



SECURITY CALIFORNIA BANCORP AND SUBSIDIARIES

Riverside, California

FINANCIAL STATEMENTS

December 31, 2014 and 2013

SECURITY CALIFORNIA BANCORP AND SUBSIDIARIES

DECEMBER 31, 2014 AND 2013

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INDEPENDENT AUDITOR'S REPORT

Board of Directors and Shareholders of
Security California Bancorp and Subsidiaries
Riverside, California

Report on the Financial Statements

We have audited the accompanying consolidated financial statements of Security California Bancorp and Subsidiaries, which comprise the consolidated balance sheets as of December 31, 2014 and 2013, and the related consolidated statements of income, comprehensive income (loss), 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 consolidated financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

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

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

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

Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Security California Bancorp and Subsidiaries as of December 31, 2014 and 2013, 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.


Crowe Horwath LLP

Sacramento, California
March 26, 2014

SECURITY CALIFORNIA BANCORP AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS AS OF DECEMBER 31, 2014 AND 2013

	<u>2014</u>	<u>2013</u>
ASSETS		
Cash and due from banks	\$ 13,233,257	\$ 11,192,509
Interest bearing deposits with other financial institutions	37,011,578	20,701,028
Federal funds sold	<u>497,042</u>	<u>497,951</u>
Cash and cash equivalents	50,741,877	32,391,488
Investment securities available-for-sale	137,323,245	143,653,075
Loans, net of deferred fees and cost	421,511,938	364,386,643
Allowance for loan and lease losses	<u>(6,680,402)</u>	<u>(5,742,482)</u>
Net loans	414,831,536	358,644,161
Premises and equipment, net	4,075,369	4,027,771
Restricted stock, at cost	3,580,000	3,042,400
Investment in limited partnerships	750,000	5,786,565
Accrued interest receivable and other assets	<u>6,939,860</u>	<u>9,202,850</u>
Total Assets	<u>\$ 618,241,887</u>	<u>\$ 556,748,310</u>
LIABILITIES AND SHAREHOLDERS' EQUITY		
LIABILITIES		
Deposits		
Noninterest bearing deposits	\$ 232,187,400	\$ 190,867,857
Interest-bearing deposits	<u>293,592,756</u>	<u>254,041,174</u>
Total deposits	525,780,156	444,909,031
Accrued interest payable and other liabilities	2,494,503	1,454,316
FHLB advances	<u>19,000,000</u>	<u>48,050,000</u>
Total liabilities	<u>547,274,659</u>	<u>494,413,347</u>
SHAREHOLDERS' EQUITY		
Preferred stock, no par value; 10,000,000 shares authorized; 7,200 Senior (series C) shares issued and outstanding in 2014 and 2013; aggregate liquidation preference \$72,000	7,133,447	7,133,447
Common stock, no par value, 40,000,000 shares authorized; 5,670,916 shares issued and outstanding in 2014 and 5,669,416 shares issued and outstanding in 2013	53,459,239	53,444,239
Additional paid-in capital	3,291,375	3,128,669
Retained earnings	8,181,628	4,104,037
Accumulated other comprehensive (loss) income	<u>(1,098,461)</u>	<u>(5,475,429)</u>
Total shareholders' equity	<u>70,967,228</u>	<u>62,334,963</u>
Total liabilities and shareholders' equity	<u>\$ 618,241,887</u>	<u>\$ 556,748,310</u>

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

SECURITY CALIFORNIA BANCORP AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF INCOME FOR THE YEARS ENDED DECEMBER 31, 2014 AND 2013

