

GBank Financial Holdings Inc. and Subsidiary

Consolidated Financial Report
December 31, 2018

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Independent Auditor's Report

RSM US LLP

To the Audit Committee
GBank Financial Holdings Inc. and Subsidiary
Las Vegas, Nevada

Report on the Financial Statements

We have audited the accompanying consolidated financial statements of GBank Financial Holdings Inc. and its subsidiary, which comprise the consolidated balance sheets as of December 31, 2018 and 2017, the related consolidated statements of income, comprehensive income, stockholders' equity and cash flows for the years then ended, and the related notes to the consolidated financial statements (collectively, the financial statements).

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

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

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

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

Opinion

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

RSM US LLP

Las Vegas, Nevada
March 22, 2019

GBank Financial Holdings Inc. and Subsidiary
Consolidated Balance Sheets
December 31, 2018 and 2017

	2018	2017
Assets		
Cash and due from banks	\$ 57,544,104	\$ 64,906,079
Interest-bearing time deposits in financial institutions	-	700,000
Securities available for sale	3,927,906	4,869,683
Federal Home Loan Bank (FHLB) stock, at cost	683,100	683,100
Loans held for sale	20,093,733	7,483,621
Loans, net	146,335,032	120,874,375
Premises and equipment, net	1,432,660	1,127,678
Bank-owned life insurance	2,873,676	2,812,643
Servicing asset	4,133,480	2,990,991
Deferred tax asset, net	393,661	1,303,167
Accrued interest receivable and other assets	1,024,410	619,871
Total assets	\$ 238,441,762	\$ 208,371,208
Liabilities and Stockholders' Equity		
Deposits:		
Noninterest-bearing demand	\$ 103,474,286	\$ 95,382,839
Interest-bearing:		
Demand	26,691,591	17,654,438
Savings	63,568,823	59,415,768
Time, \$250,000 or more	2,030,478	764,718
Time, under \$250,000	4,633,277	4,054,134
Total deposits	200,398,455	177,271,897
Accrued interest payable and other liabilities	3,527,683	1,937,358
Total liabilities	203,926,138	179,209,255
Commitments and contingencies (Note 9)		
Stockholders' equity:		
Common stock, \$0.0001 par value; 50,000,000 shares authorized; shares issued and outstanding: 9,097,224 (2018) and 8,705,145 (2017)	910	871
Additional paid-in capital	33,831,411	33,164,119
Retained earnings (accumulated deficit)	728,803	(3,971,089)
Accumulated other comprehensive loss	(45,500)	(31,948)
Total stockholders' equity	34,515,624	29,161,953
Total liabilities and stockholders' equity	\$ 238,441,762	\$ 208,371,208

See notes to consolidated financial statements.

GBank Financial Holdings Inc. and Subsidiary
Consolidated Statements of Income
Years Ended December 31, 2018 and 2017

	2018	2017
Interest income on:		
Loans	\$ 9,931,637	\$ 7,836,214
Federal funds sold and other	1,187,218	436,656
Securities available for sale	99,441	91,546
Total interest income	11,218,296	8,364,416
Interest expense on:		
Deposits	746,643	354,472
Total interest expense	746,643	354,472
Net interest income	10,471,653	8,009,944
Provision for loan losses	400,000	177,000
Net interest income after provision for loan losses	10,071,653	7,832,944
Noninterest income:		
Gain on sale of loans	4,390,041	4,608,292
Other fee income	658,710	577,098
Service charges	216,763	324,743
Total noninterest income	5,265,514	5,510,133
Noninterest expenses:		
Salaries and employee benefits	5,552,320	4,543,369
Occupancy	1,151,152	1,018,302
Data processing	702,194	543,154
Legal and professional fees	554,947	446,195
Audits and exams	240,916	294,969
Supplies	170,555	152,721
Telephone and data	138,418	111,403
Travel and auto	127,643	134,538
Servicing fees	86,985	41,059
Other insurance	72,905	53,409
Federal Deposit Insurance Corporation insurance	60,414	52,440
Marketing	57,771	57,978
Donations	38,817	51,150
Other	415,732	356,773
Total noninterest expenses	9,370,769	7,857,460
Income before income tax expense	5,966,398	5,485,617
Income tax expense	1,272,798	2,686,901
Net income	\$ 4,693,600	\$ 2,798,716

See notes to consolidated financial statements.

GBank Financial Holdings Inc. and Subsidiary
Consolidated Statements of Comprehensive Income
Years Ended December 31, 2018 and 2017

	2018	2017
Net income	\$ 4,693,600	\$ 2,798,716
Other comprehensive (loss) income:		
Unrealized (losses) gains on securities available for sale, net of taxes of (\$1,930) and \$11,149 for the years ended December 31, 2018 and 2017, respectively	<u>(7,260)</u>	<u>21,640</u>
Comprehensive income	<u>\$ 4,686,340</u>	<u>\$ 2,820,356</u>

See notes to consolidated financial statements.

GBank Financial Holdings Inc. and Subsidiary
Consolidated Statements of Stockholders' Equity
Years Ended December 31, 2018 and 2017

	Common Stock	Additional Paid-In Capital	Retained Earnings (Accumulated Deficit)	Accumulated Other Comprehensive Income (Loss)	Total
Balance, December 31, 2016	\$ 80,596	\$ 32,061,048	\$ (6,769,805)	\$ (53,588)	\$ 25,318,251
Common stock exchange	(79,889)	79,889	-	-	-
Option and warrant exercise	164	968,160	-	-	968,324
Stock compensation expense	-	55,022	-	-	55,022
Net income	-	-	2,798,716	-	2,798,716
Other comprehensive loss	-	-	-	21,640	21,640
Balance, December 31, 2017	871	33,164,119	(3,971,089)	(31,948)	29,161,953
Common stock issuance	2	-	-	-	2
Option and warrant exercise	37	559,024	-	-	559,061
Stock compensation expense	-	108,268	-	-	108,268
Net income	-	-	4,693,600	-	4,693,600
Impact of ASU 2018-02 as of January 1, 2018	-	-	6,292	(6,292)	-
Other comprehensive loss	-	-	-	(7,260)	(7,260)
Balance, December 31, 2018	\$ 910	\$ 33,831,411	\$ 728,803	\$ (45,500)	\$ 34,515,624

See notes to consolidated financial statements.

GBank Financial Holdings Inc. and Subsidiary
Consolidated Statements of Cash Flows
Years Ended December 31, 2018 and 2017

	2018	2017
Cash flows from operating activities:		
Net income	\$ 4,693,600	\$ 2,798,716
Adjustments to reconcile net income to net cash used in operating activities:		
Provision for loan losses	400,000	177,000
Depreciation and amortization	315,086	274,742
Net amortization of securities premium	10,843	13,579
Stock compensation expense	108,268	55,022
Gain on sale of equipment	(2,450)	-
Gain on sale of loans	(4,390,041)	(4,608,292)
Gross originations of loans held for sale	(97,019,992)	(72,739,183)
Proceeds from sale of loans held for sale	86,769,603	69,577,860
Capitalized mortgage servicing rights	2,030,318	1,844,304
Income from bank-owned life insurance	(61,033)	(64,452)
Net change in deferred income taxes	911,433	2,667,728
Increase in accrued interest receivable	(250,493)	(124,357)
Increase in other assets	(1,296,535)	(1,460,841)
Increase in accrued interest payable and other liabilities	1,590,325	889,417
Net cash used in operating activities	(6,191,068)	(698,757)
Cash flows from investing activities:		
Purchases of premises and equipment	(620,068)	(147,164)
Proceeds from sale of equipment	2,450	-
Proceeds from principal paydowns on securities available for sale	921,749	923,408
Purchase of FHLB stock	-	(105,500)
Net change in loans	(25,860,657)	(2,108,520)
Proceeds from matured interest-bearing time deposits in financial institutions	700,000	1,380,000
Net cash used in investing activities	(24,856,526)	(57,776)
Cash flows from financing activities:		
Net increase in deposits	23,126,558	44,595,184
Net proceeds from issuance of common stock	559,061	968,324
Net cash provided by financing activities	23,685,619	45,563,508
Net (decrease) increase in cash and cash equivalents	(7,361,975)	44,806,975
Cash and cash equivalents:		
Beginning of year	64,906,079	20,099,104
End of year	\$ 57,544,104	\$ 64,906,079
Supplemental disclosure of cash flow information:		
Cash payments for interest	\$ 721,632	\$ 350,486

See notes to consolidated financial statements.

