

**FIRST NATIONAL BANK ALASKA**  
Anchorage, Alaska

**FINANCIAL STATEMENTS**  
December 31, 2015 and 2014

FIRST NATIONAL BANK ALASKA  
Anchorage, Alaska

FINANCIAL STATEMENTS  
December 31, 2015 and 2014

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## 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, 2015 and 2014, 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.

### 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, 2015 and 2014, 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.

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(Continued)

## Report on Other Legal and Regulatory Requirements

We also have examined in accordance with attestation standards established by the American Institute of Certified Public Accountants, First National Bank Alaska's internal control over financial reporting as of December 31, 2015, based on criteria established in the 1992 Internal Control – Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) and our report dated March 9, 2016 expressed an unqualified opinion.



Crowe Horwath LLP

Oak Brook, Illinois  
March 9, 2016

FIRST NATIONAL BANK ALASKA  
STATEMENTS OF FINANCIAL CONDITION  
December 31, 2015 and 2014  
(Dollars in thousands, except per share data)

	<u>2015</u>	<u>2014</u>
<b>ASSETS</b>		
Cash and cash equivalents	\$ 81,278	\$ 95,391
Securities, available-for-sale	1,832,601	1,743,439
Real estate loans to be sold	10,418	11,023
Loans:		
Commercial and industrial	294,543	255,740
Real estate	1,237,382	1,107,416
Consumer and other	19,480	15,840
Total loans, gross	<u>1,551,405</u>	<u>1,378,996</u>
Less: Allowance for loan losses	<u>15,150</u>	<u>13,100</u>
Total loans, net	1,536,255	1,365,896
Premises and equipment, net	50,259	43,712
Other real estate owned, net	17,068	14,445
Other assets	<u>41,547</u>	<u>38,264</u>
Total assets	<u>\$ 3,569,426</u>	<u>\$ 3,312,170</u>
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
Liabilities:		
Deposits:		
Noninterest bearing	\$ 1,290,689	\$ 1,111,214
Interest bearing:		
Savings	632,948	590,238
NOW	201,665	198,412
Money market	167,051	166,132
Time	<u>133,269</u>	<u>137,236</u>
Total interest bearing	<u>1,134,933</u>	<u>1,092,018</u>
Total deposits	2,425,622	2,203,232
Securities sold under agreements to repurchase	645,838	628,276
Capital lease obligations	62	115
Other liabilities	<u>9,339</u>	<u>8,724</u>
Total liabilities	3,080,861	2,840,347
Shareholders' equity:		
Common stock, \$100 par value (authorized: 2015 and 2014 – 400,000 shares) (issued and outstanding: 2015 – 318,433; 2014 – 320,516)	31,843	32,052
Surplus	40,000	40,000
Retained earnings	414,555	397,359
Accumulated other comprehensive income	<u>2,167</u>	<u>2,412</u>
Total shareholders' equity	<u>488,565</u>	<u>471,823</u>
Total liabilities and shareholders' equity	<u>\$ 3,569,426</u>	<u>\$ 3,312,170</u>

See accompanying notes to financial statements.

FIRST NATIONAL BANK ALASKA  
STATEMENTS OF INCOME  
Years ended December 31, 2015 and 2014  
(Dollars in thousands, except per share data)

	<u>2015</u>	<u>2014</u>
Interest income and loan fees:		
Interest and fees on loans:		
Taxable	\$ 84,506	\$ 79,023
Nontaxable	<u>2,285</u>	<u>2,345</u>
Total interest and fees on loans	86,791	81,368
Interest and dividends on investment securities:		
Taxable	25,443	21,804
Nontaxable	<u>3,621</u>	<u>2,112</u>
Total interest and dividends on investment securities	29,064	23,916
Interest on cash and cash equivalents	<u>173</u>	<u>200</u>
Total interest and loan fee income	116,028	105,484
Interest expense:		
Interest on deposits	827	899
Interest on federal funds purchased and securities sold under agreements to repurchase	943	820
Interest on notes payable, capital lease obligations and other	<u>1</u>	<u>5</u>
Total interest expense	<u>1,771</u>	<u>1,724</u>
Net interest and loan fee income	114,257	103,760
Provision for loan losses	<u>2,710</u>	<u>1,006</u>
<b>Net interest and loan fee income after provision for loan losses</b>	111,547	102,754
Noninterest income:		
Bankcard fees	9,646	11,553
Service charges on deposit accounts	4,718	4,597
Gain on sale of mortgage loans	2,432	1,960
Mortgage loan servicing income	1,837	1,756
Net gains on investment securities	376	678
Other noninterest income	<u>7,178</u>	<u>7,323</u>
Total noninterest income	26,187	27,867
Noninterest expense:		
Salaries and employee benefits	50,756	49,351
Occupancy expense, net	8,318	7,986
Furniture and equipment expense	2,433	2,116
Bankcard expenses	3,557	5,102
Other noninterest expense	<u>19,775</u>	<u>18,272</u>
Total noninterest expense	<u>84,839</u>	<u>82,827</u>
<b>Income before taxes</b>	52,895	47,794
Provision for income taxes	<u>16,770</u>	<u>15,199</u>
<b>Net income</b>	<u>\$ 36,125</u>	<u>\$ 32,595</u>
Earnings per common share	\$ 113.02	\$ 101.37

See accompanying notes to financial statements.

FIRST NATIONAL BANK ALASKA  
STATEMENTS OF COMPREHENSIVE INCOME  
Years ended December 31, 2015 and 2014  
(Dollars in thousands)

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	<u>2015</u>	<u>2014</u>
Net income	\$ 36,125	\$ 32,595
Other comprehensive income (loss) –		
Unrealized gains (losses) on securities:		
Unrealized holding gains (losses) arising during the period, net of tax effect of \$17 and \$(3,933) in 2015 and 2014, respectively	(23)	6,369
Reclassification adjustment for gains included in net income, net of tax effect of \$154 and \$279 in 2015 and 2014, respectively	<u>(222)</u>	<u>(399)</u>
Other comprehensive income (loss)	<u>(245)</u>	<u>5,970</u>
<b>Comprehensive Income</b>	<u><b>\$ 35,880</b></u>	<u><b>\$ 38,565</b></u>

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See accompanying notes to financial statements.

