Performance Results	Year Ended December 31, 2018	2017	2016	2015	2014
Return on average equity	12.35%	10.56%	10.70%	11.24%	11.79%
Return on average assets	1.45%	1.23%	1.24%	1.25%	1.21%
Equity to assets	12.33%	11.90%	11.41%	11.24%	10.73%
Earnings per share - Basic	$5.29	$4.49	$4.29	$4.12	$3.90
Dividends per share	$2.70	$1.08	$0.98	$0.90	$0.79
Book value per share	$45.54	$43.90	$40.50	$38.08	$35.02
Market value per share	$54.01	$58.00	$47.25	$38.42	$35.25
Average earning assets to average total assets	95.72%	95.97%	96.85%	97.63%	97.09%
Allowance for credit losses to total loans at December 31	1.16%	1.19%	1.28%	1.49%	1.60%
Efficiency ratio	53.45%	51.35%	50.75%	50.23%	49.82%
Yield and Cost of Funds					
Tax equivalent yield on investments	2.98%	2.91%	2.65%	2.58%	2.73%
Tax equivalent yield on loans	4.03%	4.05%	4.09%	4.23%	4.47%
Cost of funds	0.39%	0.35%	0.36%	0.39%	0.53%
Tax equivalent net interest margin	3.46%	3.27%	3.25%	3.28%	3.27%
Selected Items ***(in thousands)***					
Total cash and cash equivalents	$55,231	$56,686	$125,444	$81,315	$54,205
Total investments	$442,009	$518,456	$417,677	$409,762	$475,353
Total loans	$976,619	$894,250	$872,054	$855,351	$762,273
Total assets	$1,520,773	$1,516,014	$1,454,239	$1,381,663	$1,324,604
Total deposits	$1,314,877	$1,314,302	$1,269,026	$1,203,816	$1,159,306
Total equity	$187,503	$180,458	$165,879	$155,343	$142,069

To the Shareholders and Friends of Cashmere Valley Bank

I can describe our stock performance over this past year in one word…volatile. As I said last year, the market can fall in love with your stock just as easy as it can fall out of love. Our stratospheric trading range of early 2018 all came crashing down during the 4th quarter. This despite our return on equity and our return on assets well above 2017. Part of this was the new tax law, but not all. We had excellent loan growth of 9.21% during 2018. The total return on our stock including dividend was (2.20%).

So why the stock price decline? The market decided they overestimated the impact of regulatory relief and they grew fearful of rising rates.

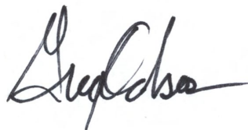
We are pleased with our performance with an all-time high in earnings per share of $5.29, up from $4.49 in 2017. The only disappointing news is the lack of deposit growth which most of the industry is experiencing. Asset and deposit growth were virtually non-existent. We continue to be well positioned for growth in the Yakima area having recently opened a second branch on Yakima Ave. in February of 2018.

Then there is all the talk about when the next recession will hit. Some say this year, some say next year or beyond. If I knew the answer to that question, I would not be sitting here on this very cold February day typing this letter. Whatever anyone thinks about a coming recession, the trick is to be ready. We have very strong earnings, very strong capital (up from 11.9% to 12.3%) and a growing loan loss reserve. All of these factors along with a conservative lending culture leads me to say, we are as ready as we can be.

As we head into our 87th year, rest assured, your board and management are focused on happy employees and happy customers because that will take "*the little bank with the big circle of friends"* to the century mark and beyond.

As always, if you have any questions about your bank, please to not hesitate contact me at 509-782-2092.

Sincerely,



Greg Oakes,
President and CEO

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601 W. Riverside Ave., Suite 900
Spokane, WA 99201-0611

Independent Auditor's Report

Management & Audit Committee
Cashmere Valley Bank
Cashmere, Washington

We have audited the accompanying consolidated financial statements of Cashmere Valley Bank and Subsidiary, which comprise the consolidated balance sheets as of December 31, 2018 and 2017, and the related consolidated statements of income and comprehensive income, shareholders' equity, and cash flows for the years then ended, and the related notes to the consolidated financial statements.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

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

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

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

Opinion

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

BDO USA, LLP

Spokane, Washington
March 8, 2019

Cashmere Valley Bank and Subsidiary
Consolidated Balance Sheets

(Dollars in Thousands, Except Share Amounts)

	December 31, 2018	December 31, 2017
Assets		
Cash and cash equivalents:		
Cash and due from banks	$21,376	$25,401
Interest-bearing deposits at other financial institutions	21,419	27,065
Federal funds sold	12,436	4,220
Total cash and cash equivalents	55,231	56,686
Securities available for sale at fair value	439,915	514,848
Securities held to maturity (fair value of $37 and $1,523)	37	1,539
Federal Home Loan Bank (FHLB) stock, at cost	1,819	1,831
Pacific Coast Banker's Bancshares (PCBB) stock, at cost	238	238
Loans held for sale	696	1,171
Loans and leases	976,619	894,250
Allowance for credit losses	(11,299)	(10,639)
Net loans and leases	965,320	883,611
Premises and equipment, net	17,993	16,834
Accrued interest receivable	5,396	5,578
Bank Owned Life Insurance (BOLI)	15,010	14,582
Goodwill	7,162	7,162
Intangibles, net	2,046	2,557
Mortgage servicing rights	1,657	1,696
Other assets	8,253	7,681
Total assets	**$1,520,773**	**$1,516,014**
Liabilities		
Deposits:		
Noninterest-bearing demand	$243,853	$218,418
Savings and interest-bearing demand	849,378	862,484
Time	221,646	233,400
Total deposits	1,314,877	1,314,302
Accrued interest payable	509	454
Short-term borrowings	9,830	9,742
Long-term borrowings	--	1,815
Other liabilities	8,054	9,243
Total liabilities	**1,333,270**	**1,335,556**
Commitments and contingencies (Note 14)		
Shareholders' Equity		
Common stock (no par value); authorized 10,000,000 shares; Issued and outstanding: 2018 – 4,117,745 ; 2017 – 4,110,845	--	--
Additional paid-in capital	2,921	2,507
Retained earnings	187,434	175,474
Other comprehensive income	(2,852)	2,477
Total shareholders' equity	**187,503**	**180,458**
Total liabilities and shareholders' equity	**$1,520,773**	**$1,516,014**

The accompanying notes are an integral part of these financial statements.

(Dollars in Thousands, Except Per Share Amounts)

	Year Ended December 31,	
	2018	**2017**
Interest Income:		
Loans and leases	$36,883	$33,051
Federal funds sold and deposits at other financial institutions	525	761
Securities available for sale:		
Taxable	6,416	5,550
Tax-exempt	6,384	6,540
Securities held to maturity – tax-exempt	11	30
Total interest income	50,219	45,932
Interest Expense:		
Deposits	4,894	4,438
Short-term borrowings	30	21
Long-term borrowings	216	133
Total interest expense	5,140	4,592
Net interest income	**45,079**	**41,340**
Provision for credit losses	1,026	--
Net interest income after provision for credit losses	**44,053**	**41,340**
Noninterest Income:		
Service charges on deposit accounts	1,886	1,366
Mortgage banking operations	2,230	2,623
Net (loss)/gain on sales of securities available for sale	(94)	439
Brokerage commissions	515	664
Insurance commissions and fees	4,110	1,669
Net interchange income	1,380	1,509
Increase in surrender value of BOLI	428	464
Other	1,482	1,546
Total noninterest income	11,937	10,280
Noninterest Expense:		
Salaries and employee benefits	17,023	14,678
Occupancy and equipment	6,152	5,140
Audits and examinations	408	791
State and local business and occupation taxes	651	600
FDIC insurance & WA state assessments	481	466
Legal and professional fees	368	453
Net (gain) on foreclosed real estate	--	(3)
Check losses and charge-offs	116	354
Low income housing fund losses	476	363
Data processing	1,061	1,205
Product delivery	1,430	1,268
Other	3,337	3,374
Total noninterest expense	31,503	28,689
Income before income taxes	**24,487**	**22,931**
Income Taxes	2,699	4,523
Net income	**$21,788**	**$18,408**
Change in the fair value of securities available for sale, net of tax	(5,329)	60
Comprehensive income, net of tax	**$16,459**	**$18,468**
Earnings per common share – Basic	$5.29	$4.49
Earnings per common share – Diluted	$5.27	$4.47

The accompanying notes are an integral part of these financial statements.

Cashmere Valley Bank and Subsidiary
Consolidated Statements of Shareholders' Equity

(Dollars in Thousands, Except Share Information)

	Shares of Common Stock	Additional Paid-In Capital	Retained Earnings	Other Comprehensive Income (Loss)	Total Equity
Balance as of December 31, 2016	**4,095,966**	**$1,962**	**$161,939**	**$1,978**	**$165,879**
Net income	--	--	18,408	--	18,408
Other comprehensive income (loss), net of tax	--	--	--	60	60
Tax rate effect reclassification	--	--	(439)	439	--
Cash dividends paid	--	--	(4,434)	--	(4,434)
Stock based compensation expense	--	247	--	--	247
Exercise of common stock options	11,689	298	--	--	298
Restricted stock grants	3,750	--	--	--	--
Restricted stock forfeitures	(560)	--	--	--	--
Balance as of December 31, 2017	**4,110,845**	**$2,507**	**$175,474**	**$2,477**	**$180,458**
Net income	--	--	21,788	--	21,788
Other comprehensive income (loss), net of tax	--	--	--	(5,329)	(5,329)
Change in accounting for MRS	--	--	1,283	--	1,283
Cash dividends paid	--	--	(11,111)	--	(11,111)
Stock based compensation expense	--	255	--	--	255
Exercise of common stock options	5,830	159	--	--	159
Restricted stock grants	1,150	--	--	--	--
Restricted stock forfeitures	(80)	--	--	--	--
Balance as of December 31, 2018	**4,117,745**	**$2,921**	**$187,434**	**$(2,852)**	**$187,503**

The accompanying notes are an integral part of these financial statements.

(Dollars in Thousands)

	Year Ended December 31,	
	2018	**2017**
Cash Flows from Operating Activities		
Net income	$21,788	$18,408
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	2,957	2,151
Provision for credit losses	1,026	--
Investment amortization – net	5,999	7,401
Stock based compensation	255	247
Net gain on sale of securities, loans, property and equipment	(939)	(2,040)
Gain on sale and impairment of foreclosed real estate	--	(3)
Increase in surrender value of BOLI	(428)	(464)
Originations of loans held for sale	(52,678)	(60,727)
Proceeds from sales of loans held for sale	54,470	61,649
Net change in:		
Accrued interest receivable	182	(1,074)
Accrued interest payable	55	9
Deferred income tax	177	(50)
Federal income tax payable	(49)	1,238
Deferred compensation	143	157
Increase in deferred income on insurance contracts	--	1,285
Increase in deferred revenue for Wealth Management	554	--
Other – net	(71)	182
Net cash provided by operating activities	**33,441**	**28,369**
Cash Flows from Investing Activities		
Activity in securities available for sale:		
Sales proceeds	115,602	46,257
Maturities, prepayments, and calls	41,075	58,644
Purchases	(94,642)	(212,561)
Activity in securities held to maturity:		
Sales proceeds	484	--
Maturities, prepayments, and calls	983	21
Proceeds from redemption of FHLB stock	85	11
Loans and leases originated in excess of principal collected	(83,706)	(23,202)
Recoveries on charged-off loans	815	486
Investment in low income housing fund	(20)	(20)
Additions to premises and equipment	(3,469)	(4,656)
Proceeds from sale of office property and equipment	--	47
Proceeds from sale of other real estate owned	--	101
Net cash paid for acquisitions	--	(1,080)
Net cash used by investing activities	**(22,793)**	**(135,952)**
Cash Flows from Financing Activities		
Net increase in deposits	575	45,276
Net increase/(decrease) in short-term borrowings	393	(2,030)
Repayments of long-term borrowings	(2,119)	(285)
Cash dividends paid	(11,111)	(4,434)
Exercise of stock options	159	298
Net cash (used in) provided by financing activities	**(12,103)**	**38,825**
Net change in cash and due from banks	**(1,455)**	**(68,758)**
Cash and due from banks at beginning of year	56,686	125,444
Cash and due from banks at end of year	**$55,231**	**$56,686**

The accompanying notes are an integral part of these financial statements.

Note 1 – Summary of Significant Accounting Policies

Cashmere Valley Bank (the Company) is a Washington State chartered bank established in 1932 and operates 11 branches in North Central Washington. The Company's lending and other banking activities are carried out in and around Chelan, Douglas, Kittitas, and Yakima counties and to a lesser degree, other areas of Western Washington. The Company provides loan and deposit services to customers, who are predominately small and middle-market businesses and middle income individuals. The consolidated financial statements include the accounts of Cashmere Valley Bank and the Bank's wholly owned subsidiary, Mitchell, Reed and Schmitten, Inc. (MRS), an insurance agency. Intercompany transactions and balances have been eliminated. MRS is based in Wenatchee, Washington and brokers personal and commercial lines of insurance, including property, casualty, life and health insurance.

