Section 1: 10-Q (10-Q)

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

FORM 10-Q

(Mark One)

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

For the quarterly period ended June 30, 2018

OR

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

For the transition period from to

Commission file number 0-30777

PACIFIC MERCANTILE BANCORP

(Exact name of Registrant as specified in its charter)

California	**33-0898238**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification No.)**
949 South Coast Drive, Suite 300, Costa Mesa, California	**92626**
(Address of principal executive offices)	**(Zip Code)**

(714) 438-2500
(Registrant's telephone number, including area code)

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

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

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

Large accelerated filer	☐	Accelerated filer	☒
Non-accelerated filer	☐	Smaller reporting company	☐

Emerging growth company ☐

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

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

As of August 1, 2018, there were 23,378,350 shares of Common Stock outstanding.

PACIFIC MERCANTILE BANCORP

QUARTERLY REPORT ON FORM 10Q
FOR THE QUARTER ENDED JUNE 30, 2018

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PACIFIC MERCANTILE BANCORP AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF FINANCIAL CONDITION
(Dollars in thousands)
(Unaudited)

	June 30, 2018	December 31, 2017
ASSETS		
Cash and due from banks	$ 15,108	$ 12,198
Interest bearing deposits with financial institutions	220,498	186,010
Cash and cash equivalents	235,606	198,208
Interest-bearing time deposits with financial institutions	2,420	2,920
Federal Reserve Bank of San Francisco and Federal Home Loan Bank Stock, at cost	8,762	8,107
Securities available for sale, at fair value	29,187	39,738
Loans (net of allowances of $13,369 and $14,196, respectively)	1,049,003	1,053,201
Other real estate owned	2,073	—
Accrued interest receivable	4,066	3,872
Premises and equipment, net	1,184	1,094
Net deferred tax assets	11,085	—
Other assets	14,488	15,464
Total assets	$ 1,357,874	$ 1,322,604
LIABILITIES AND SHAREHOLDERS' EQUITY		
Deposits:		
Noninterest-bearing	$ 343,718	$ 338,273
Interest-bearing	824,085	801,120
Total deposits	1,167,803	1,139,393
Borrowings	30,000	40,866
Accrued interest payable	412	397
Other liabilities	9,827	11,545
Junior subordinated debentures	17,527	17,527
Total liabilities	1,225,569	1,209,728
Commitments and contingencies (Note 10)		
Shareholders' equity:		
Common stock, no par value, 85,000,000 shares authorized; 23,378,350 and 23,232,515 shares issued and outstanding at June 30, 2018 and December 31, 2017, respectively	151,478	150,689
Accumulated deficit	(17,691)	(36,670)
Accumulated other comprehensive loss	(1,482)	(1,143)
Total shareholders' equity	132,305	112,876
Total liabilities and shareholders' equity	$ 1,357,874	$ 1,322,604

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

PACIFIC MERCANTILE BANCORP AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF OPERATIONS
(Dollars in thousands, except for per share data)
(Unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2018	**2017**	**2018**	**2017**
Interest income:				
Loans, including fees	$ 14,788	$ 11,544	$ 28,833	$ 22,542
Securities available for sale and stock	262	283	536	625
Interest-bearing deposits with financial institutions	864	305	1,560	569
Total interest income	15,914	12,132	30,929	23,736
Interest expense:				
Deposits	3,082	1,571	5,560	2,947
Borrowings	385	165	737	322
Total interest expense	3,467	1,736	6,297	3,269
Net interest income	12,447	10,396	24,632	20,467
Provision for loan and lease losses	—	—	—	—
Net interest income after provision for loan and lease losses	12,447	10,396	24,632	20,467
Noninterest income				
Service fees on deposits and other banking services	407	332	794	640
Net gain on sale of securities available for sale	—	—	48	—
Net (loss) gain on sale of other assets	—	—	(4)	2
Other noninterest income	729	1,099	1,353	1,760
Total noninterest income	1,136	1,431	2,191	2,402
Noninterest expense				
Salaries and employee benefits	5,916	5,662	12,076	11,375
Occupancy	590	654	1,208	1,299
Equipment and depreciation	457	400	903	818
Data processing	380	345	772	686
FDIC expense	266	262	548	566
Other real estate owned expense, net	8	—	8	—
Professional fees	636	1,032	1,386	2,142
Business development	315	214	499	357
Loan related expense	183	177	353	199
Insurance	62	62	125	124
Other operating expense	486	454	954	909
Total noninterest expense	9,299	9,262	18,832	18,475
Income before income taxes	4,284	2,565	7,991	4,394
Income tax (benefit) provision	(11,085)	64	(11,085)	113
Net income allocable to common shareholders	$ 15,369	$ 2,501	$ 19,076	$ 4,281
Basic income per common share:				
Net income available to common shareholders	$ 0.66	$ 0.11	$ 0.82	$ 0.19
Diluted income per common share:				
Net income available to common shareholders	$ 0.65	$ 0.11	$ 0.81	$ 0.19
Weighted average number of common shares outstanding:				
Basic	23,332,323	23,186,551	23,299,209	23,162,551
Diluted	23,557,516	23,296,008	23,502,403	23,268,606

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

PACIFIC MERCANTILE BANCORP AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)
(Dollars in thousands)
(Unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2018	2017	2018	2017
Net income	$ 15,369	$ 2,501	$ 19,076	$ 4,281
Other comprehensive (loss) income, net of tax:				
Change in unrealized holding (loss) gain on securities available for sale	(41)	412	(388)	652
Less: Reclassification adjustment for change in accounting principle	—	—	(97)	—
Less: Reclassification adjustment for net gains included in net income	—	—	48	—
Net unrealized holding (loss) gain on securities available for sale	(41)	412	(339)	652
Total comprehensive income	$ 15,328	$ 2,913	$ 18,737	$ 4,933

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

PACIFIC MERCANTILE BANCORP AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY
(Shares and dollars in thousands)
(Unaudited)

For the Six Months Ended June 30, 2018

	Common stock		Retained earnings (accumulated deficit)	Accumulated other comprehensive income (loss)	Total
	Number of shares	Amount			
Balance at December 31, 2017	23,233	$ 150,689	$ (36,670)	$ (1,143)	$ 112,876
Implementation of ASU 2016-01	—	—	(97)	—	(97)
Issuance of restricted stock, net	70	—	—	—	—
Common stock based compensation expense	—	416	—	—	416
Common stock options exercised	75	373	—	—	373
Net income	—	—	19,076	—	19,076
Other comprehensive loss	—	—	—	(339)	(339)
Balance at June 30, 2018	23,378	$ 151,478	$ (17,691)	$ (1,482)	$ 132,305

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

PACIFIC MERCANTILE BANCORP AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS
(Dollars in thousands)
(Unaudited)

	Six Months Ended June 30, 2018	Six Months Ended June 30, 2017
Cash Flows From Operating Activities:		
Net income	$ 19,076	$ 4,281
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	193	200
Amortization of premium on securities	96	116
Net gain on sale of securities available for sale	(48)	—
Net amortization of deferred fees and unearned income on loans	(11)	(411)
Net gain on sale of premises and equipment	—	(2)
Net loss on sale of other assets	4	—
Stock-based compensation expense	416	405
Other	59	—
Changes in operating assets and liabilities:		
Net increase in accrued interest receivable	(194)	(387)
Net decrease (increase) in other assets	1,134	(567)
Net increase in deferred taxes	(11,085)	—
Net increase in income taxes receivable	(53)	—
Net increase in accrued interest payable	15	22
Net (decrease) increase in other liabilities	(1,718)	49
Net cash provided by operating activities	7,884	3,706
Cash Flows From Investing Activities:		
Net decrease in interest-bearing time deposits with financial institutions	500	—
Maturities of and principal payments received on securities available for sale and other stock	3,125	3,924
Purchase of securities available for sale and other stock	(655)	(1,036)
Proceeds from sale of securities available for sale and other stock	6,883	—
Purchase of other investments	(141)	(133)
Net decrease (increase) in loans	1,997	(95,773)
Purchases of premises and equipment	(283)	(80)
Proceeds from sale of other assets	32	—
Proceeds from sale of premises and equipment	—	2
Net cash provided by (used in) investing activities	11,458	(93,096)
Cash Flows From Financing Activities:		
Net increase in deposits	28,410	65,404
Proceeds from borrowings	21,000	15,000
Payments of borrowings	(31,727)	(15,000)
Proceeds from exercise of common stock options	373	995
Net cash provided by financing activities	18,056	66,399
Net increase (decrease) in cash and cash equivalents	37,398	(22,991)
Cash and Cash Equivalents, beginning of period	198,208	138,845
Cash and Cash Equivalents, end of period	$ 235,606	$ 115,854
Supplementary Cash Flow Information:		
Cash paid for interest on deposits and other borrowings	$ 6,282	$ 3,247
Cash paid for income taxes	$ 53	$ 2
Non-Cash Investing Activities:		
Transfer of loans into other assets	$ —	$ 181
Transfer of loans into other real estate owned	$ 1,346	$ —
Impact of change in accounting principle	$ 97	$ —

Assumption of debt upon foreclosure of property	$ 727	$ —

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

1. Nature of Business

Organization

Pacific Mercantile Bancorp ("PMBC") is a bank holding company which, through its wholly owned subsidiary, Pacific Mercantile Bank (the "Bank"), is engaged in the commercial banking business in Southern California. PMBC is registered as a one bank holding company under the United States Bank Holding Company Act of 1956, as amended, and, as such, is regulated by the Board of Governors of the Federal Reserve System (the "Federal Reserve Board") and the Federal Reserve Bank of San Francisco ("FRBSF") under delegated authority from the Federal Reserve Board. Substantially all of our operations are conducted and substantially all of our assets are owned by the Bank, which accounts for substantially all of our consolidated revenues, expenses, and income. The Bank provides a full range of banking services to small and medium-size businesses and professionals primarily in Orange, Los Angeles, San Bernardino and San Diego counties in Southern California and is subject to competition from, among other things, other banks and financial institutions and from financial services organizations conducting operations in those same markets. The Bank is chartered by the California Department of Business Oversight under the Division of Financial Institutions and is a member of the FRBSF. In addition, the deposit accounts of the Bank's customers are insured by the Federal Deposit Insurance Corporation ("FDIC") up to the maximum amount allowed by law. PM Asset Resolution, Inc. ("PMAR") is a wholly owned subsidiary of PMBC, which exists for the purpose of purchasing certain non-performing loans and other real estate from the Bank and thereafter collecting on or disposing of those assets.

PMBC, the Bank and PMAR are sometimes referred to, together, on a consolidated basis, in this report as the "Company" or as "we", "us" or "our".

2. Significant Accounting Policies

Except as discussed below, our accounting policies are described in Note 2, Significant Accounting Policies of our audited consolidated financial statements included in our Annual Report on Form 10-K for the year ended December 31, 2017 ("Form 10-K").

Interim Consolidated Financial Statements Basis of Presentation

Our interim consolidated financial statements are prepared in accordance with generally accepted accounting principles in effect in the United States ("GAAP") for interim financial information pursuant to rules and regulations of the U.S. Securities and Exchange Commission (the "SEC"), including instructions to Form 10-Q and Article 10 of Regulation S-X, on a basis consistent with prior periods. Our financial statements reflect all adjustments that are, in the opinion of management, necessary to present a fair statement of the results for the interim periods presented. The interim results are not necessarily indicative of operating results for the full year. The interim information should be read in conjunction with our audited consolidated financial statements in our Form 10-K.

Use of Estimates

The preparation of the financial statements in conformity with GAAP requires us to make certain estimates and assumptions that could affect the reported amounts of certain of our assets, liabilities, and contingencies at the date of the financial statements and the reported amounts of our revenues and expenses during the reporting periods. For the fiscal periods covered by this report, those estimates related primarily to our determinations of the allowance for loan and lease losses ("ALLL"), the fair values of securities available for sale, and the determination of the valuation allowance pertaining to deferred tax assets. If circumstances or financial trends on which those estimates were based were to change in the future or there were to occur any currently unanticipated events affecting the amounts of those estimates, our future financial position or results of operations could differ, possibly materially, from those expected at the current time.

Principles of Consolidation

Our consolidated financial statements for the three and six months ended June 30, 2018 and 2017 include the accounts of PMBC, the Bank and PMAR. All significant intercompany balances and transactions were eliminated in consolidation.

Recent Accounting Pronouncements

In May 2014, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") 2014-09, *"Revenue from Contracts with Customers (Topic 606),"* which amended its guidance on revenue recognition to conform with international accounting guidance under the International Accounting Standards Board. The ASU provides a framework for addressing revenue recognition and replaces most existing revenue recognition guidance, as well as requires increased disclosure requirements. In August 2015, the FASB issued ASU 2015-14 to defer the effective date of ASU 2014-09 by one year. Accordingly, this guidance is effective for interim and annual periods beginning after December 15, 2017 with early adoption permitted for interim and annual periods beginning after December 15, 2016. We adopted this guidance on January 1, 2018 using the modified retrospective approach. Adoption of this guidance did not have a significant impact on our financial statements as the accounting for interest income on loans and investments, loan service fee income, prepayment fees, and loan origination fees are excluded from the scope of this standard. Upon implementation of this guidance, the cumulative effect of any adjustments was deemed immaterial and thus not significant. As such, the expanded disclosures required by the guidance, including the disaggregated revenue disclosures, were not deemed necessary since interest income sources are scoped out and there are no additional significant sources of non-interest income to be broken out on the consolidated statement of operations.

In January 2016, the FASB issued ASU 2016-01, *"Financial Instruments - Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities,"* which enhances the reporting model for financial instruments to provide users of financial statements with more useful information. Some of the provisions include: requiring equity investments to be measured at fair value with changes in fair value recognized in net income, simplifying the impairment assessment of equity investments without readily determinable fair values, eliminating the requirement to disclose the method and significant assumptions used to estimate fair value on financial instruments measured at amortized cost on the balance sheet, requiring public business entities to use the exit price notion when measuring the fair value of financial instruments, requiring the 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 when the organization has elected to measure the liability at fair value in accordance with the fair value option, requiring separate presentation of financial assets and liabilities by measurement category and form of financial asset on the balance sheet or notes to the financial statements, and clarifying that the reporting organization should evaluate the need for a valuation allowance on a deferred tax asset related to available-for-sale securities in combination with the organization's other deferred tax assets. This guidance is effective for interim and annual periods beginning after December 15, 2017. Early adoption was not permitted for public companies. We adopted this guidance on January 1, 2018. We recorded a $97 thousand adjustment to our beginning retained earnings upon adoption of this guidance as we had one available-for-sale equity investment where the change in fair value is currently recognized in net income, as compared to the previous practice of flowing through changes in fair value to other comprehensive income. This investment was sold during the three months ended March 31, 2018 limiting the impact of this accounting change on our consolidated financial statements or on our disclosures related to investments.

In February 2016, the FASB issued ASU 2016-02, *"Leases (Topic 842),"* which requires lessees to recognize the following for all leases (with the exception of short-term leases) at the commencement date: a lease liability measured on a discounted basis and a right-of-use asset a specified asset for the lease term. Under the new guidance, lessor accounting is largely unchanged and the accounting for sale and leaseback transactions were simplified. This guidance is effective for interim and annual periods beginning after December 15, 2018. Early adoption is permitted. We will adopt this guidance on January 1, 2019. We expect our statement of financial condition to be grossed up on both the asset and liability side to reflect our lease obligations, and we do not expect adoption of this guidance to have a material impact on our consolidated financial statements or on our disclosures related to leases.

In June 2016, the FASB issued ASU 2016-13, *"Financial Instruments - Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments,"* which requires the measurement of all expected credit losses for financial assets held at the reporting date, based on historical experience, current conditions, and reasonable and supportable forecasts. Financial institutions will now use forward-looking information to better inform their credit loss estimates. Additionally, the ASU amends the accounting guidance for credit losses on available-for-sale debt securities and purchased financial assets with credit deterioration. This guidance is effective for interim and annual periods beginning after December 15, 2019. Early adoption is permitted for interim and annual periods beginning after December 15, 2018. We will adopt this guidance on January 1, 2020 and expect that it will have a material impact on the determination of our ALLL. We are unable to estimate the expected impact to the ALLL upon adoption due to various factors, primarily the fine tuning of our qualitative assumptions used within our preliminary model, uncertainty regarding economic conditions and the size and mix of our loan portfolio at the time of adoption, which could impact our historical loss factors. We are currently working with our existing ALLL software provider on further developing the model to perform the ALLL calculations upon adoption and we believe that we currently have in place the internal team capable of handling this implementation.

In August 2016, the FASB issued ASU 2016-15, *"Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments,"* which provides guidance for classification of specific items on the statement of cash flows. This guidance is effective for interim and annual periods beginning after December 15, 2017. Early adoption is permitted. We adopted this guidance on January 1, 2018 and it did not have a material impact on our consolidated statement of cash flows.

In May 2017, the FASB issued ASU 2017-09, *"Compensation — Stock Compensation (Topic 718): Scope of Modification Accounting,"* which provides guidance on determining which changes to the terms and conditions of share-based payment awards require an entity to apply modification accounting. This guidance is effective for interim and annual periods beginning after

December 15, 2017. Early adoption is permitted. We adopted this guidance on January 1, 2018 and it did not have an impact on our consolidated financial statements and disclosures.

3. Fair Value Measurements

Under FASB Accounting Standards Codification ("ASC") 820-10, we group assets and liabilities at fair value in three levels, based on the markets in which the assets and liabilities are traded and the reliability of the assumptions used to determine fair value. These levels are:

Level 1	Valuation is based upon quoted prices for identical instruments traded in active markets.
Level 2	Valuation is based upon quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active, and model-based valuation techniques for which all significant assumptions are observable in the market.
Level 3	Valuation is generated from model-based techniques that use at least one significant assumption not observable in the market. These unobservable assumptions reflect estimates of assumptions that market participants would use in pricing the asset or liability. Valuation techniques include use of option pricing models, discounted cash flow models and similar techniques.

Risks with Fair Value Measurements

Fair value estimates are made at a discrete point in time based on relevant market information and other information about the financial instruments. Because no active market exists for a significant portion of our financial instruments, fair value estimates are based in large part on judgments we make primarily regarding current economic conditions, risk characteristics of various financial instruments, prepayment rates, and future expected loss experience. These estimates are subjective in nature and invariably involve some inherent uncertainties. Additionally, the occurrence of unexpected events or changes in circumstances can occur that could require us to make changes to our assumptions and which, in turn, could significantly affect and require us to make changes to our previous estimates of fair value.

In addition, the fair value estimates are based on existing on and off-balance sheet financial instruments without attempting to estimate the value of existing and anticipated future customer relationships and the value of assets and liabilities that are not considered financial instruments, such as premises and equipment and other real estate owned ("OREO").

Measurement Methodology

Cash and Cash Equivalents. The fair value of cash and cash equivalents approximates its carrying value.

Interest-Bearing Deposits with Financial Institutions. The fair values of interest-bearing deposits maturing within one year approximate their carrying values.

FHLB and FRBSF Stock. The Bank is a member of the Federal Home Loan Bank of San Francisco ("FHLB") and the FRBSF. As members, we are required to own stock of the FHLB and the FRBSF, the amount of which is based primarily on the level of our borrowings from those institutions. We also have the right to acquire additional shares of stock in either or both of the FHLB and the FRBSF. During the three and six months ended June 30, 2018, we purchased no FHLB stock. During the three and six months ended June 30, 2018, we purchased 3,143 and 9,945 shares of FRBSF stock, respectively. No shares of FHLB stock or FRBSF stock were called during the three and six months ended June 30, 2018. The fair values of the FHLB and FRBSF stock are equal to their respective carrying amounts, are classified as restricted securities and are periodically evaluated for impairment based on our assessment of the ultimate recoverability of our investments in that stock. Any cash or stock dividends paid to us on such stock are reported as income.

Investment Securities Available for Sale. Fair value measurement for our investment securities available for sale is based upon quoted prices, if available. If quoted prices are not available, fair values are measured using independent pricing models or other model-based valuation techniques such as the present value of future cash flows, adjusted for the security's credit rating, prepayment assumptions and other factors such as credit loss assumptions. Level 1 investment securities include those traded on an active exchange, such as the New York Stock Exchange, and U.S. Treasury securities that are traded by dealers or brokers in active over-the-counter markets. Level 2 investment securities include mortgage-backed securities issued by government sponsored entities, municipal bonds and corporate debt securities. Securities classified as Level 3 include asset-backed securities in less liquid markets.

Equity Investments Without Readily Determinable Fair Value. Equity investments without readily determinable fair value are accounted for under the measurement alternative method of accounting. These investments are measured at cost, less any impairment, plus or minus any changes resulting from observable price changes in orderly transactions for an identical or similar investment of the same issuer. Any cash or stock dividends paid to us on such investments are reported as noninterest income.

