

FIRST NATIONAL BANK ALASKA
Anchorage, Alaska

FINANCIAL STATEMENTS
December 31, 2018 and 2017

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INDEPENDENT AUDITOR'S REPORT

The Board of Directions 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, 2018 and 2017, and the related statements of income, comprehensive income, changes in shareholders' equity, and cash flows for the years then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibilities

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

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

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

(Continued)

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of First National Bank Alaska, as of December 31, 2018 and 2017, and the results of its operations and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Report on Other Legal and Regulatory Requirements

We also have audited in accordance with auditing standards generally accepted in the United States of America, First National Bank Alaska's internal control over financial reporting as of December 31, 2018, based on criteria established in the 2013 Internal Control – Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) relevant to reporting objectives for the express purpose of meeting the regulatory requirements of Section 112 of the Federal Deposit Insurance Corporation Improvement Act (FDICIA) and our report dated March 7, 2019 expressed an unmodified opinion.

A handwritten signature in black ink that reads "Crowe LLP". The signature is written in a cursive, flowing style.

Crowe LLP

Oak Brook, Illinois
March 7, 2019

FIRST NATIONAL BANK ALASKA
STATEMENTS OF FINANCIAL CONDITION
December 31, 2018 and 2017
(Dollars in thousands, except per share data)

	<u>2018</u>	<u>2017</u>
ASSETS		
Cash and cash equivalents	\$ 108,557	\$ 134,051
Securities, available-for-sale	1,597,992	1,590,444
Real estate loans to be sold	18,459	16,036
Loans:		
Commercial and industrial	428,425	381,499
Real estate	1,506,953	1,413,652
Consumer and other	<u>19,495</u>	<u>20,033</u>
Total loans, gross	1,954,873	1,815,184
Less: Allowance for loan losses	<u>19,400</u>	<u>17,825</u>
Total loans, net	1,935,473	1,797,359
Premises and equipment, net	46,673	49,501
Other real estate owned, net	1,625	9,875
Due from brokers	-	9,988
Other assets	<u>44,687</u>	<u>45,888</u>
Total assets	<u>\$ 3,753,466</u>	<u>\$ 3,653,142</u>
LIABILITIES AND SHAREHOLDERS' EQUITY		
Liabilities:		
Deposits:		
Noninterest bearing	\$ 1,291,866	\$ 1,231,762
Interest bearing:		
Savings	654,431	692,712
NOW	194,508	200,395
Money market	162,783	181,221
Time	<u>116,705</u>	<u>131,727</u>
Total interest bearing	<u>1,128,427</u>	<u>1,206,055</u>
Total deposits	2,420,293	2,437,817
Securities sold under agreements to repurchase	809,020	687,064
Due to brokers	3,622	19,088
Other liabilities	<u>13,680</u>	<u>12,296</u>
Total liabilities	3,246,615	3,156,265
Shareholders' equity:		
Common stock, \$10 par value (authorized: 4,000,000 shares) (issued and outstanding: 2018 – 3,168,630; 2017 – 3,170,830)	31,686	31,708
Surplus	40,000	40,000
Retained earnings	450,848	433,335
Accumulated other comprehensive loss	<u>(15,683)</u>	<u>(8,166)</u>
Total shareholders' equity	<u>506,851</u>	<u>496,877</u>
Total liabilities and shareholders' equity	<u>\$ 3,753,466</u>	<u>\$ 3,653,142</u>

See accompanying notes to financial statements.

FIRST NATIONAL BANK ALASKA
STATEMENTS OF INCOME
Years ended December 31, 2018 and 2017
(Dollars in thousands, except per share data)

	<u>2018</u>	<u>2017</u>
Interest income and loan fees:		
Interest and fees on loans:		
Taxable	\$ 106,152	\$ 94,850
Nontaxable	<u>1,544</u>	<u>2,009</u>
Total interest and fees on loans	107,696	96,859
Interest and dividends on investment securities:		
Taxable	28,816	26,085
Nontaxable	<u>4,944</u>	<u>5,055</u>
Total interest and dividends on investment securities	33,760	31,140
Interest on cash and cash equivalents	<u>1,617</u>	<u>953</u>
Total interest and loan fee income	143,073	128,952
Interest expense:		
Interest on deposits	1,482	920
Interest on federal funds purchased and securities sold under agreements to repurchase	<u>9,772</u>	<u>2,668</u>
Total interest expense	<u>11,254</u>	<u>3,588</u>
Net interest and loan fee income	131,819	125,364
Provision for loan losses	<u>1,993</u>	<u>2,586</u>
Net interest and loan fee income after provision for loan losses	129,826	122,778
Noninterest income:		
Bankcard fees	7,749	7,669
Service charges on deposit accounts	5,171	5,268
Gain on sale of mortgage loans	2,086	2,406
Mortgage loan servicing income	2,109	1,989
Net gains (losses) on investment securities	(1,950)	(928)
Gain on sale of other real estate owned	4,728	143
Other noninterest income	<u>6,580</u>	<u>6,969</u>
Total noninterest income	26,473	23,516
Noninterest expense:		
Salaries and employee benefits	55,186	52,793
Occupancy expense, net	8,332	8,552
Furniture and equipment expense	2,190	2,065
Bankcard expenses	2,143	2,138
Other noninterest expense	<u>17,705</u>	<u>19,195</u>
Total noninterest expense	<u>85,556</u>	<u>84,743</u>
Income before taxes	70,743	61,551
Provision for income taxes	<u>16,641</u>	<u>25,124</u>
Net income	<u>\$ 54,102</u>	<u>\$ 36,427</u>
Earnings per common share	\$ 17.07	\$ 11.49

See accompanying notes to financial statements.

FIRST NATIONAL BANK ALASKA
STATEMENTS OF COMPREHENSIVE INCOME
Years ended December 31, 2018 and 2017
(Dollars in thousands)

	<u>2018</u>	<u>2017</u>
Net income	\$ 54,102	\$ 36,427
Other comprehensive loss –		
Unrealized losses on securities:		
Unrealized holding gains arising during the period, net of tax effect of \$3,539 and \$714 in 2018 and 2017, respectively	(8,913)	(1,022)
Reclassification adjustment for (gains) losses included in net income, net of tax effect of \$(554) and \$(382) in 2018 and 2017, respectively	<u>1,396</u>	<u>546</u>
Other comprehensive loss	<u>(7,517)</u>	<u>(476)</u>
Comprehensive Income	<u>\$ 46,585</u>	<u>\$ 35,951</u>

See accompanying notes to financial statements.

FIRST NATIONAL BANK ALASKA
STATEMENTS OF CASH FLOWS
Years ended December 31, 2018 and 2017
(Dollars in thousands)

	<u>2018</u>	<u>2017</u>
Cash flows from operating activities		
Net income	\$ 54,102	\$ 36,427
Adjustments to reconcile net income to net cash provided by operating activities:		
Amortization of premium on investment securities, net	9,522	13,610
Loss from equity method investment	1,038	1,701
Depreciation, accretion and amortization	4,876	5,229
Provision for loan losses	1,993	2,586
Deferred taxes	1,995	(1,740)
Gain on sale of mortgage loans	(2,086)	(2,406)
Net gain on the sale of other real estate owned	(4,728)	(143)
Valuation adjustment on other real estate owned	129	757
Net gain on the sale of premises and equipment	(1,528)	(129)
Impairment loss on fixed assets	1,192	-
Net loss on investment securities	1,950	928
Real estate loans to be sold-originated	(144,940)	(148,525)
Real estate loans to be sold-shipped	143,391	145,903
Deferred tax expense from Federal tax reform	-	4,744
Net (increase) decrease in other assets	11,232	(9,791)
Net increase (decrease) in other liabilities	(10,142)	9,293
Net cash provided by operating activities	67,996	58,444
 Cash flows from investing activities		
Proceeds from calls or maturities of securities, available-for-sale	198,835	110,979
Proceeds from sales of securities, available-for-sale	177,985	254,485
Purchase of securities, available-for-sale	(406,340)	(215,837)
Net purchases of Federal Home Loan Bank stock	(52)	(49)
Net redemptions of Federal Reserve Bank stock	-	4
Net increase in loans	(10,150)	(87,530)
Purchase of participation loans	(134,520)	(51,088)
Proceeds from sales of premises and equipment	3,300	154
Purchase of land, premises and equipment	(3,778)	(3,602)
Improvements to other real estate owned	-	(85)
Proceeds from sales of other real estate owned	13,481	1,686
Net cash provided by (used in) investing activities	(161,239)	9,117

