - residential	5,044	72	-	-	5,044	72
Corporate bonds	71,718	574	44,925	127	116,643	701
Total	$ 390,637	$ 2,404	$ 395,435	$ 2,662	$ 786,072	$ 5,066

Investment securities with carrying amounts of $1,054,297 and $1,093,868 at December 31, 2016 and 2015, respectively, were pledged to secure public and trust deposits, securities sold under agreements to repurchase, and for other purposes as required or permitted by law.

Realized gains on the disposition of investment securities totaled $1,406 and $524 in 2016 and 2015, respectively. Realized losses on the disposition of investment securities were $2 and $148 for 2016 and 2015, respectively.

(Continued)

(Dollars in thousands except per share data)

NOTE 4 - LOANS

The loan portfolio consists of the following at December 31:

	2016	2015
Commercial and industrial	$ 321,575	$ 294,543
Real estate construction	290,389	227,993
Real estate mortgage	281,853	235,512
Real estate commercial	763,986	773,877
Consumer and other	19,792	19,480
Loans, gross	$ 1,677,595	$ 1,551,405

There were unamortized premiums of $1,508 and $0 as of December 31, 2016 and 2015, respectively. In 2016, the Bank purchased government guaranteed loans and multifamily loans. Government guaranteed loans are included in commercial and industrial loans. Multifamily loans are included in real estate mortgage.

Real estate loans serviced for others as of December 31, 2016 and 2015 were $1,238,020 and $1,230,551, respectively. Reserve balances, associated with these loans and held in noninterest bearing demand accounts, amounted to $9,750 and $9,201 as of December 31, 2016 and 2015, respectively.

As of December 31, 2016 and 2015 the aggregate indebtedness of all related parties (directors and executive officers of the Bank and their family members) was $11,930 and $9,795, respectively.

(Continued)

(Dollars in thousands except per share data)

NOTE 5 - ALLOWANCE FOR LOAN LOSSES

The following is an analysis of the changes in the allowance for loan losses by portfolio segment for the period ended:

	Commercial and Industrial	Real Estate	Consumer and Other	Total
2016				
Allowance for loan losses:				
Beginning balance, January 1, 2016	$ 3,674	$ 11,102	$ 374	$ 15,150
Provision for loan losses	440	1,887	95	2,422
Loans charged-off	(907)	(91)	(215)	(1,213)
Recoveries	127	18	96	241
Ending Balance, December 31, 2016	$ 3,334	$ 12,916	$ 350	$ 16,600
2015				
Allowance for loan losses:				
Beginning balance, January 1, 2015	$ 2,958	$ 9,887	$ 255	$ 13,100
Provision for loan losses	1,385	1,194	131	2,710
Loans charged-off	(849)	-	(152)	(1,001)
Recoveries	180	21	140	341
Ending Balance, December 31, 2015	$ 3,674	$ 11,102	$ 374	$ 15,150

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

	Commercial and Industrial	Real Estate	Consumer and Other	Total
2016				
Allowance for loan losses:				
Ending allowance balance attributable to loans:				
Individually evaluated for impairment	$ 120	$ 580	$ -	$ 700
Collectively evaluated for impairment	3,214	12,336	350	15,900
Total ending allowance balance	$ 3,334	$ 12,916	$ 350	$ 16,600
Loans:				
Individually evaluated for impairment	$ 540	$ 19,394	$ -	$ 19,934
Collectively evaluated for impairment	321,110	1,324,058	19,741	1,664,909
Total loans outstanding balance	$ 321,650	$ 1,343,452	$ 19,741	1,684,843
Deferred loan fees, net				(7,248)
Total loans				$ 1,677,595

(Continued)

(Dollars in thousands except per share data)

NOTE 5 - ALLOWANCE FOR LOAN LOSSES (Continued)

	Commercial and Industrial	Real Estate	Consumer and Other	Total
2015				
Allowance for loan losses:				
Ending allowance balance attributable to loans:				
Individually evaluated for impairment	$ 415	$ 235	$ -	$ 650
Collectively evaluated for impairment	3,259	10,867	374	14,500
Total ending allowance balance	$ 3,674	$ 11,102	$ 374	$ 15,150
Loans:				
Individually evaluated for impairment	$ 967	$ 16,635	$ -	$ 17,602
Collectively evaluated for impairment	294,666	1,227,469	19,434	1,541,569
Total loans outstanding balance	$ 295,633	$ 1,244,104	$ 19,434	1,559,171
Deferred loan fees, net				(7,766)
Total loans				$ 1,551,405

The following table summarizes our nonaccrual loans and loans past due by loan class as of December 31, 2016 and 2015:

	30-89 Days Past Due	Greater Than 89 Days Past Due	Total Past Due	Current	Total Loans	Non-accrual
December 31, 2016						
Commercial and industrial	$ 1,219	$ 312	$ 1,531	$ 320,119	$ 321,650	$ 535
Real Estate						
Construction and development	104	26	130	292,407	292,537	475
1– 4 and multifamily residential	1,856	304	2,160	280,514	282,674	555
Commercial real estate	2,602	3,611	6,213	762,028	768,241	6,655
Consumer and other	58	-	58	19,683	19,741	-
Total	$ 5,839	$ 4,253	$ 10,092	$ 1,674,751	1,684,843	8,220
Deferred loan fees, net					(7,248)	(39)
Total loans					$ 1,677,595	$ 8,181
December 31, 2015						
Commercial and industrial	$ 530	$ 34	$ 564	$ 295,069	$ 295,633	$ 813
Real Estate						
Construction and development	49	523	572	228,886	229,458	356
1– 4 and multifamily residential	977	313	1,290	235,310	236,600	588
Commercial real estate	1,928	376	2,304	775,742	778,046	1,175
Consumer and other	101	28	129	19,305	19,434	-
Total	$ 3,585	$ 1,274	$ 4,859	$ 1,554,312	1,559,171	2,932
Deferred loan fees, net					(7,766)	(32)
Total loans					$ 1,551,405	$ 2,900

Loans greater than 89 days past due and accruing are $239 and $372 at December 31, 2016 and 2015, respectively.