Consolidated Financial Statement Presentation

The consolidated financial statements have been prepared in accordance with U.S. generally accepted accounting principles (GAAP) and practices within the financial services industry. GAAP defines a public company as one whose securities trade in a public market, including in over-the-counter markets. As the Company's stock trades in certain over-the-counter markets, certain disclosures are required to meet public company requirements. The preparation of consolidated financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, and disclosure of contingent assets and liabilities, as of the date of the consolidated balance sheet, and the reported amounts of revenues and expenses during the reporting period. Actual results could differ significantly from those estimates. Material estimates that are particularly susceptible to significant change in the near term relate primarily to the determination of the allowance for credit losses and valuations of securities, goodwill, and mortgage servicing rights. Certain prior year amounts have been reclassified to conform to 2018 presentation, with no change to total shareholders' equity or net income reported.

In 2018 the Company adopted ASU No. 2014-19, "Revenue from Contracts with Customers." It was adopted under the "modified retrospective" approach as a cumulative adjustment to retained earnings in the amount of $1,283,000. Refer to Note 21 for the method on which insurance revenue is now recognized due to the adoption of ASC 606.

Cash and Cash Equivalents

The Company considers federal funds sold, cash and amounts due from banks, and interest-bearing deposits at other financial institutions to be cash and cash equivalents, and are reported as such on the consolidated balance sheets and statement of cash flows. Cash flows from loans, deposits, and short-term borrowings are reported net. Additional cash flow information was as follows (dollars in thousands):

	Year Ended December 31,	
	2018	**2017**
Cash paid for interest	$6,103	$5,491
Cash paid for income taxes	$2,617	$3,335
Significant non-cash transactions:		
Foreclosed real estate acquired in settlement of loans	$--	$(31)
Fair value adjustment of securities available for sale, net of tax	$(5,329)	$60

Stock Based Compensation

The Company has stock based compensation plans which are more fully discussed in Note 16. Under the plans, certain key employees have been awarded restricted stock grants and options to purchase common stock. Under the accounting guidance for stock compensation, compensation expense recognized includes the cost of stock based awards associated with restricted stock grants and incentive stock options which are recognized as compensation expense over the vesting period

on a straight-line basis. The Company recognized stock based compensation expense totaling $255,000 and $247,000 in 2018 and 2017, respectively.

Securities Available for Sale

Securities available for sale consist of debt securities that the Company intends to hold for an indefinite period, but not necessarily to maturity. Such securities may be sold to implement the Company's asset/liability management strategies and in response to changes in interest rates and similar factors. Securities available for sale are reported at fair value. Unrealized gains and losses, net of the related deferred tax effect, are reported as a net amount in a separate component of shareholders' equity entitled "other comprehensive income." Realized gains and losses on securities available for sale, determined using the specific identification method, are included in earnings. Generally, amortization of premiums and accretion of discounts are recognized in interest income over the contractual life of the security using the effective interest method. As principal repayments are received on securities, a proportionate amount of the related premium or discount is recognized so that the effective interest rate on the remaining portion of the security continues unchanged.

The Company evaluates the portfolio for impairment each quarter. In estimating other-than-temporary losses, the Company considers the following factors: (1) the length of time and the extent to which the market value has been less than cost; (2) the financial condition and near-term prospect of the issuer; (3) the intent and ability of the Company to retain its investment in a security for a period of time sufficient to allow for any anticipated recovery in market value; (4) whether it is more likely than not that the Company will be required to sell the securities before recovery; and (5) general market conditions which reflect prospects for the economy as a whole, including interest rates and sector credit spreads. If a loss is deemed to be other-than-temporary, the Company then calculates a credit loss charge against earnings by subtracting the estimated present value of estimated future cash flows on the security from its amortized cost. The other-than-temporary impairment less the credit loss charge against earnings is a component of other comprehensive income.

Securities Held to Maturity

Debt securities which the Company has the positive intent and ability to hold to maturity are reported at cost, adjusted for amortization of premiums and accretion of discounts, which are recognized in interest income over the period to maturity.

Federal Home Loan Bank Stock

The Company, as a member of the Federal Home Loan Bank (FHLB) system, is required to maintain an investment in capital stock of the FHLB based on the sum of the two following calculations (calculated at least annually as of the preceding December 31):

- The Membership Stock Purchase Requirement: based on a percentage of assets as shown in table below:

	Current Requirement	Minimum Investment	Maximum Investment
Percent of Total Assets	0.12%	0.05%	0.25%
Membership Stock Cap	$10 million	$1 million	$30 million
Membership Stock Floor	$10,000	$10,000	$30,000

- The Activity Based Stock Purchase Requirement: based on a percentage of the book value held and records of the transactions shown in the table below:

Transaction	Current Requirement	Minimum Requirement	Maximum Requirement
Outstanding Advances	4.00%	2.00%	5.00%
Outstanding Acquired Member Assets	4.00%	0.00%	5.00%
Standby Letters of Credit	0.00%	0.00%	0.18%
Advance Commitments	0.00%	0.00%	0.35%
Acquired Member Asset Commitments	0.00%	0.00%	0.60%

The recorded amount of FHLB stock equals its fair value because the shares can only be redeemed by the FHLB at the $100 per share par value.

The Company views its investment in the FHLB stock as a long-term investment. Accordingly, when evaluating for impairment, the value is determined based on the ultimate recovery of the par value rather than recognizing temporary declines in value. The determination of whether a decline affects the ultimate recovery is influenced by criteria such as: (1) the significance of the decline in net assets of the FHLB as compared to the capital stock amount and length of time a decline has persisted; (2) impact of legislative and regulatory changes on the FHLB; and (3) the liquidity position of the FHLB. Management has determined there is no impairment on its FHLB stock as of December 31, 2018.

Loans Held for Sale

Loans originated for sale in the secondary market, which is our principal market, or as whole loan sales are classified as loans held for sale. Management has elected the lower of cost or market option for all single family loans held for sale (originated with the intent to be held for sale) and records these loans at the lower of cost or market. The fair value of loans held for sale is generally based on observable market prices from other loans in the secondary market that have similar collateral, credit, and interest rate characteristics. If quoted market prices are not readily available, the Company may consider other observable market data such as dealer quotes for similar loans or forward sale commitments. In certain cases, the fair value may be based on a discounted cash flow model. Gains and losses on loans held for sale are recognized in net gain on mortgage loan origination and sale activities within noninterest income. Direct loan origination costs and fees for single family loans originated as held for sale are recognized in earnings.

Loans Held for Investment

Loans held for investment are reported at the principal amount outstanding, net of cumulative charge-offs, interest applied to principal (for loans accounted for using the cost recovery method), unamortized net deferred loan origination fees and costs, and unamortized premiums or discounts on purchased loans. Deferred fees and costs and premiums and discounts are recognized over the contractual terms of the underlying loans using the constant effective yield (the interest method). Interest on loans is accrued and recognized as interest income at the contractual rate of interest. A determination is made as of the loan commitment date as to whether a loan will be held for sale or held for investment. This determination is based primarily on the type of loan or loan program and its related profitability characteristics.

When a loan is designated as held for investment, the intent is to hold these loans until maturity or pay-off. If subsequent changes occur, the Company may change its intent to hold these loans. Once a determination has been made to sell such loans, they are immediately transferred to loans held for sale and carried at the lower of cost or fair value.

Direct financing leases are carried at the aggregate of lease payments plus estimated residual value of the leased property less unearned income. Interest income from direct financing leases is recognized over the term of the lease to achieve a constant periodic rate of return on the outstanding investment.

From time to time, the Company will originate loans to facilitate the sale of other real estate owned without a sufficient down payment from the borrower. Such loans are accounted for using the installment method and any gain on sale is deferred.

Nonaccrual Loans

Loans are placed on nonaccrual status when the full and timely collection of principal and interest is doubtful, generally when the loan becomes 90 days or more past due for principal or interest payment, or if part of the principal balance has been charged off.

All payments received on nonaccrual loans are accounted for using the cost recovery method. Under the cost recovery method, all cash collected is applied to first reduce the principal balance. A loan may be returned to accrual status if all delinquent principal and interest payments are brought current and the collectability of the remaining principal and interest payments in accordance with the loan agreement is reasonably assured. Loans that are well-secured and in the process of collection are maintained on accrual status, even if they are 90 days or more past due.

Impaired Loans

A loan is considered impaired when it is probable that all contractual principal and interest payments due will not be collected in accordance with the terms of the loan agreement. Factors considered by management in determining whether a loan is impaired include payment status, collateral value, and the probability of collecting scheduled principal and interest payments when due.

Troubled Debt Restructurings

A loan is accounted for and reported as a troubled debt restructuring (TDR) when, for economic or legal reasons, we grant a concession to a borrower experiencing financial difficulty. A restructuring that results in only an insignificant delay in payment is not considered a concession. A delay may be considered insignificant if the payments subject to the delay are insignificant relative to the unpaid principal or collateral value and the contractual amount due, or the delay in timing of the restructured payment period is insignificant relative to the frequency of payments, the debt's original contractual maturity, or original expected duration.

TDR's are designated as impaired because interest and principal payments will not be received in accordance with original contract terms. TDR's that are performing and on accrual status as of the date of the modification remain on accrual status. TDR's that are nonperforming as of the date of modification generally remain as nonaccrual until the prospect of future payments in accordance with the modified loan agreement is reasonably assured, generally demonstrated when the borrower maintains compliance with the restructured terms for a predetermined period, normally at least six months. TDR's with temporary below-market concessions remain designated as a TDR and impaired regardless of the accrual or performance status until the loan is paid off. However, if the TDR loan has been modified in a subsequent restructure with market terms and the borrower is not currently experiencing financial difficulty, then the loan may have its TDR designation removed.

Allowance for Credit Losses

The allowance for credit losses is maintained at a level sufficient to provide for probable credit losses based on evaluating known and inherent risks in the loan and lease portfolio. The allowance is provided based upon management's continuing analysis of the pertinent factors underlying the quality of the loan and lease portfolio. These factors include changes in the size and composition of the loan and lease portfolio, delinquency levels, actual loan loss experience, current economic conditions, and detailed analysis of individual loans for which full collectability may not be assured. The detailed analysis includes techniques to estimate the fair value of loan collateral and the existence of potential alternative sources of repayment. The allowance consists of specific, general, and unallocated components. For such loans that are classified as impaired, a specific allowance is established when the discounted cash flows, collateral value, or observable market price of the impaired loan is lower than the carrying value of that loan. The general component covers non-impaired loans and is based on historical loss experience adjusted for qualitative factors. An unallocated component is maintained to cover the risk of loss due to general economic uncertainties that could affect the loan portfolio and management's estimate of probable losses. The unallocated component of the allowance reflects the margin of imprecision inherent in the underlying assumptions used in the methodologies for estimating specific and general losses in the portfolio. The appropriateness of the allowance for credit losses is estimated based upon these factors and trends identified by management at the time consolidated financial statements are prepared.

When available information confirms that specific loans or portions thereof are uncollectible, identified amounts are charged against the allowance for credit losses. The existence of some or all of the following criteria will generally confirm that a loss has been incurred: the loan is significantly delinquent and the borrower has not demonstrated the ability or intent to bring the loan current; the Company has no recourse to the borrower, or if it does, the borrower has insufficient assets to pay the debt; the estimated fair value of the loan collateral is significantly below the current loan balance, and there is little or no near-term prospect for improvement.

A provision for credit losses is charged against income and added to the allowance for credit losses based on regular assessments of the loan and lease portfolio. The allowance for credit losses is allocated to certain loan and lease categories based on the relative risk characteristics, asset classifications and actual loss experience of the loan and lease portfolio. While management has allocated the allowance for credit losses to various loan and lease portfolio segments, the allowance is general in nature and is available for the loan and lease portfolio in its entirety.

The ultimate recovery of all loans and leases is susceptible to future market factors beyond the Company's control. These factors may result in losses or recoveries differing significantly from those provided in the consolidated financial statements.

In addition, regulatory agencies, as an integral part of their examination process, periodically review the Company's allowance for credit losses and may require the Company to make additions to the allowance based on their judgment about information available to them at the time of their examinations.

Premises and Equipment

Premises and equipment are stated at cost less accumulated depreciation, which is computed on the straight-line method over the estimated useful lives of the assets, which range from 35 to 40 years for buildings and 3 to 15 years for furniture, fixtures, and equipment. These assets are reviewed for impairment under FASB ASC 360, *"Property, Plant, and Equipment"* when events indicate that the carrying amount may not be recoverable. Gains or losses on dispositions are reflected in earnings.

