COMMUNITY WEST BANCSHARES /
Form 10-Q
November 02, 2018

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

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

For the quarterly period ended September 30, 2018 or

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

For the transition period from _________ to _________

Commission File Number: 000-23575

COMMUNITY WEST BANCSHARES
(Exact name of registrant as specified in its charter)

California	77-0446957
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

445 Pine Avenue, Goleta, California	93117
(Address of principal executive offices)	(Zip Code)

(805) 692-5821
(Registrant's telephone number, including area code)

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

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

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

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

Emerging growth company

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

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

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

Common stock of the registrant issued and outstanding of 8,279,882 as of October 26, 2018.

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PART I – FINANCIAL INFORMATION

Item 1. Financial Statements

COMMUNITY WEST BANCSHARES
CONSOLIDATED BALANCE SHEETS

	September 30, 2018 (unaudited)	December 31, 2017
	(in thousands, except share amounts)	
Assets:		
Cash and due from banks	$ 2,308	$ 3,639
Federal funds sold	9	12
Interest-earning demand in other financial institutions	45,436	42,218
Cash and cash equivalents	47,753	45,869
Investment securities - available-for-sale, at fair value; amortized cost of $26,058 at September 30, 2018 and $28,742 at December 31, 2017	25,802	28,783
Investment securities - held-to-maturity, at amortized cost; fair value of $7,395 at September 30, 2018 and $7,671 at December 31, 2017	7,475	7,565
Investment securities - measured at fair value; amortized cost of $66 at September 30, 2018 and December 31, 2017.	144	—
Federal Home Loan Bank stock, at cost	2,714	2,347
Federal Reserve Bank stock, at cost	1,373	1,373
Loans:		
Held for sale, at lower of cost or fair value	50,944	55,094
Held for investment, net of allowance for loan losses of $8,519 at September 30, 2018 and $8,420 at December 31, 2017	694,278	671,095
Total loans	745,222	726,189
Other assets acquired through foreclosure, net	-	372
Premises and equipment, net	6,207	5,581
Other assets	18,019	15,236
Total assets	$ 854,709	$ 833,315
Liabilities:		
Deposits:		
Non-interest-bearing demand	$ 105,580	$ 108,500
Interest-bearing demand	267,046	256,717
Savings	14,385	14,085
Certificates of deposit ($250,000 or more)	92,934	81,985
Other certificates of deposit	239,997	238,397
Total deposits	719,942	699,684
Other borrowings	50,000	56,843
Other liabilities	9,210	6,718
Total liabilities	779,152	763,245
Stockholders' equity:		
Common stock — no par value, 60,000,000 shares authorized; 8,274,882 shares issued and outstanding at September 30, 2018 and 8,193,339 at December 31,	43,318	42,604

2017		
Retained earnings	32,398	27,441
Accumulated other comprehensive income (loss)	(159)	25
Total stockholders’ equity	75,557	70,070
Total liabilities and stockholders’ equity	$ 854,709	$ 833,315

See the accompanying notes.

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COMMUNITY WEST BANCSHARES

CONSOLIDATED INCOME STATEMENTS (unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
Interest income:	(in thousands, except per share amounts)			
Loans, including fees	$ 10,612	$ 9,340	$ 30,283	$ 26,570
Investment securities and other	589	355	1,307	894
Total interest income	11,201	9,695	31,590	27,464
Interest expense:				
Deposits	2,222	1,185	5,373	2,984
Other borrowings	351	134	928	294
Total interest expense	2,573	1,319	6,301	3,278
Net interest income	8,628	8,376	25,289	24,186
Provision (credit) for loan losses	(197)	159	(224)	423
Net interest income after provision for loan losses	8,825	8,217	25,513	23,763
Non-interest income:				
Other loan fees	379	354	998	999
Document processing fees	120	146	367	430
Service charges	113	118	351	326
Other	29	98	252	299
Total non-interest income	641	716	1,968	2,054
Non-interest expenses:				
Salaries and employee benefits	4,147	3,839	12,338	11,566
Occupancy, net	778	754	2,303	2,085
Professional services	326	281	931	759
Data processing	201	192	619	525
Depreciation	199	168	552	519
FDIC assessment	169	172	547	461
Advertising and marketing	154	137	487	488
Stock based compensation	81	283	284	454
Other	347	561	1,131	1,460
Total non-interest expenses	6,402	6,387	19,192	18,317
Income before provision for income taxes	3,064	2,546	8,289	7,500
Provision for income taxes	695	992	2,239	3,034
Net income	$ 2,369	$ 1,554	$ 6,050	$ 4,466
Earnings per share:				
Basic	$ 0.29	$ 0.19	$ 0.73	$ 0.55
Diluted	$ 0.27	$ 0.18	$ 0.69	$ 0.52
Weighted average number of common shares outstanding:				
Basic	8,261	8,165	8,233	8,134
Diluted	8,761	8,598	8,724	8,569
Dividends declared per common share	$ 0.050	$ 0.040	$ 0.140	$ 0.115

See the accompanying notes.

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COMMUNITY WEST BANCSHARES

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
	(in thousands)			
Net income	$2,369	$1,554	$ 6,050	$ 4,466
Other comprehensive income, net:				
Unrealized income (loss) on securities available-for-sale (AFS), net (tax effect of $34, $11, $82 and ($70) for each respective period presented)	(48)	(17)	(125)	99
Net other comprehensive income (loss)	(48)	(17)	(125)	99
Comprehensive income	$2,321	$1,537	$ 5,925	$ 4,565

See the accompanying notes.

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COMMUNITY WEST BANCSHARES

CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY (unaudited)

	Common Stock Shares	Common Stock Amount	Accumulated Other Comprehensive Income (Loss)	Retained Earnings	Total Stockholders' Equity
	(in thousands)				
Balance, December 31, 2017:	8,193	$42,604	$ 25	$27,441	$ 70,070
Net income	—	—	—	6,050	6,050
Exercise of stock options	82	430	—	—	430
Stock based compensation	—	284	—	—	284
Dividends on common stock	—	—	—	(1,152)	(1,152)
Other comprehensive income, net	—	—	(125)	—	(125)
Impact of ASU 2016-01 and 2018-02 as of January 1, 2018	—	—	(59)	59	—
Balance, September 30, 2018	8,275	$43,318	$ (159)	$32,398	$ 75,557

See the accompanying notes.

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COMMUNITY WEST BANCSHARES
CONSOLIDATED STATEMENTS OF CASH FLOWS (unaudited)

	Nine Months Ended September 30,	
	2018	2017
	(in thousands)	
Cash flows from operating activities:		
Net income	$ 6,050	$ 4,466
Adjustments to reconcile net income to cash provided by operating activities:		
(Credit) provision for loan losses	(224)	423
Depreciation	552	519
Stock based compensation	284	454
Deferred income taxes	(466)	(714)
Net accretion of discounts and premiums for investment securities	70	65
Losses/(Gains) on:		
Sale of repossessed assets, net	62	(150)
Loans originated for sale and principal collections, net	4,150	2,855
Changes in:		
Investment securities held at fair value	12	—
Other assets	(2,464)	(1,222)
Other liabilities	2,570	2,338
Servicing assets, net	67	54
Net cash provided by operating activities	10,663	9,088
Cash flows from investing activities:		
Principal pay downs and maturities of available-for-sale securities	2,646	2,315
Purchase of available-for-sale securities	—	(9,413)
Purchase of held-to-maturity securities	(794)	—
Principal pay downs and maturities of held-to-maturity securities	869	796
Loan originations and principal collections, net	(23,132)	(94,808)
Purchase of restricted stock, net	(367)	(277)
Purchase of premises and equipment, net	(1,178)	(1,720)
Proceeds from sale of other real estate owned and repossessed assets, net	484	303
Net cash used in investing activities	(21,472)	(102,804)
Cash flows from financing activities:		
Net increase in deposits	20,258	84,918
Net (decrease) increase in borrowings	(6,843)	26,843
Exercise of stock options	430	347
Cash dividends paid on common stock	(1,152)	(936)
Net cash provided by financing activities	12,693	111,172
Net increase cash and cash equivalents	1,884	17,456
Cash and cash equivalents at beginning of year	45,869	34,116
Cash and cash equivalents at end of period	$ 47,753	$ 51,572
Supplemental disclosure:		
Cash paid during the period for:		
Interest	$ 5,586	$ 3,118
Income taxes	2,010	2,380
Non-cash investing and financing activity:		
Transfers to other assets acquired through foreclosure, net	174	502

See the accompanying notes.

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NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Nature of Operations

Community West Bancshares ("CWBC"), incorporated under the laws of the state of California, is a bank holding company providing full service banking through its wholly-owned subsidiary Community West Bank, N.A. ("CWB" or the "Bank"). Unless indicated otherwise or unless the context suggests otherwise, these entities are referred to herein collectively and on a consolidated basis as the "Company."

Basis of Presentation

The accounting and reporting policies of the Company are in accordance with accounting principles generally accepted in the United States ("GAAP") and conform to practices within the financial services industry. The accounts of the Company and its consolidated subsidiary are included in these Consolidated Financial Statements. All significant intercompany balances and transactions have been eliminated.

Use of Estimates

The preparation of financial statements in conformity with GAAP 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. Material estimates that are particularly susceptible to significant changes in the near term relate to the determination of the allowance for loan losses and the fair value of securities available for sale. Although Management believes these estimates to be reasonably accurate, actual amounts may differ. In the opinion of Management, all necessary adjustments have been reflected in the financial statements during their preparation.

Interim Financial Information

The accompanying unaudited consolidated financial statements as of and for the three and nine months ended September 30, 2018 and 2017 have been prepared in a condensed format, and therefore do not include all of the information and footnotes required by GAAP for complete financial statements. These statements have been prepared on a basis that is substantially consistent with the accounting principles applied to our audited consolidated financial statements included in our Annual Report on Form 10-K for the year ended December 31, 2017.

The information furnished in these interim statements reflects all adjustments which are, in the opinion of management, necessary for a fair statement of the results for each respective period presented. Such adjustments are of a normal recurring nature. The results of operations in the interim statements are not necessarily indicative of the results that may be expected for any other quarter or for the full year. The interim financial information should be read in conjunction with the Company's audited consolidated financial statements.

Reclassifications

Certain amounts in the consolidated financial statements as of December 31, 2017 and for the three and nine months ended September 30, 2017 have been reclassified to conform to the current presentation. The reclassifications have no effect on net income, comprehensive income or stockholders' equity as previously reported.

Loans Held For Sale

Loans which are originated and intended for sale in the secondary market are carried at the lower of cost or estimated fair value determined on an aggregate basis. Valuation adjustments, if any, are recognized through a valuation allowance by charges to lower of cost or fair value provision. Loans held for sale are mostly comprised of commercial agriculture and SBA. The Company did not incur any lower of cost or fair value provision in the three and nine months ended September 30, 2018 and 2017.

Loans Held for Investment and Interest and Fees from Loans

Loans are recognized at the principal amount outstanding, net of unearned income, loan participations and amounts charged off. Unearned income includes deferred loan origination fees reduced by loan origination costs. Unearned income on loans is amortized to interest income over the life of the related loan using the level yield method.

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Interest income on loans is accrued daily using the effective interest method and recognized over the terms of the loans. Loan fees collected for the origination of loans less direct loan origination costs (net deferred loan fees) are amortized over the contractual life of the loan through interest income. If the loan has scheduled payments, the amortization of the net deferred loan fee is calculated using the interest method over the contractual life of the loan. If the loan does not have scheduled payments, such as a line of credit, the net deferred loan fee is recognized as interest income on a straight-line basis over the contractual life of the loan commitment. Commitment fees based on a percentage of a customer's unused line of credit and fees related to standby letters of credit are recognized over the commitment period.

When loans are repaid, any remaining unamortized balances of unearned fees, deferred fees and costs and premiums and discounts paid on purchased loans are accounted for through interest income.

Nonaccrual loans: For all loan types, when a borrower discontinues making payments as contractually required by the note, the Company must determine whether it is appropriate to continue to accrue interest. Generally, the Company places loans in a nonaccrual status and ceases recognizing interest income when the loan has become delinquent by more than 90 days or when Management determines that the full repayment of principal and collection of interest is unlikely. The Company may decide to continue to accrue interest on certain loans more than 90 days delinquent if they are well secured by collateral and in the process of collection. Other personal loans are typically charged off no later than 120 days delinquent.

For all loan types, when a loan is placed on nonaccrual status, all interest accrued but uncollected is reversed against interest income in the period in which the status is changed. Subsequent payments received from the customer are applied to principal and no further interest income is recognized until the principal has been paid in full or until circumstances have changed such that payments are again consistently received as contractually required. The Company occasionally recognizes income on a cash basis for non-accrual loans in which the collection of the remaining principal balance is not in doubt.

Impaired loans: A loan is considered impaired when, based on current information; it is probable that the Company will be unable to collect the scheduled payments of principal and/or interest under 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/or interest payments. Loans that experience insignificant payment delays or payment shortfalls generally are not classified as impaired. Management determines the significance of payment delays or payment shortfalls on a case-by-case basis. When determining the possibility of impairment, management considers 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. For collateral-dependent loans, the Company uses the fair value of collateral method to measure impairment. The collateral-dependent loans that recognize impairment are charged down to the fair value less costs to sell. All other loans are measured for impairment either based on the present value of future cash flows or the loan's observable market price.

Troubled debt restructured loan ("TDR"): A TDR is a loan on which the Company, for reasons related to the borrower's financial difficulties, grants a concession to the borrower that the Company would not otherwise consider. These concessions include but are not limited to term extensions, rate reductions and principal reductions. Forgiveness of principal is rarely granted and modifications for all classes of loans are predominately term extensions. A TDR loan is also considered impaired. Generally, a loan that is modified at an effective market rate of interest may no longer be disclosed as a troubled debt restructuring in years subsequent to the restructuring if it is not impaired based on the terms specified by the restructuring agreement.