FIRST NATIONAL BANK ALASKA  
STATEMENTS OF CASH FLOWS  
Years ended December 31, 2015 and 2014  
(Dollars in thousands)

	<u>2015</u>	<u>2014</u>
<b>Cash flows from operating activities</b>		
Net income	\$ 36,125	\$ 32,595
Adjustments to reconcile net income to net cash provided by operating activities:		
Amortization of premium on investment securities, net	12,383	10,872
Loss from equity method investment	804	402
Depreciation, accretion and amortization	5,737	5,698
Provision for loan losses	2,710	1,006
Deferred taxes	(181)	(256)
Gain on sale of mortgage loans	(2,432)	(1,960)
Net gain on the sales of other real estate owned	(293)	(803)
Valuation adjustment on other real estate owned	272	813
Net loss on the sale of premises and equipment	224	2
Net gain on disposition of investment securities	(376)	(678)
Real estate loans to be sold-originated	(144,665)	(118,186)
Real estate loans to be sold-shipped	146,535	120,914
Net increase in other assets	(2,079)	(295)
Net increase in other liabilities	<u>716</u>	<u>1,022</u>
Net cash provided by operating activities	55,480	51,146
 <b>Cash flows from investing activities</b>		
Proceeds from calls and maturities of securities, available-for-sale	355,138	227,314
Proceeds from sales of securities, available-for-sale	203,268	174,851
Purchase of securities, available-for-sale	(659,992)	(535,779)
Net redemptions (purchases) of Federal Home Loan Bank stock	(2,440)	490
Net redemptions of Federal Reserve Bank stock	-	5
Net increase in loans, net of undisbursed portion	(144,012)	(62,840)
Purchase of participation loans	(29,028)	(21,544)
Proceeds from sales of premises and equipment	8	2
Purchase of land, premises and equipment	(10,965)	(3,410)
Improvements to other real estate owned	(3,074)	(2,909)
Proceeds from sales of other real estate owned	<u>743</u>	<u>5,316</u>
Net cash used in investing activities	(290,354)	(218,504)
 <b>Cash flows from financing activities</b>		
Net increase in total deposits	222,390	106,406
Net increase in securities		
sold under agreements to repurchase	17,562	82,664
Payments on notes and capital leases	(53)	(126)
Dividends paid	(15,973)	(16,081)
Retirement of common stock	<u>(3,165)</u>	<u>(3,197)</u>
Net cash provided by financing activities	<u>220,761</u>	<u>169,666</u>
 Increase (decrease) in cash and cash equivalents	(14,113)	2,308
 Cash and cash equivalents, January 1	<u>95,391</u>	<u>93,083</u>
 <b>Cash and cash equivalents, December 31</b>	<u>\$ 81,278</u>	<u>\$ 95,391</u>

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FIRST NATIONAL BANK ALASKA  
STATEMENTS OF CASH FLOWS  
Years ended December 31, 2015 and 2014  
(Dollars in thousands)

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	<u>2015</u>	<u>2014</u>
Supplemental disclosures of cash flow information:		
Cash paid during the year for interest	\$ 1,779	\$ 1,746
Cash paid during the year for income taxes	15,970	15,107
Noncash investing and financing activities:		
Transfer of loans to other real estate owned	\$ 424	\$ 441
Bank financed sales of other real estate owned	451	1,812
Transfer of land held for Bank premises to other real estate owned	546	4,779

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See accompanying notes to financial statements.

FIRST NATIONAL BANK ALASKA  
STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY  
Years ended December 31, 2015 and 2014  
(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, 2014	\$ 32,236	\$ 40,000	\$ 383,858	\$ (3,558)	\$ 452,536
Net income	-	-	32,595	-	32,595
Other comprehensive loss, net of tax	-	-	-	5,970	5,970
Dividends declared - \$50 per share	-	-	(16,081)	-	(16,081)
Retirement of common stock (1,840 shares)	<u>(184)</u>	<u>-</u>	<u>(3,013)</u>	<u>-</u>	<u>(3,197)</u>
Balance, December 31, 2014	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)	<u>(209)</u>	<u>-</u>	<u>(2,956)</u>	<u>-</u>	<u>(3,165)</u>
Balance, December 31, 2015	<u>\$ 31,843</u>	<u>\$ 40,000</u>	<u>\$ 414,555</u>	<u>\$ 2,167</u>	<u>\$ 488,565</u>

See accompanying notes to financial statements.

FIRST NATIONAL BANK ALASKA  
NOTES TO FINANCIAL STATEMENTS  
December 31, 2015 and 2014  
(Dollars in thousands except per share data)

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**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 March 9, 2016, 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.

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(Continued)

FIRST NATIONAL BANK ALASKA  
NOTES TO FINANCIAL STATEMENTS  
December 31, 2015 and 2014  
(Dollars in thousands except per share data)

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**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. 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 economic factors based on the risks present for each portfolio segment.

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(Continued)

FIRST NATIONAL BANK ALASKA  
NOTES TO FINANCIAL STATEMENTS  
December 31, 2015 and 2014  
(Dollars in thousands except per share data)

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**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. Financial information is obtained from the borrowers and/or the individual project to evaluate cash flows sufficiency to service debt 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, the loan's obtainable market price, 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.