GBank Financial Holdings Inc. and Subsidiary

Notes to Consolidated Financial Statements

Note 1. Nature of Business and Summary of Significant Accounting Policies

Nature of business: GBank Financial Holdings Inc. (GBank or Holding Company) is a holding company whose subsidiary, Bank of George (the Bank), provides banking services to commercial and consumer customers. As a state-chartered bank, GBank Financial Holdings Inc. and its subsidiary (the Company) are subject to regulation by the Federal Deposit Insurance Corporation (FDIC) and the Nevada State Division of Financial Institutions. The Company was incorporated on May 11, 2007, and commenced operations on September 24, 2007. The Company's business is concentrated in the Las Vegas, Nevada, area and is subject to the general economic conditions of that area. The accounting and reporting policies of the Company conform to accounting principles generally accepted in the United States of America (U.S. GAAP) and general industry practices.

Subsequent events have been evaluated for potential recognition and disclosure through March 22, 2019, the date the financial statements were available to be issued.

A summary of the significant accounting policies of the Company follows:

Principles of consolidation: During the year ended December 31, 2017, stockholders of Bank of George exchanged their common stock in Bank of George for common stock in the newly formed holding company, GBank Financial Holdings Inc. The transaction was accounted for at historical cost, similar to that in pooling-of-interests accounting.

The consolidated financial statements as and for the years ended December 31, 2018 and 2017, include the amounts of GBank Financial Holdings Inc. and Bank of George. All significant intercompany balances and transactions were eliminated in consolidation.

Use of estimates in the preparation of financial statements: The preparation of financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting periods. Actual results could differ from those estimates. Material estimates that are susceptible to significant changes in the near term relate to the determination of the allowance for loan losses, the fair value of the servicing asset and realization of the Company's deferred tax assets.

Concentration of credit risk: Most of the Company's activities are with customers located within southern Nevada. Note 4 discusses the types of loans in which the Company invests.

Cash and cash equivalents: For purposes of the consolidated statements of cash flows, the Company considers cash on hand, amounts due from banks, and interest-bearing deposits at other financial institutions that have original maturities of three months or less to be cash and cash equivalents. Cash flows from loans originated by the Company, interest-bearing time deposits in financial institutions and deposits are reported net.

The Company maintains amounts due from banks, which at times may exceed federally insured limits. The Company has not experienced losses in such accounts.

Interest-bearing time deposits in financial institutions: Interest-bearing deposits with other financial institutions generally mature within one month to one year and are carried at cost. None of these deposits exceed the federally insured limit at any one institution.

GBank Financial Holdings Inc. and Subsidiary

Notes to Consolidated Financial Statements

Note 1. Nature of Business and Summary of Significant Accounting Policies (Continued)

Securities available for sale: Securities classified as available-for-sale are those debt securities that the Company intends to hold for an indefinite period of time, but not necessarily to maturity. Any decision to sell a security classified as available-for-sale would be based on various factors, including significant movements in interest rates, changes in the maturity mix of the Company's assets and liabilities, liquidity needs, regulatory capital considerations and other similar factors. Securities available for sale are carried at fair value. Unrealized gains or losses are reported as a separate component of other comprehensive income (loss). The amortization of premiums and accretion of discounts are recognized in interest income over their contractual lives. Realized gains or losses, determined on the basis of the cost of specific securities sold, are included in earnings.

Management evaluates securities for other-than-temporary impairment at least on an annual basis, and more frequently when economic or market conditions warrant such evaluation. Consideration is given to (1) the length of time and the extent to which the fair value has been less than cost, (2) the financial condition and near-term prospects of the issuer, including an evaluation of credit ratings, (3) the impact of changes in market interest rates, (4) the intent of the Company to sell a security, and (5) whether it is more likely than not the Company will have to sell the security before recovery of its cost basis.

If the Company intends to sell an impaired security, the Company records an other-than-temporary loss in an amount equal to the entire difference between the fair value and amortized cost. If a security is determined to be other-than-temporarily impaired, but the Company does not intend to sell the security, only the credit portion of the estimated loss is recognized in earnings, with the other portion of the loss recognized in other comprehensive income (loss).

Loans held for sale: Loans held for sale are those loans that the Company has the intent to sell in the foreseeable future. The majority of the loans held for sale are commercial loans. The Company's loans held for sale consist primarily of Small Business Administration (SBA) loans, which are fully funded. Upon the sale of a loan, the Company will generally sell the guaranteed portion of the loan and retain the unguaranteed portion as a loan held for investment. The Company also generally retains the right to service the loans sold. The Company issues various representations and warranties associated with the sale of loans. The Company has not incurred any losses resulting from these provisions.

Loans held for sale are recorded in the consolidated balance sheets at the lower of cost or market value, which is computed by the aggregate method. Net unrealized losses, if any, are recognized through a valuation allowance by charges to income. Gains and losses on the sale of loans are recognized pursuant to Accounting Standards Codification 860, Transfers and Servicing. Interest income on these loans is accrued daily. Loan origination fees and costs on loans held for sale are deferred until the loans are sold.

Loans: Loans are stated at the amount of unpaid principal, reduced by net deferred loan fees and an allowance for loan losses.

The allowance for loan losses is established through a provision for loan losses charged to expense. Loans are charged against the allowance for loan losses when management believes that collectability of the principal is unlikely. Subsequent recoveries, if any, are credited to the allowance.

GBank Financial Holdings Inc. and Subsidiary

Notes to Consolidated Financial Statements

Note 1. Nature of Business and Summary of Significant Accounting Policies (Continued)

The allowance is an amount that management believes will be adequate to absorb probable losses on existing loans that may become uncollectable, based on an evaluation of the collectability of loans and the Company's historical loan losses and peer bank loss experience. While management uses the best information available to make its evaluation, future adjustments to the allowance may be necessary if there are significant changes in economic or other conditions. In addition, regulatory agencies, as an integral part of their examination process, periodically review the Company's allowance for loan losses and may require the Company to make additions to the allowance based on their judgment about information available to them at the time of their examinations.

When establishing the allowance for loan losses, management categorizes loans into risk categories generally based on the nature of the collateral and the basis of repayment. These risk categories and the relevant risk characteristics are as follows:

Commercial and industrial loans: Commercial and industrial loans are loans for commercial, corporate and business purposes, including issuing letters of credit. Repayment of these loans is generally largely dependent on the successful operations of the business. The Company's commercial business loan portfolio comprises loans for a variety of purposes and is generally secured by equipment, machinery and other business assets. Commercial business loans generally have terms of five years or less and interest rates that float in accordance with a designated published index. Substantially all such loans are secured and backed by the personal guarantees of the owners of the business.

