# COMMERCIAL BANK OF CALIFORNIA

## FINANCIAL STATEMENTS
## WITH
## INDEPENDENT AUDITOR'S REPORT

## DECEMBER 31, 2015 AND 2014

**CONTENTS**

Vavrinek, Trine, Day & Co., LLP
Certified Public Accountants



**INDEPENDENT AUDITOR'S REPORT**

Board of Directors and Shareholders of
Commercial Bank of California
Irvine, California

We have audited the accompanying financial statements of Commercial Bank of California ("Bank"), which are comprised of the balance sheets as of December 31, 2015 and 2014 and the related statements of income, comprehensive income, changes in shareholders' equity and cash flows for the years then ended and the related notes to 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 audit to obtain reasonable assurance about whether the financial statements are free from 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 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 Commercial Bank of California as of December 31, 2015 and 2014 and the results of its operations and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Vavrinek, Trine, Day & Co., LLP

Laguna Hills, California
March 3, 2016



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## COMMERCIAL BANK OF CALIFORNIA

### BALANCE SHEETS
### DECEMBER 31, 2015 AND 2014

**ASSETS**

| | 2015 | 2014 |
|---|---|---|
| Cash and Due from Banks | $ 4,925,000 | $ 7,250,000 |
| Interest-bearing Deposits in Other Banks | 24,521,000 | 14,102,000 |
| Federal Funds Sold | 10,275,000 | 78,245,000 |
| **TOTAL CASH AND CASH EQUIVALENTS** | 39,721,000 | 99,597,000 |
| Investment Securities Available for Sale | 37,451,000 | 33,943,000 |
| Loans, net of Allowance for Loan Losses | 236,413,000 | 173,541,000 |
| Investment in Federal Home Loan Bank Stock | 1,003,000 | 1,410,000 |
| Premises and Equipment | 892,000 | 856,000 |
| Other Real Estate Owned | 856,000 | 957,000 |
| Bank Owned Life Insurance | 8,412,000 | 8,194,000 |
| Income Tax Receivable | - | 467,000 |
| Deferred Tax Asset | 1,523,000 | 1,662,000 |
| Accrued Interest and Other Assets | 2,144,000 | 1,783,000 |
| **TOTAL ASSETS** | $ 328,415,000 | $ 322,410,000 |

**LIABILITIES AND SHAREHOLDERS' EQUITY**

| | 2015 | 2014 |
|---|---|---|
| Deposits: | | |
| Noninterest-bearing Demand | $ 70,454,000 | $ 51,925,000 |
| Savings, NOW and Money Market Accounts | 159,760,000 | 171,120,000 |
| Time Deposits | 41,397,000 | 34,331,000 |
| **TOTAL DEPOSITS** | 271,611,000 | 257,376,000 |
| Federal Home Loan Bank Borrowings | 20,000,000 | 30,000,000 |
| Accrued Interest and Other Liabilities | 847,000 | 499,000 |
| **TOTAL LIABILITIES** | 292,458,000 | 287,875,000 |
| Commitments and Contingencies - Notes 4 and 10 | - | - |
| Shareholders' Equity: | | |
| Common Stock - No Par Value, 15,000,000 Shares Authorized, Issued and Outstanding; 6,107,600 in 2015 and 2014 | 30,581,000 | 30,581,000 |
| Retained Earnings | 5,535,000 | 3,850,000 |
| Accumulated Other Comprehensive Income (Loss), Net of Taxes | (159,000) | 104,000 |
| **TOTAL SHAREHOLDERS' EQUITY** | 35,957,000 | 34,535,000 |
| **TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY** | $ 328,415,000 | $ 322,410,000 |

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

**COMMERCIAL BANK OF CALIFORNIA**

**STATEMENTS OF INCOME**
**FOR THE YEARS ENDED DECEMBER 31, 2015 AND 2014**

| | 2015 | 2014 |
|---|---|---|
| **INTEREST INCOME** | | |
| Interest and Fees on Loans | $ 10,106,000 | $ 7,530,000 |
| Interest on Investment Securities | 716,000 | 686,000 |
| Interest on Federal Funds Sold | 104,000 | 92,000 |
| Interest Other | 229,000 | 118,000 |
| **TOTAL INTEREST INCOME** | 11,155,000 | 8,426,000 |
| **INTEREST EXPENSE** | | |
| Interest on Deposit Accounts | 1,277,000 | 902,000 |
| Interest on Federal Home Loan Bank Advances | 32,000 | 25,000 |
| **TOTAL INTEREST EXPENSE** | 1,309,000 | 927,000 |
| **NET INTEREST INCOME** | 9,846,000 | 7,499,000 |
| Provision for Loan Loss Expense (Benefit) | (525,000) | 367,000 |
| **NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES** | 10,371,000 | 7,132,000 |
| **NONINTEREST INCOME** | | |
| Service Charges on Deposit Accounts | 251,000 | 366,000 |
| Loss on Sale of AFS Securities | (112,000) | - |
| Gain on Sale of Loans | 565,000 | 578,000 |
| Net Gain on Sale of Other Real Estate Owned | - | 60,000 |
| Earnings on Bank Owned Life Insurance | 218,000 | 194,000 |
| Other Income | 129,000 | 51,000 |
| **TOTAL NONINTEREST INCOME** | 1,051,000 | 1,249,000 |
| **NONINTEREST EXPENSE** | | |
| Salaries and Employee Benefits | 4,611,000 | 4,111,000 |
| Occupancy | 759,000 | 735,000 |
| Data Processing | 699,000 | 692,000 |
| Professional Services | 859,000 | 670,000 |
| Other Real Estate Owned Expenses | 120,000 | 273,000 |
| Other Expenses | 1,627,000 | 1,432,000 |
| | 8,675,000 | 7,913,000 |
| **INCOME BEFORE INCOME TAXES** | 2,747,000 | 468,000 |
| Income Tax Expense | 1,062,000 | 81,000 |
| **NET INCOME** | $ 1,685,000 | $ 387,000 |

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

## COMMERCIAL BANK OF CALIFORNIA

## STATEMENTS OF COMPREHENSIVE INCOME
## FOR THE YEARS ENDED DECEMBER 31, 2015 AND 2014

| | 2015 | 2014 |
|---|---|---|
| Net Income | $ 1,685,000 | $ 387,000 |
| **OTHER COMPREHENSIVE INCOME (LOSS):** | | |
| Change in Unrealized Gains (Losses) on Securities Available for Sale | (364,000) | 1,271,000 |
| Reclassification Adjustment for Realized Gains (Losses) on Securities | (112,000) | - |
| Net Change in Unrealized Gains (Losses) | (476,000) | 1,271,000 |
| Tax Effect | 213,000 | (523,000) |
| **OTHER COMPREHENSIVE INCOME (LOSS)** | (263,000) | 748,000 |
| **TOTAL COMPREHENSIVE INCOME** | $ 1,422,000 | $ 1,135,000 |

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

## COMMERCIAL BANK OF CALIFORNIA

## STATEMENT OF CHANGES IN SHAREHOLDERS' EQUITY
## FOR THE TWO YEARS ENDED DECEMBER 31, 2015

| | Common Stock | | | Accumulated | |
|---|---|---|---|---|---|
| | Number of Shares | Amount | Retained Earnings | Other Comprehensive Income (Loss) | Total |
| **Balance at January 1, 2014** | 6,107,600 | $ 30,581,000 | $ 3,463,000 | $ (644,000) | $ 33,400,000 |
| Net Income | | | 387,000 | | 387,000 |
| Other Comprehensive Loss, Net of Taxes | | | | 748,000 | 748,000 |
| **Balance at December 31, 2014** | 6,107,600 | 30,581,000 | 3,850,000 | 104,000 | 34,535,000 |
| Net Income | | | 1,685,000 | | 1,685,000 |
| Other Comprehensive Loss, Net of Taxes | | | | (263,000) | (263,000) |
| **Balance at December 31, 2015** | 6,107,600 | $ 30,581,000 | $ 5,535,000 | $ (159,000) | $ 35,957,000 |