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FIRST NATIONAL BANK ALASKA  
NOTES TO FINANCIAL STATEMENTS  
December 31, 2015 and 2014  
(Dollars in thousands except per share data)

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**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 \$1,200 and \$1,000 at December 31, 2015 and 2014, 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 betterments 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, (\$2,162 as of 2015 and 2014). 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 (Des Moines 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, (\$3,975 and \$1,535 as of 2015 and 2014, respectively). The minimum stock requirement is calculated based on the Bank's assets or qualifying loans, whichever applies.

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(Continued)

FIRST NATIONAL BANK ALASKA  
NOTES TO FINANCIAL STATEMENTS  
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(Dollars in thousands except per share data)

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**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 through 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. Under the equity method, the Bank includes its proportionate share of income or loss in other noninterest income or expense.

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(Continued)

FIRST NATIONAL BANK ALASKA  
NOTES TO FINANCIAL STATEMENTS  
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**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 319,633 and 321,544 for 2015 and 2014, 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 a separate note. Fair value estimates involve uncertainties and matters of significant judgment regarding interest rates, credit risk, prepayments, and other factors, especially in the absence of broad markets for particular items. Changes in assumptions or in market conditions could significantly affect these estimates.

Reclassifications: Reclassifications have been made to conform 2014 financial statement data with the 2015 presentation. Reclassifications had no effect on prior year net income or shareholders' equity.

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(Continued)



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**NOTE 1 - SIGNIFICANT ACCOUNTING AND REPORTING POLICIES** (Continued)

Adoption of New Accounting Standards: In May 2014, the 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 adoption of this standard is still being evaluated by management.

**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, 2015 and 2014 was \$22,833 and \$21,316, respectively.

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FIRST NATIONAL BANK ALASKA  
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**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, 2015:

	Amortized <u>Cost</u>	Unrealized <u>Gains</u>	Unrealized <u>Losses</u>	Fair <u>Value</u>
<u>December 31, 2015</u>				
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	<u>45,095</u>	<u>71</u>	<u>185</u>	<u>44,981</u>
Total	<u>226,001</u>	<u>1,314</u>	<u>205</u>	<u>227,110</u>
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	<u>309,014</u>	<u>698</u>	<u>1,248</u>	<u>308,464</u>
Total	<u>1,127,996</u>	<u>4,565</u>	<u>4,002</u>	<u>1,128,559</u>
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	<u>117,149</u>	<u>1,618</u>	<u>7</u>	<u>118,760</u>
Total	<u>256,586</u>	<u>2,169</u>	<u>86</u>	<u>258,669</u>
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	<u>53,545</u>	<u>165</u>	<u>345</u>	<u>53,365</u>
Total	<u>213,223</u>	<u>697</u>	<u>701</u>	<u>213,219</u>
Total securities, available-for-sale	<u>\$ 1,828,922</u>	<u>\$ 8,745</u>	<u>\$ 5,066</u>	<u>\$ 1,832,601</u>

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)

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**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
<u>2015</u>						
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	<u>71,718</u>	<u>574</u>	<u>44,925</u>	<u>127</u>	<u>116,643</u>	<u>701</u>
Total	<u>\$ 390,637</u>	<u>\$ 2,404</u>	<u>\$ 395,435</u>	<u>\$ 2,662</u>	<u>\$ 786,072</u>	<u>\$ 5,066</u>

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 bond(s) approach maturity.

At December 31, 2015, 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)

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**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, 2014:

	Amortized <u>Cost</u>	Unrealized <u>Gains</u>	Unrealized <u>Losses</u>	Fair <u>Value</u>
<u>December 31, 2014</u>				
U.S. Treasury securities maturities:				
One to 5 years	\$ 150,288	\$ 2,016	\$ -	\$ 152,304
U.S. government-sponsored enterprises maturities:				
Within 1 year	113,878	678	4	114,552
One to 5 years	885,133	5,097	3,987	886,243
Five to 10 years	<u>143,958</u>	<u>555</u>	<u>1,524</u>	<u>142,989</u>
Total	<u>1,142,969</u>	<u>6,330</u>	<u>5,515</u>	<u>1,143,784</u>
States and political subdivisions maturities:				
Within 1 year	18,042	107	-	18,149
One to 5 years	88,249	384	225	88,408
Five to 10 years	<u>95,034</u>	<u>422</u>	<u>290</u>	<u>95,166</u>
Total	<u>201,325</u>	<u>913</u>	<u>515</u>	<u>201,723</u>
Corporate bonds maturities:				
Within 1 year	103,092	464	51	103,505
One to 5 years	121,878	552	205	122,225
Five to 10 years	<u>19,792</u>	<u>107</u>	<u>1</u>	<u>19,898</u>
Total	<u>244,762</u>	<u>1,123</u>	<u>257</u>	<u>245,628</u>
Total securities, available-for-sale	<u>\$ 1,739,344</u>	<u>\$ 10,382</u>	<u>\$ 6,287</u>	<u>\$ 1,743,439</u>

Within the state and political subdivisions category, the largest concentrations of securities, available-for-sale are held in Utah with 35%, Texas with 32%, and Alaska with 17% of the category.

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, 2014, were as follows:

	<u>Less Than 12 Months</u>		<u>12 Months or More</u>		<u>Total</u>	
	<u>Fair Value</u>	<u>Unrealized Losses</u>	<u>Fair Value</u>	<u>Unrealized Losses</u>	<u>Fair Value</u>	<u>Unrealized Losses</u>
<u>2014</u>						
Available-for-sale:						
U.S. government-sponsored enterprises	99,864	\$ 349	\$ 487,780	\$ 5,166	\$ 587,644	\$ 5,515
States and political subdivisions	42,931	260	36,271	255	79,202	515
Corporate bonds	<u>40,037</u>	<u>137</u>	<u>26,396</u>	<u>120</u>	<u>66,433</u>	<u>257</u>
Total	<u>\$ 182,832</u>	<u>\$ 746</u>	<u>\$ 550,447</u>	<u>\$ 5,541</u>	<u>\$ 733,279</u>	<u>\$ 6,287</u>

(Continued)

FIRST NATIONAL BANK ALASKA  
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**NOTE 3 - SECURITIES (Continued)**

Investment securities with carrying amounts of \$1,093,868 and \$1,024,708 at December 31, 2015 and 2014, 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 \$524 and \$716 in 2015 and 2014, respectively. Realized losses on the disposition of investment securities were \$148 and \$38 for 2015 and 2014, respectively.