Commercial real estate loans: Commercial real estate loans are primarily secured by office and industrial buildings, warehouses, small retail shopping centers and various special-purpose properties, including hotels and restaurants. Repayment of these loans is generally largely dependent on the successful operation of the property securing the loan or the business conducted on the property securing the loan. Although terms vary, commercial real estate loans generally have amortizations of 15 to 25 years, as well as balloon payments of two to five years, and terms which provide that the interest rates thereon may be adjusted annually at the Company's discretion, based on a designated index.

Construction and land development loans: Construction and land development loans consist of vacant land and property that is in the process of improvement. Repayment of these loans can be dependent on the sale of the property to third parties or the successful completion of the improvements by the builder for the end user. In the event a loan is made on property that is not yet improved for the planned development, there is the risk that approvals will not be granted or will be delayed. Construction loans also run the risk that improvements will not be completed on time or in accordance with specifications and projected costs. Construction real estate loans generally have terms of one year to 18 months during the construction period and interest rates based on a designated index.

Residential real estate loans: Residential 1-4 family loans, including home equity lines of credit, are generally smaller in size and are homogenous because they exhibit similar characteristics. Repayment for residential single-family loans is largely dependent upon the personal cash flow of the individual borrowers. Residential multifamily loans generally involve a greater degree of credit risk than residential single-family loans as repayment is dependent on the successful operation of the project. This loan type is sensitive to adverse economic conditions.

The allowance consists of specific and general components. The specific component relates to loans that are classified as impaired. For such loans that are classified as impaired, an allowance is established when the discounted cash flows (or collateral value or observable market price) of the impaired loan are less than the carrying value of that loan. The general component covers nonimpaired loans and is based on the Company's historical loan losses and peer bank loss experience, adjusted for qualitative and environmental factors.

GBank Financial Holdings Inc. and Subsidiary

Notes to Consolidated Financial Statements

Note 1. Nature of Business and Summary of Significant Accounting Policies (Continued)

A loan is impaired when it is probable the Company will be unable to collect all principal and interest payments due in accordance with the terms of the loan agreement. Impaired loans are measured based on the present value of expected future cash flows discounted at the loan's effective interest rate or, as a practical expedient, at the loan's observable market price or the fair value of the collateral if the loan is collateral-dependent. The amount of impairment, if any, and any subsequent changes are included in the allowance for loan losses.

Large groups of smaller-balance homogeneous loans are collectively evaluated for impairment. Accordingly, the Company does not separately identify individual consumer loans for impairment disclosures.

Troubled debt restructurings: A loan is classified as a troubled debt restructuring when a borrower is experiencing financial difficulties that leads to a restructuring of the loan, and the Company grants concessions to the borrower in the restructuring that it would not otherwise consider. These concessions may include rate reductions, principal forgiveness, extension of maturity date and other actions intended to minimize potential losses. A loan that is modified at a market rate of interest may no longer be classified as troubled debt restructuring in the year subsequent to the restructuring if it is in compliance with the modified terms. Performance prior to the restructuring is considered when assessing whether the borrower can meet the new terms and may result in the loan being returned to accrual at the time of the restructuring or after a shorter performance period.

Interest and fees on loans: Interest on loans is recognized over the terms of the loans and is generally calculated using the effective interest method. The accrual of interest on impaired loans is discontinued when, in management's opinion, the borrower may be unable to make payments as they become due. When the accrual of interest is discontinued, all unpaid accrued interest is reversed. Cash collections on impaired loans are generally credited to the loan receivable balance and no interest income is recognized on these loans until the principal balance has been collected.

The Company determines a loan to be delinquent when payments have not been made according to the contractual terms, typically evidenced by nonpayment of a monthly installment by the due date. The accrual of interest on loans is discontinued at the time the loan is 90 days delinquent unless the loan is well-secured and in the process of collection. Consumer loans are typically charged off no later than 180 days delinquent.

Loan origination and commitment fees and certain direct loan origination costs are deferred and the net amount amortized as an adjustment of the related loan's yield. The Company is generally amortizing these amounts over the contractual life of the loan. Commitment fees based upon a percentage of a customer's unused line of credit and fees related to standby letters of credit are generally recognized over the commitment period.

GBank Financial Holdings Inc. and Subsidiary

Notes to Consolidated Financial Statements

Note 1. Nature of Business and Summary of Significant Accounting Policies (Continued)

Transfers of financial assets: Transfers of financial assets are accounted for as sales when control over the assets has been surrendered. Control over transferred assets is deemed to be surrendered when (1) the assets have been isolated from the Company, (2) the transferee obtains the right (free of conditions that constrain it from taking advantage of that right) to pledge or exchange the transferred assets, and (3) the Company does not maintain effective control over the transferred assets through an agreement to repurchase them before their maturity or the ability to unilaterally cause the holder to return specific assets. In addition, for transfers of a portion of financial assets (for example, participations of loans receivable), the transfer must meet the definition of a "participating interest" in order to account for the transfer as a sale. Following are the characteristics of a participating interest:

- Pro rata ownership in an entire financial asset.
- From the date of the transfer, all cash flows received from entire financial assets are divided proportionately among the participating interest holders in an amount equal to their share of ownership.
- The rights of each participating interest holder have the same priority, and no participating interest holder's interest is subordinated to the interest of another participating interest holder. That is, no participating interest holder is entitled to receive cash before any other participating interest holder under its contractual rights as a participating interest holder.
- No party has the right to pledge or exchange the entire financial asset unless all participating interest holders agree to pledge or exchange the entire financial asset.

Servicing rights: The Company generally retains the right to service the guaranteed portion of SBA loans sold to others. The Company generally receives a standard fee for providing this servicing function. The cost allocated to the servicing rights retained has been recognized as a separate asset and is initially recorded at fair value, and is being amortized in proportion to and over the period of estimated net servicing income.

Servicing rights are periodically evaluated for impairment to ensure the recorded balance is at the lower of amortized cost or fair value. Servicing rights are stratified based on origination dates. Fair values are estimated using a discounted cash flow model, which utilizes various assumptions, including prepayment speeds and current market rates of interest or other available information. Servicing assets of approximately \$4,133,000 and \$2,991,000 are included in other assets on the consolidated balance sheets at December 31, 2018 and 2017, respectively. The fair value of servicing rights at December 31, 2018 and 2017 approximated their carrying values. As of December 31, 2018 and 2017, the Company's servicing assets are not impaired.

Premises and equipment: Premises and equipment are stated at cost, less accumulated depreciation and amortization. Depreciation and amortization are computed using the straight-line method over the following estimated useful lives: improvements, 10 to 15 years; and equipment, furniture and automobiles, three to seven years. Improvements are depreciated over the shorter of the term of the lease or life of the improvements.

GBank Financial Holdings Inc. and Subsidiary

Notes to Consolidated Financial Statements

Note 1. Nature of Business and Summary of Significant Accounting Policies (Continued)

Other real estate owned: Assets acquired through foreclosure or other proceedings are initially recorded at fair value at the date of foreclosure less estimated costs of disposal, which establishes a new cost basis. After foreclosure, valuations are periodically performed by management and foreclosed assets held for sale are carried at the lower of cost or fair value less estimated costs of disposal. Any write-down to fair value at the time of transfer to foreclosed assets is charged to the allowance for loan and lease losses. Property is evaluated regularly to ensure the recorded amount is supported by its current fair value, and valuation allowances to reduce the carrying amount to fair value less estimated costs to dispose are recorded as necessary. Net revenues from the operations of foreclosed assets are included in noninterest income. Changes in the valuation allowance are included in other expenses.

Bank-owned life insurance: Bank-owned life insurance is stated at its cash surrender value with changes recorded in other noninterest income in the consolidated statement of income. The face amount of the underlying policies, including death benefits, was approximately \$8,233,000, with cash surrender value of approximately \$2,874,000 and \$2,813,000 as of December 31, 2018 and 2017, respectively.