Allowance for Loan Losses and Provision for Loan Losses

The Company maintains a detailed, systematic analysis and procedural discipline to determine the amount of the allowance for loan losses ("ALL"). The ALL is based on estimates and is intended to be appropriate to provide for probable losses inherent in the loan portfolio. This process involves deriving probable loss estimates that are based on migration analysis and historical loss rates, in addition to qualitative factors that are based on management's judgment. The migration analysis and historical loss rate calculations are based on the annualized loss rates utilizing a twelve-quarter loss history. Migration analysis is utilized for the Commercial Real Estate ("CRE"), Commercial, Commercial Agriculture, Small Business Administration ("SBA"), Home Equity Line of Credit ("HELOC"), Single Family Residential, and Consumer portfolios. The historical loss rate method is utilized primarily for the Manufactured Housing portfolio. The migration analysis takes into account the risk rating of loans that are charged off in each loan category. Loans that are considered Doubtful are typically charged off. The following is a description of the characteristics of loan ratings. Loan ratings are reviewed as part of our normal loan monitoring process, but, at a minimum, updated on an annual basis.

Outstanding – This is the highest quality rating that is assigned to any loan in the portfolio. These loans are made to the highest quality borrowers with strong financial statements and unquestionable repayment sources. Collateral securing these types of credits are generally cash deposits in the bank or marketable securities held in custody.

Good – Loans rated in this category are strong loans, underwritten well, that bear little risk of loss to the Company. Loans in this category are loans to quality borrowers with very good financial statements that present an identifiable strong primary source and good secondary source of repayment. Generally, these credits are well collateralized by good quality and liquid assets or low loan to value market real estate.

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Pass - Loans rated in this category are acceptable loans, appropriately underwritten, bearing an ordinary risk of loss to the Company. Loans in this category are loans to quality borrowers with financial statements presenting a good primary source as well as an adequate secondary source of repayment. In the case of individuals, borrowers with this rating are quality borrowers demonstrating a reasonable level of secure income, a net worth adequate to support the loan and presenting a good primary source as well as an adequate secondary source of repayment.

Watch – Acceptable credit that requires a temporary increase in attention by management. This can be caused by declines in sales, margins, liquidity or working capital. Generally the elevated risk comes from lack of current financial statements and industry issues.

Special Mention - A Special Mention loan has potential weaknesses that require management's close attention. If left uncorrected, these potential weaknesses may result in deterioration of the repayment prospects for the loan or in the institution's credit position at some future date. Special mention assets are not adversely classified and do not expose an institution to sufficient risk to warrant adverse classification.

Substandard - A Substandard loan is inadequately protected by the current sound net worth and paying capacity of the obligor or of the collateral pledged, if any. These loans have a well-defined weakness or weaknesses that jeopardize full collection of amounts due. They are characterized by the distinct possibility that the Company will sustain some loss if the borrower’s deficiencies are not corrected.

Doubtful - A loan classified Doubtful has all the weaknesses inherent in one classified 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 possibility of loss is extremely high, but because of certain important and reasonably specific pending factors, which may work to the advantage and strengthening of the loan, its classification as an estimated loss is deferred until its more exact status may be determined. Pending factors include proposed merger, acquisition or liquidation procedures, capital injection, perfecting liens on additional collateral and refinancing plans.

Loss - Loans classified Loss are considered uncollectible and of such little value that their continuance as bankable loans is not warranted. This classification does not mean that the asset has absolutely no recovery or salvage value, but rather it is not practical or desirable to defer writing off this loan even though partial recovery may be realized in the future. Losses are taken in the period in which they are considered uncollectible.

The Company’s ALL is maintained at a level believed appropriate by management to absorb known and inherent probable losses on existing loans. The allowance is charged for losses when management believes that full recovery on the loan is unlikely. The following is the Company’s policy regarding charging off loans.

Commercial, CRE and SBA Loans

Charge-offs on these loan categories are taken as soon as all or a portion of any loan balance is deemed to be uncollectible. A loan is considered impaired when, based on current information, it is probable that the Company will be unable to collect the scheduled payments of principal and/or interest under 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/or interest payments. Loans that experience insignificant payment delays or payment shortfalls generally are not classified as impaired. Generally, loan balances are charged-down to the fair value of the collateral, if, based on a current assessment of the value, an apparent deficiency exists. In the event there is no perceived equity, the loan is charged-off in full. Unsecured loans which are delinquent over 90 days are also charged-off in full.

Single Family Real Estate, HELOC's and Manufactured Housing Loans

Consumer loans and residential mortgages secured by one-to-four family residential properties, HELOC and manufactured housing loans in which principal or interest is due and unpaid for 90 days, are evaluated for impairment. Loan balances are charged-off to the fair value of the property, less estimated selling costs, if, based on a current appraisal, an apparent deficiency exists. In the event there is no perceived equity, the loan is generally fully charged-off.

Consumer Loans

All consumer loans (excluding real estate mortgages, HELOCs and savings secured loans) are charged-off or charged-down to net recoverable value before becoming 120 days or five payments delinquent.

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The ALL calculation for the different loan portfolios is as follows:

- Commercial Real Estate, Commercial, Commercial Agriculture, SBA, HELOC, Single Family Residential, and Consumer – Migration analysis combined with risk rating is used to determine the required ALL for all non-impaired loans. In addition, the migration results are adjusted based upon qualitative factors that affect the specific portfolio category. Reserves on impaired loans are determined based upon the individual characteristics of the loan.
- Manufactured Housing – The ALL is calculated on the basis of loss history and risk rating, which is primarily a function of delinquency. In addition, the loss results are adjusted based upon qualitative factors that affect this specific portfolio.

The Company evaluates and individually assesses for impairment loans classified as substandard or doubtful in addition to loans either on nonaccrual, considered a TDR or when other conditions exist which lead management to review for possible impairment. Measurement of impairment on impaired loans is determined on a loan-by-loan basis and in total establishes a specific reserve for impaired loans. The amount of impairment is determined by comparing the recorded investment in each loan with its value measured by one of three methods:

- The expected future cash flows are estimated and then discounted at the effective interest rate.
- The value of the underlying collateral net of selling costs. Selling costs are estimated based on industry standards, the Company's actual experience or actual costs incurred as appropriate. When evaluating real estate collateral, the Company typically uses appraisals or valuations, no more than twelve months old at time of evaluation. When evaluating non-real estate collateral securing the loan, the Company will use audited financial statements or appraisals no more than twelve months old at time of evaluation. Additionally, for both real estate and non-real estate collateral, the Company may use other sources to determine value as deemed appropriate.
- The loan's observable market price.

Interest income is not recognized on impaired loans except for limited circumstances in which a loan, although impaired, continues to perform in accordance with the loan contract and the borrower provides financial information to support maintaining the loan on accrual.

The Company determines the appropriate ALL on a monthly basis. Any differences between estimated and actual observed losses from the prior month are reflected in the current period in determining the appropriate ALL determination and adjusted as deemed necessary. The review of the appropriateness of the allowance takes into consideration such factors as concentrations of credit, changes in the growth, size and composition of the loan portfolio, overall and individual portfolio quality, review of specific problem loans, collateral, guarantees and economic and environmental conditions that may affect the borrowers' ability to pay and/or the value of the underlying collateral. Additional factors considered include: geographic location of borrowers, changes in the Company's product-specific credit policy and lending staff experience. These estimates depend on the outcome of future events and, therefore, contain inherent uncertainties.

Another component of the ALL considers qualitative factors related to non-impaired loans. The qualitative portion of the allowance on each of the loan pools is based on changes in any of the following factors:

- Concentrations of credit
- International risk
- Trends in volume, maturity, and composition of loans
- Volume and trend in delinquency, nonaccrual, and classified assets
- Economic conditions
- Geographic distance
- Policy and procedures or underwriting standards

- Staff experience and ability
- Value of underlying collateral
- Competition, legal, or regulatory environment
- Results of outside exams and quality of loan review and Board oversight

Off Balance Sheet and Credit Exposure

In the ordinary course of business, the Company has entered into off-balance sheet financial instruments consisting of commitments to extend credit and standby letters of credit. Such financial instruments are recorded in the consolidated financial statements when they are funded. They involve, to varying degrees, elements of credit risk in excess of amounts recognized in the consolidated balance sheets. Losses would be experienced when the Company is contractually obligated to make a payment under these instruments and must seek repayment from the borrower, which may not be as financially sound in the current period as they were when the commitment was originally made. 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. The Company enters into credit arrangements that generally provide for the termination of advances in the event of a covenant violation or other event of default. Since many of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. The Company evaluates each customer's creditworthiness on a case-by-case basis. The amount of collateral obtained, if deemed necessary by the Company upon extension of credit, is based on management's credit evaluation of the party. The commitments are collateralized by the same types of assets used as loan collateral.

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As with outstanding loans, the Company applies qualitative factors to its off-balance sheet obligations in determining an estimate of losses inherent in these contractual obligations. The estimate for loan losses on off-balance sheet instruments is included within other liabilities and the charge to income that establishes this liability is included in non-interest expense.

Foreclosed Real Estate and Repossessed Assets

Foreclosed real estate and other repossessed assets are recorded at fair value at the time of foreclosure less estimated costs to sell. Any excess of loan balance over the fair value less estimated costs to sell of the other assets is charged-off against the allowance for loan losses. Any excess of the fair value less estimated costs to sell over the loan balance is recorded as a loan loss recovery to the extent of the loan loss previously charged-off against the allowance for loan losses; and, if greater, recorded as a gain on foreclosed assets. Subsequent to the legal ownership date, the Company periodically performs a new valuation and the asset is carried at the lower of carrying amount or fair value less estimated costs to sell. Operating expenses or income, and gains or losses on disposition of such properties, are recorded in current operations.

Income Taxes

The Company uses the asset and liability method, which recognizes an asset or liability representing the tax effects of future deductible or taxable amounts that have been recognized in the consolidated financial statements. Due to tax regulations, certain items of income and expense are recognized in different periods for tax return purposes than for financial statement reporting. These items represent “temporary differences.” Deferred income taxes are recognized for the tax effect of temporary differences between the tax basis of assets and liabilities and their financial reporting amounts at each period end based on enacted tax laws and statutory tax rates applicable to the periods in which the differences are expected to affect taxable income. A valuation allowance is established for deferred tax assets if, based on the weight of available evidence, it is more likely than not that some portion or all of the deferred tax assets may not be realized. Any interest or penalties assessed by the taxing authorities is classified in the financial statements as income tax expense. Deferred tax assets are included in other assets on the consolidated balance sheets.

Management evaluates the Company’s deferred tax asset for recoverability using a consistent approach which considers the relative impact of negative and positive evidence, including the Company’s historical profitability and projections of future taxable income. The Company is required to establish a valuation allowance for deferred tax assets and record a charge to income if management determines, based on available evidence at the time the determination is made, that it is more likely than not that some portion or all of the deferred tax assets may not be realized.

The Company is subject to the provisions of ASC 740, Income Taxes (“ASC 740”). ASC 740 prescribes a more likely than not threshold for the financial statement recognition of uncertain tax positions. ASC 740 clarifies the accounting for income taxes by prescribing a minimum recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. On a quarterly basis, the Company evaluates income tax accruals in accordance with ASC 740 guidance on uncertain tax positions.

Earnings Per Share

Basic earnings per common share is computed using the weighted average number of common shares outstanding for the period divided into the net income. Diluted earnings per share include the effect of all dilutive potential common shares for the period. Potentially dilutive common shares include stock options and warrants.

Recent Accounting Pronouncements

In May 2014, the FASB issued guidance codified within ASU 2014-09, "Revenue Recognition - Revenue from Contracts with Customers," which amends the guidance in former Topic 605, Revenue Recognition. The new revenue recognition standard superseded virtually all revenue guidance in U.S. GAAP, including industry specific guidance. The guidance in this Update affects any entity that either enters into contracts with customers to transfer goods or services or enters into contracts for the transfer of nonfinancial assets, unless those contracts are within the scope of other standards. ASU 2014-09 is effective for the Company for annual reporting periods beginning after December 15, 2016. In August 2015, this effective date was extended for the Company to December 15, 2017. This Update allowed for using one of the following two adoption methods: 1) retrospectively to each prior reporting period presented or 2) retrospectively with the cumulative effect of initially applying this Update recognized at the date of initial application with the cumulative effect of initially applying the standard. Our revenue is comprised of net interest income on financial assets and liabilities, which is explicitly excluded from the scope of the new guidance, and noninterest income. The contracts that are in scope of the guidance are primarily related to service charges on deposit accounts, cardholder income, and other service charge fees. The Company adopted this standard effective January 1, 2018 using the modified retrospective approach. Since there was no net income impact upon adoption of the new guidance, a cumulative effect adjustment to opening retained earnings was not deemed necessary. See Note 10 Revenue Recognition for further information.

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In January 2016, the FASB issued guidance codified within ASU 2016-01, “Financial Instruments – Overall, Subtopic 825-10: Recognition and Measurement of Financial Assets and Financial Liabilities,” which amends certain guidance on classification and measurement of financial instruments. The update is intended to enhance the reporting model for financial instruments to provide users of financial instruments with more decision-useful information and addresses certain aspects of the recognition, measurement, presentation, and disclosure of financial instruments. ASU 2016-01 is effective for the Company for annual reporting periods beginning after December 15, 2017. The Company has evaluated the impact of the provisions in this standard on the Company's Consolidated Financial Statements. The adoption of ASU 2016-01 on January 1, 2018 did not have material impact on the Company's Consolidated Financial Statements. In accordance with the guidance, the Company measured the fair value of its loan portfolio as of March 31, 2018 using an exit price notion (see Note 6 Fair Value Measurement).

In February 2016, the FASB amended its standards with respect to the accounting for leases. The amended guidance serves to replace all current U.S. GAAP guidance on this topic and requires that an operating lease be recognized on the statement of financial condition as a “right-to-use” asset along with a corresponding liability representing the rent obligation. Key aspects of current lessor accounting remain unchanged from existing guidance. This standard is expected to result in an increase to assets and liabilities recognized and, therefore, increase risk-weighted assets for regulatory capital purposes. The guidance requires the use of the modified retrospective transition approach for existing leases that have not expired before the date of initial application and will become effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2018. The standard is effective for the Company as of January 1, 2019. The Company is currently implementing lease accounting software to determine how our financial statements will be affected, and we believe the primary effect of adopting the new standard will be to record right-of-use assets and obligations for our leases currently classified as operating leases and does not anticipate these to be significant.