**NOTE 4 - LOANS**

The loan portfolio consists of the following at December 31:

	<u>2015</u>	<u>2014</u>
Commercial and industrial	\$ 294,543	\$ 255,740
Real estate construction	227,993	202,317
Real estate mortgage	235,512	229,035
Real estate commercial	773,877	676,064
Consumer and other	<u>19,480</u>	<u>15,840</u>
Loans, gross	<u>\$ 1,551,405</u>	<u>\$ 1,378,996</u>

Real estate loans serviced for others as of December 31, 2015 and 2014 were \$1,230,551 and \$1,266,432, respectively. Reserve balances, associated with these loans and held in noninterest bearing demand accounts, amounted to \$9,201 and \$9,684 as of December 31, 2015 and 2014, respectively.

As of December 31, 2015 and 2014 the aggregate indebtedness of all related parties (directors and executive officers of the Bank and their family members) was \$9,795 and \$184, respectively.

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**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 <u>Industrial</u>	Real <u>Estate</u>	Consumer and <u>Other</u>	<u>Total</u>
<u>2015</u>				
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	<u>180</u>	<u>21</u>	<u>140</u>	<u>341</u>
Ending Balance, December 31, 2015	<u>\$ 3,674</u>	<u>\$ 11,102</u>	<u>\$ 374</u>	<u>\$ 15,150</u>
<u>2014</u>				
Allowance for loan losses:				
Beginning balance, January 1, 2014	\$ 3,255	\$ 8,620	\$ 375	\$ 12,250
Provision for loan losses	(354)	1,357	3	1,006
Loans charged-off	(49)	(155)	(250)	(454)
Recoveries	<u>106</u>	<u>65</u>	<u>127</u>	<u>298</u>
Ending Balance, December 31, 2014	<u>\$ 2,958</u>	<u>\$ 9,887</u>	<u>\$ 255</u>	<u>\$ 13,100</u>

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, 2015 and 2014:

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

(Continued)

FIRST NATIONAL BANK ALASKA  
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**NOTE 5 - ALLOWANCE FOR LOAN LOSSES (Continued)**

2014

Allowance for loan losses:

Ending allowance balance attributable to loans:

Individually evaluated for impairment	\$ 175	\$ 375	\$ -	\$ 550
Collectively evaluated for impairment	<u>2,783</u>	<u>9,512</u>	<u>255</u>	<u>12,550</u>

Total ending allowance balance	<u>\$ 2,958</u>	<u>\$ 9,887</u>	<u>\$ 255</u>	<u>\$ 13,100</u>
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Loans:

Individually evaluated for impairment	\$ 1,378	\$ 22,903	\$ -	\$ 24,281
Collectively evaluated for impairment	<u>255,448</u>	<u>1,090,763</u>	<u>15,818</u>	<u>1,362,029</u>

Total loans outstanding balance	<u>\$ 256,826</u>	<u>\$ 1,113,666</u>	<u>\$ 15,818</u>	1,386,310
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Deferred loan fees, net				<u>(7,314)</u>
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Total loans				<u>\$ 1,378,996</u>
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The following table summarizes our nonaccrual loans and loans past due by loan class as of December 31, 2015 and 2014:

	30-89 Days Past Due	Greater Than 89 Days Past Due	Total Past Due	Current	Total Loans	Non-accrual
<u>December 31, 2015</u>						
Commercial and industrial Real Estate	\$ 530	\$ 34	\$ 564	\$ 295,069	\$ 295,633	\$ 813
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	<u>101</u>	<u>28</u>	<u>129</u>	<u>19,305</u>	<u>19,434</u>	<u>-</u>
Total	<u>\$ 3,585</u>	<u>\$ 1,274</u>	<u>\$ 4,859</u>	<u>\$ 1,554,312</u>	1,559,171	2,932
Deferred loan fees, net					<u>(7,766)</u>	<u>(32)</u>
Total loans					<u>\$ 1,551,405</u>	<u>\$ 2,900</u>
<u>December 31, 2014</u>						
Commercial and industrial Real Estate	\$ 296	\$ 149	\$ 445	\$ 256,453	\$ 256,898	\$ 643
Construction and development	486	-	486	203,107	203,593	1,258
1- 4 and multifamily residential	1,241	406	1,647	228,425	230,072	283
Commercial real estate	3,085	154	3,239	676,690	679,929	1,373
Consumer and other	<u>45</u>	<u>4</u>	<u>49</u>	<u>15,769</u>	<u>15,818</u>	<u>-</u>
Total	<u>\$ 5,153</u>	<u>\$ 713</u>	<u>\$ 5,866</u>	<u>\$ 1,380,444</u>	1,386,310	3,557
Deferred loan fees, net					<u>(7,314)</u>	<u>(29)</u>
Total loans					<u>\$ 1,378,996</u>	<u>\$ 3,528</u>

Loans greater than 89 days past due and accruing are \$372 and \$202 at December 31, 2015 and 2014, respectively.

