REPORT OF INDEPENDENT AUDITORS
AND CONSOLIDATED FINANCIAL STATEMENTS

U & I FINANCIAL CORP. AND SUBSIDIARY

December 31, 2018 and 2017

MOSSADAMS

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Report of Independent Auditors

To the Board of Directors and Shareholders of
U & I Financial Corp. and Subsidiary

Report on the Financial Statements

We have audited the accompanying consolidated financial statements of U & I Financial Corp. and Subsidiary (the Company), which comprise the consolidated statements of financial condition as of December 31, 2018 and 2017, and the related consolidated statements of income, comprehensive income, changes in 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, whether due to fraud or error.

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 audits to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

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

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

Opinion

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

Moss Adams LLP

Everett, Washington
March 18, 2019

Consolidated Statements of Financial Condition (dollars in thousands)

ASSETS

	December 31, 2018	December 31, 2017
ASSETS		
Cash and due from banks	$ 17,528	$ 22,346
Interest-bearing deposits in other financial institutions	13,988	21,956
Securities available-for-sale, at fair value	46,546	33,234
Loans receivable, net of allowance for loan losses of $2,310 and $2,000 at December 31, 2018 and 2017, respectively	208,501	178,555
Federal Home Loan Bank stock, at cost	809	430
Premises and equipment, net	5,778	6,036
Bank-owned life insurance	8,895	8,652
Accrued interest receivable	869	706
Deferred income tax asset, net	209	41
Other real estate owned (OREO)	100	100
Servicing asset	1,518	1,830
Other assets	277	142
Total assets	$ 305,018	$ 274,028

LIABILITIES AND SHAREHOLDERS' EQUITY

	December 31, 2018	December 31, 2017
LIABILITIES		
Deposits		
Noninterest-bearing	$ 38,459	$ 40,051
Interest-bearing		
Savings	9,369	9,935
Money market accounts and NOW	100,692	114,965
Time deposits	100,352	66,088
Total deposits	248,872	231,039
Borrowings	12,000	3,000
Accrued interest payable	127	59
Other liabilities	963	530
Total liabilities	261,962	234,628
SHAREHOLDERS' EQUITY		
Preferred stock, $1,000 par value; 5,500 shares authorized; no shares issued and outstanding at December 31, 2018 and 2017, respectively	-	-
Common stock - no par value; 10,000,000 shares authorized; 5,575,038 and 5,450,098 shares issued and outstanding at December 31, 2018 and 2017, respectively	28,486	28,152
Retained earnings	15,354	11,373
Accumulated other comprehensive loss, net of tax benefit	(784)	(125)
Total shareholders' equity	43,056	39,400
Total liabilities and shareholders' equity	$ 305,018	$ 274,028

See accompanying notes.

U & I Financial Corp. and Subsidiary
Consolidated Statements of Income
(dollars in thousands, except per share amounts)

	Years Ended December 31, 2018	2017
INTEREST INCOME		
Interest and fees on loans	$ 11,874	$ 9,438
Interest on securities	1,313	647
Interest on other investments	398	493
Total interest income	13,585	10,578
INTEREST EXPENSE		
Interest on deposits	2,268	1,445
Interest on borrowings	188	-
Interest on debentures	-	7
Total interest expense	2,456	1,452
Net interest income before provision for loan losses	11,129	9,126
PROVISION FOR LOAN LOSSES	294	334
Net interest income after provision for loan losses	10,835	8,792
NONINTEREST INCOME		
Service charges on deposit accounts	298	262
Gain on sale of investments	-	497
Gain on sale of loans	1,639	835
Other income	486	474
Total noninterest income	2,423	2,068
NONINTEREST EXPENSES		
Salaries and employee benefits	4,904	3,812
Occupancy and equipment	937	926
(Gain) loss on sale of OREO, net	-	49
Professional fees, net	357	806
Advertising	110	51
Data processing and communication	295	281
Directors' expenses	221	181
State B&O tax	261	209
Other	642	557
Total noninterest expenses	7,727	6,872
Income before income tax provision	5,531	3,988
INCOME TAX PROVISION	1,025	793
NET INCOME	$ 4,506	$ 3,195
Earnings per common share		
Basic	$ 0.82	$ 0.60
Diluted	$ 0.82	$ 0.59

See accompanying notes.

Consolidated Statements of Comprehensive Income (dollars in thousands)

	Years Ended December 31, 2018	2017
NET INCOME	$ 4,506	$ 3,195
Other comprehensive loss, net of tax		
Unrealized gain on securities		
Unrealized holding (loss) gain, net of tax (benefit) expense benefit of ($168) and $2, respectively	(634)	4
Adjustment for realized gains included in net income, net of tax expense of $0 and $(169), respectively	-	(328)
Other comprehensive loss, net of tax	(634)	(324)
COMPREHENSIVE INCOME	$ 3,872	$ 2,871

See accompanying notes.

U & I Financial Corp. and Subsidiary
Consolidated Statements of Changes in Shareholders' Equity
(dollars in thousands, except share amounts)

	Preferred Stock		Common Stock		Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total Shareholders' Equity
	Shares	Amount	Shares	Amount			
BALANCE, December 31, 2016	-	$ -	4,972,920	$ 25,879	$ 10,752	$ 199	$ 36,830
Cash dividend	-	-	-	-	(1,287)	-	(1,287)
Stock dividend	-	-	257,494	1,287	(1,287)	-	-
Exercised stock options	-	-	219,684	986	-	-	986
Net income	-	-	-	-	3,195	-	3,195
Other comprehensive loss, net of tax	-	-	-	-	-	(324)	(324)
BALANCE, December 31, 2017	-	-	5,450,098	28,152	11,373	(125)	39,400
Cash dividend	-	-	-	-	(550)	-	(550)
Share-based compensation	-	-	-	134	-	-	134
Reclassification resulting from the Tax Cuts and Jobs Act of 2017	-	-	-	-	25	(25)	-
Exercised stock options	-	-	44,940	200	-	-	200
Restricted stock awards issued	-	-	80,000	-	-	-	-
Net income	-	-	-	-	4,506	-	4,506
Other comprehensive loss, net of tax	-	-	-	-	-	(634)	(634)
BALANCE, December 31, 2018	-	$ -	5,575,038	$ 28,486	$ 15,354	$ (784)	$ 43,056

 See accompanying notes.

Consolidated Statements of Cash Flows (dollars in thousands)

	Years Ended December 31, 2018	2017
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income	$ 4,506	$ 3,195
Adjustments to reconcile net income to net cash from operating activities		
Depreciation and amortization	280	292
Increase in cash surrender value of life insurance	(243)	(258)
Provision for loan losses	294	334
Accretion of premiums and discounts on investment securities	244	11
Stock compensation expense	134	-
Proceeds from sales of loans	20,678	10,619
Origination of loans held-for-sale	(19,039)	(7,838)
Gain on sale of loans, investments, and OREO	(1,639)	(1,381)
(Gain) loss on disposal of fixed assets	-	(9)
Deferred income tax benefit	-	363
Servicing asset capitalized	(456)	(236)
Servicing asset amortization	768	844
Changes in operating assets and liabilities		
Change in accrued interest receivable	(163)	(144)
Change in other assets	(135)	16
Change in accrued interest payable	68	(11)
Change in other liabilities	433	(51)
Net cash from operating activities	5,730	5,746
CASH FLOWS FROM INVESTING ACTIVITIES		
Net change in loans receivable	(30,240)	(14,106)
Change in interest-bearing deposits in other financial institutions	7,968	513
Proceeds from sales of securities available-for-sale	-	9,094
Proceeds from matured, called and principal repayment of securities available-for-sale	1,362	3,985
Purchase of securities available-for-sale	(15,720)	(30,114)
Purchase of Federal Home Loan Bank stock	(379)	(96)
Proceeds from sale of OREO	-	1,223
Purchases of premises and equipment, net	(22)	(26)
Net cash from investing activities	(37,031)	(29,527)
CASH FLOWS FROM FINANCING ACTIVITIES		
Net increase in deposits	17,833	11,326
Proceeds from Federal Home Loan Bank advances	9,000	3,000
Maturity of debentures	-	(1,260)
Proceeds from exercise of stock options	200	986
Common stock cash dividend	(550)	(1,287)
Net cash from financing activities	26,483	12,765
NET CHANGE IN CASH AND CASH EQUIVALENTS	(4,818)	(11,016)
CASH AND CASH EQUIVALENTS, beginning of year	22,346	33,362
CASH AND CASH EQUIVALENTS, end of year	$ 17,528	$ 22,346
SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION		
Cash paid during the year for		
Interest paid	$ 2,388	$ 1,462
Income taxes paid	$ 1,110	$ 350
NONCASH INVESTING ACTIVITIES		
Unrealized loss on securities available for sale	$ (802)	$ (490)

See accompanying notes.

