2018

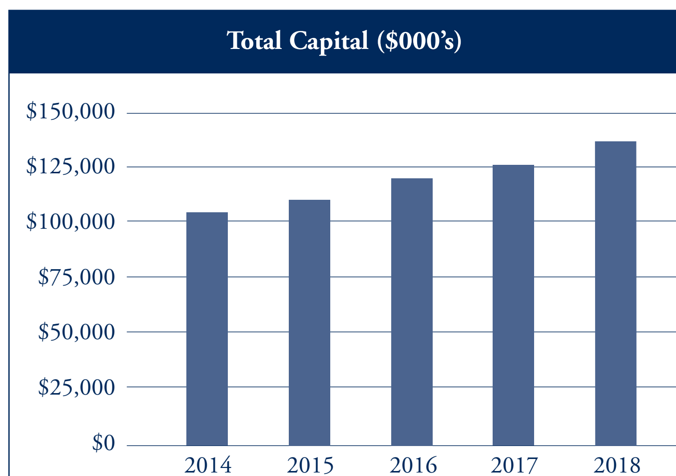
MALAGA
FINANCIAL CORPORATION

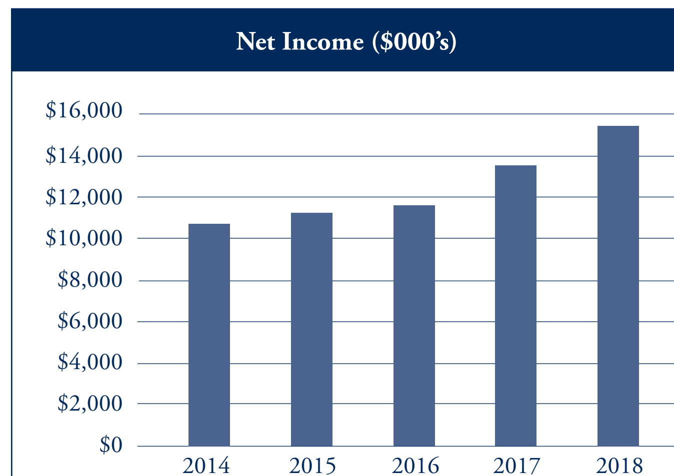
ANNUAL REPORT

We wish to express our thanks for the opportunity to serve the residents and businesses of Palos Verdes and the surrounding communities for the last thirty-four years. We look forward to continuing to be your local community bank of choice in the years to come.

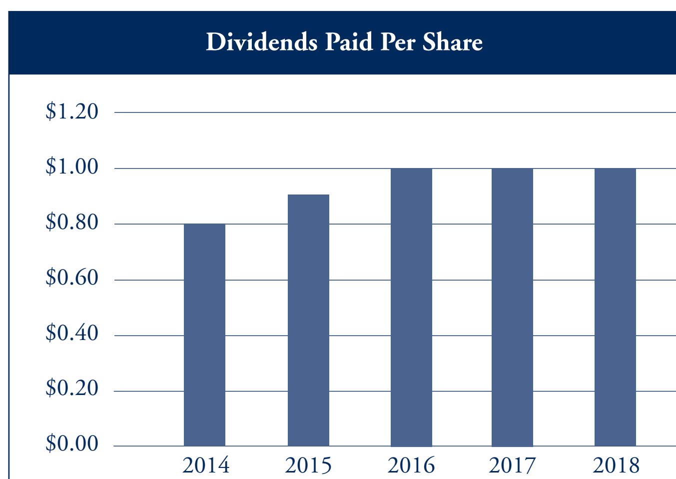
F I N A N C I A L S T R E N G T H

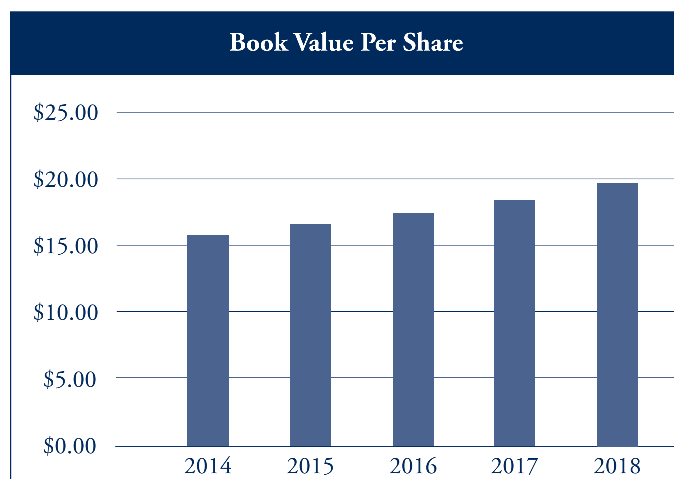
Strong and Stable Capital and Income





Shareholder Value





2 0 1 8 A C C O M P L I S H M E N T S

Record earnings for the 2nd consecutive year.

Excellent asset quality.

Strong capital levels.

Quarterly cash dividends for the 58th consecutive quarter and special 5% common stock dividend at year-end 2018.

For over 10 years Malaga Bank has been consistently awarded premier Top 5-Star rating by one of the nation's leading independent bank rating and reseach firms, Bauer Financial Inc.

Completed the acquisition of 1 Malaga Cove Plaza, a historic building in Malaga Cove Plaza and long recognized as Malaga Bank's corporate headquarters.

*Malaga Bank is a wholly owned subsidiary of Malaga Financial Corporation.

DEAR SHAREHOLDERS AND FRIENDS,

2018 was a good year for Malaga Financial Corporation and its shareholders. We were pleased to report record earnings for the 2nd consecutive year. This was due to the benefit of a lower tax rate as a result of the Tax Cut and Jobs Act enacted in December 2017, and an improvement in operations that together contributed to a $1.8 million or over 13% increase from the prior year's record earnings. In spite of intense competition, we were also able to achieve modest organic growth in our loan portfolio while continuing to adhere to our disciplined and conservative underwriting practices. We were also pleased with the results of our efforts to control growth of non-interest expenses.

Shareholders were rewarded with $1.00 per share cash dividends during the year in addition to a 2nd consecutive year-end 5% common stock dividend. Total cash dividends paid in 2018 increased by $302,087 compared to the prior year, primarily as a result of the stock dividend paid at year-end 2017.

Highlights of 2018 are as follows:

- Book value per share increased from $18.38 to $19.62 after adjusting for the issuance of the 5% common stock dividend
- Earnings per share of $2.22 (basic) and $2.20 (fully diluted) compared to $1.98 (basic) and $1.96 (fully diluted) after adjusting for the issuance of the 5% common stock dividend
- Net income of $15.3 million
- Return on average equity (ROE) was 11.65%
- Return on average assets (ROA) was 1.44%
- Excellent credit quality with no non-performing assets/foreclosures at year-end
- Capital levels remained stable with a 13.64% core capital ratio and a 25.22% risk-based ratio at year-end 2018, substantially exceeding the minimum "well-capitalized" requirements of 5% and 10%, respectively
- Completed the acquisition of 1 Malaga Cove Plaza, a historic building located in Malaga Cove Plaza and long recognized as Malaga Bank's corporate headquarters. The purchase of the building makes evident that Malaga Bank is here to stay and dedicated to the communities we serve.

Total gross loans at December 31, 2018 were $986.9 million, up $37.3 million or 4% from prior year-end. Loan growth was restrained by increasing competition reflected by both relaxed underwriting standards and aggressive pricing; however, we continue to adhere to our past discipline placing our emphasis on safe, conservative underwriting over growth.

Malaga Bank was awarded the Bauer Financial Inc. premier Top 5-Star rating for the 45th consecutive quarter as of December 2018. Bauer Financial Inc. is one of the nation's leading independent bank rating and research firms. In July 2018, Malaga Bank was awarded the Daily Breeze 27th annual Reader's Choice Award as South Bay's Best Bank.

We anticipate the operating environment in 2019 will continue to be volatile with uncertainty as to the direction of interest rates, economic activity and ongoing contention in the political arena. However, we approach the coming year with optimism for the continued success of Malaga Financial Corporation and its subsidiary, Malaga Bank.

On behalf of Malaga Financial Corporation and Malaga Bank, we thank our board of directors, management and staff for their commitment and contributions to our day to day success, and you, our shareholders, for your loyalty, your business, and your investment.

Randy Bowers
President and
Chief Executive Officer

Richard Oas
Chairman of the Board

MANAGEMENT'S DISCUSSION AND ANALYSIS

The following discussion and financial information are presented to aid in understanding results of operations and financial condition of Malaga Financial Corporation ("MFC") and its consolidated subsidiary, Malaga Bank FSB ("Malaga Bank"). In this discussion, references to the "Company" or "we" or "us" refer to MFC, Malaga Bank and PVFC.

OVERVIEW

MFC is the holding company for Malaga Bank, and the stock of Malaga Bank is MFC's primary asset. Malaga Bank is a full-service community bank with headquarters located on the Palos Verdes Peninsula in Southern California. It is the largest independent bank headquartered in the South Bay area of Los Angeles.

We originate primarily adjustable rate multifamily (apartment) mortgage loans in Southern California and to a lesser extent 1-4 family residential loans, consumer loans, construction loans, commercial mortgage loans and commercial loans. At December 31, 2018, multifamily mortgage loans represented 83% of our loan portfolio and loans represented 91% of our total assets.

In 2018, our market area for deposits continued to be concentrated in the areas immediately surrounding our five branch offices in Palos Verdes Estates, Rolling Hills Estates, Torrance and San Pedro, California.

RESULTS OF OPERATIONS

Our net income was $15.3 million in 2018 compared to net income of $13.5 million in the previous year, an increase of $1.8 million or 13%. Earnings per share for 2018 were $2.22 (basic) and $2.20 (fully diluted), compared to $1.98 (basic) and $1.96 (fully diluted) in 2017.