Impaired Loans. Loans measured for impairment are measured at an observable market price (if available), or the fair value of the loan's collateral (if the loan is collateral dependent). The fair value of an impaired loan may be estimated using one of several methods, including collateral value, market value of similar debt, liquidation value and discounted cash flows. Those impaired loans not requiring a specific loan loss reserve represent loans for which the fair value of the expected repayments or collateral exceeds the recorded investments in such loans. When the fair value of the collateral is based on an observable market price or a current appraised value, we record the impaired loan at Level 2. When an appraised value is not available or we determine that the fair value of the collateral is further impaired below the appraised value and there is no observable market price, we record the impaired loan at Level 3.

Loans. The fair value for loans with variable interest rates less a credit discount is the carrying amount. The fair value of fixed rate loans is derived by calculating the present value of expected future cash flows discounted at the loan's original interest rate by the various homogeneous categories of loans. All loans have been adjusted to reflect changes in credit risk and represent the exit price of the loans. Changes are not recorded directly as an adjustment to current earnings or comprehensive income, but rather as an adjustment component in determining the overall adequacy of the loan loss reserve.

Other Real Estate Owned. OREO is reported at its net realizable value (fair value less estimated costs to sell) at the time any real estate collateral is acquired by the Bank in satisfaction of a loan. Subsequently, OREO is carried at the lower of carrying value or fair value less estimated costs to sell. Fair value is determined based upon independent market prices, appraised values of the collateral or management's estimation of the value of the collateral. When the fair value of the collateral is based on an observable market price or a current appraised value, we record the foreclosed asset at Level 2. When an appraised value is not available or management determines the fair value of the collateral is further impaired below the appraised value and there is no observable market price, we record the foreclosed asset at Level 3.

Other Foreclosed Assets. Other foreclosed assets are reported at their net realizable value (fair value less estimated costs to sell) at the time any collateral other than real estate is acquired by the Bank in satisfaction of a loan. Subsequently, other foreclosed assets are carried at the lower of carrying value or fair value less estimated costs to sell. Fair value is determined based upon independent market prices, appraised values of the collateral or management's estimation of the value of the collateral. When the fair value of the collateral is based on an observable market price or a current appraised value, we record the foreclosed asset at Level 2. When an appraised value is not available or management determines the fair value of the collateral is further impaired below the appraised value and there is no observable market price, we record the foreclosed asset at Level 3.

Deposits. Deposits are carried at historical cost. The carrying amounts of deposits from savings and money market accounts are deemed to approximate fair value as they either have no stated maturities or short-term maturities. Certificates of deposit are estimated utilizing discounted cash flow techniques. The interest rates applied are rates currently being offered for similar certificates of deposit.

Borrowings. The fair value of borrowings is the carrying amount for those borrowings that mature on a daily basis. The fair value of term borrowings is derived by calculating the discounted value of future cash flows expected to be paid out by the Company. We classify our borrowings in Level 2 of the fair value hierarchy.

Junior Subordinated Debentures. The fair value of the junior subordinated debentures is based on quoted market prices of the underlying securities. These securities are variable rate in nature and repriced quarterly. We classify our junior subordinated debentures in Level 2 of the fair value hierarchy.

Commitments to Extend Credit and Standby Letters of Credit. The fair value of commitments to extend credit and standby letters of credit are based on fees currently charged to enter into similar agreements, taking into account the remaining terms of the agreements and the counterparties' credit standing.

Interest Receivable and Interest Payable. The carrying amounts of our accrued interest receivable and accrued interest payable are deemed to approximate fair value.

Assets Recorded at Fair Value on a Recurring Basis

The following tables show the recorded amounts of assets and liabilities measured at fair value on a recurring basis at June 30, 2018 and December 31, 2017:

(Dollars in thousands)	At June 30, 2018 Total	Level 1	Level 2	Level 3
Assets at Fair Value:				
Debt securities available for sale				
U.S. Treasury securities	$ 2,966	$ —	$ 2,966	$ —
Residential mortgage backed securities issued by U.S. agencies	26,221	—	26,221	—
Total debt securities available for sale at fair value	$ 29,187	$ —	$ 29,187	$ —

(Dollars in thousands)	At December 31, 2017 Total	Level 1	Level 2	Level 3
Assets at Fair Value:				
Debt securities available for sale				
U.S. Treasury securities	$ 2,971	$ —	$ 2,971	$ —
Residential mortgage backed securities issued by U.S. agencies	30,122	—	30,122	—
Asset-backed security [(1)]	1,741	—	—	1,741
Total debt securities available for sale	34,834	—	33,093	1,741
Equity securities				
Mutual funds [(1)]	4,904	4,904	—	—
Total debt and equity securities available for sale at fair value	$ 39,738	$ 4,904	$ 33,093	$ 1,741

(1) These investments were sold during the six months ended June 30, 2018. Refer to *Note 4, Investments* for further detail regarding these sales.

The changes in Level 3 assets measured at fair value on a recurring basis are summarized as follows for the six months ended June 30, 2018:

	Asset Backed Securities (Dollars in thousands)
Balance of recurring Level 3 instruments at December 31, 2017	$ 1,741
Total gains or losses (realized/unrealized):	
Included in earnings-realized	53
Included in other comprehensive income	251
Sales	(2,054)
Settlements	9
Balance of recurring Level 3 instruments at June 30, 2018	$ —

Assets Recorded at Fair Value on a Nonrecurring Basis

We may be required, from time to time, to measure certain assets at fair value on a nonrecurring basis in accordance with GAAP. These nonrecurring fair value adjustments typically involve application of the lower of cost or market accounting or write-downs of individual assets. Information regarding assets measured at fair value on a nonrecurring basis is set forth in the table below.

(Dollars in thousands)	At June 30, 2018 Total	Level 1	Level 2	Level 3	At December 31, 2017 Total	Level 1	Level 2	Level 3
Assets at Fair Value:								
Impaired loans	$ 5,325	$ —	$ —	$ 5,325	$ 6,360	$ —	$ —	$ 6,360
Other real estate owned	2,073	—	2,073	—	—	—	—	—
Total	$ 7,398	$ —	$ 2,073	$ 5,325	$ 6,360	$ —	$ —	$ 6,360

Significant Unobservable Inputs and Valuation Techniques of Level 3 Fair Value Measurements

For our fair value measurements classified in Level 3 of the fair value hierarchy as of June 30, 2018, a summary of the significant unobservable inputs and valuation techniques is as follows:

	Fair Value Measurement as of June 30, 2018	Valuation Techniques[2]	Unobservable Inputs[2]	Range	Weighted Average
	(Dollars in thousands)				
Assets					
Impaired loans	5,325	Third-Party Pricing	Discounted cash flow	N/A [1]	N/A [1]
	$ 5,325				

(1) As part of our process, we obtain appraisals for our various properties included within impaired loans which primarily rely upon market comparisons. These market comparisons support our assumption that the carrying value of the respective loans either requires or does not require additional impairment.

(2) As of June 30, 2018, there has been no change to our valuation techniques or the types of unobservable inputs used in the calculation of fair value from December 31, 2017.

Fair Value Measurements for Other Financial Instruments

The table below provides estimated fair values and related carrying amounts of our financial instruments as of June 30, 2018 and December 31, 2017, excluding financial assets and liabilities which are recorded at fair value on a recurring basis.

	Estimated Fair Value									
	At June 30, 2018					At December 31, 2017				
	Carrying Value	Total	Level 1	Level 2	Level 3	Carrying Value	Total	Level 1	Level 2	Level 3
	(Dollars in thousands)									
Financial assets:										
Cash and cash equivalents	$ 235,606	$ 235,606	$ 235,606	$ —	$ —	$ 198,208	$ 198,208	198,208	—	—
Interest-bearing deposits with financial institutions	2,420	2,420	2,420	—	—	2,920	2,920	2,920	—	—
Federal Reserve Bank of San Francisco and Federal Home Loan Bank stock	8,762	8,762	8,762	—	—	8,107	8,107	8,107	—	—
Loans, net	1,049,003	1,039,721	—	—	1,039,721	1,053,201	1,046,171	—	—	1,046,171
Accrued interest receivable	4,066	4,066	4,066	—	—	3,872	3,872	3,872	—	—
Financial liabilities:										
Noninterest bearing deposits	343,718	343,718	343,718	—	—	338,273	338,273	338,273	—	—
Interest-bearing deposits	824,085	821,959	—	821,959	—	801,120	800,169	—	800,169	—
Borrowings	30,000	30,229	—	30,229	—	40,866	41,238	—	41,238	—
Junior subordinated debentures	17,527	17,527	—	17,527	—	17,527	17,527	—	17,527	—
Accrued interest payable	412	412	412	—	—	397	397	397	—	—

4. Investments

Securities Available For Sale, at Fair Value

The following table sets forth the major components of securities available for sale and compares the amortized costs and estimated fair market values of, and the gross unrealized gains and losses on, these securities at June 30, 2018 and December 31, 2017:

	June 30, 2018				December 31, 2017			
	Amortized	Gross Unrealized		Estimated	Amortized	Gross Unrealized		Estimated
(Dollars in thousands)	Cost	Gain	Loss	Fair Value	Cost	Gain	Loss	Fair Value
Securities Available for Sale								
U.S. Treasury securities	$ 2,997	$ —	$ (31)	$ 2,966	$ 2,996	$ —	$ (25)	$ 2,971
Residential mortgage backed securities issued by U.S. Agencies[1]	27,672	1	(1,452)	26,221	30,894	5	(777)	30,122
Asset backed security[2]	—	—	—	—	1,992	—	(251)	1,741
Mutual funds[3]	—	—	—	—	5,000	11	(107)	4,904
Total	$ 30,669	$ 1	$ (1,483)	$ 29,187	$ 40,882	$ 16	$ (1,160)	$ 39,738

(1) Secured by closed-end first liens on 1-4 family residential mortgages.

(2) Comprised of a security that represented an interest in a pool of trust preferred securities issued by U.S.-based banks and insurance companies. This

investment was sold during the six months ended June 30, 2018.

(3) Consisted primarily of mutual fund investments in closed-end first liens on 1-4 family residential mortgages. As a result of the adoption of ASU 2016-01 effective January 1, 2018, the change in fair value for all equity securities is required to be recorded within the income statement and would no longer be included in this table. However, this investment was sold during the six months ended June 30, 2018 so the only impact from the adoption of ASU 2016-01 in 2018 relates to the adjustment to beginning retained earnings for the $97 thousand gross unrealized loss as of December 31, 2017.

At June 30, 2018 and December 31, 2017, U.S. agency residential mortgage backed securities with an aggregate fair market value of $16.1 million and $22.7 million, respectively, were pledged to secure repurchase agreements, local agency deposits and treasury, tax and loan accounts.

The amortized cost and estimated fair values of securities available for sale at June 30, 2018 and December 31, 2017 are shown in the tables below by contractual maturities taking into consideration historical prepayments based on the prior twelve months of principal payments. Expected maturities will differ from contractual maturities and historical prepayments, particularly with respect to collateralized mortgage obligations, primarily because prepayment rates are affected by changes in conditions in the interest rate market and, therefore, future prepayment rates may differ from historical prepayment rates.

	At June 30, 2018 Maturing in				
(Dollars in thousands)	**One year or less**	**Over one year through five years**	**Over five years through ten years**	**Over ten Years**	**Total**
Securities available for sale, amortized cost	$ 6,616	$ 16,628	$ 7,120	$ 305	$ 30,669
Securities available for sale, estimated fair value	6,301	15,863	6,727	296	29,187
Weighted average yield	1.43%	1.49%	1.63%	2.60%	1.52%

	At December 31, 2017 Maturing in				
(Dollars in thousands)	**One year or less**	**Over one year through five years**	**Over five years through ten years**	**Over ten Years**	**Total**
Securities available for sale, amortized cost [(1)]	$ 5,685	$ 23,772	$ 8,956	$ 2,469	$ 40,882
Securities available for sale, estimated fair value [(1)]	5,543	23,253	8,727	2,215	39,738
Weighted average yield [(1)]	1.49%	1.60%	1.63%	3.86%	1.73%

(1) Included within these balances are equity securities that consisted primarily of mutual fund investments in closed-end first liens on 1-4 family residential mortgages. As a result of the adoption of ASU 2016-01 effective January 1, 2018, the change in fair value for all equity securities is required to be recorded within the income statement and would no longer be included in this table. However, this investment was sold during the six months ended June 30, 2018 so the only impact from the adoption of ASU 2016-01 in 2018 relates to the adjustment to beginning retained earnings for the $97 thousand gross unrealized loss as of December 31, 2017.

We purchased no securities available for sale during the three and six months ended June 30, 2018. During the three and six months ended June 30, 2017, we purchased $0 and $1.0 million of securities available for sale. During the six months ended June 30, 2018, we had sales proceeds of $2.1 million on the sale of debt securities available for sale, with a gain of $53 thousand, and sales proceeds of $4.8 million on the sale of our equity securities, with a loss of $5 thousand. We had no sales of securities available for sale during the three months ended June 30, 2018 and the three and six months ended June 30, 2017.

The tables below indicate, as of June 30, 2018 and December 31, 2017, the gross unrealized losses and fair values of our investments, aggregated by investment category, and length of time that the individual securities have been in a continuous unrealized loss position.

	Securities with Unrealized Loss at June 30, 2018					
	Less than 12 months		12 months or more		Total	
(Dollars in thousands)	**Fair Value**	**Unrealized Loss**	**Fair Value**	**Unrealized Loss**	**Fair Value**	**Unrealized Loss**
U.S. Treasury securities	$ 2,966	$ (31)	$ —	$ —	$ 2,966	$ (31)
Residential mortgage backed securities issued by U.S. Agencies	1,665	(47)	24,492	(1,405)	26,157	(1,452)
Total	$ 4,631	$ (78)	$ 24,492	$ (1,405)	$ 29,123	$ (1,483)

(Dollars in thousands)	Securities with Unrealized Loss at December 31, 2017					
	Less than 12 months		12 months or more		Total	
	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
U.S. Treasury securities	$ 2,971	$ (25)	$ —	$ —	$ 2,971	$ (25)
Residential mortgage backed securities issued by U.S. Agencies	1,400	(15)	28,241	(762)	29,641	(777)
Asset-backed security	—	—	1,740	(251)	1,740	(251)
Mutual funds [(1)]	1,485	(15)	2,658	(92)	4,143	(107)
Total	$ 5,856	$ (55)	$ 32,639	$ (1,105)	$ 38,495	$ (1,160)

(1) Consisted primarily of mutual fund investments in closed-end first liens on 1-4 family residential mortgages. As a result of the adoption of ASU 2016-01 effective January 1, 2018, the change in fair value for all equity securities is required to be recorded within the income statement and would no longer be included in this table. However, this investment was sold during the six months ended June 30, 2018 so the only impact from the adoption of ASU 2016-01 in 2018 relates to the adjustment to beginning retained earnings for the $97 thousand gross unrealized loss as of December 31, 2017.

We regularly monitor investments for significant declines in fair value. We have determined that declines in the fair values of these investments below their respective amortized costs, as set forth in the tables above, are temporary because (i) those declines were due to interest rate changes and not to a deterioration in the creditworthiness of the issuers of those investment securities, and (ii) we have the ability to hold those securities until there is a recovery in their values or until their maturity.

We recognize other-than-temporary impairments (“OTTI”) to our available-for-sale debt securities in accordance with FASB ASC 320-10. When there are credit losses associated with, but we have no intention to sell, an impaired debt security, and it is more likely than not that we will not have to sell the security before recovery of its cost basis, we will separate the amount of impairment, or OTTI, between the amount that is credit related and the amount that is related to non-credit factors. Credit-related impairments are recognized in our consolidated statements of operations. Any non-credit-related impairments are recognized and reflected in other comprehensive income in our consolidated statements of financial condition.

Through the impairment assessment process, we determined that there were no available-for-sale debt securities that were other-than-temporarily impaired at June 30, 2018. We recorded no impairment credit losses on available-for-sale debt securities in our consolidated statements of operations for the three and six months ended June 30, 2018 and 2017.

We have made a determination that the remainder of our securities with respect to which there were unrealized losses as of June 30, 2018 are not other-than-temporarily impaired, because we have concluded that we have the ability to continue to hold those securities until their respective fair market values increase above their respective amortized costs or, if necessary, until their respective maturities. In reaching that conclusion we considered a number of factors and other information, which included: (i) the significance of each such security, (ii) the amount of the unrealized losses attributable to each such security, (iii) our liquidity position, (iv) the impact that retention of those securities could have on our capital position and (v) our evaluation of the expected future performance of these securities (based on the criteria discussed above).

Equity Investments Without Readily Determinable Fair Value

As of June 30, 2018, we had two investments in limited partnerships without a readily determinable fair value. As of June 30, 2018, we owned less than 3% of the total investment in each partnership. Under ASU 2016-01, we elected to measure these equity investments using the measurement alternative, which requires that these investments are measured at cost, less any impairment, plus or minus any changes resulting from observable price changes in orderly transactions for an identical or similar investment of the same issuer. During the three and six months ended June 30, 2018, these investments were not impaired and there were no observable price changes. As a result, the balance shown below as of June 30, 2018 represents the cost of the investments and is included within other assets on the consolidated statements of financial condition. Prior to the adoption of ASU 2016-01, these investments were accounted for under the cost method of accounting and included within other assets on the consolidated statements of financial condition. During the three and six months ended June 30, 2018, we had $52 thousand and $141 thousand, respectively, of capital contributions to these investments. We had $133 thousand of capital contributions to these investments during both the three and six months ended June 30, 2017. As of June 30, 2018 and December 31, 2017, our equity investments without readily determinable fair value were as follows:

	June 30, 2018	December 31, 2017
	(Dollars in thousands)	
Equity investments without readily determinable fair value	$ 1,035	$ 893

5. Loans and Allowance for Loan and Lease Losses

The loan portfolio consisted of the following at:

(Dollars in thousands)	June 30, 2018 Amount	June 30, 2018 Percent	December 31, 2017 Amount	December 31, 2017 Percent
Commercial loans	$ 403,152	38.1%	$ 394,493	37.1%
Commercial real estate loans – owner occupied	225,018	21.2%	214,365	20.1%
Commercial real estate loans – all other	224,555	21.2%	228,090	21.4%
Residential mortgage loans – multi-family	90,270	8.5%	114,302	10.7%
Residential mortgage loans – single family	24,583	2.3%	24,848	2.3%
Construction and land development loans	30,395	2.9%	34,614	3.3%
Consumer loans	61,084	5.8%	53,918	5.1%
Gross loans	1,059,057	100.0%	1,064,630	100.0%
Deferred fee (income) costs, net	3,315		2,767	
Allowance for loan and lease losses	(13,369)		(14,196)	
Loans, net	$ 1,049,003		$ 1,053,201	

At June 30, 2018 and December 31, 2017, real estate loans of approximately $800 million and $669 million, respectively, were pledged to secure borrowings obtained from the FHLB and to support our unfunded borrowing capacity. During the three and six months ended June 30, 2018, we sold $15.1 million of commercial real estate loans - all other at par value. No loans were sold during the three and six months ended June 30, 2017. During the three and six months ended June 30, 2018, we purchased no loans. During the three and six months ended June 30, 2017, we purchased $30.1 million of performing commercial real estate loans - owner occupied and commercial real estate loans - all other.

Allowance for Loan and Lease Losses

The ALLL represents our estimate of credit losses in our loan and lease portfolio that are probable and estimable at the balance sheet date. We employ economic models that are based on bank regulatory guidelines, industry standards and our own historical loan loss experience, as well as a number of more subjective qualitative factors, to determine both the sufficiency of the ALLL and the amount of the provisions that are required to increase or replenish the ALLL.

The ALLL is first determined by (i) analyzing all classified loans (graded as “Substandard” or “Doubtful” under our internal asset quality grading parameters) on nonaccrual status for loss exposure and (ii) establishing specific reserves as needed. ASC 310-10 defines loan impairment as the existence of uncertainty concerning collection of all principal and interest in accordance with the contractual terms of a loan. For collateral dependent loans, impairment is typically measured by comparing the loan amount to the fair value of collateral, less estimated costs to sell, with any “shortfall” amount charged off. Other methods can be used in estimating impairment, including market price and the present value of expected future cash flows discounted at the loan’s original interest rate. We are an active lender with the U.S. Small Business Administration and collection of a percentage of the loan balance of many of the loans originated is guaranteed. The ALLL reserves are calculated against the non-guaranteed loan balances.