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

## COMMERCIAL BANK OF CALIFORNIA

### STATEMENTS OF CASH FLOWS
### FOR THE YEARS ENDED DECEMBER 31, 2015 AND 2014

| | 2015 | 2014 |
|---|---|---|
| **OPERATING ACTIVITIES** | | |
| Net Income | $ 1,685,000 | $ 387,000 |
| Adjustments to Reconcile Net Income to Net Cash | | |
| From Operating Activities: | | |
| Depreciation and Amortization | 181,000 | 87,000 |
| Provision for Loan Loss Expense (Benefit) | (525,000) | 367,000 |
| Earnings on Bank Owned Life Insurance | (218,000) | (194,000) |
| Gain on Sale of Loans | (565,000) | (578,000) |
| Gain on Sale of Other Real Estate Owned | - | (60,000) |
| Loss on Sale of Available-for-Sale Securities | 112,000 | - |
| Write-downs on Other Real Estate Owned | 101,000 | 243,000 |
| Deferred Tax Expense | 352,000 | 316,000 |
| Changes in Other Assets and Liabilities | 797,000 | (832,000) |
| **NET CASH FROM OPERATING ACTIVITIES** | 1,920,000 | (264,000) |
| **INVESTING ACTIVITIES** | | |
| Purchase of Securities Available for Sale | (25,969,000) | (14,108,000) |
| Proceeds from Maturities and Calls of Available-for-Sale Securities | 7,892,000 | 9,959,000 |
| Proceeds from Sale of Available-for-Sale Securities | 13,638,000 | - |
| Proceeds from Sale of Loans | 8,399,000 | 9,017,000 |
| Net Increase in Loans | (70,181,000) | (69,370,000) |
| Net Change in FHLB Stock | 407,000 | (976,000) |
| Proceeds from Sale of Other Real Estate Owned | - | 496,000 |
| Purchases of Premises and Equipment | (217,000) | (743,000) |
| Purchase of Bank Owned Life Insurance | - | (8,000,000) |
| **NET CASH FROM INVESTING ACTIVITIES** | (66,031,000) | (73,725,000) |
| **FINANCING ACTIVITIES** | | |
| Net Change in Deposits | 14,235,000 | 75,082,000 |
| Net Change in FHLB Borrowings | (10,000,000) | 30,000,000 |
| **NET CASH FROM FINANCING ACTIVITIES** | 4,235,000 | 105,082,000 |
| **INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS** | (59,876,000) | 31,093,000 |
| Cash and Cash Equivalents at Beginning of Period | 99,597,000 | 68,504,000 |
| **CASH AND CASH EQUIVALENTS AT END OF YEAR** | $ 39,721,000 | $ 99,597,000 |
| **Supplemental Disclosures of Cash Flow Information:** | | |
| Interest Paid | $ 1,307,000 | $ 920,000 |
| Taxes Paid (Refunded), net | $ 310,000 | $ (201,000) |

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

## NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

### Nature of Operations

Commercial Bank of California ("Bank") is a California state-chartered commercial bank that was incorporated on October 22, 2002 and opened for business on May 15, 2003, with its headquarters located in Irvine, California and one full service branch located in Brea, California. The Bank's deposits are insured by the Federal Deposit Insurance Corporation ("FDIC"). The Bank is a full service bank offering customers traditional deposit and lending services. The Bank's customers consist generally of high net-worth individuals and small-to-midsize businesses located in Southern California. A substantial portion of the Bank's customers' abilities to honor their loan contracts depend on the business economy and real estate values in this area.

The accounting and reporting policies of the Bank are in accordance with accounting principles generally accepted in the United States of America and conform to practices within the banking industry.

### Subsequent Events

The Bank has evaluated subsequent events for recognition and disclosure through March 3, 2016, which is the date the financial statements were available to be issued.

### Use of Estimates in the Preparation of Financial Statements

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

### Cash and Cash Equivalents

For purposes of reporting cash flows, cash and cash equivalents include cash, due from banks, deposits with other financial institutions with maturities of less than ninety days and federal funds sold. Generally, federal funds are sold for one-day periods.

### Cash and Due from Banks

Banking regulations require that banks maintain a percentage of their deposits as reserves in cash or on deposit with the Federal Reserve Bank. The Bank complied with the reserve requirement as of December 31, 2015.

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

## NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued

Investment Securities

Bonds, notes, and debentures for which the Bank has the positive intent and ability to hold to maturity are reported at cost, adjusted for premiums and discounts that are recognized in interest income using the interest method over the period to maturity.

Investments not classified as trading securities nor as held-to-maturity securities are classified as available-for-sale securities and recorded at fair value. Unrealized gains or losses on available-for-sale securities are excluded from net income and reported as an amount net of taxes as a separate component of other comprehensive income included in shareholders' equity. Premiums or discounts on held-to-maturity and available-for-sale securities are amortized or accreted into income using the interest method. Realized gains or losses on sales of held-to-maturity or available-for-sale securities are recorded using the specific identification method.

Management evaluates securities for other-than-temporary impairment ("OTTI") on at least a quarterly basis, and more frequently when economic or market conditions warrant such an evaluation. For securities in an unrealized loss position, management considers the extent and duration of the unrealized loss, and the financial condition and near-term prospects of the issuer. Management also assesses whether it intends to sell, or it is more likely than not that it will be required to sell, a security in an unrealized loss position before recovery of its amortized cost basis. If either of the criteria regarding intent or requirement to sell is met, the entire difference between amortized cost and fair value is recognized as impairment through earnings. For debt securities that do not meet the aforementioned criteria, the amount of impairment is split into two components as follows: 1) OTTI related to credit loss, which must be recognized in the income statement and 2) OTTI related to other factors, which is recognized in other comprehensive income. The credit loss is defined as the difference between the present value of the cash flows expected to be collected and the amortized cost basis. For equity securities, the entire amount of impairment is recognized through earnings.

Federal Home Loan Bank ("FHLB") Stock

The Bank is a member of the FHLB system. Members are required to own a certain amount of stock based upon the level of borrowings and other factors, and may invest in additional amounts at the discretion of the FHLB. FHLB stock is carried at cost, classified as a restricted security, and periodically evaluated for impairment based on the ultimate recovery of par value. Both cash and stock dividends are reported as income.

## NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued

### Loans

Loans receivable that management has the intent and ability to hold for the foreseeable future or until maturity or payoff are reported at their outstanding unpaid principal balances reduced by any charge-offs or specific valuation accounts and net of deferred fees or costs on originated loans, or unamortized premiums or discounts on purchased loans. Loan origination fees and certain direct origination costs are deferred and recognized in interest income using the level-yield method without anticipating prepayments. Amortization of deferred loan fees is discontinued when a loan is placed on nonaccrual status.

Loans on which the accrual of interest has been discontinued are designated as nonaccrual loans. The accrual of interest on loans is discontinued when principal or interest is past due 90 days based on the contractual terms of the loan unless the loan is both well-secured and in the process of collection or when, in the opinion of management, there is reasonable doubt as to collectability based upon the contractual terms of the loan. When loans are placed on nonaccrual status, all interest previously accrued but not collected is reversed against current period interest income. Income on nonaccrual loans is subsequently recognized only to the extent that cash is received and the loan's principal balance is deemed collectible. Interest accruals are resumed on such loans only when they are brought current with respect to interest and principal and when, in the judgment of management, the loans are estimated to be fully collectible as to all principal and interest.