In June of 2016, the FASB issued update guidance codified within ASU-2016-13, “Financial Instruments – Credit Losses (Topic 326), Measurement of Credit Losses on Financial Instruments,” which amends the guidance for recognizing credit losses from an “incurred loss” methodology that delays recognition of credit losses until it is probable a loss has been incurred to an expected credit loss methodology. The guidance requires the use of the modified retrospective transition method by means of a cumulative-effect adjustment to equity as of the beginning of the period in which the guidance is adopted. The standard is effective for the Company as of January 1, 2020. The Company is currently evaluating the impact of the amended guidance and has not yet determined the effect of the standard on its ongoing financial reporting.

In March 2017, the FASB issued updated guidance codified within ASU-2017-08, “Receivables – Nonrefundable Fees and Other Costs (Subtopic 310-20),” which is intended to enhance the accounting for the amortization of premiums for purchased callable debt securities. The standard is effective for the Company as of January 1, 2019. The Company does not believe the standard will have a material impact on the Company’s financials.

In February 2018, the FASB issued guidance codified within ASU-2018-02, "Income Statement – Reporting Comprehensive Income (Topic 220), Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income," to address the income tax accounting treatment of the standard tax effects within other comprehensive income due to the prohibition of backward tracing due to an income tax rate change that was initially recorded in other comprehensive income. This issue came about from the enactment of the Tax Cuts and Jobs Act on December 22, 2017 that changed the Company's income tax rate from 34% to 21%. The ASU changed current accounting whereby an entity may elect to reclassify the standard tax effect from accumulated other comprehensive income to retained earnings. The ASU is effective for periods beginning after December 15, 2018 although early adoption is permitted. The Company elected to early adopt ASU-2018-02 in the first quarter of 2018 and elected to reclassify the income tax effects of the Tax Act from accumulated other comprehensive income ("AOCI") to retained earnings. The reclassification did not have a material impact to the Consolidated Financial Statements.

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2. INVESTMENT SECURITIES

The amortized cost and estimated fair value of investment securities are as follows:

	September 30, 2018			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized (Losses)	Fair Value
Securities available-for-sale	(in thousands)			
U.S. government agency notes	$12,722	$ —	$ (202)	$12,520
U.S. government agency collateralized mortgage obligations ("CMO")	13,336	28	(82)	13,282
Total	$26,058	$ 28	$ (284)	$25,802
Securities held-to-maturity				
U.S. government agency mortgage backed securities ("MBS")	$7,475	$ 125	$ (205)	$7,395
Total	$7,475	$ 125	$ (205)	$7,395
Securities measured at fair value				
Equity securities: Farmer Mac class A stock	$66	$78	$—	$144
Total	$66	$78	$—	$144

	December 31, 2017			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized (Losses)	Fair Value
Securities available-for-sale	(in thousands)			
U.S. government agency notes	$14,035	$ 35	$ (92)	$13,978
U.S. government agency collateralized mortgage obligations ("CMO")	14,641	66	(58)	14,649
Equity securities: Farmer Mac class A stock	66	90	—	156
Total	$28,742	$ 191	$ (150)	$28,783
Securities held-to-maturity				
U.S. government agency mortgage backed securities ("MBS")	$7,565	$ 216	$ (110)	$7,671
Total	$7,565	$ 216	$ (110)	$7,671

At September 30, 2018 and December 31, 2017, $33.3 million and $36.2 million of securities at carrying value, respectively, were pledged to the Federal Home Loan Bank (“FHLB”), as collateral for current and future advances.

The maturity periods and weighted average yields of investment securities at the period ends indicated were as follows:

	September 30, 2018									
	Less than One Year		One to Five Years		Five to Ten Years		Over Ten Years		Total	
	Amount	Yield	Amount	Yield	Amount	Yield	Amount	Yield	Amount	Yield
Securities available-for-sale	(dollars in thousands)									
U.S. government agency notes	$1,912	2.6 %	$ 1,411	2.3 %	$ 9,197	2.8 %	$ —	—	$12,520	2.7 %

U.S. government agency CMO	—	—	2,237	2.3 %	8,158	2.5 %	2,887	3 %	13,282	2.6 %
Total	$1,912	2.6 %	$ 3,648	2.3 %	$ 17,355	2.7 %	$ 2,887	3.0 %	$25,802	2.7 %
Securities held-to-maturity										
U.S. government agency MBS	$—	—	$ 1,751	4.2 %	$ 4,927	3.3 %	$ 797	3.6 %	$7,475	3.6 %
Total	$—	—	$ 1,751	4.2 %	$ 4,927	3.3 %	$ 797	3.6 %	$7,475	3.6 %
Securities measured at fair value										
Farmer Mac class A stock	$—	—	$ —	—	$ —	—	$ —	—	$ 144	—
Total	$—	—	$ —	—	$ —	—	$ —	—	$ 144	—

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	December 31, 2017									
	Less than One Year		One to Five Years		Five to Ten Years		Over Ten Years		Total	
	Amount	Yield	Amount	Yield	Amount	Yield	Amount	Yield	Amount	Yield
Securities available-for-sale	(dollars in thousands)									
U.S. government agency notes	$1,967	2.6 %	$ 1,833	1.6 %	$ 10,178	2.0 %	$—	—	$13,978	2.0 %
U.S. government agency CMO	—	—	3,362	1.9 %	8,361	1.9 %	2,926	2.3 %	14,649	1.9 %
Farmer Mac class A stock	—	—	—	—	—	—	—	—	156	—
Total	$1,967	2.6 %	$ 5,195	1.8 %	$ 18,539	1.9 %	$ 2,926	2.3 %	$28,783	2.0 %
Securities held-to-maturity										
U.S. government agency MBS	$—	—	$ 2,802	3.6 %	$ 4,763	3.1 %	$—	—	$7,565	3.3 %
Total	$—	—	$ 2,802	3.6 %	$ 4,763	3.1 %	$—	—	$7,565	3.3 %

The amortized cost and fair value of investment securities by contractual maturities as of the periods presented were as shown below:

	September 30, 2018		December 31, 2017	
	Amortized Cost	Estimated Fair Value	Amortized Cost	Estimated Fair Value
Securities available-for-sale	(in thousands)			
Due in one year or less	$1,997	$ 1,912	$1,997	$ 1,967
After one year through five years	3,687	3,648	5,220	5,195
After five years through ten years	17,443	17,355	18,506	18,539
After ten years	2,931	2,887	2,953	2,926
Farmer Mac class A stock	—	—	66	156
Total	$26,058	$ 25,802	$28,742	$ 28,783
Securities held-to-maturity				
Due in one year or less	$—	$ —	$—	$ —
After one year through five years	1,751	1,837	2,802	2,938
After five years through ten years	4,927	4,775	4,763	4,733
After ten years	797	783	—	—
Total	$7,475	$ 7,395	$7,565	$ 7,671
Securities measured at fair value				
Farmer Mac class A stock	$66	$ 144	$—	$ —
Total	$66	$ 144	$—	$ —

Actual maturities may differ from contractual maturities as borrowers or issuers have the right to prepay or call the investment securities. Changes in interest rates may also impact prepayments.

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The following tables show all securities that are in an unrealized loss position:

	September 30, 2018					
	Less Than Twelve Months		More Than Twelve Months		Total	
	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value
Securities available-for-sale	(in thousands)					
U.S. government agency notes	$113	$6,185	$ 89	$ 6,335	$202	$12,520
U.S. government agency CMO	30	774	52	2,629	82	3,403
Total	$143	$6,959	$ 141	$ 8,964	$284	$15,923
Securities held-to-maturity						
U.S. Government-agency MBS	$31	$2,504	$ 174	$ 2,074	$205	$4,578
Total	$31	$2,504	$ 174	$ 2,074	$205	$4,578
Securities measured at fair value						
Farmer Mac class A stock	$—	$—	$ —	$ —	$—	$—
Total	$—	$—	$ —	$ —	$—	$—

	December 31, 2017					
	Less Than Twelve Months		More Than Twelve Months		Total	
	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value
Securities available-for-sale	(in thousands)					
U.S. government agency notes	$70	$6,324	$ 22	$ 3,106	$92	$9,430
U.S. government agency CMO	8	985	50	3,430	58	4,415
Equity securities: Farmer Mac class A stock	—	—	—	—	—	—
Total	$78	$7,309	$ 72	$ 6,536	$150	$13,845
Securities held-to-maturity						
U.S. Government-agency MBS	$—	$—	$ 110	$ 2,496	$110	$2,496
Total	$—	$—	$ 110	$ 2,496	$110	$2,496

As of September 30, 2018 and December 31, 2017, there were 19 and 14 securities, respectively, in an unrealized loss position. Declines in the fair value of held-to-maturity and available-for-sale securities below their cost that are deemed to be other-than-temporary are reflected in earnings as realized losses. In estimating other-than-temporary impairment losses, management considers, among other things (i) the length of time and the extent to which the fair value has been less than cost (ii) the financial condition and near-term prospects of the issuer and (iii) the Company's intent to sell an impaired security and if it is not more likely than not it will be required to sell the security before the recovery of its amortized basis.

The unrealized losses are primarily due to increases in market interest rates over the yields available at the time the underlying securities were purchased. The fair value is expected to recover as the bonds approach their maturity date, repricing date or if market yields for such investments decline. Management does not believe any of the securities are impaired due to reasons of credit quality. Accordingly, as of September 30, 2018 and December 31, 2017, management believes the impairments detailed in the table above are temporary and no other-than-temporary impairment loss has been realized in the Company’s consolidated income statements.

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3. LOANS HELD FOR SALE

SBA and Agriculture Loans

As of September 30, 2018 and December 31, 2017, the Company had approximately $15.0 million and $18.9 million, respectively, of SBA loans included in loans held for sale. As of September 30, 2018 and December 31, 2017, the principal balance of SBA loans serviced for others was $8.0 million and $10.8 million, respectively.

The Company's agricultural lending program includes loans for agricultural land, agricultural operational lines, and agricultural term loans for crops, equipment and livestock. The primary products are supported by guarantees issued from the USDA, FSA, and the USDA Business and Industry loan program.

As of September 30, 2018 and December 31, 2017, the Company had $35.9 million and $36.2 million of USDA loans included in loans held for sale, respectively. As of September 30, 2018 and December 31, 2017, the principal balance of USDA loans serviced for others was $2.0 million.

4. LOANS HELD FOR INVESTMENT

The composition of the Company's loans held for investment loan portfolio follows:

	September 30, 2018	December 31, 2017
	(in thousands)	
Manufactured housing	$240,010	$ 223,115
Commercial real estate	353,136	354,617
Commercial	83,328	75,282
SBA	6,131	7,424
HELOC	9,446	9,422
Single family real estate	11,153	10,346
Consumer	73	83
	703,277	680,289
Allowance for loan losses	(8,519)	(8,420)
Deferred fees, net	(402)	(652)
Discount on SBA loans	(78)	(122)
Total loans held for investment, net	$694,278	$ 671,095

The following table presents the contractual aging of the recorded investment in past due held for investment loans by class of loans:

September 30, 2018							
Current	30-59 Days Past Due	60-89 Days Past Due	Over 90 Days Past Due	Total Past Due	Nonaccrual	Total	Recorded Investment Over 90 Days and Accruing
(in thousands)							
$239,574	$ 144	$ —	$ —	$ 144	$ 292	$240,010	$ —

Manufactured housing								
Commercial real estate:								
Commercial real estate	258,807	235	—	—	235	107	259,149	—
SBA 504 1st trust deed	24,333	—	—	—	—	—	24,333	—
Land	6,070	—	—	—	—	—	6,070	—
Construction	62,257	1,327	—	—	1,327	—	63,584	—
Commercial	79,141	99	—	—	99	4,088	83,328	—
SBA	5,275	—	—	—	—	856	6,131	—
HELOC	9,244	—	—	—	—	202	9,446	—
Single family real estate	10,946	17	—	25	42	165	11,153	25
Consumer	73	—	—	—	—	—	73	—
Total	$695,720	$ 1,822	$ —	$ 25	$ 1,847	$ 5,710	$703,277	$ 25

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	December 31, 2017							
	Current	30-59 Days Past Due	60-89 Days Past Due	Over 90 Days Past Due	Total Past Due	Nonaccrual	Total	Recorded Investment Over 90 Days and Accruing
	(in thousands)							
Manufactured housing	$222,342	$ 355	$ —	$ —	$ 355	$ 418	$223,115	$ —
Commercial real estate:								
Commercial real estate	271,134	—	—	—	—	122	271,256	—
SBA 504 1st trust deed	26,463	—	—	—	—	184	26,647	—
Land	5,092	—	—	—	—	—	5,092	—
Construction	51,622	—	—	—	—	—	51,622	—
Commercial	70,481	15	—	—	15	4,786	75,282	—
SBA	6,461	19	—	—	19	944	7,424	—
HELOC	9,208	—	—	—	—	214	9,422	—
Single family real estate	10,170	—	—	—	—	176	10,346	—
Consumer	83	—	—	—	—	—	83	—
Total	$673,056	$ 389	$ —	$ —	$ 389	$ 6,844	$680,289	$ —

Allowance for Loan Losses

The following table summarizes the changes in the allowance for loan losses:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
	(in thousands)			
Beginning balance	$8,622	$7,994	$ 8,420	$ 7,464
Charge-offs	—	(33)	(6)	(203)
Recoveries	94	192	329	628
Net recoveries	94	159	323	425
Provision (credit)	(197)	159	(224)	423
Ending balance	$8,519	$8,312	$ 8,519	$ 8,312

As of September 30, 2018 and December 31, 2017, the Company had reserves for credit losses on undisbursed loans of $80,000 and $95,000, respectively, which were included in other liabilities.