(Continued)

(Dollars in thousands except per share data)

NOTE 5 - ALLOWANCE FOR LOAN LOSSES (Continued)

The following table presents information related to impaired loans, net of deferred fees, by class of loans as of December 31, 2016:

December 31, 2016	Unpaid Principal Balance	Recorded Investment	Allowance for Loan Losses Allocated	Average Recorded Investment	Interest Income Recognized	Cash Basis Interest Recognized
With no allowance recorded:						
Commercial and industrial	$ 675	$ 382	$ -	$ 313	$ 44	$ 22
Real estate						
Construction and other	1,757	1,259	-	1,113	71	52
1-4 and multifamily residential	1,661	1,581	-	1,385	74	74
Commercial real estate	12,272	11,068	-	9,771	683	442
Consumer and other	-	-	-	-	-	-
Subtotal	16,365	14,290	-	12,582	872	590
With an allowance recorded:						
Commercial and industrial	162	151	120	87	1	1
Real estate						
Construction and other	1,565	838	80	822	219	98
1-4 and multifamily residential	1,720	1,665	200	1,691	109	106
Commercial real estate	3,078	2,883	300	2,921	258	127
Consumer and other	-	-	-	-	-	-
Subtotal	6,525	5,537	700	5,521	587	332
Total	$ 22,890	$ 19,827	$ 700	$ 18,103	$ 1,459	$ 922

(Continued)

(Dollars in thousands except per share data)

NOTE 5 - ALLOWANCE FOR LOAN LOSSES (Continued)

The following table presents information related to impaired loans, net of deferred fees, by class of loans as of December 31, 2015:

December 31, 2015	Unpaid Principal Balance	Recorded Investment	Allowance for Loan Losses Allocated	Average Recorded Investment	Interest Income Recognized	Cash Basis Interest Recognized
With no allowance recorded:						
Commercial and industrial	$ 669	$ 509	$ -	$ 674	$ 52	$ 26
Real estate						
Construction and other	3,668	2,319	-	3,042	310	194
1-4 and multifamily residential	2,868	2,736	-	2,851	145	147
Commercial real estate	12,154	10,749	-	10,884	1,085	645
Consumer and other	-	-	-	-	-	-
Subtotal	19,359	16,313	-	17,451	1,592	1,012
With an allowance recorded:						
Commercial and industrial	663	445	415	386	1	1
Real estate						
Construction and other	-	-	-	-	-	-
1-4 and multifamily residential	632	590	85	598	42	42
Commercial real estate	277	150	150	153	-	-
Consumer and other	-	-	-	-	-	-
Subtotal	1,572	1,185	650	1,137	43	43
Total	$ 20,931	$ 17,498	$ 650	$ 18,588	$ 1,635	$ 1,055

(Continued)

(Dollars in thousands except per share data)

NOTE 5 - ALLOWANCE FOR LOAN LOSSES (Continued)

The Bank categorizes loans into risk categories based on relevant information about the ability of borrowers to service their debt such as: current financial information, historical payment experience, credit documentation, public information, and current economic trends, among other factors. The Bank analyzes loans individually by classifying loans as to credit risk. Formal analysis of classified loans is performed quarterly, including all loans 60 days delinquent. Ongoing evaluation of certain performing loans is conducted through internal credit examinations and loan committee reviews.

The Bank uses the following definitions for risk ratings:

Pass/Watch: Loans classified as pass/watch include current loans performing in accordance with contractual terms, pools of homogenous residential real estate and installment/consumer loans that are not individually risk rated and loans which exhibit certain risk factors that require greater than usual monitoring by management.

Special Mention: Loans classified as special mention have a potential weakness that deserves management's close attention. If left uncorrected, these potential weaknesses may result in deterioration of the repayment prospects for the loan or of the institution's credit position at some future date.

Substandard: Loans classified as substandard are inadequately protected by the current net worth and paying capacity of the borrower or of the collateral pledged, if any. Loans so classified have a well-defined weakness or weaknesses that jeopardize the liquidation of the debt. They are characterized by the distinct possibility that the institution will sustain some loss if the deficiencies are not corrected.

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

The following table summarizes our internal risk rating by loan class based on the most recent analysis performed as of December 31, 2016 and 2015:

	Pass/ Watch	Special Mention	Sub- Standard	Doubtful/ Loss	Total
December 31, 2016					
Commercial and Industrial	$ 318,163	$ 2,405	$ 927	$ 155	$ 321,650
Real Estate,					
Construction and development	290,033	321	2,183	-	292,537
1-4 and multifamily residential	274,281	1,438	6,955	-	282,674
Commercial real estate	753,041	987	14,084	129	768,241
Consumer and other	19,709	27	5	-	19,741
Total	$ 1,655,227	$ 5,178	$ 24,154	$ 284	1,684,843
Deferred loan fees, net					(7,248)
Total					$ 1,677,595

(Continued)

(Dollars in thousands except per share data)

NOTE 5 - ALLOWANCE FOR LOAN LOSSES (Continued)

	Pass/ Watch	Special Mention	Sub- Standard	Doubtful/ Loss	Total
December 31, 2015					
Commercial and Industrial	$ 291,664	$ 2,407	$ 1,153	$ 409	$ 295,633
Real Estate					
Construction and development	226,463	235	2,760	-	229,458
1-4 and multifamily residential	228,094	1,569	6,888	49	236,600
Commercial real estate	764,050	2,400	11,445	151	778,046
Consumer and other	19,196	7	231	-	19,434
Total	$ 1,529,467	$ 6,618	$ 22,477	$ 609	1,559,171
Deferred loan fees, net					(7,766)
Total					$ 1,551,405

Troubled Debt Restructurings:

At December 31, 2016 and 2015, the Bank had loans of $16,742 and $15,415 classified as troubled debt restructurings, respectively, which are included in impaired loans. These loans had allocated specific reserves of $632 and $357 at December 31, 2016 and 2015, respectively. The Bank has committed to lend $134 as of December 31, 2016 and 2015 to customers with outstanding loans that are classified as troubled debt restructurings.