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FIRST NATIONAL BANK ALASKA
 STATEMENTS OF CASH FLOWS
 Years ended December 31, 2018 and 2017
 (Dollars in thousands)

	<u>2018</u>	<u>2017</u>
Cash flows from financing activities		
Net decrease in total deposits	(17,524)	(37,858)
Net increase in securities		
sold under agreements to repurchase	121,956	57,098
Payments on notes and capital leases	(72)	(68)
Dividends paid	(36,134)	(31,711)
Retirement of common stock	(477)	(98)
Net cash provided by (used in) financing activities	<u>67,749</u>	<u>(12,637)</u>
Increase (decrease) in cash and cash equivalents	(25,494)	54,924
Cash and cash equivalents, January 1	<u>134,051</u>	<u>79,127</u>
Cash and cash equivalents, December 31	<u>\$ 108,557</u>	<u>\$ 134,051</u>
Supplemental disclosures of cash flow information:		
Cash paid during the year for interest	\$ 11,169	\$ 3,565
Cash paid during the year for income taxes	13,481	21,271
Noncash investing and financing activities:		
Transfer of loans to other real estate owned	\$ 1,180	\$ 404
Transfer of bank premises to other real estate owned	41	-
Bank financed sales of other real estate owned	238	784
Due to brokers for security and loan purchases	3,622	19,088
Due from brokers for matured securities	-	9,988

See accompanying notes to financial statements

FIRST NATIONAL BANK ALASKA
STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY
Years ended December 31, 2018 and 2017
(Dollars in thousands, except per share data)

	Common Stock (\$10 Par Value)	Surplus	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total Shareholders' Equity
Balance, January 1, 2017	\$ 31,714	\$ 40,000	\$ 427,264	\$ (6,243)	\$ 492,735
Net income	-	-	36,427	-	36,427
Other comprehensive loss, net of tax	-	-	-	(476)	(476)
Dividends declared - \$10 per share	-	-	(31,711)	-	(31,711)
Retirement of common stock (560 shares)	(6)	-	(92)	-	(98)
Reclassification due to Tax Cuts and Jobs Act	-	-	1,447	(1,447)	-
Balance, December 31, 2017	31,708	40,000	433,335	(8,166)	496,877
Net income	-	-	54,102	-	54,102
Other comprehensive loss, net of tax	-	-	-	(7,517)	(7,517)
Dividends declared - \$11.40 per share	-	-	(36,134)	-	(36,134)
Retirement of common stock (2,200 shares)	(22)	-	(455)	-	(477)
Balance, December 31, 2018	<u>\$ 31,686</u>	<u>\$ 40,000</u>	<u>\$ 450,848</u>	<u>\$ (15,683)</u>	<u>\$ 506,851</u>

See accompanying notes to financial statements

FIRST NATIONAL BANK ALASKA
NOTES TO FINANCIAL STATEMENTS
December 31, 2018 and 2017
(Dollars in thousands except per share data)

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 28 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 7, 2019, 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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FIRST NATIONAL BANK ALASKA
NOTES TO FINANCIAL STATEMENTS
December 31, 2018 and 2017
(Dollars in thousands except per share data)

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 payoff, generally are reported at their outstanding unpaid principal balances adjusted for charge-offs and any deferred fees or costs on originated loans. Interest income is accrued on the unpaid principal balance. Loan origination fees, net of certain direct origination costs, are deferred and recognized as an adjustment of the related loan yield using the effective interest method.

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

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

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

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

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

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

NOTE 1 - SIGNIFICANT ACCOUNTING AND REPORTING POLICIES (Continued)

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

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

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

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

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

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

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

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

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FIRST NATIONAL BANK ALASKA
NOTES TO FINANCIAL STATEMENTS
December 31, 2018 and 2017
(Dollars in thousands except per share data)

NOTE 1 - SIGNIFICANT ACCOUNTING AND REPORTING POLICIES (Continued)

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

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

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

The recorded liability was \$900 at December 31, 2018 and 2017.

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

Federal Reserve Bank: This stock is a required holding of capital stock of the Federal Reserve Bank and is carried in other assets in the accompanying statements of condition at cost and periodically evaluated for impairment based on ultimate recovery of par value (\$2,151 as of 2018 and 2017). Calculation of the stock requirement is based solely on the capital structure of the Bank.

Federal Home Loan Bank Stock: This is a required stock holding of the Federal Home Loan Bank of Des Moines and is carried in other assets in the accompanying statements of condition at cost and periodically evaluated for impairment based on ultimate recovery of par value (\$4,384 and \$4,332 as of 2018 and 2017, respectively). The minimum stock requirement is calculated based on the Bank's assets or qualifying loans, whichever applies.

(Continued)

FIRST NATIONAL BANK ALASKA
NOTES TO FINANCIAL STATEMENTS
December 31, 2018 and 2017
(Dollars in thousands except per share data)

NOTE 1 - SIGNIFICANT ACCOUNTING AND REPORTING POLICIES (Continued)

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

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

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

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

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

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

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

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FIRST NATIONAL BANK ALASKA
NOTES TO FINANCIAL STATEMENTS
December 31, 2018 and 2017
(Dollars in thousands except per share data)

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 3,169,582 and 3,171,130 for 2018 and 2017, respectively. The Bank does not have any potentially dilutive securities.

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

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

Reclassifications: Reclassifications have been made to conform 2017 financial statement data with the 2018 presentation. Reclassifications had no effect on prior year net income or shareholders' equity.

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FIRST NATIONAL BANK ALASKA
NOTES TO FINANCIAL STATEMENTS
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NOTE 1 - SIGNIFICANT ACCOUNTING AND REPORTING POLICIES (Continued)

Adoption of New Accounting Standards: On January 1, 2018, the Bank adopted ASU 2014-09 Revenue from Contracts with Customers and all subsequent amendments to the ASU (ASC 606), which (i) creates a single framework for recognizing revenue from contracts with customers that fall within its scope and (ii) revises when it is appropriate to recognize a gain (loss) from the transfer of nonfinancial assets, such as OREO. The majority of the Banks' revenues come from interest income and other sources, including loans and securities, that are outside the scope of ASC 606. The Bank's services that fall within the scope of ASC 606 are presented within noninterest income and are recognized as revenue as the Bank satisfies the obligation to the customer. Services within the scope of ASC 606 include deposit service charges on deposits, interchange income, wealth management fees, and the sale of OREO.

The Bank adopted ASC 606 using the modified retrospective method applied to all contracts not completed as of January 1, 2018. Results for reporting periods beginning after January 1, 2018 are presented under ASC 606 while prior period amounts continue to be reported in accordance with legacy GAAP. The adoption of ASC 606 did not result in a change to the accounting of any of the in-scope revenue streams; as such, no cumulative effective adjustment was recorded.

A description of the Bank's revenue streams accounted for under ASC 606 follows:

Service Charges on Deposit Accounts: The Bank earns fees from its deposit customers for transaction-based, account maintenance, and overdraft services. Transaction-based fees, which include services such as ATM use fees, stop payment charges, statement rendering, and ACH fees, are recognized at the time the transaction is executed as that is the point in the Bank fulfills the customer's request. Account maintenance fees, which relate primarily to monthly maintenance, are earned over the course of the month, representing the period over which the Bank satisfies the performance obligation. Overdraft fees are recognized at the point in time that the overdraft occurs. Service charges on deposits are withdrawn from the customer's account balance.