	<u>2014</u>	<u>2013</u>
Interest Income		
Interest and fees on loans	\$ 19,238,357	\$ 16,067,757
Interest on federal funds sold	1,226	1,250
Interest on investment securities	3,222,576	2,999,902
Interest on deposits with other financial institutions	<u>97,664</u>	<u>88,215</u>
Total interest income	22,559,823	19,157,124
Interest Expense		
Interest expense on deposits	1,481,179	1,329,271
Interest expense on other borrowings	<u>46,791</u>	<u>36,969</u>
Total Interest Expense	<u>1,527,970</u>	<u>1,366,240</u>
Net Interest Income	<u>21,031,853</u>	<u>17,790,884</u>
Provisions for loan and lease losses	<u>940,000</u>	<u>1,127,664</u>
Net Interest Income After Provision for Loan and Lease Losses	<u>20,091,853</u>	<u>16,663,220</u>
Other Income		
Gains from sales of Small Business Administration (SBA) loans and related fees	1,502,727	1,513,865
Service charges on deposit accounts	964,778	995,981
Earnings in investment in limited partnerships	67,751	356,477
Net gain on sale of investment securities	86,930	260,779
Other fees and miscellaneous income	<u>599,038</u>	<u>292,378</u>
Total Other Income	<u>3,221,224</u>	<u>3,419,480</u>
Operating Expenses		
Salaries and other employee benefits	10,321,431	9,021,033
Occupancy	1,782,618	1,918,737
Advertising and marketing	209,741	216,124
Professional services	697,281	744,829
Core processing	343,143	269,558
Item processing	376,576	354,769
Stationery, printing and supplies	347,513	312,721
Information and communication	358,233	310,446
Corporate insurance	65,145	56,443
Supervisory assessments	409,054	379,545
Correspondent bank charges	205,570	148,221
Other	<u>1,088,918</u>	<u>1,079,793</u>
Total Operating Expenses	<u>16,205,223</u>	<u>14,812,219</u>
Income Before Provision for Income Taxes	7,107,854	5,270,481
Income Tax Provision	<u>2,958,263</u>	<u>2,105,011</u>
Net Income	\$ 4,149,591	\$ 3,165,470
Dividends Paid on Preferred Stock	<u>72,000</u>	<u>72,000</u>
Net income available to common shareholders	<u>\$ 4,077,591</u>	<u>\$ 3,093,470</u>
Earnings Per Common Share – Basic	<u>\$ 0.72</u>	<u>\$ 0.55</u>
Earnings Per Common Share – Diluted	<u>\$ 0.72</u>	<u>\$ 0.55</u>

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

SECURITY CALIFORNIA BANCORP AND SUBSIDIARIES

**CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)
FOR THE YEARS ENDED DECEMBER 31, 2014 AND 2013**

	<u>2014</u>	<u>2013</u>
Net Income	\$ 4,149,591	\$ 3,165,470
Other Comprehensive (Loss) Income		
Unrealized gain (loss) on securities:		
Unrealized holding gain (loss) arising during the period	7,505,519	(9,831,883)
Less: reclassification adjustment for net (gains) included in net income	<u>(86,930)</u>	<u>(260,779)</u>
Other comprehensive income (loss) before tax	7,418,589	(10,092,662)
Tax effect	<u>(3,041,621)</u>	<u>4,137,991</u>
Net of tax	<u>4,376,968</u>	<u>(5,954,671)</u>
Comprehensive Income (Loss)	<u><u>\$ 8,526,559</u></u>	<u><u>\$ (2,789,201)</u></u>

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

SECURITY CALIFORNIA BANCORP AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY
AS OF DECEMBER 31, 2014

	Preferred Stock		Common Stock		Additional	Retained Earnings	Accumulated	Total
	Shares		Shares		Paid-in	(Accumulated	Other	Shareholders'
	Outstanding	Amount	Outstanding	Amount	Capital	Deficit)	Comprehensive	Equity
							Income (Loss)	
Balance at January 1, 2013	7,200	7,133,447	5,663,276	53,444,239	2,949,061	1,010,567	479,242	65,016,556
Share-based compensation expense	-	-	-	-	2,281	-	-	2,281
Restricted shares grants and compensation expense	-	-	6,140	-	177,327	-	-	177,327
Cash dividends on SBLF preferred shares	-	-	-	-	-	(72,000)	-	(72,000)
Comprehensive income	-	-	-	-	-	-	(5,954,671)	(5,954,671)
Net Income	-	-	-	-	-	3,165,470	-	3,165,470
Balance at December 31, 2013	7,200	\$ 7,133,447	5,669,416	\$ 53,444,239	\$ 3,128,669	\$ 4,104,037	\$ (5,475,429)	\$ 62,334,963
Share-based compensation expense	-	-	-	-	-	-	-	-
Exercise of stock options	-	-	1,500	15,000	(15,000)	-	-	-
Restricted shares compensation expense	-	-	-	-	177,706	-	-	177,706
Cash dividends on SBLF preferred shares	-	-	-	-	-	(72,000)	-	(72,000)
Comprehensive income	-	-	-	-	-	-	4,376,968	4,376,968
Net Income	-	-	-	-	-	4,149,591	-	4,149,591
Balance at December 31, 2014	<u>7,200</u>	<u>\$ 7,133,447</u>	<u>5,670,916</u>	<u>\$ 53,459,239</u>	<u>\$ 3,291,375</u>	<u>\$ 8,181,628</u>	<u>\$ (1,098,461)</u>	<u>\$ 70,967,228</u>