During the year ended December 31, 2016, the terms of certain loans were modified as troubled debt restructurings. The modification of the terms of such loans included one or a combination of the following: an extension of the maturity date at a stated rate of interest lower than the current market rate for new debt with similar risk or a temporary deferral of all or part of the original periodic principal payments.

Commercial loans: There were no restructurings of commercial loans stated interest rates. There were no extensions of maturity dates, but temporary deferrals of all or part of the scheduled principal payments were for periods ranging from 4 years to 9 years.

1-4 and multifamily residential loans: There were no restructurings of commercial real estate loans stated interest rates. Extensions of maturity dates were for periods ranging from 2 months to 7 years and temporary deferrals of all or part of the scheduled principal payments were for periods ranging from 2 years to 13 years.

Commercial real estate loans: There was one restructuring of a commercial real estate loans stated interest rate for 8 years. There was one maturity date extension of 6 months and deferrals of all or part of the loan's scheduled principal payments were for periods ranging from 4 years to 8 years.

There were no restructurings of constructions loans and consumer loans.

(Continued)

NOTE 5 - ALLOWANCE FOR LOAN LOSSES (Continued)

During the year ended December 31, 2015, the terms of certain loans were modified as troubled debt restructurings. The modification of the terms of such loans included one or a combination of the following: an extension of the maturity date at a stated rate of interest lower than the current market rate for new debt with similar risk or a temporary deferral of all or part of the original periodic principal payments.

Commercial loans: There were no restructurings of commercial loans stated interest rates. There was one extension of maturity date for 5 years, and temporary deferrals of all or part of the scheduled principal payments was for a period of 5 years.

1-4 and multifamily residential loans: There were no restructurings of 1-4 and multifamily residential loans stated interest rates. Extensions of maturity dates were for a period of 6 years and temporary deferrals of all or part of the scheduled principal payments were for periods ranging from 2 years to 16 years.

Commercial real estate loans: There were no restructurings of commercial real estate loans stated interest rates. Extensions of maturity dates were for periods ranging from 3 months to 7 years and there were no deferrals of all or part of the loan’s scheduled principal payments.

There were no restructurings of commercial and consumer loans.

(Continued)

(Dollars in thousands except per share data)

NOTE 5 - ALLOWANCE FOR LOAN LOSSES (Continued)

The following table presents loans by class modified as troubled debt restructurings that occurred during the years ended December 31, 2016 and 2015:

	Number of Loans	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment
2016 Troubled Debt Restructurings:			
Commercial	2	$ 241	$ 241
Real estate:			
Construction and other	-	-	-
1-4 and multifamily residential	3	306	306
Commercial real estate	2	1,968	1,968
Consumer and other	-	-	-
Total	7	$ 2,515	$ 2,515
2015 Troubled Debt Restructurings:			
Commercial	1	$ 16	$ 16
Real estate:			
Construction and other	-	-	-
1-4 and multifamily residential	2	180	180
Commercial real estate	2	172	172
Consumer and other	-	-	-
Total	5	$ 368	$ 368

The troubled debt restructurings described in the above table had allocated specific reserves of $105 and $15 as of December 31, 2016 and 2015 and resulted in no charge-offs during the years ended December 31, 2016 and 2015.

The following table presents loans by class which had defaulted (became at least 60 days past due) during the years ended December 31, 2016 and 2015 after having been modified as a troubled debt restructuring within the previous 12 months:

Troubled Debt Restructurings That Subsequently Defaulted:	Number of Loans	Recorded Investment
2016:		
Commercial	-	$ -
Real estate:		
Construction and other	-	-
1-4 and multifamily residential	-	-
Commercial Real Estate	1	71
Consumer and other	-	-
Total	1	$ 71

(Dollars in thousands except per share data)

NOTE 5 - ALLOWANCE FOR LOAN LOSSES (Continued)

Troubled Debt Restructurings That Subsequently Defaulted:	Number of Loans	Recorded Investment
2015:		
Commercial	-	$ -
Real estate:		
Construction and other	1	152
1-4 and multifamily residential	2	240
Commercial Real Estate	-	-
Consumer and other	-	-
Total	3	$ 392

The troubled debt restructurings that subsequently defaulted described in the above table did not have a specific reserve as of December 31, 2016 and 2015 and resulted in no charge-offs during the years ended December 31, 2016 and 2015.

In order to determine whether a borrower is experiencing financial difficulty, an evaluation is performed of the probability that the borrower will be in payment default on any of its debt in the foreseeable future without the modification. This evaluation is performed under the Bank's internal underwriting policy.

NOTE 6 - PREMISES AND EQUIPMENT

The following is a summary of the major components of premises and equipment as of December 31:

	2016	2015
Land	$ 13,898	$ 13,273
Bank premises	76,468	71,411
Leasehold improvements	219	219
Furniture and equipment	32,742	31,246
Construction in process	633	5,524
Total premises and equipment	123,960	121,673
Less: Accumulated depreciation and amortization	74,724	71,414
Premises and equipment, net	$ 49,236	$ 50,259

Depreciation and amortization expense on premises and equipment for the years ended December 31, 2016 and 2015 totaled $3,726 and $3,640, respectively.

During 2016 and 2015, the Bank transferred $0 and $546, respectively from premises and equipment to other real estate owned. The properties were transferred at the lower of cost or fair value. The property transferred in 2015 was a previous branch location the Bank vacated upon opening a new branch in the same area. The branch was sold in 2016.

(Continued)

(Dollars in thousands except per share data)

NOTE 7 - OTHER REAL ESTATE OWNED

The following is an analysis of the changes in other real estate owned:

	2016	2015
Balance, January 1	$ 19,975	$ 17,181
Acquired upon foreclosure	546	424
Transfers from Bank premises	-	546
Capitalized improvements	225	3,074
Dispositions	(3,491)	(1,102)
Depreciation	(152)	(148)
Balance, December 31	17,103	19,975
Less Devaluation Reserves:		
Balance, January 1	(2,907)	(2,736)
Impairments subsequent to foreclosure	(2,490)	(272)
Dispositions	516	101
Balance, December 31	(4,881)	(2,907)
Other real estate owned, net	$ 12,222	$ 17,068

Net gains on sales of other real estate owned included in other noninterest expense for the years ended December 31, 2016 and 2015, totaled $184 and $293, respectively. Operating expenses, net of rental income totaled $43 and $227 for the years ended December 31, 2016 and 2015, respectively.