Note 1 – Summary of Significant Accounting Policies

UniBank (the Bank) is a Washington State–chartered commercial bank incorporated on September 1, 2006. The Bank opened for business on November 1, 2006. UniBank is a community bank conducting general business banking that includes deposits, lending, and investing, with its primary market encompassing the Korean-American community of King, Snohomish, and Pierce Counties. The principal office is located at 19315 Hwy. 99, Lynnwood, Washington, 98036. In addition, the Bank has full-service branch offices in Tacoma, Bellevue, and Federal Way, Washington.

U & I Financial Corp. was issued a certificate of incorporation in the state of Washington on August 19, 2010. On September 10, 2010, the Federal Reserve Board granted authority to U & I Financial Corp. to become a bank holding company through a reorganization of the ownership interests of UniBank. The Washington Department of Financial Institutions Divisions of Banks approved the articles of share exchange and plan of share exchange, and issued a certificate of reorganization.

The consolidated financial statements include the transactions of U & I Financial Corp. and its wholly owned subsidiary, UniBank (collectively, the Company). All significant intercompany transactions have been eliminated in consolidation.

The accounting and reporting policies of the Company conform to generally accepted accounting principles in the United States of America (GAAP) and general practices within the banking industry.

Operating segments – The Company and the Bank are managed as a legal entity and not by lines of business. The Bank's operations include commercial banking services, such as lending activities, deposit products, and other cash management services.

Use of estimates in the preparation of financial statements – The preparation of the consolidated financial statements in accordance with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities, and the reported amounts of revenues and expenses during the reporting period. Material estimates that are particularly susceptible to significant change in the near term relate to the determination of the valuation of the allowance for loan losses, other real estate owned, fair value of financial instruments, and deferred income taxes. Actual results could differ from those estimates.

Concentration of credit risk – Assets and liabilities that subject the Company to concentration of credit risk consist of investments, loans, other real estate owned, and deposits. Most of the Company's customers are located within Snohomish County, King County, Pierce County, and the surrounding areas. The types of securities that the Company invests in are discussed in Note 2 and the Company's primary lending products are discussed in Note 3. As of December 31, 2018 and 2017, the Company had significant concentrations in commercial real estate loans. The Company did not have any significant concentrations to any one customer. The Company obtains what it believes to be sufficient collateral to secure potential losses. The extent and value of the collateral varies depending on the details underlying each loan agreement.

Note 1 – Summary of Significant Accounting Policies (continued)

At times, the Company has cash and interest-bearing deposits in other banks in excess of the Federal Deposit Insurance Corporation (FDIC)-insured limits. The Company places these deposits with major financial institutions and monitors the financial condition of these institutions.

Cash and cash equivalents – Cash and cash equivalents include cash and due from banks, and term and overnight federal funds sold, all of which have original maturities less than 90 days.

Interest-bearing deposits in other financial institutions – Interest-bearing deposits in other financial institutions represent short-term deposits that mature over a period of 90 days to 3 years and are carried at cost.

Restricted assets – Zions Bank requires a minimum balance of $100,000 as of December 31, 2018 and 2017, related to a line of credit (Note 9). This balance is included in cash and cash equivalents.

Investment securities – Investment securities are classified into one of three categories: (1) held-to-maturity, (2) available-for-sale, or (3) trading. The Company had no trading securities or held-to-maturity securities as of December 31, 2018 and 2017. Investment securities are categorized as held-to-maturity when the Company has the positive intent and ability to hold those securities to maturity. Securities that are held-to-maturity are stated at cost and adjusted for amortization of premiums and accretion of discounts, which are recognized as adjustments to interest income.

Investment securities categorized as available-for-sale are generally held for investment purposes (to maturity), although unanticipated future events may result in the sale of some securities. Available-for-sale securities are recorded at estimated fair value, with the net unrealized gain or loss included in comprehensive income, net of the related tax effect. Realized gains or losses on dispositions are based on the net proceeds and the adjusted carrying amount of securities sold, using the specific identification method. Amortization of premiums and accretion of discounts are recognized in interest income over the period to maturity.

Management reviews investment securities on an ongoing basis for the presence of other-than-temporary impairment (OTTI) or permanent impairment, taking into consideration current market conditions; fair value in relationship to cost; extent and nature of the change in fair value; issuer rating changes and trends; whether to sell the security before recovery of the amortized cost basis of the investment, which may be maturity; and other factors. For debt securities, if management intends to sell the security or it is likely that the Company will be required to sell the security before recovering its cost basis, the entire impairment loss would be recognized in earnings as an OTTI. If management does not intend to sell the security and it is not likely that the Company will be required to sell the security, but management does not expect to recover the entire amortized cost basis of the security, only the portion of the impairment loss representing credit losses would be recognized in earnings. The credit loss on a security is measured as the difference between the amortized cost basis and the present value of the cash flows expected to be collected. Projected cash flows are discounted by the original or current effective interest rate depending on the nature of the security being measured for potential OTTI. The remaining impairment related to all other factors, i.e., the difference between the present value of the cash flows expected to be collected and fair value, is recognized as a charge to other comprehensive income. Impairment losses related to all other factors are presented as separate categories within other comprehensive income.

Note 1 – Summary of Significant Accounting Policies (continued)

Federal Home Loan Bank (FHLB) stock – The Company is a member of the FHLB of Des Moines. The Company's investment in FHLB stock totaled $809,000 and $430,000 as of December 31, 2018 and 2017, respectively. FHLB stock is carried at cost and classified as a restricted security. Both cash and stock dividends received are reported as dividend income.

The Company evaluates FHLB stock for impairment. The determination of whether these investments are impaired is based on the Company's assessment of the ultimate recoverability of cost, rather than by recognizing temporary declines in value. The determination of whether a decline affects the ultimate recoverability of cost is influenced by criteria such as (1) the significance of any decline in net assets of the FHLB as compared with the capital stock amount for the FHLB and the length of time this situation has persisted; (2) commitments by the FHLB to make payments required by law or regulation and the level of such payments in relation to the operating performance of the FHLB; (3) the impact of legislative and regulatory changes on institutions and, accordingly, the customer base of the FHLB; and (4) the liquidity position of the FHLB. Based on the above, the Company has determined that there is not an other-than-temporary impairment on the FHLB stock investment as of December 31, 2018 or 2017.

Bank-owned life insurance (BOLI) – The Bank owns bank-owned life insurance for various individuals in management positions. The carrying amount of the life insurance approximates fair value. Fair value of life insurance is estimated using the cash surrender value, less applicable surrender charges. The change in the cash surrender value is included in noninterest income. At December 31, 2018 and 2017, the BOLI had a total cash surrender value of $8,895,000 and $8,652,000, respectively.

Loans held-for-sale – Certain Small Business Administration (SBA) and United States Department of Agriculture (USDA) loans that may be sold prior to maturity are designated as held-for-sale at origination and are recorded at the lower of cost or market, determined on an aggregate basis. A valuation allowance is established if the market value of such loans is lower than their cost, and operations are charged or credited for valuation adjustments. The Company typically sells the guaranteed portion of the SBA or USDA loan and retains the unguaranteed portion.

Loans – Loans that management has the intent and ability to hold for the foreseeable future or until maturity or payoff are reported at the principal balance outstanding, net of deferred loan fees and unearned income. Interest revenue on loans is generally accrued based on the principal amount outstanding. The accrual of interest on loans is discontinued when the payment of principal or interest is considered to be in doubt, or when a loan becomes contractually past due by 90 days or more with respect to principal or interest, unless the credit is well secured and in the process of collection. When a loan is placed on nonaccrual status, any accrued but uncollected interest is reversed from current income. Subsequent payments received, in general, on nonaccrual loans are recorded as principal reductions. Nonaccrual loans may be restored to accrual status when principal and interest become current and full repayment is expected.

Loan origination fees are deferred and amortized as yield adjustments over the contractual lives of the related loans. Other loan fees and charges, representing service costs for the prepayment of loans, delinquent payments, or miscellaneous loan services, are recorded as income when collected.

Note 1 – Summary of Significant Accounting Policies (continued)

Allowance for loan losses – The allowance for loan losses is maintained at a level considered adequate to absorb potential losses in the loan portfolio. The allowance for loan losses is increased by charges to income and decreased by charge-offs. Subsequent recoveries, if any, are credited to the allowance. The adequacy of the allowance is determined by management based on evaluation and review of the loan portfolio considering loan loss experience, current economic conditions, changes in the composition of the loan portfolio, and other risk factors. The Company also maintains an unallocated allowance amount to provide for uncertainties inherent in a loan portfolio that could affect management's estimate of probable losses. Allocations of the allowance may be made for specific loans, but the entire allowance is available for any loan that, in management's judgment, should be charged off.