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

SECURITY CALIFORNIA BANCORP AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS FOR THE YEARS ENDED DECEMBER 31, 2014 AND 2013

	<u>2014</u>	<u>2013</u>
Cash Flows From Operating Activities:		
Net income	\$ 4,149,591	\$ 3,165,470
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization, net	499,383	576,650
Amortization accretion of securities, net	590,537	810,405
Equity in earnings from Investment in limited partnership	(67,751)	(356,477)
Provision for loan and lease losses	940,000	1,127,664
Share-based compensation expense	177,706	179,608
Gain on sale of investments	(86,930)	(260,779)
Gain on sale of SBA loans	(1,502,727)	(1,208,736)
Amortization of SBA servicing rights	175,977	93,843
Amortization of deferred loan fees	46,125	130,021
Amortization of core deposit intangible	16,795	17,155
Discount income on SBA loans	(189,926)	(89,878)
Deferred income tax expense (benefit)	(782,000)	(580,000)
Change in:		
Accrued interest receivable and other assets	84,990	(36,267)
Accrued interest payable and other liabilities	<u>1,040,189</u>	<u>611,295</u>
Net cash provided by operating activities	<u>5,091,957</u>	<u>4,179,974</u>
Cash Flows From Investing Activities:		
Activity in available-for-sale securities:		
Purchase of available-for-sale investment securities	(30,716,157)	(90,473,676)
Net sales, maturities, principal repayments of available-for-sale-investment securities	45,547,258	46,063,421
(Purchases) redemption of restricted stock	(537,600)	(642,600)
Loan originations and payment, net	(57,341,529)	(41,458,064)
Contribution to investment in limited partnership	-	(750,000)
Distribution from investment in limited partnership	5,104,316	535,358
Purchase of premises and equipment	<u>(546,981)</u>	<u>(3,437,987)</u>
Net cash used in investing activities	<u>(38,490,693)</u>	<u>(90,163,548)</u>
Cash Flows From Financing Activities:		
Net change in noninterest bearing deposits	41,319,543	4,698,596
Net change in interest bearing deposits	39,551,582	19,760,694
Net change in FHLB advances	(29,050,000)	48,050,000
Preferred stock dividend paid	<u>(72,000)</u>	<u>(72,000)</u>
Net cash provided by financing activities	<u>51,749,125</u>	<u>72,437,290</u>

SECURITY CALIFORNIA BANCORP AND SUBSIDIARIES

**CONSOLIDATED STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED DECEMBER 31, 2014 AND 2013**

	<u>2014</u>	<u>2013</u>
Net increase in cash and cash equivalents	\$ 18,350,389	\$ (13,546,284)
Cash and cash equivalents at beginning of period	<u>32,391,488</u>	<u>45,937,772</u>
Cash and cash equivalents at end of period	<u><u>\$ 50,741,877</u></u>	<u><u>\$ 32,391,488</u></u>
Supplemental cash flow information:		
Interest paid	\$ 1,514,546	\$ 1,375,568
Income taxes paid	3,140,000	2,735,000
Supplemental noncash disclosures:		
Transfer from loans to OREO	746,985	2,816,000

SECURITY CALIFORNIA BANCORP AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2014 AND 2013

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The accounting and reporting policies of Security California Bancorp (the Company) and Subsidiaries are in accordance with accounting principles generally accepted in the United States of America and conform to practices within the banking industry. A summary of the accompanying financial statements follows:

Nature of Operations

The Company is a bank holding company with a single banking subsidiary, Security Bank of California (the Bank), and a single nonbank subsidiary, SCB Asset Management, Inc. (SCBAM). The Company was incorporated on March 20, 2008. The Company acquired all of the stock of the Bank pursuant to a Plan of Reorganization between the holding company and the Bank approved by the shareholders of the Bank on May 8, 2008. On October 1, 2008, the Company obtained regulatory approval to become the parent company of the Bank.