Our return on average assets (ROA) was 1.44% in 2018 compared to 1.33% in 2017. Our return on average equity (ROE) was 11.65% in 2018 compared to 11.12% in 2017.

The following table sets forth selected financial data for the past five years:

	2018	2017	2016	2015	2014
Total assets (000's)	$1,087,559	$1,041,067	$ 981,376	$ 984,382	$ 947,282
Stockholders' equity (000's)	$ 136,251	$ 125,986	$ 117,341	$ 111,007	$ 104,225
Net income (000's)	$ 15,305	$ 13,500	$ 11,559	$ 11,406	$ 11,211
Basic earnings per share*	$ 2.22	$ 1.98	$ 1.71	$ 1.71	$ 1.69
Diluted earnings per share*	$ 2.20	$ 1.96	$ 1.70	$ 1.70	$ 1.68
Dividends paid per share	$ 1.00	$ 1.00	$ 1.00	$ .90	$ .80
ROA	1.44%	1.33%	1.16%	1.16%	1.22%
ROE	11.65%	11.12%	10.09%	10.55%	11.07%

*Adjusted for the 5% stock dividend on December 28, 2018 and December 29, 2017.

On December 28, 2018, MFC paid a 5% common stock dividend which increased the number of shares outstanding by 330,532. On December 29, 2017, MFC paid a 5% common stock dividend that increased the number of shares outstanding by 310,782.

NET INTEREST INCOME

Net interest income is the primary component of our income. The chief determinants of net interest income are the dollar amounts of interest-earning assets and interest-bearing liabilities and the interest rates earned or paid on these assets and liabilities. The greater the excess of average interest-earning assets over average interest-bearing liabilities, the more beneficial the impact on net interest income.

For 2018, net interest income totaled $32,577,000, an increase of $321,000 or 1% from 2017. This increase reflected higher average interest-earning assets of $34.9 million offset by a decrease of 0.11% in the interest rate spread to 3.07%. The decrease in the interest rate spread is primarily attributable to an increase in the average cost of funds of 0.29% offset by an increase in the yield on average interest-earning assets of 0.18%.

The following table sets forth the weighted-average balances, yields earned and rates paid with respect to the major components of our interest-earning assets and interest-bearing liabilities, and net interest rate spread, for the periods indicated:

WEIGHTED-AVERAGE BALANCES AND RATES

	2018		2017	
	(000's)		(000's)	
Loans receivable	$ 965,624	4.05%	$ 927,774	3.92%
Federal funds sold	44,021	1.91	40,498	1.15
Interest-bearing deposits in banks	12,196	1.97	18,896	1.17
FHLB stock	6,656	8.66	6,402	7.76
Total interest-earning assets	1,028,497	3.96	993,570	3.78
Deposits	753,117	0.61	763,286	0.39
FHLB borrowings	150,907	1.98	105,001	1.72
Junior subordinated debentures	13,404	4.51	13,404	3.53
Total interest-bearing liabilities	917,428	0.89	881,691	0.60
Excess of interest-earning assets over interest-bearing liabilities; interest rate spread	$ 111,069	3.07 %	$ 111,879	3.18%

PROVISIONS FOR CREDIT LOSSES

We recorded a provision for credit losses of $49,000 in 2018 versus $93,000 in 2017. There were two charge-offs totaling $8,200 in 2018 and three charge-offs totaling $22,200 in 2017.

OTHER OPERATING INCOME

Other operating income, which consists primarily of deposit related fees, increased $51,000 from 2017 to 2018.

OTHER OPERATING EXPENSES

The main components of other operating expenses or "overhead" are compensation, office rent and utilities, regulatory assessments and general and administrative expenses. Operating expenses increased $370,000 or 3% from $11.6 million in 2017 to $12.0 million in 2018. This increase was due primarily to a $500,000 increase in compensation expense offset by a $116,000 decrease in office rent and utilities, a $23,000 decrease in data processing and a $13,000 decrease in deposit insurance premiums. The decrease in office rent and utilities of $116,000 was due primarily to a decrease in the rent expense as a result of our purchase of the main branch in May 2018.

At December 31, 2018 and 2017, we employed 80 and 77 full-time equivalent employees, respectively, with an average of 7.4 and 7.1 years of service, respectively. The tenure and experience of our employees continue to be a major part of our successful and efficient operations.

Banks measure their ability to manage overhead through an efficiency ratio expressed as total overhead expenses as a percentage of net interest income and other operating income. Malaga Bank's efficiency ratios of 34.67% in 2018 and 33.98% in 2017 continued to be very favorable compared to the efficiency ratios of our peers, insured savings banks having assets greater than $1 billion, which averaged 62.93% in 2018 and 62.46% in 2017. Another measure of overhead efficiency is the percentage of overhead expense to average assets. Malaga Bank's ratio was 1.12% in 2018 and 2017, which compared with our peer group average of 2.56% and 2.61% in 2018 and 2017, respectively. Malaga Bank had $12.9 million in average assets per employee at December 31, 2018 as compared to $12.8 million in average assets per employee at December 31, 2017.

FINANCIAL CONDITION

Total assets increased to $1.088 billion at December 31, 2018 from $1.041 billion at December 31, 2017.

LOAN PORTFOLIO

Total gross loans at December 31, 2018 were $986.9 million, up $37.3 million or 4% from the prior year-end. Our primary lending emphasis continued to be multifamily mortgage loans, which comprised 83% of our loan portfolio at December 31, 2018. The weighted-average yield on the loan portfolio was 4.05% at December 31, 2018 and 3.92% at December 31, 2017.

CREDIT LOSS RESERVES AND NON-PERFORMING ASSETS

Our allowance for credit losses, including reserves for losses on commitments for lines of credit and construction loans, totaled $3.2 million at December 31, 2018 and $3.1 million at December 31, 2017. As of December 31, 2018, there were no loans past due. As of December 31, 2017, there was one loan for $228,000 or 0.02% of total loans past due 30-59 days, and all other loans were current. Our allowance for credit losses to total loans outstanding was 0.32% at December 31, 2018 and 0.33% at December 31, 2017.

Management's determination of the adequacy of the allowance for credit losses requires the use of judgment and estimates that may change in the future. Some factors considered by management in determining the adequacy of the allowance include: detailed reviews of individual loans; gross and net charge-offs in the current year; historical loss levels; past due and non-accruing loans; collateral values of properties securing loans; types of loans and risk profiles; and management's analysis of current economic conditions and the resulting impact on the loan portfolio. Changes in the factors used by management to determine the adequacy of the allowance, or the availability of new information, could cause the allowance for credit losses to be increased or decreased. In addition, bank regulatory agencies, as a part of their examination process, may require that additions be made to the allowance for credit losses based on their judgment and estimates.

BUILDING

In May 2018 we purchased the land and building that house our main branch and administrative offices in Malaga Cove Plaza Shopping Center for $7.1 million. This purchase resulted in an increase in our building and property assets, while decreasing our rent expense.

DEPOSITS

Our deposit strategy in 2018 continued to focus on attracting core customer relationships at our branches. Total deposits increased by $2.0 million to $757.5 million at December 31, 2018. During the year, non-interest bearing demand deposits decreased $379,000 to $116.4 million, lower cost money market and other accounts decreased $4.5 million to $369.4 million and certificates of deposit increased $6.9 million to $271.7 million. Lower cost money market and other accounts decreased as customers moved to higher yielding certificates of deposit, stocks and real estate investments as interest rates increased. At December 31, 2018, we had outstanding certificates of deposit from the State of California totaling $90 million bearing interest at a weighted-average rate of 2.31%. Our weighted-average cost of deposits was 0.61% at December 31, 2018 and 0.39% at December 31, 2017.

FHLB BORROWINGS

Another major source of funding for us is advances from the Federal Home Loan Bank of San Francisco ("FHLB"). As of December 31, 2018, we had FHLB borrowings totaling $175.0 million as compared to $139.0 million at December 31, 2017. Our FHLB borrowings at December 31, 2018 had an average remaining maturity of 26 months and bore interest at a weighted-average rate of 2.38%. At that date, we had approximately $355 million of unused FHLB borrowing capacity.

JUNIOR SUBORDINATED DEBENTURES

From time to time MFC has issued junior subordinated debentures related to issuance of trust-preferred securities by business trusts MFC has formed in order to generate regulatory capital. This capital has a relatively low cost as interest payments on the debentures are deductible for income tax purposes. At December 31, 2018 and 2017, MFC had $13.4 million junior subordinated debentures outstanding bearing interest at a weighted-average rate of 5.08% and 3.90% per annum, respectively. These debentures mature commencing in 2033.

STOCKHOLDERS' EQUITY AND REGULATORY CAPITAL

Our stockholders' equity grew by $10.3 million or 8% to $136.3 million at December 31, 2018, from $126.0 million at December 31, 2017. The increase was due principally to net income of $15.3 million and cash proceeds from the exercise of stock options of $1.5 million, net of $6.5 million of dividends paid to our stockholders.

Malaga Bank continues to be "well capitalized" under applicable regulations. The following table compares Malaga Bank's actual capital ratios at December 31, 2018 to those required by regulatory agencies for capital adequacy and well capitalized classification purposes:

	Malaga Bank	Minimum Capital Requirements	Well Capitalized Requirements
Tier 1 Capital to Average Assets	13.64%	4.00%	5.00%
Total Capital to Risk-Weighted Assets	25.22%	8.00%	10.00%
Common Tier 1 Capital to Risk-Weighted Assets	24.68%	4.50%	6.50%
Tier 1 Capital to Risk-Weighted Assets	24.68%	6.00%	8.00%

STOCKHOLDERS AND STOCK INFORMATION

At December 31, 2018, MFC had 148 stockholders of record. Many of our stockholders purchased stock in connection with the organization of Malaga Bank. MFC's common stock is traded in the OTC PINK market under the symbol MLGF.