On a quarterly basis, we utilize a classification based loan loss migration model as well as review individual loans in determining the adequacy of the ALLL for homogenous pools of loans that are not subject to specific reserve allocations. Our loss migration analysis tracks 16 quarters of loan loss history and industry loss factors to determine historical losses by classification category for each loan type, except certain consumer loans (automobile, mortgage and credit cards). We then apply these calculated loss factors, together with qualitative factors based on external economic conditions and trends and internal assessments, to the outstanding loan balances in each homogenous group of loans, and then, using our internal asset quality grading parameters, we grade the loans as “Pass,” “Special Mention,” “Substandard” or “Doubtful”. We analyze impaired loans individually. This grading is based on the credit classifications of assets as prescribed by government regulations and industry standards and is separated into the following groups:

- Pass: Loans classified as pass include current loans performing in accordance with contractual terms, installment/consumer loans that are not individually risk rated, and loans which exhibit certain risk factors that require greater than usual monitoring by management.
- Special Mention: Loans classified as special mention, while generally not delinquent, have potential weaknesses that deserve management’s close attention. If left uncorrected, these potential weaknesses may result in deterioration of the repayment prospects for the loan or in the Bank’s credit position at some future date.

- Substandard: Loans classified as substandard have a well-defined weakness or weaknesses that jeopardize the liquidation of the debt. There is a distinct possibility that the Bank will sustain some loss if the deficiencies are not corrected.
- Doubtful: Loans classified as doubtful have all the weaknesses inherent in a substandard loan, and may also be at delinquency status and have defined weaknesses based on currently existing facts, conditions and values making collection or liquidation in full highly questionable and improbable.

Set forth below is a summary of the activity in the ALLL, by portfolio type, during the three and six months ended June 30, 2018 and 2017:

(Dollars in thousands)	Commercial	Real Estate	Construction and Land Development	Consumer and Single Family Mortgages	Unallocated	Total
ALLL in the three months ended June 30, 2018:						
Balance at beginning of period	$ 7,634	$ 3,255	$ 888	$ 1,112	$ 516	$ 13,405
Charge offs	(355)	—	—	—	—	(355)
Recoveries	288	—	—	31	—	319
Provision	(74)	(302)	(561)	435	502	—
Balance at end of period	$ 7,493	$ 2,953	$ 327	$ 1,578	$ 1,018	$ 13,369
ALLL in the six months ended June 30, 2018:						
Balance at beginning of period	$ 9,155	$ 2,906	$ 650	$ 1,043	$ 442	$ 14,196
Charge offs	(1,423)	—	—	—	—	(1,423)
Recoveries	560	—	—	36	—	596
Provision	(799)	47	(323)	499	576	—
Balance at end of period	$ 7,493	$ 2,953	$ 327	$ 1,578	$ 1,018	$ 13,369
ALLL in the three months ended June 30, 2017:						
Balance at beginning of period	$ 10,234	$ 3,857	$ 116	$ 806	$ 1,781	$ 16,794
Charge offs	(19)	(432)	—	(105)	—	(556)
Recoveries	934	—	—	6	—	940
Provision	(1,036)	1,232	41	416	(653)	—
Balance at end of period	$ 10,113	$ 4,657	$ 157	$ 1,123	$ 1,128	$ 17,178
ALLL in the six months ended June 30, 2017:						
Balance at beginning of period	$ 11,276	$ 4,226	$ 343	$ 642	$ 314	$ 16,801
Charge offs	$ (465)	$ (432)	$ —	$ (114)	$ —	$ (1,011)
Recoveries	1,194	—	27	167	—	1,388
Provision	(1,892)	863	(213)	428	814	—
Balance at end of period	$ 10,113	$ 4,657	$ 157	$ 1,123	$ 1,128	$ 17,178

Set forth below is information regarding loan balances and the related ALLL, by portfolio type, as of June 30, 2018 and December 31, 2017.

(Dollars in thousands)	Commercial	Real Estate	Construction and Land Development	Consumer and Single Family Mortgages	Unallocated	Total
ALLL balance at June 30, 2018 related to:						
Loans individually evaluated for impairment	$ —	$ —	$ —	$ —	$ —	$ —
Loans collectively evaluated for impairment	7,493	2,953	327	1,578	1,018	13,369
Total	$ 7,493	$ 2,953	$ 327	$ 1,578	$ 1,018	$ 13,369
Loans balance at June 30, 2018 related to:						
Loans individually evaluated for impairment	$ 4,413	$ 862	$ —	$ 50	$ —	$ 5,325
Loans collectively evaluated for impairment	398,739	538,981	30,395	85,617	—	1,053,732
Total	$ 403,152	$ 539,843	$ 30,395	$ 85,667	$ —	$ 1,059,057
ALLL balance at December 31, 2017 related to:						
Loans individually evaluated for impairment	$ 7	$ —	$ —	$ —	$ —	$ 7
Loans collectively evaluated for impairment	9,148	2,906	650	1,043	442	14,189
Total	$ 9,155	$ 2,906	$ 650	$ 1,043	$ 442	$ 14,196
Loans balance at December 31, 2017 related to:						
Loans individually evaluated for impairment	$ 3,672	$ 2,461	$ —	$ 227	$ —	$ 6,360
Loans collectively evaluated for impairment	390,821	554,296	34,614	78,539	—	1,058,270
Total	$ 394,493	$ 556,757	$ 34,614	$ 78,766	$ —	$ 1,064,630

Credit Quality

The amounts of nonperforming assets and delinquencies that occur within our loan portfolio factor into our evaluation of the adequacy of the ALLL.

The following table provides a summary of the delinquency status of loans by portfolio type at June 30, 2018 and December 31, 2017:

(Dollars in thousands)	30-59 Days Past Due	60-89 Days Past Due	90 Days and Greater	Total Past Due	Current	Total Loans Outstanding	Loans >90 Days and Accruing
At June 30, 2018							
Commercial loans	$ 553	$ 6,245	$ 2,669	$ 9,467	$ 393,685	$ 403,152	$ —
Commercial real estate loans – owner-occupied	—	3,870	—	3,870	221,148	225,018	—
Commercial real estate loans – all other	—	—	—	—	224,555	224,555	—
Residential mortgage loans – multi-family	—	—	—	—	90,270	90,270	—
Residential mortgage loans – single family	—	—	—	—	24,583	24,583	—
Construction and land development loans	—	—	—	—	30,395	30,395	—
Consumer loans	—	—	—	—	61,084	61,084	—
Total	$ 553	$ 10,115	$ 2,669	$ 13,337	$ 1,045,720	$ 1,059,057	$ —
At December 31, 2017							
Commercial loans	$ 1,387	$ —	$ 2,125	$ 3,512	$ 390,981	$ 394,493	$ —
Commercial real estate loans – owner-occupied	—	—	—	—	214,365	214,365	—
Commercial real estate loans – all other	—	936	—	936	227,154	228,090	—
Residential mortgage loans – multi-family	—	—	—	—	114,302	114,302	—
Residential mortgage loans – single family	—	—	—	—	24,848	24,848	—
Construction and land development loans	—	—	—	—	34,614	34,614	—
Consumer loans	—	—	—	—	53,918	53,918	—
Total	$ 1,387	$ 936	$ 2,125	$ 4,448	$ 1,060,182	$ 1,064,630	$ —

Generally, the accrual of interest on a loan is discontinued when principal or interest payments become more than 90 days past due, unless we believe that the loan is adequately collateralized and it is in the process of collection. There were no loans 90 days or more past due and still accruing interest at June 30, 2018 or December 31, 2017. In certain instances, when a loan is placed on nonaccrual status, previously accrued but unpaid interest is reversed against current income. Subsequent collections of cash are applied as principal reductions when received (referred to as full nonaccrual basis of accounting), except when the ultimate collectability of principal is probable, in which case such payments are applied to accrued and unpaid interest, which is credited to income (referred to as nonaccrual cash basis of accounting). Nonaccrual loans may be restored to accrual status when principal and interest become current and full repayment becomes expected.

The following table provides information with respect to loans on nonaccrual status, by portfolio type, as of June 30, 2018 and December 31, 2017:

	June 30, 2018	December 31, 2017
	(Dollars in thousands)	
Nonaccrual loans:		
Commercial loans	$ 4,413	$ 3,222
Commercial real estate loans – owner occupied	862	893
Commercial real estate loans – all other	—	1,568
Residential mortgage loans – single family	—	171
Consumer	50	56
Total[(1)]	$ 5,325	$ 5,910

(1) Nonaccrual loans may include loans that are currently considered performing loans.

We classify our loan portfolio using internal asset quality ratings. The following table provides a summary of loans by portfolio type and our internal asset quality ratings as of June 30, 2018 and December 31, 2017:

	June 30, 2018	December 31, 2017
	(Dollars in thousands)	
Pass:		
Commercial loans	$ 385,462	$ 375,024
Commercial real estate loans – owner occupied	217,697	207,094
Commercial real estate loans – all other	214,055	226,522
Residential mortgage loans – multi family	90,270	114,302
Residential mortgage loans – single family	24,583	24,677
Construction and land development loans	30,395	34,614
Consumer loans	61,034	53,862
Total pass loans	$ 1,023,496	$ 1,036,095
Special Mention:		
Commercial loans	$ 9,788	$ 11,009
Commercial real estate loans – owner occupied	2,589	6,378
Commercial real estate loans – all other	10,500	—
Total special mention loans	$ 22,877	$ 17,387
Substandard:		
Commercial loans	$ 7,902	$ 8,094
Commercial real estate loans – owner occupied	4,732	893
Commercial real estate loans – all other	—	1,568
Residential mortgage loans – single family	—	171
Consumer loans	50	56
Total substandard loans	$ 12,684	$ 10,782
Doubtful:		
Commercial loans	$ —	$ 366
Total doubtful loans	$ —	$ 366
Total Loans:	$ 1,059,057	$ 1,064,630

Impaired Loans

A loan generally is classified as impaired when, in our opinion, principal or interest is not likely to be collected in accordance with the contractual terms of the loan agreement. We measure for impairments on a loan-by-loan basis, using either the present value of expected future cash flows discounted at the loan's effective interest rate, or the fair value of the collateral if the loan is collateral dependent.

The following table sets forth information regarding impaired loans, at June 30, 2018 and December 31, 2017:

	June 30, 2018	December 31, 2017
	(Dollars in thousands)	
Impaired loans:		
Nonaccruing loans	$ 5,325	$ 5,101
Nonaccruing restructured loans[(1)]	—	809
Accruing restructured loans[(1)(2)]	—	450
Total impaired loans	$ 5,325	$ 6,360
Impaired loans less than 90 days delinquent and included in total impaired loans	$ 2,656	$ 3,994

(1) As of June 30, 2018, we had no restructured loans.

(2) See "*Troubled Debt Restructurings*" below for a description of accruing restructured loans at June 30, 2018 and December 31, 2017.

The table below contains additional information with respect to impaired loans, by portfolio type, as of June 30, 2018 and December 31, 2017:

	June 30, 2018			December 31, 2017		
	Recorded Investment	Unpaid Principal Balance	Related Allowance (1)	Recorded Investment	Unpaid Principal Balance	Related Allowance (1)
	(Dollars in thousands)					
No allowance recorded:						
Commercial loans	$ 4,413	$ 5,268	$ —	$ 3,222	$ 5,910	$ —
Commercial real estate loans – owner occupied	862	933	—	893	945	—
Commercial real estate loans – all other	—	—	—	1,568	1,965	—
Residential mortgage loans – single family	—	—	—	171	185	—
Consumer loans	50	70	—	56	73	—
Total	5,325	6,271	—	5,910	9,078	—
With allowance recorded:						
Commercial loans	$ —	$ —	$ —	$ 450	$ 450	$ 7
Total	—	—	—	450	450	7
Total						
Commercial loans	$ 4,413	$ 5,268	$ —	$ 3,672	$ 6,360	$ 7
Commercial real estate loans – owner occupied	862	933	—	893	945	—
Commercial real estate loans – all other	—	—	—	1,568	1,965	—
Residential mortgage loans – single family	—	—	—	171	185	—
Consumer loans	50	70	—	56	73	—
Total	5,325	6,271	—	6,360	9,528	7

(1) When the discounted cash flows, collateral value or market price equals or exceeds the recorded investment in the loan, then specific reserves are not required to be set aside for the loan within the ALLL. This typically occurs when the impaired loans have been partially charged-off and/or there have been interest payments received and applied to the balance of the principal outstanding.

At June 30, 2018 and December 31, 2017, there were $5.3 million and $5.9 million, respectively, of impaired loans for which no specific reserves had been allocated because these loans, in our judgment, were sufficiently collateralized. Of the impaired loans at June 30, 2018 for which no specific reserves were allocated, $1.7 million had been deemed impaired in the prior year.

Average balances and interest income recognized on impaired loans, by portfolio type, for the three and six months ended June 30, 2018 and 2017 were as follows:

	Three Months Ended June 30,				Six Months Ended June 30,			
	2018		2017		2018		2017	
	Average Balance	Interest Income Recognized	Average Balance	Interest Income Recognized	Average Balance	Interest Income Recognized	Average Balance	Interest Income Recognized
	(Dollars in thousands)							
No allowance recorded:								
Commercial loans	$ 4,408	$ —	$ 17,312	$ 10	$ 4,013	$ 62	$ 16,462	$ 39
Commercial real estate loans – owner occupied	871	—	1,411	—	879	—	2,057	—
Commercial real estate loans – all other	739	—	1,647	—	1,016	—	1,683	—
Residential mortgage loans – multi-family	—	—	—	—	—	—	107	—
Residential mortgage loans – single family	—	—	195	—	57	—	212	—
Consumer loans	52	—	133	—	53	—	66	1
Total	6,070	—	20,698	10	6,018	62	20,587	40
With allowance recorded:								
Commercial loans	193	—	3,584	8	279	—	4,562	15
Total	193	—	3,584	8	279	—	4,562	15
Total								
Commercial loans	4,601	—	20,896	18	4,292	62	21,024	54
Commercial real estate loans – owner occupied	871	—	1,411	—	879	—	2,057	—
Commercial real estate loans – all other	739	—	1,647	—	1,016	—	1,683	—
Residential mortgage loans – multi-family	—	—	—	—	—	—	107	—
Residential mortgage loans – single family	—	—	195	—	57	—	212	—
Consumer loans	52	—	133	—	53	—	66	1
Total	$ 6,263	$ —	$ 24,282	$ 18	$ 6,297	$ 62	$ 25,149	$ 55

The interest that would have been earned had the impaired loans remained current in accordance with their original terms was $101 thousand and $429 thousand during the three months ended June 30, 2018 and 2017, respectively, and $206 thousand and $836 thousand during the six months ended June 30, 2018 and 2017, respectively.

Troubled Debt Restructurings ("TDRs")

Pursuant to the FASB's ASU No. 2011-2, *A Creditor's Determination of whether a Restructuring is a Troubled Debt Restructuring*, the Bank's TDRs totaled $0 and $1.3 million at June 30, 2018 and December 31, 2017, respectively. TDRs consist of loans to which modifications have been made for the purpose of alleviating temporary impairments of the borrower's financial condition and cash flows. Those modifications have come in the form of changes in amortization terms, reductions in interest rates, interest only payments and, in limited cases, concessions to outstanding loan balances. The modifications are made as part of workout plans we enter into with the borrower that are designed to provide a bridge for the borrower's cash flow shortfalls in the near term. If a borrower works through the near term issues, then in most cases, the original contractual terms of the borrower's loan will be reinstated.

The following table presents loans restructured as TDRs during the three and six months ended June 30, 2018 and 2017:

	Three Months Ended					
	June 30, 2018			June 30, 2017		
(Dollars in thousands)	Number of Loans	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment	Number of loans	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment
Performing						
Commercial loans	—	$ —	$ —	1	$ 510	$ 510
	—	—	—	1	510	510
Nonperforming						
Commercial loans	—	—	—	1	1,416	1,416
	—	—	—	1	1,416	1,416
Total Troubled Debt Restructurings[(1)]	—	$ —	$ —	2	$ 1,926	$ 1,926

	Six Months Ended					
	June 30, 2018			June 30, 2017		
(Dollars in thousands)	Number of loans	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment	Number of loans	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment
Performing						
Commercial loans	—	$ —	$ —	1	$ 510	$ 510
	—	—	—	1	510	510
Nonperforming						
Commercial loans	—	—	—	2	1,819	1,526
	—	—	—	2	1,819	1,526
Total Troubled Debt Restructurings[(1)]	—	$ —	$ —	3	$ 2,329	$ 2,036

(1) No outstanding loans were restructured during the three and six months ended June 30, 2018.

During the three and six months ended June 30, 2018 and 2017, TDRs that were modified within the preceding 12-month period which subsequently defaulted were as follows:

	Three Months Ended				Six Months Ended			
	June 30, 2018		June 30, 2017		June 30, 2018		June 30, 2017	
	Number of loans	Recorded Investment	Number of loans	Recorded Investment	Number of loans	Recorded Investment	Number of loans	Recorded Investment
	(Dollars in thousands)							
Commercial loans	—	$ —	—	$ —	—	$ —	—	$ —
Commercial real estate - owner occupied	—	$ —	—	$ —	—	$ —	—	$ —
Total[(1)]	—	$ —	—	$ —	—	$ —	—	$ —

(1) During the three and six months ended June 30, 2018 and 2017, there were no TDRs that were modified within the preceding 12-month period which subsequently defaulted.

6. Income Taxes

At June 30, 2018 and December 31, 2017, we have a net deferred tax asset of $11.0 million and $0, respectively. The net deferred tax asset was $0 at December 31, 2017 as a result of the full valuation allowance recorded against our gross deferred tax asset, which we reversed at June 30, 2018. The components of our net deferred tax asset are as follows at:

(Dollars in thousands)	June 30, 2018	December 31, 2017
Deferred tax asset:		
Allowance for loan and lease losses	$ 3,956	$ 4,207
Other than temporary impairment on securities	56	56
Deferred compensation	667	693
Litigation reserve	131	131
Other accrued expenses	878	927
Charitable contributions	241	241
Reserve for unfunded commitments	103	103
Tax credits	60	60
Net operating loss carry forward	5,086	9,754
Stock based compensation	528	363
Depreciation and amortization	—	—
Unrealized losses on securities and deferred compensation	438	338
Total deferred tax assets	12,144	16,873
Deferred tax liabilities:		
Depreciation and amortization	(133)	(133)
Other	(981)	(803)
Total deferred tax liabilities	(1,114)	(936)
Valuation allowance	—	(15,937)
Total net deferred tax asset	$ 11,030	$ —

For both the three and six months ended June 30, 2018, we had an income tax benefit of $11.1 million, as a result of the release of our full valuation allowance of $11.1 million on our net deferred tax asset, discussed further below. Accounting rules specify that management must evaluate the deferred tax asset on a recurring basis to determine whether enough positive evidence exists to determine whether it is more-likely-than-not that the deferred tax asset will be available to offset or reduce future taxes. The tax code allows net operating losses incurred prior to December 31, 2017 to be carried forward for 20 years from the date of the loss, and based on its evaluation, management believes that the Company will be able to realize the deferred tax asset within the period that our net operating losses may be carried forward. Due to the hierarchy of evidence that the accounting rules specify, management determined that the valuation allowance that was previously established on the balance of our deferred tax asset was no longer required at June 30, 2018 and released the entire $11.1 million during the three months ended June 30, 2018. Significant positive evidence included our three-year cumulative income position, continued improvement in asset quality, and the expectation that we will continue to have positive earnings based on seven trailing quarters of positive income and our forecast. Negative evidence included our accumulated deficit. The value of our deferred tax asset is computed based upon an estimate of taxable income for the full year of 2018, which will result in only minimal tax provision in subsequent quarters during 2018.

For the three and six months ended June 30, 2017, we had income tax expense of $64 thousand and $113 thousand, respectively. The income tax expense for the three and six months ended June 30, 2017 represented the payment to the State of California for the cost of doing business within the state and an estimated alternative minimum tax payment. No additional income tax expense was recorded during the three and six months ended June 30, 2017 as a result of our full valuation allowance. During the six months ended June 30, 2017, management evaluated the positive and negative evidence and determined that there continued to be enough negative evidence to support the full valuation allowance of $21.6 million at June 30, 2017. Negative evidence at June 30, 2017 included our accumulated deficit and our three-year cumulative loss position.

We file income tax returns with the U.S. federal government and the State of California. As of June 30, 2018, we were subject to examination by the Internal Revenue Service with respect to our U.S. federal tax returns for the 2014 to 2016 tax years and the Franchise Tax Board for California state income tax returns for the 2013 to 2016 tax years. Net operating losses on our U.S. federal and California state income tax returns may be carried forward up to 20 years. As of June 30, 2018, we do not have any unrecognized tax benefits.

Our policy is to recognize interest and penalties accrued on any unrecognized tax benefits as a component of tax expense. We did not have any accrued interest or penalties associated with any unrecognized tax benefits, and no interest expense was recognized during the three and six months ended June 30, 2018 and 2017.