NOTE 8 - MORTGAGE SERVICING RIGHTS

The following is an analysis of the changes in mortgage servicing rights:

	2016	2015
Balance, January 1,	$ 3,254	$ 3,738
Additions -		
Capitalization of servicing assets	1,489	1,168
Subtractions:		
Amortization	(1,176)	(1,283)
Accelerated amortization due to early payoffs	(421)	(369)
Balance, December 31,	$ 3,146	$ 3,254

(Dollars in thousands except per share data)

NOTE 8 - MORTGAGE SERVICING RIGHTS (Continued)

Mortgage servicing rights (MSRs) are accounted for under the amortization method. MSRs are included in other assets. MSRs are initially recorded at estimated fair value and are then amortized in proportion to and over the period of estimated net servicing income. The fair value of MSRs is estimated at the present value of the estimated expected future cash flows using a discount rate equivalent with the risks involved. MSRs are amortized against mortgage loan servicing income over seven years based upon prepayment assumptions. Those prepayment assumptions predict mortgages will pay off or refinance at lower levels during the first 30 months and at a constant level over the remaining 54 months. Accordingly, MSRs are amortized against mortgage loan servicing income at higher levels during the initial 30 months. If actual payments received exceed the prepayment assumptions, an impairment is recorded. An impairment of $94 and $0 has been recorded for 2016 and 2015, respectively.

NOTE 9 - DEPOSITS

Total deposits by type of depositor as of December 31:

	2016	2015
Deposits of individuals, partnerships, and corporations	$ 2,401,745	$ 2,375,070
Deposits of U.S. government	828	637
Deposits of states and political subdivisions	72,936	49,710
Other deposits	166	205
Total deposits	$ 2,475,675	$ 2,425,622

As of December 31, 2016 and 2015 the aggregate deposits of related parties (directors and executive officers of the Bank and their family members) were $14,317 and $11,960, respectively.

Time deposits have aggregate maturities as of December 31 as follows:

Maturity:	2016
2017	123,122
2018	5,015
2019	3,848
2020	2,253
2021	2,975
Total time deposits	$ 137,213

Time deposits that meet or exceed the FDIC Insurance Limit of $250 were $57,458 and $52,772 as of December 31, 2016 and 2015, respectively.

(Continued)

(Dollars in thousands except per share data)

NOTE 10 - SECURITIES SOLD UNDER AGREEMENTS TO REPURCHASE

Selected balances and rates are as follows:

	2016	2015
Maximum monthly average balance	$ 664,677	$ 736,791
Average daily balance	$ 647,518	$ 677,216
Average rate during year	0.15%	0.14%
Average rate at December 31	0.16%	0.14%

Investment securities, primarily including U.S. Treasuries and U.S. government-sponsored enterprises, with carrying amounts of $784,195 and $854,457 at December 31, 2016 and 2015, respectively, were pledged to secure securities sold under agreements to repurchase. As of December 31, 2016 all repurchase agreements matured within 1 business day.

As of December 31, 2016 and 2015, aggregate repurchase agreement balances of related parties (directors and executive officers of the Bank and their family members) were $3,254 and $1,601, respectively.

NOTE 11 - LEASES

The Bank is party to various operating leases for the rental of premises and equipment. Total rental expenses for Bank premises and equipment were $326 and $352 as of December 31, 2016 and 2015, respectively.

Aggregate minimum rental commitments under noncancelable operating leases (with initial or remaining lease terms in excess of one year) and future minimum capital lease payments as of December 31, 2016 were:

	Operating Leases
Year ended December 31:	
2017	179
2018	167
2019	148
2020	142
2021	142
Thereafter	3,678
Total minimum lease payments	$ 4,456

(Continued)

NOTE 12 - SHAREHOLDERS' EQUITY

Since November 2008 the Bank has been authorized to repurchase up to a value of $100,000 of its outstanding common stock on the open market and through privately negotiated transactions. The original program term expired in August 2009 and has been renewed annually since that period. The existing authority expires March 29, 2017.

Repurchase transactions are accounted for as a reduction in common stock and retained earnings. Repurchases are funded from available capital and retired. These transactions have not impacted the surplus balance of $40,000 as of December 31, 2016 and 2015, which is maintained to comply with regulatory requirements. Changes to surplus require regulatory approval.

During 2016, the Bank repurchased a total of 1,294 shares of common stock representing an aggregate purchase value of $1,835, at an average price per share of $1,418. During 2015, the Bank repurchased a total of 2,083 shares of common stock representing an aggregate purchase value of $3,165, at an average price per share of $1,519. Cumulative shares of 27,620 have been repurchased under the program since inception for a combined purchase total of $44,499.

At the January 26, 2017, Board of Directors meeting, cash dividends of $20 per share were declared, payable March 15, 2017 to shareholders of record as of March 1, 2017.

NOTE 13 - LITIGATION

From time to time in the normal course of business, various claims are asserted against the Bank. Management and legal counsel are of the opinion that ultimate resolution of the matters presently known to exist will not have a material effect on the Bank's financial statements.

The Bank's payment services include acquisition of Visa credit card transactions from merchants who use the Bank's merchant services. In order to be able to acquire those transactions the Bank is a member of the Visa U.S.A. credit card association.

During 2004, Discover Financial Services, Inc. filed an action against Visa U.S.A. and others seeking treble damages and injunctive relief under Federal antitrust laws. Also in 2004, American Express Travel Related Services Company, Inc. filed a similar action against Visa U.S.A. and others. There was other related litigation as well.

During 2007, Visa closed a restructuring of its organization. As part of this reorganization, the Visa U.S.A. by-laws were amended and included an indemnification provision whereby the Bank, as a member of Visa U.S.A., is required to indemnify Visa for acts and omissions of the Bank related to the Visa network and for certain specified litigation involving Visa U.S.A. An escrow arrangement was established anticipating the use of escrowed funds to pay the amount of certain Visa U.S.A. litigation expenses and settlements, including the Discover and American Express cases discussed above. Consequently, under ASC Topic 460, the Bank was required to measure the indemnification obligation related to the Visa litigation at fair value.