### Allowance for Loan Losses

The allowance for loan losses is a valuation allowance for probable incurred credit losses. Loan losses are charged against the allowance when management believes the uncollectibility of a loan balance is confirmed. Subsequent recoveries, if any, are credited to the allowance. Management estimates the allowance balance required using past loan loss experience, the nature and volume of the portfolio, information about specific borrower situations and estimated collateral values, economic conditions, and other factors. Allocations of the allowance may be made for specific loans, but the entire allowance is available for any loan that, in management's judgment, should be charged off. Amounts are charged-off when available information confirms that specific loans or portions thereof, are uncollectible. This methodology for determining charge-offs is consistently applied to each segment.

The Bank determines a separate allowance for each portfolio segment. The allowance consists of specific and general reserves. Specific reserves relate to loans that are individually classified as impaired. A loan is impaired when, based on current information and events, it is probable that the Bank will be unable to collect all amounts due according to the contractual terms of the loan agreement. Factors considered in determining impairment include payment status, collateral value and the probability of collecting all amounts when due. Measurement of impairment is based on the expected future cash flows of an impaired loan, which are to be discounted at the loan's effective interest rate, or measured by reference to an observable market value, if one exists, or the fair value of the collateral for a collateral-dependent loan. The Bank selects the measurement method on a loan-by-loan basis except that collateral-dependent loans for which foreclosure is probable are measured at the fair value of the collateral.

## NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued

Allowance for Loan Losses - Continued

The Bank recognizes interest income on impaired loans based on its existing methods of recognizing interest income on nonaccrual loans. Loans, for which the terms have been modified resulting in a concession, and for which the borrower is experiencing financial difficulties, are considered troubled debt restructurings and classified as impaired with measurement of impairment as described above.

If a loan is impaired, a portion of the allowance is allocated so that the loan is reported, net, at the present value of estimated future cash flows using the loan's existing rate or at the fair value of collateral if repayment is expected solely from the collateral.

General reserves cover non-impaired loans and are based on loss rates developed by management for each portfolio segment, adjusted for the effects of qualitative or environmental factors that are likely to cause estimated credit losses as of the evaluation date to differ from the portfolio segment's loss factors used. Qualitative factors include consideration of the following: changes in lending policies and procedures; changes in economic conditions, changes in the nature and volume of the portfolio; changes in the experience, ability and depth of lending management and other relevant staff; changes in the volume and severity of past due, nonaccrual and other adversely graded loans; changes in the loan review system; changes in the value of the underlying collateral for collateral-dependent loans; concentrations of credit and the effect of other external factors such as competition and legal and regulatory requirements.

Portfolio segments identified by the Bank include real estate, commercial & industrial and consumer loans. Relevant risk characteristics for these portfolio segments generally include debt service coverage, loan-to-value ratios and financial performance on non-consumer loans and credit scores, debt-to income, collateral type and loan-to-value ratios for consumer loans.

Premises and Equipment

Premises and equipment are carried at cost less accumulated depreciation and amortization. Depreciation is computed using the straight-line method over the estimated useful lives, which ranges from three to ten years for furniture and equipment. Leasehold improvements are amortized using the straight-line method over the estimated useful lives of the improvements or the lease term, whichever is shorter. Expenditures for betterments or major repairs are capitalized and those for ordinary repairs and maintenance are charged to operations as incurred.

Other Real Estate Owned

Assets acquired through or instead of loan foreclosure are initially recorded at fair value less costs to sell when acquired, establishing a new cost basis. These assets are subsequently accounted for at lower of cost or fair value less estimated costs to sell. If fair value declines subsequent to foreclosure, a valuation allowance is recorded through expense. Operating costs after acquisition are expensed.

**NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued**

Bank Owned Life Insurance

The Bank has purchased life insurance policies on certain key executives. Bank owned life insurance is recorded at the amount that can be realized under the insurance contract at the balance sheet date, which is the cash surrender value adjusted for other charges or other amounts due that are probable at settlement.

Transfers of Financial Assets

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

Servicing Rights

When Small Business Administration ("SBA") loans are sold with servicing retained, servicing rights are initially recorded at fair value with the income statement effect recorded in gains on sales of loans. Fair value is based on a valuation model that calculates the present value of estimated future net servicing income. All classes of servicing assets are subsequently measured using the amortization method which requires servicing rights to be amortized into noninterest income in proportion to, and over the period of, the estimated future net servicing income of the underlying loans.

Servicing rights are evaluated for impairment based upon the fair value of the rights as compared to carrying amount. Impairment is recognized through a valuation allowance for an individual grouping, to the extent that fair value is less than the carrying amount. If the Company later determines that all or a portion of the impairment no longer exists for a particular grouping, a reduction of the allowance may be recorded as an increase to income.

Servicing fee income, which is reported on the income statement as Other Income, is recorded for fees earned for servicing loans. The fees are based on a contractual percentage of the outstanding principal. The amortization of mortgage servicing rights is netted against loan servicing fee income. Servicing fees net of servicing right amortization totaled $17,000 and $7,000 for the years ended December 31, 2015 and 2014, respectively.

SBA loans serviced for others totaled approximately $16,102,000 and $11,545,000 as of December 31, 2015 and 2014, respectively. The carrying value of servicing assets was $333,000 and $206,000 as of December 31, 2015 and 2014, respectively. The fair value of servicing assets approximates the carrying value.

Financial Instruments

In the ordinary course of business, the Bank has entered into off-balance sheet financial instruments consisting of commitments to extend credit, commercial letters of credit, and standby letters of credit as described in Note 10. Such financial instruments are recorded in the financial statements when they are funded or related fees are incurred or received.

## NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued

Income Taxes

Deferred income taxes are computed using the asset and liability method, which recognizes a liability or asset representing the tax effects, based on current tax law, of future deductible or taxable amounts attributable to events that have been recognized in the financial statements. A valuation allowance is established to reduce the deferred tax asset to the level at which it is "more likely than not" that the tax asset or benefits will be realized. Realization of tax benefits of deductible temporary differences and operating loss carryforwards depends on having sufficient taxable income of an appropriate character within the carryforward periods.

The Bank has adopted guidance issued by the Financial Accounting Standards Board ("FASB") that clarifies the accounting for uncertainty in tax positions taken or expected to be taken on a tax return and provides that the tax effects from an uncertain tax position can be recognized in the financial statements only if, based on its merits, the position is more likely than not to be sustained on audit by the taxing authorities. Interest and penalties related to uncertain tax positions are recorded as part of income tax expense.

Comprehensive Income

The change in unrealized gains and losses on available-for-sale securities is the only component of accumulated other comprehensive income for the Bank. The amount reclassified out of other accumulated comprehensive income relating to realized losses on securities available for sale was $112,000 in 2015, with a related tax effect of $46,000.

Fair Value Measurement

Fair value is the exchange price that would be received for an asset or paid to transfer a liability (exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. There are three levels of inputs that may be used to measure fair values:

> Level 1: Quoted prices (unadjusted) for identical assets or liabilities in active markets that the entity has the ability to access as of the measurement date.
>
> Level 2: Significant other observable inputs other than Level 1 prices such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data.
>
> Level 3: Significant unobservable inputs that reflect a Bank's own assumptions about the assumptions that market participants would use in pricing an asset or liability.

See Note 14 for more information and disclosures relating to the Bank's fair value measurements.

## NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued

Reclassifications

Certain reclassifications have been made in the 2014 financial statements to conform to the presentation used in 2015. These reclassifications had no impact on the Bank's previously reported financial statements.