7. Stock-Based Employee Compensation Plans

In May 2010, our shareholders approved the adoption of our 2010 Equity Incentive Plan (the "2010 Incentive Plan"), which authorized and set aside a total of 400,000 shares of our common stock for issuance on the exercise of stock options or the grant of restricted stock or other equity incentives to our officers, and other key employees and directors. An additional 158,211 shares of common stock were also set aside which was equal to the total of the shares that were available for the grant of equity incentives under our shareholder-approved 2008 and 2004 Equity Incentive Plans (the "Previously Approved Plans") at the time of the adoption of the 2010 Incentive Plan. Options to purchase a total of 66,442 shares of our common stock granted under the Previously Approved Plans were outstanding at June 30, 2018. The 2010 Incentive Plan provides that if any of these outstanding options under the Previously Approved Plans expire or are terminated for any reason, then the number of shares that would become available for grants or awards of equity incentives under the 2010 Incentive Plan would be increased by an equivalent number of shares. At the Annual Shareholders meeting held in May 2013, our shareholders approved an additional 800,000 share increase in the maximum number of shares of our common stock that may be issued pursuant to grants or exercises of options or restricted shares or other equity incentives under the 2010 Incentive Plan, of which 306,757 shares of restricted stock, net of shares withheld for taxes, have vested as of June 30, 2018 thereby decreasing the maximum number of shares authorized under the 2010 Incentive Plan. As a result, as of June 30, 2018, the maximum number of shares that were authorized for the grant of options or other equity incentives under the 2010 Incentive Plan totaled 1,117,896 (assuming that all shares of our common stock subject to options and other equity awards expire or are terminated prior to vesting), or approximately 5% of the shares of our common stock then outstanding.

A stock option entitles the recipient to purchase shares of our common stock at a price per share that may not be less than 100% of the fair market value of the Company's shares on the date the option is granted. Restricted shares may be granted at such purchase prices and on such other terms, including restrictions and Company repurchase or reacquisition rights, as are fixed by the Compensation Committee at the time rights to purchase such restricted shares are granted. Stock Appreciation Rights ("SARs") entitle the recipient to receive a cash payment in an amount equal to the difference between the fair market value of the Company's shares on the date of vesting and a "base price" (which, in most cases, will be equal to the fair market value of the Company's shares on the date the SAR is granted), subject to the right of the Company to make such payment in shares of its common stock at their then fair market value. Options, restricted shares and SARs may vest immediately or in installments over various periods generally ranging up to five years, subject to the recipient's continued employment or service or the achievement of specified performance goals, as determined by the Compensation Committee at the time it grants or awards the options, the restricted shares or the SARs. Stock options and SARs may be granted for terms of up to 10 years after the date of grant, but will terminate sooner upon or shortly after a termination of service occurring prior to the expiration of the term of the option or SAR. The Company will become entitled to repurchase any unvested restricted shares, at the same price that was paid for the shares by the recipient, or to cancel those shares in the event of a termination of employment or service of the holder of such shares or if any performance goals specified in the award are not satisfied. To date, the Company has not granted any SARs.

Under FASB ASC 718-10, we are required to recognize, in our financial statements, the fair value of the options or any restricted shares that we grant as compensation cost over their respective service periods. The fair values of the options that were outstanding at June 30, 2018 under the 2010 Incentive Plan were estimated as of their respective dates of grant using the Black-Scholes option-pricing model. The Company, under the 2010 Incentive Plan, has also granted restricted stock for the benefit of its employees and directors. These restricted shares vest over a period ranging from three to five years for employees and one year for directors. The recipients of restricted shares have the right to vote all shares subject to such grant and receive all dividends with respect to such shares whether or not the shares have vested. The recipients do not pay any cash consideration for the shares.

Stock Options

The table below summarizes the weighted average assumptions used to determine the fair values of the options granted during the following periods:

	Three Months Ended June 30,		Six Months Ended June 30,	
Assumptions with respect to:	**2018**	**2017**	**2018**	**2017**
Expected volatility	—%	33%	30%	33%
Risk-free interest rate	—%	1.95%	2.69%	1.95%
Expected dividends	—%	—%	—%	—%
Expected term (years)	0.0	5.7	5.8	5.7
Weighted average fair value of options granted during period	$ —	$ 2.81	$ 2.81	$ 2.81

The following table summarizes the stock option activity under the Company's equity incentive plans during the six months ended June 30, 2018 and 2017, respectively.

	2018 Number of Shares	2018 Weighted-Average Exercise Price Per Share	2017 Number of Shares	2017 Weighted-Average Exercise Price Per Share
Outstanding – January 1,	792,577	$ 6.41	1,066,914	$ 6.35
Granted	154,011	8.20	3,000	8.05
Exercised	(75,108)	4.95	(171,834)	5.77
Forfeited/Canceled	(7,150)	6.47	(49,300)	7.19
Outstanding – June 30,	864,330	6.86	848,780	6.42
Options Exercisable – June 30,	585,482	$ 6.49	568,249	$ 6.19
Options Vested – June 30,	585,482	$ 6.49	568,249	$ 6.19

Options to purchase 67,108 and 20,500 shares of our common stock were exercised during the three months ended June 30, 2018 and 2017, respectively, and 75,108 and 171,834 shares during the six months ended June 30, 2018 and 2017, respectively. The aggregate intrinsic value of options exercised during the three months ended June 30, 2018 and 2017 was $311 thousand and $85 thousand, respectively, and $356 thousand and $309 thousand during the six months ended June 30, 2018 and 2017, respectively. The fair value of options that vested during the three months ended June 30, 2018 and 2017 was $75 thousand and $83 thousand, respectively, and $349 thousand and $390 thousand during the six months ended June 30, 2018 and 2017, respectively.

The following table provides additional information regarding the vested and unvested options that were outstanding at June 30, 2018.

	Options Outstanding as of June 30, 2018				Options Exercisable as of June 30, 2018[(1)]	
Exercise Price	Vested	Unvested	Weighted Average Exercise Price Per Share	Weighted Average Remaining Contractual Life (Years)	Shares	Weighted Average Exercise Price Per Share
$2.97 – $3.99	18,003	—	$ 3.48	2.95	18,003	$ 3.48
$4.00 – $4.99	16,000	—	4.34	2.80	16,000	4.34
$5.00– $5.99	15,000	—	5.30	4.97	15,000	5.30
$6.00– $6.99	411,833	84,654	6.61	6.00	411,833	6.57
$7.00-$8.90	124,646	194,194	7.63	8.44	124,646	7.09
	585,482	278,848	$ 6.86	6.76	585,482	$ 6.49

(1) The weighted average remaining contractual life of the options that were exercisable as of June 30, 2018 was 5.82 years.

The aggregate intrinsic value of options that were outstanding and exercisable under the 2010 Incentive Plan at June 30, 2018 and December 31, 2017 was $1.9 million and $1.4 million, respectively.

A summary of the status of the unvested options outstanding as of June 30, 2018 and 2017, and changes in the weighted average grant date fair values of the unvested options during the six months ended June 30, 2018 and 2017, are set forth in the following table.

	For the six months ended June 30, 2018 Number of Shares Subject to Options	2018 Weighted Average Grant Date Fair Value Per Share	2017 Number of Shares Subject to Options	2017 Weighted Average Grant Date Fair Value Per Share
Unvested at the beginning of the period	255,348	$ 2.80	461,944	$ 2.79
Granted	154,011	2.81	3,000	2.81
Vested	(123,361)	2.83	(137,913)	2.83
Forfeited/Canceled	(7,150)	2.66	(46,500)	2.62
Unvested at the end of the period	278,848	2.79	280,531	2.80

At June 30, 2018, the weighted average period over which nonvested awards were expected to be recognized was 2.31 years.

Restricted Stock

The following table summarizes the activity related to restricted stock granted, vested and forfeited under our equity incentive plans during the six months ended June 30, 2018 and 2017.

	For the six months ended June 30,			
	2018		2017	
	Number of Shares	Average Grant Date Fair Value Per Share	Number of Shares	Average Grant Date Fair Value Per Share
Outstanding at the beginning of the period	103,508	$ 7.33	151,298	$ 6.84
Granted	75,417	8.19	29,907	7.69
Vested	(62,564)	7.26	(66,558)	6.81
Forfeited	(4,690)	7.55	(12,500)	6.81
Outstanding at the end of the period	111,671	$ 7.94	102,147	$ 7.11

Compensation Expense

We expect that the compensation expense that will be recognized during the periods presented below in respect of stock options and restricted stock outstanding at June 30, 2018, will be as follows:

	Estimated Stock Based Compensation Expense Stock Options	Estimated Stock Based Compensation Expense Restricted Stock	Estimated Stock Based Compensation Expense Total
(Dollars in thousands)			
For the years ending December 31,			
Remainder of 2018	$ 223	$ 244	$ 467
2019	193	225	418
2020	153	175	328
2021	45	67	112
2022 and beyond	21	38	59
	$ 635	$ 749	$ 1,384

The aggregate amounts of stock based compensation expense recognized in our consolidated statements of operations for the three months ended June 30, 2018 and 2017 were $170 thousand and $208 thousand, respectively, in each case net of taxes, and $298 thousand and $405 thousand for the six months ended June 30, 2018 and 2017, respectively, in each case net of taxes.

8. Earnings Per Share ("EPS")

Basic EPS excludes dilution and is computed by dividing net income or loss available to common shareholders by the weighted average number of common shares outstanding for the period. Diluted EPS reflects the potential dilution that could occur if stock options or other contracts to issue common stock were exercised or converted into common stock that would then share in our earnings.

The following table shows how we computed basic and diluted EPS for the three and six months ended June 30, 2018 and 2017.

	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
(In thousands, except per share data)	**2018**	**2017**	**2018**	**2017**
Numerator:				
Numerator for basic and diluted net income available to common shareholders	$ 15,369	$ 2,501	$ 19,076	$ 4,281
Denominator:				
Basic weighted average outstanding shares of common stock	23,332	23,187	23,299	23,163
Dilutive effect of employee stock options	226	109	203	106
Diluted weighted average common stock and common stock equivalents	23,558	23,296	23,502	23,269
Basic income per common share[(1)]:				
Net income available to common shareholders	$ 0.66	$ 0.11	$ 0.82	$ 0.19
Diluted income per common share[(1)]:				
Net income available to common shareholders	$ 0.65	$ 0.11	$ 0.81	$ 0.19

(1) The basic and diluted earnings per share amounts for the three and six months ended June 30, 2018 and 2017 are the same under both the Treasury Stock Method and the Two-Class Method as prescribed in FASB ASC 260-10, *Earnings Per Share*.

The weighted average shares that have an antidilutive effect in the calculation of diluted net income per share and have been excluded from the computations above were as follows:

	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	2018	**2017**	**2018**	**2017**
Stock options[(1)]	157,711	378,355	113,971	427,018

(1) Represents stock options that were excluded from the computation of diluted earnings per common share for the three and six months ended June 30, 2018 and 2017 as a result of the shares being "out-of-the-money."

9. Shareholders' Equity

Accumulated Other Comprehensive Income (Loss), net

Accumulated other comprehensive income (loss), net as of June 30, 2018 and December 31, 2017 was as follows:

	Unrealized Gain (Loss) on Securities Available-for-Sale, net of tax	Accumulated Other Comprehensive Income (Loss), Net
	(Dollars in thousands)	
Ending balance as of December 31, 2016	$ (1,842)	$ (1,842)
Other comprehensive income before reclassifications [(1)]	695	695
Amounts reclassified from accumulated other comprehensive income, net of tax	4	4
Other comprehensive income [(1)]	699	699
Ending balance as of December 31, 2017	$ (1,143)	$ (1,143)
Other comprehensive loss before reclassifications [(2)]	(388)	(388)
Amounts reclassified from accumulated other comprehensive loss [(3)]	49	49
Other comprehensive loss [(2)]	(339)	(339)
Ending balance as of June 30, 2018	$ (1,482)	$ (1,482)

(1) No tax impact as a result of the full valuation allowance recorded against our deferred tax asset at December 31, 2017.
(2) No tax impact as a result of the release of the valuation allowance being recorded within continuing operations at June 30, 2018.
(3) This balance consists of the $48 thousand net gain on sale of available for sale debt securities included in our *consolidated statement of operations* offset by $97 thousand included in our *consolidated statement of shareholders' equity* as an adjustment to our beginning retained earnings.

10. Commitments and Contingencies

Commitments

To meet the financing needs of our customers in the normal course of business, we are a party to financial instruments with off-balance sheet risk. These financial instruments include commitments to extend credit and standby letters of credit. These instruments involve, to varying degrees, elements of credit and interest rate risk in excess of the amount recognized in the consolidated financial statements. At June 30, 2018 and December 31, 2017, we were committed to fund certain loans including letters of credit amounting to approximately $271 million and $295 million, respectively. The contractual amounts of a credit-related financial instrument, such as a commitment to extend credit, a credit-card arrangement or a letter of credit, represent the amount of potential accounting loss should the commitment be fully drawn upon, the customer were to default, and the value of any existing collateral securing the customer's payment obligation becomes worthless. The loss reserve for unfunded loan commitments was $350 thousand at both June 30, 2018 and December 31, 2017.

As a result, we use the same credit policies in making commitments to extend credit and conditional obligations as we do for on-balance sheet instruments. Commitments generally have fixed expiration dates; however, since many of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. We evaluate each customer's creditworthiness on a case-by-case basis, using the same credit underwriting standards that are employed in making commercial loans. The amount of collateral obtained, if any, upon an extension of credit is based on our evaluation of the creditworthiness of the customer. Collateral held varies, but may include accounts receivable, inventory, property, plant and equipment, residential real estate and income-producing commercial properties.

Borrowings

At June 30, 2018 and December 31, 2017, our borrowings and contractual obligations consisted of the following:

(Dollars in thousands)	June 30, 2018	December 31, 2017
FHLB advances—short-term	$ 30,000	$ 40,000
Other borrowings—short-term[(1)]	—	866
Total borrowings—short-term	30,000	40,866
FHLB advances—long-term	—	—
Total	$ 30,000	$ 40,866

(1) Borrowings had an interest rate of 15% as of December 31, 2017. This represented the portion of a participated loan that was required under GAAP to be recorded as other borrowings as of December 31, 2017. The participated portion of this loan was repurchased during the first quarter of 2018 and is no longer required to be recorded in other borrowings.

The table below sets forth the amounts of, the interest rates we pay on, and the maturity dates of these FHLB borrowings. These borrowings had a weighted-average annualized interest rate of 1.93% for the six months ended June 30, 2018.

Principal Amounts	Interest Rate	Maturity Dates
	(Dollars in thousands)	
10,000	1.72%	September 4, 2018
10,000	1.77%	December 3, 2018
10,000	2.31%	January 15, 2019

At June 30, 2018, $800 million of loans were pledged to support our FHLB borrowings and our unfunded borrowing capacity. As of June 30, 2018, we had unused borrowing capacity of $383 million with the FHLB. The highest amount of borrowings outstanding at any month-end during the six months ended June 30, 2018 was $40.9 million.

As of December 31, 2017, we had $40.0 million of outstanding short-term borrowings and no outstanding long-term borrowings that we had obtained from the FHLB. These borrowings had a weighted-average annualized interest rate of 1.65% for the year ended December 31, 2017. As of December 31, 2017, we had unused borrowing capacity of $285 million with the FHLB. The highest amount of borrowings outstanding at any month-end during the year ended December 31, 2017 was $40.9 million.

Litigation, Claims and Assessments

We are a defendant in or a party to a number of legal actions or proceedings that arise in the ordinary course of business. In some of these actions and proceedings, claims for monetary damages are asserted against us.

In accordance with applicable accounting guidance, we establish an accrued liability for lawsuits or other legal proceedings when they present loss contingencies that are both probable and estimable. We estimate any potential loss based upon currently available information and significant judgments and a variety of assumptions, and known and unknown uncertainties. Moreover, the facts and circumstances on which such estimates are based will change over time. Therefore, the amount of any losses we might incur in any lawsuits or other legal proceedings may exceed amounts which we had accrued based on our estimates and those estimates do not represent the maximum loss exposure that we may have in connection with any lawsuits or other legal proceedings.

In December 2016, following an ongoing review related to alleged discriminatory practices within our discontinued mortgage banking business, we received notice that the U.S. Department of Justice ("DOJ") had authorized a potential enforcement action against the Bank. During the three months ended June 30, 2018, we settled this matter with the DOJ for $1.0 million, which we have fully accrued for as of June 30, 2018.

Based on our evaluation of the remaining lawsuits and other proceedings that were pending against us as of June 30, 2018, the outcomes in those suits or other proceedings are not expected to have, either individually or in the aggregate, a material adverse effect on our consolidated financial position, results of operations or cash flows. However, in light of the inherent uncertainties involved, some of which are beyond our control, and the very large or indeterminate damages often sought in such legal actions or proceedings, an adverse outcome in one or more of these suits or proceedings could be material to our results of operations or cash flows for any particular reporting period.

11. Business Segment Information

We have one reportable business segment, commercial banking. The commercial banking segment provides small and medium-size businesses, professional firms and individuals with a diversified range of products and services such as various types of deposit accounts, various types of commercial and consumer loans, cash management services, and online banking services.

Since our operating segment derives all of its revenues from interest and noninterest income and interest expense constitutes its most significant expense, this segment is reported below using net interest income (interest income less interest expense) and noninterest income (primarily net gains on sales of small business administration loans and fee income). We do not allocate general and administrative expenses or income taxes to our operating segment.

The following table sets forth information regarding the net interest income and noninterest income for our commercial banking segment for the three and six months ended June 30, 2018 and 2017.

(Dollars in thousands)	Commercial	Other[(1)]	Total
Net interest income for the three months ended June 30,			
2018	$ 11,849	$ 598	$ 12,447
2017	$ 10,560	$ (164)	$ 10,396
Noninterest income for the three months ended June 30,			
2018	$ 1,130	$ 6	$ 1,136
2017	$ 1,053	$ 378	$ 1,431
Net interest income for the six months ended June 30,			
2018	$ 23,449	$ 1,183	$ 24,632
2017	$ 20,527	$ (60)	$ 20,467
Noninterest income for the six months ended June 30,			
2018	$ 2,179	$ 12	$ 2,191
2017	$ 1,986	$ 416	$ 2,402
Segment Assets at:			
June 30, 2018	$ 1,357,135	$ 739	$ 1,357,874
December 31, 2017	$ 1,320,454	$ 2,150	$ 1,322,604

(1) Represents net interest income and noninterest income for PMAR and PMBC.

12. Regulatory Capital

Under federal banking regulations that apply to all United States-based bank holding companies and federally insured banks, the Company (on a consolidated basis) and the Bank (on a stand-alone basis) must meet specific capital adequacy requirements that, for the most part, involve quantitative measures, primarily in terms of the ratios of their capital to their assets, liabilities, and certain off-balance sheet items, calculated under regulatory accounting practices. Under those regulations, each bank holding company must meet a minimum capital ratio and each federally insured bank is determined by its primary federal bank regulatory agency to come within one of the following capital adequacy categories on the basis of its capital ratios:

- well-capitalized
- adequately capitalized
- undercapitalized
- significantly undercapitalized; or
- critically undercapitalized

Certain qualitative assessments also are made by a banking institution's primary federal regulatory agency that could lead the agency to determine that the banking institution should be assigned to a lower capital category than the one indicated by the quantitative measures used to assess the institution's capital adequacy. At each successive lower capital category, a banking institution is subject to greater operating restrictions and increased regulatory supervision by its federal bank regulatory agency.

The following table sets forth the capital and capital ratios of the Company (on a consolidated basis) and the Bank (on a stand-alone basis) at June 30, 2018, as compared to the respective regulatory requirements applicable to them.

			Applicable Federal Regulatory Requirement			
			For Capital Adequacy Purposes		To be Categorized As Well-Capitalized	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
			(Dollars in thousands)			
Total Capital to Risk Weighted Assets:						
Company	$ 159,695	13.6%	$ 101,296	At least 8.625	N/A	N/A
Bank	150,879	12.9%	101,277	At least 8.625	$ 117,423	At least 10.0
Common Equity Tier 1 Capital to Risk Weighted Assets:						
Company	$ 128,976	11.0%	$ 60,190	At least 5.125	N/A	N/A
Bank	137,160	11.7%	60,179	At least 5.125	$ 76,325	At least 6.5
Tier 1 Capital to Risk Weighted Assets:						
Company	$ 145,976	12.4%	$ 77,807	At least 6.625	N/A	N/A
Bank	137,160	11.7%	77,793	At least 6.625	$ 93,938	At least 8.0
Tier 1 Capital to Average Assets:						
Company	$ 145,976	10.8%	$ 53,853	At least 4.0	N/A	N/A
Bank	137,160	10.2%	53,644	At least 4.0	$ 67,056	At least 5.0

In early July 2013, the Federal Reserve Board and the FDIC issued final rules implementing the Basel III regulatory capital framework and related Dodd-Frank Wall Street Reform and Consumer Protection Act changes. The rules revise minimum capital requirements and adjust prompt correct action thresholds. The final rules revise the regulatory capital elements, add a new common equity Tier 1 capital ratio, increase the minimum Tier 1 capital ratio requirement, and implement a new capital conservation buffer. The rules also permit certain banking organizations to retain, through a one-time election, the existing treatment for accumulated other comprehensive income. The final rules took effect for community banks on January 1, 2015, subject to a transition period for certain parts of the rules. At June 30, 2018, the Bank (on a stand-alone basis) continued to qualify as a well-capitalized institution, and the Company continued to exceed the minimum required capital ratios applicable to it, under the capital adequacy guidelines described above.