The Company considers a loan as impaired when it is probable that all amounts due (principal plus interest) will not be collected according to the contractual terms of the loan agreement. Factors considered by management include payment status, collateral value, and probability of collecting scheduled principal and interest payments when due. Loans that experience insignificant payment delays and payment shortfalls generally are not classified as impaired. Management determines the significance of payment delays and payment shortfalls on a case-by-case basis, taking into consideration all of the circumstances surrounding the loan and the borrower.

The allowance for impaired loans is determined based on the present value of estimated cash flows or on the fair value of the collateral, if the loan is collateral-dependent. Although management uses available information to recognize losses on loans, because of uncertainties associated with local economic conditions, collateral values, and future cash flows on impaired loans, it is reasonably possible that a material change could occur in the allowance for loan losses in the near term.

Various regulatory agencies, as an integral part of their examination processes, periodically review the Company's allowance for loan losses. Such agencies may require the Company to recognize additional losses based on their judgment using information available to them at the time of their examination.

SBA loan sales and servicing – The Company sells or transfers loans, including the guaranteed portion of SBA or USDA loans (with servicing retained) for cash proceeds equal to the principal amount of loans, as adjusted to yield interest to the investor based on the current market rates. The Company records an asset representing the right to service loans for others when it sells a loan and retains the servicing rights. The carrying value of loans is allocated between the loan and the servicing rights, based on their relative fair values. The fair value of servicing rights is estimated by discounting estimated future cash flows from servicing using discount rates that approximate current market rates and using estimated prepayment rates. The servicing rights are carried at the lower of cost or market and are amortized in proportion to, and over the period of, the estimated net servicing income, assuming prepayments. For purposes of evaluating and measuring impairment, servicing rights are based on a discounted cash flow methodology, current prepayment speeds, and market discount rates. Any impairment is measured as the amount by which the carrying value of servicing rights for a stratum exceeds its fair value. A premium over the adjusted carrying value is received upon the sale of the guaranteed portion of an SBA or USDA loan. Because the portion retained does not carry an SBA or USDA guarantee, part of the gain recognized on the sold portion of the loan may be deferred and amortized as a yield enhancement on the retained portion in order to obtain a market equivalent yield.

Note 1 – Summary of Significant Accounting Policies (continued)

Premises and equipment – Premises and equipment are stated at cost, less accumulated depreciation and amortization. Depreciation is provided using the straight-line method over 3 to 39 years (leasehold improvements are amortized over the lesser of the terms of the respective leases or the estimated useful lives). Repairs and maintenance are charged to operating expenses as incurred.

Impairment of long-lived assets – Long-lived assets are evaluated for impairment whenever events or changes in circumstances indicate that the carrying value of an asset may not be recoverable. No impairment loss was recognized in 2018 or 2017.

Other real estate owned (OREO) – Assets acquired through or in lieu of loan foreclosure are held-for-sale and are initially recorded at lower of cost or estimated fair value, less cost to sell, at the date of foreclosure. Losses arising from the acquisition of property, in full or partial satisfaction of loans, are charged to the allowance for loan losses. Subsequent to foreclosure, valuations are periodically performed by management and the assets are carried at the lower of carrying amount or fair value less cost to sell. Revenue and expenses from operations and changes in the valuation allowance are included in noninterest expense.

Share-based compensation – The Company measures the cost of employee services received in exchange for an award of share-based compensation based on the grant-date fair value of the award. The cost is recognized over the requisite service period, except for awards granted to retirement-eligible employees, which are fully expensed by the grant date.

Income taxes – The Company records its provision for income tax under the liability method. Deferred tax assets and liabilities 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. As changes in tax laws or rates are enacted, deferred tax assets and liabilities are adjusted through the provision for income taxes. Deferred taxes result from temporary differences in the recognition of certain income and expense amounts between the Company's consolidated financial statements and its tax returns.

Earnings per common share – Basic earnings per common share (EPS) are computed by dividing net income by the weighted-average number of common shares outstanding during the period. Diluted earnings per share reflect the weighted-average potential dilution that could occur if all potentially dilutive shares or other commitments to issue common stock were exercised or converted into common stock using the treasury stock method.

Comprehensive income – Comprehensive income includes all changes in shareholders' equity during a period, except those resulting from transactions with shareholders. Besides net income, other components of comprehensive income include the net-of-tax effect of changes in the net unrealized gain or loss on securities available-for-sale.

Note 1 – Summary of Significant Accounting Policies (continued)

Transfer of financial assets – Transfers of an entire financial asset, a group of financial assets, or a participating interest in an entire financial asset are accounted for as sales when control has been relinquished. Control is deemed to be surrendered when the assets have been isolated from the Company, the transferee obtains the right (free of conditions that constrain it from taking advantage of that right) to pledge or exchange the transferred assets, and the Company does not maintain effective control over the transferred assets through an agreement to repurchase them before their maturity.

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

Advertising costs – The Company expenses advertising costs as they are incurred. Total advertising expenses were approximately $110,000 and $51,000 in 2018 and 2017, respectively.

Fair value measurements – On January 1, 2018, the Company adopted ASU 2016-01, *Financial Instruments – Overall (Subtopic 825- 10), Recognition and Measurement of Financial Assets and Financial Liabilities*, which requires use of the exit price notion when measuring the fair value of financial instruments for disclosure purposes. Fair value is defined as the exit price, the price that would be received for an asset or paid to transfer a liability, in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date under current market conditions. It also establishes a consistent framework for measuring fair value and expands disclosure requirements about fair value measurements. In determining fair value, the Company maximizes the use of observable inputs and minimizes the use of unobservable inputs.

Valuation inputs refer to the assumptions market participants would use in pricing a given asset or liability using one of the three valuation techniques within the fair value hierarchy. Inputs can be observable or unobservable. Observable inputs are those assumptions that market participants would use in pricing the particular asset or liability. These inputs are based on market data and are obtained from a source independent of the Company.

Unobservable inputs are assumptions based on the Company's own information or estimate of assumptions used by market participants in pricing the asset or liability. Unobservable inputs are based on the best and most current information available on the measurement date.

All inputs, whether observable or unobservable, are ranked in accordance with a prescribed fair value hierarchy that gives the highest ranking to quoted prices (unadjusted) in active markets for identical assets or liabilities (Level 1) and the lowest ranking to unobservable inputs (Level 3). Fair values for assets or liabilities classified as Level 2 are based on one or a combination of the following factors: (i) quoted prices for similar assets; (ii) observable inputs for the asset or liability, such as interest rates or yield curves; or (iii) inputs derived principally from or corroborated by observable market data.

There were no transfers between Level 1, Level 2, and Level 3 during 2018 or 2017.

Note 1 – Summary of Significant Accounting Policies (continued)

Revenue recognition – On January 1, 2018, the Company adopted ASU 2014-09, *Revenue from Contracts with Customers* and all subsequent amendments to the ASU (collectively, ASC 606), which (i) creates a single framework for recognizing revenue from contracts with customers that fall within its scope and (ii) revises when it is appropriate to recognize a gain (loss) from the transfer of nonfinancial assets, such as OREO. To determine revenue recognition for arrangements that an entity determines are within the scope of Topic 606, the Company performs the following five steps: (i) identify the contract(s) with a customer; (ii) identify the performance obligations in the contract; (iii) determine the transaction price; (iv) allocate the transaction price to the performance obligations in the contract; and (v) recognize revenue when (or as) the Company satisfies a performance obligation. The majority of the Company's revenues come from interest income including loans and securities, that are outside the scope of ASC 606. The Company's services that fall within the scope of ASC 606 are presented within noninterest income and are recognized as revenue as the Company satisfies its obligation to the customer. Services within the scope of ASC 606 include deposit service charges. Refer to Note 16 – Revenue from Contracts with Customers for further discussion on the Company's accounting policies for revenue sources within the scope of ASC 606.

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

Reclassifications – Certain account reclassifications have been made to the consolidated financial statements in order to conform to classifications used in the current year with no impact on prior year reported net income or shareholder's equity.

Subsequent events – Subsequent events are events or transactions that occur after the date of the consolidated statements of financial condition but before the consolidated financial statements are issued. Recognized subsequent events are events or transactions that provide additional evidence about conditions that existed at the date of the consolidated statements of financial condition, including the estimates inherent in the process of preparing the consolidated financial statements. Nonrecognized subsequent events are events that provide evidence about conditions that did not exist at the date of the consolidated statements of financial condition but arose after that date. Management has reviewed events through March 18, 2019, the date the consolidated financial statements were issued.