Interchange Income: The Bank earns interchange fees from debit/credit cardholder transactions conducted through the MasterCard payment network. Interchange fees from cardholder transactions represent a percentage of the underlying transaction value and are recognized daily, concurrently with the transaction processing services provided to the cardholder.

Wealth Management Fees: The Bank earns wealth management fees from its contracts with trust customers to manage assets for investment. These fees are primarily earned over time as the Bank provides the contracted monthly or quarterly services and are generally assessed based on a tiered scale of the market value of assets under management at month-end.

Gains/Losses on Sales of OREO: The Bank records a gain or loss from the sale of OREO when control of the property transfers to the buyer, which generally occurs at the time of an executed deed. When the Bank finances the sale of OREO to the buyer, the Bank assesses whether the buyer is committed to perform their obligations under the contract and whether collectability of the transaction price is probable. Once these criteria are met, the OREO asset is derecognized and the gain or loss on the sale is recorded upon the transfer of control of the property to the buyer. In determining the gain or loss on the sale, the Bank adjusts the transaction price and related gain (loss) on sale if a significant financing component is present.

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NOTE 1 - SIGNIFICANT ACCOUNTING AND REPORTING POLICIES (Continued)

On January 1, 2018, the Bank adopted ASU 2016-01 Financial Instruments – Overall, which requires public business entities to use the exit price notion when measuring the fair value of financial instruments for disclosure purposes. It requires separate presentation of financial assets and financial liabilities by measurement category and form of financial asset (i.e. securities or loans and receivables). It eliminates the requirement for public business entities to disclose the methods and significant assumptions used to estimate the fair value that is required to be disclosed for financial instruments measured at amortized cost. For additional information on fair value, see Note 16.

In February 2016, the FASB amended existing guidance that requires lessees recognize the following for all leases (with the exception of short-term leases) at the commencement date (1) A lease liability, which is a lessee's obligation to make lease payments arising from a lease, measured on a discounted basis; and (2) A right-of-use asset, which is an asset that represents the lessee's right to use, or control the use of, a specified asset for the lease term. Under the new guidance, lessor accounting is largely unchanged. Certain targeted improvements were made to align, where necessary, lessor accounting with the lessee accounting model and Topic 606, Revenue from Contracts with Customers. The Bank will adopt Topic 842 in the first quarter 2019, as required for public business entities.

The new guidance includes a number of optional transition-related practical expedients. The practical expedients relate to the identification and classification of leases that commenced before the effective date, initial direct costs for leases that commenced before the effective date, and the ability to use hindsight in evaluating lessee option to extend or terminate a lease or to purchase the underlying asset. An entity that elects to apply these practical expedients will, in effect, continue to account for leases that commence before the effective date in accordance with previous GAAP unless the lease is modified, except that lessees are required to recognize a right-of-use asset and a lease liability for all operating leases at each reporting date based on the present value of the remaining minimum rental payments that were tracked and disclosed under previous GAAP.

The effect of adopting this standard on January 1, 2019, resulted in recording a right to use asset and lease liability of approximately \$1,600.

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NOTE 1 - SIGNIFICANT ACCOUNTING AND REPORTING POLICIES (Continued)

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

In March 2017, the FASB amended existing guidance over the premium amortization period on purchased callable debt securities. The amendment require the premium recognized upon the purchase of the callable debt securities to be amortized to the earliest call date, which is expected to better align the amortization period of the premium to the expectation incorporated in marketing pricing. These amendments are effective for annual periods beginning after December 15, 2018. The effect of adopting this standard on January 1, 2019, resulted in a cumulative-effect adjustment recognized in retained earnings at the beginning of the period of adoption of approximately \$475.

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, 2018 and 2017 was \$22,704 and \$22,938, respectively.

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FIRST NATIONAL BANK ALASKA
NOTES TO FINANCIAL STATEMENTS
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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, 2018:

	<u>Amortized Cost</u>	<u>Unrealized Gains</u>	<u>Unrealized Losses</u>	<u>Fair Value</u>
<u>December 31, 2018</u>				
U.S. Treasury securities maturities:				
Within 1 year	\$ 112,469	\$ 8	\$ 179	\$ 112,298
One to 5 years	<u>213,504</u>	<u>825</u>	<u>1,404</u>	<u>212,925</u>
Total	<u>325,973</u>	<u>833</u>	<u>1,583</u>	<u>325,223</u>
U.S. government-sponsored enterprises maturities:				
Within 1 year	117,646	-	590	117,056
One to 5 years	486,955	120	8,654	478,421
Five to 10 years	134,576	800	2,650	132,726
After 10 years	<u>8,000</u>	<u>19</u>	<u>-</u>	<u>8,019</u>
Total	<u>747,177</u>	<u>939</u>	<u>11,894</u>	<u>736,222</u>
States and political subdivisions maturities:				
Within 1 year	18,139	-	41	18,098
One to 5 years	28,992	16	127	28,881
Five to 10 years	75,591	110	1,452	74,249
After 10 years	<u>41,268</u>	<u>63</u>	<u>566</u>	<u>40,765</u>
Total	<u>163,990</u>	<u>189</u>	<u>2,186</u>	<u>161,993</u>
Mortgage-backed securities: residential	2,214	-	63	2,151
Mortgage-backed securities: commercial	79,608	-	2,105	77,503
Corporate bonds maturities:				
Within 1 year	33,691	-	104	33,587
One to 5 years	257,234	112	5,625	251,721
Five to 10 years	<u>10,017</u>	<u>-</u>	<u>425</u>	<u>9,592</u>
Total	<u>300,942</u>	<u>112</u>	<u>6,154</u>	<u>294,900</u>
Total securities, available-for-sale	<u>\$ 1,619,904</u>	<u>\$ 2,073</u>	<u>\$ 23,985</u>	<u>\$ 1,597,992</u>

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FIRST NATIONAL BANK ALASKA
NOTES TO FINANCIAL STATEMENTS
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NOTE 3 - SECURITIES (Continued)

Within the state and political subdivisions category, the largest concentrations of securities, available-for-sale are held in Texas with 38%, Washington with 26%, and Alaska with 14% 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, 2018, 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>2018</u>						
Available-for-sale:						
U.S. Treasury	\$ 84,198	\$ 180	\$ 115,894	\$ 1,403	\$ 200,092	\$ 1,583
U.S. government-sponsored enterprises	153,833	1,483	465,650	10,411	619,483	11,894
States and political subdivisions	48,917	456	92,059	1,730	140,976	2,186
Mortgage-backed – residential	-	-	2,151	63	2,151	63
Mortgage-backed - commercial	-	-	77,503	2,105	77,503	2,105
Corporate bonds	<u>71,208</u>	<u>1,126</u>	<u>196,662</u>	<u>5,028</u>	<u>267,870</u>	<u>6,154</u>
Total	<u>\$ 358,156</u>	<u>\$ 3,245</u>	<u>\$ 949,919</u>	<u>\$ 20,740</u>	<u>\$ 1,308,075</u>	<u>\$ 23,985</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 bonds approach maturity.

At December 31, 2018, 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.