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

Forward Looking Statements

Statements contained in this Quarterly Report on Form 10-Q (this "Report") that are not historical facts or that discuss our expectations, beliefs or views regarding our future operations or future financial performance, or financial or other trends in our business or in the markets in which we operate, constitute "forward-looking statements" within the meaning of Section 27A of the Securities Act of 1933, as amended (the "Securities Act"), and Section 21E of the Securities Exchange Act of 1934, as amended (the "Exchange Act"). Forward-looking statements can be identified by the fact that they do not relate strictly to historical or current facts. Often, they include words such as "believe," "expect," "anticipate," "intend," "plan," "estimate," "project," "forecast," or words of similar meaning, or future or conditional verbs such as "will," "would," "should," "could," or "may." The information contained in such forward-looking statements is based on current information available to us and on assumptions that we make about future economic and market conditions and other events over which we do not have control. In addition, our business and the markets in which we operate are subject to a number of risks and uncertainties. Such risks and uncertainties, and the occurrence of events in the future or changes in circumstances that had not been anticipated, could cause our financial condition or actual operating results in the future to differ materially from our expected financial condition or operating results that are set forth in the forward-looking statements contained in this Report and could, therefore, also affect the price performance of our shares.

In addition to the risk of incurring loan losses and provision for loan losses, which is an inherent risk of the banking business, these risks and uncertainties include, but are not limited to, the following: the risk that the credit quality of our borrowers declines; potential declines in the value of the collateral for secured loans; the risk that steps we have taken to strengthen our overall credit administration are not effective; the risk of a downturn in the United States economy, and domestic or international economic conditions, which could cause us to incur additional loan losses and adversely affect our results of operations in the future; the risk that our interest margins and, therefore, our net interest income will be adversely affected by changes in prevailing interest rates; the risk that we will not succeed in further reducing our remaining nonperforming assets, in which event we would face the prospect of further loan charge-offs and write-downs of assets; the risk that we will not be able to manage our interest rate risks effectively, in which event our operating results could be harmed; the prospect of changes in government regulation of banking and other financial services organizations, which could impact our costs of doing business and restrict our ability to take advantage of business and growth opportunities; the risk that our efforts to develop a robust commercial banking platform may not succeed; and the risk that we may be unable to realize our expected level of increasing deposit inflows. Readers of this Report are encouraged to review the additional information regarding these and other risks and uncertainties to which our business is subject that is contained in Part I, Item 1A of our Annual Report on Form 10-K for the year ended December 31, 2017 (the "2017 Form 10-K") that we filed with the Securities and Exchange Commission ("SEC") on March 2, 2018, as such information may be updated from time to time in subsequent Quarterly Reports on Form 10-Q that we file with the SEC. We urge you to read those risk factors in conjunction with your review of the following discussion and analysis of our results of operations for the three and six months ended, and our financial condition at, June 30, 2018.

Due to the risks and uncertainties we face, readers are cautioned not to place undue reliance on the forward-looking statements contained in this Report, which speak only as of the date of this Report, or to make predictions about future performance based solely on historical financial performance. We also disclaim any obligation to update forward-looking statements contained in this Report as a result of new information, future events or otherwise, except as may otherwise be required by law.

Overview

The following discussion presents information about our consolidated results of operations, financial condition, liquidity and capital resources and should be read in conjunction with our consolidated financial statements and the notes thereto included in Item 1 above of this Report.

Our principal operating subsidiary is Pacific Mercantile Bank (the "Bank"), which is a California State chartered bank. The Bank accounts for substantially all of our consolidated revenues, expenses and income and our consolidated assets and liabilities. Accordingly, the following discussion focuses primarily on the Bank's results of operations and financial condition.

As of June 30, 2018, our total assets, net loans and total deposits were $1.4 billion, $1.0 billion and $1.2 billion, respectively.

The Bank, which is headquartered in Orange County, California, approximately 40 miles south of Los Angeles, conducts a commercial banking business in Orange, Los Angeles, San Bernardino and San Diego counties in Southern California. The Bank is also a member of the Federal Reserve System and its deposits are insured, to the maximum extent permitted by law, by the Federal Deposit Insurance Corporation (the "FDIC"). For the six months ended June 30, 2018 and 2017, we operated as one reportable segment, Commercial Banking.

Unless the context otherwise requires, the "Company," "we," "our," "ours," and "us" refer to Pacific Mercantile Bancorp and its consolidated subsidiaries.

Results of Operations

Operating Results for the Three and Six Months Ended June 30, 2018 and 2017

Our operating results for the three and six months ended June 30, 2018, compared to the same period in June 30, 2017, were as follows:

	Three Months Ended June 30,		2018 vs. 2017	Six Months Ended June 30,		2018 vs. 2017
	2018	2017	% Change	2018	2017	% Change
			(Dollars in thousands)			
Interest income	$ 15,914	$ 12,132	31.2 %	$ 30,929	$ 23,736	30.3 %
Interest expense	3,467	1,736	99.7 %	6,297	3,269	92.6 %
Provision for loan and lease losses	—	—	— %	—	—	— %
Non-interest income	1,136	1,431	(20.6)%	2,191	2,402	(8.8)%
Non-interest expense	9,299	9,262	0.4 %	18,832	18,475	1.9 %
Income tax (benefit) expense	(11,085)	64	(17,420.3)%	(11,085)	113	(9,909.7)%
Net income	15,369	2,501	514.5 %	19,076	4,281	345.6 %

Interest Income

Three Months Ended June 30, 2018 and 2017

Total interest income increased 31.2% to $15.9 million for the three months ended June 30, 2018 from $12.1 million for the three months ended June 30, 2017. This was primarily due to an increase in interest income on loans and short-term investments as a result of higher average balances and an increase in the average yield during the three months ended June 30, 2018 as compared to the same prior year period. During the three months ended June 30, 2018 and 2017, interest income on loans was $14.8 million and $11.5 million, respectively, yielding 5.45% and 4.72% on average loan balances of $1.1 billion and $981.0 million, respectively. The increase in the average loan balances is attributable to an increase in loan demand. The increase in average loan yield is primarily attributable to the Board of Governors of the Federal Reserve System (“Federal Reserve Board”) raising short-term interest rates by 100 basis points since the first quarter of 2017 and the recovery of $811 thousand in interest income on one loan relationship that has been on nonaccrual status but was paid off during the three months ended June 30, 2018.

During the three months ended June 30, 2018 and 2017, interest income from our securities available-for-sale and stock was $262 thousand and $283 thousand, respectively, yielding 2.72% and 2.26% on average balances of $38.6 million and $50.1 million, respectively. The average securities balances decreased as a result of sales of $7.0 million of our available for sale securities and maturities of, and payments on, securities which we did not fully replace. Interest income from our short-term investments, including our federal funds sold and interest-bearing deposits, was $864 thousand and $305 thousand for the three months ended June 30, 2018 and 2017, respectively, yielding 1.80% and 1.04% on average balances of $192.2 million and $117.5 million, respectively. The increase in interest income from our short-term investments was primarily attributable to a higher average balance during the three months ended June 30, 2018 as compared to the three months ended June 30, 2017, and an increase in the average yield during the same period. The increase in the average yield is attributable to the Federal Reserve Board raising short-term interest rates by 100 basis points since the first quarter of 2017. As a result, total interest income on investments increased for the three months ended June 30, 2018 as compared to the three months ended June 30, 2017.

Six Months Ended June 30, 2018 and 2017

Total interest income increased 30.3% to $30.9 million for the six months ended June 30, 2018 from $23.7 million for the six months ended June 30, 2017. This was primarily due to an increase in interest income on loans and short-term investments during the six months ended June 30, 2018 as compared to the same prior year period. During the six months ended June 30, 2018 and 2017, interest income on loans was $28.8 million and $22.5 million, respectively, yielding 5.40% and 4.72% on average loan balances of $1.1 billion and $962.3 million, respectively. The increase in the average loan balances is attributable to an increase in loan demand. The increase in average loan yield is primarily attributable to the Federal Reserve Board raising short-term interest rates by 100 basis points since the first quarter of 2017 and the recovery of $1.6 million in interest income on two loan relationships that had been on nonaccrual status but were paid off during the six months ended June 30, 2018.

During the six months ended June 30, 2018 and 2017, interest income from our securities available-for-sale and stock was $536 thousand and $625 thousand, respectively, yielding 2.65% and 2.49% on average balances of $40.8 million and $50.5 million, respectively. The average securities balances decreased as a result of sales of $7.0 million of our available for sale securities and maturities of, and payments on, securities which we did not fully replace. Interest income from our short-term investments, including our federal funds sold and interest-bearing deposits, was $1.6 million and $569 thousand for the six months ended June 30, 2018 and 2017, respectively, yielding 1.69% and 0.93% on average balances of $186.4 million and $123.3 million, respectively. The increase in interest income from our short-term investments was primarily attributable to an increase in the average yield during the six months ended June 30, 2018 as compared to the six months ended June 30, 2017 as a result of the Federal Reserve Board raising short-term interest rates by 100 basis points since the first quarter of 2017. As a result, total interest income on investments increased for the six months ended June 30, 2018 as compared to the six months ended June 30, 2017.

Interest Expense

Three Months Ended June 30, 2018 and 2017

Total interest expense increased 99.7% for the three months ended June 30, 2018 compared to the three months ended June 30, 2017. The increase was primarily due to an increase in our cost of funds from 0.95% at June 30, 2017 to 1.59% at June 30, 2018 and an increase in the average balance of interest-bearing liabilities from $734.0 million at June 30, 2017 to $872.3 million at June 30, 2018, which consisted of deposits, borrowings and junior subordinated debentures. Our cost of funds increased as a result of the actions of the Federal Reserve Board to raise short-term interest rates by 100 basis points since the first quarter of 2017. The increase in our average balance of interest-bearing liabilities is primarily the result of higher deposits due to new client acquisition, our decision to increase the rate of interest paid on our non-maturing interest bearing deposits and our certificates of deposit resulting from the rising interest rate environment, and an increase in our FHLB borrowings. Interest expense on our certificates of deposit for the three months ended June 30, 2018 and 2017 was $1.3 million and $797 thousand, respectively, with a cost of funds of 1.66% and 1.15% on average balances of $326.7 million and $277.3 million, respectively.

Six Months Ended June 30, 2018 and 2017

Total interest expense increased 92.6% for the six months ended June 30, 2018 compared to the six months ended June 30, 2017. The increase was primarily due to an increase in our cost of funds from 0.92% at June 30, 2017 to 1.47% at June 30, 2018 and an increase in the average balance of interest-bearing liabilities of $720.4 million at June 30, 2017 to $861.1 million at June 30, 2018, which consisted of deposits, borrowings and junior subordinated debentures. Our cost of funds increased as a result of the actions of the Federal Reserve Board to raise short-term interest rates by 100 basis points since the first quarter of 2017. The increase in our average balance of interest-bearing liabilities is primarily the result of higher deposits due to new client acquisition, our decision to increase the rate of interest paid on our non-maturing interest bearing deposits and our certificates of deposit resulting from the rising interest rate environment, and an increase in our FHLB borrowings. Interest expense on our certificates of deposit for the six months ended June 30, 2018 and 2017 was $2.7 million and $1.5 million, respectively, with a cost of funds of 1.61% and 1.12% on average balances of $342.4 million and $267.0 million, respectively.

Net Interest Margin

One of the principal determinants of a bank's income is its net interest income, which is the difference between (i) the interest that a bank earns on loans, investment securities and other interest earning assets, on the one hand, and (ii) its interest expense, which consists primarily of the interest it must pay to attract and retain deposits and the interest that it pays on borrowings and other interest-bearing liabilities, on the other hand. As a general rule, all other things being equal, the greater the difference or "spread" between the amount of our interest income and the amount of our interest expense, the greater will be our net income; whereas, a decline in that difference or "spread" will generally result in a decline in our net income.

A bank's interest income and interest expense are affected by a number of factors, some of which are outside of its control, including national and local economic conditions and the monetary policies of the Federal Reserve Board which affect interest rates, competition in the market place for loans and deposits, the demand for loans and the ability of borrowers to meet their loan payment obligations. Net interest income, when expressed as a percentage of total average interest earning assets, is a banking organization's "net interest margin."

As a result of the Federal Reserve Board raising interest rates by 100 basis points since the first quarter of 2017, we experienced expansion in our net interest margin. The favorable impact of higher prevailing interest rates on our asset-sensitive balance sheet was evidenced in the three and six months ended June 30, 2018. While we are unable to assert as to whether the Federal Reserve Board will continue to increase short-term interest rates in the future, we expect the favorable impact on our net interest margin to remain in the event that interest rates continue to rise. However, we believe that the competition for deposits is increasing and could lead to increases in the cost of interest-bearing deposit liabilities that may partially offset the contractual increase in the yield on earning assets.

The following table sets forth information regarding our average balances, yields on interest earning assets, interest expense on interest-bearing liabilities, the interest rate spread and the interest rate margin for the three and six months ended June 30, 2018 and 2017. Average balances are calculated based on average daily balances.

	Three Months Ended June 30,					
	2018			2017		
	Average Balance	Interest Earned/ Paid	Average Yield/ Rate	Average Balance	Interest Earned/ Paid	Average Yield/ Rate
	(Dollars in thousands)					
Interest-earning assets						
Short-term investments[(1)]	$ 192,175	$ 864	1.80%	$ 117,482	$ 305	1.04%
Securities available for sale and stock[(2)]	38,633	262	2.72%	50,144	283	2.26%
Loans[(3)]	1,089,135	14,788	5.45%	980,987	11,544	4.72%
Total interest-earning assets	1,319,943	15,914	4.84%	1,148,613	12,132	4.24%
Noninterest-earning assets						
Cash and due from banks	16,617			14,598		
All other assets	12,970			(1,887)		
Total assets	$ 1,349,530			$1,161,324		
Interest-bearing liabilities:						
Interest-bearing checking accounts	$ 56,906	$ 63	0.44%	$ 95,543	$ 85	0.36%
Money market and savings accounts	434,294	1,670	1.54%	343,445	689	0.80%
Certificates of deposit	326,660	1,349	1.66%	277,264	797	1.15%
Other borrowings	36,934	171	1.86%	209	—	—%
Junior subordinated debentures	17,527	214	4.90%	17,527	165	3.78%
Total interest bearing liabilities	872,321	3,467	1.59%	733,988	1,736	0.95%
Noninterest bearing liabilities						
Demand deposits	346,553			315,483		
Accrued expenses and other liabilities	9,802			7,314		
Shareholders' equity	120,854			104,539		
Total liabilities and shareholders' equity	$ 1,349,530			$1,161,324		
Net interest income		$ 12,447			$ 10,396	
Net interest income/spread			3.25%			3.29%
Net interest margin			3.78%			3.63%

(1) Short-term investments consist of federal funds sold and interest bearing deposits that we maintain at other financial institutions.
(2) Stock consists of Federal Home Loan Bank ("FHLB") stock and Federal Reserve Bank of San Francisco ("FRBSF") stock.
(3) Loans include the average balance of nonaccrual loans.

	Six Months Ended June 30,					
	2018			2017		
	Average Balance	Interest Earned/ Paid	Average Yield/ Rate	Average Balance	Interest Earned/ Paid	Average Yield/ Rate
	(Dollars in thousands)					
Interest-earning assets						
Short-term investments[1]	$ 186,422	$ 1,560	1.69%	$ 123,308	$ 569	0.93%
Securities available for sale and stock[2]	40,789	536	2.65%	50,539	625	2.49%
Loans[3]	1,076,109	28,833	5.40%	962,317	22,542	4.72%
Total interest-earning assets	1,303,320	30,929	4.79%	1,136,164	23,736	4.21%
Noninterest-earning assets						
Cash and due from banks	16,228			14,550		
All other assets	10,051			(1,513)		
Total assets	$ 1,329,599			$1,149,201		
Interest-bearing liabilities:						
Interest-bearing checking accounts	$ 70,667	$ 177	0.51%	$ 86,606	$ 150	0.35%
Money market and savings accounts	392,046	2,654	1.37%	348,921	1,319	0.76%
Certificates of deposit	342,394	2,729	1.61%	267,038	1,478	1.12%
Other borrowings	38,489	337	1.77%	271	—	—%
Junior subordinated debentures	17,527	400	4.60%	17,527	322	3.70%
Total interest bearing liabilities	861,123	6,297	1.47%	720,363	3,269	0.92%
Noninterest bearing liabilities						
Demand deposits	339,238			318,066		
Accrued expenses and other liabilities	10,706			7,055		
Shareholders' equity	118,532			103,717		
Total liabilities and shareholders' equity	$ 1,329,599			$1,149,201		
Net interest income		$ 24,632			$ 20,467	
Net interest income/spread			3.32%			3.29%
Net interest margin			3.81%			3.63%

(1) Short-term investments consist of federal funds sold and interest bearing deposits that we maintain at other financial institutions.
(2) Stock consists of FHLB stock and FRBSF stock.
(3) Loans include the average balance of nonaccrual loans.

The following table sets forth changes in interest income, including loan fees, and interest paid in the three and six months ended June 30, 2018 and 2017 and the extent to which those changes were attributable to changes in (i) the volumes of or the rates of interest earned on interest-earning assets and (ii) the volumes of or the rates of interest paid on our interest-bearing liabilities.

	Three Months Ended June 30, 2018 Compared to Three Months Ended June 30, 2017 Increase (Decrease) due to Changes in			Six Months Ended June 30, 2018 Compared to Six Months Ended June 30, 2017 Increase (Decrease) due to Changes in		
	Volume	Rates	Total Increase (Decrease)	Volume	Rates	Total Increase (Decrease)
	(Dollars in thousands)					
Interest income						
Short-term investments[1]	$ 260	$ 299	$ 559	$ 383	$ 608	$ 991
Securities available for sale and stock[2]	(72)	51	(21)	(126)	37	(89)
Loans	1,354	1,890	3,244	2,839	3,452	6,291
Total earning assets	1,542	2,240	3,782	3,096	4,097	7,193
Interest expense						
Interest-bearing checking accounts	(40)	18	(22)	(31)	58	27
Money market and savings accounts	220	761	981	180	1,155	1,335
Certificates of deposit	160	392	552	489	762	1,251
Borrowings	—	171	171	—	337	337
Junior subordinated debentures	—	49	49	—	78	78
Total interest-bearing liabilities	340	1,391	1,731	638	2,390	3,028
Net interest income	$ 1,202	$ 849	$ 2,051	$ 2,458	$ 1,707	$ 4,165

(1) Short-term investments consist of federal funds sold and interest bearing deposits that we maintain at other financial institutions.
(2) Stock consists of FHLB stock and FRBSF stock.

Provision for Loan and Lease Losses

We maintain reserves to provide for loan losses that occur in the ordinary course of the banking business. When it is determined that the payment in full of a loan has become unlikely, the carrying value of the loan is reduced (“written down”) to what management believes is its realizable value or, if it is determined that a loan no longer has any realizable value, the carrying value of the loan is written off in its entirety (a loan “charge-off”). Loan charge-offs and write-downs are charged against our allowance for loan and lease losses (“ALLL”). The amount of the ALLL is increased periodically to replenish the ALLL after it has been reduced due to loan write-downs or charge-offs. The ALLL also is increased or decreased periodically to reflect increases or decreases in the volume of outstanding loans and to take account of changes in the risk of probable loan losses due to financial performance of borrowers, the value of collateral securing non-performing loans or changing economic conditions. Increases in the ALLL are made through a “provision for loan and lease losses” that is recorded as an expense in the statement of operations. Increases in the ALLL are also recognized through the recovery of charged-off loans which are added back to the ALLL. As such, recoveries are a direct offset for a provision for loan and lease losses that would otherwise be needed to replenish or increase the ALLL.