The Bank was formed in 2004, was incorporated on January 13, 2005, and commenced operations on June 20, 2005. The Bank operates as a commercial bank offering loans and depository services to businesses and customers. The Bank has branches in the cities of Riverside, San Bernardino, Redlands, Orange, and Palm Desert, and loan production offices in the cities of Irwindale, in Southern California. Riverside is also the location of the Company's corporate office.

SCBAM was incorporated on May 29, 2012, and is a wholly-owned subsidiary of the Company. The primary purpose of SCBAM is the acquisition of workout assets from the Bank. SCBAM's primary objective is to collect, restructure or otherwise resolve the acquired loans in an orderly manner.

Nature of Banking Activities

The Company provides a range of banking services to individual and corporate customers through the Bank. The Company has been authorized by the Federal Reserve Bank of San Francisco to engage in lending activities separate from the Bank but to date has not done so. As a State chartered bank, the Bank is subject to regulation by the California Department of Business Oversight (DBO) and the Federal Deposit Insurance Corporation (FDIC).

Consolidation and Basis of Presentation

The consolidated financial statements include the accounts of the Company, the Bank and SCBAM. All significant intercompany balances and transactions have been eliminated.

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.

SECURITY CALIFORNIA BANCORP AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2014 AND 2013

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES, Continued

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 fewer than 90 days and Federal funds sold. Net cash flows are reported for customer loan and deposit transactions, interest bearing deposits in other financial institutions, and federal funds sold and purchased.

Interest-Bearing Deposits in Other Financial Institutions:

Interest-bearing deposits in other financial institutions mature within one year and are carried at cost.

Investment Securities Available for Sale

Available for Sale securities primarily consist of U.S. Agencies, mortgage-backed securities, and collateralized mortgage obligations.

The Bank classifies its investments in securities as "held to maturity" securities, "trading" securities and "available for sale" securities, as applicable.

Securities designated as available for sale are recorded at fair value. Changes in the fair value of available for sale securities are reported as an amount in shareholders' equity net of related income taxes until realized. Gains and losses on the sale of available for sale securities are recorded on the trade date and determined using the specific-identification method. Premiums and discounts are recognized in interest income using the interest method over the securities' maturity.

The Bank had no securities classified as held to maturity or trading at December 31, 2014 and 2013.

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 issuers. 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: OTTI related to credit loss, which must be recognized in the income statement and; 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.

SECURITY CALIFORNIA BANCORP AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2014 AND 2013

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES, Continued

Loans Held for Sale

SBA loans originated and intended for sale in the secondary market are carried at the lower of aggregate cost or fair value, as determined by outstanding commitments from investors. Net unrealized losses, if any, are recorded as a valuation allowance and charged to earnings.

SBA loans held for sale are generally sold with servicing rights retained. The carrying value of mortgage loans sold is reduced by the amount allocated to the servicing right. Gains and losses on sales of mortgage loans are based on the difference between the selling price and the carrying value of the related loan sold.

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 any deferred fees or costs on originated loans, or unamortized premiums or discounts on purchased loans, and an allowance for loan and lease losses.

Loan origination fees and certain direct origination costs are capitalized and recognized as an adjustment of the yield of the related loan using the level-yield method without anticipating prepayments.

Loans on which the accrual of interest has been discontinued are designated as nonaccrual loans. For all 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 or when, in the opinion of management, there is reasonable doubt as to collectability. For all loans, that are placed on nonaccrual status, all interest previously accrued but not collected is reversed against current period interest income. Interest received on such loans is accounted for on the cash-basis or cost – recovery method. Loans are returned to accrual status when all the principle and interest amounts contractually due are brought current and future payments are reasonably assured.

Servicing Rights

When 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 market prices for comparable servicing contracts, when available or alternatively, 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 non-interest 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 determined by stratifying rights into groupings based on predominant risk characteristics, such as interest rate, loan type and investor type. The fair values of servicing rights are subject to significant fluctuations as a result of changes in estimated and actual prepayment speeds and default rates and losses, which are not prevalent on the asset being serviced by the Company.