Federal Home Loan Bank stock: The Company is a member of the Federal Home Loan Bank (FHLB) system and is required to maintain an investment in capital stock of the FHLB in an amount equal to the greater of 1 percent of its Membership Asset Value or 4.7 percent of advances from the FHLB. The stock is recorded at cost, which is also the redemption value. FHLB stock is bought from and sold to the FHLB at its \$100 par value.

The Company views its investment in the FHLB stock as a long-term investment. Accordingly, when evaluating FHLB stock for impairment, the value is determined based on the ultimate recovery of the par value rather than recognizing temporary declines in values. The FHLB of San Francisco capital ratios exceeded the required ratios as of December 31, 2018; consequently, the Company does not believe that its investment in the FHLB stock is impaired as of this date.

Income taxes: Deferred taxes are provided on an asset and liability method, whereby deferred tax assets are recognized for deductible temporary differences and operating loss and tax credit carryforwards and deferred tax liabilities are recognized for taxable temporary differences. Temporary differences are the differences between the reported amounts of assets and liabilities and their tax bases. Deferred tax assets are reduced by a valuation allowance when, in the opinion of management, it is more likely than not that some portion or all of the deferred tax assets will not be realized. Deferred tax assets and liabilities are adjusted for the effect of changes in tax laws and rates on the date of enactment.

Advertising costs: Advertising costs are expensed as incurred.

Stock compensation plan: As further described in Note 13, the Company grants stock options to its employees and directors. Pursuant to accounting guidance, the Company records compensation expense based upon the grant-date fair value of option awards. Such values are recorded over the requisite service period using the straight-line method.

Off-balance-sheet instruments: In the ordinary course of business, the Company has entered into off-balance-sheet financial instruments consisting of commitments to extend credit. Such financial instruments are recorded in the financial statements when they are funded.

GBank Financial Holdings Inc. and Subsidiary

Notes to Consolidated Financial Statements

Note 1. Nature of Business and Summary of Significant Accounting Policies (Continued)

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)*, requiring an entity to recognize the amount of revenue to which it expects to be entitled for the transfer of promised goods and services to customers. The updated standard will replace most existing revenue recognition guidance in U.S. GAAP when it becomes effective and permits the use of either a full retrospective or retrospective with cumulative effect transition method. In August 2015, the FASB issued ASU 2015-14, which defers the effective date of ASU 2014-09 one year, making it effective for annual reporting periods beginning after December 15, 2018. The adoption of this guidance is not expected to have a material effect on the Company's financial statements.

In February 2016, the FASB issued ASU 2016-02, *Leases (Topic 842)*. The guidance in this ASU supersedes the leasing guidance in Topic 840, *Leases*. Under the new guidance, lessees are required to recognize lease assets and lease liabilities on the balance sheet for all leases with terms longer than 12 months. Leases will be classified as either finance or operating, with classification affecting the pattern of expense recognition in the statement of income. The new standard is effective for fiscal years beginning after December 15, 2019, including interim periods within those fiscal years. The Company is currently evaluating the impact of its pending adoption of the new standard on its financial statements.

In March 2016, the FASB issued ASU 2016-09, *Compensation—Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting*. The ASU is intended to simplify various aspects of accounting for share-based compensation arrangements, including the income tax consequences, classification of awards as either equity or liabilities, and classification on the statement of cash flows. For example, the new guidance requires all excess tax benefits and tax deficiencies related to share-based payments to be recognized in income tax expense, and for those excess tax benefits to be recognized regardless of whether they reduce current taxes payable. The ASU also allows an entity-wide accounting policy election to either estimate the number of awards that are expected to vest or account for forfeitures as they occur. ASU 2016-09 was effective for the Company beginning on January 1, 2018 and did not have a material effect on the Company's financial statements.

In June 2016, the FASB issued ASU 2016-13, *Financial Instruments—Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments*. The updated standard applies to all entities. The updated standard is intended to provide financial statement users with more decision-useful information about the expected credit losses on financial instruments and other commitments to extend credit held by a reporting entity at each reporting date. To achieve this objective, the amendments in this ASU replace the incurred loss impairment methodology in current U.S. GAAP with a methodology that reflects expected credit losses and requires consideration of a broader range of reasonable and supportable information to inform credit loss estimates. The updated standard will be effective for fiscal years beginning after December 15, 2020. Early application is permitted for fiscal years beginning after December 15, 2018. The Company is currently evaluating the impact of its pending adoption of the new standard on its financial statements.

GBank Financial Holdings Inc. and Subsidiary

Notes to Consolidated Financial Statements

Note 1. Nature of Business and Summary of Significant Accounting Policies (Continued)

In February 2018, the FASB issued ASU 2018-02, *Income Statement—Reporting Comprehensive Income (Topic 220): Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income*. The ASU allows entities to make a one-time reclassification from accumulated other comprehensive income (AOCI) to retained earnings for the effects of remeasuring deferred tax liabilities and assets originally recorded in other comprehensive income as a result of the change in the federal tax rate by the Tax Cut and Jobs Act (TCJA). The effective date for all entities that elect to make the reclassification is for fiscal years beginning after December 15, 2018, including interim periods within those years. Early adoption is permitted in financial statements for fiscal years or interim periods that have not been issued or made available for issuance as of February 14, 2018. Upon adoption, an entity can elect to apply the guidance either: (a) at the beginning of the period (annual or interim) of adoption or (b) retrospectively to each period (or periods) in which the income tax effects of the TCJA related to items remaining in AOCI are recognized. Certain transition disclosures are to be required. This guidance was adopted in 2018 and did not have a material effect on the Company's financial statements.

In August 2018, the FASB issued ASU 2018-13, *Fair Value Measurement (Topic 820): Disclosure Framework—Changes to the Disclosure Requirements for Fair Value Measurement*. ASU 2018-13 modifies required fair value disclosures related primarily to level 3 investments. ASU 2018-13 will be effective for the Company beginning on January 1, 2020. The Company is currently evaluating the impact of its pending adoption of the new standard on its financial statements.

Note 2. Restrictions on Cash and Due From Banks

The Company is required to maintain reserve balances in cash or on deposit with correspondent banks. The total of those reserve balances was approximately \$2,693,000 and \$1,734,000 as of December 31, 2018 and 2017, respectively.

Note 3. Securities

Amortized cost and estimated fair values of securities available for sale are summarized as follows as of December 31:

	2018			
	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value
Residential mortgage-backed securities	\$3,985,496	\$1,411	\$(59,001)	\$3,927,906
	2017			
	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value
Residential mortgage-backed securities	\$4,918,089	\$2,107	\$(50,513)	\$4,869,683

The actual maturities of mortgage-backed securities may differ from their contractual maturities because the loans underlying the securities may be repaid without any penalties. Therefore, maturity schedules are not presented for these securities.

GBank Financial Holdings Inc. and Subsidiary

Notes to Consolidated Financial Statements

Note 3. Securities (Continued)

There were no realized gains or losses from the sale of securities available for sale during the years ended December 31, 2018 or 2017.

As of December 31, 2018, the Company's securities with an approximate market value of \$909,972 were pledged for debt borrowing purposes (see Note 7).

Information pertaining to securities with gross unrealized losses and the length of time that individual securities have remained in a continuous loss position are as follows as of December 31:

	2018					
	Less Than 12 Months		Over 12 Months		Total	
	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value
Residential mortgage-backed securities	\$(3,149)	\$1,683,041	\$(55,852)	\$1,988,769	\$(59,001)	\$3,671,810

	2017					
	Less Than 12 Months		Over 12 Months		Total	
	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value
Residential mortgage-backed securities	\$ -	\$ -	\$(50,513)	\$2,222,057	\$(50,513)	\$2,222,057

As of December 31, 2018 and 2017, there were six and four securities, respectively, that had unrealized losses of approximately 1 percent for both years from the Company's amortized cost basis. These unrealized losses relate primarily to fluctuations in the current interest rate environment. In analyzing an issuer's financial condition, management considers whether the securities are issued by the federal government or its agencies and whether downgrades by bond rating agencies have occurred, and various industry analysis reports. There were no Company securities downgraded during 2018 and 2017. As of December 31, 2018, management has determined that no declines are deemed to be other-than-temporarily impaired.