Foreclosed Real Estate

Real estate properties acquired through, or in lieu of, foreclosure are to be sold and are initially recorded at the fair value of the properties, less estimated costs of disposal, which becomes the new cost basis. Any write-down to fair value at the time of transfer to foreclosed real estate is charged to the allowance for credit losses. Properties are evaluated regularly to ensure that the recorded amounts are supported by their current fair values. Any subsequent reductions in carrying values and revenue and expense from the operations of properties are recognized in the consolidated statement of income.

Mortgage Servicing Rights

Mortgage servicing rights (MSR's) are recognized as separate assets when rights are acquired through purchase or through sale of loans. Generally, purchased servicing rights are capitalized at the cost to acquire the rights. For sales of mortgage loans, a portion of the cost of originating the loan is allocated to the servicing right based on relative fair value. Capitalized servicing rights are amortized into noninterest income in proportion to, and over the period of, the estimated future net servicing income of the underlying financial assets.

MSR's are evaluated for impairment based upon the fair value of the rights as compared to amortized cost. Subsequent fair value measurements of single family MSR's, which are not traded in an active market with readily observable market prices, are determined by considering the present value of estimated future net servicing cash flows. Changes in the fair value of single family MSR's result from changes in (1) model inputs and assumptions and (2) modeled amortization, representing the collection and realization of expected cash flows and curtailments over time. The significant model inputs used to measure the fair value of single family MSR's include assumptions regarding market interest rates, projected prepayment speeds, discount rates, estimated costs of servicing, and other income and additional expenses associated with the collection of delinquent loans. Impairment is recognized through a valuation allowance to the extent that fair value is less than the recorded value. If the Company later determines that all or a portion of the impairment no longer exists, a reduction of the allowance will be recorded as an increase to income.

Servicing fee income is recorded for fees earned for servicing loans. The fees are based on a contractual percentage of the outstanding principal or a fixed amount per loan and are recorded as income when earned. The amortization of MSR's is netted against loan servicing fee income.

Transfers of Financial Assets

Transfers of financial assets are accounted for as sales when control over the assets has been surrendered. Control over transferred assets is deemed to be surrendered when: (1) the assets have been isolated from the Company; (2) the transferee obtains the right (free of conditions that constrain it from taking advantage of that right) to pledge or exchange the transferred assets; and (3) the Company does not maintain effective control over the transferred assets through an agreement to repurchase them before their maturity.

Income Taxes

Deferred tax assets and liabilities result from differences between the consolidated financial statement carrying amounts and the tax basis of assets and liabilities, and are reflected at currently enacted income tax rates applicable to the period in which the deferred tax assets or liabilities are expected to be realized or settled. The deferred tax provision represents the difference between the net deferred tax asset or liability at the beginning and end of the year. As changes in tax laws or rates are enacted, deferred tax assets and liabilities are adjusted through the provision for income taxes. Deferred tax assets are

reduced by a valuation allowance when, in the opinion of management, it is more likely than not that some portion or all of the deferred tax assets will not be realized. The determination of the realization of the deferred tax assets is highly subjective and dependent upon judgment concerning management's evaluation of both positive and negative evidence. The calculation of the Company's tax provision for federal income taxes is complex and requires the use of estimates and significant judgments in arriving at the amount of tax benefits to be recognized in the financial statements for a given tax position. It is possible that the tax benefits realized upon the ultimate resolution of a tax position may result in tax benefits that are significantly different from those estimated. The Company's policy is to classify interest and penalties associated with income taxes with other expenses.

Bank Owned Life Insurance (BOLI)

Bank owned life insurance policies are recorded at their cash surrender value or the amount that can be realized upon surrender of the policy. Income from BOLI is recognized when it is earned.

Goodwill

Goodwill represents costs in excess of net assets acquired and is evaluated at least annually for impairment, in accordance with Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) 350, "*Intangibles – Goodwill and Other*." The Company tested goodwill for impairment as of December 31, 2018 using the Step 0 method to evaluate impairment and concluded that the fair value of the goodwill is greater than the carrying value, noting no impairment of recorded goodwill. No events have occurred since December 31, 2018 that would require re-evaluation.

Intangible Assets

Intangible assets include non-competition and licensing agreements, and customer contracts and lists. The non-competition and licensing agreements are amortized by the straight-line method over four to five years. The customer contracts and lists are amortized on either a straight-line method or performance basis over a period up to fifteen years. In 2018 and 2017, no circumstances existed that would indicate these assets were potentially impaired. If such circumstances had existed, the assets would have been tested for impairment in accordance with FASB ASC 350, "*Intangibles – Goodwill and Other*."

Insurance Revenue

Insurance revenue consists of commissions and fees from the sales of insurance policies and related insurance services. Insurance commission income is recognized as of the effective date of the insurance policy, net of adjustments. Such adjustments are recorded when the amount can be reasonably estimated, which is generally in the period in which they occur. Commission revenues related to installment billings are recognized on the latter of effective or invoiced date. Contingent commissions are estimated and accrued relative to the recognition of corresponding commissions. Management determines a policy cancellation reserve based upon historical cancellation experience adjusted for any known circumstances. Subsequent commission adjustments were recognized upon receipt of notification from insurance companies concerning such adjustments.

Advertising

Advertising costs are generally charged to expense during the year in which they are incurred. Advertising expense was $225,000 and $175,000 for the years ended December 31, 2018 and 2017, respectively.

Derivative Financial Instruments

The Company enters into interest rate swaps to convert fixed rate long-term loans to floating rate loans. Management individually evaluates and converts fixed rate loans to floating rate loans depending on the size, maturity, and planned amortization of each loan. The interest rate swap instruments are recognized as derivatives on the balance sheet at their fair value. On the date the derivative contract is entered into, the Company designates the derivative as a hedge of fair value of a recognized asset or liability. Changes in the fair value of a derivative that is highly effective, and that is designated and qualifies as a fair value hedge, along with the loss or gain on the hedged asset or liability that is attributable to the hedged risk, are recorded in current period earnings.

The Company formally documents all relationships between hedging instruments and hedged items, as well as its risk management objective and strategy for undertaking various hedged transactions. This process includes linking all derivatives that are designated as fair value hedges to specific assets and liabilities on the balance sheet and statement of

cash flows. The Company also formally assesses, both at the hedge's inception and on an ongoing basis, whether the derivatives that are used in hedging transactions are highly effective in offsetting changes in fair values of hedged items. When it is determined that a derivative is not highly effective as a hedge or that it has ceased to be a highly effective hedge, the Company discontinues hedge accounting prospectively, as discussed below. The Company discontinues hedge accounting prospectively when: (1) it is determined that the derivative is no longer effective in offsetting changes in the fair value of a hedged item; (2) the derivative expires or is sold, terminated, or exercised; or (3) management determines that designation of the derivative as a hedge instrument is no longer appropriate.

When hedge accounting is discontinued because it is determined that the derivative no longer qualifies as an effective fair value hedge, the derivative will continue to be carried on the balance sheet at its fair value with changes in its fair value recognized in current period earnings, and the hedged asset or liability will no longer be adjusted for changes in fair value.

Fair Value

The Company measures or monitors many of its assets and liabilities on a fair value basis. Fair value is used on a recurring basis for certain assets and liabilities in which fair value is the primary basis of accounting. Examples of these include derivative instruments and available for sale securities. Additionally, fair value is used on a non-recurring basis to evaluate assets or liabilities for impairment or for disclosure purposes. Examples of these non-recurring uses of fair value include certain loans held for sale accounted for on a lower of cost or market basis, impaired loans, foreclosed real estate, mortgage servicing rights, goodwill and long-lived assets.

Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability (an exit price) in an orderly transaction between market participants at the measurement date. Fair value estimates are based on quoted market prices, if available. If quoted market prices are not available, fair value estimates are based on quoted market prices of similar assets or liabilities or the present value of expected future cash flows and other valuation techniques. These valuations are significantly affected by discount rates, cash flow assumptions, and risk and other assumptions used. Therefore, fair value estimates may not be substantiated by comparison to independent markets and are not intended to reflect the proceeds that may be realizable in an immediate settlement of the instruments.

Fair value is determined at one point in time and is not representative of future value. Fair value amounts also do not reflect the total value of a going concern organization. Management does not have the intention to dispose of a significant portion of its assets and liabilities and therefore, the unrealized gains or losses should not be interpreted as a forecast of future earnings and cash flows.

In support of these representations, FASB ASC 820, "*Fair Value Measurements and Disclosures*," establishes fair value hierarchy that prioritizes the information used to develop those assumptions. The fair value hierarchy is as follows:

> Level 1 inputs are observable inputs, based upon the quoted prices for identical instruments in active markets that are accessible as of the measurement date, and are to be used whenever available.
>
> Level 2 inputs are other types of observable inputs, such as quoted prices for similar instruments in active markets; quoted prices for identical or similar instruments in markets that are inactive; or other inputs that are observable or can be derived from or supported by observable market data. Level 2 inputs are to be used whenever Level 1 inputs are not available.
>
> Level 3 inputs are significantly unobservable and are supported by little or no market activity. These Level 3 assets and liabilities include financial instruments whose value is determined using pricing models, discounted cash flow methodologies, or similar techniques, as well as instruments for which the determination of fair values requires significant management judgment or estimation. Level 3 inputs are to only be used when Level 1 and Level 2 inputs are unavailable.

When determining the fair value measurements for assets and liabilities, the Company considers the principal or most advantageous market in which it would transact, and considers assumptions that market participants would use when pricing the asset or liability. When possible, the Company looks to active and observable markets to price identical assets or liabilities. When identical assets or liabilities are not traded in active markets, the Company looks to market observable data for similar assets and liabilities.

Recent Accounting Pronouncements

ASU 2018-15, "Intangibles – Goodwill and Other – Internal Use Software." Issued in August 2018, ASU No. 2018-15 aligns the requirements for capitalizing implementation costs incurred in a hosting arrangement that is a service contract with the requirements for capitalizing implementation costs incurred to develop or obtain internal-use software. The amendments of ASU 2018-15 are effective for public entities for interim and annual periods beginning after December 15, 2019 and for other entities for periods beginning after December 15, 2020. Management will early adopt ASU 2018-15 as of January 1, 2019 as early adoption is permitted and is currently evaluating the impact the ASU will have on the consolidated financial statements.

ASU 2018-13, "Fair Value Measurement Disclosure Framework." Issued in August 2018, ASU No. 2018-13 modifies the disclosure requirements on fair value measurements outlined in Topic 820, Fair Value Measurements. Specifically the amendments in the ASU remove the requirements to disclose the amount and reasons for transfers between fair value hierarchy levels, the policy for timing of transfers between levels, the valuation processes for Level 3 fair value measurements, and for nonpublic entities, disclosure of the changes in unrealized gains and losses for the period included in earnings for recurring Level 3 fair value measurements. Additionally, the ASU adds disclosure requirements regarding changes in unrealized gains and losses for the period included in other comprehensive income related to Level 3 fair value measurements, and disclosure of the range and weighted average of significant unobservable inputs used to develop Level 3 fair value measurements. The amendments of ASU 2018-13 are effective for all entities for interim and annual periods beginning after December 15, 2019. Management will adopt the provisions of this ASU removing fair value disclosure requirements as of December 31, 2018 as early adoption of the removal provisions is allowed and will adopt the remaining provisions of the ASU as of the effective date.

ASU 2018-09, "Codification Improvements." Issued in July 2018, ASU No. 2018-09 makes changes to a variety of topics to clarify, correct errors in, or make minor improvements to the Accounting Standards Codification. The majority of the amendments in ASU 2018-09 will be effective in annual periods beginning after December 15, 2018. Management is currently evaluating the effects the adoption of ASU 2018-09 will have on the consolidated financial statements, results of operations and cash flows.

ASU 2018-07, "Compensation-Stock Compensation." Issued in June 2018, ASU 2018-07 expands the scope of ASC 718 to include share-based payment transactions for acquiring goods and services from nonemployees. The amendments also clarify that ASC 718 does not apply to share-based payments used to provide either financing to the issuer or awards granted in conjunction with selling goods or services to customers under a contract subject to ASC 606, Revenue from Contracts with Customers. The amendments of ASU 2018-07 are effective for public entities for interim and annual periods beginning after December 15, 2018 and for other entities for periods beginning after December 15, 2019. Management will adopt ASU 2018-07 using the public company effective date as early adoption is permitted and is currently evaluating the impact the ASU will have on the consolidated financial statements.

ASU No. 2016-13, "Financial Instruments-Credit Losses." On June 16, 2017 the amendments in this ASU were issued to provide financial statement users with more decision-useful information about the current expected credit losses (CECL) on financial instruments that are not accounted for at fair value through net income, including loans held for investment, held-to-maturity debt securities, trade and other receivables, net investment in leases and other commitments to extend credit held by a reporting entity at each reporting date. The amendments to this ASU require that financial assets measured at amortized cost be presented at the net amount expected to be collected, through an allowance for credit losses that is deducted from the amortized cost basis. The amendments in this ASU eliminate the requirement that losses be recognized only when incurred, and instead require that an entity recognize its current estimate of all expected credit losses. The measurement of expected credit losses is based upon historical experience, current conditions, and reasonable and supportable forecasts that affect the collectability of the financial assets.