On December 28, 2018 and December 29, 2017, MFC paid a 5% common stock dividend to its stockholders.

CONSOLIDATED BALANCE SHEETS

	DECEMBER 31	
	2018	**2017**
ASSETS		
Cash and due from banks	**$ 21,836,855**	$ 24,331,392
Federal funds sold	**49,774,518**	43,891,295
Cash and cash equivalents	**71,611,373**	68,222,687
Interest-bearing deposits in banks	**2,200,000**	3,175,000
Loans receivable — Net of allowance for credit loss of $3,158,400 (2018) and $3,111,100 (2017)	**991,275,902**	953,805,547
Accrued interest receivable	**3,033,025**	2,760,213
Building, office properties, and equipment — Net	**11,590,924**	4,679,726
Investment in FHLB stock — At cost	**6,759,500**	6,422,400
Other assets	**1,087,800**	2,001,228
TOTAL	**$ 1,087,558,524**	$ 1,041,066,801

	2018	2017
LIABILITIES AND STOCKHOLDERS' EQUITY		
LIABILITIES:		
Deposits:		
Noninterest-bearing	**$ 116,415,880**	$ 116,795,273
Interest-bearing	**641,111,705**	638,683,666
Total deposits	**757,527,585**	755,478,939
FHLB borrowings	**175,000,000**	139,000,000
Junior subordinated debentures	**13,404,000**	13,404,000
Accrued interest payable	**388,037**	363,177
Other liabilities	**3,037,428**	4,764,188
Deferred tax liability	**1,950,173**	2,070,390
Total liabilities	**951,307,223**	915,080,694
COMMITMENTS AND CONTINGENCIES (Note 4)		
STOCKHOLDERS' EQUITY:		
Common stock, $.001 par value — authorized, 20,000,000 shares; outstanding 6,944,643 shares (2018) and 6,529,131 shares (2017)	**6,945**	6,529
Additional paid-in capital	**39,646,695**	29,173,411
Retained earnings	**96,597,661**	96,806,167
Total stockholders' equity	**136,251,301**	125,986,107
TOTAL	**$ 1,087,558,524**	$ 1,041,066,801

See notes to consolidated financial statements.

CONSOLIDATED STATEMENTS OF OPERATIONS

	YEARS ENDED DECEMBER 31	
	2018	**2017**
INTEREST INCOME:		
Loans	**$ 39,068,208**	$ 36,364,039
Other investments	**1,667,350**	1,182,523
Total interest income	**40,735,558**	37,546,562
INTEREST EXPENSE:		
Deposits	**4,567,149**	3,012,206
Borrowings	**2,987,325**	1,805,846
Junior subordinated debentures	**604,435**	472,859
Total interest expense	**8,158,909**	5,290,911
NET INTEREST INCOME	**32,576,649**	32,255,651
PROVISION FOR CREDIT LOSSES	**48,931**	93,134
NET INTEREST INCOME AFTER PROVISION FOR CREDIT LOSSES	**32,527,718**	32,162,517
OTHER OPERATING INCOME	**822,049**	771,432
OTHER OPERATING EXPENSE:		
Compensation	**7,334,182**	6,834,471
Office rent and utilities	**885,384**	1,001,672
Professional services	**202,494**	193,926
Data processing	**930,533**	953,040
Deposit insurance premiums	**294,183**	307,571
Depreciation and amortization	**305,971**	303,237
General and administrative	**2,001,289**	1,990,334
Total other operating expense	**11,954,036**	11,584,251
INCOME BEFORE PROVISION FOR INCOME TAXES	**21,395,731**	21,349,698
PROVISION FOR INCOME TAXES	**6,091,000**	7,849,893
NET INCOME	**$ 15,304,731**	$ 13,499,805
BASIC EARNINGS PER SHARE	**$ 2.22**	$ 1.98
DILUTED EARNINGS PER SHARE	**$ 2.20**	$ 1.96

See notes to consolidated financial statements.

CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY

FOR THE YEARS ENDED DECEMBER 31, 2018 AND 2017

	Common Stock				
	Number of Shares	Amount	Additional Paid-in Capital	Retained Earnings	Total Stockholders' Equity
BALANCE — January 1, 2017	6,144,749	$ 6,145	$ 18,654,154	$ 98,680,676	$ 117,340,975
Net income	-	-	-	13,499,805	13,499,805
Cash dividends declared	-	-	-	(6,206,245)	(6,206,245)
Stock options exercised	73,600	73	1,307,063	-	1,307,136
Stock dividend	310,782	311	9,167,758	(9,168,069)	-
Stock options compensation expense	-	-	44,436	-	44,436
BALANCE — December 31, 2017	6,529,131	6,529	29,173,411	96,806,167	125,986,107
Net income	-	-	-	15,304,731	15,304,731
Cash dividends declared	-	-	-	(6,588,872)	(6,588,872)
Stock options exercised	84,980	85	1,549,250	-	1,549,335
Stock dividend	330,532	331	8,924,034	(8,924,365)	-
BALANCE — December 31, 2018	6,944,643	$ 6,945	$ 39,646,695	$ 96,597,661	$ 136,251,301

See notes to consolidated financial statements.

CONSOLIDATED STATEMENTS OF CASH FLOWS

FOR THE YEARS ENDED DECEMBER 31

	2018	2017
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	**$ 15,304,731**	$ 13,499,805
Adjustments to reconcile net income to net cash provided by operating activities:		
Accretion of deferred loan costs — net of fees	**999,381**	892,829
Provision for credit losses	**48,931**	93,134
Depreciation and amortization	**305,971**	303,237
Net decrease in deferred income taxes	**(120,217)**	(373,909)
Stock options compensation expense	**-**	44,436
Loss on sale of premises and equipment	**7,483**	-
Net decrease (increase) in accrued interest receivable and other assets	**640,616**	(1,256,251)
Net (decrease) increase in accrued interest payable and other liabilities	**(1,701,900)**	1,622,837
Net cash provided by operating activities	**15,484,996**	14,826,118
CASH FLOWS FROM INVESTING ACTIVITIES:		
Net decrease in interest-bearing deposits in banks	**975,000**	9,525,000
Net increase in loans receivable	**(38,518,667)**	(54,046,301)
Purchase of FHLB stock	**(337,100)**	(63,900)
Purchase of premises and equipment	**(7,224,652)**	(53,092)
Net cash used in investing activities	**(45,105,419)**	(44,638,293)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Net increase in deposits	**2,048,646**	2,328,840
Proceeds from FHLB borrowings	**100,000,000**	64,000,000
Repayment of FHLB borrowings	**(64,000,000)**	(15,000,000)
Dividends paid	**(6,588,872)**	(7,738,436)
Proceeds from exercise of stock options	**1,549,335**	1,307,136
Net cash provided by financing activities	**33,009,109**	44,897,540
NET CHANGE IN CASH AND CASH EQUIVALENTS	**3,388,686**	15,085,365
CASH AND CASH EQUIVALENTS — Beginning of year	**68,222,687**	53,137,322
CASH AND CASH EQUIVALENTS — End of year	**$ 71,611,373**	$ 68,222,687
SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION		
Cash paid during the year for:		
Interest	**$ 8,134,049**	$ 5,166,806
Income taxes	**$ 5,818,000**	$ 8,692,000

See notes to consolidated financial statements.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
AS OF AND FOR THE YEARS ENDED DECEMBER 31, 2018 AND 2017

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Principles of Consolidation and Presentation — The consolidated financial statements include the accounts of Malaga Financial Corporation ("MFC") and its wholly owned subsidiary, Malaga Bank FSB (the "Bank") (collectively, the "Company"). MFC was formed in 2002 to operate as a holding company for the Bank. In 2003, MFC and the Bank completed a holding company reorganization in which MFC acquired all of the outstanding capital stock of the Bank and the shareholders of the Bank became shareholders of MFC. The Company organized Palos Verdes Financial Corporation ("PVFC"), a service corporation, for the acquirement, ownership, development, improvement and management of real property. PVFC is a wholly owned subsidiary of the Bank. PVFC's primary assets are the land and building of the main branch in Palos Verdes Estates and the branch in Torrance. All intercompany balances and transactions have been eliminated in consolidation.

In June 2003, MFC issued $5,155,000 of junior subordinated debentures to PVP Statutory Trust I and in January 2005, MFC issued $2,578,000 of junior subordinated debentures to PVP Statutory Trust II and $5,671,000 of junior subordinated debentures to PVP Statutory Trust III (the "Trusts"). The Company follows generally accepted accounting principles in the United States of America which determine when variable interest entities should be consolidated and determined that the Trusts should not be consolidated. As a result, the consolidated balance sheets include $13,404,000 as junior subordinated debentures. Also included in other assets in the consolidated balance sheet is $404,000 of investments in the Trusts, which is reported using the cost method.

Nature of Operations —The Company's primary operations are related to traditional banking activities, including the acceptance of deposits and the lending and investing of money. The Company's customers consist of individuals and small-to-midsize businesses located primarily in the Palos Verdes Peninsula and adjoining areas of Los Angeles and Orange Counties, California. The Company operates through six locations, five branches and one loan center, including its headquarters located in the city of Palos Verdes Estates, California.

Use of Estimates in the Preparation of Consolidated Financial Statements — The preparation of consolidated financial statements in conformity with accounting principles generally accepted in the United States of America ("GAAP") requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, disclosure 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. Significant estimates include estimates of the allowance for loan losses and fair value determinations.