(Continued)

(Dollars in thousands except per share data)

NOTE 13 – LITIGATION (Continued)

In late 2007 and 2008, respectively, Visa Inc., Visa U.S.A. and Visa International entered into agreements with American Express and Discover Financial Services to resolve all current litigation between them. Under the agreements Visa Inc. agreed to pay American Express $2,065,000 and $1,888,000 to Discover Financial Services. The Bank's membership proportion according to the number of shares it was issued upon restructuring is 0.02331% after share repurchase adjustments.

The Bank has carried reserves for litigation expense for proportional exposure under these matters deemed covered litigation by VISA Inc. since 2007. The reserve is $1,500 as of December 31, 2016 and 2015. The Bank has not recorded in its financial statements any value for its membership interest in Visa Inc.

The Bank has a $1,500 escrow receivable as of December 31, 2016 and 2015, respectively, representing the Bank's proportionate share of remaining escrowed funds Visa set aside to the purpose of settling these litigation claims.

The specified litigation discussed above includes outstanding unresolved claims against Visa U.S.A., which are complex and subject to substantial uncertainty and unspecified damages. As such, the ultimate outcome of the cases and corresponding indemnification may be significantly different than the value estimated in the December 31, 2016 financial statements.

NOTE 14 - MORTGAGE LOAN SERVICING INCOME

Mortgage loan servicing income is comprised of the following:

	2016	2015
Mortgage loan servicing fees	$ 3,414	$ 3,489
Amortization of costs	(1,176)	(1,283)
Accelerated amortization due to early payoffs	(421)	(369)
Mortgage loan servicing income	$ 1,817	$ 1,837

NOTE 15 - EMPLOYEE BENEFIT PLANS

The Bank has a qualified non-contributory profit sharing plan for all employees. Vesting begins at 20% after completion of two full years of service, increasing 20% per year until fully vested at the completion of six years of service. The annual profit sharing contribution can be made only from profits and the amount is determined by the Board of Directors.

The Bank offers a 401(k) plan for all employees whom have attained 18 years of age. Participants are allowed to make voluntary salary deferral of up to 50% of their eligible pay subject to certain limitations. For 2016, the maximum amount that may be deferred by participant is $18. Additionally, participants who reach the age of 50 by the end of the calendar year are eligible to make a "catch-up contribution" in an amount up to $6.

(Continued)

(Dollars in thousands except per share data)

NOTE 15 - EMPLOYEE BENEFIT PLANS (Continued)

The Bank will make matching contributions equal to 50% of the portion of each participant's before-tax contributions (excluding "catch-up contributions") that do not exceed 7.5% of the participant's eligible pay. The participant's salary deferral plus any earnings they generate are 100% vested. Matching contributions made by the Bank, including any earnings generated, are vested beginning at 20% after completion of two full years of service, increasing 20% each year until fully vested at six years of service. The 2016 combined limit of all employee and employer contributions to an individual participant's account is $53.

The contribution to the profit sharing and 401(k) plan was $1,500 for each of the years ended December 31, 2016 and 2015.

NOTE 16 - PROVISION FOR INCOME TAXES

The provision for income taxes is comprised of the following as of December 31:

	2016	2015
Current:		
Federal	$ 17,975	$ 14,817
State	3,011	2,134
Total current	20,986	16,951
Deferred:		
Federal	(531)	(154)
State	(93)	(27)
Total deferred	(624)	(181)
Provision for income taxes	$ 20,362	$ 16,770

Income tax expense differed from the Federal statutory rate of 35% for 2016 and 2015 for the following reasons:

	2016	%	2015	%
Tax expense at federal statutory rate	$ 26,614	35.00%	$ 18,513	35.00%
Increase (decrease) resulting from:				
State tax, net of Federal tax effect	1,902	3.08	1,364	2.58
Disallowed interest expense	56	0.09	50	0.09
Interest exempt from federal taxation	(2,247)	(3.64)	(2,050)	(3.88)
Low income housing tax credits	(998)	(1.62)	(1,224)	(2.31)
Other items, net	35	0.06	117	0.22
Provision for income taxes	$ 20,362	32.97%	$ 16,770	31.70%

(Continued)

(Dollars in thousands except per share data)

NOTE 16 - PROVISION FOR INCOME TAXES (Continued)

The tax effect of temporary differences that give rise to the Bank's deferred tax assets and deferred tax liabilities are comprised of the following:

	2016	2015
Deferred tax assets:		
Allowance for loan losses	$ 6,824	$ 6,229
Mortgage servicing rights	397	367
Interest collected on nonperforming loans	1,422	1,550
Vacation accrual	1,375	1,353
Accumulated depreciation and amortization	1,437	1,308
Other real estate owned valuation reserve	2,899	1,981
Net unrealized holding loss on securities, available-for-sale	4,358	-
Low income housing projects	52	-
Other	766	971
Total deferred tax assets	19,530	13,759
Deferred tax liabilities:		
Net unrealized holding gain on securities, available-for-sale	-	1,513
Net deferred loan fees	3,752	3,382
Low income housing projects	-	337
Deferred loan costs	1,276	607
Other	1,194	1,107
Total deferred tax liabilities	6,222	6,946
Net deferred tax assets	$ 13,308	$ 6,813

Net deferred tax assets are included in other assets in the statements of financial condition. Net deferred tax liabilities are included in other liabilities in the statements of financial condition. The Bank believes that it is more likely than not that the previous taxes paid and results of future operations will generate sufficient taxable income to realize deferred tax assets.

The Bank does not have any material uncertain tax positions or unrecognized tax benefits for additional disclosure in the financial statements.

The total amount of interest and penalties recorded in the income statement for the years ended December 31, 2016 and 2015 were immaterial and no amounts are accrued for interest and penalties at December 31, 2016 or 2015.

The Bank is subject to U.S. federal income tax as well as income tax for the state of Alaska and various other state income and franchise taxes. The Bank is no longer subject to examination by taxing authorities for years before 2013.