Newly Issued Not Yet Effective Accounting Standards

In May 2014, the FASB issued Accounting Standards Update (ASU) No. 2014-09, *Revenue from Contracts with Customers (Topic 606)*. This Update requires an entity to recognize revenue as performance obligations are met, in order to reflect the transfer of promised goods or services to customers in an amount that reflects the consideration the entity is entitled to receive for those goods or services. The following steps are applied in the updated guidance: (1) identify the contract(s) with a customer; (2) identify the performance obligations in the contract; (3) determine the transaction price; (4) allocate the transaction price to the performance obligations in the contract; and (5) recognize revenue when, or as, the entity satisfies a performance obligation. These amendments are effective for annual reporting periods beginning after December 15, 2017, including interim periods within that reporting period. Early adoption is permitted only as of annual reporting periods beginning after December 15, 2016, including interim reporting periods within that period. The Company is currently evaluating the effects of ASU 2014-09 on its financial statements and disclosures, if any.

On January 5, 2016, the FASB issued Accounting Standards Update 2016-01, *Financial Instruments–Overall: Recognition and Measurement of Financial Assets and Financial Liabilities (Subtopic 825-10)*. Changes made to the current measurement model primarily affect the accounting for equity securities with readily determinable fair values, where changes in fair value will impact earnings instead of other comprehensive income. The accounting for other financial instruments, such as loans, investments in debt securities, and financial liabilities is largely unchanged. The Update also changes the presentation and disclosure requirements for financial instruments including a requirement that public business entities use exit price when measuring the fair value of financial instruments measured at amortized cost for disclosure purposes. This Update is generally effective for public business entities in fiscal years beginning after December 15, 2017, including interim periods within those fiscal years. The Company is currently evaluating the effects of ASU 2016-01 on its financial statements and disclosures, if any.

On February 25, 2016, the Financial Accounting Standards Board issued Accounting Standards Update (ASU) 2016-02, *Leases (Topic 842)*. The most significant change for lessees is the requirement under the new guidance to recognize right-of-use assets and lease liabilities for all leases not considered short-term leases, which is generally defined as a lease term of less than 12 months. This change will result in lessees recognizing right-of-use assets and lease liabilities for most leases currently accounted for as operating leases under current lease accounting guidance. The amendments in this Update are effective for interim and annual periods beginning after December 15, 2018 for public business entities and one year later for all other entities. The Company is currently evaluating the effects of ASU 2016-02 on its financial statements and disclosures.

## NOTE 2 - INVESTMENT SECURITIES

Debt securities have been classified in the balance sheets according to management's intent. The amortized cost of securities and their approximate fair values at December 31, 2015 and 2014 were as follows:

| December 31, 2015 | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Fair Value |
|---|---|---|---|---|
| **Available-for-Sale Securities:** | | | | |
| U.S. Government Agency | | | | |
| Mortgage-Backed Securities | $ 25,011,000 | $ 44,000 | $ (344,000) | $ 24,711,000 |
| SBA Securities | 10,181,000 | 112,000 | (81,000) | 10,212,000 |
| Municipal Securities | 1,742,000 | 28,000 | (1,000) | 1,769,000 |
| Non-Agency CMO's | 803,000 | 3,000 | (47,000) | 759,000 |
| | $ 37,737,000 | $ 187,000 | $ (473,000) | $ 37,451,000 |
| **December 31, 2014** | | | | |
| **Available-for-Sale Securities:** | | | | |
| U.S. Government Agency | | | | |
| Mortgage-Backed Securities | $ 13,994,000 | $ 110,000 | $ (17,000) | $ 14,087,000 |
| SBA Securities | 10,600,000 | 122,000 | (49,000) | 10,673,000 |
| Auction Rate Securities | 3,000,000 | - | - | 3,000,000 |
| Municipal Securities | 5,168,000 | 75,000 | (4,000) | 5,239,000 |
| Non-Agency CMO's | 991,000 | 5,000 | (52,000) | 944,000 |
| | $ 33,753,000 | $ 312,000 | $ (122,000) | $ 33,943,000 |

The amortized cost and estimated fair value of all investment securities as of December 31, 2015 by contractual maturity are shown below. Mortgage-backed and CMO securities are shown separately due the expectation of significant principal prepayments.

| | Amortized Cost | Fair Value |
|---|---|---|
| Due in Less than One Year | $ 202,000 | $ 203,000 |
| Due after One Year through Three Years | 965,000 | 966,000 |
| Due in Three Years through Five Years | 224,000 | 224,000 |
| Due in Five Years through Ten Years | 2,652,000 | 2,660,000 |
| Due after Ten Years | 7,880,000 | 7,928,000 |
| U.S. Government Agency Mortgage-Backed Securities | 25,011,000 | 24,711,000 |
| Non-Agency CMO's | 803,000 | 759,000 |
| | $ 37,737,000 | $ 37,451,000 |

## NOTE 2 - INVESTMENT SECURITIES - Continued

The gross unrealized losses and related estimated fair value of investment securities that have been in a continuous loss position for less than twelve months and over twelve months at December 31, 2015 and 2014 are as follows:

| | Less than Twelve Months | | Twelve Months or More | | Total | |
|---|---|---|---|---|---|---|
| | Unrealized Losses | Estimated Fair Value | Unrealized Losses | Estimated Fair Value | Unrealized Losses | Estimated Fair Value |
| **December 31, 2015** | | | | | | |
| U.S. Government Agency Mortgage-Backed Securities | $ (308,000) | $ 20,921,000 | $ (36,000) | $ 1,541,000 | $ (344,000) | $ 22,462,000 |
| SBA Securities | (81,000) | 7,027,000 | - | - | (81,000) | 7,027,000 |
| Municipal Securities | (1,000) | 425,000 | - | 98,000 | (1,000) | 523,000 |
| Non-Agency CMO's | - | - | (47,000) | 566,000 | (47,000) | 566,000 |
| | $ (390,000) | $ 28,373,000 | $ (83,000) | $ 2,205,000 | $ (473,000) | $ 30,578,000 |
| **December 31, 2014** | | | | | | |
| U.S. Government Agency Mortgage-Backed Securities | $ (17,000) | $ 6,055,000 | $ - | $ - | $ (17,000) | $ 6,055,000 |
| SBA Securities | (48,000) | 8,168,000 | - | - | (48,000) | 8,168,000 |
| Municipal Securities | (1,000) | 411,000 | (3,000) | 427,000 | (4,000) | 838,000 |
| Non-Agency CMO's | - | - | (53,000) | 667,000 | (53,000) | 667,000 |
| | $ (66,000) | $ 14,634,000 | $ (56,000) | $ 1,094,000 | $ (122,000) | $ 15,728,000 |

Non-Agency collateralized mortgage obligations ("CMO's") consist of three separate instruments, all of which carry a below investment grade rating as of December 31, 2015. The Bank utilized a third-party pricing service to assist in the valuation of these Non-Agency CMO's and also in the determination of whether OTTI exists. The third-party estimated the fair value and OTTI associated with each instrument by projecting cash flows using certain assumptions regarding prepayment speed, default rates and loss severity percentage upon default. Significant assumptions used in the cash flow model by the third-party to estimate OTTI on Non-Agency CMO's included constant prepayment rates (ranging from 8% to 14%), default rates (ranging from 1.4% on current loans to 70% on loans past due over 90 days) and projected loss severity rates upon default of 40%.

An OTTI loss was recognized against earnings by the Bank on these three securities in 2012 of $72,000. Since then, the third-party analyses have indicated no additional credit related OTTI losses and therefore no OTTI expense has been recognized in the Statements of Income in 2014 and 2015.

Unrealized losses on all other securities have not been recognized into income because the issuer bonds are of high credit quality, management does not intend to sell, it is not more likely than not that management would be required to sell the securities prior to their anticipated recovery and the decline in fair value is largely due to changes in interest rates. The fair value is expected to recover as the bonds approach maturity.