For purchased financial assets with a more-than-insignificant amount of credit deterioration since origination (PCD assets) that are measured at amortized cost, the initial allowance for credit losses is added to the purchase price rather than being reported as a credit loss expense. Subsequent changes in the allowance for credit losses on PCD assets are recognized through the statement of income as a credit loss expense.

Credit losses relating to available-for-sale debt securities will be recorded through an allowance for credit losses rather than as a direct write-down to the security.

The amendments to this ASU are effective for fiscal years beginning after December 15, 2020, including interim periods within those fiscal years. The amendments in this ASU should be applied on a modified-retrospective transition approach that would require a cumulative-effect adjustment to the opening retained earnings in the statement of financial condition as of the date of adoption. A prospective transition approach is required for debt securities for which an other-than-temporary impairment had been recognized before the effective date. The Company is currently evaluating the impact of this ASU and the Company expects this ASU to have a material impact on the Company's consolidated financial statements.

ASU No. 2016-02, "Leases (Topic 842)." Issued February 16, 2016 the amendments in this ASU require lessees to recognize a lease liability, which is a lessee's obligation to make lease payments arising from a lease, and a right-of-use asset, which is an asset that represents the lessee's right to use, or control the use of, a specified asset for the lease term. This ASU simplifies the accounting for sale and leaseback transactions. The amendments in this ASU are effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. Early application was permitted upon issuance of the ASU. Lessees (for capital and operating leases) and lessors (for sales-type, direct financing, and operating leases) must apply a modified retrospective transition approach for leases existing at, or entered into after, the beginning of the earliest comparative period presented in the financial statements. The modified retrospective approach would not require any transition accounting for leases that expired before the earliest comparative period presented. Lessees and lessors may not apply a full retrospective transition approach. The Company is currently evaluating the provisions of this guidance to determine the potential impact the new standard will have on the Company's consolidated financial statements. The undiscounted remaining contractual cash payments as of December 31, 2018 is $187,000.

ASU No. 2016-01, "Financial Instruments – Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities." Issued in January 2016, the new guidance is intended to improve the recognition and measurement of financial instruments. This ASU requires equity investments (except those accounted for under the equity method of accounting, or those that result in consolidation of the investee) to be measured at fair value with changes in fair value recognized in net income. In addition, the amendment requires public business entities to use the exit price notion when measuring the fair value of financial instruments for disclosure purposes and requires separate presentation of financial assets and financial liabilities by measurement category and form of financial asset (i.e., securities or loans and receivables) on the balance sheet or the accompanying notes to the financial statements. This ASU also eliminates the requirement for public business entities to disclose the method(s) and significant assumptions used to estimate the fair value that is required to be disclosed for financial instruments measured at amortized cost on the balance sheet. The amendment also requires a reporting organization to present separately in other comprehensive income the portion of the total change in the fair value of a liability resulting from a change in the instrument specific credit risk (also referred to as "own credit") when the organization has elected to measure the liability at fair value in accordance with the fair value option for financial instruments. ASU No. 2016-01 is effective for financial statements issued for fiscal years beginning after December 15, 2017. The Company has adopted this ASU during the current year and it did not have a material impact on the Company's consolidated financial statements.

ASU No. 2014-09, "Revenue from Contracts with Customers (Topic 606)." Issued in May 2014, this ASU clarifies the principles for recognizing revenue from contracts with customers. On August 12, 2015, the FASB issued ASU 2015-14 to defer the effective date of ASU 2014-09. Public business entities, certain not-for-profit entities, and certain employee benefit plans should apply the guidance in ASU 2014-09 to annual reporting periods beginning after December 15, 2017, including interim reporting periods within that reporting period. Earlier application is permitted only as of annual reporting periods beginning after December 15, 2016, including interim reporting periods within that reporting period. On March 17, 2016, the FASB issued Accounting Standards Update 2016-08 to clarify the implementation guidance on principal versus agent considerations. We will adopt this ASU on January 1, 2018 utilizing the modified retrospective approach with a cumulative effect adjustment to opening retained earnings. Management is in process of completing an analysis to determine which revenue streams are within the scope of ASU 2014-09 and the related clarifying ASU's and has determined that interest income and revenue generated from transfers and servicing of financial instruments, specifically, gain on sale of loans and mortgage servicing fees are out of scope. Management is continuing to evaluate the most appropriate transition method of application and the impact that ASU 2014-09 and the related clarifying ASU's will have on in scope revenue streams, specifically, service charges and fees, mortgage referral fees, gains or losses on other real estate owned, commissions on mutual funds and annuities and commissions on insurance policies. Expanded disclosure requirements are included in the 2018 consolidated financial statements.

Note 2 – Business Combinations

Gellatly Agency, Inc.

On April 1, 2017, the Company acquired Gellatly Agency, Inc., an insurance agency and brokerage business in Wenatchee, Washington.

The purchase price for the assets included cash at the time of the merger plus a percentage of the total commissions of the seller earned and collected from April 1, 2017 to March 31, 2022.

The Gellatly merger was accounted for using the acquisition method of accounting and accordingly, assets acquired, liabilities assumed and consideration exchanged were recorded at estimated fair value on the acquisition date. Preliminary goodwill of $277,000 was calculated as the purchase premium after adjusting for the fair value of net assets acquired and represents the value expected from the synergies created and the economies of scale expected from combining the two organizations.

Determining the fair value of the acquired assets and assumed liabilities required estimation of cash flows expected to result from those assets and liabilities and to discount those cash flows at appropriate rates of interest.

The following table provides a summary of the purchase price calculation as of the acquisition date and the identifiable assets purchased and the liabilities assumed at their estimated fair values.

Assets:	
Premises and equipment	$8,000
Non-compete agreement	20,000
Intangible asset – Gellatly portfolio	709,000
Goodwill	277,000
Total purchase price	$1,014,000

Elliott Insurance Service, Inc.

On July 1, 2017, the Company acquired Elliott Insurance Service, Inc., an insurance agency and brokerage business in Yakima, Washington.

The purchase price for the assets included cash at the time of the merger plus a percentage of the total commissions of the seller earned and collected from July 1, 2017 to June 30, 2022.

The Elliott merger was accounted for using the acquisition method of accounting and accordingly, assets acquired, liabilities assumed and consideration exchanged were recorded at estimated fair value on the acquisition date. Preliminary goodwill of $65,000 was calculated as the purchase premium after adjusting for the fair value of net assets acquired and represents the value expected from the synergies created and the economies of scale expected from combining the two organizations.

Determining the fair value of the acquired assets and assumed liabilities required estimation of cash flows expected to result from those assets and liabilities and to discount those cash flows at appropriate rates of interest.

The following table provides a summary of the purchase price calculation as of the acquisition date and the identifiable assets purchased and the liabilities assumed at their estimated fair values.

Assets:	
Premises and equipment	$10,000
Supplies	1,000
Non-compete agreement	5,000
Intangible asset – Elliott portfolio	2,090,000
Goodwill	65,000
Total purchase price	$2,171,000

All merger-related charges were recorded in the consolidated statement of income and comprehensive income for the year ended December 31, 2017. Such expenses were for human resources and professional services, among other categories, and including legal and accounting support.

Pro forma income statements are not being presented as the information is not practicable to produce.

There were no new acquisitions in 2018.

Note 3 – Restricted Assets

Federal Reserve Board regulations require that the Company maintain certain minimum reserve balances on hand or on deposit with the Federal Reserve Bank, based on a percentage of deposits. The required minimum reserve balances at December 31, 2018 and 2017 were $2,272,000 and $2,229,000, respectively. Due to sufficient balances maintained on premises, no balances were required to be on deposit with the Federal Reserve Bank for the years ended December 31, 2018 and 2017.

Note 4 – Securities

Securities have been classified according to management's intent. The amortized cost of securities and their approximate fair value are as follows (dollars in thousands):

Securities Available for Sale	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
December 31, 2018				
Money market funds	$22	$--	$--	$22
U.S. Treasury securities	8,353	2	(7)	8,348
State and municipal securities	207,103	1,476	(1,975)	206,604
Collateralized mortgage obligations	155,126	450	(3,030)	152,546
Mortgage-backed securities	53,371	112	(515)	52,968
Asset-backed securities	19,550	1	(124)	19,427
Total	$443,525	$2,041	$(5,651)	$439,915
December 31, 2017				
Money market funds	$21	$--	$--	$21
U.S. Treasury securities	--	--	--	--
State and municipal securities	258,976	5,533	(704)	263,805
Collateralized mortgage obligations	177,591	631	(2,377)	175,845
Mortgage-backed securities	75,124	280	(227)	75,177
Asset-backed securities	--	--	--	--
Total	$511,712	$6,444	$(3,308)	$514,848

Securities Held to Maturity	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
December 31, 2018				
State and municipal securities	$37	$--	$--	$37
Tax-exempt municipals	--	--	--	--
Mortgage-backed securities	--	--	--	--
Total	$37	$--	$--	$37
December 31, 2017				
State and municipal securities	$40	$--	$--	$40
Tax-exempt municipals	513	--	(15)	498
Mortgage-backed securities	986	--	(1)	985
Total	$1,539	$--	$(16)	$1,523

In determining that no securities were other-than-temporarily impaired, each security was individually evaluated for impairment by management. On a quarterly basis, the Company evaluates these securities for other-than-temporary impairment (OTTI). During 2018 and 2017 there was no OTTI recorded in earnings. The unrealized losses on securities are primarily due to elevated yield spreads at December 31, 2018 and 2017 as compared to yield relationships prevailing at the time specific securities were purchased.

At December 31, 2018, there were seventy-one securities in a continuous unrealized loss position more than twelve months. The following shows the unrealized gross losses and fair value of securities in the available for sale portfolio at December 31, 2018 and 2017, by length of time that individual securities in each category have been in a continuous loss position (dollars in thousands):

	Less Than 12 Months		More Than 12 Months		Total	
	Unrealized Gross Loss	Fair Value	Unrealized Gross Loss	Fair Value	Unrealized Gross Loss	Fair Value
December 31, 2018						
U.S. Government agency securities, including mortgage-backed securities	$(115)	$25,047	$(407)	$32,482	$(522)	$57,529
State and municipal securities	(682)	78,340	(1,293)	40,424	(1,975)	118,764
Collateralized mortgage obligations	(372)	37,946	(2,658)	91,737	(3,030)	129,683
Asset-backed securities	(124)	18,344	--	--	(124)	18,344
Total	**$(1,293)**	**$159,677**	**$(4,358)**	**$164,643**	**$(5,651)**	**$324,320**

	Less Than 12 Months		More Than 12 Months		Total	
	Unrealized Gross Loss	Fair Value	Unrealized Gross Loss	Fair Value	Unrealized Gross Loss	Fair Value
December 31, 2017						
U.S. Government agency securities, including mortgage-backed securities	$(115)	$34,973	$(112)	$8,765	$(227)	$43,738
State and municipal securities	(603)	45,269	(101)	5,587	(704)	50,856
Collateralized mortgage obligations	(698)	93,027	(1,679)	47,199	(2,377)	140,226
Asset-backed securities	--	--	--	--	--	--
Total	**$(1,416)**	**$173,269**	**$(1,892)**	**$61,551**	**$(3,308)**	**$234,820**

The contractual maturities of securities held to maturity and available for sale at December 31, 2018, are shown below (dollars in thousands):

	Held to Maturity		Available for Sale	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
Due in one year or less	$--	$--	$11,454	$11,478
Due from one year to five years	--	--	57,911	57,628
Due from five years to ten years	--	--	68,640	67,459
Due after ten years	37	37	305,520	303,350
Total	**$37**	**$37**	**$443,525**	**$439,915**

Expected maturities may differ from contractual maturities because issuers may have the right to call or prepay obligations, with or without call or prepayment penalties.

Securities carried at approximately $62 million and $100.6 million at December 31, 2018 and 2017, respectively, were pledged to secure public deposits, repurchase agreements, and other purposes required or permitted by law.

Sales of securities available for sale were as follows (dollars in thousands):

	2018	2017
Proceeds from sales	$115,602	$46,257
Gross realized gains included in earnings	697	622
Gross realized losses included in earnings	(791)	(183)

One held to maturity security was sold in 2018. Proceeds from the sale were $484,000 and gross realized losses included in earnings at December 31, 2018 were $32,000. No held to maturity securities were sold in 2017.