(Continued)

NOTE 16 - PROVISION FOR INCOME TAXES (Continued)

The Bank had purchased, at a discount, tax credits under the Alaska Film Production Incentive Program, which awards transferable tax credits to film producers who choose to film in Alaska. These credits can be used towards the Bank's State of Alaska tax liability and are fully negotiable and assignable for up to three years from the date of issuance. The Bank anticipates fully utilizing the credits against a portion of its State of Alaska tax liability. The Bank used $152 and $896 of the Alaska film tax credits as of December 31, 2016 and 2015, respectively, to offset its State of Alaska tax obligations. As of December 31, 2016, there was $0 in remaining tax credits.

NOTE 17 - ESTIMATED FAIR VALUE OF FINANCIAL INSTRUMENTS

GAAP requires disclosure of the estimated fair values of certain financial assets and liabilities, both on and off-balance sheet, for which it is practical to estimate the fair value. Because the estimated fair values provided herein exclude disclosure of the fair value of certain other financial instruments and all non-financial instruments, any aggregation of the estimated fair value amounts presented would not represent the underlying value of the Bank. Examples of non-financial instruments having significant value include the future earnings potential of significant customer relationships and the value of the Bank's trust department operations and other fee-generating businesses. In addition, other significant assets including property, plant, and equipment and mortgage servicing rights for portfolio loans are not considered financial instruments and, therefore, have not been valued.

Various methodologies and assumptions have been utilized in management's determination of the estimated fair value of the Bank's financial instruments, which are detailed below. The fair value estimates are made at a discrete point in time based on relevant market information. Because no market exists for a significant portion of these financial instruments, fair value estimates are based on judgments regarding future expected economic conditions, loss experience, and risk characteristics of the financial instruments. These estimates are subjective, involve uncertainties, and cannot be determined with precision. Changes in assumptions could significantly affect the estimates. In addition to the valuation methodology explained above for financial instruments recorded at fair value, the following methods and assumptions were used in estimating the fair value of financial instruments that are carried at cost in the Statements of Condition as of December 31, 2016 and 2015:

<u>Cash and Cash Equivalents</u>: The carrying amount is a reasonable estimate of the fair value.

<u>Securities, Available-for-Sale</u>: Where quoted prices are available in an active market for identical securities, they are utilized. If quoted market prices are not available, then fair values are estimated by using pricing models and quoted prices of securities with similar characteristics.

<u>Real Estate Loans To Be Sold</u>: The carrying amount plus unearned loan fees is a reasonable estimate of the fair value as it reflects the short-term nature of the commitment and a commitment to sell at a fixed price.

(Continued)

NOTE 17 - ESTIMATED FAIR VALUE OF FINANCIAL INSTRUMENTS (Continued)

Loans: The fair value is estimated by discounting the future scheduled cash flows using the current rates at which similar loans with similar maturities would be made to similar borrowers plus unearned income. The fair value of delinquent and nonaccrual loans are estimated on an individual basis, taking into account management's estimate of probable losses associated with the loan, and discounting the estimated future cash flows using current rates for similar maturities. The fair value does not necessarily represent an exit price.

Federal Reserve Bank (FRB) and Federal Home Loan Bank (FHLB) of Des Moines Stock: The stock is required to be sold back at its par value. It is not practicable to determine the fair value of FRB or FHLB stock due to restrictions placed on transferability.

Interest Receivable: The carrying amount is a reasonable estimate of the fair value.

Deposits: The carrying value of demand deposits, savings accounts, NOW accounts and money market accounts approximates fair value.

Time Deposits: The fair value is estimated by discounting the future cash flows using rates currently offered for time deposits of similar remaining maturities, which are based on an observation and evaluation of current market rates.

Securities Sold Under Agreements to Repurchase: The carrying amount is a reasonable estimate of the fair value.

Notes Payable and Capital Leases: The carrying amounts are reasonable estimates of the fair value of notes payable and capital leases.

Interest Payable: The carrying amount is a reasonable estimate of the fair value.

The fair value estimates presented herein are based on pertinent information available to management as of December 31, 2016 and 2015. Although management is not aware of any factors that would significantly affect the estimated fair value amounts, such amounts have not been comprehensively revalued for purposes of these financial statements since that date, and current estimates of fair value may differ significantly from the amounts presented herein.

(Continued)

(Dollars in thousands except per share data)

NOTE 17 - ESTIMATED FAIR VALUE OF FINANCIAL INSTRUMENTS (Continued)

Amounts and estimated fair value of financial instruments as of December 31,

	2016		2015	
	Carrying Amount	Estimated Fair Value	Carrying Amount	Estimated Fair Value
Financial assets:				
Cash and cash equivalents	$ 79,127	$ 79,127	$ 81,278	$ 81,278
Securities, available-for-sale	1,745,429	1,745,429	1,832,601	1,832,601
Real estate loans to be sold	12,089	12,145	10,418	10,479
Loans:				
Commercial and industrial	318,241	316,330	290,869	283,559
Real estate	1,323,312	1,325,689	1,226,280	1,233,110
Consumer and other	19,442	18,901	19,106	18,751
Total loans, net	1,660,995	1,660,920	1,536,255	1,535,420
Federal Reserve Bank stock	2,155	N/A	2,162	N/A
Federal Home Loan Bank stock	4,283	N/A	3,975	N/A
Interest receivable	16,603	16,603	15,321	15,321
Financial liabilities:				
Deposits:				
Non-interest bearing	1,306,357	1,306,357	1,290,689	1,290,689
Interest bearing:				
Savings	665,791	665,791	632,948	632,948
NOW	207,270	207,270	201,665	201,665
Money market	159,044	159,044	167,051	167,051
Time	137,213	138,319	133,269	134,455
Total interest bearing	1,169,318	1,170,424	1,134,933	1,136,119
Total deposits	2,475,675	2,476,781	2,425,622	2,426,808
Securities sold under agreements to repurchase	629,966	629,966	645,838	645,838
Notes payable and capital lease obligations	9	9	62	62
Interest payable	85	85	76	76

(Continued)

NOTE 17 - ESTIMATED FAIR VALUE OF FINANCIAL INSTRUMENTS (Continued)

In accordance with ASC Topic 820, we measure some of the financial assets and financial liabilities disclosed in the following tables at fair value in three levels based on the markets in which the assets and liabilities are traded and reliability of the assumptions used to determine fair value. The levels are:

Level 1 Valuations for assets and liabilities traded in active exchange markets, or interest in open-end mutual funds that allow the Bank to sell its ownership interest back to the fund at net asset value (NAV) on a daily basis. Valuations are obtained from readily available pricing sources for market transactions involving identical assets, liabilities, or funds. Level 1 includes U.S. Treasury Securities.