GBank Financial Holdings Inc. and Subsidiary
Notes to Consolidated Financial Statements

Note 4. Loans

Loans are summarized as follows at December 31:

	2018	2017
Commercial and industrial	\$14,673,785	\$18,807,770
Real estate:		
Commercial	120,111,911	92,798,245
Construction and land development	3,797,887	3,908,620
Residential, including multifamily	8,198,864	5,404,216
Consumer	67,766	671,637
	<u>146,850,213</u>	<u>121,590,488</u>
Allowance for loan losses	(2,269,968)	(1,869,307)
Net deferred loan costs	1,754,787	1,153,194
	<u>\$146,335,032</u>	<u>\$120,874,375</u>

As of December 31, 2018, Company loans with an approximate carrying value of \$12,085,468 were pledged for debt borrowing purposes (see Note 7).

The following table presents the contractual aging of the recorded investment in past-due and nonaccrual loans by class of loans as of December 31:

	2018				Total	Nonaccrual
	Current	30-59 Days Past Due	60-89 Days Past Due	Past Due 90 Days or More		
Commercial and industrial	\$14,673,785	\$ -	\$ -	\$ -	\$14,673,785	\$ -
Commercial real estate	120,111,911	-	-	-	120,111,911	
Construction and land development	3,797,887	-	-	-	3,797,887	
Residential real estate	8,198,864	-	-	-	8,198,864	
Consumer	67,766	-	-	-	67,766	
Total	<u>\$146,850,213</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$146,850,213</u>	<u>\$ -</u>

	2017				Total	Nonaccrual
	Current	30-59 Days Past Due	60-89 Days Past Due	Past Due 90 Days or More		
Commercial and industrial	\$18,807,770	\$ -	\$ -	\$ -	\$18,807,770	\$ -
Commercial real estate	92,798,245	-	-	-	92,798,245	
Construction and land development	3,908,620	-	-	-	3,908,620	
Residential real estate	5,404,216	-	-	-	5,404,216	
Consumer	671,637	-	-	-	671,637	
Total	<u>\$121,590,488</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$121,590,488</u>	<u>\$ -</u>

GBank Financial Holdings Inc. and Subsidiary

Notes to Consolidated Financial Statements

Note 4. Loans (Continued)

Management regularly reviews the problem loans in the Company's portfolio to determine whether any assets require classification in accordance with the Company's policy and applicable regulations. The grading analysis estimates the capability of the borrower to repay the contractual obligations of the loan agreements. The Company's internal credit risk-grading system is based on experiences with similarly graded loans.

The Company's internally assigned grades are as follows:

Pass: Loans that are protected by the current net worth and paying capacity of the obligor or by the value of the underlying collateral

Special Mention: Loans where a potential weakness or risk exists that could cause a more serious problem if not corrected.

Substandard: Loans that have a well-defined weakness based on objective evidence and can be characterized by the distinct possibility that the Company will sustain some loss if the deficiencies are not corrected.

Doubtful: Loans classified as doubtful have all the weaknesses inherent in a substandard asset. In addition, these weaknesses make full collection or liquidation highly questionable and improbable, based upon the existing circumstances.

Loss: Loans classified as a loss are considered uncollectable, or of such value that continuance as an asset is not warranted.

The following table represents credit exposures by internally assigned grades for the years ended December 31:

	2018						Total
	Commercial and Industrial	Commercial Real Estate	Construction and Land Development	Residential Real Estate	Consumer	Loss	
Pass	\$13,337,789	\$120,111,911	\$3,797,887	\$8,198,864	\$67,766	\$ -	\$145,514,217
Special Mention	1,335,996	-	-	-	-	-	1,335,996
Substandard	-	-	-	-	-	-	-
Doubtful	-	-	-	-	-	-	-
Total	\$14,673,785	\$120,111,911	\$3,797,887	\$8,198,864	\$67,766	\$ -	\$146,850,213

	2017						Total
	Commercial and Industrial	Commercial Real Estate	Construction and Land Development	Residential Real Estate	Consumer	Loss	
Pass	\$18,807,770	\$92,798,245	\$3,908,620	\$5,404,216	\$671,637	\$ -	\$121,590,488
Special Mention	-	-	-	-	-	-	-
Substandard	-	-	-	-	-	-	-
Doubtful	-	-	-	-	-	-	-
Total	\$18,807,770	\$92,798,245	\$3,908,620	\$5,404,216	\$671,637	\$ -	\$121,590,488

GBank Financial Holdings Inc. and Subsidiary

Notes to Consolidated Financial Statements

Note 4. Loans (Continued)

There were no impaired loans as of December 31, 2018 or 2017.

There was no interest income recognized on a cash basis relating to nonaccrual loans during the years ended December 31, 2018 or 2017. As of December 31, 2018 and 2017, the Company was not committed to lend additional funds on any impaired loans.

The level of the allowance reflects management's continuing evaluation of product and industry concentrations, specific credit risks, loan loss experience, current loan portfolio quality, present economic, political and regulatory conditions, and unidentified losses inherent in the current loan portfolio. Portions of the allowance may be allocated for specific credits; however, the entire allowance is available for any credit that, in management's judgment, should be charged off.

The following is a summary of activity for the allowance for loan losses for the years ended December 31:

	2018	2017
Balance, beginning	\$1,869,307	\$1,669,136
Provision for loan losses	400,000	177,000
Amounts recovered	661	23,171
Balance, ending	<u>\$2,269,968</u>	<u>\$1,869,307</u>

The following table presents, by portfolio segment, the changes in the allowance for loan losses and the recorded investment in loans for the years ended December 31:

	2018					Total
	Commercial and Industrial	Commercial Real Estate	Construction and Land Development	Residential Real Estate	Consumer	
Allowance for loan losses:						
Balance, beginning	\$302,409	\$1,301,244	\$138,809	\$110,517	\$16,328	\$1,869,307
Provision for loan losses	(66,182)	565,944	(61,539)	(21,245)	(16,978)	400,000
Amounts recovered	-	-	-	-	661	661
Less amounts charged off	-	-	-	-	-	-
Balance, ending	<u>\$236,227</u>	<u>\$1,867,188</u>	<u>\$77,270</u>	<u>\$89,272</u>	<u>\$11</u>	<u>\$2,269,968</u>
Period-end amount allocated to:						
Individually evaluated for impairment	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
Collectively evaluated for impairment	236,227	1,867,188	77,270	89,272	11	2,269,968
Balance, ending	<u>\$236,227</u>	<u>\$1,867,188</u>	<u>\$77,270</u>	<u>\$89,272</u>	<u>\$11</u>	<u>\$2,269,968</u>
Loan receivable:						
Individually evaluated for impairment	\$-	\$-	\$-	\$-	\$-	\$-
Collectively evaluated for impairment	14,673,785	120,111,911	3,797,887	8,198,864	67,766	146,850,213
Balance, ending	<u>\$14,673,785</u>	<u>\$120,111,911</u>	<u>\$3,797,887</u>	<u>\$8,198,864</u>	<u>\$67,766</u>	<u>\$146,850,213</u>

GBank Financial Holdings Inc. and Subsidiary
Notes to Consolidated Financial Statements

Note 4. Loans (Continued)