Note 2 – Investment Securities

The following is a summary of the investment securities as of December 31 (in thousands):

	Amortized Cost	Gross Unrealized Gain	Gross Unrealized Loss	Estimated Fair Value
2018				
Available-for-sale				
Mortgage-backed securities	$ 48	$ 3	$ -	$ 51
Municipal bonds	23,426	38	(375)	23,089
Corporate bonds	12,880	18	(351)	12,547
SBA securities	11,184	-	(325)	10,859
	$ 47,538	$ 59	$ (1,051)	$ 46,546
2017				
Available-for-sale				
Mortgage-backed securities	$ 61	$ 2	$ -	$ 63
Municipal bonds	20,891	115	(170)	20,836
Corporate bonds	2,540	-	(12)	2,528
SBA securities	9,932	-	(125)	9,807
	$ 33,424	$ 117	$ (307)	$ 33,234

The amortized cost and estimated fair value of securities as of December 31, 2018, by contractual maturity, are shown below. Expected maturities may differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties (in thousands):

	Available-for-Sale	
	Amortized Cost	Estimated Fair Value
Due in one year or less	$ -	$ -
Due from one to five years	2,243	2,247
Due from five to ten years	17,117	16,707
Due in more than ten years	28,130	27,541
Mortgage-backed securities	48	51
	$ 47,538	$ 46,546

Securities with an amortized cost of $20,535,000 and $7,028,000 as of December 31, 2018 and 2017, respectively, were pledged to secure public deposits and for other purposes as required or permitted by law.

There were no sales of available-for-sale securities during 2018. Proceeds from the sale of an available-for-sale security were $9,094,000 for the year ended December 31, 2017. Gross gains on the security sold during 2017 totaled $497,000. There were no gross losses on securities sold during 2017.

Note 2 – Investment Securities (continued)

Gross unrealized losses on investment securities available-for-sale and the estimated fair value of the related securities, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position, were as follows as of December 31 (in thousands):

	Less Than 12 Months		12 Months or More		Total	
2018	Unrealized Losses	Estimated Fair Value	Unrealized Losses	Estimated Fair Value	Unrealized Losses	Estimated Fair Value
Available-for-sale						
Municipal bonds	$ (16)	$ 3,388	$ (359)	$ 15,470	$ (375)	$ 18,858
Corporate bonds	(288)	8,311	(63)	1,418	(351)	9,729
SBA securities	(49)	2,220	(276)	8,639	(325)	10,859
	$ (353)	$ 13,919	$ (698)	$ 25,527	$ (1,051)	$ 39,446
2017						
Available-for-sale						
Municipal bonds	$ (104)	$ 6,829	$ (66)	$ 2,384	$ (170)	$ 9,213
Corporate bonds	(12)	2,528	-	-	(12)	2,528
SBA securities	(125)	9,807	-	-	(125)	9,807
	$ (241)	$ 19,164	$ (66)	$ 2,384	$ (307)	$ 21,548

At December 31, 2018 and 2017, there were 52 and 26 securities, respectively, in an unrealized loss position. The Company evaluates securities for other-than-temporary impairment on at least a quarterly basis, and more frequently when economic or market concerns warrant such evaluation. Consideration is given to the financial condition and near-term prospects of the issuer, the length of time and the extent to which the fair value has been less than cost, and whether the Company intends to sell or will be required to sell. In analyzing an issuer's financial condition, the Company considers whether the securities are issued by the federal government or its agencies, whether downgrades by bond rating agencies have occurred, and the results of reviews of the issuer's financial condition. The Company considers the unrealized losses on its investments in an unrealized loss position at December 31, 2018 and 2017, to be temporary.

Note 3 – Loans and Allowance for Loan Losses

The composition of the loan portfolio was as follows as of December 31 (in thousands):

	2018	2017
Construction and land	$ 6,652	$ 855
Multifamily	467	479
Commercial real estate	185,924	164,222
Commercial and industrial	13,557	12,079
Consumer and other	3,785	2,753
	210,385	180,388
Allowance for loan losses	(2,310)	(2,000)
Net deferred loan costs	426	167
	$ 208,501	$ 178,555

Management believes that as of December 31, 2018 and 2017, the allowance for loan losses is adequate to absorb losses inherent in the loan portfolio. The allowance, however, is an estimate that is inherently uncertain and depends on the outcome of future events.

The following table presents the activity in the allowance for loan losses by segment for the years ended December 31 (in thousands):

	Beginning Balance	Provision for Loan Losses	Charge-offs	Recoveries	Ending Balance
2018					
Construction and land	$ 7	$ 40	$ -	$ -	$ 47
Multifamily	3	-	-	-	3
Commercial real estate	1,656	103	-	-	1,759
Commercial and industrial	264	120	(36)	51	399
Consumer and other	13	1	-	1	15
Unallocated	57	30	-	-	87
	$ 2,000	$ 294	$ (36)	$ 52	$ 2,310
2017					
Construction and land	$ 16	$ (9)	$ -	$ -	$ 7
Multifamily	3	-	-	-	3
Commercial real estate	2,262	(262)	(485)	141	1,656
Commercial and industrial	688	601	(1,155)	130	264
Consumer and other	-	15	(2)	-	13
Unallocated	68	(11)	-	-	57
	$ 3,037	$ 334	$ (1,642)	$ 271	$ 2,000

Note 3 – Loans and Allowance for Loan Losses (continued)

A loan is considered impaired when the Company has determined that it may be unable to collect payments of principal or interest when due under the terms of the loan. In the process of identifying loans as impaired, management takes into consideration factors that include payment history and status, collateral value, financial condition of the borrower, and the probability of collecting scheduled payments in the future. Minor payment delays and insignificant payment shortfalls typically do not result in a loan being classified as impaired. The significance of payment delays and shortfalls is considered by management on a case-by-case basis, after taking into consideration the totality of circumstances surrounding the loans and the borrowers, including payment history and amounts of any payment shortfall, length and reason for delay, and likelihood of return to stable performance. Impairment is measured on a loan-by-loan basis for all loans in the portfolio except for the smaller groups of homogeneous consumer loans in the portfolio.

The following table presents loans individually evaluated for impairment by class of loans as of December 31 (in thousands):

2018	Recorded Investments (Loan Balance Less Charge-off)	Unpaid Principal Balance	Related Allowance	Average Investment in Impaired Loans	Interest Income Recognized
With no allowance recorded					
Commercial real estate	$ 1,172	$ 1,172	$ -	$ 1,246	$ 5
Construction and land	167	167	-	182	5
Total					
Commercial real estate	$ 1,172	$ 1,172	$ -	$ 1,246	$ 5
Construction and land	167	167	-	182	5
	$ 1,339	$ 1,339	$ -	$ 1,428	$ 10
2017					
With no allowance recorded					
Commercial real estate	$ 1,320	$ 1,320	$ -	$ 1,097	$ 5
Commercial and industrial	95	95	-	47	-
With an allowance recorded					
Commercial real estate	$ -	$ -	$ -	$ 909	$ -
Commercial and industrial	-	-	-	237	-
Total					
Commercial real estate	$ 1,320	$ 1,320	$ -	$ 2,006	$ 5
Commercial and industrial	95	95	-	284	-
	$ 1,415	$ 1,415	$ -	$ 2,290	$ 5

Note 3 – Loans and Allowance for Loan Losses (continued)

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

	Allowance for Loan Losses			Loans Receivable		
	Ending Balance	Ending Balance Individually Evaluated for Impairment	Ending Balance Collectively Evaluated for Impairment	Ending Balance	Ending Balance Individually Evaluated for Impairment	Ending Balance Collectively Evaluated for Impairment
2018						
Construction and land	$ 47	$ -	$ 47	$ 6,652	$ 167	$ 6,485
Multifamily	3	-	3	467	-	467
Commercial real estate	1,759	-	1,759	185,924	1,172	184,752
Commercial and industrial	399	-	399	13,557	-	13,557
Consumer and other	15	-	15	3,785	-	3,785
Unallocated	87	-	87	-	-	-
	$ 2,310	$ -	$ 2,310	$ 210,385	$ 1,339	$ 209,046
2017						
Construction and land	$ 7	$ -	$ 7	$ 855	$ -	$ 855
Multifamily	3	-	3	479	-	479
Commercial real estate	1,656	-	1,656	164,222	1,320	162,902
Commercial and industrial	264	-	264	12,079	95	11,984
Consumer and other	13	-	13	2,753	-	2,753
Unallocated	57	-	57	-	-	-
	$ 2,000	$ -	$ 2,000	$ 180,388	$ 1,415	$ 178,973

The following table presents the recorded investment in nonaccrual loans by type as of December 31 (in thousands):

	2018	2017
Construction and land	$ 167	$ -
Commercial real estate	476	1,320
Commercial and industrial	-	95
	$ 643	$ 1,415

Past due loans – Loans are considered past due if the required principal and interest payments have not been received as of the date such payments were due.