Level 2 Valuations for assets and liabilities traded in less active dealer, or broker markets, such as quoted prices for similar assets or liabilities or quoted prices in markets that are not active. Level 2 includes U. S. government-sponsored enterprises, securities of state and political subdivisions, residential mortgage-backed securities, and corporate bonds. Valuations are usually obtained from third party pricing services for identical or comparable assets or liabilities.

Level 3 Valuations for assets and liabilities that are derived from other valuation methodologies, such as option pricing models, discounted cash flow models and similar techniques, and not based on market exchange, dealer, or broker traded transactions. Level 3 valuations incorporate certain assumptions and projections in determining the fair value assigned to such assets or liabilities.

(Dollars in thousands except per share data)

NOTE 17 - ESTIMATED FAIR VALUE OF FINANCIAL INSTRUMENTS (Continued)

Assets measured at fair value on a recurring basis:

		Fair Value Measurements Using		
	Total	Quoted Prices in Active Markets For Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
2016				
Securities:				
U.S. Treasury securities	$ 226,735	$ 226,735	$ -	$ -
U.S. government-sponsored enterprises	909,330	-	909,330	-
States and political subdivisions	294,197	-	294,197	-
Mortgage-backed securities – residential	3,609	-	3,609	-
Corporate bonds	311,558	-	311,558	-
Securities total	$ 1,745,429	$ 226,735	$ 1,518,694	$ -
2015				
Securities:				
U.S. Treasury securities	$ 227,110	$ 227,110	$ -	$ -
U.S. government-sponsored enterprises	1,128,559	-	1,128,559	-
States and political subdivisions	258,669	-	258,669	-
Mortgage-backed securities – residential	5,044	-	5,044	-
Corporate bonds	213,219	-	213,219	-
Securities total	$ 1,832,601	$ 227,110	$ 1,605,491	$ -

For investment securities, where quoted prices are available in an active market for identical securities they are classified within Level 1 of the valuation hierarchy. If quoted market prices are not available, then fair values are estimated by using pricing models and quoted prices of securities with similar characteristics.

Where there is limited activity or less transparency around inputs to the valuation, investment securities are classified within Level 3 of the valuation hierarchy. No securities were classified as Level 3 during 2016 and 2015.

The majority of the Bank’s investments are in high-quality short term U.S. Treasury, U.S. government-sponsored enterprise bonds where the fair values are determined by the Bank’s pricing service using quoted prices of similar securities. As of December 31, 2016 the Bank had no investments in Fannie Mae or Freddie Mac common or preferred stock.

(Continued)

(Dollars in thousands except per share data)

NOTE 17 - ESTIMATED FAIR VALUE OF FINANCIAL INSTRUMENTS (Continued)

Assets measured at fair value on a nonrecurring basis:

	Total	Quoted Prices in Active Markets For Identical Assets Level 1	Significant Other Observable Inputs Level 2	Significant Unobservable Inputs Level 3
December 31, 2016				
Loans – Real estate	$ 4,806	$ -	$ -	$ 4,806
Other real estate owned:				
Construction and development	7,671	-	-	7,671
Commercial	2,085	-	-	2,085
Total	$ 14,595	$ -	$ -	$ 14,595
December 31, 2015				
Loans – Real estate	$ 505	$ -	$ -	$ 505
Other real estate owned:				
Construction and development	8,781	-	-	8,781
Commercial	2,883	-	-	2,883
Total	$ 12,169	$ -	$ -	$ 12,169

The fair value of impaired residential real estate loans is based on the value of the collateral securing those loans and is determined using the sale or market comparison. The market comparison evaluates the sales price of similar properties in the same market area. Impaired loans that are measured for impairment using the fair value of the collateral for collateral dependent loans resulted in an additional provision for loan losses of $350 and $21 for the years ended December 31, 2016 and 2015, respectively.

The fair value of other real estate owned is based upon the current appraised values of the properties. Appraisals are obtained at least annually and reductions in value are recorded as a valuation loss through a charge to expense. Other real estate owned measured at fair value less costs to sell resulted in write-downs of $2,022 and $272 for the years ended December 31, 2016 and 2015, respectively.

(Continued)

(Dollars in thousands except per share data)

NOTE 17 - ESTIMATED FAIR VALUE OF FINANCIAL INSTRUMENTS (Continued)

The following table presents quantitative information about level 3 fair value measurements for financial instruments measured at fair value on a nonrecurring basis at December 31, 2016 and 2015:

December 31, 2016	Fair value	Valuation Technique	Unobservable Input	Range (Weighted Average)
Loans – Real estate	$ 4,806	Sales comparison approach	Adjustment for differences between the comparable sales	-0.21% to -51.58% (-3.21%)
Other real estate owned – Construction and development	$ 7,671	Sales comparison approach	Adjustment for differences between the comparable sales	-3.27% to -12.57% (-6.26%)
Other real estate owned – Commercial	$ 2,085	Sales comparison approach	Adjustment for differences between the comparable sales	24.50%

December 31, 2015	Fair value	Valuation Technique	Unobservable Input	Range (Weighted Average)
Loans – Real estate	$ 505	Sales comparison approach	Adjustment for differences between the comparable sales	-13.26% to -60.32% (-27.10%)
Other real estate owned – Construction and development	$ 8,781	Sales comparison approach	Adjustment for differences between the comparable sales	-3.00% to -12.00% (-7.84%)
Other real estate owned – Commercial	$ 2,883	Sales comparison approach	Adjustment for differences between the comparable sales	-7.00%

ASC Topic 825 provides an option to selectively report financial assets and financial liabilities at fair value and establishes presentation and disclosure requirements. The Bank did not elect the fair value option for any additional financial assets or liabilities as of December 31, 2016. The Bank may adopt this guidance for financial assets and liabilities in the future as permitted under the guidance.