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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, 2017:

	<u>Amortized Cost</u>	<u>Unrealized Gains</u>	<u>Unrealized Losses</u>	<u>Fair Value</u>
<u>December 31, 2017</u>				
U.S. Treasury securities maturities:				
One to 5 years	\$ 140,041	\$ 31	\$ 702	\$ 139,370
Five to 10 years	<u>1,968</u>	<u>-</u>	<u>13</u>	<u>1,955</u>
Total	<u>142,009</u>	<u>31</u>	<u>715</u>	<u>141,325</u>
U.S. government-sponsored enterprises maturities:				
Within 1 year	138,572	199	275	138,496
One to 5 years	447,119	247	3,627	443,739
Five to 10 years	131,603	-	3,918	127,685
After 10 years	<u>8,000</u>	<u>79</u>	<u>-</u>	<u>8,079</u>
Total	<u>725,294</u>	<u>525</u>	<u>7,820</u>	<u>717,999</u>
States and political subdivisions maturities:				
Within 1 year	34,057	-	31	34,026
One to 5 years	153,044	340	745	152,639
Five to 10 years	85,562	397	995	84,964
After 10 years	<u>56,497</u>	<u>355</u>	<u>202</u>	<u>56,650</u>
Total	<u>329,160</u>	<u>1,092</u>	<u>1,973</u>	<u>328,279</u>
Mortgage-backed securities: residential	2,801	-	49	2,752
Mortgage-backed securities: commercial	79,986	-	716	79,270
Corporate bonds maturities:				
Within 1 year	29,791	1	15	29,777
One to 5 years	231,323	245	1,551	230,017
Five to 10 years	<u>61,489</u>	<u>151</u>	<u>615</u>	<u>61,025</u>
Total	<u>322,603</u>	<u>397</u>	<u>2,181</u>	<u>320,819</u>
Total securities, available-for-sale	<u>\$ 1,601,853</u>	<u>\$ 2,045</u>	<u>\$ 13,454</u>	<u>\$ 1,590,444</u>

Within the state and political subdivisions category, the largest concentrations of securities, available-for-sale are held in Texas with 34%, Utah with 24%, and Alaska with 14% of the category.

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FIRST NATIONAL BANK ALASKA
NOTES TO FINANCIAL STATEMENTS
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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, 2017, 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>2017</u>						
Available-for-sale:						
U.S. Treasury	\$ 72,074	\$ 235	\$ 44,593	\$ 480	\$ 116,667	\$ 715
U.S. government-sponsored enterprises	201,820	792	356,242	7,028	558,062	7,820
States and political subdivisions	41,473	120	172,523	1,853	213,996	1,973
Mortgage-backed – residential	-	-	2,751	49	2,751	49
Mortgage-backed - commercial	79,270	716	-	-	79,270	716
Corporate bonds	68,072	235	166,074	1,946	234,146	2,181
Total	<u>\$ 462,709</u>	<u>\$ 2,098</u>	<u>\$ 742,183</u>	<u>\$ 11,356</u>	<u>\$ 1,204,892</u>	<u>\$ 13,454</u>

Investment securities with carrying amounts of \$1,264,564 and \$1,099,366 at December 31, 2018 and 2017, 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 \$95 and \$315 in 2018 and 2017, respectively. Realized losses on the disposition of investment securities were \$2,045 and \$1,243 for 2018 and 2017, respectively.

NOTE 4 - LOANS

The loan portfolio consists of the following at December 31:

	<u>2018</u>	<u>2017</u>
Commercial and industrial	\$ 428,425	\$ 381,499
Real estate construction	335,157	243,087
Real estate mortgage	250,407	292,289
Real estate commercial	921,389	878,276
Consumer and other	19,495	20,033
Loans, gross	<u>\$ 1,954,873</u>	<u>\$ 1,815,184</u>

There were unamortized premiums of \$3,847 and \$3,171 from purchased government guaranteed loans and multifamily real estate loans as of December 31, 2018 and 2017, respectively. The Bank purchased \$46,613 and \$55,262 of government guaranteed loans in 2018 and 2017, respectively. The government guaranteed loan balances were \$133,981 and \$95,908 as of December 31, 2018 and 2017, respectively. Government guaranteed loans are included in commercial and industrial loans. Multifamily loans are included in real estate mortgage.

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FIRST NATIONAL BANK ALASKA
NOTES TO FINANCIAL STATEMENTS
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NOTE 4 - LOANS (Continued)

Real estate loans serviced for others as of December 31, 2018 and 2017 were \$1,285,471 and \$1,219,163, respectively. Custodial balances, associated with these loans and held in noninterest bearing demand accounts, amounted to \$9,577 and \$9,100 as of December 31, 2018 and 2017, respectively.

As of December 31, 2018 and 2017 the aggregate indebtedness of all related parties (directors and executive officers of the Bank and their family members) was \$12,652 and \$12,891, respectively.

NOTE 5 - ALLOWANCE FOR LOAN LOSSES

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

	Commercial and Industrial	Real Estate	Consumer and Other	Total
<u>2018</u>				
Allowance for loan losses:				
Beginning balance, January 1, 2018	\$ 3,715	\$ 13,710	\$ 400	\$ 17,825
Provision for loan losses	1,655	331	7	1,993
Loans charged-off	(185)	(578)	(277)	(1,040)
Recoveries	<u>310</u>	<u>67</u>	<u>245</u>	<u>622</u>
Ending Balance, December 31, 2018	<u>\$ 5,495</u>	<u>\$ 13,530</u>	<u>\$ 375</u>	<u>\$ 19,400</u>
<u>2017</u>				
Allowance for loan losses:				
Beginning balance, January 1, 2017	\$ 3,334	\$ 12,916	\$ 350	\$ 16,600
Provision for loan losses	1,547	949	90	2,586
Loans charged-off	(1,294)	(228)	(223)	(1,745)
Recoveries	<u>128</u>	<u>73</u>	<u>183</u>	<u>384</u>
Ending Balance, December 31, 2017	<u>\$ 3,715</u>	<u>\$ 13,710</u>	<u>\$ 400</u>	<u>\$ 17,825</u>

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FIRST NATIONAL BANK ALASKA
NOTES TO FINANCIAL STATEMENTS
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NOTE 5 - ALLOWANCE FOR LOAN LOSSES (Continued)

The following table presents the balance in the allowance for loan losses and the recorded investment in loans by portfolio segment and based on impairment method as of December 31, 2018 and 2017:

	Commercial and Industrial	Real Estate	Consumer and Other	Total
<u>2018</u>				
Allowance for loan losses:				
Ending allowance balance attributable to loans:				
Individually evaluated for impairment	\$ 2,350	\$ 500	\$ -	\$ 2,850
Collectively evaluated for impairment	<u>3,145</u>	<u>13,030</u>	<u>375</u>	<u>16,550</u>
Total ending allowance balance	<u>\$ 5,495</u>	<u>\$ 13,530</u>	<u>\$ 375</u>	<u>\$ 19,400</u>
Loans:				
Individually evaluated for impairment	\$ 16,546	\$ 16,545	\$ -	\$ 33,091
Collectively evaluated for impairment	<u>413,270</u>	<u>1,497,685</u>	<u>19,456</u>	<u>1,930,411</u>
Total loans outstanding balance	<u>\$ 429,816</u>	<u>\$ 1,514,230</u>	<u>\$ 19,456</u>	1,963,502
Deferred loan fees, net				<u>(8,629)</u>
Total loans				<u>\$ 1,954,873</u>
	Commercial and Industrial	Real Estate	Consumer and Other	Total
<u>2017</u>				
Allowance for loan losses:				
Ending allowance balance attributable to loans:				
Individually evaluated for impairment	\$ 100	\$ 1,175	\$ -	\$ 1,275
Collectively evaluated for impairment	<u>3,615</u>	<u>12,535</u>	<u>400</u>	<u>16,550</u>
Total ending allowance balance	<u>\$ 3,715</u>	<u>\$ 13,710</u>	<u>\$ 400</u>	<u>\$ 17,825</u>
Loans:				
Individually evaluated for impairment	\$ 2,600	\$ 19,223	\$ 16	\$ 21,839
Collectively evaluated for impairment	<u>380,245</u>	<u>1,402,157</u>	<u>19,976</u>	<u>1,802,378</u>
Total loans outstanding balance	<u>\$ 382,845</u>	<u>\$ 1,421,380</u>	<u>\$ 19,992</u>	1,824,217
Deferred loan fees, net				<u>(9,033)</u>
Total loans				<u>\$ 1,815,184</u>

(Continued)

FIRST NATIONAL BANK ALASKA
NOTES TO FINANCIAL STATEMENTS
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NOTE 5 - ALLOWANCE FOR LOAN LOSSES (Continued)