Note 3 – Loans and Allowance for Loan Losses (continued)

The following table presents past due loans, net of partial loan charge-offs, by type as of December 31 (in thousands):

	30 - 59 Days Past Due	60 - 89 Days Past Due	90 Days or More Past Due	Total Past Due	Current	Total Loans
2018						
Construction and land	$ -	$ -	$ 167	$ 167	$ 6,485	$ 6,652
Multifamily	-	-	-	-	467	467
Commercial real estate	476	-	-	476	185,448	185,924
Commercial and industrial	-	-	-	-	13,557	13,557
Consumer and other	-	-	-	-	3,785	3,785
	$ 476	$ -	$ 167	$ 643	$ 209,742	$ 210,385
2017						
Construction and land	$ -	$ -	$ -	$ -	$ 855	$ 855
Multifamily	-	-	-	-	479	479
Commercial real estate	1,361	-	-	1,361	162,861	164,222
Commercial and industrial	-	-	95	95	11,984	12,079
Consumer and other	-	-	-	-	2,753	2,753
	$ 1,361	$ -	$ 95	$ 1,456	$ 178,932	$ 180,388

Credit quality indicator – Federal regulations provide for the classification of lower quality loans and other assets, such as debt and equity securities, as substandard, doubtful, or loss. An asset is considered substandard if it is inadequately protected by the current net worth and pay capacity of the borrower or of any collateral pledged. Substandard assets include those characterized by the distinct possibility that the Company will sustain some loss if the deficiencies are not corrected. Assets classified as doubtful have all the weaknesses inherent in those classified substandard, with the added characteristic that the weaknesses present make collection or liquidation in full highly questionable and improbable on the basis of currently existing facts, conditions, and values. Assets classified as loss are those considered uncollectible and of such little value that their continuance as assets without the establishment of a specific loss reserve is not warranted.

When the Company classifies problem assets as either substandard or doubtful, it may determine the loan is impaired and establish a specific allowance to address the risk specifically, or the Company may allow the loss to be addressed in the general allowance. General allowances represent loss allowances that have been established to recognize the inherent risk associated with lending activities, but that, unlike specific allowances, have not been specifically allocated to particular problem assets. When an insured institution classifies problem assets as a loss, it is required to charge off such assets in the period in which they are deemed uncollectible. At December 31, 2018 and 2017, the Company had no loans classified as loss. Assets that do not currently expose the Company to sufficient risk to warrant classification as substandard or doubtful but possess identified weaknesses are designated as either watch or special mention assets. Assets not otherwise classified or criticized are graded pass.

Additionally, the Company categorizes loans as performing or nonperforming based on payment activity. Loans that are more than 90 days past due and nonaccrual loans are considered nonperforming.

Note 3 – Loans and Allowance for Loan Losses (continued)

The following tables represent the internally assigned grade as of December 31 by type of loan (in thousands):

Credit Risk Profile by Internally Assigned Grade

2018	Construction and Land Loans	Multifamily Loans	Commercial Real Estate Loans	Commercial and Industrial Loans	Consumer and Other Loans	Total
Grade						
Pass	$ 6,485	$ 467	$ 170,119	$ 12,839	$ 3,785	$ 193,695
Watch	-	-	12,495	206	-	12,701
Special mention	-	-	2,517	494	-	3,011
Substandard	167	-	793	18	-	978
Doubtful	-	-	-	-	-	-
	$ 6,652	$ 467	$ 185,924	$ 13,557	$ 3,785	$ 210,385

Credit Risk Profile Based on Payment Activity

Performing	$ 6,485	$ 467	$ 185,448	$ 13,557	$ 3,785	$ 209,742
Nonperforming	167	-	476	-	-	643
	$ 6,652	$ 467	$ 185,924	$ 13,557	$ 3,785	$ 210,385

Credit Risk Profile by Internally Assigned Grade

2017	Construction and Land Loans	Multifamily Loans	Commercial Real Estate Loans	Commercial and Industrial Loans	Consumer and Other Loans	Total
Grade						
Pass	$ 658	$ 479	$ 150,250	$ 11,746	$ 2,753	$ 165,886
Watch	-	-	11,628	210	-	11,838
Special mention	197	-	-	-	-	197
Substandard			2,344	28		2,372
Doubtful	-	-	-	95	-	95
	$ 855	$ 479	$ 164,222	$ 12,079	$ 2,753	$ 180,388

Credit Risk Profile Based on Payment Activity

Performing	$ 855	$ 479	$ 162,902	$ 11,984	$ 2,753	$ 178,973
Nonperforming	-	-	1,320	95	-	1,415
	$ 855	$ 479	$ 164,222	$ 12,079	$ 2,753	$ 180,388

Note 3 – Loans and Allowance for Loan Losses (continued)

Loans classified as troubled debt restructurings totaled $1,172,000 and $1,319,000 at December 31, 2018 and 2017, respectively. A troubled debt restructuring is a loan to a borrower that is experiencing financial difficulty that has been modified from its original terms and conditions in such a way that the Company is granting the borrower a concession of some kind. The Company has granted a variety of concessions to borrowers in the form of loan modifications. The modifications granted can generally be described in the following categories:

Rate modification – A modification in which the interest rate is changed.

Term modification – A modification in which the maturity date, timing of payments, or frequency of payments is changed.

Payment modification – A modification in which the dollar amount of the payment is changed. Interest-only modifications in which a loan is converted to interest-only payments for a period of time are included in this category.

Combination modification – Any other type of modification, including the use of multiple categories above.

Upon identifying those receivables as troubled debt restructurings, the Company identified them as impaired for purposes of determining the allowance for loan losses. This requires the loans to be evaluated individually for impairment, generally based on the expected cash flows under the new terms discounted at the loans' original effective interest rates. For troubled debt restructured loans that subsequently default, the method of determining impairment is generally the fair value of the collateral less estimated selling costs.

There were no loans modified under trouble debt restructurings in 2018 and 2017. There were no commitments to lend to borrowers whose loans had been modified under troubled debt restructuring as of December 31, 2018.

At December 31, 2018 and 2017, loans (including amounts committed) of $2,782,000 and $964,000, respectively, represent real estate secured loans that have loan-to-value ratios above supervisory guidelines.

There were no related party loans to officers and directors at December 31, 2018 and 2017.

Note 4 – Other Real Estate Owned

The following table presents other real estate owned activity as of and for the years ended December 31 (in thousands):

	2018	2017
Beginning balance	$ 100	$ 1,274
Proceeds from sales	-	(1,223)
Net gain on sales	-	49
Ending balance	$ 100	$ 100

Note 5 – Premises and Equipment

Premises and equipment as of December 31 are summarized as follows (in thousands):

	2018	2017
Land	$ 1,432	$ 1,432
Building	4,284	4,284
Leasehold improvements	915	915
Furniture, fixtures, and equipment	1,064	1,051
Vehicles	84	84
	7,779	7,766
Less accumulated depreciation and amortization	(2,001)	(1,730)
	$ 5,778	$ 6,036

Total depreciation and amortization expense of premises and equipment for the years ended December 31, 2018 and 2017, amounted to $280,000 and $292,000, respectively.

Note 6 – Servicing Asset

The sold portions of SBA and USDA loans are not included in the accompanying consolidated statements of financial condition. The sold portions of SBA and USDA loans at December 31, 2018 and 2017, were $90,672,000 and $98,385,000, respectively. The fair value of servicing rights held as of December 31, 2018 and 2017 were $1,649,000 and $2,137,000, respectively.

Changes in the balance of the servicing asset, net of the valuation allowance, were as follows for the years ended December 31 (in thousands):

	2018	2017
Balance, beginning of year	$ 1,830	$ 2,438
Additions	456	236
Amortization	(768)	(844)
Balance, end of year	$ 1,518	$ 1,830

At December 31, 2018, the expected weighted-average life of the Company's servicing asset was 4.93 years. Projected amortization expense at December 31, 2018, is estimated to be as follows (in thousands):

2019	$ 310
2020	304
2021	296
2022	276
2023	212
Thereafter	120
Gross carrying value of servicing asset	1,518
Less valuation allowance	-
Net carrying value of servicing asset	$ 1,518

The following represents servicing fees earned in connection with the servicing asset, indicated net of the servicing asset amortization. These amounts are included in the accompanying consolidated financial statements as components of noninterest income for the years ended December 31 (in thousands):

	2018	2017
Servicing fees	$ 190	$ 191

Late fees associated with the servicing asset are immaterial for the years ended December 31, 2018 and 2017.