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**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:

	<u>Unpaid Principal Balance</u>	<u>Recorded Investment</u>	<u>Allowance for Loan Losses Allocated</u>	<u>Average Recorded Investment</u>	<u>Interest Income Recognized</u>	<u>Cash Basis Interest Recognized</u>
<u>December 31, 2015</u>						
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	<u>19,359</u>	<u>16,313</u>	<u>-</u>	<u>17,451</u>	<u>1,592</u>	<u>1,012</u>
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	<u>1,572</u>	<u>1,185</u>	<u>650</u>	<u>1,137</u>	<u>43</u>	<u>43</u>
Total	<u>\$ 20,931</u>	<u>\$ 17,498</u>	<u>\$ 650</u>	<u>\$ 18,588</u>	<u>\$ 1,635</u>	<u>\$ 1,055</u>

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**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, 2014:

	Unpaid Principal Balance	Recorded Investment	Allowance for Loan Losses Allocated	Average Recorded Investment	Interest Income Recognized	Cash Basis Interest Recognized
<u>December 31, 2014</u>						
With no allowance recorded:						
Commercial and industrial	\$ 1,187	\$ 1,021	\$ -	\$ 1,134	\$ 60	\$ 60
Real estate						
Construction and other	5,370	3,778	-	3,821	324	225
1-4 and multifamily residential	2,581	2,453	-	2,460	147	146
Commercial real estate	18,140	15,744	-	15,697	1,386	941
Consumer and other	-	-	-	-	-	-
Subtotal	<u>27,278</u>	<u>22,996</u>	<u>-</u>	<u>23,112</u>	<u>1,917</u>	<u>1,372</u>
With an allowance recorded:						
Commercial and industrial	506	352	175	352	2	2
Real estate						
Construction and other	-	-	-	-	-	-
1-4 and multifamily residential	701	656	105	638	43	36
Commercial real estate	276	156	270	161	-	-
Consumer and other	-	-	-	2	-	-
Subtotal	<u>1,483</u>	<u>1,164</u>	<u>550</u>	<u>1,153</u>	<u>45</u>	<u>38</u>
Total	<u>\$ 28,761</u>	<u>\$ 24,160</u>	<u>\$ 550</u>	<u>\$ 24,265</u>	<u>\$ 1,962</u>	<u>\$ 1,410</u>

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**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, 2015 and 2014:

	<u>Pass/ Watch</u>	<u>Special Mention</u>	<u>Sub- Standard</u>	<u>Doubtful/ Loss</u>	<u>Total</u>
<u>December 31, 2015</u>					
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	<u>19,196</u>	<u>7</u>	<u>231</u>	<u>-</u>	<u>19,434</u>
Total	<u>\$ 1,529,467</u>	<u>\$ 6,618</u>	<u>\$ 22,477</u>	<u>\$ 609</u>	1,559,171
Deferred loan fees, net					<u>(7,766)</u>
Total					<u>\$ 1,551,405</u>

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

	<u>Pass/ Watch</u>	<u>Special Mention</u>	<u>Sub- Standard</u>	<u>Doubtful/ Loss</u>	<u>Total</u>
<u>December 31, 2014</u>					
Commercial and Industrial	\$ 253,610	\$ 1,439	\$ 1,604	\$ 245	\$ 256,898
Real Estate					
Construction and development	199,680	-	3,913	-	203,593
1-4 and multifamily residential	224,308	1,630	4,066	68	230,072
Commercial real estate	659,812	6,270	13,691	156	679,929
Consumer and other	<u>15,807</u>	<u>10</u>	<u>1</u>	<u>-</u>	<u>15,818</u>
Total	<u>\$ 1,353,217</u>	<u>\$ 9,349</u>	<u>\$ 23,275</u>	<u>\$ 469</u>	1,386,310
Deferred loan fees, net					<u>(7,314)</u>
Total					<u>\$ 1,378,996</u>

**Troubled Debt Restructurings:**

At December 31, 2015 and 2014, the Bank had loans of \$15,415 and \$22,507 classified as troubled debt restructurings, respectively, which are included in impaired loans. These loans had allocated specific reserves of \$357 and \$524 at December 31, 2015 and 2014, respectively. The Bank has committed to lend \$134 and \$0 as of December 31, 2015 and 2014, respectively, to customers with outstanding loans that are classified as troubled debt restructurings.

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.

**Construction loans:** There were no restructurings of constructions loans.

**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.

**Consumer loans:** There were no restructurings of consumer loans.

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

During the year ended December 31, 2014, 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.

**Construction loans:** There were no restructurings of constructions loans stated interest rates. Extensions of maturity dates were for periods ranging from 2 years to 3 years, and temporary deferrals of all or part of the scheduled principal payments were for a period of 2 years.

**1-4 and multifamily residential loans:** Restructurings of 1-4 and multifamily loans reduced the loan's stated interest rate for periods ranging from 5 years to 17 years. Extensions of maturity dates were for periods ranging from 7 months to 7 years, and temporary deferrals of all or part of the scheduled principal payments were for periods ranging from 4 months to 17 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 2 years to 16 years, and deferrals of all or part of the loan's scheduled principal payments were for periods ranging from 1 year to 16 years.

**Consumer loans:** There were no restructurings of consumer loans.

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**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, 2015 and 2014:

	<u>Number of Loans</u>	<u>Pre-Modification Outstanding Recorded Investment</u>	<u>Post-Modification Outstanding Recorded Investment</u>
<b>2015 Troubled Debt Restructurings:</b>			
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	<u>-</u>	<u>-</u>	<u>-</u>
Total	<u>5</u>	<u>\$ 368</u>	<u>\$ 368</u>
<b>2014 Troubled Debt Restructurings:</b>			
Commercial	1	\$ 326	\$ 326
Real estate:			
Construction and other	2	176	176
1-4 and multifamily residential	8	657	657
Commercial real estate	3	791	791
Consumer and other	<u>-</u>	<u>-</u>	<u>-</u>
Total	<u>14</u>	<u>\$ 1,950</u>	<u>\$ 1,950</u>

The troubled debt restructurings described in the above table had allocated specific reserves of \$15 and \$106 as of December 31, 2015 and 2014 and resulted in no charge-offs during the years ended December 31, 2015 and 2014.