## NOTE 3 - LOANS

A summary of loans as of December 31 follows:

| | 2015 | 2014 |
|---|---|---|
| Real Estate: | | |
| Construction and Land Development | $ 24,643,000 | $ 16,655,000 |
| Owner-Occupied Commercial Real Estate ("CRE") | 38,936,000 | 30,204,000 |
| Non Owner-Occupied CRE | 103,006,000 | 64,299,000 |
| Residential Real Estate | 4,156,000 | 3,909,000 |
| Commercial & Industrial | 67,109,000 | 58,961,000 |
| Consumer | 1,693,000 | 3,074,000 |
| | 239,543,000 | 177,102,000 |
| Less: | | |
| Deferred Loan Fees, net of Costs | 156,000 | 62,000 |
| Allowance for Loan Losses | (3,286,000) | (3,623,000) |
| | $ 236,413,000 | $ 173,541,000 |

**NOTE 3 - LOANS - Continued**

The following table presents the recorded investment in loans and impairment method as of December 31, 2015 and 2014 by portfolio segment and activity in the allowance for loan losses for the years then ended:

| **December 31, 2015** | Real Estate | Commercial & Industrial | Consumer | Total |
|---|---|---|---|---|
| Allowance for Loan Losses: | | | | |
| Beginning of Year | $ 1,449,000 | $ 2,114,000 | $ 60,000 | $ 3,623,000 |
| Provisions | (312,000) | (171,000) | (42,000) | (525,000) |
| Recoveries | 666,000 | 79,000 | - | 745,000 |
| Charge-offs | - | (557,000) | - | (557,000) |
| End of Year | $ 1,803,000 | $ 1,465,000 | $ 18,000 | $ 3,286,000 |
| Reserves: | | | | |
| Specific | $ - | $ - | $ - | $ - |
| General | 1,803,000 | 1,465,000 | 18,000 | 3,286,000 |
| | $ 1,803,000 | $ 1,465,000 | $ 18,000 | $ 3,286,000 |
| Loans Evaluated for Impairment: | | | | |
| Individually | $ 2,992,000 | $ 1,500,000 | $ - | $ 4,492,000 |
| Collectively | 167,749,000 | 65,609,000 | 1,693,000 | 235,051,000 |
| | $ 170,741,000 | $ 67,109,000 | $ 1,693,000 | $ 239,543,000 |
| | | | | |
| **December 31, 2014** | | | | |
| Allowance for Loan Losses: | | | | |
| Beginning of Year | $ 1,174,000 | $ 2,417,000 | $ 71,000 | $ 3,662,000 |
| Provisions | 275,000 | 103,000 | (11,000) | 367,000 |
| Recoveries | - | 60,000 | - | 60,000 |
| Charge-offs | - | (466,000) | - | (466,000) |
| End of Year | $ 1,449,000 | $ 2,114,000 | $ 60,000 | $ 3,623,000 |
| Reserves: | | | | |
| Specific | $ - | $ 900,000 | $ - | $ 900,000 |
| General | 1,449,000 | 1,214,000 | 60,000 | 2,723,000 |
| | $ 1,449,000 | $ 2,114,000 | $ 60,000 | $ 3,623,000 |
| Loans Evaluated for Impairment: | | | | |
| Individually | $ 4,698,000 | $ 2,673,000 | $ - | $ 7,371,000 |
| Collectively | 110,369,000 | 56,288,000 | 3,074,000 | 169,731,000 |
| | $ 115,067,000 | $ 58,961,000 | $ 3,074,000 | $ 177,102,000 |

## NOTE 3 - LOANS - Continued

The Bank categorizes loans into risk categories based on relevant information about the ability of borrowers to service their debt such as current financial information, historical payment experience, collateral adequacy, credit documentation, and current economic trends, among other factors. The Bank analyzes loans individually by classifying the loans as to credit risk. This analysis typically includes larger, non-homogeneous loans such as commercial real estate and commercial and industrial loans. This analysis is performed on an ongoing basis as new information is obtained. The Bank uses the following definitions for risk ratings:

**Pass -** Loans classified as pass include loans not meeting the risk ratings defined below.

**Special Mention -** Loans classified as special mention have a potential weakness that deserves management's close attention. If left uncorrected, these potential weaknesses may result in deterioration of the repayment prospects for the loan or of the institution's credit position at some future date.

**Substandard -** Loans classified as substandard are inadequately protected by the current net worth and paying capacity of the obligor or of the collateral pledged, if any. Loans so classified have a well-defined weakness or weaknesses that jeopardize the liquidation of the debt. They are characterized by the distinct possibility that the institution will sustain some loss if the deficiencies are not corrected.

**Impaired -** A loan is considered impaired, when, based on current information and events, it is probable that the Bank will be unable to collect all amounts due according to the contractual terms of the loan agreement. Additionally, all loans classified as troubled debt restructurings are considered impaired.

The risk category of loans by class of loans was as follows as of December 31, 2015 and 2014:

| **December 31, 2015** | Pass | Special Mention | Substandard | Impaired | Total |
|---|---|---|---|---|---|
| Real Estate: | | | | | |
| Construction and Land Development | $ 24,643,000 | $ - | $ - | $ - | $ 24,643,000 |
| Owner-Occupied CRE | 38,936,000 | - | - | - | 38,936,000 |
| Non Owner-Occupied CRE | 100,014,000 | - | - | 2,992,000 | 103,006,000 |
| Residential Real Estate | 4,156,000 | - | - | - | 4,156,000 |
| Commercial & Industrial | 64,535,000 | - | 1,074,000 | 1,500,000 | 67,109,000 |
| Consumer | 1,693,000 | - | - | - | 1,693,000 |
| | $ 233,977,000 | $ - | $ 1,074,000 | $ 4,492,000 | $ 239,543,000 |
| **December 31, 2014** | | | | | |
| Real Estate: | | | | | |
| Construction and Land Development | $ 16,030,000 | $ - | $ - | $ 625,000 | $ 16,655,000 |
| Owner-Occupied CRE | 30,462,000 | - | - | - | 30,462,000 |
| Non Owner-Occupied CRE | 59,968,000 | - | - | 4,073,000 | 64,041,000 |
| Residential Real Estate | 3,909,000 | - | - | - | 3,909,000 |
| Commercial & Industrial | 55,320,000 | 488,000 | 480,000 | 2,673,000 | 58,961,000 |
| Consumer | 3,074,000 | - | - | - | 3,074,000 |
| | $ 168,763,000 | $ 488,000 | $ 480,000 | $ 7,371,000 | $ 177,102,000 |

## NOTE 3 - LOANS - Continued

Past due and nonaccrual loans presented by loan class were as follows as of December 31, 2015 and 2014:

| | Still Accruing | | | |
|---|---|---|---|---|
| **December 31, 2015** | 30-59 Days Past Due | 60-89 Days Past Due | Over 90 Days Past Due | Nonaccrual |
| Commercial & Industrial | $ - | $ - | $ - | $ 1,500,000 |
| **December 31, 2014** | | | | |
| Real Estate: | | | | |
| Non Owner-Occupied CRE | $ - | $ - | $ - | $ 1,037,000 |
| Commercial & Industrial | - | - | - | 1,721,000 |
| | $ - | $ - | $ - | $ 2,758,000 |

Information relating to individually impaired loans presented by class of loans was as follows as of December 31, 2015 and 2014:

| | | | Impaired Loans | | | | |
|---|---|---|---|---|---|---|---|
| **December 31, 2015** | Unpaid Principal Balance | Recorded Investment | Without Specific Allowance | With Specific Allowance | Related Allowance | Average Recorded Investment | Interest Income Recognized |
| Real Estate - | | | | | | | |
| Non Owner-Occupied CRE | $ 2,292,000 | $ 2,992,000 | $ 2,992,000 | $ - | $ - | $3,011,000 | $ 199,000 |
| Commercial & Industrial | 2,466,000 | 1,500,000 | 1,500,000 | - | - | 2,396,000 | - |
| | $ 4,758,000 | $ 4,492,000 | $ 4,492,000 | $ - | $ - | $5,407,000 | $ 199,000 |
| **December 31, 2014** | | | | | | | |
| Real Estate: | | | | | | | |
| Construction | $ 625,000 | $ 625,000 | $ 625,000 | $ - | $ - | $ 775,000 | $ 53,670 |
| Non Owner-Occupied CRE | 5,384,000 | 4,073,000 | 4,073,000 | - | - | 4,031,000 | 52,663 |
| Commercial & Industrial | 3,208,000 | 2,673,000 | 966,000 | 1,707,000 | 900,000 | 2,925,000 | - |
| | $ 9,217,000 | $ 7,371,000 | $ 5,664,000 | $ 1,707,000 | $ 900,000 | $7,731,000 | $ 106,333 |

Interest earned on impaired loans was not recognized on the cash basis.