Cash and Cash Equivalents — Cash and cash equivalents include cash and due from banks and overnight federal funds sold, all of which have original maturities of less than 90 days at the time of purchase. The Company is required to maintain reserve balances with the Federal Reserve Bank under the Federal Reserve Act. The reserve balance was approximately $9,374,000 and $10,712,000 at December 31, 2018 and 2017, respectively. As of December 31, 2018 and 2017, the Company had cash deposits at other financial institutions in excess of the FDIC insured limits. However, the Company places these deposits with major financial institutions and monitors the financial condition of these institutions, and management believes the risk of loss to be minimal.

Interest-Bearing Deposits in Banks — Interest-bearing deposits in banks mature within one year and are carried at cost.

Loans Receivable — Loans receivable are stated at unpaid principal balances, plus premiums on purchased loans, less the allowance for loan losses and unamortized deferred loan origination fees and costs. Premiums on loans are amortized to interest income using the interest method over the remaining period to contractual maturity. The accrual of interest on loans is discontinued at the time the loan is 90 days delinquent unless the credit is well secured and in the process of collection. 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 are reversed against interest income. The interest on these 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.

A loan is considered impaired when it is probable that the Company will be unable to collect all amounts due according to the contractual terms of the loan. Impaired loans are measured based on the present value of expected future cash flows discounted at the loans' effective interest rates, the loans' estimated

market value, or the fair value of the collateral if the loans are collateral dependent. If the fair value of an impaired loan is less than the carrying value, a specific allowance is included in the allowance for credit losses. Impairment is measured on a loan-by-loan basis for multi-family, construction, and commercial loans. Large groups of smaller balance homogenous loans are collectively evaluated for impairment.

Loans are reported as troubled debt restructurings when the Company grants a concession to a borrower experiencing financial difficulties that it would not otherwise consider. As a result of these concessions, restructured loans are impaired as the Company will not collect all amounts due, both principal and interest, in accordance with the terms of the original loan agreement. Impairment reserves on non-collateral dependent restructured loans are measured by comparing the present value of expected future cash flows on the restructured loans discounted at the interest rate of the original loan agreement to the loan's carrying value. These impairment reserves are recognized as a specific component to be provided for in the allowance for credit losses.

Loan origination fees and certain direct loan origination costs are deferred, and the net fee or cost is recognized as an adjustment to interest income using the interest method over the contractual life of the loans. Other loan fees and charges, representing service costs for prepayment of loans, for delinquent payments, or for miscellaneous loan services, are recorded as income when collected.

The Company's lending is concentrated in surrounding areas of Los Angeles and Orange Counties, and substantially all of the Company's loans have adjustable interest rates.

Allowance for Credit Losses —Management's periodic evaluation of the adequacy of the allowance for credit losses is based on the Company's past loan loss experience, known and inherent risks in the loan portfolio, adverse situations that may affect borrowers' ability to repay, estimated values of underlying collateral, and current economic conditions. The allowance consists of specific, general, and unallocated components. The specific component relates to loans that are classified as impaired. The general component covers non-impaired loans and is based on historical loss experience adjusted for qualitative factors. An unallocated component is maintained to cover uncertainties that could affect management's estimate of probable losses. The unallocated component of the allowance reflects the margin of imprecision inherent in the underlying assumptions used in the methodologies for estimating specific and general losses in the portfolio.

Although management believes that the level of the allowance as of December 31, 2018 is adequate to absorb known and inherent risks in the loan portfolio, no assurances can be given that adverse future economic conditions will not lead to higher amounts of problem loans, provisions for loan losses, or charge-offs.

Building, Office Properties, and Equipment — Building, leasehold improvements, office properties, and equipment are carried at cost, less accumulated depreciation and amortization. The cost of the building is depreciated using the straight-line method over 39 years. Office properties and equipment are depreciated using the straight-line method over the estimated useful lives of the assets (three to seven years). The cost of leasehold improvements is being amortized using the straight-line method over the terms of the related leases or the estimated lives of the improvements, whichever is shorter.

Impairment of Long-Lived Assets — Long-lived assets are reviewed at least annually for impairment. When impairment is indicated, the amount of impairment is the excess of the asset's net book value over its fair value. Furthermore, long-lived assets to be disposed of are reported at the lower of historical cost or fair value, less cost to sell.

Federal Home Loan Bank ("FHLB") Stock — The Bank is a member of the FHLB system. Members are required to own a certain amount of stock based on the level of borrowings and other factors. FHLB stock is carried at cost, classified as a restricted security, and both cash and stock dividends are reported as income when earned. An impairment analysis of FHLB stock is performed annually or when events or circumstances indicate possibility of impairment.

Income Taxes — The Company utilizes the liability method in accounting for income taxes. Deferred tax assets or liabilities shown on the balance sheets reflect the tax effects of differences between the tax basis of assets and liabilities and their reported amounts in the financial statements. Under this method, deferred tax assets and liabilities are determined based on the differences between the financial statements and tax basis of assets and liabilities using enacted tax rates in effect for the year in which the differences are expected to reverse. The effect of a change in tax rates for deferred tax assets and liabilities is recognized in income in the period that includes the enacted date.

The Company recognizes the tax benefit from uncertain tax positions only if it is more likely than not that the tax positions will be sustained on examination by the tax authorities, based on the technical merits of the position. The tax benefit is measured based on the largest benefit that has a greater than 50% likelihood of being realized upon ultimate settlement. The Company reviews and evaluates tax positions in its major jurisdictions and determines whether or not there are uncertain tax positions that require financial statement recognition. Based on this review, the Company has determined that no reserves for uncertain tax positions were required to have been recorded as a result of the adoption of such guidance for any of the Company's open tax years. The Company files income tax returns in the U.S. federal jurisdiction and in California. The Company is no longer subject to income tax examinations by taxing authorities for years before 2015 for its federal filings and 2014 for its California filings. The

Company accounts for interest and penalties related to uncertain tax positions as part of its provision for federal and state taxes.

The Tax Cuts and Jobs Act of 2017 was enacted December 22, 2017, and changed the federal corporate tax rate to 21% from 35%, effective January 1, 2018, and preserved the full deductibility of state corporate taxes. Accordingly, the Company has recognized the effects of changes in tax laws and rates on the deferred tax assets and liabilities as of December 31, 2017 (see Note 8 – Income Taxes). The resulting adjustment of $823,000 to decrease the value of the net deferred tax liability was recognized by the Company in December 2017 as tax expense.

Financial Instruments — In the ordinary course of business, the Company has entered into off-balance sheet agreements consisting of commitments to extend credit, commercial letters of credit, and standby letters of credit. Such financial instruments are recorded in the financial statements when they are funded or the related fees are incurred or received.

Capital Stock — The Company's authorized capital stock consists of 20 million shares of common stock and 2,000,000 shares of preferred stock. As of December 31, 2018, only common stock was issued and outstanding. All per share amounts have been adjusted to reflect a 5% common stock dividend on each of December 28, 2018 and December 29, 2017. Each common share entitles the holder to one vote on each matter voted on by the shareholders. There are no dividend or liquidation preferences, participation rights, call prices or dates, conversion prices or rates, sinking fund requirements, or unusual voting rights associated with the common shares.

Earnings Per Share ("EPS") — Basic EPS is determined by dividing net income by the average number of shares of common stock outstanding, while diluted EPS is determined by dividing net income by the average number of shares of common stock outstanding, adjusted for the dilutive effect of common stock equivalents. All per share amounts have been adjusted to reflect a 5% common stock dividend on each of December 28, 2018 and December 29, 2017.

Dividends — Dividends are recorded when declared. The Company declared cash dividends of $1.00 per share of common stock in 2018 and 2017. On November 19, 2018, the Company declared a 5% common stock dividend to shareholders of record at the close of business on December 14, 2018 that was paid on December 28, 2018. On November 16, 2017, the Company declared a 5% common stock dividend to shareholders of record at the close of business on December 15, 2017 that was paid on December 29, 2017.

Stock-Based Compensation — Compensation costs relating to stock-based compensation transactions are recognized in the statements of operations based upon the grant-date fair value of the stock-based compensation granted by the Company. The effect of stock-based accounting rules is to require entities to measure the cost of director and employee services received in exchange for stock-based compensation and to recognize the cost over the period the director or employee is required to provide services for the award. The Company uses the Black-Scholes option-pricing model. Forfeitures are accounted for when they occur.

Comprehensive Income — Accounting principles require that recognized revenue, expenses, gains and losses be included in net income. Certain changes in shareholders' equity from non-owner sources, such as unrealized gains and losses on available-for-sale securities or defined benefit pension liability adjustments, among other items, are reported within comprehensive income and shown as a separate component of the equity section in the consolidated balance sheets. The Company does not have any other comprehensive income items for the years ended December 31, 2018 and 2017; therefore, total comprehensive income equals net income.

Revenue Recognition — Accounting Standards Codification ("ASC") 606, Revenue from Contracts with Customers ("ASC 606"), establishes principles for reporting information about the nature, amount, timing and uncertainty of revenue and cash flows arising from the entity's contracts to provide goods or services to customers. The core principle requires an entity to recognize revenue to depict the transfer of goods or services to customers in san amount that reflects the consideration that it expects to be entitled to receive in exchange for those goods or services recognized as performance obligations are satisfied.

The majority of our revenue-generating transactions are not subject to ASC 606, including revenue generated from financial instruments, such as our loans and letters of credit, as these activities are subject to other GAAP discussed elsewhere within our disclosures. Descriptions of our revenue-generating activities that are within the scope of ASC 606, which are presented in our income statements as components of non-interest income are as follows:

- Service charges on deposit accounts - these represent general service fees for monthly account maintenance and activity- or transaction-based fees and consist of transaction-based revenue, time-based revenue (service period), item-based revenue or some other individual attribute-based revenue. Revenue is recognized when our performance obligation is completed which is generally monthly for account maintenance services or when a transaction has been completed (such as a wire transfer). Payment for such performance obligations are generally received at the time the performance obligations are satisfied.