Note 6 – Servicing Asset (continued)

The projected amortized expense of the servicing asset is an estimate. The amortization expense for future periods was calculated by applying the same quantitative factors, such as servicing asset prepayment assumptions that were used to determine amortization expense for 2018. These factors are inherently subject to significant fluctuations, primarily due to the effect that changes in interest rates have on loan prepayment experience. Accordingly, any projection of servicing asset amortization in future periods is limited by the conditions that existed at the time the calculations were performed and may not be indicative of actual amortization expense that will be recorded in future periods. The constant prepayment rate as of December 31, 2018 and 2017, is 14.7% and 10.1%, respectively. The discount rate as of December 31, 2018 and 2017, is 13.9% and 13.2%, respectively.

Note 7 – Deposits

The scheduled maturities of time deposits as of December 31, 2018, are as follows (in thousands):

2019	$ 81,389
2020	13,553
2021	3,400
2022	1,233
2023	777
	$ 100,352

Brokered deposits of $5,016,000 and $5,007,000 are included in money market accounts as of December 31, 2018 and 2017, respectively. The Company held related party deposits of $374,000 and $8,655,000 as of December 31, 2018 and 2017, respectively. At December 31, 2018 and 2017, time deposits equal to or greater than $250,000 totaled $50,052,000 and $23,295,000, respectively.

Note 8 – Commitments and Contingencies

Operating leases – The Company leases facilities in Tacoma, Bellevue, and Federal Way, Washington. These operating leases expire at various times through 2022, subject to the Company's option to extend the lease term under those agreements. The agreements require the Company to pay certain operating expenses.

Future minimum lease payments under the lease agreements as of December 31, 2018, are as follows (in thousands):

2019	$ 297
2020	304
2021	261
2022	60
	$ 922

Rental expense recorded under such leases amounted to $353,000 and $341,000 for the years ended December 31, 2018 and 2017, respectively.

Litigation – In the normal course of business, U & I Financial Corp. and UniBank are involved in various legal claims. Management has reviewed all legal claims with counsel and has taken into consideration the views of such counsel regarding the outcome of the claims. In management's opinion, the final disposition of all such claims will not have a material adverse effect on the financial condition, results of operations, or cash flows of the Company.

Financial instruments with off-balance-sheet risk – The accompanying consolidated financial statements do not reflect various other commitments and contingent liabilities. These commitments and contingent liabilities include various commitments to extend credit and standby letters of credit, which arise in the normal course of business. Commitments to extend credit are legally binding loan commitments with set expiration dates. Standby letters of credit are conditional commitments issued by the Company to guarantee the performance of a customer to a third party. They are intended to be disbursed, subject to certain conditions, upon request of the borrower.

The Company evaluates the creditworthiness of each customer. The amount of collateral obtained, if deemed necessary by the Company upon the extension of credit, is based on management's evaluation of the borrower. Collateral for commercial loans may vary, but may include securities; accounts receivable; inventory; property, plant, and equipment; and income-producing commercial or other properties.

The following is a summary of the Company's financial instruments relating to extension of credit with off-balance-sheet risk as of December 31 (in thousands):

	2018	2017
Commitments to extend credit	$ 7,829	$ 12,718
Standby letters of credit	-	-

Note 9 – Borrowing Arrangements

The Company periodically uses FHLB advances as a funding source to provide operating liquidity and to fund loan origination. At December 31, 2018, the Company had $12,000,000 of overnight fixed-rate borrowings outstanding with the FHLB, at the average rate of 2.46%. At December 31, 2017, the Company had $3,000,000 of overnight fixed-rate borrowings outstanding, at a rate of 1.63%.

As of December 31, 2018 and 2017, under the FHLB borrowing agreement, the borrowing capacity was limited to the lower 45% of total assets or available collateral balance. The Company has pledged loans as collateral with an approximate total carrying value of $121,044,000 and $90,889,000 as of December 31, 2018 and 2017, respectively. The unused and available line of credit at December 31, 2018, was equal to $70,602,000.

In addition, the Company had three unsecured lines of credit to borrow up to a total of $23,500,000 for overnight purchase of federal funds as of December 31, 2018, at the then current rates. As of December 31, 2018 and 2017, there were no outstanding balances on these lines.

During 2012, the Company issued $1,060,000 in debentures. During 2014, the Company issued $200,000 in debentures. Both of these debentures matured in 2017 and bore an interest rate of 4.00%. There were no new debentures issued during 2018.

Note 10 – Income Taxes

The provision for income taxes consists of the following for the years ended December 31 (in thousands):

	2018	2017
Current income tax expense	$ 1,025	$ 430
Deferred income tax (benefit) expense	-	363
	$ 1,025	$ 793

Reconciliation of the provision for income tax expense based on the statutory income tax rate to actual income tax expense is provided as follows (in thousands):

	2018		2017	
	Amount	Percent	Amount	Percent
Federal income tax at statutory rate	$ 1,162	21%	$ 1,355	34%
Change in federal tax rate	-	0%	25	1%
Interest income on tax-exempt bonds	(125)	-2%	(185)	-5%
Income from bank owned life insurance	(51)	-1%	(87)	-2%
Equity compensation	(28)	-1%	(357)	-9%
Other	67	1%	42	1%
	$ 1,025	18%	$ 793	20%

Note 10 – Income Taxes (continued)

The cumulative temporary differences, as tax effected, are as follows as of December 31 (in thousands):

	2018	2017
Deferred tax assets		
Allowance for loan losses	$ 485	$ 420
Organizational costs	20	26
Nonaccrual loan interest	78	2
Unrealized loss on securities available-for-sale	208	40
Stock based compensation	18	-
Other	16	14
Total deferred tax assets	825	502
Deferred tax liabilities		
Deferred loan costs	(86)	-
Servicing asset	(319)	(384)
Fixed asset basis	(50)	(77)
Other	(161)	-
Total deferred tax liabilities	(616)	(461)
Net deferred tax assets	$ 209	$ 41

In assessing the realizability of deferred tax assets, management considers whether it is more likely than not that some portion or all of the deferred tax assets will not be realized. The ultimate realization of deferred tax assets is dependent upon the generation of future taxable income during the periods in which those temporary differences become deductible. Management considers the scheduled reversal of deferred tax liabilities, the projected future taxable income, and tax-planning strategies in making this assessment. A valuation allowance against deferred tax assets at the consolidated statement of financial condition date is not considered necessary because it is more likely than not that the deferred tax asset will be fully realized. The unamortized organizational costs were $97,000 and $128,000 at December 31, 2018 and 2017, respectively.

The Company applies a more-likely-than-not recognition criterion. The Company had no unrecognized tax benefits at December 31, 2018 and 2017. The Company recognizes interest accrued and penalties related to unrecognized tax benefits in tax expense. During the years ended December 31, 2018 and 2017, the Company recognized no interest and penalties. The Company files income tax returns in the U.S. federal jurisdiction and is no longer subject to examination for years before 2015.

Note 11 – Stock-Based Compensation

During 2006, the Company's board of directors granted the 2006 incentive and nonqualified share-based compensation plan that provided for the issuance of options to purchase its authorized but unissued common stock to eligible employees and directors. The exercise price of each option equals the fair market value of the Company's stock on the date of grant, and options are scheduled to vest over the periods ranging from three to five years. The 2006 incentive and nonqualified share-based compensation plan expired in November 2016 and all stock compensation expense was fully recognized. In 2018, stockholders approved an equity incentive plan (the Plan). The Plan permits the grant of incentive stock options, nonqualified stock options, and restricted stock awards. The maximum amount of common stock that may be issued under the Plan is 824,256, of which there are 82,426 shares allowable for restricted stock grants. As of December 31, 2018, 204,256 shares remained available to grant out of the Plan, of which 2,426 remained available for restricted stock. The Plan will expire in 2028.

Stock options – Incentive stock and nonqualified stock options are awarded with an exercise price generally equal to the fair market value of the Company's stock as of the grant date, and vest ratably over their respective vesting periods, provided continuous service by the awardees. The exercise period commences on the vesting date and expires 10 years from the grant date. Certain option awards provide for accelerated vesting upon a "change in control" as defined by the Plan.