The following table summarizes our nonaccrual loans and loans past due by loan class as of December 31, 2018 and 2017:

	<u>30-89 Days Past Due</u>	<u>Greater Than 89 Days Past Due</u>	<u>Total Past Due</u>	<u>Current</u>	<u>Total Loans</u>	<u>Non-accrual</u>
December 31, 2018						
Commercial and industrial	\$ 1,431	\$ 110	\$ 1,541	\$ 428,275	\$ 429,816	\$ 2,534
Real Estate						
Construction and development	110	-	110	336,825	336,935	315
1- 4 and multifamily residential	1,067	219	1,286	249,793	251,079	1,327
Commercial real estate	1,321	753	2,074	924,142	926,216	3,701
Consumer and other	<u>29</u>	<u>11</u>	<u>40</u>	<u>19,416</u>	<u>19,456</u>	<u>-</u>
Total	<u>\$ 3,958</u>	<u>\$ 1,093</u>	<u>\$ 5,051</u>	<u>\$ 1,958,451</u>	1,963,502	7,877
Deferred loan fees, net					(8,629)	(50)
Total loans					<u>\$ 1,954,873</u>	<u>\$ 7,827</u>
December 31, 2017						
Commercial and industrial	\$ 926	\$ 140	\$ 1,066	\$ 381,779	\$ 382,845	\$ 2,070
Real Estate						
Construction and development	1,399	173	1,572	243,655	245,227	306
1- 4 and multifamily residential	5,924	40	5,964	287,115	293,079	153
Commercial real estate	4,522	188	4,710	878,364	883,074	6,406
Consumer and other	<u>59</u>	<u>-</u>	<u>59</u>	<u>19,933</u>	<u>19,992</u>	<u>-</u>
Total	<u>\$ 12,830</u>	<u>\$ 541</u>	<u>\$ 13,371</u>	<u>\$ 1,810,846</u>	1,824,217	8,935
Deferred loan fees, net					(9,033)	(47)
Total loans					<u>\$ 1,815,184</u>	<u>\$ 8,888</u>

There were no loans greater than 89 days past due and accruing at December 31, 2018 and 2017.

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FIRST NATIONAL BANK ALASKA
NOTES TO FINANCIAL STATEMENTS
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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, 2018:

	Unpaid Principal Balance	Recorded Investment	Allowance for Loan Losses Allocated	Average Recorded Investment	Interest Income Recognized	Cash Basis Interest Recognized
<u>December 31, 2018</u>						
With no allowance recorded:						
Commercial and industrial	\$ 2,349	\$ 1,990	\$ -	\$ 1,984	\$ 187	\$ 190
Real estate						
Construction and other	810	780	-	814	49	53
1-4 and multifamily residential	2,257	2,196	-	1,912	149	158
Commercial real estate	12,440	10,772	-	11,015	865	857
Consumer and other	-	-	-	-	-	-
Subtotal	<u>17,856</u>	<u>15,738</u>	<u>-</u>	<u>15,725</u>	<u>1,250</u>	<u>1,258</u>
With an allowance recorded:						
Commercial and industrial	14,541	14,510	2,350	7,260	113	41
Real estate						
Construction and other	684	626	220	431	46	37
1-4 and multifamily residential	1,187	1,158	140	1,110	82	85
Commercial real estate	957	954	140	709	45	45
Consumer and other	-	-	-	-	-	-
Subtotal	<u>17,369</u>	<u>17,248</u>	<u>2,850</u>	<u>9,510</u>	<u>286</u>	<u>208</u>
Total	<u>\$ 35,225</u>	<u>\$ 32,986</u>	<u>\$ 2,850</u>	<u>\$ 25,235</u>	<u>\$ 1,536</u>	<u>\$ 1,466</u>

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FIRST NATIONAL BANK ALASKA
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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, 2017:

	Unpaid Principal Balance	Recorded Investment	Allowance for Loan Losses Allocated	Average Recorded Investment	Interest Income Recognized	Cash Basis Interest Recognized
<u>December 31, 2017</u>						
With no allowance recorded:						
Commercial and industrial	\$ 2,834	\$ 2,529	\$ -	\$ 1,476	\$ 185	\$ 239
Real estate						
Construction and other	1,055	823	-	752	59	61
1-4 and multifamily residential	1,362	1,310	-	1,316	100	102
Commercial real estate	10,987	9,791	-	9,786	707	730
Consumer and other	-	-	-	-	-	-
Subtotal	<u>16,238</u>	<u>14,453</u>	<u>-</u>	<u>13,330</u>	<u>1,051</u>	<u>1,132</u>
With an allowance recorded:						
Commercial and industrial	153	152	100	82	12	14
Real estate						
Construction and other	2,694	2,091	600	1,464	166	161
1-4 and multifamily residential	2,177	2,125	225	1,885	137	136
Commercial real estate	3,151	2,915	350	2,899	175	173
Consumer and other	<u>16</u>	<u>16</u>	<u>-</u>	<u>8</u>	<u>2</u>	<u>2</u>
Subtotal	<u>8,191</u>	<u>7,299</u>	<u>1,275</u>	<u>6,338</u>	<u>492</u>	<u>486</u>
Total	<u>\$ 24,429</u>	<u>\$ 21,752</u>	<u>\$ 1,275</u>	<u>\$ 19,668</u>	<u>\$ 1,543</u>	<u>\$ 1,618</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, 2018 and 2017:

	<u>Pass/ Watch</u>	<u>Special Mention</u>	<u>Sub- Standard</u>	<u>Doubtful/ Loss</u>	<u>Total</u>
<u>December 31, 2018</u>					
Commercial and Industrial	\$ 409,812	\$ 940	\$ 16,631	\$ 2,433	\$ 429,816
Real Estate,					
Construction and development	334,631	-	2,098	206	336,935
1-4 and multifamily residential	243,784	1,052	6,104	139	251,079
Commercial real estate	912,193	1,208	12,715	100	926,216
Consumer and other	<u>19,456</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>19,456</u>
Total	<u>\$ 1,919,876</u>	<u>\$ 3,200</u>	<u>\$ 37,548</u>	<u>\$ 2,878</u>	1,963,502
Deferred loan fees, net					<u>(8,629)</u>
Total					<u>\$ 1,954,873</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, 2017</u>					
Commercial and Industrial	\$ 379,010	\$ 882	\$ 2,870	\$ 83	\$ 382,845
Real Estate,					
Construction and development	240,902	253	4,072	-	245,227
1-4 and multifamily residential	285,468	915	6,682	14	293,079
Commercial real estate	866,175	3,627	13,015	257	883,074
Consumer and other	<u>19,976</u>	<u>-</u>	<u>-</u>	<u>16</u>	<u>19,992</u>
Total	<u>\$ 1,791,531</u>	<u>\$ 5,677</u>	<u>\$ 26,639</u>	<u>\$ 370</u>	1,824,217
Deferred loan fees, net					<u>(9,033)</u>
Total					<u>\$ 1,815,184</u>

Troubled Debt Restructurings:

At December 31, 2018 and 2017, the Bank had loans of \$25,770 and \$16,708 classified as troubled debt restructurings, respectively, which are included in impaired loans. These loans had allocated specific reserves of \$2,219 and \$396 at December 31, 2018 and 2017, respectively. The Bank has committed to lend \$56 and \$30 as of December 31, 2018 and 2017, respectively, to customers with outstanding loans that are classified as troubled debt restructurings.

At December 31, 2018 \$22,933 of troubled debt restructurings were performing and \$2,837 were nonaccrual and impaired. At December 31, 2017, \$13,737 of troubled debt restructurings were performing and \$2,971 were nonaccrual and impaired.

During the year ended December 31, 2018, 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 three restructurings of commercial loans with maturity date extensions of 1.35 and 3 years.