Recent Accounting Pronouncements — In January 2016, the FASB issued ASU No. 2016-01, Financial Instruments – Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities. The new guidance is intended to improve the recognition and measurement of financial instruments. This ASU requires equity investments (except those accounted for under the equity method of accounting, or those that result in consolidation of the investee) to be measured at fair value with changes in fair value recognized in net income. In addition, the amendment requires public business entities to use the exit price notion when measuring the fair value of financial instruments for disclosure purposes and requires separate presentation of financial assets and financial liabilities by measurement category and form of financial asset (i.e., securities or loans and receivables) on the balance sheet or the accompanying notes to the financial statements. This ASU also eliminates the requirement for public business entities to disclose the method(s) and significant assumptions used to estimate the fair value that is required to be disclosed for financial instruments measured at amortized cost on the balance sheet.

The amendment also requires a reporting organization to present separately in other comprehensive income the portion of the total change in the fair value of a liability resulting from a change in the instrument specific credit risk (also referred to as "own credit") when the organization has elected to measure the liability at fair value in accordance with the fair value option for financial instruments. ASU No. 2016-01 is effective for financial statements issued for fiscal years beginning after December 15, 2017, and interim periods within those fiscal years. ASU No. 2016-01 became effective for us on January 1, 2018, and emphasizes the existing requirement to use exit prices to measure fair value for disclosure purposes and clarifies that entities should not make use of a practicability exception in determining the fair value of loans. Accordingly, we refined the calculation used to determine the disclosed fair value of our loan portfolio as part of adopting this standard. The refined calculation did not have a significant impact on our fair value disclosures.

ASU 2014-09 "Revenue from Contracts with Customers (Topic 606)" ("ASU 2014-09") implements a common revenue standard that clarifies the principles for recognizing revenue. The core principle of ASU 2014-09 is that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. ASU 2014-09 establishes a five-step model which entities must follow to recognize revenue and removes inconsistencies and weaknesses in existing guidance. The guidance does not apply to revenue associated with financial instruments, including loans and investment securities that are accounted for under other GAAP, which comprises a significant portion of our revenue stream. ASU 2014-09 became effective for us on January 1, 2018 and had no material effect on how we recognize revenue or to our consolidated financial statements and disclosures.

In February 2016, the FASB issued ASU No. 2016-02, Leases (Topic 842). The amendments in this ASU require lessees to recognize a lease liability and a right of use asset for all leases (other than short term leases). Lessees will no longer be provided with a source of off-balance sheet financing. Under the new guidance, lessor accounting is largely unchanged. ASU No. 2016-02 is effective for financial statements issued for fiscal years beginning after December 15, 2018, and interim periods within those fiscal years. ASU No. 2016-02 should be applied using a modified retrospective transition approach for leases existing at, or entered into after, the beginning of the earliest comparative period presented in the financial statements. The Company is currently evaluating the impact of this ASU on the Company's consolidated financial statements.

In June 2016, the FASB issued ASU No. 2016-13, Financial Instruments — Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments. The ASU is intended to improve financial reporting by requiring timelier recording of credit losses on loans and other financial instruments held by financial institutions and other organizations. The ASU requires the measurement of all expected credit losses for certain financial assets held at the reporting date based on historical experience, current conditions, and reasonable and supportable forecasts. Financial institutions and other organizations will now use forward looking information to better inform their credit loss estimates, but will continue to use judgment to determine which loss estimation method is appropriate for their circumstances. The ASU requires enhanced disclosures to help investors and other financial statement users better understand significant estimates and judgments used in estimating credit losses, as well as the credit quality and underwriting standards of an organization's portfolio. These disclosures include qualitative and quantitative requirements that provide additional information about the amounts recorded in the financial statements. In addition, the ASU amends the accounting for credit losses on available-for-sale debt securities and purchased financial assets with credit deterioration. The ASU is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2020. Early application will be permitted for specified periods. The Company is in the process of evaluating the impact of this ASU on the Company's consolidated financial statements.

2. LOANS RECEIVABLE

Loans receivable as of December 31, 2018 and 2017 are summarized as follows:

Description	2018	2017
Residential mortgage loans–multi-family	**$ 819,539,147**	$ 772,103,077
Residential mortgage loans–single family	**120,946,500**	132,825,834
Commercial real estate loans	**43,362,456**	36,724,507
Construction loans	**-**	4,039,962
Land loans	**-**	750,000
Business banking loans	**2,820,077**	2,709,817
Consumer loans	**257,436**	475,577
	986,925,616	949,628,774
Less:		
Allowance for credit losses	**(3,158,400)**	(3,111,100)
Deferred loan costs–net of fees	**7,508,686**	7,287,873
	4,350,286	4,176,773
Total	**$ 991,275,902**	$ 953,805,547

As of December 31, 2018 and 2017, loans with adjustable rates of interest (including loans with an initial fixed rate for 1 to 10 years that subsequently convert to adjustable rate) totaled $983.6 million and $947.3 million, respectively, and loans with fixed rates of interest totaled $3.3 million and $2.3 million, respectively. Adjustable-rate loans are generally indexed to the FHLB's Eleventh District Cost of Funds Index, the 12-Month Constant Maturity Index, the London InterBank Offered Rate (LIBOR), or the prime rate and are subject to limitations on the timing and extent of adjustment. Most adjustable-rate loans adjust within six months of changes in the index rate.

At December 31, 2018 and 2017, real estate loans aggregating $769.8 million and $735.0 million, respectively, were pledged as collateral against FHLB borrowings and real estate loans totaling $137.1 million and $138.9 million, respectively, were pledged to secure deposits held by the state of California. In addition, home equity lines of credit totaling $397,000 and $996,000 were pledged as collateral to the Federal Reserve Bank discount window at December 31, 2018 and 2017, respectively.

Activity in the allowance for credit losses and unfunded loan commitments for the years ended December 31, 2018 and 2017 is summarized as follows:

	2018	2017
Allowance for credit losses:		
Balance — beginning of year	**$ 3,111,100**	$ 3,049,300
Provision for credit losses	**53,431**	84,034
Charge-offs, net	**(6,131)**	(22,234)
Balance — end of year	**$ 3,158,400**	$ 3,111,100
Reserve for unfunded loan commitments:		
Balance — beginning of year	**$ 53,200**	$ 44,100
Provision for (recovery of) losses on unfunded loan commitments	**(4,500)**	9,100
Balance — end of year	**$ 48,700**	$ 53,200

A breakdown of the allowance for credit losses as of December 31, 2018 and 2017, by loan type, is as follows:

	Multi-Family	Single Family	Commercial	Construction	Land	Business Banking	Consumer	Total
Balance - December 31, 2016	$ 2,510,400	$ 453,500	$ 46,600	$ 30,800	$ 3,300	$ 3,400	$ 1,300	**$ 3,049,300**
Charge-offs	-	-	-	-	-	-	(22,769)	**(22,769)**
Recoveries	-	-	-	-	-	-	535	**535**
Provision for (recovery of) credit losses	190,700	(125,700)	(2,500)	1,500	(1,800)	(500)	22,334	**84,034**
Balance - December 31, 2017	$ 2,701,100	$ 327,800	$ 44,100	$ 32,300	$ 1,500	$ 2,900	$ 1,400	**$ 3,111,100**
Charge-offs	-	-	-	-	-	-	(8,188)	**(8,188)**
Recoveries	-	-	-	-	-	-	2,057	**2,057**
Provision for (recovery of) credit losses	84,200	(16,600)	12,300	(32,300)	(1,500)	1,000	6,331	**53,431**
Balance - December 31, 2018	$ 2,785,300	$ 311,200	$ 56,400	$ -	$ -	$ 3,900	$ 1,600	**$ 3,158,400**

The reserve for unfunded loan commitments is primarily related to undisbursed funds on construction loans and lines of credit. The Company evaluates credit risk associated with the loan portfolio at the same time it evaluates credit risk associated with the unfunded loan commitments. However, the reserves necessary for the commitments are reported separately in other liabilities in the accompanying consolidated balance sheets and not as part of the allowance for credit losses as presented above.

There were no loans considered to be impaired for the years ended and as of December 31, 2018 and December 31, 2017.

The Company manages asset quality and controls credit risk through diversification of the loan portfolio and the application of policies designed to promote sound underwriting and loan monitoring practices. The Company's senior management team is charged with monitoring asset quality, establishing credit policies and procedures, and enforcing the consistent application of these policies and procedures across the Company. Reviews of non-performing loans, past due loans, and larger credits are intended to identify potential charges to the allowance for credit losses and to determine the adequacy of the allowance, and are conducted on an ongoing basis. These reviews consider risk factors such as the financial strength of the borrowers, value of the applicable collateral, loan loss experience, estimated loan losses, growth in the loan portfolio, prevailing economic conditions, and other factors, which are collectively evaluated in order to determine if adjustments are necessary to the historical losses of each portfolio segment, the baseline for determining the allowance for credit losses.

The Company uses several credit quality indicators to manage credit risk. The Company's primary credit quality indicators are derived from an internal credit risk rating system that categorizes loans into pass, special mention, or classified categories. A credit risk rating is applied individually to each loan that has significant or unique credit characteristics that benefit from a case-by-case evaluation. The following are the definitions of the categories of the Company's internal credit risk rating:

- Pass: Loans in all classes that comprise the commercial and consumer portfolio segments that are not adversely rated, are contractually current as to principal and interest, and are otherwise in compliance with the contractual terms of the loan agreement. Management believes that there is a low likelihood of loss related to those loans that are considered pass.
- 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 Company'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 obligor or of the collateral pledged, if any. Loans so classified have a well-defined weakness or weaknesses that jeopardize the repayment of the debt. They are characterized by the distinct possibility that the Company will sustain some loss if the deficiencies are not corrected.
- Doubtful/Loss: Loans classified as doubtful have all the weaknesses inherent in those classified as substandard, with the added characteristic that the weaknesses make collection or repayment in full, on the basis of currently existing facts, conditions, and values, highly questionable and improbable. The possibility of loss is extremely high, but because of certain important and reasonably specific pending factors, which may work towards strengthening of the asset, classification as a loss (and immediate charge off) is deferred until more exact status may be determined. In certain circumstances, a doubtful rating will be temporary, while the Company is awaiting an updated collateral valuation. In these cases, once the collateral is valued and appropriate margin applied, the remaining un-collateralized portion will be charged off. The remaining balance, properly margined, may then be upgraded to substandard but must remain on non-accrual. A loss rating is assigned to loans considered un-collectible and of such little value that the continuance as an active Company asset is not warranted. This rating does not mean that the loan has no recovery or salvage value but rather that the loan should be charged off now, even though partial or full recovery may be possible in the future.