The Bank has allocated approximately $0 and $900,000 of specific reserves to loan customers whose loan terms have been modified in troubled debt restructurings ("TDR's") as of December 31, 2015 and 2014. The Bank has not committed to lend additional amounts to these customers with outstanding loans that are classified as TDR's as of December 31, 2015 and 2014.

During the year ended December 31, 2014, the Bank extended two loans rated substandard at nonmarket rates and as a result were classified as TDR's. There were no new TDR's in 2015 and there were no TDR's for which there was a payment default within twelve months following the modification during the years ended December 31, 2015 and 2014. A loan is considered to be in payment default once it is 90 days contractually past due under the modified terms.

## NOTE 4 - PREMISES AND EQUIPMENT

A summary of premises and equipment as of December 31 follows:

| | 2015 | 2014 |
|---|---|---|
| Furniture, Fixtures, and Equipment | $ 2,174,000 | $ 2,007,000 |
| Leasehold Improvements | 912,000 | 862,000 |
| | 3,086,000 | 2,869,000 |
| Less Accumulated Depreciation and Amortization | (2,194,000) | (2,013,000) |
| | $ 892,000 | $ 856,000 |

The Bank has entered into leases for its main office and branch facility, which expire in 2024 and 2017, respectively. The main office location is leased from an affiliate of the majority shareholder of the Bank.

These leases include provision for periodic rent increases as well as payment by the lessee of certain operating expenses. Total rental expense for all leases was $501,000 and $546,000 for 2015 and 2014, respectively. Rental expense on the related party lease was $381,000 and $94,000 in 2015 and 2014, respectively.

At December 31, 2015, the future lease rental payable under noncancellable operating lease commitments was as follows:

| | Related Party | Other |
|---|---|---|
| 2016 | $ 349,000 | $ 126,000 |
| 2017 | 349,000 | 118,000 |
| 2018 | 349,000 | - |
| 2019 | 349,000 | - |
| 2020 | 349,000 | - |
| Thereafter | 1,653,000 | - |
| | $ 3,398,000 | $ 244,000 |

The minimum rental payments shown above are given for the existing lease obligation and are not a forecast of future rental expense.

## NOTE 5 - DEPOSITS

The aggregate amount of time deposits in denominations of $250,000 or more at December 31, 2015 and 2014 was approximately $7,287,000 and $7,354,000, respectively. Substantially all time deposits mature within one year.

## NOTE 5 - DEPOSITS - Continued

Brokered deposits amounted to approximately $27,252,000 and $20,303,000 at December 31, 2015 and 2014, respectively. The majority of these deposits are with a program called CDARs which allows the Bank to transfer funds of its customers in excess of the FDIC insurance limit (currently $250,000) to other institutions in exchange for an equal amount of funds from customers of these other institutions. This has allowed the Bank to provide FDIC insurance coverage to its customers. Regulatory guidelines require that deposits placed through the CDARs program be considered brokered deposits.

Brokered deposits represented 65.8% and 59.1% of all certificates of deposit held by the Bank at December 31, 2015 and 2014, respectively.

## NOTE 6 - BORROWINGS

The Bank may borrow up to $26 million overnight on an unsecured basis from its correspondent banks as of December 31, 2015. No amounts were outstanding under these arrangements.

The Bank may also borrow up to approximately $98.1 million from the Federal Home Loan Bank of San Francisco as of December 31, 2015. This borrowing capacity is based on $156.6 million of qualifying loans pledged as collateral. As of December 31, 2015, there was $20 million in outstanding advances with a rate of 0.59% maturing on January 6, 2016.

## NOTE 7 - INCOME TAXES

Income tax expense for the years ended December 31, is comprised of the following:

| | 2015 | 2014 |
|---|---|---|
| Current | $ 710,000 | $ (235,000) |
| Deferred | 352,000 | 316,000 |
| | $ 1,062,000 | $ 81,000 |

A comparison of the federal statutory income tax rates to the Bank's effective income tax rates at December 31 follows:

| | 2015 | | 2014 | |
|---|---|---|---|---|
| | Amount | Rate | Amount | Rate |
| Statutory Federal Tax | $ 934,000 | 34.0% | $ 159,000 | 34.0% |
| State Franchise Tax, Net of Federal Benefit | 189,000 | 6.9% | 20,000 | 4.3% |
| Bank Owned Life Insurance | (74,000) | ( 2.7%) | (66,000) | ( 14.1%) |
| Tax-Exempt Income | (30,000) | ( 1.1%) | (43,000) | ( 9.2%) |
| Other Items, Net | 43,000 | 1.6% | 11,000 | 2.3% |
| Tax Expense | $ 1,062,000 | 38.7% | $ 81,000 | 17.3% |

## NOTE 7 - INCOME TAXES - Continued

Deferred taxes are a result of differences between income tax accounting and generally accepted accounting principles with respect to income and expense recognition. The following is a summary of the components of the net deferred tax asset accounts recognized in the accompanying balance sheets at December 31:

| | 2015 | 2014 |
|---|---|---|
| Deferred Tax Assets: | | |
| Depreciation | $ - | $ 15,000 |
| Allowance for Loan Losses Due to Tax Limitations | 585,000 | 862,000 |
| Operating Loss Carryforwards | 253,000 | 438,000 |
| Other Real Estate Owned Write-Downs | 257,000 | 215,000 |
| Unrealized Loss on Securities Available for Sale | 13,000 | - |
| Other | 601,000 | 358,000 |
| | 1,709,000 | 1,888,000 |
| Deferred Tax Liabilities: | | |
| Depreciation | (11,000) | - |
| Deferred Loan Costs | (138,000) | (110,000) |
| Unrealized Gain on Securities Available for Sale | - | (85,000) |
| Other | (37,000) | (31,000) |
| | (186,000) | (226,000) |
| Net Deferred Tax Assets | $ 1,523,000 | $ 1,662,000 |

The Bank has net operating loss carryforwards of approximately $3.5 million for California franchise tax purposes, which if not used will begin to expire in 2031. Management believes that it is more likely than not that they will be able to fully realize the deferred tax asset and consequently has not recorded a valuation allowance at December 31, 2015 and 2014.

The Bank is subject to federal income tax and franchise tax of the state of California. Income tax returns for the periods 2012 through 2014 are open to audit by federal authorities and 2011 through 2014 by California state authorities. Unrecognized tax benefits are not expected to significantly increase or decrease within the next twelve months.