1-4 and multifamily residential loans: There were three restructurings of 1-4 and multifamily residential loans. There were two maturity date extensions of 15.4 and 15.9 years. All three loans had a temporary deferral of all or part of the original periodic principal payments.

There were no restructurings of construction loans, commercial real estate loans, and consumer loans.

FIRST NATIONAL BANK ALASKA
NOTES TO FINANCIAL STATEMENTS
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NOTE 5 - ALLOWANCE FOR LOAN LOSSES (Continued)

During the year ended December 31, 2017, 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 restructuring of commercial loan stated interest rates. There were two maturity date extensions of 4 years. The temporary deferrals of all or part of the scheduled principal payments were for periods ranging from 4 years to 8.6 years.

Commercial real estate loans: There was one restructuring of a commercial real estate loan stated interest rate for 15 years and its maturity date was extended 7 years and deferrals of all or part of the loan's scheduled principal payments were for 15 years.

Consumer loans: There was one restructuring of a consumer loan stated interest rate for 2 months and its maturity date extension of 3 months and deferrals of all or part of the loan's scheduled principal payments were for 2 months.

There were no restructurings of construction loans and 1-4 and multifamily residential loans.

FIRST NATIONAL BANK ALASKA
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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, 2018 and 2017:

	<u>Number of Loans</u>	<u>Pre-Modification Outstanding Recorded Investment</u>	<u>Post-Modification Outstanding Recorded Investment</u>
<u>2018 Troubled Debt Restructurings:</u>			
Commercial	3	\$ 12,871	\$ 12,254
Real estate:			
Construction and other	-	-	-
1-4 and multifamily residential	3	114	114
Commercial real estate	-	-	-
Consumer and other	<u>-</u>	<u>-</u>	<u>-</u>
Total	<u>6</u>	<u>\$ 12,985</u>	<u>\$ 12,368</u>
<u>2017 Troubled Debt Restructurings:</u>			
Commercial	2	\$ 266	\$ 266
Real estate:			
Construction and other	-	-	-
1-4 and multifamily residential	-	-	-
Commercial real estate	1	576	508
Consumer and other	<u>1</u>	<u>16</u>	<u>-</u>
Total	<u>4</u>	<u>\$ 858</u>	<u>\$ 774</u>

The troubled debt restructurings described in the above table had allocated specific reserves of \$2,155 and \$85 as of December 31, 2018 and 2017 and resulted in no charge-offs during the years ended December 31, 2018 and 2017.

There were no loans that defaulted (became at least 60 days past due) during December 31, 2018 and 2017 after having been modified as a troubled debt restructuring within the previous 12 months.

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.

FIRST NATIONAL BANK ALASKA
NOTES TO FINANCIAL STATEMENTS
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NOTE 6 - PREMISES AND EQUIPMENT

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

	<u>2018</u>	<u>2017</u>
Land	\$ 13,516	\$ 13,898
Bank premises	72,912	78,222
Leasehold improvements	122	122
Furniture and equipment	34,808	33,797
Construction in process	<u>2,589</u>	<u>1,026</u>
Total premises and equipment	123,947	127,065
Less: Accumulated depreciation and amortization	<u>77,274</u>	<u>77,564</u>
Premises and equipment, net	<u>\$ 46,673</u>	<u>\$ 49,501</u>

Depreciation and amortization expense on premises and equipment for the years ended December 31, 2018 and 2017 totaled \$3,599 and \$3,667, respectively.

In 2018, the Bank recorded an impairment of \$1,192 as a write-down to market value prior to the sale of one of its branches.

NOTE 7 - OTHER REAL ESTATE OWNED

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

	<u>2018</u>	<u>2017</u>
Balance, January 1	\$ 15,267	\$ 17,103
Acquired upon foreclosure	1,180	404
Transfers from bank premises	41	-
Capitalized improvements	-	85
Dispositions	(14,593)	(2,178)
Depreciation	<u>(105)</u>	<u>(147)</u>
Balance, December 31	<u>1,790</u>	<u>15,267</u>
Less Devaluation Reserves:		
Balance, January 1	(5,392)	(4,881)
Impairments subsequent to foreclosure	(129)	(757)
Dispositions	<u>5,356</u>	<u>246</u>
Balance, December 31	<u>(165)</u>	<u>(5,392)</u>
Other real estate owned, net	<u>\$ 1,625</u>	<u>\$ 9,875</u>

Net gains on sales of other real estate owned included in other noninterest expense for the years ended December 31, 2018 and 2017, totaled \$4,728 and \$143, respectively. Operating expenses, net of rental income totaled \$144 and \$198 for the years ended December 31, 2018 and 2017, respectively.

FIRST NATIONAL BANK ALASKA
NOTES TO FINANCIAL STATEMENTS
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NOTE 8 - MORTGAGE SERVICING RIGHTS

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

	<u>2018</u>	<u>2017</u>
Balance, January 1,	\$ 2,825	\$ 3,146
Additions -		
Capitalization of servicing assets	1,210	1,080
Subtractions:		
Amortization	(1,045)	(1,146)
Accelerated amortization due to early payoffs	<u>(250)</u>	<u>(255)</u>
Balance, December 31,	<u>\$ 2,740</u>	<u>\$ 2,825</u>

Mortgage loan servicing income is comprised of the following:

	<u>2018</u>	<u>2017</u>
Mortgage loan servicing fees	\$ 3,404	\$ 3,390
Amortization of costs	(1,045)	(1,146)
Accelerated amortization due to early payoffs	<u>(250)</u>	<u>(255)</u>
Mortgage loan servicing income	<u>\$ 2,109</u>	<u>\$ 1,989</u>

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 2018 and 2017.

NOTE 9 - DEPOSITS

Total deposits by type of depositor as of December 31:

	<u>2018</u>	<u>2017</u>
Deposits of individuals, partnerships, and corporations	\$ 2,356,948	\$ 2,385,844
Deposits of U.S. government	1,212	817
Deposits of states and political subdivisions	61,773	51,041
Other deposits	<u>360</u>	<u>115</u>
Total deposits	<u>\$ 2,420,293</u>	<u>\$ 2,437,817</u>

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NOTE 9 – DEPOSITS (Continued)

As of December 31, 2018 and 2017 the aggregate deposits of related parties (directors and executive officers of the Bank and their family members) were \$9,992 and \$10,692, respectively.

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

<u>Maturity:</u>	<u>2018</u>
2019	101,699
2020	5,867
2021	4,800
2022	2,574
2023	<u>1,765</u>
Total time deposits	<u>\$ 116,705</u>

Time deposits that meet or exceed the FDIC Insurance Limit of \$250 were \$45,149 and \$55,942 as of December 31, 2018 and 2017, respectively.

NOTE 10 - SECURITIES SOLD UNDER AGREEMENTS TO REPURCHASE

Investment securities, primarily including U.S. Treasuries and U.S. government-sponsored enterprises, with carrying amounts of \$1,011,342 and \$885,174 at December 31, 2018 and 2017, respectively, were pledged to secure securities sold under agreements to repurchase. As of December 31, 2018 all repurchase agreements matured within 1 business day.

As of December 31, 2018 and 2017, aggregate repurchase agreement balances of related parties (directors and executive officers of the Bank and their family members) were \$638 and \$909, respectively.

NOTE 11 - LEASES

The Bank is party to various operating leases for the rental of premises and equipment. Total rental expenses for Bank premises and equipment were \$324 and \$322 as of December 31, 2018 and 2017, respectively.

The Bank leases mail equipment under capital leases. Amortization of assets held under capital leases is included with depreciation expense.

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NOTE 11 – LEASES (Continued)

Aggregate minimum rental commitments under noncancellable operating leases (with initial or remaining lease terms in excess of one year) and future minimum capital lease payments as of December 31, 2018 were:

	<u>Capital Leases</u>	<u>Operating Leases</u>
Year ended December 31:		
2019	\$ 72	\$ 121
2020	72	112
2021	72	93
2022	11	80
2023	-	80
Thereafter	<u>-</u>	<u>3,460</u>
Total minimum lease payments	<u>\$ 227</u>	<u>\$ 3,946</u>

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 17, 2019.