Loans with classification of pass, special mention, substandard, and doubtful as of December 31, 2018 and 2017 are summarized as follows:

December 31, 2018					
	Pass	Special Mention	Substandard	Doubtful	Total
Residential mortgage loans — multi-family	$ 819,156,424	$ 382,723	$ -	$ -	**$ 819,539,147**
Residential mortgage loans — single family	120,946,500	-	-	-	**120,946,500**
Commercial loans	43,362,456	-	-	-	**43,362,456**
Construction loans	-	-	-	-	**-**
Land loans	-	-	-	-	-
Business banking loans	2,820,077	-	-	-	**2,820,077**
Consumer loans	257,436	-	-	-	**257,436**
Total	$ 986,542,893	$ 382,723	$ -	$ -	**$ 986,925,616**

December 31, 2017					
	Pass	Special Mention	Substandard	Doubtful	Total
Residential mortgage loans — multi-family	$ 771,478,981	$ 624,096	$ -	$ -	**$ 772,103,077**
Residential mortgage loans — single family	132,825,834	-	-	-	**132,825,834**
Commercial loans	36,724,507	-	-	-	**36,724,507**
Construction loans	4,039,962	-	-	-	**4,039,962**
Land loans	750,000	-	-	-	**750,000**
Business banking loans	2,709,817	-	-	-	**2,709,817**
Consumer loans	475,577	-	-	-	**475,577**
Total	$ 949,004,678	$ 624,096	$ -	$ -	**$ 949,628,774**

There were no loans past due 30-59 days as of December 31, 2018. As of December 31, 2017, there was one loan for $227,997 past due 30-59 days, and all remaining loans were current. There were no nonaccrual loans at December 31, 2018 and 2017.

In the ordinary course of business, the Company has granted loans to certain executive officers and directors and the companies with which they are associated. In management's opinion, such loans and commitments to lend were made under terms and prevailing interest rates that are consistent with the Company's normal lending policies. Interest income from loans to executive officers and directors was $434,112 and $423,662 during the years ending December 31, 2018 and 2017, respectively.

A summary of related-party loan activity for the years ended December 31, 2018 and 2017 is as follows:

	2018	2017
Beginning balance	**$ 10,689,093**	$ 8,970,490
Credit granted — including renewals	**806,912**	3,379,684
Repayments	**(805,859)**	(1,661,081)
Ending balance	**$ 10,690,146**	$ 10,689,093

3. BUILDING, OFFICE PROPERTIES, AND EQUIPMENT

Buildings, office properties, and equipment as of December 31, 2018 and 2017 are summarized as follows:

Description	2018	2017
Land	**$ 5,930,364**	$ 1,275,364
Building	**6,050,534**	3,553,211
Leasehold improvements	**1,389,396**	1,877,559
Equipment	**1,471,260**	1,430,104
Furniture and fixtures	**667,486**	660,608
Construction in progress	**1,152**	-
	15,510,192	8,796,846
Accumulated depreciation and amortization	**(3,919,268)**	(4,117,120)
Total	**$ 11,590,924**	$ 4,679,726

Depreciation and amortization expense for the years ended December 31, 2018 and 2017 was $305,971 and $303,237, respectively.

In May 2018, PVFC, a wholly owned subsidiary of the Bank, purchased the land and building which house the Company's main branch and administrative offices in Palos Verdes Estates for $7.1 million.

4. COMMITMENTS AND CONTINGENCIES

Off-Balance-Sheet Financial Instruments — The Company is a party to financial instruments with off balance-sheet risk, in the normal course of business, to meet the financing needs of its customers. These financial instruments include commitments to extend credit, standby letters of credit, and financial guarantees. The Company's maximum exposure to credit loss under standby letters of credit, financial guarantees, and commitments to extend credit is represented by the contractual amount of those instruments. The Company uses the same credit policies in making commitments and conditional obligations as it does for on-balance-sheet instruments.

The Company requires collateral to support financial instruments when it is deemed necessary. The Company evaluates each customer's creditworthiness on a case-by-case basis. The amount of collateral obtained upon extension of credit is based on management's credit evaluation of the counterparty. Collateral held varies but generally includes real estate or deposits held in the Company.

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Some of the commitments are expected to expire without being drawn upon; the total commitment amounts do not necessarily represent future cash requirements. The Company had commitments to originate loans of $15.9 million and $7.6 million, undisbursed funds for construction loans of $0 and $2.3 million, and undrawn lines of credit previously granted of approximately $26.3 million and $26.4 million at December 31, 2018 and 2017, respectively.

From time to time, the Company enters into certain types of contracts that contingently require the Company to indemnify parties against third-party claims and other obligations customarily indemnified in the ordinary course of the Company's business. The terms of such obligations vary, and generally, a maximum obligation is not explicitly stated. Therefore, the overall maximum amount of the obligations cannot be reasonably estimated. The most significant of these contracts relate to certain agreements with the Company's officers and directors under which the Company may be required to indemnify such persons for liabilities arising out of their performance of services for the Company. Historically, the Company has not been subject to indemnification claims and no liabilities have been recorded for these obligations on the balance sheet as of December 31, 2018 and 2017.

Collateralized standby letters of credit and financial guarantees written are conditional commitments issued by the Company to guarantee the performance of a customer to a third party. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loan facilities to customers. Management does not anticipate any material losses as a result of these transactions. There were no loan commitments collateralized by standby letters of credit and financial guarantees written at December 31, 2018 and 2017.

Leases — The Company leases office premises under operating leases that expire at various dates through December 31, 2023. Rental expense was $542,111 and $693,962 for the years ended December 31, 2018 and 2017, respectively. The projected minimum rental payments under the terms of the leases as of December 31, 2018 are as follows:

Years Ending December 31	
2019	$ 498,749
2020	437,081
2021	375,413
2022	325,256
2023	174,785
Total	$ 1,811,284

5. DEPOSITS

Deposit balances and the weighted-average interest rates for each category of deposits as of December 31, 2018 and 2017 are summarized as follows:

	2018		2017	
	Interest Rate	**Amount**	**Interest Rate**	**Amount**
Demand deposits	**- %**	**$ 116,415,880**	- %	$ 116,795,273
NOW accounts	**0.16**	**76,164,392**	0.14	77,722,502
Passbooks	**0.17**	**66,015,344**	0.17	63,872,766
Money market accounts	**0.46**	**227,232,509**	0.26	232,338,664
Certificates of deposit - less than $250,000	**1.26**	**121,987,026**	0.87	123,287,697
Certificates of deposit - $250,000 and over	**2.03**	**149,712,434**	1.10	141,462,037
Total	**0.77**	**$ 757,527,585**	0.45	$ 755,478,939

Certificates of deposit maturities as of December 31, 2018 are summarized as follows:

Years Ending December 31	
2019	$ 199,174,631
2020	25,967,688
2021	14,978,644
2022	13,747,604
2023	17,830,893
Total	$ 271,699,460

As of December 31, 2018 and 2017, the Company had certificates of deposit from the state of California Treasurer's Office of $90 million.

In the ordinary course of business and as part of its normal banking activities, the Company has received deposits from certain directors, major shareholders and officers as well as entities with which these individuals are associated. These related parties had deposits at the Company of $4.4 million and $4.3 million at December 31, 2018 and 2017, respectively. Management believes these transactions were made on substantially the same terms, conditions, and prevailing interest rates as comparable transactions with other customers.

6. FHLB BORROWINGS

A primary additional funding source for the Company is a credit line with the FHLB of San Francisco of up to 50% of the Company's total assets. Interest is payable monthly at a weighted-average rate of 2.38% as of December 31, 2018. Average FHLB borrowings were $150.9 million and $105.0 million at a weighted-average interest rate of 1.98% and 1.72% in 2018 and 2017, respectively. The FHLB borrowings are collateralized by real estate loans (see Note 2) and the capital stock of the FHLB owned by the Company.

Maturities of FHLB borrowings as of December 31, 2018 are summarized as follows:

Years Ending December 31	
2019	$ 80,000,000
2020	20,000,000
2021	10,000,000
2022	15,000,000
2023	40,000,000
Thereafter	10,000,000
Total	$ 175,000,000

The company also had a $4.2 million letter of credit with FHLB as collateral to secure a large local agency deposit at December 31, 2018 and 2017.

7. JUNIOR SUBORDINATED DEBENTURES

MFC has from time to time issued junior subordinated debentures related to concurrent issuances of trust-preferred securities by business trusts formed by MFC in order to generate regulatory capital for the Bank. This capital has a relatively low cost as interest payments on the debentures are deductible for income tax purposes. PVP Statutory Trust I, II, and III were formed by the Company for the sole purpose of issuing trust preferred securities. For financial reporting purposes, the Trusts are not consolidated, and the junior subordinated debentures held by the Trusts, issued and guaranteed by the Company, are reflected within the Company's consolidated balance sheets. MFC's investment in the common trust securities of the trusts is included in other assets on its balance sheets. MFC has unconditionally guaranteed distributions on, and payments on liquidation and redemption of, all of these trust-preferred securities.