Note 5 – Loans and Leases

Loans and leases at December 31 consist of the following (dollars in thousands):

	2018	2017
Commercial and agricultural	$71,651	$61,093
Real estate:		
Residential 1-4 family	152,219	143,913
Commercial	335,751	329,329
Construction	69,283	46,794
Farmland	11,245	9,773
Municipal	118,633	113,622
Consumer	19,510	17,845
Dealer contracts	188,334	162,795
Leases	3,365	2,155
Credit card	5,173	5,533
Plus deferred loan costs, less deferred loan fees	1,455	1,398
Total loans and leases	**$976,619**	**$894,250**

The following tables detail activity in the allowance for loan and lease losses (ALLL) by portfolio segment for the years ended December 31, 2018 and 2017 (dollars in thousands). Allocation of a portion of the allowance to one category of loans does not preclude its availability to absorb losses in other categories.

		Real Estate					
2018	**Commercial and Agricultural**	**Residential 1-4 Family**	**Commercial, Construction, and Farmland**	**Municipal**	**Consumer and Other**	**Unallocated**	**Total ALLL**
Beginning Balance	$792	$1,095	$5,421	$120	$2,584	$627	$10,639
Provision for loan and lease losses	373	41	367	8	864	(627)	1,026
Charge-offs	(288)	(21)	--	--	(872)	--	(1,181)
Recoveries	200	21	--	--	594	--	815
Net Charge-offs	(88)	--	--	--	(278)	--	(366)
Ending balance	$1,077	$1,136	$5,788	$128	$3,170	$--	$11,299
Period end amount allocated to:							
Loans and leases individually evaluated for impairment	$13	$230	$51	$--	$5	$--	$299
Loans and leases collectively evaluated for impairment	1,064	906	5,737	128	3,165	--	11,000
Ending balance	$1,077	$1,136	$5,788	$128	$3,170	$--	$11,299

		Real Estate					
2017	**Commercial and Agricultural**	**Residential 1-4 Family**	**Commercial, Construction, and Farmland**	**Municipal**	**Consumer and Other**	**Unallocated**	**Total ALLL**
Beginning Balance	$895	$1,110	$6,316	$111	$2,576	$29	$11,037
Provision for loan and lease losses	(155)	(15)	(919)	9	482	598	--
Charge-offs	(179)	--	--	--	(705)	--	(884)
Recoveries	231	--	24	--	231	--	486
Net Charge-offs	52	--	24	--	(474)	--	(398)
Ending balance	$792	$1,095	$5,421	$120	$2,584	$627	$10,639
Period end amount allocated to:							
Loans and leases individually evaluated for impairment	$2	$177	$74	$--	$1	$--	$254
Loans and leases collectively evaluated for impairment	790	918	5,347	120	2,583	627	10,385
Ending balance	$792	$1,095	$5,421	$120	$2,584	$627	$10,639

The reserve for unfunded commitments totaled $256,000 and $235,000 as of December 31, 2018 and 2017, respectively.

The Company’s recorded investment in loans and leases as of December 31, 2018 and 2017 related to each balance in the allowance for loan and lease losses by portfolio segment and disaggregated on the basis of the Company’s impairment methodology was as follows (dollars in thousands):

		Real Estate				
	Commercial and Agricultural	Residential 1-4 Family	Commercial, Construction, and Farmland	Municipal	Consumer and Other	Total Loans and Leases
2018						
Loans and leases individually evaluated for impairment	$1,240	$4,987	$2,154	$--	$158	$8,539
Loans and leases collectively evaluated for impairment	70,411	147,232	414,125	118,633	217,679	968,080
Ending balance	$71,651	$152,219	$416,279	$118,633	$217,837	$976,619
2017						
Loans and leases individually evaluated for impairment	$1,337	$5,905	$2,977	$--	$169	$10,388
Loans and leases collectively evaluated for impairment	59,756	138,008	382,919	113,622	189,557	883,862
Ending balance	$61,093	$143,913	$385,896	$113,622	$189,726	$894,250

A summary of loans and leases by age, segregated by class of loans and leases, as of December 31, 2018 and 2017 was as follows (dollars in thousands):

2018	Loans and Leases 30-89 Days Past Due	Loans and Leases 90 or More Days Past Due	Total Past Due Loans and Leases	Current Loans and Leases	Total Loans and Leases	Accruing Loans 90 or more Days Past Due
Commercial and agricultural	$356	$--	$356	$71,295	$71,651	$--
Residential 1-4 family real estate	1,047	26	1,073	151,146	152,219	--
Commercial, construction, and farmland real estate	41	34	75	416,204	416,279	--
Municipal	--	--	--	118,633	118,633	--
Consumer and other	905	193	1,098	216,739	217,837	3
Total	$2,349	$253	$2,602	$974,017	$976,619	$3
2017						
Commercial and agricultural	$68	$--	$68	$61,025	$61,093	$--
Residential 1-4 family real estate	28	--	28	143,885	143,913	--
Commercial, construction, and farmland real estate	136	51	187	385,709	385,896	--
Municipal	--	--	--	113,622	113,622	--
Consumer and other	737	119	856	188,870	189,726	24
Total	$969	$170	$1,139	$893,111	$894,250	$24

The following table provides information with respect to nonaccrual loans as of the years ended December 31, 2018 and 2017 (dollars in thousands):

Nonaccrual Loans:

	2018	2017
Commercial and agricultural	$--	$--
Residential 1-4 family real estate	26	--
Commercial, construction, and farmland real estate	34	51
Municipal	--	--
Consumer and other	190	95
Total	$250	$146

The following table provides information with respect to impaired loans as of the years ended December 31, 2018 and 2017 (dollars in thousands):

2018	**Unpaid Contractual Principal Balance**	**Recorded Investment With No Allowance**	**Recorded Investment With Allowance**	**Total Recorded Investment**	**Related Allowance**	**Average Recorded Investment**
Commercial and agricultural	$1,240	$814	$426	$1,240	$13	$1,298
Residential 1-4 family real estate	4,987	3,069	1,918	4,987	230	5,344
Commercial, construction, and farmland real estate	2,154	1,188	966	2,154	51	2,354
Municipal	--	--	--	--	--	--
Consumer and other	158	3	155	158	5	162
Total	$8,539	$5,074	$3,465	$8,539	$299	$9,158
2017						
Commercial and agricultural	$1,337	$1,290	$47	$1,337	$2	$1,318
Residential 1-4 family real estate	5,905	3,261	2,644	5,905	177	5,425
Commercial, construction, and farmland real estate	2,977	1,724	1,253	2,977	74	3,092
Municipal	--	--	--	--	--	--
Consumer and other	169	--	169	169	1	240
Total	$10,388	$6,275	$4,113	$10,388	$254	$10,075

At December 31, 2018, there were no commitments to lend additional funds to borrowers whose loans have been impaired. Loans over 90 days past due still accruing interest totaled $3,000 at December 31, 2018 and $24,000 at December 31, 2017.

No interest income was recognized on a cash basis for impaired loans for the years ended December 31, 2018 and December 31, 2017. All impaired loans were paying according to terms and were accruing interest income in 2018.

The Company assigns risk rating classifications to its loans. These risk ratings are divided into the following groups:

> Pass – asset is considered of sufficient quality to preclude a Special Mention or an adverse rating. Pass assets generally are well protected by the current net worth and paying capacity of the obligor, by the value of the asset, or the underlying collateral.

Special Mention – asset has potential weaknesses that deserve management's close attention. If left uncorrected, these potential weaknesses may result in deterioration of the repayment prospects for the asset or in the Company'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 – asset is inadequately protected by the current net worth and paying capacity of the obligor or by the collateral pledged, if any. Assets so classified have well-defined weaknesses. They are characterized by the distinct possibility that the Company will sustain some loss if the deficiencies are not corrected.

Doubtful – asset has the weaknesses of those 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.

Credit quality indicators for the Company's loan portfolio as of December 31, 2018 and 2017 grouped according to internally assigned risk ratings and payment activity (dollars in thousands):

		Real Estate				
	Commercial and Agricultural	Residential 1-4 Family	Commercial, Construction, and Farmland	Municipal	Consumer and Other	Total Loans and Leases
2018						
Pass	$69,611	$144,830	$392,467	$118,633	$214,786	$940,327
Special Mention	708	3,966	19,611	--	2,535	26,820
Substandard	1,332	3,423	4,201	--	513	9,469
Doubtful	--	--	--	--	3	3
Total Loans and Leases	$71,651	$152,219	$416,279	$118,633	$217,837	$976,619
Restructured	$--	$--	$--	$--	$--	$--
Nonaccrual	--	26	34	--	190	250
Nonperforming	--	26	34	--	190	250
Performing	71,651	152,193	416,245	118,633	217,647	976,369
Total Loans and Leases	$71,651	$152,219	$416,279	$118,633	$217,837	$976,619

		Real Estate				
	Commercial and Agricultural	Residential 1-4 Family	Commercial, Construction, and Farmland	Municipal	Consumer and Other	Total Loans and Leases
2017						
Pass	$59,205	$134,120	$364,959	$113,622	$186,960	$858,866
Special Mention	420	3,586	2,216	--	2,297	8,519
Substandard	1,468	6,207	18,721	--	464	26,860
Doubtful	--	--	--	--	5	5
Total Loans and Leases	$61,093	$143,913	$385,896	$113,622	$189,726	$894,250
Restructured	$--	$--	$118	$--	$24	$142
Nonaccrual	--	--	51	--	95	146
Nonperforming	--	--	169	--	119	288
Performing	61,093	143,913	385,727	113,622	189,607	893,962
Total Loans and Leases	$61,093	$143,913	$385,896	$113,622	$189,726	$894,250

Restructured loans are defined as the period end outstanding balance of loans that previously underwent a troubled debt restructuring.

The following table presents by class troubled debt restructurings (TDR's) recorded during the years ended December 31, 2018 and 2017 (dollars in thousands, except number of contracts):

2018	Number of Contracts	Pre-Modification Recorded Investment	Post-Modification Recorded Investment
Commercial and agricultural	4	$11	$11
Residential 1-4 family real estate	3	143	143
Commercial, construction, and farmland real estate	6	679	679
Municipal	--	--	--
Consumer and other	1	3	3
Total*	14	$836	$836

*Amounts exclude specific loan loss reserves

2017	Number of Contracts	Pre-Modification Recorded Investment	Post-Modification Recorded Investment
Commercial and agricultural	2	$80	$80
Residential 1-4 family real estate	15	3,442	3,442
Commercial, construction, and farmland real estate	12	1,282	1,282
Municipal	--	--	--
Consumer and other	--	--	--
Total*	29	$4,804	$4,804

*Amounts exclude specific loan loss reserves

The majority of TDR's are determined to be impaired prior to being restructured. As such, they are individually evaluated for impairment, unless they are considered homogeneous loans in which case they are collectively evaluated for impairment. As of December 31, 2018 the Company had $21,000 in specific reserves on TDR's which were restructured during the year ended December 31, 2018. The primary type of concession granted in all TDR's during the year ended December 31, 2018 was maturity extensions. There were no TDR's that were restructured and subsequently defaulted during the year ended December 31, 2018.

Note 6 - Premises and Equipment

Components of premises and equipment at December 31 are as follows (dollars in thousands):

	2018	2017
Land	$5,133	$3,725
Buildings and improvements	18,050	15,668
Furniture	5,347	5,140
Equipment	4,467	3,435
Assets in process	303	2,655
Total cost	33,300	30,623
Less accumulated depreciation	(15,307)	(13,789)
Total premises and equipment	$17,993	$16,834

As of December 31, 2018 there were no commitments for capital expenditures. As of December 31, 2017 there was a $1 million commitment for a land purchase which was completed in 2018.

Depreciation expense was $1,813,000 and $1,411,000 in 2018 and 2017, respectively.

Note 7 – Goodwill and Other Intangible Assets

The Bank recorded approximately $300,000 of goodwill and $729,000 of amortizable intangible assets in connection with the Gellatly Agency, Inc. merger that occurred on April 1, 2017.

The Bank recorded approximately $100,000 of goodwill and $2,095,000 of amortizable intangible assets in connection with the Elliott Insurance Service, Inc. merger that occurred on July 1, 2017.

There were no new additions to goodwill or intangible assets in 2018.

The amortization schedule of intangible assets in connection with acquisitions for future years ending December 31 is as follows (dollars in thousands):

2019	$594
2020	594
2021	594
2022	264
Thereafter	--
	$2,046

Note 8– Mortgage Servicing Rights

Mortgage servicing rights (MSR's) are evaluated periodically for possible impairment based on the difference between the carrying amount and current fair value of the MSR's by risk stratification. If a temporary impairment exists, a valuation allowance is established for any excess of amortized cost over the current fair value through a charge to income. A direct write-down is performed when the recoverability of a recorded valuation allowance is determined to be remote. Unlike a valuation allowance, a direct write-down permanently reduces the carrying value of the MSR and the valuation allowance, precluding subsequent reversals.