The following tables summarize the changes in the allowance for loan losses by portfolio type:

For the Three Months Ended September 30,

2018	Manufactured Housing	Commercial Real Estate	Commercial	SBA	HELOC	Single Family Real Estate	Consumer	Total
	(in thousands)							
Beginning balance	$2,145	$ 5,007	$ 1,221	$57	$ 93	$ 99	$ —	$8,622
Charge-offs	—	—	—	—	—	—	—	—
Recoveries	6	—	19	34	35	—	—	94
Net (charge-offs) recoveries	6	—	19	34	35	—	—	94
Provision (credit)	17	(134)	4	(38)	(36)	(10)	—	(197)
Ending balance	$2,168	$ 4,873	$ 1,244	$53	$ 92	$ 89	$ —	$8,519
2017								
Beginning balance	$2,124	$ 4,332	$ 1,262	$91	$ 98	$ 87	$ —	$7,994
Charge-offs	—	—	—	—	—	(33)	—	(33)
Recoveries	38	—	43	104	7	—	—	192
Net (charge-offs) recoveries	38	—	43	104	7	(33)	—	159
Provision (credit)	(15)	359	(100)	(108)	(11)	34	—	159
Ending balance	$2,147	$ 4,691	$ 1,205	$87	$ 94	$ 88	$ —	$8,312

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	For the Nine Months Ended September 30,							
	Manufactured Housing	Commercial Real Estate	Commercial	SBA	HELOC	Single Family Real Estate	Consumer	Total
2018	(in thousands)							
Beginning balance	$2,180	$ 4,844	$ 1,133	$73	$ 92	$ 98	$ —	$8,420
Charge-offs	(6)	—	—	—	—	—	—	(6)
Recoveries	114	15	43	102	54	1	—	329
Net (charge-offs) recoveries	108	15	43	102	54	1	—	323
Provision (credit)	(120)	14	68	(122)	(54)	(10)	—	(224)
Ending balance	$2,168	$ 4,873	$ 1,244	$53	$ 92	$ 89	$ —	$8,519
2017								
Beginning balance	$2,201	$ 3,707	$ 1,241	$106	$ 100	$ 109	$ —	$7,464
Charge-offs	(119)	—	—	(30)	—	(54)	—	(203)
Recoveries	105	227	116	168	11	1	—	628
Net (charge-offs) recoveries	(14)	227	116	138	11	(53)	—	425
Provision (credit)	(40)	757	(152)	(157)	(17)	32	—	423
Ending balance	$2,147	$ 4,691	$ 1,205	$87	$ 94	$ 88	$ —	$8,312

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The following tables present impairment method information related to loans and allowance for loan losses by loan portfolio segment:

	Manufactured Housing	Commercial Real Estate	Commercial	SBA	HELOC	Single Family Real Estate	Consumer	Total Loans
Loans Held for Investment as of September 30, 2018:	(in thousands)							
Recorded Investment:								
Impaired loans with an allowance recorded	$5,906	$245	$219	$1	$—	$282	$ —	$6,653
Impaired loans with no allowance recorded	2,330	107	6,978	865	203	1,980	—	12,463
Total loans individually evaluated for impairment	8,236	352	7,197	866	203	2,262	—	19,116
Loans collectively evaluated for impairment	231,774	352,784	76,131	5,265	9,243	8,891	73	684,161
Total loans held for investment	$240,010	$353,136	$83,328	$6,131	$9,446	$11,153	$ 73	$703,277
Unpaid Principal Balance								
Impaired loans with an allowance recorded	$5,906	$245	$219	$20	$—	$282	$ —	$6,672
Impaired loans with no allowance recorded	3,520	162	7,082	1,470	249	2,030	—	14,513
Total loans individually evaluated for impairment	9,426	407	7,301	1,490	249	2,312	—	21,185
Loans collectively evaluated for impairment	231,774	352,784	76,131	5,265	9,243	8,891	73	684,161
Total loans held for investment	$241,200	$353,191	$83,432	$6,755	$9,492	$11,203	$ 73	$705,346
Related Allowance for Credit Losses								
Impaired loans with an allowance recorded	$429	$9	$1	$—	$—	$20	$ —	$459
Impaired loans with no allowance recorded	—	—	—	—	—	—	—	—
Total loans individually evaluated for impairment	429	9	1	—	—	20	—	459
Loans collectively evaluated for impairment	1,739	4,864	1,243	53	92	69	—	8,060
Total loans held for investment	$2,168	$4,873	$1,244	$53	$92	$89	$ —	$8,519

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Loans Held for Investment as of December 31, 2017:	Manufactured Housing	Commercial Real Estate	Commercial	SBA	HELOC	Single Family Real Estate	Consumer	Total Loans
	(in thousands)							
Recorded Investment:								
Impaired loans with an allowance recorded	$5,830	$ 557	$ 3,551	$281	$—	$ 2,133	$ —	$12,352
Impaired loans with no allowance recorded	2,163	—	5,023	699	214	176	—	8,275
Total loans individually evaluated for impairment	7,993	557	8,574	980	214	2,309	—	20,627
Loans collectively evaluated for impairment	215,122	354,060	66,708	6,444	9,208	8,037	83	659,662
Total loans held for investment	$223,115	$354,617	$ 75,282	$7,424	$9,422	$ 10,346	$ 83	$680,289
Unpaid Principal Balance								
Impaired loans with an allowance recorded	$5,836	$ 661	$ 3,551	$281	$—	$ 2,133	$ —	$12,462
Impaired loans with no allowance recorded	3,328	—	5,042	1,026	249	220	—	9,865
Total loans individually evaluated for impairment	9,164	661	8,593	1,307	249	2,353	—	22,327
Loans collectively evaluated for impairment	215,122	354,060	66,708	6,444	9,208	8,037	83	659,662
Total loans held for investment	$224,286	$354,721	$ 75,301	$7,751	$9,457	$ 10,390	$ 83	$681,989
Related Allowance for Credit Losses								
Impaired loans with an allowance recorded	$427	$ 11	$ 50	$1	$—	$ 35	$ —	$524
Impaired loans with no allowance recorded	—	—	—	—	—	—	—	—
Total loans individually evaluated for impairment	427	11	50	1	—	35	—	524
Loans collectively evaluated for impairment	1,753	4,833	1,083	72	92	63	—	7,896
Total loans held for investment	$2,180	$4,844	$ 1,133	$73	$92	$ 98	$ —	$8,420

Included in impaired loans are $2.4 million and $2.6 million of loans guaranteed by government agencies at September 30, 2018 and December 31, 2017, respectively. A valuation allowance is established for an impaired loan when the fair value of the loan is less than the recorded investment. In certain cases, portions of impaired loans are charged-off to realizable value instead of establishing a valuation allowance and are included, when applicable in the table below as “Impaired loans without specific valuation allowance under ASC 310.” The valuation allowance disclosed above is included in the allowance for loan losses reported in the consolidated balance sheets as of September 30, 2018 and December 31, 2017.

The table below reflects recorded investment in loans classified as impaired:

	September 30, 2018	December 31, 2017
	(in thousands)	
Impaired loans with a specific valuation allowance under ASC 310	$6,653	$ 12,352
Impaired loans without a specific valuation allowance under ASC 310	12,463	8,275
Total impaired loans	$19,116	$ 20,627
Valuation allowance related to impaired loans	$459	$ 524

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The following table summarizes impaired loans by class of loans:

	September 30, 2018	December 31, 2017
	(in thousands)	
Manufactured housing	$ 8,236	$ 7,993
Commercial real estate :		
Commercial real estate	107	122
SBA 504 1st trust deed	245	435
Land	—	—
Construction	—	—
Commercial	7,197	8,574
SBA	866	980
HELOC	203	214
Single family real estate	2,262	2,309
Consumer	—	—
Total	$ 19,116	$ 20,627

The following tables summarize average investment in impaired loans by class of loans and the related interest income recognized:

	Three Months Ended September 30,			
	2018		2017	
	Average Investment in Impaired Loans	Interest Income	Average Investment in Impaired Loans	Interest Income
	(in thousands)			
Manufactured housing	$ 8,175	$ 162	$ 7,483	$ 174
Commercial real estate:				
Commercial real estate	111	—	120	1
SBA 504 1st trust deed	407	5	402	5
Land	—	—	—	—
Construction	—	—	—	—
Commercial	7,444	47	4,789	54
SBA	902	17	662	1
HELOC	203	11	214	—
Single family real estate	2,223	27	1,951	25
Consumer	—	—	—	—
Total	$ 19,465	$ 269	$ 15,621	$ 260

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	Nine Months Ended September 30, 2018		2017	
	Average Investment in Impaired Loans	Interest Income	Average Investment in Impaired Loans	Interest Income
	(in thousands)			
Manufactured housing	$ 8,226	$ 497	$ 7,634	$ 488
Commercial real estate:				
Commercial real estate	116	—	123	1
SBA 504 1st trust deed	378	14	523	15
Land	—	—	—	—
Construction	—	—	—	—
Commercial	7,737	145	4,486	155
SBA	921	18	767	3
HELOC	207	12	273	—
Single family real estate	2,276	81	1,973	75
Consumer	—	—	—	—
Total	$ 19,861	$ 767	$ 15,779	$ 737

The Company is not committed to lend additional funds on these impaired loans.

The following table reflects the recorded investment in certain types of loans at the periods indicated:

	September 30, 2018	December 31, 2017
	(in thousands)	
Nonaccrual loans	$ 5,710	$ 6,844
Government guaranteed portion of loans included above	$ 1,955	$ 2,372
Troubled debt restructured loans, gross	$ 17,644	$ 16,603
Loans 30 through 89 days past due with interest accruing	$ 1,822	$ 389
Loans 90 days or more past due with interest accruing	$ 25	$ —
Allowance for loan losses to gross loans held for investment	1.21 %	1.24 %

The accrual of interest is discontinued when substantial doubt exists as to collectability of the loan; generally at the time the loan is 90 days delinquent. Any unpaid but accrued interest is reversed at that time. Thereafter, interest income is no longer recognized on the loan. Interest income may be recognized on impaired loans to the extent they are not past due by 90 days. Interest on nonaccrual 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 of the principal and interest amounts contractually due are brought current and future payments are reasonably assured. Foregone interest on nonaccrual and TDR loans for the three months ended September 30, 2018 and 2017 was $0.1 million. Foregone interest on nonaccrual and TDR loans for the nine months ended September 30, 2018 and 2017 was $0.3 million.

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The following table presents the composition of nonaccrual loans by class of loans:

	September 30, 2018	December 31, 2017
	(in thousands)	
Manufactured housing	$292	$ 418
Commercial real estate:		
Commercial real estate	107	122
SBA 504 1st trust deed	—	184
Land	—	—
Construction	—	—
Commercial	4,088	4,786
SBA	856	944
HELOC	202	214
Single family real estate	165	176
Consumer	—	—
Total	$5,710	$ 6,844

Included in nonaccrual loans are $2.0 million of loans guaranteed by government agencies at September 30, 2018 and $2.4 million at December 31, 2017.

The guaranteed portion of each SBA loan is repurchased from investors when those loans become past due 120 days by either CWB or the SBA directly. After the foreclosure and collection process is complete, the principal balance of loans repurchased by CWB are reimbursed by the SBA. Although these balances do not earn interest during this period, they generally do not result in a loss of principal to CWB; therefore a repurchase reserve has not been established related to these loans.

The Company utilizes an internal asset classification system as a means of reporting problem and potential problem loans. Under the Company's risk rating system, the Company classifies problem and potential problem loans as "Special Mention," "Substandard," "Doubtful" and "Loss". For a detailed discussion on these risk classifications see "Note 1 Summary of Significant Accounting Policies - Allowance for Loan Losses and Provision for Loan Losses". Loans that do not currently expose the Company to sufficient risk to warrant classification in one of the aforementioned categories but possess weaknesses that deserve management's close attention are deemed to be Special Mention. If left uncorrected, these potential weaknesses may result in deterioration of the repayment prospects for the loan or in the institution's credit position at some future date. Special Mention assets are not adversely classified and do not expose an institution to sufficient risk to warrant adverse classification. Risk ratings are updated as part of our normal loan monitoring process, at a minimum, annually.

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The following tables present gross loans by risk rating:

	September 30, 2018				
	Pass	Special Mention	Substandard	Doubtful	Total
	(in thousands)				
Manufactured housing	$239,459	$ —	$ 551	$ —	$240,010
Commercial real estate:					
Commercial real estate	259,042	—	107	—	259,149
SBA 504 1st trust deed	23,854	—	479	—	24,333
Land	6,070	—	—	—	6,070
Construction	62,257	1,327	—	—	63,584
Commercial	75,838	350	5,655	—	81,843
SBA	4,474	44	374	—	4,892
HELOC	9,243	—	203	—	9,446
Single family real estate	10,983	—	170	—	11,153
Consumer	73	—	—	—	73
Total, net	691,293	1,721	7,539	—	700,553
Government guarantee	—	—	2,724	—	2,724
Total	$691,293	$ 1,721	$ 10,263	$ —	$703,277

	December 31, 2017				
	Pass	Special Mention	Substandard	Doubtful	Total
	(in thousands)				
Manufactured housing	$222,429	$ —	$ 686	$ —	$223,115
Commercial real estate:					
Commercial real estate	271,134	—	122	—	271,256
SBA 504 1st trust deed	25,973	—	674	—	26,647
Land	5,092	—	—	—	5,092
Construction	49,832	1,790	—	—	51,622
Commercial	64,543	817	8,083	—	73,443
SBA	4,221	102	1,752		6,075
HELOC	9,208	—	214	—	9,422
Single family real estate	10,165	—	181	—	10,346
Consumer	83	—	—	—	83
Total, net	662,680	2,709	11,712	$ —	677,101
Government guarantee	—	—	3,188	—	3,188
Total	$662,680	$ 2,709	$ 14,900	$ —	$680,289

Troubled Debt Restructured Loan (TDR)

A TDR is a loan on which the bank, for reasons related to a borrower’s financial difficulties, grants a concession to the borrower that the bank would not otherwise consider. The loan terms that have been modified or restructured due to a borrower’s financial situation include, but are not limited to, a reduction in the stated interest rate, an extension of the maturity or renewal of the loan at an interest rate below current market, a reduction in the face amount of the debt, a reduction in the accrued interest, extensions, deferrals, renewals and rewrites. The majority of the bank’s modifications are extensions in terms or deferral of payments which result in no lost principal or interest followed by reductions in interest rates or accrued interest. A TDR is also considered impaired. Generally, a loan that is modified at an effective market rate of interest may no longer be disclosed as a troubled debt restructuring in years subsequent to the restructuring if it is not impaired based on the terms specified by the restructuring agreement.