The following table presents loans by class which had defaulted (became at least 60 days past due) during the years ended December 31, 2015 and 2014 after having been modified as a troubled debt restructuring within the previous 12 months:

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

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

Troubled Debt Restructurings That Subsequently Defaulted:	<u>Number of Loans</u>	<u>Recorded Investment</u>
<u>2014:</u>		
Commercial	-	\$ -
Real estate:		
Construction and other	-	-
1-4 and multifamily residential	-	-
Commercial Real Estate	1	566
Consumer and other	<u>-</u>	<u>-</u>
Total	<u><u>1</u></u>	<u><u>\$ 566</u></u>

The troubled debt restructurings that subsequently defaulted described in the above table did not have a specific reserve as of December 31, 2015 and 2014 and resulted in no charge-offs during the years ended December 31, 2015 and 2014.

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:

	<u>2015</u>	<u>2014</u>
Land	\$ 13,273	\$ 13,121
Bank premises	71,411	67,722
Leasehold improvements	219	219
Furniture and equipment	31,246	35,358
Construction in process	<u>5,524</u>	<u>1,661</u>
Total premises and equipment	121,673	118,081
Less: Accumulated depreciation and amortization	<u>71,414</u>	<u>74,369</u>
Premises and equipment, net	<u><u>\$ 50,259</u></u>	<u><u>\$ 43,712</u></u>

Depreciation and amortization expense on premises and equipment for the years ended December 31, 2015 and 2014 totaled \$3,640 and \$3,368, respectively.

During 2015 and 2014, the Bank transferred \$546 and \$4,779, 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 properties transferred in 2014 include a location the Bank substantially leases and management determined the portion of the building used by the Bank was less than the regulatory level to maintain the property in premises and equipment, as well as a building purchased to allow expansion of a parking lot for an existing branch. The Bank is evaluating these properties for future sale or use.

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**NOTE 7 - OTHER REAL ESTATE OWNED**

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

	<u>2015</u>	<u>2014</u>
Balance, January 1	\$ 17,181	\$ 16,769
Acquired upon foreclosure	424	441
Transfers from Bank premises	546	4,779
Capitalized improvements	3,074	2,909
Dispositions	(1,102)	(7,717)
Depreciation	(148)	-
Balance, December 31	<u>19,975</u>	<u>17,181</u>
Less Devaluation Reserves:		
Balance, January 1	(2,736)	(3,436)
Impairments subsequent to foreclosure	(272)	(813)
Dispositions	101	1,513
Balance, December 31	<u>(2,907)</u>	<u>(2,736)</u>
Other real estate owned, net	<u>\$ 17,068</u>	<u>\$ 14,445</u>

Net gains on sales of other real estate owned included in other noninterest expense for the years ended December 31, 2015 and 2014, totaled \$293 and \$803, respectively. Impairments recorded subsequent to foreclosure in the amounts of \$272 and \$813 for the years ended December 31, 2015 and 2014, respectively. Operating expenses, net of rental income totaled \$227 and \$80 for the years ended December 31, 2015 and 2014, respectively.

**NOTE 8 - MORTGAGE SERVICING RIGHTS**

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

	<u>2015</u>	<u>2014</u>
Balance, January 1,	\$ 3,738	\$ 4,532
Additions -		
Capitalization of servicing assets	1,168	1,048
Subtractions:		
Amortization	(1,283)	(1,475)
Accelerated amortization due to early payoffs	<u>(369)</u>	<u>(367)</u>
Balance, December 31,	<u>\$ 3,254</u>	<u>\$ 3,738</u>

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**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. Fair value of MSRs exceed amortized cost for each individual stratum. Accordingly, there has been no impairment for 2015 and 2014.

**NOTE 9 - DEPOSITS**

Total deposits by type of depositor as of December 31:

	<u>2015</u>	<u>2014</u>
Deposits of individuals, partnerships, and corporations	\$ 2,375,070	\$ 2,160,639
Deposits of U.S. government	637	957
Deposits of states and political subdivisions	49,710	41,351
Other deposits	<u>205</u>	<u>285</u>
Total deposits	<u>\$ 2,425,622</u>	<u>\$ 2,203,232</u>

As of December 31, 2015 and 2014 the aggregate deposits of related parties (directors and executive officers of the Bank and their family members) were \$11,960 and \$48,251, respectively.

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

<u>Maturity:</u>	<u>2015</u>
2016	116,165
2017	8,553
2018	3,144
2019	2,849
2020	2,511
Thereafter	<u>47</u>
Total time deposits	<u>\$ 133,269</u>

Time deposits that meet or exceed the FDIC Insurance Limit of \$250 were \$52,772 and \$50,466 as of December 31, 2015 and 2014, respectively.

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**NOTE 10 - SECURITIES SOLD UNDER AGREEMENTS TO REPURCHASE**

Selected balances and rates are as follows:

	<u>2015</u>	<u>2014</u>
Maximum monthly average balance	\$ 736,791	\$ 673,195
Average daily balance	\$ 677,216	\$ 594,289
Average rate during year	0.14%	0.14%
Average rate at December 31	0.14%	0.14%

As of December 31, 2015 and 2014, aggregate repurchase agreement balances of related parties (directors and executive officers of the Bank and their family members) were \$1,601 and \$1,614, respectively

Investment securities with carrying amounts of \$854,457 and \$803,816 at December 31, 2015 and 2014, respectively, were pledged to secure securities sold under agreements to repurchase. As of December 31, 2015 all repurchase agreements matured within 1 business day.

**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 \$352 and \$215 as of December 31, 2015 and 2014, 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, 2015 were:

Year ended December 31:	<u>Operating Leases</u>
2016	\$ 160
2017	142
2018	142
2019	142
2020	142
Thereafter	<u>3,686</u>
Total minimum lease payments	<u>\$ 4,414</u>

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**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 April 2, 2016.

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, 2015 and 2014, which is maintained to comply with regulatory requirements. Changes to surplus require regulatory approval.