Mortgage loans serviced for others are not included on the accompanying consolidated balance sheets. The unpaid principal balances of mortgage loans serviced for others were $389,559,000 and $393,051,000 at December 31, 2018 and 2017, respectively. Custodial escrow balances maintained in connection with the foregoing loan servicing were approximately $2,271,000 and $2,181,000 at December 31, 2018 and 2017, respectively. The weighted average amortization period of the Company's servicing rights was 6.9 years and 6.6 years in 2018 and 2017.

The following summarizes the activity in mortgage servicing rights for the years ended December 31 (dollars in thousands):

	2018	**2017**
Balance as of beginning of year	$1,696	$1,723
Originations	215	265
Amortization	(254)	(292)
Adjustment valuation	--	--
Balance as of end of year	$1,657	$1,696

The estimated fair value of the Company's MSR portfolio was $4,244,000 and $3,952,000 at December 31, 2018 and 2017, respectively. Fair value of mortgage servicing rights is based on market prices for comparable mortgage servicing contracts when available. In periods of market inactivity, fair value is determined using a discounted cash flow analysis, utilizing observable market data with unobservable adjustments. The analysis takes into consideration existing conditions in the secondary servicing markets, such as prices from recently executed servicing transactions and market discount rates. The adjustments made to observable data include adjustments for delinquency, and loss rates.

Note 9 - Deposits

The composition of deposits is as follows (dollars in thousands):

	Deposits at December 31		Interest Expense for the Years Ended December 31	
	2018	**2017**	**2018**	**2017**
Noninterest bearing demand deposits	$243,853	$218,418	$--	$--
NOW accounts	248,622	245,170	593	365
Money market and savings accounts	600,756	617,314	1,422	1,207
Time deposits greater than $250,000	33,981	35,736	443	452
Time deposits $250,000 or less	187,665	197,664	2,436	2,414
Total	$1,314,877	$1,314,302	$4,894	$4,438

Time deposits at December 31, 2018, are scheduled to mature as follows (dollars in thousands):

	$250,000 or Less	Greater than $250,000
0 to 90 days	$22,718	$2,160
91 to 365 days	53,076	8,992
1 year to 3 years	69,031	10,779
Over 3 years	42,840	12,050
Total	$187,665	$33,981

Total demand deposit overdrafts that have been reclassified to loans were $238,000 and $224,000 at December 31, 2018 and 2017, respectively.

The Company is a State of Washington Public Depository. All such public depositories are required to be members of Washington State's Public Deposit Protection Commission (PDPC). As such, when there is a loss of public funds at a member institution, those funds are in most instances insured to some extent by the federal government. To the degree a public deposit is not insured by the federal government, the PDPC will assess a claim first against the institution responsible for the loss and then against the pool of collateral held by other PDPC member institutions. Each institution is then responsible to pay its portion of the cost in proportion to the share of public funds held by that institution. The Company held $36,779,000 and $35,068,000 of public deposits as of December 31, 2018 and 2017, respectively.

Note 10 - Short-Term Borrowings

Securities sold under agreements to repurchase and line of credit advances from the Federal Home Loan Bank Des Moines (FHLB) represent short-term borrowings. At December 31, 2018 there were no outstanding balances for line of credit advances. The outstanding balance for line of credit advances at December 31, 2017 was $304,000 with a weighted average interest rate of 5.92%.

The following is a summary of such short-term borrowings for the years ended December 31 (dollars in thousands):

	2018	**2017**
Average balance during the year	$10,403	$8,601
Average interest rate during the year	0.95%	1.27%
Maximum month end balance during the year	$21,144	$10,170

Securities sold under agreements to repurchase are secured by specific securities which, in all cases, the Company maintains control. The securities' underlying agreements to repurchase entered into by the Company are for the same securities originally sold, with a one-day maturity.

	2018	2017
Balance at December 31:		
Securities under agreements to repurchase	$6,333	$7,030
Weighted average interest rate at year end	0.50%	0.18%
Carrying value of underlying securities	$15,607	$19,682
Market value of underlying securities	$15,370	$19,718

Note 11 - Long-Term Borrowings

There were no long-term borrowings at December 31, 2018. Long-term borrowings at December 31, 2017 was $1,815,000 bearing fixed interest rates ranging from 5.42% to 6.23%. Amounts were paid in full in July 2018, including prepayment penalties of $147,000 included in interest expense. All funds borrowed from the FHLB are secured by a blanket pledge of 15% of the Company's assets.

Note 12 - Income Taxes

On December 22, 2017, the United States enacted the Tax Cuts and Jobs Act (the "Act") resulting in significant modifications to existing law. We have completed the accounting for the effects of the Act during the quarter ended December 31, 2017. Our financial statements for the year ended December 31, 2017, reflect certain effects of the Act which includes a reduction in the corporate tax rate from 35.0% to 21.0% as well as other changes. As a result of the changes to tax laws and tax rates under the Act, we incurred incremental income tax expense of $312,000 during the year ended December 31, 2017, which consisted primarily of the re-measurement of deferred tax assets and liabilities from 35.0% to 21.0%.

Income taxes are comprised of the following for the years ended December 31 (dollars in thousands):

	2018	2017
Current	$2,480	$4,538
Deferred	177	(50)
State income taxes	42	35
Total income taxes	$2,699	$4,523

The following is a reconciliation of the statutory income tax rate to the effective income tax rate for the years ended December 31 (dollars in thousands):

	2018		2017	
	Amount	**Percent of Pretax Income**	**Amount**	**Percent of Pretax Income**
Income tax at statutory rates	$5,138	21.0%	$8,026	35.0%
Increase resulting from:				
State income tax	42	0.2%	35	0.2%
Tax Cuts and Jobs Act	--	-- %	312	1.4%
Decrease resulting from:				
Tax-exempt income	(1,959)	(8.0%)	(3,182)	(13.9%)
Tax credits	(500)	(2.0%)	(520)	(2.3%)
Other	(22)	(0.1%)	(148)	(0.6%)
Total income tax expense	$2,699	11.1%	$4,523	19.8%

The tax effects of temporary differences that give rise to significant portions of deferred tax assets and liabilities at December 31 are as follows (dollars in thousands):

	2018	2017
Deferred Tax Assets:		
Allowance for credit losses	$2,373	$2,234
Unrealized loss on securities available for sale	758	--
Deferred compensation	534	504
Other	510	606
Total deferred tax assets	4,175	3,344
Deferred Tax Liabilities:		
Accumulated depreciation and amortization	$1,490	$1,286
Deferred income	492	438
Unrealized gain on securities available for sale	--	659
Mortgage servicing rights	346	355
FHLB dividends	138	138
Total deferred tax liabilities	2,466	2,876
Net deferred tax assets	$1,709	$468

Note 13 – Related-Party Transactions

In the ordinary course of business, the Company has transactions with directors, principal officers, their immediate families, and affiliated companies in which they are principal shareholders (commonly referred to as related parties), all of which have been, in the opinion of management, on the same terms, including interest rates and collateral, as those prevailing at the time for comparable transactions with outside parties.

The following table details the loan activity with related parties at December 31 (dollars in thousands):

	2018	2017
Beginning balance	$21,490	$23,462
New loans or advances during period	2,956	3,043
Repayments during period	(2,895)	(5,015)
Aggregate amount outstanding	$21,551	$21,490
Loan commitments	$23,252	$22,518
Related party deposits	$6,573	$6,290

Note 14 - Commitments and Contingencies

Credit

The Company is party to financial instruments with off-balance sheet risk in the normal course of business to meet the financing needs of its customers. These financial instruments include commitments to extend credit and standby letters of credit. These instruments involve, to varying degrees, elements of credit risk in excess of the amount recognized on the consolidated balance sheets.

The Company's exposure to credit loss in the event of nonperformance by the other party to the financial instrument for commitments to extend credit and standby letters of credit is represented by the contractual amount of those instruments. The Company uses the same credit policies in making commitments and conditional obligations as it does for balance sheet instruments.

A summary of the Company's commitments at December 31 is as follows (dollars in thousands):

	2018	2017
Commitments to extend credit:		
Credit card lines	$33,531	$33,029
Commercial real estate, construction and development	45,473	45,660
Other	101,092	100,619
Total commitments to extend credit	$180,096	$179,308
Standby letters of credit	$140	$164

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. 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's experience has been that between approximately 10% and 25% of loan commitments are drawn upon by customers. 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 customer. Associated with the unfunded commitment, the Company has established a loss reserve in the amount of $256,000 and $235,000 as of December 31, 2018 and 2017, respectively.

Standby Letters of Credit

Standby letters of credit are conditional commitments issued by the Company to guarantee the performance of a customer to a third-party. Those guarantees are primarily issued to support public and private borrowing arrangements. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loan facilities to customers. In certain circumstances collateral is deemed necessary to secure the commitment.

Legal

Because of the nature of its activities, the Company is subject to various pending and threatened legal actions which arise in the ordinary course of business. In the opinion of management, liabilities arising from these claims, if any, will not have a material effect on the financial position of the Company.

Borrowing Facilities

The Company has agreements with commercial banks for lines of credit totaling $49,000,000, none of which was used at December 31, 2018. The Company has a credit line with the Federal Home Loan Bank of Des Moines for 45% of assets. As of December 31, 2018 the credit line was approximately $684,348,000 none of which was used at December 31, 2018. This line is secured with a Blanket Pledge Agreement with the Federal Home Loan Bank (Note 10).

Investments

The Company entered into a subscription agreement to purchase four units at $500,000 per unit for an interest in Homestead Equity Fund A Washington Limited Partnership (HEFA-WA) for which funding has been completed. HEFA-WA has been formed to invest in partnerships or limited liability companies, which will acquire, construct, rehabilitate, operate, and dispose of low income housing developments which are located in Washington State. The housing developments will be eligible for the federal low income housing tax credit and, in some cases, the historic rehabilitation tax credit available under the Internal Revenue Code of 1986, as amended. The Company accounts for the investment under the equity method in accordance with ASC 323, "*Investments – Equity Method and Joint Ventures,*" and a pass-through loss of $22,000 and $32,000 was recorded during 2018 and 2017, respectively. At December 31, 2018 and 2017, the Company's partnership equity was $51,000 and $98,000, respectively, and is included in other assets.

The Company entered into a subscription agreement to purchase one unit at $1,000,000 for an interest in Homestead Western Communities Fund Limited Partnership (HWCF) for which funding has been completed. HWCF has been formed to invest in partnerships or limited liability companies, which will acquire, construct, rehabilitate, operate, and dispose of low income housing developments which are located in the states of Oregon, Washington, Idaho, and California. The housing developments will be eligible for the federal low income housing tax credit and, in some cases, the historic rehabilitation

tax credit available under the Internal Revenue Code of 1986, as amended. The Company accounts for the investment under the equity method in accordance with ASC 323, "*Investments – Equity Method and Joint Ventures,*" and a pass-through loss of $53,000 and $22,000 was recorded during 2018 and 2017, respectively. At December 31, 2018 and 2017, the Company's partnership equity was $42,000 and $75,000, respectively.

The Company entered into a subscription agreement to purchase five units at $1,000,000 per unit for an interest in Homestead Equity Fund X Limited Partnership (HEF-X). HEF-X has been formed to invest in partnerships or limited liability companies, which will acquire, construct, rehabilitate, operate, and dispose of low income housing developments primarily located in the states of Oregon, Washington, Idaho, and California. The housing developments will be eligible for the federal low income housing tax credit and, in some cases, the historic rehabilitation tax credit available under the Internal Revenue Code of 1986, as amended. The Company accounts for the investment under the equity method in accordance with ASC 323, "*Investments – Equity Method and Joint Ventures,*" and a pass-through loss of $400,000 and $309,000 was recorded during 2018 and 2017, respectively. At December 31, 2018 and 2017, the Company's partnership equity was $3,265,000 and $3,862,000, respectively.

The Company's remaining contractual contribution for Homestead Equity Fund X (HEF-X) of $127,000 is expected to be paid as follows (dollars in thousands):

2019	$20
2020	20
2021	87
	$127

Employment Agreements

The Company has entered into employment contracts with certain key employees, which provide for contingent payments subject to future events. These agreements are discussed in Note 16.

Derivatives

For the years ended December 31, 2018 and 2017, the fair value of the hedged loans of $122,000 and $278,000, respectively, are recorded in loans held for investment and the related swap liability is recorded in other liabilities at $122,000 and $278,000, respectively. The Company pledged a certificate of deposit due from the counterparty of the hedging instruments as collateral for the swap liability. This certificate of deposit had a balance of $100,000 and $550,000 at December 31, 2018 and 2017, respectively. The notional amounts of the interest rate swaps were $2,353,000 and $6,466,000 at December 31, 2018 and 2017, respectively. The Company recognized no loss in 2018 and 2017 which represents the ineffective portion of all fair value hedges. All components of each derivative's gain or loss are included in the assessment of hedge effectiveness, unless otherwise noted.