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The following tables summarize the financial effects of TDR loans by loan class for the periods presented:

	Number of Loans	Pre-Modification Recorded Investment	Post Modification Recorded Investment	Balance of Loans with Rate Reduction	Balance of Loans with Term Extension	Effect on Allowance for Loan Losses
	For the Three Months Ended September 30, 2018 (dollars in thousands)					
Manufactured housing	2	$ —	$ 166	$ 53	$ 166	$ 3
Total	2	$ —	$ 166	$ 53	$ 166	$ 3

	Number of Loans	Pre-Modification Recorded Investment	Post Modification Recorded Investment	Balance of Loans with Rate Reduction	Balance of Loans with Term Extension	Effect on Allowance for Loan Losses
	For the Nine Months Ended September 30, 2018 (dollars in thousands)					
Manufactured housing	12	$ 1,047	$ 1,213	$ 1,100	$ 1,213	$ 66
Commercial	3	1,781	1,781	—	1,781	—
Total	15	$ 2,828	$ 2,994	$ 1,100	$ 2,994	$ 66

	Number of Loans	Pre-Modification Recorded Investment	Post Modification Recorded Investment	Balance of Loans with Rate Reduction	Balance of Loans with Term Extension	Effect on Allowance for Loan Losses
	For the Three Months Ended September 30, 2017 (dollars in thousands)					
Manufactured housing	2	$ 363	$ 363	$ 363	$ 363	$ 24
Commercial	1	14	14	-	14	-
Total	3	$ 377	$ 377	$ 363	$ 377	$ 24

	Number of Loans	Pre-Modification Recorded Investment	Post Modification Recorded Investment	Balance of Loans with Rate Reduction	Balance of Loans with Term Extension	Effect on Allowance for Loan Losses
	For the Nine Months Ended September 30, 2017 (dollars in thousands)					
Manufactured housing	9	$ 807	$ 807	$ 807	$ 807	$ 45
Commercial	2	$ 102	$ 102	$ —	$ 102	$ 2
SBA	1	$ 17	$ 17	$ —	$ 17	$ 1
Total	12	$ 926	$ 926	$ 807	$ 926	$ 48

The average rate concessions were 50 basis points and 73 basis points, for the three and nine months ended September 30, 2018 and 100 basis points and 97 basis points for the three and nine months ended September 30, 2017, respectively. The average term extension in months was 180 and 151 for the three and nine months ended September 30, 2018 and 126 and 138 for the three and nine months ended September 30, 2017, respectively.

A TDR loan is deemed to have a payment default when the borrower fails to make - consecutive payments or the collateral is transferred to repossessed assets. The Company had no TDR's with payment defaults for the three or nine months ended September 30, 2018 or 2017.

At September 30, 2018 there were no material loan commitments outstanding on TDR loans.

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5. OTHER ASSETS ACQUIRED THROUGH FORECLOSURE

The following table summarizes the changes in other assets acquired through foreclosure:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
	(in thousands)			
Balance, beginning of period	$ 213	$ 362	$ 372	$ 137
Additions	—	132	174	502
Proceeds from dispositions	(213)	(60)	(484)	(303)
(Loss) gain on sales, net	—	52	(62)	150
Balance, end of period	$ —	$ 486	$ —	$ 486

6. FAIR VALUE MEASUREMENT

The Company uses fair value measurements to record fair value adjustments to certain assets and liabilities. FASB ASC 820, Fair Value Measurements and Disclosures ("ASC 820") established a framework for measuring fair value using a three-level valuation hierarchy for disclosure of fair value measurement. The valuation hierarchy is based upon the transparency of inputs to the valuation of an asset as of the measurement date. ASC 820 establishes a hierarchy for inputs used in measuring fair value that maximizes the use of observable inputs and minimizes the use of unobservable inputs by requiring that observable inputs be used when available. Observable inputs are inputs that market participants would use in pricing the asset or liability developed based on market data obtained from sources independent of the Company. Unobservable inputs are inputs that reflect the Company's assumptions about the factors market participants would consider in pricing the asset or liability developed based on the best information available in the circumstances. The hierarchy is broken down into three levels based on the reliability of inputs, as follows:

Level 1— Observable quoted prices in active markets that are accessible at the measurement date for identical, unrestricted assets or liabilities.

Level 2— Observable quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active, matrix pricing or model-based valuation techniques where all significant assumptions are observable, either directly or indirectly in the market.

Level 3— Model-based techniques where all significant assumptions are not observable, either directly or indirectly, in the market. These unobservable assumptions reflect management's estimates of assumptions that market participants would use in pricing the asset or liability. Valuation techniques may include use of discounted cash flow models and similar techniques.

The availability of observable inputs varies based on the nature of the specific financial instrument. To the extent that valuation is based on models or inputs that are less observable or unobservable in the market, the determination of fair value requires more judgment. Accordingly, the degree of judgment exercised by the Company in determining fair value is greatest for instruments categorized in Level 3. In certain cases, the inputs used to measure fair value may fall into different levels of the fair value hierarchy. In such cases, for disclosure purposes, the level in the fair value hierarchy within which the fair value measurement in its entirety falls is determined based on the lowest level input that is significant to the fair value measurement in its entirety.

Fair value is a market-based measure considered from the perspective of a market participant who holds the asset or owes the liability rather than an entity-specific measure. When market assumptions are available, ASC 820 requires the Company to make assumptions regarding the assumptions that market participants would use to estimate the fair value of the financial instrument at the measurement date.

FASB ASC 825, Financial Instruments ("ASC 825") requires disclosure of fair value information about financial instruments, whether or not recognized in the balance sheet, for which it is practicable to estimate that value.

Management uses its best judgment in estimating the fair value of the Company's financial instruments; however, there are inherent limitations in any estimation technique. Therefore, for substantially all financial instruments, the fair value estimates presented herein are not necessarily indicative of the amounts the Company could have realized in a sales transaction at September 30, 2018 and December 31, 2017. The estimated fair value amounts for September 30, 2018 and December 31, 2017 have been measured as of period-end, and have not been reevaluated or updated for purposes of these consolidated financial statements subsequent to those dates. As such, the estimated fair values of these financial instruments subsequent to the reporting date may be different than the amounts reported at the period-end.

This information should not be interpreted as an estimate of the fair value of the entire Company since a fair value calculation is only required for a limited portion of the Company's assets and liabilities.

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Due to the wide range of valuation techniques and the degree of subjectivity used in making the estimate, comparisons between the Company's disclosures and those of other companies or banks may not be meaningful.

The following tables summarize the fair value of assets measured on a recurring basis:

	Fair Value Measurements at the End of the Reporting Period Using:			
September 30, 2018	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Fair Value
Assets:	(in thousands)			
Investment securities available-for-sale	$ 144	$ 25,802	$ —	$ 25,946
Interest only strips	—	—	62	62
Servicing assets	—	—	56	56
	$ 144	$ 25,802	$ 118	$ 26,064

	Fair Value Measurements at the End of the Reporting Period Using:			
December 31, 2017	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Fair Value
Assets:	(in thousands)			
Investment securities available-for-sale	$ 156	$ 28,627	$ —	$ 28,783
Interest only strips	—	—	87	87
Servicing assets	—	—	97	97
	$ 156	$ 28,627	$ 184	$ 28,967

Market valuations of our investment securities which are classified as level 2 are provided by an independent third party. The fair values are determined by using several sources for valuing fixed income securities. Their techniques include pricing models that vary based on the type of asset being valued and incorporate available trade, bid and other market information. In accordance with the fair value hierarchy, the market valuation sources include observable market inputs and are therefore considered Level 2 inputs for purposes of determining the fair values.

On certain SBA loan sales, the Company retained interest only strip assets ('I/O strips") which represent the present value of excess net cash flows generated by the difference between (a) interest at the stated rate paid by borrowers and (b) the sum of (i) pass-through interest paid to third-party investors and (ii) contractual servicing fees. I/O strips are classified as Level 3 in the fair value hierarchy. The fair value is determined on a quarterly basis through a discounted cash flow analysis prepared by an independent third party using industry prepayment speeds. I/O strip valuation adjustments are recorded as additions or offsets to loan servicing income.

Historically, the Company has elected to use the amortizing method for the treatment of servicing assets and has measured for impairment on a quarterly basis through a discounted cash flow analysis prepared by an independent third party using industry prepayment speeds. In connection with the sale of certain SBA and USDA loans the Company recorded servicing assets and elected to measure those assets at fair value in accordance with ASC 825-10. Significant assumptions in the valuation of servicing assets include estimated loan repayment rates, the discount rate, and servicing costs, among others. Servicing assets are classified as Level 3 measurements due to the use of significant unobservable inputs, as well as significant management judgment and estimation.

The Company also has assets that under certain conditions are subject to measurement at fair value on a non-recurring basis. These assets include loans held for sale, foreclosed real estate and repossessed assets and certain loans that are considered impaired per generally accepted accounting principles.

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The following summarizes the fair value measurements of assets measured on a non-recurring basis:

		Fair Value Measurements at the End of the Reporting Period Using:		
	Total	Quoted Prices in Active Markets for Identical Assets (Level 1)	Active Markets for Similar Assets (Level 2)	Unobservable Inputs (Level 3)
	(in thousands)			
September 30, 2018:				
Impaired loans	$4,746	$ —	$ 4,746	$ —
Loans held for sale	51,558	—	51,558	—
Foreclosed real estate and repossessed assets	—	—	—	—
	$56,304	$ —	$ 56,304	$ —

		Fair Value Measurements at the End of the Reporting Period Using:		
	Total	Quoted Prices in Active Markets for Identical Assets (Level 1)	Active Markets for Similar Assets (Level 2)	Unobservable Inputs (Level 3)
	(in thousands)			
December 31, 2017:				
Impaired loans	$6,323	$ —	$ 6,323	$ —
Loans held for sale	56,222	—	56,222	—
Foreclosed real estate and repossessed assets	372	—	372	—
	$62,917	—	62,917	—

The Company records certain loans at fair value on a non-recurring basis. When a loan is considered impaired an allowance for a loan loss is established. The fair value measurement and disclosure requirement applies to loans measured for impairment using the practical expedients method permitted by accounting guidance for impaired loans. Impaired loans are measured at an observable market price, if available or at the fair value of the loan’s collateral, if the loan is collateral dependent. The fair value of the loan’s collateral is determined by appraisals or independent valuation. When the fair value of the loan’s collateral is based on an observable market price or current appraised value, given the current real estate markets, the appraisals may contain a wide range of values and accordingly, the Company classifies the fair value of the impaired loans as a non-recurring valuation within Level 2 of the valuation hierarchy. For loans in which impairment is determined based on the net present value of cash flows, the Company classifies these as a non-recurring valuation within Level 3 of the valuation hierarchy.

Foreclosed real estate and repossessed assets are carried at the lower of book value or fair value less estimated costs to sell. Fair value is based upon independent market prices obtained from certified appraisers or the current listing price, if lower. When the fair value of the collateral is based on a current appraised value, the Company reports the fair value of the foreclosed collateral as non-recurring Level 2. When a current appraised value is not available or if management determines the fair value of the collateral is further impaired, the Company reports the foreclosed collateral as non-recurring Level 3.

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FAIR VALUES OF FINANCIAL INSTRUMENTS

The estimated fair values of financial instruments have been determined by the Company using available market information and appropriate valuation methodologies. However, considerable judgment is required to interpret market data to develop 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. The use of different market assumptions and/or estimation methodologies may have a material effect on the estimated fair value amounts.

The estimated fair value of the Company's financial instruments are as follows:

	September 30, 2018				
	Carrying	Fair Value			
	Amount	Level 1	Level 2	Level 3	Total
Financial assets:	(in thousands)				
Cash and cash equivalents	$47,753	$47,753	$—	$—	$47,753
FRB and FHLB stock	4,087	—	4,087	—	4,087
Investment securities	33,421	144	33,197	—	33,341
Loans, net	745,222	—	725,139	14,076	739,215
Financial liabilities:					
Deposits	719,942	—	701,534	—	701,534
Other borrowings	50,000	—	49,799	—	49,799

	December 31, 2017				
	Carrying	Fair Value			
	Amount	Level 1	Level 2	Level 3	Total
Financial assets:	(in thousands)				
Cash and cash equivalents	$45,869	$45,869	$—	$—	$45,869
FRB and FHLB stock	3,720	—	3,720	—	3,720
Investment securities	36,348	156	36,298	—	36,454
Loans, net	726,189	—	705,723	13,779	719,502
Financial liabilities:					
Deposits	699,684	—	699,211	—	699,211
Other borrowings	56,843	—	56,842	—	56,842

The following methods and assumptions were used by the Company in estimating the fair value of its financial instruments:

Cash and cash equivalents

The carrying amounts reported in the consolidated balance sheets for cash and due from banks approximate their fair value.

Money market investments

The carrying amounts reported in the consolidated balance sheets for money market investments approximate their fair value.

Investment securities

The fair value of Farmer Mac class A stock is based on quoted market prices and are categorized as Level 1 of the fair value hierarchy.

The fair value of other investment securities were determined based on matrix pricing. Matrix pricing is a mathematical technique that utilizes observable market inputs including, for example, yield curves, credit ratings and prepayment speeds. Fair values determined using matrix pricing are generally categorized as Level 2 in the fair value hierarchy.

Federal Reserve Stock and Federal Home Loan Bank Stock

CWB is a member of the FHLB system and maintains an investment in capital stock of the FHLB. CWB also maintains an investment in capital stock of the Federal Reserve Bank ("FRB"). These investments are carried at cost since no ready market exists for them, and they have no quoted market value. The Company conducts a periodic review and evaluation of our FHLB stock to determine if any impairment exists. The fair values have been categorized as Level 2 in the fair value hierarchy.

Loans Held for Sale

Loans held for sale are carried at the lower of cost or fair value. The fair value of loans held for sale is based on what secondary markets are currently offering for portfolios with similar characteristics or based on the agreed-upon sale price. As such, the Company classifies the fair value of loans held for sale as a non-recurring valuation within Level 2 of the fair value hierarchy. At September 30, 2018 and December 31, 2017, the Company had loans held for sale with an aggregate carrying value of $50.9 million and $55.1 million respectively.