The fair value of each option award is estimated on the date of grant using the Black-Scholes-Merton valuation model that uses the assumptions noted in the following table. Expected volatilities are based on historical volatility of the Bank's stock and other factors. The expected term of options granted was evaluated by a calculation that factored in the contractual term and vesting period, and considered different employee segments. The risk-free interest rate for periods within the contractual life of the option is based on the U.S. Treasury yield curve in effect at the time of grant.

	2018
Assumptions	
Risk-free interest rate	3.02 - 3.05%
Dividend yield	2%
Expected volatility	25%
Expected option life in years	6.5 - 7.5 years

Note 11 – Stock-Based Compensation (continued)

The following is a summary of the incentive and nonqualified stock option activity for the year ended December 31, 2018:

	Number of Options Outstanding	Weighted-Average Exercise Price	Weighted-Average Remaining Term
Outstanding, beginning of year	111,659	$ 4.59	5.50
Options granted	540,000	9.15	-
Options exercised	(44,940)	4.45	-
Options forfeited/canceled	(4,927)	7.51	-
Outstanding, end of year	601,792	$ 8.67	9.24
Options expected to vest assuming 0% forfeiture rate	540,000	$ 9.15	9.76
Options exercisable at year-end	61,792	$ 4.45	4.75

The weighted-average grant-date fair value of options granted during 2018 was $2.31. As of December 31, 2018, there was $1,176,000 in unrecognized compensation cost related to incentive and nonqualified stock options granted under the Plan. The cost is expected to be recognized over the remaining weighted average period of 4.32 years.

Restricted stock grants - The fair value of restricted stock awards granted is equal to the fair market value of the Company's stock at the date of grant. Restricted stock awards vest ratably over three years from the date of grant.

The following is a summary of the nonvested restricted stock award activity for the year ended December 31, 2018:

	Number of Shares Outstanding	Weighted-Average Grant Date Fair Value	Weighted-Average Remaining Term
Outstanding, beginning of year	-	$ -	
Restricted stock granted	80,000	9.15	
Outstanding, end of year	80,000	$ 9.15	2.75
Grants expected to vest assuming 0% forfeiture rate	80,000	$ 9.15	2.75

Note 11 – Stock-Based Compensation (continued)

As of December 31, 2018, there was $671,000 in unrecognized compensation cost related to restricted stock awards. The cost is expected to be recognized over the remaining weighted average vesting period of 2.75 years.

The Company's pre-tax compensation expense for share-based employee compensation was $134,000 and $0 for the years ended December 31, 2018 and 2017, respectively.

Note 12 – Employee Benefit Plan

On January 1, 2008, the Company established a 401(k) profit sharing plan (the Plan), which is available to all eligible employees who have completed three months of service. Each employee is allowed to contribute to the Plan up to the maximum percentage allowable, but not to exceed the limits of the Internal Revenue Service. As of January 1, 2018, the Plan requires the Company to match 75% up to 8% of employee deferrals. Total employer contribution expense amounted to approximately $81,000 and $66,000 for 2018 and 2017, respectively.

Note 13 – Fair Value

The Company used the following methods and assumptions in estimating fair value disclosure for financial instruments. Financial assets and liabilities recorded at fair value on a recurring and nonrecurring basis are as listed below:

Securities available-for-sale – Available-for-sale securities are valued using prices from an independent pricing service using Level 2 inputs. 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.

Impaired loans – A loan is considered to be impaired when it is probable that all of the principal and interest due under the original underwriting terms of the loan may not be collected. Fair value of collateral-dependent loans is measured based on the fair value of the underlying collateral. The fair value is determined through appraisals, which requires a significant degree of management judgment.

Other real estate owned – OREO consists principally of properties acquired through foreclosures. Management determines valuations through appraisals or other market evaluations, and the OREO is carried at the lower of carrying value or fair value, less cost to sell.

Note 13 – Fair Value (continued)

As of December 31, assets measured at fair value on a recurring basis (there were no liabilities measured at fair value on a recurring basis) are as follows (in thousands):

2018	Level 1 Quoted Prices in Active Markets	Level 2 Significant Other Observable Inputs	Level 3 Significant Unobservable Inputs	Total Fair Value
Assets				
Securities available-for-sale				
Mortgage-backed securities	$ -	$ 51	$ -	$ 51
Municipal bonds	-	23,089	-	23,089
Corporate bonds	-	12,547	-	12,547
SBA securities	-	10,859	-	10,859
Total	$ -	$ 46,546	$ -	$ 46,546
2017				
Assets				
Securities available-for-sale				
Mortgage-backed securities	$ -	$ 63	$ -	$ 63
Municipal bonds	-	20,836	-	20,836
Corporate bonds	-	2,528	-	2,528
SBA securities	-	9,807	-	9,807
Total	$ -	$ 33,234	$ -	$ 33,234

As of December 31, assets measured at fair value on a nonrecurring basis (there were no liabilities measured at fair value on a nonrecurring basis) are as follows (in thousands):

2018	Level 1 Quoted Prices in Active Markets	Level 2 Significant Other Observable Inputs	Level 3 Significant Unobservable Inputs	Total Fair Value
Assets				
Impaired loans	$ -	$ -	$ 1,339	$ 1,339
Other real estate owned	-	-	100	100
Total	$ -	$ -	$ 1,439	$ 1,439
2017				
Assets				
Impaired loans	$ -	$ -	$ 1,415	$ 1,415
Other real estate owned	-	-	100	100
Total	$ -	$ -	$ 1,515	$ 1,515

Note 13 – Fair Value (continued)

Quantitative information about Level 3 fair value measurements – The range and weighted average of the significant unobservable inputs used to fair value Level 3 nonrecurring assets as of December 31, 2018 and 2017, along with the valuation techniques used, are shown in the following table (in thousands):

	Fair Value at December 31, 2018	Valuation Technique	Unobservable Input	Range (Weighted Average) [1]
Impaired loans	$ 1,339	Market comparable	Adjustment to appraisal value	0% - 0% (0%)
OREO	100	Market comparable	Adjustment to appraisal value	0% - 50% (17%)

[1] Discount to appraisal value

	Fair Value at December 31, 2017	Valuation Technique	Unobservable Input	Range (Weighted Average) [1]
Impaired loans	$ 1,415	Market comparable	Adjustment to appraisal value	0% - 0% (0%)
OREO	100	Market comparable	Adjustment to appraisal value	0% - 50% (17%)

[1] Discount to appraisal value

Carrying amounts and estimated fair values of financial instruments, not previously presented, as of December 31 are as follows (in thousands):

	Carrying	Estimated	Fair Value Level		
December 31, 2018	Amount	Fair Value	Level 1	Level 2	Level 3
Financial assets					
Cash and due from banks	$ 17,528	$ 17,528	$ 17,528	$ -	$ -
Interest-bearing deposits in other financial institutions	13,988	13,988	13,988	-	-
Securities available-for-sale	46,546	46,546	-	46,546	-
Loans receivable, net	208,501	203,313	-	-	203,313
Servicing asset	1,518	1,649	-	-	1,649
Federal Home Loan Bank stock	809	809	809	-	-
Accrued interest receivable	869	869	869	-	-
Financial liabilities					
Savings, money market, and NOW	148,520	148,520	148,520	-	-
Time deposits	100,352	99,860	-	99,860	-
Accrued interest payable	127	127	127	-	-
FHLB borrowings	12,000	11,981	-	11,981	-
December 31, 2017					
Financial assets					
Cash and due from banks	$ 22,346	$ 22,346	$ 22,346	$ -	$ -
Interest-bearing deposits in other financial institutions	21,956	21,956	21,956	-	-
Securities available-for-sale	33,234	33,234	-	33,234	-
Loans receivable, net	178,555	175,283	-	-	175,283
Servicing asset	1,830	2,137	-	-	2,137
Federal Home Loan Bank stock	430	430	430	-	-
Accrued interest receivable	706	706	706	-	-
Financial liabilities					
Savings, money market, and NOW	164,951	164,951	164,951	-	-
Time deposits	66,088	65,805	-	65,805	-
Accrued interest payable	59	59	59	-	-
FHLB borrowings	3,000	3,000	-	3,000	-

Note 13 – Fair Value (continued)

The methods and assumptions used to estimate fair value are described as follows:

Cash and due from banks and interest-bearing deposits in other financial institutions – The carrying amounts approximate fair value, due to the short-term nature of these instruments.

Securities – U.S. government agency securities, municipal securities, and mortgage-backed securities are valued using prices from an independent pricing service using Level 2 inputs. 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.