Note 15 – Significant Concentration of Credit Risk

Most of the Company's business activity is with customers located in the state of Washington. Investments in state and municipal securities involve government entities primarily within the state. At December 31, 2018, 7.09% of total loans outstanding were for construction related projects. Of those, 1.98% of total loans outstanding were residential developed lot loans to consumers.

Loans are generally limited, by state banking regulations, to 20% of the Company's capital to any one borrower, excluding accumulated other comprehensive income. At December 31, 2018 the Company's legal lending limit was $38,350,000. Standby letters of credit were granted primarily to commercial borrowers. The Company, as a matter of practice, generally does not extend credit to any single borrower or group of related borrowers in excess of $21,500,000. At December 31, 2018, one borrowing relationship was in excess of this limit at $22,173,000.

Note 16 - Employee Compensation Plans

Stock Option Plan

The Company has a stock option plan under which certain key employees have been granted options to purchase shares of common stock. Under the plan, the Company may grant options of its common stock to certain key employees, of which 272,774 were available for grant at December 31, 2018. Options have an exercise price equal to the fair market value of the stock as of the date of grant. In 2018 the company adopted a vesting schedule with no vesting on grant date, and 20% vesting on each of the five subsequent anniversaries of the grant. Options have a maximum contractual term of ten years. The Black-Scholes model requires the use of assumptions noted in the following table. The dividend yield is based on the Company's actual and expected dividends paid to shareholders. The Company uses historical data to estimate the option exercise and forfeitures to estimate the expected life, which represents the period of time the options are expected to be outstanding. Expected stock price volatility is based on the Company's historical stock price, adjusted for dividends. The risk-free interest rate is based on the U.S. Treasury yield curve rate in effect at grant date with average equivalent term.

The fair value of each option was estimated on the date of grant based on the Black-Scholes option pricing model and used the following weighted average assumptions:

	2018	2017
Dividend yield	1.79%	1.56%
Expected life	6.2 years	6.2 years
Risk-free interest rate	2.44%	2.02%
Expected volatility	22.41%	19.44%

A summary of the status of the Company's stock option plan as of December 31, 2018, and changes during the years ending on those dates, is presented below:

2018	Shares	Weighted Average Exercise Price	Weighted Average Fair Value At Grant
Outstanding at beginning of year	49,350	$40.82	$7.53
Granted	26,750	59.36	12.55
Exercised	6,400	29.96	4.68
Expired	250	16.00	2.00
Outstanding at end of year	69,450	$49.05	$9.74

2018	Shares	Weighted Average Exercise Price	Weighted Average Fair Value At Grant
Vested and expected to vest	63,373	$49.05	$9.74
Options exercisable at year end	36,800	$42.43	$8.29

The following information summarizes information about stock options outstanding and exercisable at December 31, 2018:

	Options Outstanding			Options Exercisable		
Range of Exercise Prices	Number Outstanding	Weighted Average Remaining Contractual Life (Years)	Weighted Average Exercise Price	Number Exercisable	Weighted Average Remaining Contractual Life (Years)	Weighted Average Exercise Price
$ 15.00 – 25.00	5,600	2.88	$22.08	5,600	2.88	$22.08
$ 25.01 – 40.00	12,500	4.93	$32.63	12,500	4.93	$32.63
$ 40.01 – 50.00	5,000	8.09	$48.45	3,000	8.09	$48.45
$ 50.01 – 58.50	44,350	8.80	$56.21	14,900	8.74	$55.61
$ 58.51 – 70.00	2,000	9.54	$70.00	800	9.54	$70.00
Balance at December 31, 2018	69,450	7.60	$49.05	36,800	6.52	$42.43

The total intrinsic value of the options exercised during 2018 and 2017 was $206,000 and $301,000, respectively. The total intrinsic value of options outstanding was $486,000 and $819,000 in 2018 and 2017, respectively. Weighted average remaining contractual life of options vested and expected to vest is 7.29 years. Total proceeds from options exercised in 2018 and 2017 were $158,000 and $298,000 respectively. As a result of disqualifying dispositions of options exercised, the Company recorded a tax benefit of $2,000 in 2018 and no tax benefit in 2017.

At December 31, 2018, unrecognized compensation expense related to unvested options totaled $301,000 and is expected to be recognized over a weighted average period of thirty-five months. During 2018, 7,700 options vested with a weighted average fair value at grant date of $11.61. During 2017, 9,000 options vested with a weighted average fair value at grant date of $9.63.

Restricted Stock Plan

Restricted stock awards are generally scheduled to vest over a 3 to 5 year period, with the unearned compensation related to restricted stock amortized to expense on a dynamic prorated straight-line basis. Unrecognized compensation cost related to unvested restricted stock awards in 2018 and 2017 totaled $102,000 and $111,000, respectively. Total expense recognized by the Company for restricted stock awards for the year ended December 31, 2018 and 2017 was $78,000 and $139,000, respectively.

The following table summarizes our restricted stock awards activity:

	Shares	**Weighted Average Fair Value At Grant**
Outstanding at December 31, 2016	3,280	$39.34
Granted	3,750	48.45
Vested	(2,600)	44.18
Forfeited	(560)	41.83
Outstanding at December 31, 2017	3,870	$44.55
Granted	1,150	$62.56
Vested	(1,960)	44.53
Forfeited	(80)	48.45
Outstanding at December 31, 2018	2,980	$51.41

Scheduled vesting for outstanding restricted stock awards as of December 31, 2018 is as follows:

	Year Ended					
	2019	**2020**	**2021**	**2022**	**2023**	**Total**
Scheduled vesting - restricted stock awards	1,580	970	310	60	60	2,980

Profit-Sharing Plans

The Company has a 401(k) employee benefit plan for those employees who meet eligibility requirements set forth in the plan. Eligible employees may contribute up to 100% of their compensation, subject to certain IRS limits. The Company provides a Safe Harbor match of 100% of the first 4% contributed by participants, subject to certain IRS limits. Additionally, matching contributions may be made by the Company pursuant to a prescribed formula based on the Company's achievement of certain performance goals. The Company contributed $490,000 and $436,000 in 2018 and 2017, respectively.

Incentive compensation is awarded to certain employees based on the financial performance of the Company. Cash bonuses were awarded pursuant to a formula targeted on the Company achieving certain performance goals for the years ended in

2018 and 2017, with the amounts awarded in 2019 and 2018. Amounts awarded under the plan for 2018 and 2017 were $536,000 and $396,000, respectively.

Deferred Compensation Plan

The Company entered into deferred compensation arrangements with key employees. The agreements provide for employee and Company matching contributions equal to the amount that would have been contributed under the Company's 401(k) plan, had the employees not been otherwise excluded from the plan. At December 31, 2018 and 2017, the Company had a recorded liability in the amount of $2,541,000 and $2,394,000 respectively. The Company contributed $169,000 and $122,000 in 2018 and 2017, which represented plan earnings in accordance with the deferred compensation agreements.

Insurance

The Company provides certain health care, disability, and life insurance benefits for current employees. The cost of health care benefits for employees is recognized as expense when paid. Life insurance benefits for employees are provided through an insurance company whose premiums are based on the benefits paid during the year. The Company recognizes the cost of providing such benefits by expensing the monthly insurance premiums. For 2018 and 2017, the cost of providing health care, disability, and life insurance benefits was $1,566,000 and $1,335,000, respectively.

Note 17 - Regulatory Matters

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

Quantitative measures established by regulation to ensure capital adequacy require the Company maintain minimum amounts and ratios (set forth in the table below) of Tier 1 capital to total average assets and minimum ratios of Tier 1 and total capital to risk-weighted assets.

In July 2013, the Board of Governors of the Federal Reserve System and the Federal Deposit Insurance Corporation (FDIC) approved the final rules implementing the Basel Committee on Banking Supervision's capital guidelines for U.S. banks (Basel III). Under the final rules, which became effective for the Company on January 1, 2015 and are subject to a phase-in period through January 1, 2019, minimum requirements increased for both the quantity and the quality of capital held by the Bank. The rules include a new Common Equity Tier 1 capital to risk-weighted assets ratio (CET1 ratio) of 4.5% and a capital conservation buffer of 2.5% above the regulatory minimum risk-based capital requirements, which when fully phased in, effectively results in a minimum CET1 ratio of 7.0%. Basel III also (i) raises the minimum ratio of Tier 1 capital to risk-weighted assets from 4.0% to 6.0% (which, with the capital conservation buffer, effectively results in a minimum Tier 1 capital to risk-weighted assets ratio of 8.5% when fully phased in); (ii) effectively results in a minimum total capital to risk-weighted assets ratio of 10.5% (with the capital conservation buffer fully phased in); and (iii) requires a minimum leverage ratio of 4.0%. Basel III also makes changes to risk weights for certain assets and off-balance sheet exposures.

As of December 31, 2018, the most recent notification from the Company's regulator categorized the Company as well capitalized under the regulatory framework for prompt corrective action. To be categorized as well capitalized, the Company must maintain minimum total risk-based, Tier 1 risk-based, Common Equity Tier 1, and Tier 1 leverage ratios as set forth in the table. There are no conditions or events since that notification that management believes have changed the institution's category.

The Company’s actual capital amounts and ratios are also presented in the following table (dollars in thousands). Management believes as of December 31, 2018, that the Company meets all capital requirements to which it is subject.

December 31, 2018	Actual		Regulatory Minimum to be "Adequately Capitalized"		Basel III Minimum Adequacy with Capital Conservation Buffer		Regulatory Minimum to be "Well Capitalized"	
	Capital Amount	Ratio	Capital Amount	Ratio	Capital Amount	Ratio	Capital Amount	Ratio
Tier 1 leverage (to average assets)	$180,196	11.97%	$60,215	4.00%	N/A	N/A	$75,268	5.00%
CET1 capital (to risk-weighted assets)	180,196	17.71%	45,796	4.50%	64,878	6.38%	66,150	6.50%
Tier 1 capital (to risk-weighted assets)	180,196	17.71%	61,061	6.00%	80,143	7.88%	81,415	8.00%
Total capital (to risk-weighted assets)	191,751	18.84%	81,415	8.00%	100,497	9.88%	101,769	10.00%

December 31, 2017	Actual		Regulatory Minimum to be "Adequately Capitalized"		Basel III Minimum Adequacy with Capital Conservation Buffer		Regulatory Minimum to be "Well Capitalized"	
	Capital Amount	Ratio	Capital Amount	Ratio	Capital Amount	Ratio	Capital Amount	Ratio
Tier 1 leverage (to average assets)	$168,085	11.15%	$60,310	4.00%	N/A	N/A	$75,387	5.00%
CET 1 capital (to risk-weighted assets)	168,085	17.71%	42,704	4.50%	54,566	5.75%	61,684	6.50%
Tier 1 capital (to risk-weighted assets)	168,085	17.71%	56,939	6.00%	68,801	7.25%	75,918	8.00%
Total capital (to risk-weighted assets)	178,959	18.86%	75,918	8.00%	87,781	9.25%	94,898	10.00%

Restrictions on Retained Earnings

The Company is restricted from paying dividends in an amount that would decrease regulatory capital below the minimum amounts shown above.

Note 18 - Fair Value

The Company is required to disclose the estimated fair value of financial instruments, both assets and liabilities on and off the balance sheet, for which it is practicable to estimate fair value. These fair value estimates are made at December 31, 2018 based on relevant market information and information about the financial instruments. Fair value estimates are intended to represent the price an asset could be sold at, or the price a liability could be settled for. However, given there is no active market or observable market transactions for many of the Company’s financial instruments, the Company has made estimates of many of these fair values. Those estimates, which are subjective in nature, involve uncertainties and matters of significant judgment, and therefore cannot be determined with precision. Changes in assumptions could significantly affect the estimated values.

Fair Value of Financial Instruments

The carrying amounts and estimated fair value of the Company's financial instruments are as follows (dollars in thousands):

		December 31, 2018		December 31, 2017	
	Level	Carrying Amount	Fair Value	Carrying Amount	Fair Value
Financial Assets					
Cash and cash equivalents	1	$55,231	$55,231	$56,686	$56,686
Securities available for sale	1	8,347	8,347	3,636	3,636
Securities available for sale	2	431,567	431,567	511,212	511,212
Securities held to maturity	2	37	37	1,539	1,523
FHLB and PCBB stock	2	2,057	2,057	2,069	2,069
Loans held for sale	2	696	699	1,171	1,195
Loans and leases, net	3	965,320	946,903	883,661	877,984
Mortgage servicing rights	3	1,657	4,244	1,696	3,952
Accrued interest receivable	2	5,396	5,396	5,578	5,578
Bank Owned Life Insurance	2	15,010	15,010	14,582	14,582
Financial Liabilities					
Deposits	3	$1,314,877	$1,313,056	$1,314,302	$1,343,308
Borrowings	3	9,830	9,819	11,557	11,784
Interest rate swaps	2	122	122	278	278
Accrued interest payable	2	509	509	454	454

The Company assumes interest rate risk (the risk that general interest rate levels will change) as a result of its normal operations. As a result, the fair values of the Company's financial instruments will change when interest rate levels change and that change may either be favorable or unfavorable to the Company. Management attempts to match maturities of assets and liabilities to the extent believed necessary to minimize interest rate risk. However, borrowers with fixed rate obligations are less likely to prepay in a rising rate environment and more likely to prepay in a falling rate environment. Conversely, depositors who are receiving fixed rates are more likely to withdraw funds before maturity in a rising rate environment and less likely to do so in a falling rate environment. Management monitors rates and maturities of assets and liabilities, and attempts to minimize interest rate risk by adjusting terms of new loans and deposits and by investing in securities with terms that mitigate the Company's overall interest rate risk.