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Loans

Fair value of loans is estimated by calculating loan level fair values for all loans utilizing a discounted cash flow methodology incorporating "exit pricing" analytics in conformance with ASU 2016-01. All active loans were valued in the portfolio as of date of exercise, excluding any loans held for sale, and utilized assumptions such as probability of default, loss given default, recovery delay and prepayment assumptions. Fair value was calculated in accordance with ASC 820. The fair value for loans is categorized as Level 2 in the fair value hierarchy. Fair values of impaired loans using a discounted cash flow method to measure impairment have been categorized as Level 3.

Deposits

The amount payable at demand at report date is used to estimate the fair value of demand and savings deposits. The estimated fair values of fixed-rate time deposits are determined by discounting the cash flows of segments of deposits that have similar maturities and rates, utilizing a discount rate that approximates the prevailing rates offered to depositors as of the measurement date. The fair value measurement of deposit liabilities is categorized as Level 2 in the fair value hierarchy.

Federal Home Loan Bank advances and other borrowings

The fair values of the Company's borrowings are estimated using discounted cash flow analyses, based on the market rates for similar types of borrowing arrangements. The FHLB advances have been categorized as Level 2 in the fair value hierarchy.

Off-balance sheet instruments

Fair values for the Company's off-balance sheet instruments (lending commitments and standby letters of credit) are based on quoted fees currently charged to enter into similar agreements, taking into account the remaining terms of the agreements and the counterparties' credit standing.

There were no standby letters of credit outstanding at September 30, 2018 or at December 31, 2017. Unfunded loan commitments at September 30, 2018 and December 31, 2017 were $61.6 million and $68.8 million, respectively.

7. OTHER BORROWINGS

Federal Home Loan Bank Advances – The Company through the bank has a blanket lien credit line with the FHLB. FHLB advances are collateralized in the aggregate by CWB's eligible loans and securities. Total FHLB advances were $47.0 million and $50.0 million at September 30, 2018 and December 31, 2017, respectively, borrowed at fixed rates. The Company also had $125.0 million of letters of credit with FHLB at September 30, 2018 to secure public funds. At September 30, 2018, CWB had pledged to the FHLB, $33.3 million of securities and $239.0 million of loans. At September 30, 2018, CWB had $70.2 million available for additional borrowing. At December 31, 2017, CWB had pledged to the FHLB, $36.2 million of securities and $235.4 million of loans. At December 31, 2017, CWB had $56.8 million available for additional borrowing. Total FHLB interest expense for the three months ended September 30, 2018 and 2017 was $0.3 million and $0.1 million, respectively. Total FHLB interest expense for the nine months ended September 30, 2018 and 2017 was $0.7 million and $0.2 million, respectively.

Federal Reserve Bank – The Company has established a credit line with the FRB. Advances are collateralized in the aggregate by eligible loans for up to 28 days. There were no outstanding FRB advances as of September 30, 2018 and December 31, 2017. Available borrowing capacity was $105.1 million and $104.3 million as of September 30, 2018 and December 31, 2017, respectively.

Federal Funds Purchased Lines – The Company has federal funds borrowing lines at correspondent banks totaling $20.0 million. There was no amount outstanding as of September 30, 2018 and December 31, 2017.

Line of Credit - In July of 2017, the Company entered into a one-year revolving line of credit agreement for up to $15.0 million. The Company must maintain a compensating deposit with the lender of 25% of the outstanding principal balance in a non-interest-bearing deposit account which was $0.8 million at September 30, 2018. In addition, the Company must maintain a minimum debt service coverage ratio of 1.65, a minimum Tier 1 leverage ratio of 7.0% and a minimum total risked based capital ratio of 10.0%. At September 30, 2018, the line of credit balance was $3.0 million at a rate of 5.85%.

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8. STOCKHOLDERS' EQUITY

The following table summarizes the changes in other comprehensive income (loss) by component, net of tax for the period indicated:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
	Unrealized holding gains (losses) on AFS		Unrealized holding gains (losses) on AFS	
	(in thousands)			
Beginning balance	$(111)	$87	$ 25	$ (29)
Other comprehensive income before reclassifications	(48)	(17)	(125)	99
Amounts reclassified from accumulated other comprehensive income	—	—	(59)	—
Net current-period other comprehensive income	(48)	(17)	(184)	99
Ending Balance	$(159)	$70	$ (159)	$ 70

The adoption of ASU-2018-02 during the first quarter of 2018 created a $6,000 reclassification within accumulated other comprehensive income to retained earnings. The Company also recorded a $53,000 adjustment during the first quarter of 2018 from AOCI to retained earnings on adoption of ASU 2016-01.

Common Stock

On August 24, 2017, the Board of Directors extended the common stock repurchase program of up to $3.0 million for two additional years. Under this program the Company has repurchased 187,569 common stock shares for $1.4 million at an average price of $7.25 per share. There were no repurchases of common stock under this program during the three or nine months ended September 30, 2018.

During the three and nine months ended September 30, 2018, the Company paid common stock dividends of $0.4 million and $1.2 million, respectively. During the three and nine months ended September 30, 2017, the Company paid common stock dividends of $0.3 million and $0.9 million, respectively.

Common Stock Warrant

The Warrant issued as part of the TARP provides for the purchase of up to 521,158 shares of the common stock, at an exercise price of $4.49 per share ("Warrant Shares"). The Warrant is immediately exercisable and expires on December 19, 2018. The exercise price and the ultimate number of shares of common stock that may be issued under the Warrant are subject to certain anti-dilution adjustments, such as upon stock splits or distributions of securities or other assets to holders of the common stock, and upon certain issuances of the common stock at or below a specified price relative to the then current market price of the common stock. In the second quarter of 2013, the Treasury sold its warrant position to a private investor. Pursuant to the Securities Purchase Agreement, the private investor has agreed not to exercise voting power with respect to any Warrant Shares.

9. CAPITAL REQUIREMENT

The Federal Reserve has adopted capital adequacy guidelines that are used to assess the adequacy of capital in supervising a bank holding company. In July 2013, the federal banking agencies approved the final rules (“Final Rules”) to establish a new comprehensive regulatory capital framework with a phase-in period beginning January 1, 2015 and ending January 1, 2019. The Final Rules implement the third installment of the Basel Accords (“Basel III”) regulatory capital reforms and changes required by the Dodd-Frank Wall Street Reform and Consumer Protection Act (“Dodd-Frank Act”) and substantially amend the regulatory risk-based capital rules applicable to the Company. Basel III redefines the regulatory capital elements and minimum capital ratios, introduces regulatory capital buffers above those minimums, revises rules for calculating risk-weighted assets and adds a new component of Tier 1 capital called Common Equity Tier 1, which includes common equity and retained earnings and excludes preferred equity.

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The following tables illustrates the Bank's regulatory ratios and the Federal Reserve's current adequacy guidelines as of September 30, 2018 and December 31, 2017. The Federal Reserve's fully phased-in guidelines applicable in 2019 are also summarized.

	Total Capital (To Risk-Weighted Assets)		Tier 1 Capital (To Risk-Weighted Assets)		Common Equity Tier 1 (To Risk-Weighted Assets)		Leverage Ratio/Tier 1 Capital (To Average Assets)	
September 30, 2018								
CWB's actual regulatory ratios	10.78	%	9.63	%	9.63	%	8.22	%
Minimum capital requirements	8.00	%	6.00	%	4.50	%	4.00	%
Well-capitalized requirements	10.00	%	8.00	%	6.50	%	5.00	%
Minimum capital requirements including fully-phased in capital conservation buffer (2019)	10.50	%	8.50	%	7.00	%	N/A	

	Total Capital (To Risk-Weighted Assets)		Tier 1 Capital (To Risk-Weighted Assets)		Common Equity Tier 1 (To Risk-Weighted Assets)		Leverage Ratio/Tier 1 Capital (To Average Assets)	
December 31, 2017								
CWB's actual regulatory ratios	11.31	%	10.10	%	10.10	%	8.83	%
Minimum capital requirements	8.00	%	6.00	%	4.50	%	4.00	%
Well-capitalized requirements	10.00	%	8.00	%	6.50	%	5.00	%
Minimum capital requirements including fully-phased in capital conservation buffer (2019)	10.50	%	8.50	%	7.00	%	N/A	

The Company has evaluated the impact of the Final Rules and believes that, as of September 30, 2018, the Company would meet all capital adequacy requirements under the Basel III capital rules on a fully phased-in basis as if all such requirements were currently in effect. There are no conditions or events since September 30, 2018 that management believes have changed the Company's or the Bank's risk-based capital category.

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10. REVENUE RECOGNITION

The Company adopted ASU No, 2014-09 “Revenue from Contracts with Customers” (Topic 606) and all subsequent ASUs that modified Topic 606 on January 1, 2018. The implementation of the new standard did not have a material impact on the measurement or recognition of revenue; as such, a cumulative effect adjustment to opening retained earnings was not deemed necessary. Results for reporting periods beginning after January 1, 2018 are presented under Topic 606, while prior period amounts were not adjusted and continue to be reported in accordance with our historic accounting under Topic 605.

Topic 606 does not apply to revenue associated with financial instruments, including revenue from loans and securities. In addition, certain non-interest income streams such as servicing rights, financial guarantees and certain credit card fees are also not in scope of the new guidance. Topic 606 is applicable to non-interest income streams such as deposit related fees, interchange fees and merchant income. However the recognition of these income streams did not change upon the adoption of Topic 606. Substantially all of the Company’s revenue is generated from contracts with customers. Non-interest revenue streams in-scope of Topic 606 are discussed below.

Service Charges on Deposit Accounts

Service charges on deposit accounts consist of monthly service fees, check orders, account analysis fees, and other deposit account related fees. The Company’s performance obligation for monthly service fees and account analysis fees is generally satisfied, and the related income recognized, over the period in which the service is provided. Check orders and other deposit related fees are largely transactional based and therefore, the Company’s performance obligation is satisfied and related income recognized, at a point in time. Payment for service charges on deposit accounts is primarily received immediately or in the following month through a direct charge to customers’ accounts.

Exchange Fees and Other Service Charges

Exchange fees and other service charges are primarily comprised of debit and credit card income, merchant services income, ATM fees and other service charges. Debit and credit card income is primarily comprised of interchange fees earned whenever the Company’s debit and credit cards are processed through card payment networks such as Visa or MasterCard. Merchant services income is primarily fees charged to merchants to process their debit and credit card transactions. ATM fees are primarily generated when a Company cardholder uses a non-Company ATM or a non-Company cardholder uses a Company ATM. Other service charges include fees from processing wire transfers, cashier’s checks and other services. The Company’s performance obligation for exchange and other service charges are largely satisfied, and related revenue recognized, when the services are rendered or upon completion. Payment is typically received immediately or in the following month.

The following table presents non-interest income, segregated by revenue streams in-scope and out-of-scope of Topic 606, for periods indicated.

Non-interest income	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
In-scope of Topic 606:	(in thousands)			
Service charges on deposit accounts	$ 95	$ 89	$ 281	$ 248
Exchange fees and other service charges	43	46	142	113
Non-interest income (in-scope of Topic 606)	138	135	423	361
Non-interest income (out-of-scope of Topic 606)	503	581	1,545	1,693

	$ 641	$ 716	$ 1,968	$ 2,054

Contract Balances

A contract asset balance occurs when an entity performs a service for a customer before the customer pays consideration (resulting in a contract receivable) or before payment is due (resulting in a contract asset). A contract liability balance is an entity's obligation to transfer a service to a customer for which the entity has already received payment (or payment is due) from the customer. The Company's non-interest income streams are largely based on transactional activity. Consideration is often received immediately or shortly after the Company satisfies its performance obligation and income is recognized. The Company does not typically enter into long-term revenue contracts with customers, and therefore, does not experience significant contract balances. As of September 30, 2018 and December 31, 2017, the Company did not have any signficant contract balances.

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Contract Acquisition Costs

In connection with the adoption of Topic 606, an entity is required to capitalize, and subsequently amortize into expense, certain incremental costs of obtaining a contract with a customer if these costs are expected to be recovered. The incremental costs of obtaining a contract are those costs that an entity incurs to obtain a contract with a customer that it would not have incurred if the contract had not been obtained. The Company utilizes the practical expedient which allows entities to immediately expense contract acquisition costs when the asset that would have resulted from capitalizing these costs would have been amortized in one year or less. Upon adoption of Topic 606, the Company did not capitalize any contract acquisition cost.

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

This discussion is designed to provide insight into management's assessment of significant trends related to the Company's consolidated financial condition, results of operations, liquidity, capital resources and interest rate sensitivity. It should be read in conjunction with the Company's unaudited interim consolidated financial statements and notes thereto included herein and the audited consolidated financial statements and notes thereto included in the Company's Annual Report on Form 10-K for the year ended December 31, 2017, and the other financial information appearing elsewhere in this report.

Forward Looking Statements

This report contains certain forward-looking statements, within the meaning of Section 27A of the Securities Act and Section 21E of the Securities Exchange Act of 1934, which are intended to be covered by the safe harbor for "forward-looking statements" provided by the Private Securities Litigation Reform Act of 1995. These statements may include statements that expressly or implicitly predict future results, performance or events. Statements other than statements of historical fact are forward-looking statements. In addition, the words "anticipates," "expects," "believes," "estimates" and "intends" or the negative of these terms or other comparable terminology constitute "forward-looking statements." Forward-looking statements relate to expectations, beliefs, projections, future plans and strategies, anticipated events or trends and similar expressions concerning matters that are not historical facts. Except as required by law, the Company disclaims any obligation to update any such forward-looking statements or to publicly announce the results of any revisions to any of the forward-looking statements contained herein to reflect future events or developments.