	2017					Total
	Commercial and Industrial	Commercial Real Estate	Construction and Land Development	Residential Real Estate	Consumer	
Allowance for loan losses:						
Balance, beginning	\$277,629	\$1,140,013	\$131,729	\$110,517	\$9,248	\$1,669,136
Provision for loan losses	24,780	138,060	7,080	-	7,080	177,000
Amounts recovered	-	23,171	-	-	-	23,171
Less amounts charged off	-	-	-	-	-	-
Balance, ending	\$302,409	\$1,301,244	\$138,809	\$110,517	\$16,328	\$1,869,307
Period-end amount allocated to:						
Individually evaluated for impairment	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
Collectively evaluated for impairment	302,409	1,301,244	138,809	110,517	16,328	1,869,307
Balance, ending	\$302,409	\$1,301,244	\$138,809	\$110,517	\$16,328	\$1,869,307
Loan receivable:						
Individually evaluated for impairment	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
Collectively evaluated for impairment	18,807,770	92,798,245	3,908,620	5,404,216	671,637	121,590,488
Balance, ending	\$18,807,770	\$92,798,245	\$3,908,620	\$5,404,216	\$671,637	\$121,590,488

During 2018 and 2017, there were no troubled debt restructurings. There were no re-defaulted troubled debt restructurings that occurred for the years ended December 31, 2018 or 2017.

Note 5. Premises and Equipment

Premises and equipment are summarized at December 31 as follows:

	2018	2017
Leasehold improvements	\$2,860,224	\$2,845,809
Furniture, fixtures and equipment	2,087,682	1,504,371
	4,947,906	4,350,180
Accumulated depreciation and amortization	(3,515,246)	(3,222,502)
	\$1,432,660	\$1,127,678

Note 6. Deposits

The scheduled maturities of time deposits at December 31, 2018, are as follows:

Years ending December 31:	
2019	\$6,073,299
2020	590,456
	<u>\$6,663,755</u>

GBank Financial Holdings Inc. and Subsidiary

Notes to Consolidated Financial Statements

Note 6. Deposits (Continued)

At December 31, 2018, there were no depositors exceeding 5 percent of the Company's total deposits. The Company had brokered deposits of approximately \$618,000 and \$8,291,000 as of December 31, 2018 and 2017, respectively. The Company's policy is to limit brokered deposits to no more than 20 percent of total deposits.

Note 7. Other Borrowings and Available Lines of Credit

The Company has a line of credit available from the FHLB of San Francisco. Borrowing capacity is determined based on collateral pledged, generally consisting of loans and securities, at the time of borrowing. Pursuant to collateral agreements with the FHLB of San Francisco, the arrangement is collateralized by qualifying securities and pledged loans with approximate market values of \$12,933,725 as of December 31, 2018. The borrowing capacity at December 31, 2018, with the FHLB of San Francisco, as collateralized by qualifying securities and pledged loans, was approximately \$11,186,698. There were no outstanding advances as of December 31, 2018 or 2017.

In addition, the Company has a borrowing agreement with the Federal Reserve Bank Discount Window. The total borrowing limit under this agreement is based on any amount that can be pledged as collateral to cover any such advances. As of December 31, 2018 and 2017, there were no borrowings under this agreement and there was no collateral pledged.

Note 8. Income Taxes

The Company files income tax returns in the U.S. federal jurisdiction. The Company identifies its federal tax return as its major tax jurisdiction. The periods subject to examination for the Company's federal tax return are 2015, 2016 and 2017. The Company believes that its income tax filing positions and deductions will be sustained on audit and does not anticipate any adjustments that will result in a material change to its financial position. Therefore, no reserves for uncertain income tax positions have been recorded pursuant to applicable guidance.

From time to time, the Company may be assessed interest or penalties by tax jurisdictions, although the Company has had no such assessments historically. The Company's policy is to include interest and penalties related to income taxes as a component of income tax expense.

The net cumulative effects of the primary temporary differences as of December 31 are shown in the following table:

	2018	2017
Deferred tax assets:		
Net operating loss carryforwards	\$ -	\$932,358
Allowance for loan losses	489,000	256,888
Depreciation	193,885	290,195
Organization and startup costs	46,114	57,049
Other	240,103	103,075
Unrealized loss on securities available for sale	12,407	10,165
Total deferred tax assets	<u>981,509</u>	<u>1,649,730</u>
Deferred tax liabilities:		
Other	<u>(587,848)</u>	<u>(346,563)</u>
Total deferred tax liabilities	<u>(587,848)</u>	<u>(346,563)</u>
Net deferred tax assets	<u>\$393,661</u>	<u>\$1,303,167</u>

GBank Financial Holdings Inc. and Subsidiary

Notes to Consolidated Financial Statements

Note 8. Income Taxes (Continued)

The Company has no valuation allowance as of December 31, 2018. The effective rate for 2018 differs from the expected statutory rate due to permanent differences and state taxes. The following table presents the tax provision as of December 31:

	2018	2017
Current	\$363,292	\$ -
Deferred	909,506	2,686,901
Total	<u>\$1,272,798</u>	<u>\$2,686,901</u>

On December 22, 2017, the President of the United States signed into law the Tax Cuts and Jobs Act tax reform legislation. This legislation makes significant changes to U.S. tax law, including a reduction in the corporate tax rates, changes to net operating loss carryforwards and carrybacks, and a repeal of the corporate alternative minimum tax. The legislation reduced the U.S. corporate tax rate from the current rate of 34 percent to 21 percent. As a result of the enacted law, the Company was required to revalue deferred tax assets and liability at the enacted rate. This revaluation resulted in an additional \$800,000 to income tax expense in continuing operations and a corresponding reduction in the deferred tax asset. The other provisions of the Tax Cuts and Jobs Act did not have a material impact on the fiscal 2017 consolidated financial statements.

Note 9. Commitments and Contingencies

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

The Company's exposure to credit loss in the event of nonperformance by the other parties to the financial instruments for these commitments is represented by the contractual amounts of those instruments. The Company uses the same credit policies in making commitments and conditional obligations as it does for on-balance-sheet instruments.

A summary of the contractual amounts of the Company's exposure to off-balance-sheet risk as of December 31 is as follows:

	2018	2017
Commitments to extend credit, including unsecured commitments of \$1,743,000 and \$2,302,000 for 2018 and 2017, respectively	\$23,789,700	\$16,969,653
Standby letters of credit, cash secured	245,000	193,000
	<u>\$24,034,700</u>	<u>\$17,162,653</u>

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee since many of the commitments are expected to expire without being drawn upon. The total commitment amounts do not necessarily represent future cash requirements. The Company evaluates each customer's creditworthiness on a case-by-case basis. The amount of collateral obtained, if deemed necessary by the Company upon extension of credit, is based upon management's credit evaluation of the counterparty. Collateral held varies, but may include accounts receivable; inventory; property, plant and equipment; income-producing commercial properties; and land loans.

GBank Financial Holdings Inc. and Subsidiary

Notes to Consolidated Financial Statements

Note 9. Commitments and Contingencies (Continued)

Standby letters of credit are conditional commitments issued by the Company to guarantee the performance of a customer to a third party. Those guarantees are primarily issued to support public and private borrowing arrangements. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loan facilities to customers. Collateral held varies as specified above and is required as the Company deems necessary.