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

Securities Available for Sale and Held to Maturity

Securities totaling $439,915,000 are reported at fair value utilizing Level 1 and Level 2 inputs for available for sale securities. The fair values of securities utilizing Level 2 inputs are based on quoted market prices of similar instruments and dealer quotes or determined utilizing a present value income model that utilized observable market-based inputs, as described in Note 1. The fair values were obtained from an independent pricing service and internally validated. The fair value measurements consider observable data that may include dealer quotes, market spreads, cash flows, the U.S. Treasury yield curve, live trading levels, trade execution data, market consensus, prepayment speeds, credit information, and the bond's terms and conditions, among other things.

Interest Rate Swap Derivatives

The fair values of interest rate swap derivatives are estimated by an independent third-party using a discounted cash flow method based on current incremental rates for similar types of arrangements. For purposes of potential valuation adjustments to its derivative positions, the Company evaluates the credit risk of its counterparties as well as that of the Company. Accordingly, the Company has considered factors such as the likelihood of default by the Company and its counterparties, its net exposures, and remaining contractual life, among other things, in determining if any fair value adjustments related to credit risk are required. Counterparty exposure is evaluated by considering the amounts of collateral

securing the position. The Company reviews its counterparty exposure on a regular basis, and when necessary, appropriate business actions would be taken to adjust the exposures. The Company also uses this approach to estimate its own credit risk on derivative liability positions. To date, the Company has not realized any significant losses due to a counterparty's inability to pay any net uncollateralized position. The change in value of derivative assets and derivative liabilities attributable to credit risk was not significant during the reported periods.

		Fair Value Measurement Using		
December 31, 2018	**Assets/(Liabilities) Total**	**Level 1**	**Level 2**	**Level 3**
U.S. Treasury	$8,347	$8,347	$--	$--
State and municipal securities	206,604	--	206,604	--
Collateralized mortgage obligations	152,547	--	152,547	--
Mortgage-backed securities	52,968	--	52,968	--
Asset-backed securities	19,427	--	19,427	--
Money market mutual funds	22	--	22	--
Total securities available for sale	$439,915	$8,347	$431,567	$--
Interest rate swap derivatives	$(122)	$--	$(122)	$--
December 31, 2017				
State and municipal securities	$263,805	$3,636	$260,169	$--
Collateralized mortgage obligations	175,845	--	175,845	--
Mortgage-backed securities	75,177	--	75,177	--
Money market mutual funds	21	--	21	--
Total securities available for sale	$514,848	$3,636	$511,212	$--
Interest rate swap derivatives	$(278)	$--	$(278)	$--

Assets and Liabilities Measured at Fair Value on a Nonrecurring Basis

As of December 31, 2018 and 2017, the Company did not hold any significant assets or liabilities measured at fair value on a nonrecurring basis.

Note 19 – Other Comprehensive Income

Net unrealized gains and losses on available for sale securities reported in other comprehensive income comprised of the following (dollars in thousands):

	Before Tax Amount	Tax Effect	Net of Tax Amount
Year Ended December 31, 2018			
Unrealized holding losses arising during the year	$(6,841)	$1,438	$(5,403)
Reclassification adjustment for gains realized in net income	94	(20)	74
Net unrealized (losses)	$(6,747)	$1,418	$(5,329)
Year Ended December 31, 2017			
Unrealized holding gains arising during the year	$532	$(186)	$346
Reclassification adjustment for losses realized in net income	(439)	153	(286)
Net unrealized gains	$93	$(33)	$60

Note 20 – Shareholders' Equity and Earnings per Common Share

Earnings per Common Share

The following table presents a reconciliation of the number of shares used in the calculation of basic and diluted earnings per common share (dollars in thousands, except share and per share amounts):

	2018	2017
Distributed earnings allocated to common stock	$11,111	$4,434
Undistributed earnings allocated to common stock	10,677	13,974
Net earnings allocated to common stock	$21,788	$18,408
Weighted average common shares outstanding - Basic	4,115,537	4,103,992
Dilutive effect of options outstanding	16,057	15,616
Weighted average common shares outstanding - Diluted	4,131,594	4,119,608
Earnings per common share – Basic	$5.29	$4.49
Earnings per common share – Diluted	$5.27	$4.47
"Out of the money" stock options	26,350	--

Stock Repurchase Plans

From time to time, the Company's board of directors has authorized stock repurchase plans. In general, stock repurchase plans allow the Company to proactively manage its capital position and return excess capital to shareholders. Shares purchased under such plans also provide the Company with shares of common stock necessary to satisfy obligations related to stock compensation awards. Under the most recent plan, there were no shares repurchased in 2018 and 2017.

Note 21 – Revenue from Contracts with Customers

All of the Company's revenue from contracts with customers in the scope of ASC 606 is recognized in noninterest income. The following table presents the Company's sources of noninterest income for the year ended December 31, 2018 (dollars in thousands). Items outside of the scope of ASC 606 are noted as such.

	2018
Noninterest income:	
Service charges on deposit accounts	$1,886
Mortgage banking operations (a)	2,230
Net (loss) on sales of securities available for sale (a)	(94)
Brokerage commissions	515
Insurance commissions and fees	4,110
Net Interchange income	1,380
BOLI cash value (a)	428
Remaining other (a)	1,482
Total noninterest income	$11,937

(a) Not within scope of ASC 606

Deposit Service Charges

The Company earns fees from its deposit customers for account maintenance, transaction-based and overdraft services. Account maintenance fees consist primarily of account fees and analyzed account fees charged on deposit accounts on a monthly basis. The performance obligation is satisfied and the fees are recognized on a monthly basis as the service period is completed. Transaction-based fees on deposit accounts are charged to deposit customers for specific services provided to the customer, such as non-sufficient funds fees, overdraft fees, and wire fees. The performance obligation is completed as the transaction occurs and the fees are recognized at the time each specific service is provided to the customer.

Debit and Credit Card Interchange Fee Income and Expenses

Debit and credit interchange income represent fees earned when a card issued by t is used. The Company earns interchange fees from debit cardholder transactions through the *Visa* payment network. Interchange fees from cardholder transactions represent a percentage of the underlying transaction value and are recognized daily, concurrently with the transaction processing services provided to the cardholder. The performance obligation is satisfied and the fees are earned when the cost of the transaction is charged to the cardholders' card. Certain expenses directly associated with the credit and debit card are recorded on a net basis with the interchange income.

Brokerage Revenue

Brokerage fees consist of fees earned from advisory asset management, trade execution and administrative fees from investments. Advisory asset management fees are variable, since they are based on the underlying portfolio value, which is subject to market conditions and asset flows. Advisory asset management fees are recognized quarterly and are based on the portfolio values at the end of each quarter. Brokerage accounts are charged commissions at the time of a transaction and the commission schedule is based upon the type of security and quantity. The amount of revenue earned is determined by the value and type of each instrument sold and is recognized at the time the policy or contract is written. In addition, revenues are earned from selling insurance and annuity policies.

Insurance Revenue

Insurance revenue consists of commissions and fees from the sales of insurance policies and related insurance services. Insurance commission income is recognized at the later of the effective date of the insurance policy or billing date, net of adjustments. Such adjustments are recorded when the amount can be reasonably estimated, which is generally in the period in which they occur. Commission revenues related to installment billings are recognized on the latter of effective or invoiced date. Contingent commissions are estimated and accrued relative to the recognition of corresponding commissions. Management determines a policy cancellation reserve based upon historical cancellation experience adjusted for any known circumstances. Subsequent commission adjustments were recognized upon receipt of notification from insurance companies concerning such adjustments.

Prior to adoption of ASC 606, commission revenues were recognized over the life of the policies. Upon adoption utilizing the modified retrospective approach, a cumulative adjustment to retained earnings in the amount of $1,283,000 was recorded.

Note 22 – Subsequent Events

The Company performed an evaluation of subsequent events through March 11, 2019, the date these financial statements were available to be issued.

On January 22, 2018, the Company's Board of Directors approved a dividend of $0.65 per share, payable and paid on February 11, 2019, to shareholders of record as of February 1, 2019.

Directors and Officers

Board of Directors
Brian Nelson, Chairman
Lyman Boyd, Vice Chairman
Judy Conner, CPA
Bill Dronen
Greg Oakes
John Doyle
Keith Wiggins

Administrative Officers
Greg Oakes, President & Chief Executive Officer
Mike Lundstrom, EVP & Chief Financial Officer
Connie Fritz, EVP & Chief Retail Banking Officer
Steve Vradenburg, EVP & Chief Lending Officer
Sue Ozburn, EVP & Chief Information Officer

Mitchell, Reed & Schmitten Insurance Board of Directors
Greg Oakes, Chairman
Lori Reed
Lyman Boyd
Jim Gibbons
Laura Mounter
Brent Schmitten
Marc Heminger

Finance
DeAnne Williams, VP & Controller

Internal Audit
Dennis Combs, AVP & Examiner

Credit Administration
Ann Rankin, AVP & Credit Operations Supervisor
Kyle Bruggman, AVP & Assistant Credit Administrator

Compliance
Deidra Anderson, VP & Compliance Officer

Retail Operations and Personnel
Jennifer West, AVP & Human Resource Director
Jeff Burton, AVP & Retail Operations Officer
Christy Tomlinson, AVP & HR Generalist

Financial Services Group
Art Hansen, SVP & Financial Services Manager

Contract Purchasing and Equipment Leasing
Chris Ewer, SVP & Indirect Lending
Jeff Miller, VP & Dealer Finance Manager
Jessica Steinburg, Financial Services Supervisor
Elliott McLeod, Loan Officer
Thomas Christopherson, Loan Officer

Electronic Banking and Card Services
Sharon Low, VP & Electronic Banking Manager
Nicole Ivarsen, Credit Card Services Manager

Municipal Banking
Thomas Brown, VP & Municipal Finance Manager

Information Technology
Terri Howard, AVP& Information Systems Operations Officer

Cashmere Valley Mortgage
Shirley Reyes, SVP & Mortgage Servicing Manager
Kyle Lewis, SVP & Mortgage Production Manager
Mireya Sanchez, Mortgage Operations Officer

Mitchell Reed & Schmitten Insurance
Brent Schmitten, President & Chief Operations Officer

Cashmere Valley Wealth Management
Timothy Meyers, Division Director

Customer Support Center
Sheryl Rivera, Customer Support Center Supervisor

Cashmere Branch
Josh Price, AVP & Manager
Jana Flores, Retail Operations Officer

Maple Street, Wenatchee Branch
Steve Lee, SVP & Manager
Mike Kintner, VP & Commercial Lender
Kelly Walker, Retail Operations Officer

Leavenworth Branch
Darrin Rylaarsdam, SVP & Manager
Shawna Alexander, VP & Retail Operations Officer
Gary Waunch, AVP & Loan Officer

East Wenatchee Branch
Alex Cruz, VP & Manager
Ann Kinzel, AVP & Retail Operations Officer
Kellen Parton, Loan Officer

Chelan Street, Wenatchee Branch
Jenny Pulver, VP & Manager

Easy Street, Wenatchee Branch
Claudia De Robles, VP & Manager
Elizabeth Mejia, Retail Operations Officer

Ellensburg Branch
Pam Wilson, VP & Manager
Miriam Nation, Retail Operations Officer
Kimberly Bonjorni, AVP & Loan Officer

Cle Elum Branch
Dale Loveland, SVP & Manager
Caren Reed, Retail Operations Officer

Lake Chelan Branch
Russ Jones, VP & Manager
Griselda Hernandez, Retail Operations Officer

Summitview Avenue, Yakima Branch
Maria Fabara, Retail Operations Officer

Yakima Avenue, Yakima Branch
Taylor Stormo, VP & Manager
Brittanie Vaughn, Retail Operations Officer

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Cashmere Valley Mortgage
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Valley Contract Servicing
124 East Penny Road, Suite 205, Wenatchee
509-664-5452

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ATM/Debit Cards 509-664-5453

Dealer Financing
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Equipment Finance Solutions
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