On April 28, 2018, the Bank's shareholders approved a split of all approved and outstanding shares of the Bank's common stock at a ratio of 10-for-1. All share and earnings per share information have been retroactively adjusted to reflect the stock split.

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, 2018 and 2017, which is maintained to comply with regulatory requirements. Changes to surplus require regulatory approval.

During 2018, the Bank repurchased a total of 2,200 shares of common stock representing an annual aggregate purchase value of \$477 at an average price per share of \$217. During 2017, the Bank repurchased a total of 560 shares of common stock representing an aggregate value of \$98, at an average price per share of \$174. Cumulative shares of 278,960 have been repurchased under the program since inception for a combined purchase total of \$45,074.

At the January 31, 2019 Board of Directors meeting, cash dividends of \$4.80 per share were declared, payable March 15, 2019 to shareholders of record as of March 1, 2019.

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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.

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 0.01691% 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, 2018 and 2017. 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, 2018 and 2017, 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, 2018 financial statements.

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NOTE 14 - EMPLOYEE BENEFIT PLANS

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 2018, the maximum amount that may be deferred by participants is \$18.5. 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. The participant’s salary deferral plus any earnings they generate are 100% vested.

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. Matching contributions made by the Bank, including any earnings generated, are vested beginning at 20% after completion of one full year of service, increasing 20% each year until fully vested at five years of service. The 2018 combined limit of all employee and employer contributions to an individual participant’s account is \$55.

The Bank has a qualified non-contributory profit sharing plan for all employees. The annual profit sharing contribution can be made only from profits and the amount is determined by the Board of Directors.

The contribution to the profit sharing and 401(k) plan was \$1,721 and \$1,500 for the years ended December 31, 2018 and 2017, respectively.

NOTE 15 - PROVISION FOR INCOME TAXES

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

	<u>2018</u>	<u>2017</u>
Current:		
Federal	\$ 10,583	\$ 20,364
State	<u>4,062</u>	<u>3,203</u>
Total current	<u>14,645</u>	<u>23,567</u>
Deferred:		
Federal	1,474	(2,585)
Deferred expense from Federal tax reform	-	4,744
State	<u>522</u>	<u>(602)</u>
Total deferred	<u>1,996</u>	<u>1,557</u>
Provision for income taxes	<u>\$ 16,641</u>	<u>\$ 25,124</u>

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NOTE 15 - PROVISION FOR INCOME TAXES (Continued)

Income tax expense differed from the Federal statutory rate of 21% and 35% for 2018 and 2017, respectively, for the following reasons:

	<u>2018</u>	<u>%</u>	<u>2017</u>	<u>%</u>
Tax expense at federal statutory rate	\$ 14,856	21.00%	\$ 21,543	35.00%
Increase (decrease) resulting from:				
State tax, net of Federal tax effect	3,601	5.09	2,010	3.27
Disallowed interest expense	174	0.24	118	0.19
Interest exempt from federal taxation	(1,286)	(1.82)	(2,451)	(3.98)
Low income housing tax credits	(667)	(0.94)	(957)	(1.55)
Deferred tax write-down from change in				
Federal tax rate	-	-	4,744	7.71
Other items, net	<u>(37)</u>	<u>(0.05)</u>	<u>117</u>	<u>0.19</u>
Provision for income taxes	<u>\$ 16,641</u>	<u>23.52%</u>	<u>\$ 25,124</u>	<u>40.83%</u>

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>2018</u>	<u>2017</u>
Deferred tax assets:		
Allowance for loan losses	\$ 5,515	\$ 5,067
Mortgage servicing rights	394	315
Interest collected on nonperforming loans	740	854
Vacation accrual	1,012	975
Accumulated depreciation and amortization	743	1,008
Other real estate owned valuation reserve	244	2,157
Net unrealized holding loss on securities, available-for-sale	6,229	3,243
Low income housing projects	427	345
Other	800	399
Total deferred tax assets	<u>16,104</u>	<u>14,363</u>
Deferred tax liabilities:		
Net deferred loan fees	2,736	2,450
Deferred loan costs	532	545
Other	1,210	732
Total deferred tax liabilities	<u>4,478</u>	<u>3,727</u>
Net deferred tax assets	<u>\$ 11,626</u>	<u>\$ 10,636</u>

Net deferred tax assets are included in other assets 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.

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NOTE 15 - PROVISION FOR INCOME TAXES (Continued)

During December 2017, the Tax Cuts and Jobs Act (the Act) was signed into law, which reduces the Bank's federal tax rate from 35% to 21% effective in 2018. The Bank was required to re-measure, through income tax expense, its deferred tax assets and liabilities using the enacted tax rate, the rate that deferred taxes are expected to be recovered or settled. This re-measurement of the deferred taxes resulted in additional provision for income taxes of \$4,744 during 2017. The Company also early adopted ASU 2018-02 and reclassified out of accumulated other comprehensive loss and into retained earnings \$1,447 of tax benefit due to re-measuring the deferred tax assets on securities available for sale.

As a further result of the Act, the Bank was required to re-measure their investment in certain community development projects at the new, lower federal tax rate. As a result of the re-measurement, the Bank recognized impairment expense of \$620 within Other Interest Expense on the Statement of Income in 2017.

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, 2018 and 2017 were immaterial and no amounts are accrued for interest and penalties at December 31, 2018 or 2017.

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 2015.

NOTE 16 - 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

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NOTE 16 - ESTIMATED FAIR VALUE OF FINANCIAL INSTRUMENTS (Continued)

The fair value estimates presented herein are based on pertinent information available to management as of December 31, 2018 and 2017. 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.

ASU 2016-01 requires use of an exit price in fair value disclosures. Prior to January 1, 2018, the Bank used an entry price in the estimate of the fair value of the loans. Amounts and estimated fair value of financial instruments as of December 31,

	2018		2017	
	Carrying Amount	Estimated Fair Value	Carrying Amount	Estimated Fair Value
<u>Financial assets:</u>				
Cash and cash equivalents	\$ 108,557	\$ 108,557	\$ 134,051	\$ 134,051
Securities, available-for-sale	1,597,992	1,597,992	1,590,444	1,590,444
Real estate loans to be sold	18,459	18,531	16,036	16,240
Loans:				
Commercial and industrial	422,930	419,280	377,784	367,148
Real estate	1,493,423	1,521,449	1,399,942	1,321,657
Consumer and other	19,120	19,771	19,633	20,548
Total loans, net	1,935,473	1,960,500	1,797,359	1,709,353
Federal Reserve Bank stock	2,151	N/A	2,151	N/A
Federal Home Loan Bank stock	4,384	N/A	4,332	N/A
Interest receivable	17,138	17,138	16,702	16,702
<u>Financial liabilities:</u>				
Deposits:				
Non-interest bearing	1,291,866	1,291,866	1,231,762	1,231,762
Interest bearing:				
Savings	654,431	654,431	692,712	692,712
NOW	194,508	194,508	200,395	200,395
Money market	162,783	162,783	181,221	181,221
Time	116,705	117,679	131,727	132,717
Total interest bearing	1,128,427	1,129,401	1,206,055	1,207,045
Total deposits	2,420,293	2,421,267	2,437,817	2,438,807
Securities sold under agreements to repurchase	809,020	809,020	687,064	687,064
Notes payable and capital lease obligations	227	227	299	299
Interest payable	197	197	112	112

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NOTE 16 - 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. 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.