## NOTE 8 - OTHER EXPENSES

Other expenses as of December 31 are comprised of the following:

| | 2015 | 2014 |
|---|---|---|
| Telephone | $ 123,000 | $ 87,000 |
| Marketing and Business Development | 136,000 | 168,000 |
| Other Employee Expenses | 124,000 | 180,000 |
| Printing | 42,000 | 60,000 |
| Correspondent Bank Fees | 65,000 | 47,000 |
| Insurance | 50,000 | 74,000 |
| Loan Expenses | 311,000 | 225,000 |
| Supplies | 47,000 | 69,000 |
| Regulatory Assessments | 314,000 | 359,000 |
| Courier and Postage | 52,000 | 48,000 |
| Provision for Off Balance Sheet Commitments | 225,000 | - |
| Other Expenses | 138,000 | 115,000 |
| | $ 1,627,000 | $ 1,432,000 |

## NOTE 9 - RELATED PARTY TRANSACTIONS

The outstanding balance of loans granted to executive officers, directors and companies with which they are associated was $5,925,000 and $6,102,000 at December 31, 2015 and 2014, respectively. The amount of unused lines of credit to related parties at December 31, 2015 was $75,000.

Related party deposits from executive officers and directors amounted to approximately $14,465,000 and $9,871,000 at December 31, 2015 and 2014, respectively.

The principal shareholder of the Bank, who owns more than 50% of the common stock, also owns over 50% of the common stock of NCAL Bancorp. The two companies have executed a definitive agreement, discussed in Note 16, which provides for a merger between these affiliated entities expected to occur in 2016. In 2015, the two entities shared various employees beginning in 2015 with related payments made and received amounting to $77,000 and $273,000, respectively. Loans were participated between the two entities, with the balance of participation loans purchased (sold) amounting to $15,211,000 and ($14,753,000) at December 31, 2015, respectively.

The Bank maintains a demand deposit account for an irrevocable trust where NCAL Bancorp is the primary beneficiary, with the balance of that account equaling $3,985,000 as of December 31, 2015.

## NOTE 10 - COMMITMENTS

In the ordinary course of business, the Bank enters into financial commitments to meet the financing needs of its customers. These financial commitments include commitments to extend credit and standby letters of credit. Those instruments involve to varying degrees, elements of credit and interest rate risk not recognized in the Bank's financial statements.

The Bank's exposure to loan loss in the event of nonperformance on commitments to extend credit and standby letters of credit is represented by the contractual amount of those instruments. The Bank uses the same credit policies in making commitments as it does for loans reflected in the financial statements.

As of December 31, the Bank had the following outstanding financial commitments whose contractual amount represents credit risk:

| | 2015 | 2014 |
|---|---|---|
| Commitments to Extend Credit | $ 58,029,000 | $ 51,263,000 |
| Financial Standby Letters of Credit | 100,000 | - |
| | $ 58,129,000 | $ 51,263,000 |

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Since many of the commitments are expected to expire without being drawn upon, the total amounts do not necessarily represent future cash requirements. The Bank evaluates each client's credit worthiness on a case-by-case basis. The amount of collateral obtained if deemed necessary by the Bank is based on management's credit evaluation of the customer. The majority of the Bank's commitments to extend credit are secured by real estate.

The Bank may become involved in legal actions arising in the ordinary course of business. In the opinion of management, the Bank is not currently a party to any legal proceedings whose outcome will have a material adverse effect on its financial condition or results of operations.

## NOTE 11 - STOCK OPTION PLAN

In 2003, the Board of Directors approved the adoption of a stock option plan for the benefit of the organizers, directors and employees. Option prices under the plan are generally determined to be the fair market value of such shares at the date of grant. Option granted shall expire no later than 10 years from the date of grant. The plan authorized granting up to a maximum of 1,641,000 shares of the Bank's common stock as either incentive stock options or nonqualified stock options. The plan expires 10 years from the date of adoption. Options granted under the plan generally become exercisable in equal increments over a three or five-year period.

The Bank recognized no stock-based compensation expense in 2015 and 2014.

A summary of the status of the Bank's stock option plan as of December 31, 2015 and changes during the period ended thereon is presented below:

| | Shares | Weighted-Average Exercise Price |
|---|---|---|
| Outstanding at January 1, 2015 | 62,000 | $ 5.00 |
| Exercised | - | - |
| Forfeited or Expired | (62,000) | 5.00 |
| Outstanding at December 31, 2015 | - | $ 5.00 |
| Options Exercisable | - | $ - |

## NOTE 12 - EMPLOYEE 401K PLAN

The Bank has adopted a 401(k) for its employees. Under the plan, eligible employees may defer a portion of their salaries. The plan also provides for matching contributions up to 50% of any deferrals not exceeding 6% of compensation. The Bank contributed and expensed approximately $115,000 and $120,000 in the years ended December 31, 2015 and 2014, respectively.

## NOTE 13 - REGULATORY MATTERS

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

In July, 2013, the federal bank regulatory agencies approved the final rules implementing the Basel Committee on Banking Supervision's capital guidelines for U.S. banks. The new rules became effective on January 1, 2015, with certain of the requirements phased-in over a multi-year schedule. Under the rules, minimum requirements increased for both the quantity and quality of capital held by the Bank. The rules include a new common equity Tier 1 ("CET1") capital to risk-weighted assets ratio with minimums for capital adequacy and prompt corrective action purposes of 4.5% and 6.5%, respectively. The minimum Tier 1 capital to risk-weighted assets ratio was raised from 4.0% to 6.0% under the capital adequacy framework and from 6.0% to 8.0% to be well-capitalized under the prompt corrective action framework.

In addition, the rules introduced the concept of a "conservation buffer" of 2.5% applicable to the three capital adequacy risk-weighted asset ratios (CET1, Tier 1 and Total). The conservation buffer will be phased-in on a pro rata basis over a four year period beginning in 2016. If the capital adequacy minimum ratios plus the phased-in conservation buffer amount exceed actual risk-weighted capital ratios, then dividends, share buybacks and discretionary bonuses to executives could be limited in amount. Based on the level of actual risk-weighted capital ratios at December 31, 2015, the Bank does not expect to be limited by the provisions of the conservation buffer when it becomes effective in 2016.

Quantitative measures established by regulation to ensure capital adequacy require the Bank to maintain minimum amounts and ratios (set forth in the table below) of total, Tier 1 and CET1 capital (as defined in the regulations) to risk-weighted assets (as defined), and of Tier 1 capital (as defined) to average assets (as defined). Management believes, as of December 31, 2015, that the Bank meets all capital adequacy requirements.

## NOTE 13 - REGULATORY MATTERS - Continued

As of December 31, 2015, the most recent notification from the FDIC categorized the Bank as well-capitalized under the regulatory framework for prompt corrective action (there are no conditions or events since that notification that management believes have changed the Bank's category). To be categorized as well-capitalized, the Bank must maintain minimum ratios as set forth in the table below. The following table also sets forth the Bank's actual capital amounts and ratios (dollar amounts in thousands):

| | Actual | | Amount of Capital Required: For Capital Adequacy Purposes | | Amount of Capital Required: To Be Well-Capitalized Under Prompt Corrective Provisions | |
|---|---|---|---|---|---|---|
| | Amount | Ratio | Amount | Ratio | Amount | Ratio |
| **As of December 31, 2015:** | | | | | | |
| Total Capital (to Risk-Weighted Assets) | $39,367 | 14.0% | $22,549 | 8.0% | $28,186 | 10.0% |
| Tier 1 Capital (to Risk-Weighted Assets) | $35,842 | 12.7% | $16,911 | 6.0% | $22,549 | 8.0% |
| CET1 Capital (to Risk-Weighted Assets) | $35,842 | 12.7% | $12,684 | 4.5% | $18,321 | 6.5% |
| Tier 1 Capital (to Average Assets) | $35,842 | 11.1% | $12,891 | 4.0% | $16,114 | 5.0% |
| **As of December 31, 2014:** | | | | | | |
| Total Capital (to Risk-Weighted Assets) | $35,821 | 15.2% | $18,885 | 8.0% | $23,606 | 10.0% |
| Tier 1 Capital (to Risk-Weighted Assets) | $32,862 | 13.9% | $9,442 | 4.0% | $14,163 | 6.0% |
| Tier 1 Capital (to Average Assets) | $32,862 | 11.5% | $11,398 | 4.0% | $14,248 | 5.0% |

The California Financial Code provides that a bank may not make cash distribution to its shareholders in excess of the lesser of the bank's undivided profits or the bank's net income for its last three fiscal years less the amount of any distribution made by the bank to shareholders during the same period.