Forward-looking statements contained in this Quarterly Report on Form 10-Q involve substantial risks and uncertainties, many of which are difficult to predict and are generally beyond the control of the Company and may cause our actual results to differ significantly from historical results and those expressed in any forward-looking statement. Risks and uncertainties include those set forth in our filings with the Securities and Exchange Commission and the following factors that could cause actual results to differ materially from those presented:

- general economic conditions, either nationally or locally in some or all areas in which business is conducted, or conditions in the real estate or securities markets or the banking industry which could affect liquidity in the capital markets, the volume of loan origination, deposit flows, real estate values, the levels of non-interest income and the amount of loan losses;
- changes in existing loan portfolio composition and credit quality, and changes in loan loss requirements;
- legislative or regulatory changes which may adversely affect the Company's business;
- the water shortage in certain areas of California and its impact on the economy;
- the Company's success in implementing its new business initiatives, including expanding its product line, adding new branches and successfully building its brand image;

- changes in interest rates which may reduce or increase net interest margin and net interest income;
- increases in competitive pressure among financial institutions or non-financial institutions;
- technological changes which may be more difficult to implement or more expensive than anticipated;
- changes in borrowing facilities, capital markets and investment opportunities which may adversely affect the business;
- changes in accounting principles, policies or guidelines which may cause conditions to be perceived differently;
- litigation or other matters before regulatory agencies, whether currently existing or commencing in the future, which may delay the occurrence or non-occurrence of events longer than anticipated;
- the ability to originate loans with attractive terms and acceptable credit quality;
- the ability to attract and retain key members of management;
- the ability to realize cost efficiencies; and
- a failure or breach of our operational or security systems or infrastructure.

For additional information regarding risks that may cause our actual results to differ materially from any forward-looking statements, see “Risk Factors” in our Annual Report on Form 10-K for the year ended December 31, 2017 and in item 1A of Part II of this Quarterly Report.

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Financial Overview and Highlights

Community West Bancshares (“CWBC”) incorporated under the laws of the state of California, is a bank holding company headquartered in Goleta, California providing full service banking and lending through its wholly-owned subsidiary Community West Bank (“CWB” or the “Bank”), which has eight California branch banking offices in Goleta, Ventura, Santa Maria, Santa Barbara, Westlake Village, San Luis Obispo, Oxnard, and Paso Robles. These entities are collectively referred to herein as the “Company”.

Financial Result Highlights for the Third Quarter of 2018

Net income of $2.4 million, or $0.27 per diluted share in the third quarter of 2018 (3Q18) compared to a net income of $1.6 million or $0.18 per diluted share in the third quarter a year ago (3Q17).

The significant factors impacting the Company’s third quarter earnings performance were:

- Net income of $2.4 million in 3Q18 compared to $1.6 million in 3Q17.
- Net interest margin for 3Q18 was 4.02% compared to 4.27% in 3Q17.
- Total loans increased $19.0 million to $745.2 million at September 30, 2018 compared to $726.2 million at December 31, 2017.
- Total deposits increased $20.2 million to $719.9 million at September 30, 2018, compared to $699.7 at December 31, 2017.
- Allowance for loan losses was $8.5 million at September 30, 2018, or 1.21% of total loans held for investment compared to 1.24% at December 31, 2017 and 1.25% at September 30, 2017.

The impact to the Company from these items, and others of both a positive and negative nature, will be discussed in more detail as they pertain to the Company’s overall comparative performance for the three and nine months ended September 30, 2018 throughout the analysis sections of this report.

Critical Accounting Policies

A number of critical accounting policies are used in the preparation of the Company’s consolidated financial statements. These policies relate to areas of the financial statements that involve estimates and judgments made by management. These include provision and allowance for loan losses and investment securities. These critical accounting policies are discussed in the Company’s Annual Report on Form 10-K for the fiscal year ended December 31, 2017 with a description of how the estimates are determined and an indication of the consequences of an over or under estimate.

RESULTS OF OPERATIONS

A summary of our results of operations and financial condition and select metrics is included in the following table:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
	(in thousands, except per share amounts)			

Net income	$2,369		$1,554		$6,050		$4,466	
Basic earnings per share	0.29		0.19		0.73		0.55	
Diluted earnings per share	0.27		0.18		0.69		0.52	
Total assets	854,709		829,150		854,709		829,150	
Total loans	745,222		714,383		745,222		714,383	
Total deposits	719,942		697,154		719,942		697,154	
Total stockholders' equity	75,557		69,766		75,557		69,766	
Book value per common share	9.13		8.54		9.13		8.54	
Net interest margin	4.02	%	4.27	%	4.11	%	4.36	%
Return on average assets	1.08	%	0.78	%	0.96	%	0.79	%
Return on average stockholders' equity	12.57	%	8.88	%	11.07	%	8.80	%

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The following table sets forth a summary financial overview for the comparable three and nine months ended September 30, 2018 and 2017:

	Three Months Ended September 30,		Increase	Nine Months Ended September 30,		Increase
	2018	2017	(Decrease)	2018	2017	(Decrease)
	(in thousands, except per share amounts)					
Consolidated Income Statement Data:						
Interest income	$11,201	$9,695	$ 1,506	$31,590	$27,464	$ 4,126
Interest expense	2,573	1,319	1,254	6,301	3,278	3,023
Net interest income	8,628	8,376	252	25,289	24,186	1,103
Credit (provision) for loan losses	(197)	159	(356)	(224)	423	(647)
Net interest income after provision for loan losses	8,825	8,217	608	25,513	23,763	1,750
Non-interest income	641	716	(75)	1,968	2,054	(86)
Non-interest expenses	6,402	6,387	15	19,192	18,317	875
Income before income taxes	3,064	2,546	518	8,289	7,500	789
Provision for income taxes	695	992	(297)	2,239	3,034	(795)
Net income	$2,369	$1,554	$ 815	$6,050	$4,466	$ 1,584
Income per share - basic	$0.29	$0.19	$ 0.10	$0.73	$0.55	$ 0.18
Income per share - diluted	$0.27	$0.18	$ 0.09	$0.69	$0.52	$ 0.17

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Interest Rates and Differentials

The following table illustrates average yields on interest-earning assets and average rates on interest-bearing liabilities for the periods indicated:

	Three Months Ended September 30,					
	2018			2017		
	Average Balance	Interest	Average Yield/Cost(2)	Average Balance	Interest	Average Yield/Cost(2)
Interest-Earning Assets	(in thousands)					
Federal funds sold and interest-earning deposits	$59,087	$229	1.54 %	$27,787	$77	1.10 %
Investment securities	37,850	360	3.77 %	42,382	278	2.60 %
Loans (1)	755,146	10,612	5.58 %	708,244	9,340	5.23 %
Total earnings assets	852,083	11,201	5.22 %	778,413	9,695	4.94 %
Nonearning Assets						
Cash and due from banks	2,824			2,419		
Allowance for loan losses	(8,589)			(8,159)		
Other assets	20,856			19,606		
Total assets	$867,174			$792,279		
Interest-Bearing Liabilities						
Interest-bearing demand deposits	271,314	617	0.90 %	265,546	294	0.44 %
Savings deposits	14,303	32	0.89 %	14,266	29	0.81 %
Time deposits	339,405	1,573	1.84 %	294,385	862	1.16 %
Total interest-bearing deposits	625,022	2,222	1.41 %	574,197	1,185	0.82 %
Other borrowings	49,831	351	2.79 %	29,677	134	1.79 %
Total interest-bearing liabilities	674,853	2,573	1.51 %	603,874	1,319	0.87 %
Noninterest-Bearing Liabilities						
Noninterest-bearing demand deposits	109,369			113,598		
Other liabilities	8,153			5,369		
Stockholders' equity	74,799			69,438		
Total Liabilities and Stockholders' Equity	$867,174			$792,279		
Net interest income and margin (3)		$8,628	4.02 %		$8,376	4.27 %
Net interest spread (4)			3.71 %			4.07 %

(1) Includes nonaccrual loans.
(2) Annualized.
(3) Net interest margin is computed by dividing net interest income by total average earning assets.
(4) Net interest spread represents average yield earned on interest-earning assets less the average rate paid on interest-bearing liabilities.

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	Nine Months Ended September 30,					
	2018			2017		
	Average Balance	Interest	Average Yield/Cost(2)	Average Balance	Interest	Average Yield/Cost(2)
Interest-Earning Assets	(in thousands)					
Federal funds sold and interest-earning deposits	$37,476	$418	1.49 %	$23,827	$162	0.91 %
Investment securities	38,613	889	3.08 %	39,717	732	2.46 %
Loans (1)	747,518	30,283	5.42 %	677,445	26,570	5.24 %
Total earnings assets	823,607	31,590	5.13 %	740,989	27,464	4.96 %
Nonearning Assets						
Cash and due from banks	3,294			2,275		
Allowance for loan losses	(8,513)			(7,870)		
Other assets	20,567			18,746		
Total assets	$838,955			$754,140		
Interest-Bearing Liabilities						
Interest-bearing demand deposits	264,994	1,412	0.71 %	260,754	790	0.41 %
Savings deposits	14,339	92	0.86 %	14,154	83	0.78 %
Time deposits	323,050	3,869	1.60 %	273,979	2,111	1.03 %
Total interest-bearing deposits	602,383	5,373	1.19 %	548,887	2,984	0.73 %
Other borrowings	44,828	928	2.77 %	27,660	294	1.42 %
Total interest-bearing liabilities	647,211	6,301	1.30 %	576,547	3,278	0.76 %
Noninterest-Bearing Liabilities						
Noninterest-bearing demand deposits	111,407			104,998		
Other liabilities	7,250			4,704		
Stockholders' equity	73,087			67,891		
Total Liabilities and Stockholders' Equity	$838,955			$754,140		
Net interest income and margin (3)		$25,289	4.11 %		$24,186	4.36 %
Net interest spread (4)			3.83 %			4.20 %

(1) Includes nonaccrual loans.
(2) Annualized.
(3) Net interest margin is computed by dividing net interest income by total average earning assets.
(4) Net interest spread represents average yield earned on interest-earning assets less the average rate paid on interest-bearing liabilities.

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The table below sets forth the relative impact on net interest income of changes in the volume of earning assets and interest-bearing liabilities and changes in rates earned and paid by the Company on such assets and liabilities. For purposes of this table, nonaccrual loans have been included in the average loan balances.

	Three Months Ended September 30, 2018 versus 2017 Increase (Decrease) Due to Changes in (1)			Nine Months Ended September 30, 2018 versus 2017 Increase (Decrease) Due to Changes in (1)		
	Volume	Rate	Total	Volume	Rate	Total
	(in thousands)			(in thousands)		
Interest income:						
Federal funds sold and interest-earning deposits	$ 121	$ 31	$ 152	$ 152	$ 104	$ 256
Investment securities	(43)	125	82	(25)	182	157
Loans, net	660	612	1,272	2,841	872	3,713
Total interest income	738	768	1,506	2,968	1,158	4,126
Interest expense:						
Interest-bearing demand deposits	13	310	323	23	599	622
Savings deposits	—	3	3	1	8	9
Time deposits	209	502	711	587	1,171	1,758
Short-term borrowings	142	75	217	356	278	634
Total interest expense	364	890	1,254	967	2,056	3,023
Net increase	$ 374	$ (122)	$ 252	$ 2,001	$ (898)	$ 1,103

(1) Changes due to both volume and rate have been allocated to volume changes.

Comparison of interest income, interest expense and net interest margin

The Company's primary source of revenue is interest income. Interest income for the three and nine months ended September 30, 2018 was $11.2 million and $31.6 million, respectively, compared to $9.7 million and $27.5 million for the three and nine months ended September 30, 2017. Total interest income in the third quarter of 2018 benefited from loan growth of $30.8 million compared to the third quarter of 2017. Interest income from interest-bearing deposits in other institutions increased primarily due to an increased average balance held with the Federal Reserve Bank during the third quarter of 2018 compared to 2017. The annualized yield on interest-earning assets for the third quarter 2018 compared to 2017 was 5.22% and 4.94%, respectively. Fed rate increases of 25 basis points each in December 2017, March 2018, June 2018, and September 2018 were partially responsible for the increased yield on interest-earning assets, primarily through the loan portfolio.

Interest expense for the three and nine months ended September 30, 2018 compared to 2017 increased by $1.3 million and $3.0 million, respectively. This increase for the comparable periods was primarily due to increased time deposit balances, repricing of maturing time deposits, increase in interest-bearing demand deposits costs, and increased cost of borrowings. The annualized average cost of interest-bearing liabilities increased by 64 basis points to 1.51% for the three months ended September 30, 2018 compared to the same period in 2017. The increase in deposit interest expense for the nine months ended September 30, 2018 compared to 2017 was due to both growth in interest bearing certificates of deposits and increased average cost of those deposits due to the 100 basis points of Federal Reserve rate increases. The cost of other borrowings for the comparable periods increased by 100 basis points to 2.79% for the three months ended September 30, 2018 compared to the same period in 2017 due to the increased use of longer term FHLB borrowings to manage interest rate risk.

The net impact of the changes in yields on interest-earning assets and the rates paid on interest-bearing liabilities were decreases in the interest margin for the three and nine months ended September 30, 2018 to 4.02% and 4.11%, respectively, compared to 4.27% and 4.36% in the three and nine months ended September 30, 2017, respectively.

Provision for loan losses

The provision for loan losses in each period is reflected as a charge against earnings in that period. The provision for loan losses is equal to the amount required to maintain the allowance for loan losses at a level that is adequate to absorb probable losses inherent in the loan portfolio. The provision (credit) for loan losses was $(0.2) million and $0.2 million for the third quarter of 2018 and 2017, respectively. The provision (credit) for the nine months ended September 30, 2018 was $(0.2) million compared to $0.4 million for the nine months ended September 30, 2017. The improvements in credit quality, historical loss rates and net recoveries resulted in the decrease in the ratio of allowance for loan losses to loans held for investment from 1.25% at September 30, 2017 to 1.21% at September 30, 2018.