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. During 2014, the Bank repurchased a total of 1,840 shares of common stock representing an aggregate purchase value of \$3,197, at an average price per share of \$1,738. Cumulative shares of 26,326 have been repurchased under the program since inception for a combined purchase total of \$42,664.

At the January 28, 2016, Board of Directors meeting, cash dividends of \$12.50 per share were declared, payable March 15, 2016 to shareholders of record as of March 1, 2016.

**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.

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**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, 2015 and 2014. 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, 2015 and 2014, 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, 2015 financial statements.

**NOTE 14 - MORTGAGE LOAN SERVICING INCOME**

Mortgage loan servicing income is comprised of the following:

	<u>2015</u>	<u>2014</u>
Mortgage loan servicing fees	\$ 3,489	\$ 3,598
Amortization of costs	(1,283)	(1,475)
Accelerated amortization due to early payoffs	<u>(369)</u>	<u>(367)</u>
Mortgage loan servicing income	<u>\$ 1,837</u>	<u>\$ 1,756</u>

**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 2015, 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.

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**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 2015 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, 2015 and 2014.

**NOTE 16 - PROVISION FOR INCOME TAXES**

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

	<u>2015</u>	<u>2014</u>
Current:		
Federal	\$ 14,817	\$ 13,414
State	<u>2,134</u>	<u>2,041</u>
Total current	<u>16,951</u>	<u>15,455</u>
Deferred:		
Federal	(154)	(218)
State	<u>(27)</u>	<u>(38)</u>
Total deferred	<u>(181)</u>	<u>(256)</u>
Provision for income taxes	<u>\$ 16,770</u>	<u>\$ 15,199</u>

Income tax expense differed from the Federal statutory rate of 35% for 2015 and 2014 for the following reasons:

	<u>2015</u>	<u>%</u>	<u>2014</u>	<u>%</u>
Tax expense at federal statutory rate	\$ 18,513	35.00%	\$ 16,728	35.00%
Increase (decrease) resulting from:				
State tax, net of Federal tax effect	1,364	2.58	1,290	2.70
Disallowed interest expense	50	0.09	35	0.07
Interest exempt from federal taxation	(2,050)	(3.88)	(1,544)	(3.23)
Low income housing tax credits	(1,224)	(2.31)	(1,381)	(2.89)
Other items, net	<u>117</u>	<u>0.22</u>	<u>71</u>	<u>0.15</u>
Provision for income taxes	<u>\$ 16,770</u>	<u>31.70%</u>	<u>\$ 15,199</u>	<u>31.80%</u>

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**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:

	<u>2015</u>	<u>2014</u>
Deferred tax assets:		
Allowance for loan losses	\$ 6,229	\$ 5,385
Mortgage servicing rights	367	213
Interest collected on nonperforming loans	1,550	1,947
Vacation accrual	1,353	1,345
Accumulated depreciation and amortization	1,308	1,612
Other real estate owned valuation reserve	1,981	1,797
Other	971	776
Total deferred tax assets	<u>13,759</u>	<u>13,075</u>
Deferred tax liabilities:		
Net unrealized holding gain on securities, available-for-sale	1,513	1,683
Net deferred loan fees	3,382	3,054
Low income housing projects	337	530
Deferred loan costs	607	550
Other	1,107	797
Total deferred tax liabilities	<u>6,946</u>	<u>6,614</u>
Net deferred tax assets	<u>\$ 6,813</u>	<u>\$ 6,461</u>

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, 2015 and 2014 were immaterial and no amounts are accrued for interest and penalties at December 31, 2015 or 2014.

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 2012.

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**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 \$896 and \$313 of the Alaska film tax credits as of December 31, 2015 and 2014, respectively, to offset its State of Alaska tax obligations. As of December 31, 2015, there was \$0 in remaining tax credits. The Bank will consider additional tax credit purchases under the Alaska Film Production Incentive Program in the future to offset future State of Alaska tax obligations.

**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, 2015 and 2014:

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

Securities, Available-for-Sale: 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.

Real Estate Loans To Be Sold: 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.

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**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, 2015 and 2014. 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.

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

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

	2015		2014	
	Carrying Amount	Estimated Fair Value	Carrying Amount	Estimated Fair Value
<u>Financial assets:</u>				
Cash and cash equivalents	\$ 81,278	\$ 81,278	\$ 95,391	\$ 95,391
Securities, available-for-sale	1,832,601	1,832,601	1,743,439	1,743,439
Real estate loans to be sold	10,418	10,479	11,023	11,099
Loans:				
Commercial and industrial	290,869	283,559	252,782	247,799
Real estate	1,226,280	1,233,110	1,097,528	1,107,296
Consumer and other	<u>19,106</u>	<u>18,751</u>	<u>15,586</u>	<u>15,367</u>
Total loans, net	<u>1,536,255</u>	<u>1,535,420</u>	<u>1,365,896</u>	<u>1,370,462</u>
Federal Reserve Bank stock	2,162	N/A	2,162	N/A
Federal Home Loan Bank stock	3,975	N/A	1,535	N/A
Interest receivable	15,321	15,321	13,132	13,132
<u>Financial liabilities:</u>				
Deposits:				
Non-interest bearing	1,290,689	1,290,689	1,111,214	1,111,214
Interest bearing:				
Savings	632,948	632,948	590,238	590,238
NOW	201,665	201,665	198,412	198,412
Money market	167,051	167,051	166,132	166,132
Time	<u>133,269</u>	<u>134,455</u>	<u>137,236</u>	<u>138,543</u>
Total interest bearing	<u>1,134,933</u>	<u>1,136,119</u>	<u>1,092,018</u>	<u>1,093,325</u>
Total deposits	2,425,622	2,426,808	2,203,232	2,204,539
Securities sold under agreements to repurchase	645,838	645,838	628,276	628,276
Notes payable and capital lease obligations	62	62	115	115
Interest payable	76	76	84	84

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**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.