## NOTE 14 - FAIR VALUE MEASUREMENT

The following is a description of valuation methodologies used for assets and liabilities recorded at fair value:

Securities: The fair values of Level 3 securities (Non-Agency CMO's) are based upon estimates provided by a third party pricing service and which reflect various assumptions using indirect unobservable inputs. The fair values of all other securities are obtained from the Bank's bond accounting service and reflect matrix pricing, which is a mathematical technique used widely in the industry to value debt securities without relying exclusively on quoted prices for specific securities but rather by relying on the securities' relationship to other benchmark quoted securities (Level 2).

## NOTE 14 - FAIR VALUE MEASUREMENT - Continued

Other Real Estate Owned: Nonrecurring adjustments to certain real estate properties classified as other real estate owned are measured at the lower of carrying amount or fair value, less costs to sell. In cases where the carrying amount exceeds the fair value, less costs to sell, an impairment loss is recognized. Fair values are generally based on third party appraisals of the property which are commonly adjusted by management to reflect current conditions and selling costs (Level 3).

Appraisals for other real estate owned are performed by certified general appraisers whose qualifications and licenses have been reviewed and verified by the Bank. Once received, a member of the loan department reviews the assumptions and approaches utilized in the appraisal as well as the overall resulting fair value in comparison to independent data sources such as recent market data or industry wide-statistics. The Bank also compares the actual selling price of collateral that has been sold to the most recent appraised value to determine what additional adjustments, if any, should be made to the appraisal values on any remaining other real estate owned to arrive at fair value. No significant adjustments to appraised values have been made as a result of this comparison process as of December 31, 2015.

The following table provides the hierarchy and fair value for each major category of assets and liabilities measured at fair value at December 31, 2015 and 2014:

| | Fair Value Measurements Using | | | |
|---|---|---|---|---|
| **December 31, 2015** | Level 1 | Level 2 | Level 3 | Total |
| **Assets Measured at Fair Value:** | | | | |
| **Recurring Basis** | | | | |
| Securities Available for Sale | $ - | $ 36,692,000 | $ 759,000 | $ 37,451,000 |
| **Non-recurring Basis** | | | | |
| Other Real Estate Owned, Net of Valuation Allowance of $534,000 | $ - | $ - | $ 856,000 | $ 856,000 |
| **December 31, 2014** | | | | |
| **Assets Measured at Fair Value:** | | | | |
| **Recurring Basis** | | | | |
| Securities Available for Sale | $ - | $ 32,999,000 | $ 944,000 | $ 33,943,000 |
| **Non-recurring Basis** | | | | |
| Other Real Estate Owned, Net of Valuation Allowance of $433,000 | $ - | $ - | $ 957,000 | $ 957,000 |

## NOTE 14 - FAIR VALUE MEASUREMENT - Continued

Quantitative information about the Bank's non-recurring Level 3 fair value measurements as of December 31, 2015 and 2014 is as follows:

| | | Fair Value Amount | Valuation Technique | Adjustment Range | Weighted-Average Adjustment |
|---|---|---|---|---|---|
| **December 31, 2015** | | | | | |
| Other Real Estate Owned | $ | 856,000 | Third Party Appraisals | 8% | 8% |
| **December 31, 2014** | | | | | |
| Other Real Estate Owned | $ | 957,000 | Third Party Appraisals | 8% | 8% |

## NOTE 15 - FAIR VALUE OF FINANCIAL INSTRUMENTS

The Financial Accounting Standards Board ("FASB") accounting guidance specifies the disclosure of the estimated fair value of financial instruments. The Bank's estimated fair value amounts have been determined using available market information and appropriate valuation methodologies. However, considerable judgment is required to develop the estimates of fair value. Accordingly, the estimates are not necessarily indicative of the amounts the Bank could have realized in a current market exchange. The use of different market assumptions and/or estimation methodologies may have a material effect on the estimated fair value amounts.

Fair value estimates are subjective in nature and involve uncertainties and matters of significant judgment and therefore cannot be determined with precision. Changes in assumptions could significantly affect the estimates.

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

Cash and Cash Equivalents and Interest-Bearing Deposits in Other Banks: The carrying values reported in the balance sheets approximate fair values due to the short-term nature of the assets.

Securities: See Fair Value Measurement discussion in Note 14.

Loans: Fair value is estimated by discounting expected future cash flows at a market rate of interest for loans of similar credit risk and maturity. The methods utilized to estimate the fair value of loans do not necessarily represent an exit price.

Deposits: The fair values of certificates of deposits are estimated by discounting the expected cash flows at current rates for instruments with similar maturities. The carrying values of transaction accounts are deemed to be fair value since they are payable on demand.

FHLB Borrowings: Fair value is equal to carrying value due to the short-term nature of the borrowing.

Off-Balance Sheet Financial Instruments: The fair value of commitments to extend credit and standby letters of credit is estimated using the fees currently charged to enter into similar agreements. The fair value of these financial instruments is not considered material.

## NOTE 15 - FAIR VALUE OF FINANCIAL INSTRUMENTS - Continued

The estimated fair value of significant financial instruments at December 31 is summarized as follows (amounts in thousands):

| | 2015 | | 2014 | |
|---|---|---|---|---|
| | Carrying Value | Fair Value | Carrying Value | Fair Value |
| **Financial Assets:** | | | | |
| Cash and Due From Banks | $ 4,925 | $ 4,925 | $ 7,250 | $ 7,250 |
| Interest-bearing Deposits | 24,521 | 24,521 | 14,102 | 14,102 |
| Federal Funds Sold | 10,275 | 10,275 | 78,245 | 78,245 |
| Investment Securities | 37,451 | 37,451 | 33,943 | 33,943 |
| Loans, net | 236,413 | 235,719 | 173,541 | 176,506 |
| **Financial Liabilities:** | | | | |
| Deposits | $ 271,611 | $ 263,607 | $ 257,376 | $ 266,235 |
| FHLB Borrowings | 20,000 | 20,000 | 30,000 | 30,000 |

## NOTE 16 - PROPOSED MERGER

On October 14, 2015 the Bank announced the execution of a definitive agreement providing for an exchange of interests under common control whereby the Bank will:

- Be acquired by NCAL Bancorp through a merger with a newly formed wholly-owned subsidiary of NCAL Bancorp, with Commercial Bank of California as the surviving entity,
- Merge NCAL's wholly-owned subsidiary National Bank of California with and into Commercial Bank of California.

In the merger, each share of Commercial Bank of California common stock will be exchanged for a number of shares of NCAL Bancorp common stock having an aggregate adjusted book value per share equal to the adjusted book value per share of a share of Commercial Bank of California common stock, determined as of the end of the month preceding the month in which closing occurs. The combined bank will continue to serve its Los Angeles County and Orange County customer base and all existing branches of both banks will remain open after the merger. On a pro forma basis, based on September 30, 2015 financial information, the combined bank would have total assets of over $700 million and total deposits of over $600 million.

The transaction is considered an exchange of interests under common control as one shareholder owns over 50% of the common stock of both NCAL Bancorp and Commercial Bank of California. Consequently, the merger is not considered a business combination under ASC 805. Instead the merger will be accounted for similar to a pooling of interests using the carrying values of the two entities.

The merger is subject to customary closing conditions, including the receipt of all regulatory approvals and the approval of the shareholders of both NCAL Bancorp and Commercial Bank of California. It is anticipated that the transaction will close in the first or second quarter of 2016.