We employ economic models and data that conform to bank regulatory guidelines and reflect sound industry practices as well as our own historical loan loss experience to determine the sufficiency of the ALLL and any provisions needed to increase or replenish the ALLL. Those determinations involve judgments and assumptions about current economic conditions and external events that can impact the ability of borrowers to meet their loan obligations. However, the duration and impact of these factors cannot be determined with any certainty. As such, unanticipated changes in economic or market conditions, bank regulatory guidelines or the sound practices that are used to determine the sufficiency of the ALLL, could require us to record additional, and possibly significant, provisions to increase the ALLL. This would have the effect of reducing reportable income or, in the most extreme circumstance, creating a reportable loss. In addition, the Federal Reserve Bank and the California Department of Business Oversight (“CDBO”), as an integral part of their regulatory oversight, periodically review the adequacy of our ALLL. These agencies may require us to make additional provisions for perceived potential loan losses, over and above the provisions that we have already made, the effect of which would be to reduce our income or increase any losses we might incur.

We recorded no provision for loan and lease losses during the three and six months ended June 30, 2018 and 2017. There was no provision for the three and six months ended June 30, 2018 due primarily to the slight decrease in our loan portfolio for these periods. There was no provision for loan and lease losses for the three and six months ended June 30, 2017 due primarily to reserves for new loan growth being offset by a decline in the level of classified assets. During the three months ended June 30, 2018, we had net charge-offs of $36 thousand.

See “—*Financial Condition—Nonperforming Assets and Allowance for Loan and Lease Losses*” below in this Item 2 for additional information regarding the ALLL.

Noninterest Income

The following table identifies the components of and the percentage changes in noninterest income during the three and six months ended June 30, 2018 and 2017:

	Three Months Ended June 30,			Six Months Ended June 30,		
	Amount 2018	Amount 2017	Percentage Change 2018 vs. 2017	Amount 2018	Amount 2017	Percentage Change 2018 vs. 2017
	(Dollars in thousands)					
Service fees on deposits and other banking services	$ 407	$ 332	22.6 %	$ 794	$ 640	24.1 %
Net gain on sale of securities available for sale	—	—	— %	48	—	100.0 %
Net (loss) gain on sale of other assets	—	—	— %	(4)	2	(300.0)%
Other noninterest income	729	1,099	(33.7)%	1,353	1,760	(23.1)%
Total noninterest income	$ 1,136	$ 1,431	(20.6)%	$ 2,191	$ 2,402	(8.8)%

Three Months Ended June 30, 2018 and 2017

Noninterest income decreased by $295 thousand, or 20.6%, for the three months ended June 30, 2018 as compared to the three months ended June 30, 2017, primarily as a result of:

- A decrease in other noninterest income attributable to recoveries of fees on previously charged-off loans during the second quarter of 2017 for which similar level of recoveries did not occur during the second quarter of 2018; partially offset by
- An increase in loan servicing and referral fees during the second quarter of 2018 as compared to the same period in 2017.

Six Months Ended June 30, 2018 and 2017

Noninterest income decreased $211 thousand, or 8.8%, for the six months ended June 30, 2018 as compared to the six months ended June 30, 2017, primarily as a result of:

- A decrease in other noninterest income attributable to recoveries of fees on previously charged-off loans during the second quarter of 2017 for which a similar level of recoveries did not occur during the six months ended June 30, 2018; partially offset by
- An increase in loan servicing and referral fees during the six months ended June 30, 2018 as compared to the same period in 2017; and
- An increase of $48 thousand in gain on the sale of securities available-for-sale during the six months ended June 30, 2018 as compared to the same period in 2017.

Noninterest Expense

The following table sets forth the principal components and the amounts of, and the percentage changes in, noninterest expense during the three and six months ended June 30, 2018 and 2017.

	Three Months Ended June 30,			Six Months Ended June 30,		
	2018 Amount	2017 Amount	2018 vs. 2017 Percent Change	2018 Amount	2017 Amount	2018 vs. 2017 Percent Change
	(Dollars in thousands)					
Salaries and employee benefits	$ 5,916	$ 5,662	4.5 %	$ 12,076	$ 11,375	6.2 %
Occupancy	590	654	(9.8)%	1,208	1,299	(7.0)%
Equipment and depreciation	457	400	14.3 %	903	818	10.4 %
Data processing	380	345	10.1 %	772	686	12.5 %
FDIC expense	266	262	1.5 %	548	566	(3.2)%
Other real estate owned expense, net	8	—	100.0 %	8	—	100.0 %
Professional fees	636	1,032	(38.4)%	1,386	2,142	(35.3)%
Business development	315	214	47.2 %	499	357	39.8 %
Loan related expense	183	177	3.4 %	353	199	77.4 %
Insurance	62	62	— %	125	124	0.8 %
Other operating expenses (1)	486	454	7.0 %	954	909	5.0 %
Total noninterest expense	$ 9,299	$ 9,262	0.4 %	$ 18,832	$ 18,475	1.9 %

(1) Other operating expenses primarily consist of telephone, investor relations, promotional, regulatory expenses, and correspondent bank fees.

Three Months Ended June 30, 2018 and 2017

Noninterest expense increased $37 thousand, or 0.4%, for the three months ended June 30, 2018 as compared to the three months ended June 30, 2017, primarily as a result of:

- An increase of $254 thousand in salaries and employee benefits primarily related to an increase in employee compensation expense during the third quarter of 2017; and
- An increase in various expense accounts related to the normal course of operating, including expenses related to charitable contributions, loan production and business development, during the three months ended June 30, 2018 as compared to the three months ended June 30, 2017; partially offset by
- A decrease of $396 thousand in our professional fees primarily related to the recovery of legal fees attributable to the payoff of a loan relationship in the second quarter of 2018 that was previously on nonaccrual status.

Six Months Ended June 30, 2018 and 2017

Noninterest expense increased $357 thousand, or 1.9%, for the six months ended June 30, 2018 as compared to the six months ended June 30, 2017, primarily as a result of:

- An increase of $701 thousand in salaries and employee benefits primarily related to an increase in employee compensation expense during the third quarter of 2017; and
- An increase in various expense accounts related to the normal course of operating, including expenses related to charitable contributions, loan production and business development during the six months ended June 30, 2018 as compared to the six months ended June 30, 2017; partially offset by
- A decrease of $756 thousand in our professional fees primarily related to lower legal fees in the first quarter of 2018 and the recovery of legal fees attributable to the payoff of a loan relationship in the second quarter of 2018 that was previously on nonaccrual status.

Provision for Income Tax

For both the three and six months ended June 30, 2018, we had an income tax benefit of $11.1 million, as a result of the release of our full valuation allowance of $11.1 million on our net deferred tax asset, discussed further below. Accounting rules specify that management must evaluate the deferred tax asset on a recurring basis to determine whether enough positive evidence exists to determine whether it is more-likely-than-not that the deferred tax asset will be available to offset or reduce future taxes. The tax code allows net operating losses incurred prior to December 31, 2017 to be carried forward for 20 years from the date of the loss, and based on its evaluation, management believes that the Company will be able to realize the deferred tax asset within the period that our net operating losses may be carried forward. Due to the hierarchy of evidence that the accounting rules specify, management determined that the valuation allowance that was previously established on the balance of our deferred tax asset was no longer required at June 30, 2018 and released the entire $11.1 million during the three months ended June 30, 2018. Significant positive evidence included our three-year cumulative income position, continued improvement in asset quality, and the expectation that we will continue to have positive earnings based on seven trailing quarters of positive income and our forecast. Negative evidence included our accumulated deficit. The value of our deferred tax asset is computed based upon an estimate of taxable income for the full year of 2018, which will result in only minimal tax provision in subsequent quarters during 2018.

For the three and six months ended June 30, 2017, we had income tax expense of $64 thousand and $113 thousand, respectively. The income tax expense for the three and six months ended June 30, 2017 represented the payment to the State of California for the cost of doing business within the state and an estimated alternative minimum tax payment. No additional income tax expense was recorded during the three and six months ended June 30, 2017 as a result of our full valuation allowance. During the six months ended June 30, 2017, management evaluated the positive and negative evidence and determined that there continued to be enough negative evidence to support the full valuation allowance of $21.6 million at June 30, 2017. Negative evidence at June 30, 2017 included our accumulated deficit and our three-year cumulative loss position.

Financial Condition

Assets

Our total assets increased by $35 million at June 30, 2018 compared to December 31, 2017. The following table sets forth the composition of our interest earning assets at:

	June 30, 2018	December 31, 2017
	(Dollars in thousands)	
Interest-bearing deposits with financial institutions [(1)]	$ 220,498	$ 186,010
Interest-bearing time deposits with financial institutions	2,420	2,920
Federal Reserve Bank of San Francisco and Federal Home Loan Bank Stock, at cost	8,762	8,107
Securities available for sale, at fair value	29,187	39,738
Loans (net of allowances of $13,369 and $14,196, respectively)	1,049,003	1,053,201

(1) Includes interest-earning balances maintained at the FRBSF.

Investment Portfolio

Securities Available for Sale. Securities that we intend to hold for an indefinite period of time, but which may be sold in response to changes in liquidity needs, in interest rates, or in prepayment risks or other similar factors, are classified as “securities available for sale”. Such securities are recorded on our balance sheet at their respective fair values and increases or decreases in those values are recorded as unrealized gains or losses, respectively, and are reported as other comprehensive income (loss) on our accompanying consolidated statements of financial condition, rather than included in or deducted from our earnings.

The following is a summary of the major components of securities available for sale and a comparison of the amortized cost, estimated fair values and the gross unrealized gains and losses attributable to those securities, as of June 30, 2018 and December 31, 2017:

(Dollars in thousands)	Amortized Cost	Gross Unrealized Gain	Gross Unrealized Loss	Estimated Fair Value
Securities available for sale at June 30, 2018:				
U.S. Treasury securities	$ 2,997	$ —	$ (31)	$ 2,966
Residential mortgage backed securities issued by U.S. Agencies	27,672	1	(1,452)	26,221
Total securities available for sale	$ 30,669	$ 1	$ (1,483)	$ 29,187
Securities available for sale at December 31, 2017:				
U.S. Treasury securities	$ 2,996	$ —	$ (25)	$ 2,971
Residential mortgage backed securities issued by U.S. Agencies	30,894	5	(777)	30,122
Asset backed security	1,992	—	(251)	1,741
Mutual funds	5,000	11	(107)	4,904
Total securities available for sale	$ 40,882	$ 16	$ (1,160)	$ 39,738

The amortized cost of securities available for sale at June 30, 2018 is shown in the table below by contractual maturities taking into consideration historical prepayments based on the prior twelve months of principal payments. Expected maturities will differ from contractual maturities and historical prepayments, particularly with respect to collateralized mortgage obligations, if any, primarily because prepayment rates are affected by changes in conditions in the interest rate market and, therefore, future prepayment rates may differ from historical prepayment rates.

(Dollars in thousands)	June 30, 2018 Maturing in — One year or less — Amortized Cost	Weighted Average Yield	Over one year through five years — Amortized Cost	Weighted Average Yield	Over five years through ten years — Amortized Cost	Weighted Average Yield	Over ten years — Amortized Cost	Weighted Average Yield	Total — Amortized Cost	Weighted Average Yield
Securities available for sale:										
U.S. Treasury securities	$ 999	1.23%	$ 1,998	1.33%	$ —	—%	$ —	—%	$ 2,997	1.30%
Residential mortgage-backed securities issued by U.S. Agencies	5,617	1.47%	14,630	1.51%	7,120	1.63%	305	2.60%	27,672	1.54%
Total securities available for sale	$ 6,616	1.43%	$ 16,628	1.49%	$ 7,120	1.63%	$ 305	2.60%	$ 30,669	1.52%

Loans

The following table sets forth the composition, by loan category, of our loan portfolio at June 30, 2018 and December 31, 2017:

	June 30, 2018		December 31, 2017	
	Amount	Percent	Amount	Percent
	(Dollars in thousands)			
Commercial loans	$ 403,152	38.1%	$ 394,493	37.1%
Commercial real estate loans – owner occupied	225,018	21.2%	214,365	20.1%
Commercial real estate loans – all other	224,555	21.2%	228,090	21.4%
Residential mortgage loans – multi-family	90,270	8.5%	114,302	10.7%
Residential mortgage loans – single family	24,583	2.3%	24,848	2.3%
Construction and land development loans	30,395	2.9%	34,614	3.3%
Consumer loans	61,084	5.8%	53,918	5.1%
Total loans	1,059,057	100.0%	1,064,630	100.0%
Deferred loan origination costs, net	3,315		2,767	
Allowance for loan and lease losses	(13,369)		(14,196)	
Loans, net	$ 1,049,003		$ 1,053,201	

Commercial loans are loans to businesses to finance capital purchases or improvements, or to provide cash flow for operations. Commercial real estate and residential mortgage loans are loans secured by trust deeds on real properties, including commercial properties and single family and multi-family residences. Construction loans are interim loans to finance specific construction projects. Land development loans are loans secured by non-arable bare land. Consumer loans include installment loans to consumers.

The following table sets forth the maturity distribution of our loan portfolio (excluding single and multi-family residential mortgage loans and consumer loans) at June 30, 2018:

	June 30, 2018 — One Year or Less	Over One Year Through Five Years	Over Five Years	Total
	(Dollars in thousands)			
Real estate loans[(1)]				
Floating rate	$ 49,597	$ 35,096	$ 129,888	$ 214,581
Fixed rate	3,624	62,284	199,479	265,387
Commercial loans				
Floating rate	119,139	172,108	28,075	319,322
Fixed rate	21,720	28,635	33,475	83,830
Total	$ 194,080	$ 298,123	$ 390,917	$ 883,120

(1) Does not include mortgage loans on single or multi-family residences or consumer loans, which totaled $114.9 million and $61.1 million, respectively, at June 30, 2018.

Nonperforming Assets and Allowance for Loan and Lease Losses

Nonperforming Assets. Nonperforming loans consist of (i) loans on nonaccrual status which are loans on which the accrual of interest has been discontinued and include restructured loans when there has not been a history of past performance on debt service in accordance with the contractual terms of the restructured loans, and (ii) loans 90 days or more past due and still accruing interest. Nonperforming assets are comprised of non-performing loans and other real estate owned ("OREO"), which consists of real properties that we have acquired by or in lieu of foreclosure and which we intend to offer for sale.

Loans are placed on nonaccrual status when, in our opinion, the full timely collection of principal or interest is in doubt. Generally, the accrual of interest is discontinued when principal or interest payments become more than 90 days past due, unless we believe the loan is adequately collateralized and the loan is in the process of collection. However, in certain instances, we may place a particular loan on nonaccrual status earlier, depending upon the individual circumstances involved in that loan's delinquency. When a loan is placed on nonaccrual status, previously accrued but unpaid interest is reversed against current income. Subsequent collections of unpaid amounts on such a loan are applied to reduce principal when received, except when the ultimate collectability of principal is probable, in which case such payments are applied to interest and are credited to income. Nonaccrual loans may be restored to accrual status if and when principal and interest become current and full repayment is expected. Interest income is recognized on the accrual basis for impaired loans which, based on our nonaccrual policy, do not require nonaccrual treatment.

The following table sets forth information regarding our nonperforming assets, as well as information regarding restructured loans, at June 30, 2018 and December 31, 2017:

	At June 30, 2018	At December 31, 2017
	(Dollars in thousands)	
Nonaccrual loans:		
Commercial loans	$ 4,413	$ 3,222
Commercial real estate	862	2,461
Residential real estate	—	171
Consumer	50	56
Total nonaccrual loans	$ 5,325	$ 5,910
Other real estate owned (OREO):		
Commercial loans	$ 2,073	$ —
Total other real estate owned	$ 2,073	$ —
Other nonperforming assets:		
Other foreclosed assets	—	36
Total nonperforming assets	$ 7,398	$ 5,946
Restructured loans[(1)]:		
Accruing loans	$ —	$ 450
Nonaccruing loans (included in nonaccrual loans above)	—	809
Total restructured loans	$ —	$ 1,259

(1) As of June 30, 2018, we had no restructured loans.

As the table above indicates, total nonperforming assets increased by approximately $1.5 million, or 24.4%, to $7.4 million as of June 30, 2018 from $5.9 million as of December 31, 2017. The decrease in our non-performing loans resulted primarily from $2.7 million of payoffs or paydowns on our nonaccrual loans, the transfer to OREO of $1.3 million, and charge-offs of $140 thousand during the six months ended June 30, 2018, partially offset by the addition of two new loan relationships totaling $3.6 million during the same period. The increase in our other real estate owned balance from December 31, 2017 related to the foreclosure of two residential properties securing a commercial loan during the six months ended June 30, 2018. The decrease in our other foreclosed assets balance from December 31, 2017 related to the sale of our last remaining automobile for $36 thousand during the six months ended June 30, 2018.

Information Regarding Impaired Loans. At June 30, 2018, loans deemed impaired totaled $5.3 million as compared to $6.4 million at December 31, 2017. We had an average investment in impaired loans of $6.3 million for the six months ended June 30, 2018 as compared to $24.3 million for the six months ended June 30, 2017. The interest that would have been earned during the six months ended June 30, 2018 had the nonaccruing impaired loans remained current in accordance with their original terms was approximately $206 thousand.

The following table sets forth the amount of impaired loans to which a portion of the ALLL has been specifically allocated, and the aggregate amount so allocated, in accordance with Accounting Standards Codification 310-10, and the amount of the ALLL and the amount of impaired loans for which no such allocations were made, in each case at June 30, 2018 and December 31, 2017:

	June 30, 2018			December 31, 2017		
	Loans	Reserves for Loan Losses	% of Reserves to Loans	Loans	Reserves for Loan Losses	% of Reserves to Loans
	(Dollars in thousands)					
Impaired loans with specific reserves	$ —	$ —	—%	$ 450	$ 7	1.6%
Impaired loans without specific reserves	5,325	—	—	5,910	—	—
Total impaired loans	$ 5,325	$ —	—%	$ 6,360	$ 7	0.1%

The $1.0 million decrease in impaired loans to $5.3 million at June 30, 2018 from $6.4 million at December 31, 2017 was primarily attributable to $2.7 million in principal payments, $1.3 million thousand transferred to OREO and $567 thousand charged-off during the six months ended June 30, 2018, partially offset by additions of $3.6 million to impaired loans during the same period. Based on an internal analysis, using the current estimated fair values of the collateral or the discounted present values of the future estimated cash flows of the impaired loans, we concluded that, at June 30, 2018, no specific reserves were required on our impaired loans and that all impaired loans were well secured and adequately collateralized.

Allowance for Loan and Lease Losses. The ALLL totaled $13.4 million, representing 1.26% of loans outstanding, at June 30, 2018, as compared to $14.2 million, or 1.33% of loans outstanding, at December 31, 2017.

The adequacy of the ALLL is determined through periodic evaluations of the loan portfolio and other factors that can reasonably be expected to affect the ability of borrowers to meet their loan obligations. Those factors are inherently subjective as the process for determining the adequacy of the ALLL involves some significant estimates and assumptions about such matters such as (i) economic conditions and trends and the amounts and timing of expected future cash flows of borrowers which can affect their ability to meet their loan obligations to us, (ii) the fair value of the collateral securing non-performing loans, (iii) estimates of losses that we may incur on non-performing loans, which are determined on the basis of historical loss experience and industry loss factors and bank regulatory guidelines, which are subject to change, and (iv) various qualitative factors. Since those factors are subject to changes in economic and other conditions and changes in regulatory guidelines or other circumstances over which we have no control, the amount of the ALLL may prove to be insufficient to cover all of the loan losses we might incur in the future. In such an event, it may become necessary for us to increase the ALLL from time to time to maintain its adequacy. Such increases are effectuated by means of a charge to income, referred to as the "provision for loan and lease losses", in our statements of our operations. See "*—Results of Operations— Provision for Loan and Lease Losses*, above in this Item 2.

The amount of the ALLL is first determined by assigning reserve ratios for all loans. All nonaccrual loans and other loans classified as "Special Mention," "Substandard" or "Doubtful" ("classified loans" or "classification categories") and not fully collateralized are then assigned specific reserves within the ALLL, with greater reserve allocations made to loans deemed to be of a higher risk. These ratios are determined based on prior loss history and industry guidelines and loss factors, by type of loan, adjusted for current economic factors and current economic trends. Refer to Note 5, *Loans and Allowance for Loan and Lease Losses*, in Item 1 for definitions related to our internal asset quality indicators stated above.

On a quarterly basis, we utilize a classification based loan loss migration model as well as review individual loans in determining the adequacy of the ALLL. Our loss migration analysis tracks a certain number of quarters of loan loss history and industry loss factors to determine historical losses by classification category for each loan type, except certain consumer loans (automobile, mortgage and credit cards), which are analyzed as homogeneous loan pools. These calculated loss factors are then applied to outstanding loan balances. We analyze impaired loans individually.