Loans receivable, net – For variable-rate loans that reprice frequently with no significant change in credit risk, fair values are based on carrying amounts. The fair values of other loans (for example, fixed-rate real estate and commercial loans) are estimated using discounted cash flow analysis, based on interest rates currently being offered for loans with similar terms to borrowers of similar credit quality. The estimated fair value is net of allowance for loan losses. Additionally, to be consistent with the requirements under FASB ASC Topic 820 for Fair Value Measurements and Disclosures, effective January 1, 2018, the loans were valued at a price that represents the Company’s exit price or the price at which these instruments would be sold or transferred.

Servicing asset – The fair value of the servicing asset is based on a valuation model that calculates the present value of estimated net future cash flows related to contractually specified servicing fees. The valuation model incorporates the assumption that market participants would use in estimating future cash flows.

Federal Home Loan Bank stock – The carrying value is par value, which approximates fair value.

Accrued interest receivable and payable – The carrying amounts of accrued interest receivable and payable approximate their fair value, due to their short-term nature.

Deposits – The fair values of demand deposits such as interest-bearing checking accounts, savings accounts, super NOW accounts, and money market demand accounts are, by definition, equal to the amount payable on demand at the reporting date. The fair values of certificates of deposit are estimated using a discounted cash flow analysis that applies interest rates currently being offered on certificates to a schedule of aggregated contractual maturities on such time deposits.

Federal Home Loan Bank advances – The fair value of debt is based on discounted cash flows. The discount rate used is based on the current market rate.

Commitments to extend credit represent the principal categories of off-balance-sheet financial instruments. The fair values of these commitments are not material because they are for a short period of time and are subject to customary credit terms.

Note 14 – Regulatory Matters

U & I Financial Corp. and UniBank are subject to various regulatory capital requirements administered by the federal banking agencies. Failure to meet minimum capital requirements can initiate certain mandatory and possibly additional discretionary actions by the regulators that, if undertaken, could have a direct material effect on the financial statements. Under capital adequacy guidelines and regulatory framework for prompt corrective actions, U & I Financial Corp. and UniBank must meet specific capital guidelines that involve quantitative measures of assets, liabilities, and certain off-balance-sheet items as calculated under regulatory accounting practices. U & I Financial Corp. and UniBank's capital amounts and classification are also subject to qualitative judgments by the regulators about components, risk weightings, and other factors. Management believes that as of December 31, 2018 and 2017, U & I Financial Corp. and UniBank met all of the capital adequacy requirements to which they are subject.

U & I Financial Corp. and UniBank are periodically examined by the FDIC, the Department of Financial Institutions of the State of Washington, and the Federal Reserve Bank. As of December 31, 2018, U & I Financial Corp. and UniBank are categorized as well capitalized under the regulatory framework. To be categorized as well capitalized, the Bank must maintain minimum amounts and ratios (set forth in the following table) of total and Tier I capital (as defined in the regulations) to risk-weighted assets (as defined), of Tier I capital (as defined) to average assets (as defined), and common equity Tier 1 capital. There are no conditions or events that have occurred since that notification that management believes would result in a change to the institution's category.

The actual capital amounts and ratios are presented in the table below (in thousands):

	Actual		For Capital Adequacy Purposes		To Be Well Capitalized Under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
As of December 31, 2018						
Total capital (to risk-weighted assets)						
Consolidated	$ 46,124	19.23%	$ 19,193	≥ 8.00%	NA	NA
UniBank	$ 45,970	19.16%	$ 19,193	≥ 8.00%	$ 23,989	≥ 10.00%
Tier I capital (to risk-weighted assets)						
Consolidated	$ 43,814	18.26%	$ 14,395	≥ 6.00%	NA	NA
UniBank	$ 43,660	18.20%	$ 14,395	≥ 6.00%	$ 19,192	≥ 8.00%
Common equity Tier 1 capital						
Consolidated	$ 43,814	18.26%	$ 10,796	≥ 4.50%	NA	NA
UniBank	$ 43,660	18.20%	$ 10,796	≥ 4.50%	$ 15,593	≥ 6.50%
Tier I capital (to average assets)						
Consolidated	$ 43,814	15.46%	$ 11,333	≥ 4.00%	NA	NA
UniBank	$ 43,660	15.42%	$ 11,333	≥ 4.00%	$ 14,158	≥ 5.00%
As of December 31, 2017						
Total capital (to risk-weighted assets)						
Consolidated	$ 41,561	20.00%	$ 16,624	≥ 8.00%	NA	NA
UniBank	$ 41,194	19.82%	$ 16,627	≥ 8.00%	$ 20,784	≥ 10.00%
Tier I capital (to risk-weighted assets)						
Consolidated	$ 39,561	19.03%	$ 12,473	≥ 6.00%	NA	NA
UniBank	$ 39,194	18.86%	$ 12,469	≥ 6.00%	$ 16,628	≥ 8.00%
Common equity Tier 1 capital						
Consolidated	$ 39,561	19.03%	$ 9,355	≥ 4.50%	NA	NA
UniBank	$ 39,194	18.86%	$ 9,352	≥ 4.50%	$ 13,508	≥ 6.50%
Tier I capital (to average assets)						
Consolidated	$ 39,561	15.51%	$ 10,206	≥ 4.00%	NA	NA
UniBank	$ 39,194	15.37%	$ 10,200	≥ 4.00%	$ 12,750	≥ 5.00%

Note 14 – Regulatory Matters (continued)

The Federal Reserve and the FDIC approved final capital rules in July 2013 that substantially amended the existing capital rules for banks. These rules reflect, in part, certain standards initially adopted by the Basel Committee on Banking Supervision in December 2010 (which standards are commonly referred to as “Basel III”) as well as requirements contemplated by the Dodd-Frank Act.

Under the amended capital rules, there is a capital ratio of common equity Tier I capital to risk-weighted assets ratio. Common equity Tier I capital generally consists of retained earnings and common stock (subject to certain adjustments). In March 2015, the Bank exercised a one-time irrevocable option to exclude investment components of accumulated other comprehensive income. The Bank is also required to establish a “conservation buffer,” consisting of a common equity Tier I capital amount equal to 2.5% of risk weighted assets to be phased in by 2019. The conservation buffer was 1.875% as of December 31, 2018. An institution that does not meet the conservation buffer will be subject to restrictions on certain activities including payment of dividends, stock repurchases, and discretionary bonuses to executive officers.

Note 15 – Earnings Per Share

The following table presents a reconciliation of the components used to compute basic and diluted earnings per share (dollars in thousands, except per-share amounts):

	2018	2017
Net income	$ 4,506	$ 3,195
Basic weighted-average common shares outstanding	5,485,188	5,334,772
Plus common stock options considered outstanding for dilutive purposes (excludes antidilutive options)	11,194	99,582
Diluted weighted-average common shares outstanding	5,496,382	5,434,354
Basic earnings per share of common stock	$ 0.82	$ 0.60
Diluted earnings per share of common stock	$ 0.82	$ 0.59

Antidilutive options for 2018 and 2017 were 0 and 4,926, respectively.

Note 16 – Revenue from Contracts with Customers

As noted in Note 1, the Company adopted the provisions of ASU No. 2014-09, *Revenue from Contracts with Customers* (Topic 606), on January 1, 2018, and all subsequent ASUs that modified Topic 606. Results for reporting periods beginning after December 31, 2017, are presented under Topic 606, while prior period amounts have not been adjusted and continue to be reported in accordance with Topic 605.

All of the Company's revenue from contracts with customers in the scope of ASC 606 is recognized in noninterest income except for gains/losses on the sale of other real estate owned. Gains/losses on the sale of other real estate owned are included in noninterest expense and are generally recognized when the performance obligation is complete. This is typically at delivery of control over the property to the buyer at time of each real estate closing.

The following table presents the Company's sources of noninterest income for the twelve months ended December 31 (in thousands):

	2018	2017
Noninterest income		
Service charges on deposit accounts	$ 298	$ 262
Gain on sale of investments [(1)]	-	497
Gain on sale of loans [(1)]	1,639	835
Other income [(1)]	486	474
Total non-interest income	2,423	2,068
Gain (loss) on sale of other real estate owned, net	$ -	$ (49)

[(1)] Not within the scope of ASC 606

Service charges on deposit accounts – The Company earns fees from its deposit customers for account maintenance, transaction-based activity, 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.

Gain/loss on sale other real estate owned, net – The Company records a gain or loss from the sale of other real estate owned when control of the property transfers to the buyer, which generally occurs at the time of an executed deed of trust. When the Company finances the sale of other real estate owned to the buyer, the Company assesses whether the buyer is committed to perform their obligations under the contract and whether collectability of the transaction price is probable. Once these criteria are met, the other real estate owned asset is derecognized and the gain or loss on sale is recorded upon the transfer of control of the property to the buyer. In determining the gain or loss on sale, the Company adjusts the transaction price and related gain or loss on sale if a significant financing component is present.

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