In June 2003, MFC issued $5,155,000 of junior subordinated debentures to PVP Statutory Trust I. This trust purchased the debentures with the proceeds of the sale of its common trust securities to MFC for $155,000 and trust-preferred securities in a private placement for $5,000,000. The debentures and trust-preferred securities have generally identical terms, including that they mature in June 2033, have been redeemable at par at MFC's option since June 2008, and require quarterly distributions/interest payments at a fixed rate of 5.67% per annum through June 2008, and thereafter at a variable rate that adjusts quarterly at the three-month LIBOR rate plus 3.10%. The interest rate on the debentures was 5.92% and 4.77% per annum at December 31, 2018 and 2017, respectively.

In January 2005, MFC issued $2,578,000 of junior subordinated debentures to PVP Statutory Trust II. This trust purchased the debentures with the proceeds of the sale of its common trust securities to MFC for $78,000 and trust-preferred securities in a private placement for $2,500,000. The debentures and trust-preferred securities have generally identical terms, including that they mature in March 2035, have been redeemable at par at MFC's option since March 2010, and require quarterly distributions/interest payments at a rate that adjusts quarterly at the three-month LIBOR rate plus 1.77%. The interest rate on the debentures was 4.56% and 3.36% per annum at December 31, 2018 and 2017, respectively.

In January 2005, MFC issued $5,671,000 of junior subordinated debentures to PVP Statutory Trust III. This trust purchased the debentures with the proceeds of the sale of its common trust securities to MFC for $171,000 and trust-preferred securities in a private placement for $5,500,000. The debentures and trust-preferred securities have generally identical terms, including that they mature in March 2035, have been redeemable at par at MFC's option since March 2010, and require quarterly distributions/interest payments at a fixed rate of 5.67% through March 2010, and thereafter at a variable rate that adjusts quarterly at the three-month LIBOR rate plus 1.77%. The interest rate on the debentures was 4.56% and 3.36% per annum at December 31, 2018 and 2017, respectively.

8. INCOME TAXES

A summary of income tax provision for the years ended December 31, 2018 and 2017 is as follows:

	2018	2017
Current:		
State	**$ 2,276,407**	$ 2,133,350
Federal	**3,934,810**	6,090,452
Total current	**6,211,217**	8,223,802
Deferred:		
State	**(32,754)**	108,084
Federal	**(87,463)**	(481,993)
Total deferred	**(120,217)**	(373,909)
Total	**$ 6,091,000**	$ 7,849,893

The components of the net deferred liability as of December 31, 2018 and 2017 are as follows:

	2018	2017
FEDERAL		
Deferred tax liabilities:		
Loan fees/costs	**$ (2,021,140)**	$ (1,992,275)
FHLB dividends	**(318,975)**	(318,975)
Depreciation	**(17,551)**	(25,690)
Other	**(83,191)**	(200,897)
Gross deferred tax liability	**(2,440,857)**	(2,537,837)
Deferred tax assets:		
California franchise tax	**655,407**	632,243
Depreciation	-	-
Bad debt and loan loss deduction	**679,422**	669,172
Other	**433**	43,364
Gross deferred tax asset	**1,335,262**	1,344,779
Net deferred tax liability	**$ (1,105,595)**	$ (1,193,058)

	2018	2017
STATE		
Deferred tax liabilities:		
Loan fees/costs	**$ (1,043,293)**	$ (1,028,394)
FHLB dividends	**(164,652)**	(164,652)
Depreciation	-	-
Other	**(42,942)**	(103,702)
Gross deferred tax liability	**(1,250,887)**	(1,296,748)
Deferred tax assets:		
California franchise tax	-	-
Depreciation	**41,443**	52,544
Bad debt and loan loss deduction	**350,711**	345,420
Other	**14,155**	21,452
Gross deferred tax asset	**406,309**	419,416
Net deferred tax liability	**$ (844,578)**	$ (877,332)

A reconciliation of total income tax expense for 2018 and 2017 to the expected tax expense computed by applying the statutory corporate income tax rate to pretax income for the years ended December 31, 2018 and 2017 is as follows:

	2018		2017	
	Amount	Percent	Amount	Percent
Tax expense at statutory rates	**$ 4,493,103**	**21%**	$ 7,472,394	35%
State franchise tax — net of federal benefit	**1,772,486**	**8**	1,456,932	7
Rate change	-	-	(796,576)	(4)
Other	**(174,589)**	**(1)**	(282,857)	(1)
Total	**$ 6,091,000**	**28%**	$ 7,849,893	37%

9. REGULATORY CAPITAL

MFC and the Bank are subject to various regulatory capital requirements administered by the federal banking agencies. Failure to meet minimum capital requirements can initiate certain mandatory – and possibly additional discretionary – actions by regulators that, if undertaken, could have a direct material effect on MFC's and the Bank's financial statements. Under capital adequacy guidelines, MFC and the Bank must meet specific capital adequacy guidelines that involve quantitative measures of MFC's and the Bank's assets, liabilities and certain off-balance-sheet items as calculated under regulatory accounting practices. MFC's and the Bank's capital classifications are also subject to qualitative judgments by the regulators about components, risk weightings and other factors.

Quantitative measures established by regulation to ensure capital adequacy require MFC and the Bank to maintain minimum amounts and ratios (set forth in the following table) of Tier 1 capital (as defined in the regulations) to total average assets (as defined), and minimum ratios of Tier 1, common equity Tier 1 and total capital (as defined) to risk-weighted assets (as defined). Management believes, as of December 31, 2018 and 2017, that MFC and the Bank met all regulatory capital requirements to which they were subject.

The Bank has been notified by the Office of the Comptroller of the Currency that, as of its most recent regulatory examination, the Bank is regarded as "well capitalized" under the regulatory framework for prompt corrective action. Such determination has been made based on the Bank's Tier 1, common equity Tier 1, total capital and leverage ratios. There have been no conditions or events since this notification that management believes would change the Bank's categorization as well capitalized under the ratios listed below.

MFC's and the Bank's capital amounts and ratios are substantially the same. The Bank's actual and required capital amounts and ratios are as follows:

	Actual		For Capital Adequacy Purposes		Applicable Federal Regulatory Requirements to be Categorized as Well Capitalized Under Prompt Corrective Action Provisions	
	Amount	**Ratio**	**Amount**	**Ratio**	**Amount**	**Ratio**
As of December 31, 2018:						
Tier 1 capital to average assets	$ 146,644,974	13.64 %	$ 43,008,235	4.00%	$ 53,760,294	5.00%
Total capital to risk-weighted assets	149,852,073	25.22	47,527,266	8.00	59,409,083	10.00
Common Tier 1 capital to risk-weighted assets	146,644,974	24.68	26,734,087	4.50	38,615,904	6.50
Tier 1 capital to risk-weighted assets	146,644,974	24.68	35,645,450	6.00	47,527,266	8.00
As of December 31, 2017:						
Tier 1 capital to average assets	$ 136,815,409	13.23%	$ 41,373,152	4.00%	$ 51,716,440	5.00%
Total capital to risk-weighted assets	139,979,710	24.18	46,307,972	8.00	57,884,965	10.00
Common Tier 1 capital to risk-weighted assets	136,815,409	23.64	26,048,234	4.50	37,625,227	6.50
Tier 1 capital to risk-weighted assets	136,815,409	23.64	34,730,979	6.00	46,307,972	8.00

Since 2016, FDIC insured financial institutions have been required to maintain a "capital conservation buffer" which started at 0.625% in 2016, and increased to 1.25% in 2017, to 1.875% in 2018 and will be 2.50% commencing January 1, 2019 and thereafter. If a financial institution's capital conservation buffer is less than the specified amount of the institution's risk-weighted assets at the end of any quarter, the institution will be subject to restrictions on certain activities including payment of cash dividends, stock repurchases, and discretionary bonuses to executive officers. During 2017 and 2018, the Bank's capital conservation buffer exceeded the specified percentage of risk weighted assets.

Regulations of the FDIC do not permit the Bank to pay cash dividends on its common stock if the Bank is, or would be following the payment of the cash dividend, not in compliance with its regulatory capital requirements.

10. STOCK OPTION PLANS

MFC has one stock option plan, the 2017 Stock Option Plan ("2017 Plan"). The 2017 Plan authorizes MFC to issue to officers, directors, employees, and consultants of the Company up to 341,775 shares of common stock upon exercise of options. The exercise price of each option granted under the 2017 Plan may not be less than the fair market value of the common stock on the date of grant and the term of any option may not exceed 10 years. The 2017 Plan expires on December 31, 2026.

MFC had two stock option plans, the 2003 Stock Option Plan ("2003 Plan") and the 2007 Director Stock Option Plan ("2007 Director Plan"). The 2003 Plan authorized MFC to issue to officers, directors, employees, and consultants of the Company up to 383,796 shares of the common stock upon exercise of options. The exercise price of options granted under the 2003 Plan could not be less than the fair market value of the common stock on the date of grant and the term of any option could not exceed 10 years. The 2003 Stock Option Plan was replaced by the 2017 Plan in June 2017.

Under the 2007 Director Plan, MFC could issue up to 661,500 shares of common stock pursuant to automatic grants to each director on January 1 of each year of an option to purchase 10,143 shares of common stock. The exercise price of each option granted under the 2007 Director Plan was the fair market value of the common stock on the date the option was granted. Each option granted under the 2007 Director Plan vested one year from the date the option was granted and expired five years from the date of grant, subject to earlier termination if the optionee ceases to be a director. No options could be granted under the 2007 Director Plan after January 1, 2017. The 2007 Director Plan was replaced by the 2017 Plan in June 2017.

Stock-based compensation expense was $0 and $44,436 for 2018 and 2017, respectively, which decreased each year's income before taxes by such amount and its effect on basic and diluted EPS was negligible.