NOTE 18 - CREDIT ARRANGEMENTS

The Bank had a committed line of credit, secured by investment securities, of $65,733 and $95,135 from the Federal Reserve Bank at a rate of 1.25% and 1.00% as of December 31, 2016 and 2015, respectively. In addition, the Bank also had federal funds arrangements available from unaffiliated banks totaling $80,000 at a rate estimated at 0.64 – 0.70% and 0.52 – 0.64% as of December 31, 2016 and 2015 respectively. There were no outstanding balances against these lines of credit as of December 31, 2016 or 2015.

(Dollars in thousands except per share data)

NOTE 19 - COMMITMENTS AND CONTINGENCIES

The Bank is party to financial instruments with off-balance-sheet risk in the normal course of business to meet the financing needs of its customers. These instruments include standby letters of credit, loan commitments, subscriptions for the purchase of stock in the Federal Reserve Bank, and commitments to purchase and sell securities. The credit and market risks involved in issuing letters of credit and loan commitments are essentially the same as those involved in extending loans to customers. Such transactions are made under the same terms, including interest rates and collateral, as those prevailing at the same time for comparable on-balance-sheet transactions.

To reduce credit risk, related to the use of credit-related financial instruments, the Bank might deem it necessary to obtain collateral. The amount and nature of the collateral obtained is based on the Bank's credit evaluation of the customer. Collateral varies but may include cash, securities, accounts receivable, inventory, premises and equipment, and real estate.

Amounts of off-balance-sheet commitments as of December 31,

	2016	2015
Loan commitments	$ 551,844	$ 559,992
Bankcard commitments	67,288	67,426
Commitments to fund mortgage loans to be sold	37,774	31,864
Total loan commitments	$ 656,906	$ 659,282
Commitments at fixed interest rates	$ 309,390	$ 177,875
Commitments at variable interest rates	347,516	481,407
Total loan commitments	$ 656,906	$ 659,282
Standby and commercial letters of credit	$ 8,406	$ 8,480
Subscriptions to purchase Federal Reserve Bank stock	2,155	2,162

Commitments to make loans are generally made for periods of 90 days or less. At December 31, 2016, the fixed rate loan commitments have interest rates ranging from 2.88% to 16.50%.

(Continued)

NOTE 20 - REGULATORY MATTERS

The Bank is subject to various regulatory capital requirements administered by the federal banking agencies. Failure to meet minimum capital requirements can initiate certain mandatory - and possible additional discretionary - actions by regulators that, if undertaken, could have a direct material effect on the Bank's financial statements.

The directors of the Bank may declare and pay dividends as frequently and of such amount of undivided profits as they judge prudent, subject to certain restrictions on capital accounts as defined in Federal banking regulations.

Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Bank must meet specific capital guidelines that involve quantitative measures of the Bank's assets, liabilities, and certain off-balance-sheet items as calculated under regulatory accounting practices. The Bank's capital amounts and classification are also subject to qualitative judgments by the regulators about components, risk weightings, and other factors.

The final rules implementing Basel Committee on Banking Supervision's capital guidelines for U.S. Banks (Basel III rules) became effective for the Bank on January 1, 2015 with full compliance with all of the requirements being phased in over a multi-year schedule, and fully phased in by January 1, 2019. Under the Basel III rules, the Bank must hold a capital conservation buffer above the adequately capitalized risk-based capital ratios. The capital conservation buffer is being phased in from 0.0% for 2015 to 2.50% by 2019. The capital conservation buffer for 2016 is 0.625%. The net unrealized gain or loss on available for sale securities is not included in computing regulatory capital. Management believes, as of December 31, 2016, that the Bank meets all capital adequacy requirements to which it is subject.

As of December 31, 2016, the most recent notifications from the Comptroller of the Currency (OCC) categorized the Bank as well capitalized under the regulatory framework for prompt corrective action for both 2016 and 2015. To be categorized as well capitalized, the Bank is required to maintain minimum total risk-based, Common Tier I, Tier I risk-based, Tier I leverage ratios as set forth in the table. There are no conditions or events since that notification that management believes have changed the institution's category.

(Dollars in thousands except per share data)

NOTE 20 - REGULATORY MATTERS (Continued)

The Bank's actual amounts and ratios at December 31, 2016 and 2015 are as follows:

	Actual		Minimum Requirement for Capital Adequacy Purposes Plus Fully Phased In Capital Conservation Buffer		Minimum Requirement to Be Well Capitalized Under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
2016						
Total capital (to risk-weighted assets)	$ 516,478	20.60%	$200,557	10.50%	$250,696	10.00%
Tier I capital (to risk-weighted assets)	498,978	19.90%	150,418	8.50%	200,557	8.00%
Common Tier I (CET1)	498,978	19.90%	112,813	7.00%	162,953	6.50%
Tier I capital (to average assets)	498,978	13.57%	147,039	4.00%	183,798	5.00%
2015						
Total capital (to risk-weighted assets)	$ 502,748	21.40%	$187,965	10.50%	$ 234,957	10.00%
Tier I capital (to risk-weighted assets)	486,398	20.70%	140,974	8.50%	187,965	8.00%
Common Tier I (CET1)	486,398	20.70%	105,730	7.00%	152,722	6.50%
Tier I capital (to average assets)	486,398	13.18%	147,619	4.00%	184,524	5.00%

The Bank's principal source of funds for dividend payments is net income and cash provided by operations. Banking regulations limit the amount of dividends that may be paid without prior approval of the OCC. Under these regulations, the amount of dividends that may be paid in any calendar year is subject to the current year's net profits (net income less dividends paid), combined with the retained net profits of the preceding two years, subject to the minimum requirements for capital adequacy in the table above. The maximum dividend that can be paid as of December 31, 2016 is $51,081 without OCC approval.