Assets measured at fair value on a recurring basis:

	Total	Fair Value Measurements Using		
		Quoted Prices in Active Markets For Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
<u>2015</u>				
<u>Securities:</u>				
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	<u>213,219</u>	<u>-</u>	<u>213,219</u>	<u>-</u>
Securities total	<u>\$ 1,832,601</u>	<u>\$ 227,110</u>	<u>\$ 1,605,491</u>	<u>\$ -</u>
<u>2014</u>				
<u>Securities:</u>				
U.S. Treasury securities	\$ 152,304	\$ 152,304	\$ -	\$ -
U.S. government-sponsored enterprises	1,143,784	-	1,143,784	-
States and political subdivisions	201,723	-	201,723	-
Corporate bonds	<u>245,628</u>	<u>-</u>	<u>245,628</u>	<u>-</u>
Securities total	<u>\$ 1,743,439</u>	<u>\$ 152,304</u>	<u>\$ 1,591,135</u>	<u>\$ -</u>

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

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 2015 and 2014.

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, 2015 the Bank had no investments in Fannie Mae or Freddie Mac common or preferred stock.

Assets measured at fair value on a nonrecurring basis:

	<u>Total</u>	Quoted Prices in Active Markets For Identical Assets <u>Level 1</u>	Significant Other Observable Inputs <u>Level 2</u>	Significant Unobservable Inputs <u>Level 3</u>
<u>December 31, 2015</u>				
Other real estate owned:				
Construction and development	\$ 8,781	-	-	8,781
Commercial	<u>2,883</u>	<u>-</u>	<u>-</u>	<u>2,883</u>
Total	<u>\$ 11,664</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 11,664</u>
<u>December 31, 2014</u>				
Other real estate owned:				
Construction and development	\$ 6,686	-	-	\$ 6,686

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 had a net carrying amount of \$11,860, which is made up of the gross book value of \$14,767, net of a valuation allowance of \$2,907 at December 31, 2015, resulting in write-downs of \$272 for the year ended December 31, 2015. At December 31, 2014, other real estate owned measured at fair value less costs to sell had a net carrying amount of \$6,776, which is made up of the gross book value of \$9,512, net of a valuation allowance of \$2,736, resulting in write-downs of \$761 for the year ended December 31, 2014.

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**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, 2015 and 2014:

<u>December 31, 2015</u>	<u>Fair value</u>	<u>Valuation Technique</u>	<u>Unobservable Input</u>	<u>Range (Weighted Average)</u>
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%
<u>December 31, 2014</u>	<u>Fair value</u>	<u>Valuation Technique</u>	<u>Unobservable Input</u>	<u>Range (Weighted Average)</u>
Other real estate owned – Construction and development	\$ 6,686	Sales comparison approach	Adjustment for differences between the comparable sales	0.00% to -3.00% (-1.39%)

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, 2015. 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 \$95,135 and \$108,552 from the Federal Reserve Bank at a rate of 1.00% and 0.75% as of December 31, 2015 and 2014, respectively. In addition, the Bank also had federal funds arrangements available from unaffiliated banks totaling \$80,000 at a rate estimated at 0.52 – 0.64% and 0.30% - 0.40% as of December 31, 2015 and 2014, respectively. There were no outstanding balances against these lines of credit as of December 31, 2015 or 2014.

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**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,

	<u>2015</u>	<u>2014</u>
Loan commitments	\$ 559,992	\$ 478,520
Bankcard commitments	67,426	63,264
Commitments to fund mortgage loans to be sold	<u>31,864</u>	<u>15,874</u>
Total loan commitments	<u>\$ 659,282</u>	<u>\$ 557,658</u>
Commitments at fixed interest rates	\$ 177,875	\$ 129,253
Commitments at variable interest rates	<u>481,407</u>	<u>428,405</u>
Total loan commitments	<u>\$ 659,282</u>	<u>\$ 557,658</u>
Standby and commercial letters of credit	\$ 8,480	\$ 14,699
Subscriptions to purchase Federal Reserve Bank stock	2,162	2,162

Commitments to make loans are generally made for periods of 90 days or less. At December 31, 2015, the fixed rate loan commitments have interest rates ranging from 2.27% to 16.50%.

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**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. The net unrealized gain or loss on available for sale securities is not included in computing regulatory capital. Capital amounts and ratios for December 31, 2014 are calculated using Basel I rules. Management believes, as of December 31, 2015, that the Bank meets all capital adequacy requirements to which it is subject.

As of December 31, 2015, 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 2015 and 2014. 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.

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**NOTE 20 - REGULATORY MATTERS** (Continued)

The Bank's actual amounts and ratios at December 31, 2015 and 2014 are as follows:

	<u>Actual</u>		<u>for Capital Adequacy Purposes</u>		<u>Required to Be Well Capitalized Under Prompt Corrective Action Provisions</u>	
	<u>Amount</u>	<u>Ratio</u>	<u>Amount</u>	<u>Ratio</u>	<u>Amount</u>	<u>Ratio</u>
<u>2015</u>						
Total capital (to risk-weighted assets)	\$ 502,748	21.40%	\$187,965	8.00%	\$ 234,957	10.00%
Tier I capital (to risk-weighted assets)	486,398	20.70%	140,974	6.00%	187,965	8.00%
Common Tier I (CET1)	486,398	20.70%	105,730	4.50%	152,722	6.50%
Tier I capital (to average assets)	486,398	13.18%	147,619	4.00%	184,524	5.00%
<u>2014</u>						
Total capital (to risk-weighted assets)	\$ 483,137	22.00%	\$175,697	8.00%	\$ 219,621	10.00%
Tier I capital (to risk-weighted assets)	469,037	21.36%	87,848	4.00%	131,773	6.00%
Tier I capital (to average assets)	469,037	13.96%	134,376	4.00%	167,970	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, 2015 is \$56,430 without OCC approval.