In determining whether and the extent to which we will make adjustments to our loan loss migration model for purposes of determining the ALLL, we also consider a number of qualitative factors that can affect the performance and the collectability of the loans in our loan portfolio. Such qualitative factors include:

- The effects of changes that we may make in our loan policies or underwriting standards on the quality of the loans and the risks in our loan portfolios;
- Trends and changes in local, regional and national economic conditions, as well as changes in industry specific conditions, and any other reasonably foreseeable events that could affect the performance or the collectability of the loans in our loan portfolios;
- Material changes that may occur in the mix or in the volume of the loans in our loan portfolios that could alter, whether positively or negatively, the risk profile of those portfolios;

- Changes in management or loan personnel or other circumstances that could, either positively or negatively, impact the application of our loan underwriting standards, the monitoring of nonperforming loans or our loan collection efforts; and
- External factors that, in addition to economic conditions, can affect the ability of borrowers to meet their loan obligations, such as fires, earthquakes and terrorist attacks.

Determining the effects that these qualitative factors may have on the performance of each category of loans in our loan portfolio requires numerous judgments, assumptions and estimates about conditions, trends and events which may subsequently prove to have been incorrect due to circumstances outside of our control. Moreover, the effects of qualitative factors such as these on the performance of our loan portfolios are often difficult to quantify. As a result, we may sustain loan losses in any particular period that are sizable in relation to the ALLL or that may even exceed the ALLL.

Set forth below is information regarding loan balances and the related ALLL, by portfolio type, for the six months ended June 30, 2018 and 2017.

(Dollars in thousands)	Commercial	Real Estate	Construction and land Development	Consumer and Single Family Mortgages	Unallocated	Total
ALLL for the six months ended June 30, 2018:						
Balance at beginning of year	$ 9,155	$ 2,906	$ 650	$ 1,043	$ 442	$ 14,196
Charge-offs	(1,423)	—	—	—	—	(1,423)
Recoveries	560	—	—	36	—	596
Provision	(799)	47	(323)	499	576	—
Balance at June 30, 2018	$ 7,493	$ 2,953	$ 327	$ 1,578	$ 1,018	$ 13,369
Allowance for loan and lease losses as a percentage of average total loans						1.24 %
Allowance for loan and lease losses as a percentage of total outstanding loans						1.26 %
Ratio of net charge-offs to average loans outstanding (annualized)						0.15 %
ALLL for the six months ended June 30, 2017:						
Balance at beginning of year	$ 11,276	$ 4,226	$ 343	$ 642	$ 314	$ 16,801
Charge-offs	(465)	(432)	—	(114)	—	(1,011)
Recoveries	1,194	—	27	167	—	1,388
Provision	(1,892)	863	(213)	428	814	—
Balance at June 30, 2017	$ 10,113	$ 4,657	$ 157	$ 1,123	$ 1,128	$ 17,178
Allowance for loan and lease losses as a percentage of average total loans						1.79 %
Allowance for loan and lease losses as a percentage of total outstanding loans						1.65 %
Ratio of net charge-offs to average loans outstanding (annualized)						(0.08)%

The ALLL decreased $3.8 million from June 30, 2017 to June 30, 2018 primarily as a result of a decrease in our classified loan portfolio during the twelve months ended June 30, 2018, which was partially offset by charge-offs exceeding recoveries and new loan growth during that same period. The reserve for loan losses may include an unallocated amount based upon our judgment as to possible credit losses inherent in the loan portfolio that may not have been captured by historical loss experience, qualitative factors, or specific evaluations of impaired loans. Unallocated reserves may be adjusted for factors including, but not limited to, unexpected or unusual events, volatile market and economic conditions, effects of changes or seasoning in methodologies, regulatory guidance and recommendations, or other factors that may impact borrower operating conditions and loss expectations. Management's judgment as to unallocated reserves is determined in the context of, but separate from, the historical loss trends and qualitative factors described above. The unallocated reserve for loan losses of $1.0 million at June 30, 2018 has increased $576 thousand from the balance at December 31, 2017, primarily due to some uncertainties related to our classified loans as of June 30, 2018, partially offset by charge-offs during the six months ended June 30, 2018. Management believes that the amount of unallocated reserve for loan losses is appropriate and will continue to evaluate it on an ongoing basis.

We classify our loan portfolios using asset quality ratings. The credit quality table in Note 5, *Loans and Allowance for Loan and Lease Losses* above in Item 1, provides a summary of loans by portfolio type and asset quality ratings as of June 30, 2018 and December 31, 2017. Loans totaled approximately $1.1 billion at June 30, 2018, a decrease of $5.6 million from $1.1 billion at December 31, 2017. The disaggregation of the loan portfolio by risk rating in the credit quality table located in Note 5 reflects the following changes that occurred between December 31, 2017 and June 30, 2018:

- Loans rated “Pass” totaled $1.0 billion, a decrease of $12.6 million from $1.0 billion at December 31, 2017. The decrease was primarily attributable to the sale of $15.1 million of loans during the second quarter of 2018, downgrades to “Special Mention” and “Substandard” of $20.3 million and $824 thousand, respectively, and paydowns of principal payments, partially offset by new loan growth and upgrades of $1.3 million and $3.2 million from “Special Mention” and “Substandard”, respectively.
- Loans rated “Special Mention” totaled $22.9 million, an increase of $5.5 million from $17.4 million at December 31, 2017. The increase was primarily the result of $20.3 million downgraded from “Pass”, partially offset by $10.5 million downgraded to “Substandard”, $3.0 million of payoffs and principal payments, $1.3 million upgraded to “Pass”, and $71 thousand of loans charged-off.
- Loans rated “Substandard” totaled $12.7 million, an increase of $1.9 million from $10.8 million at December 31, 2017. This increase was primarily the result of $824 thousand and $10.1 million downgraded from “Pass” and “Special Mention”, respectively, partially offset by $4.3 million in principal payments, upgrades of $3.2 million to “Pass”, $1.1 million transferred to OREO and $423 thousand of loans charged-off.
- Loans rated “Doubtful” totaled $0, a decrease of $366 thousand from $366 thousand at December 31, 2017. This decrease was the result of a commercial loan of $366 thousand transferred to OREO.

Our loss migration analysis currently utilizes a series of twelve staggered 16-quarter migration periods. As a result, for purposes of determining applicable loss factors at June 30, 2018, our migration analysis covered the period from June 30, 2013 to June 30, 2017. We believe this was consistent with and reasonably reflects current economic conditions, portfolio trends and the risks that were inherent in our loan portfolio at June 30, 2018.

The table below sets forth loan delinquencies, by quarter, for the five preceding quarters ended June 30, 2018.

	June 30, 2018	March 31, 2018	December 31, 2017	September 30, 2017	June 30, 2017
Loans Delinquent:			(Dollars in thousands)		
90 days or more:					
Commercial loans	$ 2,669	$ 1,385	$ 2,125	$ 2,212	$ 12,261
Commercial real estate	—	—	—	—	—
	2,669	1,385	2,125	2,212	12,261
30-89 days:					
Commercial loans	6,798	100	1,387	1,561	4,129
Commercial real estate	3,870	1,746	936	955	968
Consumer loans	—	18	—	—	—
	10,668	1,864	2,323	2,516	5,097
Total Past Due[1]:	$ 13,337	$ 3,249	$ 4,448	$ 4,728	$ 17,358

(1) Past due balances include nonaccrual loans.

As the above table indicates, total past due loans increased by $8.9 million, to $13.3 million at June 30, 2018 from $4.4 million at December 31, 2017. Loans past due 90 days or more increased by $544 thousand, to $2.7 million at June 30, 2018, from $2.1 million at December 31, 2017 primarily resulting from additions of $2.6 million related to one loan relationship and $76 thousand that migrated from 30-89 days past due, partially offset by $1.2 million transferred to OREO, $809 thousand of payoffs, $140 thousand charged-off.

Loans 30-89 days past due increased by $8.3 million to $10.7 million at June 30, 2018 from $2.3 million at December 31, 2017 primarily attributable to $10.7 million of additions, of which $10.1 million related to one loan relationship that is fully collateralized, partially offset by $936 thousand of payoffs, $1.1 million brought current and $240 thousand that moved to 90 days or more past due.

Deposits

Average Balances of and Average Interest Rates Paid on Deposits

Set forth below are the average amounts of, and the average rates paid on, deposits for the six months ended June 30, 2018 and year ended December 31, 2017:

	Six Months Ended June 30, 2018		Year Ended December 31, 2017	
	Average Balance	Average Rate	Average Balance	Average Rate
	(Dollars in thousands)			
Noninterest bearing demand deposits	$ 339,238	—	$ 326,105	—
Interest-bearing checking accounts	70,667	0.51%	87,771	0.40%
Money market and savings deposits	392,046	1.37%	334,703	0.85%
Time deposits[(1)]	342,394	1.61%	298,531	1.26%
Total deposits	$ 1,144,345	0.98%	$ 1,047,110	0.66%

(1) Comprised of time certificates of deposit in denominations of less than and more than $100,000.

Deposit Totals

Deposits totaled $1.2 billion at June 30, 2018 as compared to $1.1 billion at December 31, 2017. The following table provides information regarding the mix of our deposits at June 30, 2018 and December 31, 2017:

	At June 30, 2018		At December 31, 2017	
	Amounts	% of Total Deposits	Amounts	% of Total Deposits
	(Dollars in thousands)			
Deposits				
Noninterest bearing demand deposits	$ 343,718	29.5%	$ 338,273	29.7%
Savings and other interest-bearing transaction deposits	508,515	43.5%	439,784	38.6%
Time deposits[(1)]	315,570	27.0%	361,336	31.7%
Total deposits	$ 1,167,803	100.0%	$ 1,139,393	100.0%

(1) Comprised of time certificates of deposit in denominations of less than and more than $100,000.

Certificates of deposit in denominations of $100,000 or more, on which we pay higher rates of interest than on other deposits, aggregated $287.1 million, or 24.6%, of total deposits at June 30, 2018, as compared to $330.5 million, or 29.0%, of total deposits at December 31, 2017.

Set forth below is a maturity schedule of domestic time certificates of deposit outstanding at June 30, 2018 and December 31, 2017:

	June 30, 2018		December 31, 2017	
Maturities	Certificates of Deposit Under $ 100,000	Certificates of Deposit $100,000 or more	Certificates of Deposit Under $100,000	Certificates of Deposit $100,000 or more
	(Dollars in thousands)			
Three months or less	$ 5,793	$ 56,794	$ 8,674	$ 77,981
Over three and through six months	4,691	38,455	5,532	47,652
Over six and through twelve months	12,332	120,979	10,391	90,470
Over twelve months	5,631	70,895	6,214	114,422
Total	$ 28,447	$ 287,123	$ 30,811	$ 330,525

Liquidity

We actively manage our liquidity needs to ensure that sufficient funds are available to meet our needs for cash, including to fund new loans and deposit withdrawals by our customers. We project the future sources and uses of funds and maintain liquid funds for unanticipated events. Our primary sources of cash include cash we have on deposit at other financial institutions, payments from borrowers on their loans, proceeds from sales or maturities of securities held for sale, sales of residential mortgage loans, increases in deposits and increases in borrowings principally from the FHLB. The primary uses of cash include funding new loans and making advances on existing lines of credit, purchasing investments, including securities available for sale, funding new residential mortgage loans, funding deposit withdrawals and paying operating expenses. We maintain funds in overnight federal funds and other short-term investments to provide for short-term liquidity needs. We also have obtained credit lines from the FHLB and other financial institutions to meet any additional liquidity requirements we might have. See "—*Contractual Obligations—Borrowings*" below for additional information related to our borrowings from the FHLB.

Our liquid assets, which included cash and due from banks, federal funds sold, interest earning deposits that we maintain with financial institutions and unpledged securities available for sale (excluding FRBSF and FHLB stock) totaled $251.2 million, which represented 18% of total assets, at June 30, 2018. We believe that our cash and cash equivalent resources, together with available borrowings under our credit facilities, will be sufficient to meet normal operating requirements for at least the next twelve months, including to enable us to meet any increase in deposit withdrawals that might occur in the foreseeable future.

Cash Flow Provided by Operating Activities. During the six months ended June 30, 2018, operating activities provided net cash of $7.9 million, primarily attributable to our net income of $19.1 million, partially offset by a non-cash recognition of $11.1 million in our deferred tax asset, which resulted from the full release of our valuation allowance. During the six months ended June 30, 2017, operating activities provided net cash of $3.7 million, primarily attributable to our net income of $4.3 million, partially offset by a non-cash increase in our other assets and accrued interest receivable.

Cash Flow Provided by (Used in) Investing Activities. During the six months ended June 30, 2018, investing activities provided net cash of $11.5 million, primarily attributable to $6.9 million of cash from the sale of debt securities available for sale and equity securities and $3.1 million of cash from maturities of and principal payments on securities available for sale and other stock and a $2.0 million decrease in loans. During the six months ended June 30, 2017, investing activities used net cash of $93.1 million, primarily attributable to $95.8 million used to fund an increase in loans and $1.0 million for the purchase of securities available for sale and stock, partially offset by $3.9 million of cash from maturities and principal payments on securities available for sale and other stock.

Cash Flow Provided by Financing Activities. During the six months ended June 30, 2018, financing activities provided net cash of $18.1 million, consisting of a $28.4 million increase in our deposits, which was primarily the result of new client acquisition and $21.0 million in proceeds from FHLB borrowings, partially offset by a $31.8 million decrease in borrowings. During the six months ended June 30, 2017, financing activities provided net cash of $66.4 million, consisting of a $65.4 million increase in our deposits, which was primarily the result of new client acquisition, $15.0 million in proceeds from FHLB borrowings and $995 thousand from the exercise of stock options, partially offset by a $15.0 million decrease in borrowings.

Ratio of Loans to Deposits. The relationship between gross loans and total deposits can provide a useful measure of a bank's liquidity. Since repayment of loans tends to be less predictable than the maturity of investments and other liquid resources, the higher the loan-to-deposit ratio the less liquid are our assets. On the other hand, since we realize greater yields on loans than we do on investments, a lower loan-to-deposit ratio can adversely affect interest income and earnings. As a result, our goal is to achieve a loan-to-deposit ratio that appropriately balances the requirements of liquidity and the need to generate a fair return on our assets. At June 30, 2018 and December 31, 2017, the loan-to-deposit ratio was 91% and 93%, respectively.

Capital Resources

Regulatory Capital Requirements Applicable to Banking Institutions

Under federal banking regulations that apply to all United States-based bank holding companies and federally insured banks, the Company (on a consolidated basis) and the Bank (on a stand-alone basis) must meet specific capital adequacy requirements that, for the most part, involve quantitative measures, primarily in terms of the ratios of their capital to their assets, liabilities, and certain off-balance sheet items, calculated under regulatory accounting practices. Under those regulations, each bank holding company must meet a minimum capital ratio and each federally insured bank is determined by its primary federal bank regulatory agency to come within one of the following capital adequacy categories on the basis of its capital ratios:

- well-capitalized
- adequately capitalized
- undercapitalized
- significantly undercapitalized; or
- critically undercapitalized

Certain qualitative assessments also are made by a banking institution's primary federal regulatory agency that could lead the agency to determine that the banking institution should be assigned to a lower capital category than the one indicated by the quantitative measures used to assess the institution's capital adequacy. At each successive lower capital category, a banking institution is subject to greater operating restrictions and increased regulatory supervision by its federal bank regulatory agency.

The following table sets forth the capital and capital ratios of the Company (on a consolidated basis) and the Bank (on a stand-alone basis) at June 30, 2018, as compared to the respective regulatory requirements applicable to them.

				Applicable Federal Regulatory Requirement					
				For Capital Adequacy Purposes			**To be Categorized As Well-Capitalized**		
		Amount	**Ratio**		**Amount**	**Ratio**		**Amount**	**Ratio**
				(Dollars in thousands)					
Total Capital to Risk Weighted Assets:									
Company	$	159,695	13.6%	$	101,296	At least 8.625		N/A	N/A
Bank		150,879	12.9%		101,277	At least 8.625	$	117,423	At least 10.0
Common Equity Tier 1 Capital to Risk Weighted Assets:									
Company	$	128,976	11.0%	$	60,190	At least 5.125		N/A	N/A
Bank		137,160	11.7%		60,179	At least 5.125	$	76,325	At least 6.5
Tier 1 Capital to Risk Weighted Assets:									
Company	$	145,976	12.4%	$	77,807	At least 6.625		N/A	N/A
Bank		137,160	11.7%		77,793	At least 6.625	$	93,938	At least 8.0
Tier 1 Capital to Average Assets:									
Company	$	145,976	10.8%	$	53,853	At least 4.0		N/A	N/A
Bank		137,160	10.2%		53,644	At least 4.0	$	67,056	At least 5.0

As the above table indicates, at June 30, 2018, the Bank (on a stand-alone basis) qualified as a “well-capitalized” institution, and the capital ratios of the Company (on a consolidated basis) exceeded the capital ratios mandated for bank holding companies, under federally mandated capital standards and federally established prompt corrective action regulations. Since June 30, 2018, there have been no events or circumstances known to us which have changed or which are expected to result in a change in the Company’s or the Bank’s classifications as well-capitalized institutions.

In early July 2013, the Federal Reserve Board and the FDIC issued final rules implementing the Basel III regulatory capital framework and related Dodd-Frank Wall Street Reform and Consumer Protection Act changes. The rules revise minimum capital requirements and adjust prompt corrective action thresholds. The final rules revise the regulatory capital elements, add a new common equity Tier 1 capital ratio, increase the minimum Tier 1 capital ratio requirement, and implement a new capital conservation buffer. The rules also permit certain banking organizations to retain, through a one-time election, the existing treatment for accumulated other comprehensive income. The final rules took effect for community banks on January 1, 2015, subject to a transition period for certain parts of the rules. At June 30, 2018, the Bank (on a stand-alone basis) continued to qualify as a well-capitalized institution, and the Company continued to exceed the minimum required capital ratios applicable to it, under the capital adequacy guidelines described above.

The consolidated total capital and Tier 1 capital of the Company at June 30, 2018 includes an aggregate of $17.0 million principal amount of the $17.5 million of 30-year junior subordinated debentures that we issued in 2002 and 2004 (the “Debentures”). See “*—Contractual Obligations—Junior Subordinated Debentures*” below for additional information. We contributed the net proceeds from the sales of the Debentures to the Bank, thereby providing it with additional cash to fund the growth of its banking operations and, at the same time, to increase its total capital and Tier 1 capital.

Quarterly interest payments on the Debentures require prior approval of the FRBSF. As of June 30, 2018, we were current on all interest payments.

Dividend Policy and Share Repurchase Programs.

It is, and since the beginning of 2009 it has been, the policy of the Boards of Directors of the Company and the Bank to preserve cash to enhance our capital positions and the Bank’s liquidity. In addition, we have agreed that the Bank will not, without the FRB and the CDBO’s prior written approval, pay any dividends to Bancorp. Accordingly, we do not expect to pay dividends or make share repurchases for the foreseeable future.

The principal source of cash available to a bank holding company consists of cash dividends from its bank subsidiaries. There are currently several restrictions on the Bank’s ability to pay us cash dividends. Government regulations, including the laws of the State of California, as they pertain to the payment of cash dividends by California State-chartered banks, limits the amount of funds that the Bank is permitted to dividend to us. Further, Section 23(a) of the Federal Reserve Act limits the amounts that a bank may loan to its bank holding company to an aggregate of no more than 10% of the bank subsidiary's capital surplus and retained earnings and requires that such loans be secured by specified assets of the bank holding company. We have committed to obtaining approval from the FRB and the CDBO prior to Bancorp paying any dividends, or making any distributions representing interest, principal or other sums on subordinated debentures or trust preferred securities. There can be no assurance that our regulators will approve such payments or dividends in the future. Refer to "*Regulatory Matters*" in Item 1 of our 2017 Form 10-K and *Note 14, Shareholders' Equity* in the notes to our consolidated financial statements on our 2017 Form 10-K for more detail regarding the regulatory restrictions on our and the Bank's ability to pay dividends. While restrictions on the payment of dividends from the Bank to us exist, there are no restrictions on the dividends that PMAR may pay us. As of June 30, 2018, PMAR has approximately $3.5 million in assets and could provide us with additional cash if required. In addition, we currently have sufficient cash on hand to meet our cash obligations. As a result, we do not expect that these restrictions will impact our ability to meet our cash obligations.

Off-Balance Sheet Arrangements

Loan Commitments and Standby Letters of Credit. To meet the financing needs of our customers in the normal course of business, we are a party to financial instruments with off-balance sheet risk. These financial instruments include commitments to extend credit and standby letters of credit. At June 30, 2018 and December 31, 2017, we were committed to fund certain loans including letters of credit amounting to approximately $271 million and $295 million, respectively.

Commitments to extend credit and standby letters of credit generally have fixed expiration dates or other termination clauses and the customer may be required to pay a fee and meet other conditions in order to draw on those commitments or standby letters of credit. We expect, based on historical experience, that many of the commitments will expire without being drawn upon and, therefore, the total commitment amounts do not necessarily represent future cash requirements.