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The following schedule summarizes the provision, charge-offs (recoveries) by loan category for the three and nine months ended September 30, 2018 and 2017:

For the Three Months Ended September 30,

	Manufactured Housing	Commercial Real Estate	Commercial	SBA	HELOC	Single Family Real Estate	Consumer	Total
2018	(in thousands)							
Beginning balance	$2,145	$ 5,007	$ 1,221	$57	$ 93	$ 99	$ —	$8,622
Charge-offs	—	—	—	—	—	—	—	—
Recoveries	6	—	19	34	35	—	—	94
Net (charge-offs) recoveries	6	—	19	34	35	—	—	94
Provision (credit)	17	(134)	4	(38)	(36)	(10)	—	(197)
Ending balance	$2,168	$ 4,873	$ 1,244	$53	$ 92	$ 89	$ —	$8,519
2017								
Beginning balance	$2,124	$ 4,332	$ 1,262	$91	$ 98	$ 87	$ —	$7,994
Charge-offs	—	—	—	—	—	(33)	—	(33)
Recoveries	38	—	43	104	7	—	—	192
Net (charge-offs) recoveries	38	—	43	104	7	(33)	—	159
Provision (credit)	(15)	359	(100)	(108)	(11)	34	—	159
Ending balance	$2,147	$ 4,691	$ 1,205	$87	$ 94	$ 88	$ —	$8,312

For the Nine Months Ended September 30,

	Manufactured Housing	Commercial Real Estate	Commercial	SBA	HELOC	Single Family Real Estate	Consumer	Total
2018	(in thousands)							
Beginning balance	$2,180	$ 4,844	$ 1,133	$73	$ 92	$ 98	$ —	$8,420
Charge-offs	(6)	—	—	—	—	—	—	(6)
Recoveries	114	15	43	102	54	1	—	329
Net (charge-offs) recoveries	108	15	43	102	54	1	—	323
Provision (credit)	(120)	14	68	(122)	(54)	(10)	—	(224)
Ending balance	$2,168	$ 4,873	$ 1,244	$53	$ 92	$ 89	$ —	$8,519
2017								
Beginning balance	$2,201	$ 3,707	$ 1,241	$106	$ 100	$ 109	$ —	$7,464
Charge-offs	(119)	—	—	(30)	—	(54)	—	(203)
Recoveries	105	227	116	168	11	1	—	628
Net (charge-offs) recoveries	(14)	227	116	138	11	(53)	—	425
Provision (credit)	(40)	757	(152)	(157)	(17)	32	—	423
Ending balance	$2,147	$ 4,691	$ 1,205	$87	$ 94	$ 88	$ —	$8,312

The percentage of net nonaccrual loans to the total loan portfolio has decreased to 0.50% as of September 30, 2018 from 0.61% at December 31, 2017.

The allowance for loan losses compared to net nonaccrual loans has increased to 226.9% as of September 30, 2018 from 188.3% as of December 31, 2017. Total past due loans increased to $1.8 million as of September 30, 2018 from $0.4 million as of December 31, 2017. This increase was primarily from one $1.3 million commercial real estate loan.

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Non-Interest Income

The Company earned non-interest income primarily through fees related to services provided to loan and deposit customers.

The following table summarizes the Company's non-interest income for the periods indicated:

	Three Months Ended September 30,		Increase	Nine Months Ended September 30,		Increase
	2018	2017	(Decrease)	2018	2017	(Decrease)
	(in thousands)					
Other loan fees	$379	$354	$ 25	$ 998	$ 999	$ (1)
Document processing fees	120	146	(26)	367	430	(63)
Service charges	113	118	(5)	351	326	25
Other	29	98	(69)	252	299	(47)
Total non-interest income	$641	$716	$ (75)	$ 1,968	$ 2,054	$ (86)

Total non-interest income decreased slightly to $0.6 million for the three months ended September 30, 2018 compared to 2017. Document processing fees for the three months ended September 30, 2018 were lower due to decreased loan originations compared to the same period in 2017. Other fees decreased during the three months ended September 30, 2018 compared to the three months ended September 30, 2017 primarily due to a $34,000 mark-down on securities held at fair value.

Total non-interest income decreased slightly to $2.0 million for the nine months ended September 30, 2018 compared to 2017. Document processing fees for the nine months ended September 30, 2018 were lower due to decreased loan originations compared to the nine months ended September 30, 2017. Other fees decreased during the nine months ended September 30, 2018 compared to the nine months ended September 30, 2017 primarily due to reduced loan servicing fees of $54,000.

Non-Interest Expenses

The following table summarizes the Company's non-interest expenses for the periods indicated:

	Three Months Ended September 30,		Increase	Nine Months Ended September 30,		Increase
	2018	2017	(Decrease)	2018	2017	(Decrease)
	(in thousands)					
Salaries and employee benefits	$4,147	$3,839	$ 308	$ 12,338	$ 11,566	$ 772
Occupancy, net	778	754	24	2,303	2,085	218
Professional services	326	281	45	931	759	172
Data processing	201	192	9	619	525	94
Depreciation	199	168	31	552	519	33
FDIC assessment	169	172	(3)	547	461	86
Advertising and marketing	154	137	17	487	488	(1)
Stock based compensation	81	283	(202)	284	454	(170)

Other	347	561	(214)	1,131	1,460	(329)
Total non-interest expenses	$6,402	$6,387	$ 15	$19,192	$18,317	$ 875

Total non-interest expenses remained unchanged between the three months ended September 30, 2018 and 2017, and increased $0.9 million in the nine months ended September 30, 2018 compared to 2017, respectively. The increase in non-interest expenses for the year to date 2018 is primarily due to increased salaries and employee benefits, and occupancy as a result of the Bank's expansions in the Northern and Southern regions, and addition of customer relationship and support positions. FDIC assessment increased $0.1 million the nine months ended September 30, 2018 compared to 2017 due to a higher asset base for assessment and increased assessment factor. Professional services increased $0.2 million in the nine months ended September 30, 2018 compared to 2017 due to increased consulting costs for operational training and project implementation. Stock based compensation decreased $0.2 million for the three and nine months ended September 30, 2018 compared to 2017 due to $0.2 million of non-qualified stock options granted during the third quarter 2017. The decrease in other expenses were mainly due to higher loan origination cost deferrals during the nine months ended September 30, 2018 compared to 2017.

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Income Taxes

Income tax provision for the three and nine months ended September 30, 2018 was $0.7 million and $2.2 million, respectively, compared to $1.0 million and $3.0 million in the same periods during 2017. The combined state and federal effective income tax rates for the nine months ended September 30, 2018 and 2017 were 27.0% and 40.5%, respectively. The effective tax rate decreased in 2018 primarily as a result of the enacted tax rate change from 34% to 21% under the Tax Cuts and Jobs Act of December 2017.

Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts and their respective tax basis including operating losses and tax credit carryforwards. Net deferred tax assets of $3.2 million at September 30, 2018 are reported in the consolidated balance sheet as a component of total assets.

Accounting standards Codification Topic 740, Income Taxes, requires that companies assess whether a valuation allowance should be established against their deferred tax assets based on the consideration of all available evidence using a “more likely than not” standard.

A valuation allowance is established for deferred tax assets if, based on weight of available evidence, it is more likely than not that some portion or all of the deferred tax assets may not be realized. Management evaluates the Company’s deferred tax assets for recoverability using a consistent approach which considers the relative impact of negative and positive evidence, including the Company’s historical profitability and projections of future taxable income. The Company is required to establish a valuation allowance for deferred tax assets and record a charge to income if management determines, based on available evidence at the time the determination is made, that it is more likely than not that some portion or all of the deferred tax assets may not be realized.

There was no valuation allowance on deferred tax assets at September 30, 2018 or December 31, 2017.

The Company is subject to the provisions of ASC 740, Income Taxes (ASC 740). ASC 740 prescribes a more likely than not threshold for the financial statement recognition of uncertain tax positions. ASC 740 clarifies the accounting for income taxes by prescribing a minimum recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. On a quarterly basis, the Company undergoes a process to evaluate whether income tax accruals are in accordance with ASC 740 guidance on uncertain tax positions. There were no uncertain tax positions at September 30, 2018 and December 31, 2017.

BALANCE SHEET ANALYSIS

Total assets increased $21.4 million to $854.7 million at September 30, 2018 from $833.3 million at December 31, 2017. Net loans increased by $19.0 million to $745.2 million at September 30, 2018 from $726.2 million at December 31, 2017. The majority of the loan increase was due to increases of $8.0 million and $16.9 million in our commercial and manufactured housing portfolios, respectively. This increase was partially offset by a decrease of $3.0 million in investment securities available-for-sale.

Total liabilities increased $15.9 million to $779.2 million at September 30, 2018 from $763.2 million at December 31, 2017 mostly due to increased total deposits of $20.3 million. Non-interest-bearing demand deposits decreased by $2.9 million and interest-bearing demand deposits increased by $10.3 million, while certificates of deposit increased $12.5 million due to a certificate of deposit promotion that ran during the third quarter of 2018.

Total stockholders’ equity increased $5.5 million to $75.6 million at September 30, 2018 from $70.1 million at December 31, 2017. The $6.1 million increase in retained earnings from net income was offset by a $1.2 million decrease from common stock dividends. The book value per common share was $9.13 at September 30, 2018 compared to $8.55 at December 31, 2017.

Selected Balance Sheet Accounts

	September 30, 2018	December 31, 2017	Increase (Decrease)	Percent Increase (Decrease)
	(dollars in thousands)			
Cash and cash equivalents	$47,753	$ 45,869	$ 1,884	4.1 %
Investment securities available-for-sale	25,802	28,783	(2,981)	(10.4)%
Investment securities held-to-maturity	7,475	7,565	(90)	(1.2)%
Loans - held for sale	50,944	55,094	(4,150)	(7.5)%
Loans - held for investment, net	694,278	671,095	23,183	3.5 %
Total assets	854,709	833,315	21,394	2.6 %
Total deposits	719,942	699,684	20,258	2.9 %
Other borrowings	50,000	56,843	(6,843)	(12.0)%
Total stockholder's equity	75,557	70,070	5,487	7.8 %

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The table below summarizes the distribution of the Company's loans held for investment at the end of each of the periods indicated.

	September 30, 2018	December 31, 2017
	(in thousands)	
Manufactured housing	$240,010	$ 223,115
Commercial real estate	353,136	354,617
Commercial	83,328	75,282
SBA	6,131	7,424
HELOC	9,446	9,422
Single family real estate	11,153	10,346
Consumer	73	83
	703,277	680,289
Allowance for loan losses	(8,519)	(8,420)
Deferred costs, net	(402)	(652)
Discount on SBA loans	(78)	(122)
Total loans held for investment, net	$694,278	$ 671,095

The Company had $50.9 million of loans held for sale at September 30, 2018 compared to $55.1 million at December 31, 2017. Loans held for sale at September 30, 2018 consisted of $15.0 million SBA loans and $35.9 million commercial agriculture loans. Loans held for sale at December 31, 2017, were $18.9 million SBA loans and $36.2 million commercial agriculture loans.

Concentrations of Lending Activities

The Company's lending activities are primarily driven by the customers served in the market areas where the Company has branch offices in the Central Coast of California. The Company monitors concentrations within selected categories such as geography and product. The Company originates manufactured housing, commercial, SBA, construction, real estate and consumer loans to customers through branch offices located in the Company's primary markets. The Company's business is concentrated in these areas and the loan portfolio includes significant credit exposure to the manufactured housing and commercial real estate markets of these areas. As of September 30, 2018 and December 31, 2017, manufactured housing loans comprised 32.2% and 30.7%, respectively, of total loans. As of September 30, 2018 and December 31, 2017, commercial real estate loans accounted for approximately 47.4% and 48.8% of total loans, respectively. Approximately 34.1% and 33.9% of these commercial real estate loans were owner-occupied at September 30, 2018 and December 31, 2017, respectively. Substantially all of these loans are secured by first liens with an average loan to value ratios of 55.0% at September 30, 2018 and December 31, 2017. The Company was within established concentration policy limits at September 30, 2018 and December 31, 2017.

Asset Quality

For all banks and bank holding companies, asset quality plays a significant role in the overall financial condition of the institution and results of operations. The Company measures asset quality in terms of nonaccrual loans as a percentage of gross loans, and net charge-offs as a percentage of average loans. Net charge-offs are calculated as the difference between charged-off loans and recovery payments received on previously charged-off loans.

December 31,

	September 30, 2018	2017
	(in thousands)	
Nonaccrual loans (net of government guaranteed portion)	$3,755	$ 4,472
Troubled debt restructured loans, gross	17,644	16,603
Nonaccrual loans (net of government guaranteed portion) to gross loans	0.50 %	0.93 %
Net charge-offs (recoveries) (annualized) to average loans	(0.05)%	(0.03)%
Allowance for loan losses to nonaccrual loans (net of government guaranteed portion)	226.87 %	314.27 %
Allowance for loan losses to gross loans	1.21 %	1.24 %

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The following table reflects the recorded investment in certain types of loans at the dates indicated:

	September 30, 2018	December 31, 2017
	(in thousands)	
Total nonaccrual loans	$5,710	$ 6,844
Government guaranteed portion of loans included above	(1,955)	(2,372)
Total nonaccrual loans, without guarantees	$3,755	$ 4,472
Troubled debt restructured loans, gross	$17,644	$ 16,603
Loans 30 through 89 days past due with interest accruing	$1,822	$ 389
Loans 90 days or more past due with interest accruing	$25	$ —
Allowance for loan losses to gross loans held for investment	1.21 %	1.24 %

Impaired loans

A loan is considered impaired when, based on current information, it is probable that the Company will be unable to collect the scheduled payments of principal and/or interest under 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/or interest payments. Loans that experience insignificant payment delays or payment shortfalls generally are not classified as impaired. Management determines the significance of payment delays or payment shortfalls on a case-by-case basis. When determining the possibility of impairment, management considers 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. For collateral-dependent loans, the Company uses the fair value of collateral method to measure impairment. All other loans are measured for impairment based on the present value of future cash flows. Impairment is measured on a loan-by-loan basis for all loans in the portfolio.

A loan is considered a troubled debt restructured loan (“TDR”) when concessions have been made to the borrower and the borrower is in financial difficulty. These concessions include but are not limited to term extensions, rate reductions and principal reductions. Forgiveness of principal is rarely granted and modifications for all classes of loans are predominantly term extensions. TDR loans are also considered impaired.

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The following schedule summarizes impaired loans and specific reserves by loan class as of the periods indicated:

	Manufactured Housing	Commercial Real Estate	Commercial	SBA	HELOC	Single Family Real Estate	Consumer	Total Loans
Impaired Loans as of September 30, 2018:	(in thousands)							
Recorded Investment:								
Impaired loans with an allowance recorded	$5,906	$ 245	$ 219	$1	$ —	$ 282	$ —	$6,653
Impaired loans with no allowance recorded	2,330	107	6,978	865	203	1,980	—	12,463
Total loans individually evaluated for impairment	8,236	352	7,197	866	203	2,262	—	19,116
Related Allowance for Credit Losses								