Lease commitments: The Company leases its facilities from related parties with terms of five to 15 years expiring through September 2024. Rent expense paid to related parties was approximately \$596,000 and \$519,000 for the years ended December 31, 2018 and 2017, respectively. Future minimum rental payments under the Company's operating leases as of December 31, 2018, are as follows:

Years ending December 31:	
2019	\$730,788
2020	741,996
2021	755,668
2022	678,996
2023	350,116
Thereafter	71,564
	<u>\$3,329,128</u>

Financial instruments with concentrations of credit risk: The Company makes commercial, commercial real estate, residential real estate and consumer loans to customers primarily in southern Nevada. The Company's loan portfolio includes a significant credit exposure to the real estate market of this area and upon the economic viability of this area. Substantially all of these loans are secured by first liens with an initial loan to value ratio of generally not more than 80 percent. Real estate loans accounted for approximately 90 percent and 84 percent of the total at December 31, 2018 and 2017, respectively. As of December 31, 2018, commercial real estate loans represent 82 percent of total loans. Owner-occupied commercial real estate loans represent 26 percent of commercial real estate loans.

The Company also makes Small Business Administration (SBA) and U.S. Department of Agriculture (USDA) loans that have an unguaranteed portion. At December 31, 2018, SBA and USDA unguaranteed portion accounted for approximately 45 percent of the total loans. The Company makes loans to customers who are not located in southern Nevada and as of December 31, 2018, 55 percent of total loans are considered out of market.

The Company's loans are expected to be repaid from cash flow or from proceeds from the sale of selected assets of the borrowers. Additionally, unsecured loans accounted for approximately 2 percent of total loans at December 31, 2018.

Legal contingencies: The Company is a party to various legal actions normally associated with collections of loans and other business activities of financial institutions, the aggregate effect of which, in management's opinion, would not have a material adverse effect on the Company's financial statements. In the opinion of management, such proceedings are substantially covered by insurance, and the ultimate disposition of such proceedings are not expected to have a material adverse effect on the Company's financial position, results of operations, or cash flows.

Executive agreements: The Company has entered into agreements with its key employees, which states that in the event the Company terminates the employment of these officers without cause, or upon change in control of the Company, the Company may be liable for the employees' salary for a period of time as outlined in the agreements.

GBank Financial Holdings Inc. and Subsidiary

Notes to Consolidated Financial Statements

Note 9. Commitments and Contingencies (Continued)

On December 31, 2018, the Company entered into a Stock Exchange Agreement and Plan (the Agreement) with BankCard Services, LLC (BCS). Under the terms of the agreement, ownership interests in BCS will be exchanged for shares of the Company and cash, and BCS will become a wholly owned subsidiary of the Company. Closing of the transaction is subject to various conditions, including approval by regulatory authorities, the Company's Board of Directors and stockholders, and BCS' members; a fairness opinion and valuation report for BCS; and various representations and warranties for both the Company and BCS. The Agreement may be terminated prior to closing by mutual consent of the Company and BCS, or by either party if closing does not occur by September 30, 2019.

Note 10. Related-Party Transactions

In the course of ordinary business, the Company has granted loans to officers, directors and their affiliates. At December 31, 2018 and 2017, direct loans to such parties approximated \$6,185,000 and \$5,169,000, respectively. Total borrowings were approximately \$2,400,000 and total repayments were approximately \$1,384,000 for the year ended December 31, 2018. Undisbursed loan commitments with related parties totaled approximately \$1,241,000 and \$1,913,000 at December 31, 2018 and 2017, respectively.

In April 2015, the Company entered into a sponsorship and program management with Bankcard Services, LLC (BCS), a newly formed entity that is related by common ownership to the Company. Under this agreement, the Company will issue prepaid debit cards through its membership in the Discover Network, and BCS will serve as the program manager for the cards. In addition to card issuance, the Company will provide settlement accounts and receive a percentage of BCS's gross revenues as compensation for these services. Revenue recognized by the Company associated with this arrangement during the year ended December 31, 2018 and 2017, was not significant.

Deposits from related parties in the normal course of business totaled approximately \$12,141,000 and \$14,724,000 at December 31, 2018 and 2017, respectively.

Note 11. Regulatory Capital Requirements

The Company is subject to various regulatory capital requirements administered by federal and state banking agencies. Failure to meet minimum capital requirements can initiate certain mandatory and possibly additional discretionary actions by regulators that, if undertaken, could have a direct material effect on the Company's financial statements.

Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Company must meet specific capital guidelines that involve quantitative measures of the Company's assets, liabilities and certain off-balance-sheet items as calculated under regulatory accounting practices. The Company's capital amounts and classifications are also subject to qualitative judgments by the regulators about components, risk weightings and other factors.

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

GBank Financial Holdings Inc. and Subsidiary

Notes to Consolidated Financial Statements

Note 11. Regulatory Capital Requirements (Continued)

As of December 31, 2018, the most recent notification from the FDIC categorized the Bank as well-capitalized as defined by the banking regulatory agencies. To be categorized as well-capitalized, the Bank must maintain minimum total risk-based, Tier 1 risk-based, Tier 1 leverage and common equity capital ratios as set forth in the table below. The actual capital amounts and ratios of the Bank are presented in the following table:

	Actual		For Capital Adequacy Purposes		To Be Well-Capitalized Under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
	As of December 31, 2018:					
Total capital (to risk-weighted assets)	\$34,505,000	20.9%	\$13,189,000	8.0%	\$16,486,000	10.0%
Tier I capital (to risk-weighted assets)	32,431,000	19.7%	9,893,000	6.0%	13,191,000	8.0%
Tier I common equity capital (to risk-weighted assets)	32,431,000	19.7%	7,420,000	4.5%	10,717,000	6.5%
Tier I capital (to average assets)	32,431,000	13.6%	9,539,000	4.0%	11,924,000	5.0%
As of December 31, 2017:						
Total capital (to risk-weighted assets)	\$29,014,000	21.3%	\$10,898,000	8.0%	\$13,622,000	10.0%
Tier I capital (to risk-weighted assets)	27,305,000	20.0%	8,176,000	6.0%	10,901,000	8.0%
Tier I common equity capital (to risk-weighted assets)	27,305,000	20.0%	6,132,000	4.5%	8,857,000	6.5%
Tier I capital (to average assets)	27,305,000	14.2%	7,719,000	4.0%	9,649,000	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 corrective action thresholds. The final rules revise the regulatory capital requirements, add a new common equity Tier 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.

Additionally, State of Nevada banking regulations restrict distribution of the net assets of the Company because such regulations require the sum of the Company's stockholders' equity and allowance for loan losses to be at least 6 percent of the average of the Company's total daily deposit liabilities for the preceding 60 days. As a result of these regulations, approximately \$12,382,000 of the Company's stockholders' equity was restricted at December 31, 2018.

Note 12. Fair Value Accounting

The Company uses a fair value hierarchy that prioritizes inputs to valuation techniques used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1 measurements) and the lowest priority to unobservable inputs (Level 3 measurements). The three levels of the fair value hierarchy are described below:

Level 1: Valuations for assets and liabilities traded in active exchange markets. Valuations are obtained from readily available pricing sources for market transactions involving identical assets or liabilities.

Level 2: Valuations for assets and liabilities traded in less active dealer or broker markets. Valuations are obtained from third-party pricing services for identical or similar assets or liabilities.

GBank Financial Holdings Inc. and Subsidiary

Notes to Consolidated Financial Statements

Note 12. Fair Value Accounting (Continued)

Level 3: Valuations for assets and liabilities that are derived from other valuation methodologies, including option pricing models, discounted cash flow models and similar techniques, and not based on market exchange, dealer or broker-traded transactions. Level 3 valuations incorporate certain unobservable assumptions and projections in determining the fair value assigned to such assets.

Fair value on a recurring basis: The table below presents the balance of securities available for sale at December 31, 2018, which is measured at fair value on a recurring basis:

	Fair Value Measurements Using			
	Total	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Securities available for sale, 2018:				
Residential mortgage-backed securities	\$3,927,906	\$ -	\$3,927,906	\$ -
Securities available for sale, 2017:				
Residential mortgage-backed securities	\$4,869,683	\$ -	\$4,869,683	\$ -

At December 31, 2018 and 2017, there were no security transfers between levels.