To varying degrees, commitments to extend credit involve elements of credit and interest rate risk for us that are in excess of the amounts recognized in our balance sheets. Our maximum exposure to credit loss in the event of nonperformance by the customers to whom such commitments are made could potentially be equal to the amount of those commitments. As a result, before making such a commitment to a customer, we evaluate the customer's creditworthiness using the same underwriting standards that we would apply if we were approving loans to the customer. In addition, we often require the customer to secure its payment obligations for amounts drawn on such commitments with collateral such as accounts receivable, inventory, property, plant and equipment, income-producing commercial properties, residential properties and properties under construction. As a consequence, our exposure to credit and interest rate risk on such commitments is not different in character or amount than risks inherent in the outstanding loans in our loan portfolio.

Standby letters of credit are conditional commitments issued by the Bank to guarantee a payment obligation of a customer to a third party. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loan commitments to customers.

Contractual Obligations

Borrowings. At June 30, 2018 and December 31, 2017, our borrowings consisted of the following:

(Dollars in thousands)	June 30, 2018	December 31, 2017
FHLB advances—short-term	$ 30,000	$ 40,000
Other borrowings—short-term[1]	—	866
Total borrowings—short-term	30,000	40,866
FHLB advances—long-term	—	—
Total	$ 30,000	$ 40,866

(1) Borrowings had an interest rate of 15% as of December 31, 2017. This represented the portion of a participated loan that was required under GAAP to be recorded as other borrowings as of December 31, 2017. The participated portion of this loan was repurchased during the first quarter of 2018 and is no longer required to be recorded in other borrowings.

The table below sets forth the amounts of, the interest rates we pay on, and the maturity dates of these FHLB borrowings. These borrowings had a weighted-average annualized interest rate of 1.93% for the six months ended June 30, 2018.

Principal Amounts	Interest Rate	Maturity Dates
	(Dollars in thousands)	
10,000	1.72%	September 4, 2018
10,000	1.77%	December 3, 2018
10,000	2.31%	January 15, 2019

At June 30, 2018, $800 million of loans were pledged to support our unfunded borrowing capacity. At June 30, 2018, we had unused borrowing capacity of $383 million with the FHLB. The highest amount of borrowings outstanding at any month-end during the six months ended June 30, 2018 was $40.9 million from the FHLB. The highest amount of borrowings outstanding at any month end in 2017 consisted of $40.9 million of borrowings from the FHLB.

Junior Subordinated Debentures. Pursuant to rulings of the Federal Reserve Board, bank holding companies were permitted to issue long term subordinated debt instruments that, subject to certain conditions, would qualify as and, therefore, augment capital for regulatory purposes. At June 30, 2018, we had outstanding approximately $17.5 million principal amount of Debentures, of which $17.0 million qualified as additional Tier 1 capital for regulatory purposes as of June 30, 2018.

Set forth below is certain information regarding the Debentures:

Original Issue Dates	Principal Amount	Interest Rates	Maturity Dates[(1)]
September 2002	$ 7,217	LIBOR plus 3.40%	September 2032
October 2004	10,310	LIBOR plus 2.00%	October 2034
Total	$ 17,527		

(1) Subject to the receipt of prior regulatory approval, we may redeem the Debentures, in whole or in part, without premium or penalty, at any time prior to maturity.

These Debentures require quarterly interest payments, which are used to make quarterly distributions required to be paid on the corresponding trust preferred securities. Subject to certain conditions, we have the right, at our discretion, to defer those interest payments, and the corresponding distributions on the trust preferred securities, for up to five years. Exercise of this deferral right does not constitute a default of our obligations to pay the interest on the Debentures or the corresponding distributions that are payable on the trust preferred securities. We have committed to obtaining approval from the FRB and the CDBO prior to making any distributions representing interest, principal or other sums on subordinated debentures or trust preferred securities. Refer to "*Regulatory Matters*" in Item 1 of our 2017 Form 10-K for further detail. As of June 30, 2018, we were current on all interest payments. There can be no assurance that our regulators will approve such payments in the future.

Credit Risk

Credit risk is the risk of loss arising from adverse changes in a client's or counterparty's ability to meet its financial obligations under agreed-upon terms. Credit risk primarily exists in our loan and investment portfolio. The degree of credit risk will vary based on many factors including the duration of the transaction, the financial capacity of the client, the contractual terms of the agreement and the availability and quality of collateral. We manage credit risk by limiting the total amount of credit extended to a single borrower relationship, by verification of its business operations and assets and with a thorough understanding of the nature and scope of the business activities in which they are engaged.

As appropriate, management and Board level committees evaluate and approve credit standards and oversee the credit risk management function related to loans and investments. These committees' primary responsibilities include ensuring the adequacy of our credit risk management infrastructure, overseeing credit risk management strategies and methodologies, monitoring economic and market conditions that may impact our credit-related activities, and finally, evaluating and monitoring overall portfolio credit risk.

We maintain a comprehensive credit policy that includes specific underwriting guidelines as well as standards for loan origination and reporting as well as portfolio management. The credit policy is developed by credit management and approved by the Board of Directors, which also reviews it at least biannually. In addition, the credit policy sets forth requirements that ensure compliance with all applicable laws and regulatory guidance.

Our underwriting guidelines outline specific standards and risk management criteria for each lending product offered. Loan types are further segmented into subsections where the inherent credit risk warrants detailed transaction and monitoring parameters, as follows:

- Loan structures, which includes the lien priority, amortization terms and loan tenors;
- Collateral requirements, coverage margins and valuation methods;

- Underwriting considerations which include recommended due diligence and verification requirements; and
- Specific credit performance standards. Examples include minimum debt service coverage ratios, liquidity requirements as well as limits on financial leverage.

We measure and document each loan's compliance with our policy criteria at underwriting. If an exception to these criteria exists, an explanation of the factors that mitigate this additional risk is considered before an approval is granted. A report of loans with policy exceptions is reported to the Credit Policy Committee of the Board of Directors of the Bank on a monthly basis.

We continuously monitor a client's ability to perform under its obligations. Reporting requirements and loan covenants are set forth in each loan approval and compliance with these items are monitored on at least an annual basis or more frequently as conditions warrant. Loan covenant compliance is tracked and results are reported to credit management.

Under our credit risk management structure, each loan is assigned an internal asset quality rating that is based on defined credit standards. While the criteria may vary by product, each rating focuses on the borrower's inherent operating risks, the quality of management, historical financial performance, financial capacity, the stability of profits and cash flow, and the adequacy of the secondary repayment sources. Asset quality ratings for each loan are monitored and reassessed on an ongoing basis. If necessary, ratings are adjusted to reflect changes in the client's financial condition, cash flow, financial position, or the absence of current financial information. Refer to "*Financial Condition — Nonperforming Assets and Allowance for Loan and Lease Losses*" above in this Item 2 for further detail regarding our internal asset quality ratings.

The Bank recognizes that substantial risks are posed by concentrations of credit assets. As such, it seeks to maintain a diversified loan portfolio by limiting exposures by loan structure, business type or purpose, collateral type, and perceived asset quality. Credit management defines areas of concentration, recommends appropriate thresholds to the Board of Directors and takes action if needed to manage potential risk where asset concentrations exist.

Market Risk

Market risk is the risk that values of assets and liabilities or revenues will be adversely affected by changes in market conditions such as interest rate fluctuations. This risk is inherent in the financial instruments associated with our operations and/or activities, including loans, securities and short-term borrowings.

The primary market risk to which we are exposed is interest rate risk, which is inherent in the financial instruments associated with our operations, primarily including our loans, deposits and borrowings. Interest rate risk is the exposure of a company's financial condition, both earnings and the market value of assets and liabilities, to adverse movements in interest rates. Interest rate risk results from differences in the maturity or timing of interest earning assets and interest bearing liabilities, changes in the slope of the yield curve over time, imperfect correlation in the adjustment of rates earned and paid on different instruments with otherwise similar characteristics (e.g. three-month Treasury bill versus three-month LIBOR) and from interest-rate-related options embedded in bank products (e.g. loan prepayments, floors and caps, callable investment securities, customers redeploying non-interest bearing to interest bearing deposits, etc.).

The potential impact of interest rate risk is significant because of the liquidity and capital adequacy consequences that reduced earnings or net operating losses caused by a reduction in net interest income imply. We recognize and accept that interest rate risk is a routine part of bank operations and will from time to time impact our profits and capital position. The objective of interest rate risk management is to control exposure of net interest income to risks associated with interest rate movements in the market, to achieve consistent growth in net interest income and to profit from favorable market opportunities.

We measure interest rate risk and the effect of changes in market interest rates using a net interest income simulation analysis. The analysis incorporates our balance sheet as of June 30, 2018 and assumptions that reflect the current interest rate environment. The analysis estimates the interest rate impact of a parallel increase in interest rates over a twelve-month horizon.

The analysis below incorporates our assumptions for the market yield curve, pricing sensitivities on loans and deposits, reinvestment of asset and liability cash flows, and prepayments on loans and securities. The new loans, investment securities, borrowings and deposits are assumed to have interest rates that reflect our forecast of prevailing market terms. We also assumed that LIBOR and prime rates do not fall below 0% for loans and borrowings. FHLB borrowings are assumed to convert to cash as they run off. Actual results may differ from forecasted results due to changes in market conditions as well as changes in management strategies.

The estimated changes in net interest income for a twelve-month period based on changes in the interest rates applied as of June 30, 2018 were as follows:

Change in Market Interest Rates (basis points)	Amount ($)	Percent (%)
	(in thousands)	
+200	$ 7,964	16.3 %
+100	4,002	8.2 %
-100	(4,188)	(8.6)%

In addition to NII simulation, we measure the impact of market interest rate changes on our economic value of equity ("EVE"). EVE is defined as the net present value of assets, less the net present value of liabilities, adjusted for any off-balance sheet items.

The estimated changes in EVE in the following table are based on a discounted cash flow analysis which incorporates the impacts of changes in market interest rates. The model simulations and calculations are highly assumption-dependent and will change regularly as our asset/liability structure changes, as interest rate environments evolve, and as we change our assumptions in response to relevant market or business circumstances. These calculations do not reflect the changes that we anticipate or may make to reduce our EVE exposure in response to a change in market interest rates as part of our overall interest rate risk management strategy. As with any method of measuring interest rate risk, certain limitations are inherent in the method of analysis presented in the preceding table. We are exposed to yield curve risk, prepayment risk and basis risk, which cannot be fully modeled and expressed using the above methodology. Accordingly, the results in the following table should not be relied upon as a precise indicator of actual results in the event of changing market interest rates. Additionally, the resulting changes in EVE and NII estimates are not intended to represent, and should not be construed to represent the underlying value.

The estimated changes in EVE based on interest rates applied as of June 30, 2018 were as follows:

Change in Market Interest Rates (basis points)	Amount ($)	Percent (%)
	(in thousands)	
+200	$ 44,357	24.7%
+100	22,599	12.6%
-100	(6)	—%

Critical Accounting Policies

Our consolidated financial statements are prepared in accordance with generally accepted accounting principles in the United States ("GAAP") and general practices in the banking industry. Certain of those accounting policies are considered critical accounting policies, because they require us to make assumptions and judgments regarding circumstances or trends that could affect the carrying value of our material assets, such as, for example, assumptions regarding economic conditions or trends that could impact our ability to fully collect our loans or ultimately realize the carrying value of certain of our other assets, such as securities available for sale and our deferred tax asset. Those assumptions and judgments are based on current information available to us regarding those economic conditions or trends or other circumstances. If adverse changes were to occur in the conditions, trends or other events on which our assumptions or judgments had been based, then under GAAP it could become necessary for us to reduce the carrying values of any affected assets on our balance sheet. In addition, because reductions in the carrying value of assets are sometimes effectuated by or require charges to income, such reductions also may have the effect of reducing our income.

There have been no significant changes during the six months ended June 30, 2018 to the items that we disclosed as our critical accounting policies and estimates in *Critical Accounting Policies* within *Management's Discussion and Analysis of Financial Condition and Results of Operations* included in our 2017 Form 10-K.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

We are exposed to certain financial risks, which are discussed in detail in *Management's Discussion and Analysis of Financial Condition and Results of Operations* in the *Credit Risk* and *Market Risk* sections.

ITEM 4. CONTROLS AND PROCEDURES

Disclosure Controls and Procedures

We maintain disclosure controls and procedures that are designed to ensure that information required to be disclosed in our reports under the Exchange Act, is recorded, processed, summarized and reported within the time periods specified in the rules and forms of the SEC, and that such information is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, to allow timely decisions regarding required disclosure. In designing and evaluating our disclosure controls and procedures, our management recognized that any system of controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives, as ours are designed to do, and management necessarily was required to apply its judgment in evaluating the cost-benefit relationship of possible controls and procedures.

As required by SEC rules, an evaluation was performed under the supervision and with the participation of our Chief Executive Officer and Chief Financial Officer of the effectiveness, as of June 30, 2018, of the Company's disclosure controls and procedures (as defined in Rule 13a-15(e) under the Exchange Act). Based on that evaluation, our Chief Executive Officer and Chief Financial Officer concluded that, as of June 30, 2018, the Company's disclosure controls and procedures were effective to provide reasonable assurance that information required to be disclosed in the reports that we file under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms and that such information is accumulated and communicated to management, including our Chief Executive Officer and Chief Financial Officer, to allow timely decisions regarding required disclosure.

Internal Control Over Financial Reporting

There were no changes in our internal control over financial reporting during the three months ended June 30, 2018 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

We are subject to legal actions that arise from time to time in the ordinary course of our business. Currently, neither we nor any of our subsidiaries is a party to, and none of our or our subsidiaries' property is the subject of, any material legal proceeding.

ITEM 1A. RISK FACTORS

There have been no material changes in our assessment of our risk factors from those set forth in our 2017 Form 10-K.

ITEM 6. EXHIBITS

Exhibit No.	Description of Exhibit
3.1	Articles of Incorporation of Pacific Mercantile Bancorp (Incorporated by reference to the same numbered exhibit to the Company's Registration Statement (No. 333-33452) on Form S-1 filed with the Commission on March 28, 2000.)
3.2	Certificate of Amendment of Articles of Incorporation of Pacific Mercantile Bancorp (Incorporated by reference to Exhibit 3.1 to the Quarterly Report on Form 10-Q dated August 14, 2001.)
3.3	Certificate of Amendment of Articles of Incorporation of Pacific Mercantile Bancorp (Incorporated by reference to Exhibit 3.1 to the Current Report on Form 8-K dated January 26, 2012 and filed with the Commission on February 1, 2012.)
3.4	Certificate of Determination of Rights, Preferences, Privileges and Restrictions of Series A Convertible 10% Cumulative Preferred Stock of Pacific Mercantile Bancorp. (Incorporated by reference to Exhibit 3.1 to the Current Report on Form 8-K (No. 000-30777) dated October 9, 2009 and filed with the Commission on October 13, 2009.)
3.5	Certificate of Amendment of Certificate of Determination of Rights, Preferences, Privileges and Restrictions of the Series A Convertible 10% Cumulative Preferred Stock of Pacific Mercantile Bancorp. (Incorporated by reference to Exhibit 3.2 to the Current Report on Form 8-K dated January 26, 2012 and filed with the Commission on February 1, 2012.)
3.6	Certificate of Determination of Rights, Preferences, Privileges and Restrictions of the Series B Convertible 8.4% Noncumulative Preferred Stock of Pacific Mercantile Bancorp. (Incorporated by reference to Exhibit 3.1 to the Current Report on Form 8-K (No. 000-30777) dated August 16, 2011 and filed with the Commission on August 22, 2011.)
3.7	Certificate of Determination of Rights, Preferences, Privileges and Restrictions of the Series C 8.4% Noncumulative Preferred Stock of Pacific Mercantile Bancorp. (Incorporated by reference to Exhibit 3.2 to the Current Report on Form 8-K (No. 000-30777) dated August 16, 2011 and filed with the Commission on August 22, 2011.)
3.8	Pacific Mercantile Bancorp Bylaws, Amended and Restated as of May 16, 2018. (Incorporated by reference to Exhibit 3.1 to the Current Report on Form 8-K (No. 000-30777) dated May 16, 2018 and filed with the Commission on May 16, 2018.)
10.1	Employment Agreement dated April 10, 2018 between Pacific Mercantile Bank and Curt A. Christianssen (Incorporated by reference to Exhibit 10.1 to the Current Report on Form 8-K (No. 000-30777) dated April 11, 2018.)
31.1	Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
31.2	Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
32.1**	Certification of Chief Executive Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
32.2**	Certification of Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
Exhibit 101.INS	XBRL Instance Document
Exhibit 101.SCH	XBRL Taxonomy Extension Schema Document
Exhibit 101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document
Exhibit 101.DEF	XBRL Taxonomy Extension Definition Linkbase Document
Exhibit 101.LAB	XBRL Taxonomy Extension Labels Linkbase Document
Exhibit 101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document

** Furnished herewith.

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized, on August 3, 2018.

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PACIFIC MERCANTILE BANCORP

By: /s/ THOMAS M. VERTIN

Thomas M. Vertin
President and Chief Executive Officer
(Principal Executive Officer)

PACIFIC MERCANTILE BANCORP

By: /s/ CURT A. CHRISTIANSSEN

Curt A. Christianssen
Chief Financial Officer
(Principal Financial Officer)

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Section 2: EX-31.1 (EXHIBIT 31.1)

Exhibit 31.1

CERTIFICATIONS OF CHIEF EXECUTIVE OFFICER
UNDER
SECTION 302 OF THE SARBANES-OXLEY ACT

I, Thomas M. Vertin, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of Pacific Mercantile Bancorp for the quarter ended June 30, 2018.
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant’s other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
   (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
   (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
   (c) Evaluated the effectiveness of the registrant’s disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures as of the end of the period covered by this report based on such evaluation; and
   (d) Disclosed in this report any change in the registrant’s internal control over financial reporting that occurred during the registrant’s most recent fiscal quarter (the registrant’s fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant’s internal control over financial reporting; and
5. The registrant’s other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant’s auditors and the audit committee of the registrant’s board of directors (or persons performing the equivalent functions):
   (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant’s ability to record, process, summarize and report financial information; and

(b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: August 3, 2018

/S/ THOMAS M. VERTIN

Thomas M. Vertin
President and Chief Executive Officer

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Section 3: EX-31.2 (EXHIBIT 31.2)

Exhibit 31.2

CERTIFICATIONS OF CHIEF FINANCIAL OFFICER
UNDER
SECTION 302 OF THE SARBANES-OXLEY ACT

I, Curt Christianssen, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of Pacific Mercantile Bancorp for the quarter ended June 30, 2018.
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:

   (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

   (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

   (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures as of the end of the period covered by this report based on such evaluation; and

   (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

   (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

   (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: August 3, 2018

/S/ CURT A. CHRISTIANSSEN

Curt A. Christianssen
Chief Financial Officer

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Section 4: EX-32.1 (EXHIBIT 32.1)

Exhibit 32.1

CERTIFICATIONS OF CHIEF EXECUTIVE OFFICER
UNDER
SECTION 906 OF THE SARBANES-OXLEY ACT

PACIFIC MERCANTILE BANCORP

Quarterly Report on Form 10-Q
for the quarter ended June 30, 2018

In connection with the accompanying Quarterly Report on Form 10-Q of Pacific Mercantile Bancorp (the "Company") for the quarter ended June 30, 2018 (the "Quarterly Report"), and pursuant to 18 U.S.C. §1350, as adopted pursuant to §906 of the Sarbanes-Oxley Act of 2003, I, Thomas M. Vertin, certify that:

(1) The Quarterly Report fully complies with the requirements of Section 13(a) and 15(d) of the Securities Exchange Act of 1934; and

(2) The information contained in the Quarterly Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Dated: August 3, 2018

/S/ THOMAS M. VERTIN
Thomas M. Vertin
President and Chief Executive Officer

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Section 5: EX-32.2 (EXHIBIT 32.2)

Exhibit 32.2

CERTIFICATIONS OF CHIEF FINANCIAL OFFICER
UNDER
SECTION 906 OF THE SARBANES-OXLEY ACT

PACIFIC MERCANTILE BANCORP

Quarterly Report on Form 10-Q
for the quarter ended June 30, 2018

In connection with the accompanying Quarterly Report on Form 10-Q of Pacific Mercantile Bancorp (the "Company") for the quarter ended June 30, 2018 (the "Quarterly Report"), and pursuant to 18 U.S.C. §1350, as adopted pursuant to §906 of the Sarbanes-Oxley Act of 2003, I, Curt Christianssen, certify that:

(1) The Quarterly Report fully complies with the requirements of Section 13(a) and 15(d) of the Securities Exchange Act of 1934; and

(2) The information contained in the Quarterly Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Dated: August 3, 2018

/S/ CURT A. CHRISTIANSSEN
Curt A. Christianssen
Chief Financial Officer

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