The status of shares subject to options and exercise prices during the year ended December 31, 2018 is as follows:

	Number of Options	Weighted–Average Exercise Price	Weighted-Average Remaining Contractual Life (Years)	Aggregate Intrinsic Value
Outstanding — beginning of year	228,658	$ 19.63		$ 1,457,322
Granted	-	-		-
Exercised	(89,229)	17.36		(770,619)
Outstanding — end of year	139,429	$ 21.07	2.09	$ 686,707
Vested and exercisable — year-end	139,429	$ 21.07	2.09	$ 686,707
Shares available	341,775			

The status of shares subject to options and exercise price during the year ended December 31, 2017 is as follows:

	Number of Options	Weighted–Average Exercise Price	Weighted-Average Remaining Contractual Life (Years)	Aggregate Intrinsic Value
Outstanding — beginning of year	238,801	$ 17.22		$ 2,615,445
Granted	71,001	23.71		316,462
Exercised	(81,144)	16.11		(978,806)
Outstanding — end of year	228,658	$ 19.63	2.29	$ 1,953,841
Vested and exercisable — year-end	157,658	$ 17.79	1.52	$ 1,637,057
Shares available	341,775			

Information pertaining to options outstanding as of December 31, 2018 is as follows:

Range of Exercise Prices	Number Outstanding	Weighted–Average Remaining Contractual Life (Years)	Weighted–Average Exercise Price	Number Exercisable	Weighted–Average Exercise Price
$14.00–$18.99	15,655	0.65	$ 16.29	15,655	$ 16.29
$19.00–$24.00	123,774	2.27	21.68	123,774	21.68
Total	139,429	2.09	$ 21.07	139,429	$ 21.07

Certain information regarding options for the years ended December 31, 2018 and 2017 is as follows:

	2018	2017
Weighted-average fair value of stock options granted during the year	$ -	$ 1.23
Total intrinsic value of options exercised	770,619	978,806
Tax benefit from options exercised	259,000	281,000
Total fair value of shares vested	143,422	15,649

The fair value of each option grant is estimated on the date of grant using the Black Scholes option pricing model with the following assumptions:

	2018	2017
Expected life (1)	-	5 year
Expected volatility (2)	-	11.15 %
Expected dividend yield (3)	-	3.87
Risk-free interest rate (4)	-	1.93

(1) The expected life is the vesting period of the option.
(2) The expected volatility was based on historical volatility for a period equal to the stock option's expected term.
(3) The expected dividend yield is based on the Company's prevailing dividend rate at the time of grant.
(4) The risk-free rate is based on the U.S. Treasury strips in effect at the time of grant equal to the stock option's expected term.

11. EARNINGS PER SHARE ("EPS")

A reconciliation of the numerator and denominator of the basic and diluted EPS computation for the years ended December 31, 2018 and 2017 is as follows. For the years ended December 31, 2018 and 2017, the dilutive effect of all options outstanding is included in the determination of diluted EPS since there were no options outstanding with an exercise price which exceeded the average market price of the Company's common stock for those years.

On December 28, 2018, the Company paid a 5% common stock dividend that increased the number of shares outstanding by 330,532. On December 29, 2017, the Company paid a 5% common stock dividend that increased the number of shares outstanding by 310,782.

	2018			2017		
	Income (Numerator)	Shares (Denominator)	Per-Share Amount	Income (Numerator)	Shares (Denominator)	Per-Share Amount
Basic EPS						
Income available to common stockholders	$ 15,304,731	6,904,720	$ 2.22	$ 13,499,805	6,820,643	$ 1.98
Effect of Dilutive Securities						
Options — common stock equivalents		52,044	(0.02)		75,667	(0.02)
Diluted EPS						
Income available to common stockholders, plus assumed conversion	$ 15,304,731	6,956,764	$ 2.20	$ 13,499,805	6,896,310	$ 1.96

12. ESTIMATED FAIR VALUE INFORMATION

ASC Topic 820 provides a framework for measuring fair value under GAAP. This standard applies to all financial assets and liabilities that are being measured and reported at fair value on a recurring and nonrecurring basis.

As defined in ASC Topic 820, fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. In determining fair value, the Company may use various methods, including market and income approaches. Based on these approaches, the Company often utilizes certain assumptions that market participants would use in pricing the asset or liability. These inputs can be readily observable, market corroborated, or generally unobservable firm inputs. The Company utilizes valuation techniques that maximize the use of observable inputs and minimize the use of unobservable inputs. Based on the observability of the inputs used in the valuation techniques, the Company is required to provide the following information according to the fair value hierarchy. The hierarchy ranks the quality and reliability of the information used to determine fair values. The hierarchy gives the highest priority to quoted prices available in active markets and the lowest priority to data lacking transparency. Financial assets and liabilities carried at fair value will be classified and disclosed in one of the following three categories:

> ***Level 1*** — Quoted prices (unadjusted) for identical assets or liabilities in active markets that the entity has the ability to access as of the measurement date.
>
> ***Level 2*** — Significant other observable inputs other than Level 1 prices, such as quoted prices for similar assets or liabilities in active markets; quoted prices for identical or similar assets or liabilities in markets that are not active; or other inputs that are observable or can be derived from or corroborated by observable market data by correlation or other means.
>
> ***Level 3*** — Significant unobservable inputs that reflect the reporting entity's own assumptions about the assumptions that market participants would use in pricing an asset or liability.

There were no impaired loans at December 31, 2018 and December 31, 2017.

Financial assets and liabilities recorded at carrying value have estimated fair value amounts determined by the Company using available market information and appropriate valuation methodologies. However, considerable judgment is required to interpret market data to develop the estimates of fair value. Accordingly, the estimates presented herein are not necessarily indicative of the amounts the Company could realize in a current market exchange. In some cases, book value is a reasonable estimate of fair value due to the relative short period of time between origination of the instrument and its expected realization. The valuation of loans receivable held for investment was impacted by the adoption of ASU 2016-01. In accordance with ASU 2016-01, the fair value of loans held for investment is estimated using discounted cash flow analysis. The discount rates used to determine fair value use interest rate spreads that reflect factors such as liquidity, credit and nonperformance risk of the loans. Loans are considered a Level 3 classification. The use of different market assumptions and/or estimation methodologies may have a material effect on the estimated fair value amounts as of December 31, 2018 and 2017:

2018					
			Fair Value Measurement Using		
	Carrying Amount	Estimated Fair Value	Level 1	Level 2	Level 3
Assets:					
Cash and cash equivalents	$ 71,611,000	$ 71,611,000	$ 71,611,000	$ -	$ -
Interest-bearing deposits in banks	2,200,000	2,200,000	-	2,200,000	-
Loans receivable	991,276,000	-	-	-	998,696,000
Accrued interest receivable	3,033,000	3,033,000	3,033,000	-	-
Investment in FHLB stock	6,760,000	6,760,000	-	6,760,000	-
Liabilities:					
Deposits	757,528,000	-	-	755,386,000	-
FHLB borrowings	175,000,000	-	-	173,252,000	-
Junior subordinated debentures	13,404,000	-	-	15,431,000	-
Accrued interest payable	388,000	388,000	388,000	-	-

2017					
			Fair Value Measurement Using		
	Carrying Amount	Estimated Fair Value	Level 1	Level 2	Level 3
Assets:					
Cash and cash equivalents	$ 68,223,000	$ 68,223,000	$ 68,223,000	$ -	$ -
Interest-bearing deposits in banks	3,175,000	3,175,000	-	3,175,000	-
Loans receivable	953,806,000	-	-	-	941,967,000
Accrued interest receivable	2,760,000	2,760,000	2,760,000	-	-
Investment in FHLB stock	6,422,000	6,422,000	-	6,422,000	-
Liabilities:					
Deposits	755,479,000	-	-	754,158,000	-
FHLB borrowings	139,000,000	-	-	137,943,000	-
Junior subordinated debentures	13,404,000	-	-	14,436,000	-
Accrued interest payable	363,000	363,000	363,000	-	-

13. SUBSEQUENT EVENTS

The Company has evaluated subsequent events through February 20, 2019, which is the date the consolidated financial statements were available to be issued. There were no subsequent events that required disclosure in the consolidated financial statements.

REPORT OF INDEPENDENT AUDITORS

The Board of Directors and Stockholders of
Malaga Financial Corporation and Subsidiary

Report on the Financial Statements

We have audited the accompanying consolidated financial statements of Malaga Financial Corporation and its subsidiary, which comprise the consolidated balance sheets as of December 31, 2018 and 2017, and the related consolidated statements of operations, stockholders' 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 consolidated financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

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

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

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

Opinion

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

Report on Internal Control Over Financial Reporting

We also have audited, in accordance with auditing standards generally accepted in the United States of America, Malaga Financial Corporation and Subsidiary's internal control over financial reporting as of December 31, 2018, based on criteria established in the Internal Control—Integrated Framework (2013), issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) relevant to internal 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 February 20, 2019, expressed an unmodified opinion.

Moss Adams LLP

Los Angeles, California
February 20, 2019

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Raymond L. Craemer, M.D.*
Corporate Secretary

Randy C. Bowers*

Jerry A. Donahue*

Leo K. C. Lee*

Andrew C. T. Sheng, D.M.D.*

Doug Wible

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Executive Vice President
Chief Financial Officer

Connie Begovich
Vice President
Deposit Compliance / BSA Officer

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Ana Straser
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Dennis Mezzo
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Business Banking

John Tellenbach
Senior Vice President
Chief Credit Officer

Nina Brister
Vice President
Loan Service / Funding Manager

Cathy Jaramillo
Vice President
Loan Processing Manager

*Directors or Officers of MFC and Malaga Bank.

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MALAGA FINANCIAL CORPORATION

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