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NOTE 16 - ESTIMATED FAIR VALUE OF FINANCIAL INSTRUMENTS (Continued)

Assets measured at fair value on a recurring basis:

	<u>Total</u>	<u>Fair Value Measurements Using</u>		
		<u>Quoted Prices in Active Markets For Identical Assets (Level 1)</u>	<u>Significant Other Observable Inputs (Level 2)</u>	<u>Significant Unobservable Inputs (Level 3)</u>
<u>2018</u>				
<u>Securities:</u>				
U.S. Treasury securities	\$ 325,223	\$ 325,223	\$ -	\$ -
U.S. government-sponsored enterprises	736,222	-	736,222	-
States and political subdivisions	161,993	-	161,993	-
Mortgage-backed securities – residential	2,151	-	2,151	-
Mortgage-backed securities – commercial	77,503	-	77,503	-
Corporate bonds	<u>294,900</u>	<u>-</u>	<u>294,900</u>	<u>-</u>
Securities total	<u>\$ 1,597,992</u>	<u>\$ 325,223</u>	<u>\$ 1,272,769</u>	<u>\$ -</u>
<u>2017</u>				
<u>Securities:</u>				
U.S. Treasury securities	\$ 141,325	\$ 141,325	\$ -	\$ -
U.S. government-sponsored enterprises	717,999	-	717,999	-
States and political subdivisions	328,279	-	328,279	-
Mortgage-backed securities – residential	2,752	-	2,752	-
Mortgage-backed securities – commercial	79,270	-	79,270	-
Corporate bonds	<u>320,819</u>	<u>-</u>	<u>320,819</u>	<u>-</u>
Securities total	<u>\$ 1,590,444</u>	<u>\$ 141,325</u>	<u>\$ 1,449,119</u>	<u>\$ -</u>

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 and securities are classified as Level 2.

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 2018 and 2017.

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, 2018 the Bank had no investments in Fannie Mae or Freddie Mac common or preferred stock.

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NOTE 16 - ESTIMATED FAIR VALUE OF FINANCIAL INSTRUMENTS (Continued)

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, 2018</u>				
Impaired loans:				
Commercial and Industrial	\$ 12,138	\$ -	\$ -	\$ 12,138
Real estate	2,213	-	-	2,213
Other real estate owned – Construction and development	<u>499</u>	<u>-</u>	<u>-</u>	<u>499</u>
Total	<u>\$ 14,850</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 14,850</u>
<u>December 31, 2017</u>				
Impaired loans – Real estate	\$ 5,956	\$ -	\$ -	\$ 5,956
Other real estate owned – Construction and development	<u>6,403</u>	<u>-</u>	<u>-</u>	<u>6,403</u>
Total	<u>\$ 13,904</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 13,904</u>

The fair value of impaired loans is based on the value of the collateral securing those loans and is determined using the sale or market comparison. The market comparison evaluates the sales price of similar properties or assets in the same market area. Impaired loans that are measured for impairment using the fair value of the collateral for collateral dependent loans resulted in an additional provision for loan losses of \$1,636 and \$739 for the years ended December 31, 2018 and 2017, respectively.

The fair value of other real estate owned is based upon the current appraised values of the properties. Appraisals are obtained at least annually and reductions in value are recorded as a valuation loss through a charge to expense. Other real estate owned measured at fair value less costs to sell resulted in write-downs of \$71 and \$701 for the years ended December 31, 2018 and 2017, respectively.

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NOTE 16 - 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, 2018 and 2017:

<u>December 31, 2018</u>	<u>Fair value</u>	<u>Valuation Technique</u>	<u>Unobservable Input</u>	<u>Range (Weighted Average)</u>
Loans – Commercial and Industrial	\$ 12,138	Sales comparison approach	Adjustment for differences between the comparable sales	-2.56% to -14.57% (-2.84%)
Loans – Real estate	\$ 2,213	Sales comparison approach	Adjustment for differences between the comparable sales	-0.29% to -30.3% (-6.06%)
Other real estate owned – Construction and development	\$ 499	Sales comparison approach	Adjustment for differences between the comparable sales	-9.75% to -9.75% (-9.75%)
<u>December 31, 2017</u>	<u>Fair value</u>	<u>Valuation Technique</u>	<u>Unobservable Input</u>	<u>Range (Weighted Average)</u>
Loans – Real estate	\$ 5,956	Sales comparison approach	Adjustment for differences between the comparable sales	-0.16% to -38.57% (-6.05%)
Other real estate owned – Construction and development	\$ 6,403	Sales comparison approach	Adjustment for differences between the comparable sales	0.24% to -9.33% (-5.07%)

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, 2018. The Bank may adopt this guidance for financial assets and liabilities in the future as permitted under the guidance.

NOTE 17 - CREDIT ARRANGEMENTS

The Bank had a committed line of credit, secured by investment securities, of \$103,672 and \$64,540 from the Federal Reserve Bank at a rate of 3.00% and 2.00% as of December 31, 2018 and 2017, respectively. The Bank had a line of credit from Federal Home Loan Bank Des Moines, secured by loans, of \$100,000 at a rate of 2.63% as of December 31, 2018. In addition, the Bank also had federal funds arrangements available from unaffiliated banks totaling \$80,000 at a rate estimated at 2.64 – 3.00% and 1.64 – 2.00% as of December 31, 2018 and 2017 respectively. There were no outstanding balances against these lines of credit as of December 31, 2018 or 2017.

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NOTE 18 - 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>2018</u>	<u>2017</u>
Loan commitments	\$ 485,473	\$ 516,528
Bankcard commitments	60,133	67,108
Commitments to fund mortgage loans to be sold	<u>31,368</u>	<u>39,996</u>
Total loan commitments	<u>\$ 576,974</u>	<u>\$ 623,632</u>
Commitments at fixed interest rates	\$ 233,296	\$ 245,698
Commitments at variable interest rates	<u>343,678</u>	<u>377,934</u>
Total loan commitments	<u>\$ 576,974</u>	<u>\$ 623,632</u>
Standby and commercial letters of credit	\$ 10,259	\$ 7,379
Subscriptions to purchase Federal Reserve Bank stock	2,151	2,151

Commitments to make loans are generally made for periods of 90 days or less. At December 31, 2018, the fixed rate loan commitments have interest rates ranging from 2.27% to 16.5%.

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NOTE 19 - REGULATORY MATTERS

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

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

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

The final rules implementing Basel Committee on Banking Supervision's capital guidelines for U.S. Banks (Basel III rules) became effective for the Bank on January 1, 2015 with full compliance with all of the requirements being phased in over a multi-year schedule, and fully phased in by January 1, 2019. Under the Basel III rules, the Bank must hold a capital conservation buffer above the adequately capitalized risk-based capital ratios. The capital conservation buffer is being phased in from 0.0% for 2015 to 2.50% by 2019. The capital conservation buffer for 2018 is 1.875%. The net unrealized gain or loss on available for sale securities is not included in computing regulatory capital. Management believes, as of December 31, 2018, that the Bank meets all capital adequacy requirements to which it is subject.

As of December 31, 2018, 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 2018 and 2017. 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 19 - REGULATORY MATTERS (Continued)

The Bank's actual amounts and ratios at December 31, 2018 and 2017 are as follows:

	<u>Actual</u>		<u>Minimum Requirement for Capital Adequacy Purposes Plus Fully Phased In Capital Conservation Buffer</u>		<u>Minimum Requirement 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>2018</u>						
Total capital (to risk-weighted assets)	\$ 542,834	20.89%	\$272,896	10.50%	\$259,901	10.00%
Tier I capital (to risk-weighted assets)	522,534	20.11%	220,916	8.50%	207,921	8.00%
Common Tier I (CET1)	522,534	20.11%	181,931	7.00%	168,936	6.50%
Tier I capital (to average assets)	522,534	13.62%	153,499	4.00%	191,874	5.00%
<u>2017</u>						
Total capital (to risk-weighted assets)	\$ 525,018	20.01%	\$275,435	10.50%	\$262,319	10.00%
Tier I capital (to risk-weighted assets)	505,043	19.25%	222,971	8.50%	209,855	8.00%
Common Tier I (CET1)	505,043	19.25%	183,623	7.00%	170,507	6.50%
Tier I capital (to average assets)	505,043	13.48%	149,886	4.00%	187,358	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, 2018 is \$37,099 without OCC approval.