Fair value on a nonrecurring basis: Certain assets are measured at fair value on a nonrecurring basis; that is, the instruments are not measured at fair value on an ongoing basis, but are subject to fair value adjustments in certain circumstances (for example, when there is evidence of impairment). There were no such assets carried on the consolidated balance sheet at December 31, 2018 and 2017.

Note 13. Stock Option Plan and Equity Incentive Plan

During 2008, the shareholders approved a stock option plan (the Plan) that provides for a maximum of 252,000 shares of the Company's stock to be purchased under options. The options to purchase shares may be issued to employees, officers and directors as either incentive stock options or nonqualified stock options. The Plan requires that the exercise price be equal to the fair market value of the Company's common stock at the date of grant. Certain option awards provide for accelerated vesting if there is a change in control as described in the Plan agreement. In April 2014, the shareholders approved an increase of options available to be granted from 252,000 to 700,000 as a result of the increase in the Company's shares of common stock issued and outstanding.

GBank Financial Holdings Inc. and Subsidiary

Notes to Consolidated Financial Statements

Note 13. Stock Option Plan and Equity Incentive Plan (Continued)

Effective March 22, 2016, the Company established the 2016 Equity Incentive Plan (the Equity Plan) for its directors, consultants and certain of its employees. The Equity Plan permits the grant and award of stock options, stock appreciation rights, restricted stock, restricted stock units, stock awards, and other stock-based awards and stock-related awards. The maximum total number of shares available for incentive awards under the Equity Plan shall be 250,000 shares of common stock, plus all shares subject to incentive awards that are canceled, surrendered, modified or exchanged for substitute incentive awards, or that expire or terminate prior to the exercise or vesting of the incentive awards in full, plus shares that are surrendered to the Company in connection with the exercise or vesting of incentive awards, whether previously owned or otherwise subject to such incentive awards. However, the number of shares that may be granted under the Equity Plan shall not exceed, on a cumulative basis, 15 percent of the aggregate shares of common stock issued and outstanding at any grant date. There were 50,000 shares and 99,640 shares of restricted stock granted to employees and directors under the Equity Plan during the years ended December 31, 2018 and 2017, respectively. Unless earlier terminated by the Company, no incentive award shall be granted under the Equity Plan after March 22, 2026.

Options are generally granted with a vesting term of five years and expire five years after the final vesting date. The following provides activities of outstanding options as of December 31, 2018:

	Shares	Weighted-Average Exercise Price	Weighted-Average Remaining Contractual Term (Years)
Outstanding, beginning of year	684,950	\$ 1.57	
Granted	-	-	
Exercised	(4,000)	\$ 1.50	
Canceled/forfeited	(10,200)	-	
Outstanding, end of year	<u>670,750</u>	<u>\$ 1.57</u>	<u>6.3</u>
Options exercisable, end of year	<u>431,700</u>	<u>\$ 1.48</u>	<u>6.3</u>

Total stock compensation expense recorded during the years ended December 31, 2018 and 2017, related to stock options granted in previous years was approximately \$45,000 for both years. As of December 31, 2018, there was approximately \$56,000 of total unrecognized compensation cost associated with nonvested share-based compensation arrangements granted under the Plan. The remaining cost is expected to be recognized over a weighted-average period of approximately 31 months. There were 15,250 shares available to be granted under the Plan at December 31, 2018.

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Notes to Consolidated Financial Statements

Note 13. Stock Option Plan and Equity Incentive Plan (Continued)

The following provides activity of outstanding restricted awards as of December 31:

	2018	2017
Outstanding, beginning of year	99,640	-
Granted	50,000	99,640
Vested	(19,370)	-
Canceled/forfeited	(2,790)	-
Outstanding, end of year	<u>127,480</u>	<u>99,640</u>

The grant date fair values were \$3.25 and \$2.75 per share for totals of \$162,500 and \$274,010 for years ended December 31, 2018 and 2017, respectively. The shares vest over a period of five years, beginning on the first anniversary following the award date. Total compensation expense recorded during the years ended December 31, 2018 and 2017 were approximately \$63,000 and \$10,000, respectively. As of December 31, 2018, there was approximately \$363,000 of total unrecognized compensation cost associated with nonvested share-based compensation. The remaining cost is expected to be recognized over a weighted average period of approximately 34 months. There were 100,360 shares available to be granted under the Equity Plan at December 31, 2018.

Note 14. Employee Benefit Plans

401(k) plan: During 2007, the Company entered into a qualified 401(k) employee benefit plan (EBP) for all eligible employees. Participants are able to defer up to 96 percent of their annual compensation in accordance with statutory limits. There is no Company match under the EBP. Effective first-quarter 2016, the Company elected to reinstitute its 401(k) matching program where the Company matches 50 percent of the first 6 percent of employee contributions. Additionally, the Company can make a discretionary contribution to the EBP on an annual basis. For the years ended December 31, 2018 and 2017, the Company contributed approximately \$153,000 and \$143,000 to the EBP, which are included in noninterest expense on the consolidated statements of income, respectively.

Effective January 1, 2017, the Company elected a Safe Harbor matching contribution wherein the Company matches 100 percent of the first 4 percent of employee contributions.

Deferred incentive compensation plan: On December 15, 2016, the Company adopted an unfunded nonqualified deferred incentive compensation plan (the Plan) primarily to provide supplemental retirement benefits and incentive compensation for selected employees. Eligible participants may elect to defer compensation in an amount not to exceed \$200,000 in any Plan year. In addition, within 90 days following the end of each Plan year, the Company contributes to the Plan in the amounts determined according to the terms of each participant's agreement. Each participant shall vest in an amount of one-third of each contribution each Plan year. Each year, contributions and deferrals are to be distributed for each of the three immediately preceding years, plus related interest. For the years ended December 31, 2018 and 2017, the Company recorded approximately \$466,000 and \$468,000 of contributions and deferrals, respectively, and at December 31, 2018 and 2017, these same amounts were recorded as liabilities associated with this Plan.

GBank Financial Holdings Inc. and Subsidiary

Notes to Consolidated Financial Statements

Note 15. Common Stock Offering and Warrants

During 2014, the Company commenced a stock offering to existing shareholders that included the sale of up to a maximum of 1,520,000 units, with each unit comprising one share of common stock and a five- year warrant to acquire one-third of a share of common stock of the Company. Each unit is priced at \$1.50 and the warrant exercise price is \$1.50 per share. Under this offering, the Company sold 1,520,000 units, resulting in the issuance of 1,520,000 common shares, and received proceeds of approximately \$2,263,000, net of issuance costs of approximately \$17,000. Under this offering, warrants to purchase 506,655 common stock shares were issued during December 2014.

In March 2016, the Company commenced a stock offering to accredited investors that included the sale of up to a maximum of 1,000,000 shares of common stock. Each share is priced at \$2.50. Under this offering, the Company issued 1,033,265 shares and received proceeds of approximately \$2,579,000, net of issuance costs of approximately \$22,000. There were no warrants issued associated with this stock offering.

There were 368,819 and 635,549 warrants exercised during the years ended December 31, 2018 and 2017, respectively. At December 31, 2018, there were 10,000 warrants outstanding from the 2014 and previous offerings, with an exercise price of \$1.50 per share. While the common stock warrants were issued at different times and have varying expiration terms depending on the date of issuance, all of these common stock warrants have an expiration date set at the end of business on December 31, 2018, except for the remaining 10,000 warrants whereby the expiration date was extended by the Board to January 31, 2019.