SECURITY CALIFORNIA BANCORP AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2014 AND 2013

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES, Continued

Servicing fee income, which is reported on the income statement as other fees and miscellaneous income is recorded for fees earned for servicing loans. The fees are based on a contractual percentage of the outstanding principal; or a fixed amount per loan and are recorded as income when earned. The amortization of loan servicing rights is netted against loan servicing fee income. Net servicing fees totaled \$126,246 and \$188,796 for the years ended December 31, 2014 and 2013, respectively. Late fees and ancillary fees related to loan servicing are not material.

Troubled Debt Restructurings

In situations where, for economic or legal reasons related to a borrower's financial difficulties, management may grant a concession for other than an insignificant period of time to the borrower that would not otherwise be considered, the related loan is classified as a troubled debt restructuring ("TDR"). The amount of TDR's outstanding at December 31, 2014 and 2013, totaled \$2,570,495 and \$1,162,838, respectively. Management strives to identify borrowers in financial difficulty early and work with them to modify their loans to more affordable terms before their loan reaches nonaccrual status. Concessions may include interest rate reductions or below market interest rates, principal forgiveness, restructuring amortization schedules and other actions intended to minimize potential losses.

Allowance for Loan and Lease Losses

The allowance for loan and lease losses is a valuation allowance for probable incurred credit losses. For all portfolio segments loan losses are charged against the allowance when management believes the uncollectability of a loan balance is confirmed. Subsequent recoveries, if any, are credited to the allowance. For all portfolio segments 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. For all portfolio segments amounts are charged-off when available information confirms that specific loans or portions thereof, are uncollectible.

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, if it is probable that the Bank will be unable to collect all amounts due according to the original 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. Loans that experience insignificant payment delays and payment shortfalls generally are not classified as impaired. Management determines the significance of payment delays and payment shortfalls on a case-by-case basis, taking into consideration all of the circumstances surrounding the loan and the borrower, including the length of the delay, the reasons for the delay, the borrower's prior payment record, and the amount of the shortfall in relation to the principal and interest owed. 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. A loan is collateral dependent if the repayment of the loan is expected to be provided solely by the sale or operation of the underlying collateral. 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.

SECURITY CALIFORNIA BANCORP AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2014 AND 2013

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES, Continued

Allowance for Loan and Lease 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 based on expected future cash flows discounted using the loan's effective rate immediately prior to the restructuring.

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 sale or operations of the collateral. Smaller balance, homogeneous loans are collectively evaluated for impairment.

General reserves cover non-impaired loans and are based on historical loss rates for each portfolio segment using actual historical losses over the most recent eight quarters, 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 historical loss experience. 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.

The Company assigns a risk rating to all loans, and periodically performs detailed reviews of all such loans over a certain threshold to identify credit risks and to assess the overall collectability of the portfolio. The reviews are prepared on an on-going basis throughout the year. These risk ratings are also subject to examination by independent specialists engaged by the Company and the Company's regulators. During these internal reviews, management monitors and analyzes the financial condition of borrowers and guarantors, trends in the industries in which borrowers operate and the fair values of collateral securing these loans. These credit quality indicators are used to assign a risk rating to each individual loan. The risk ratings can be grouped into five major categories, defined as follows:

Pass — A pass loan is a strong credit with no existing or known potential weaknesses deserving of management's close attention.

Special Mention — A special mention loan has potential weaknesses that deserve management's close attention. If left uncorrected, these potential weaknesses may result in deterioration of the repayment prospects for the loan or in the Company's credit position at some future date. Special Mention loans are not adversely classified and do not expose the Company to sufficient risk to warrant adverse classification.

Substandard — A substandard loan is not adequately protected by the current sound worth and paying capacity of the borrower or the value of the collateral pledged, if any. Loans classified as substandard have a well-defined weakness or weaknesses that jeopardize the liquidation of the debt. Well defined weaknesses include a project's lack of marketability, inadequate cash flow or collateral support, failure to complete construction on time or the project's failure to fulfill economic expectations. They are characterized by the distinct possibility that the Company will sustain some loss if the deficiencies are not corrected.

SECURITY CALIFORNIA BANCORP AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2014 AND 2013

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES, Continued

Doubtful — Loans classified doubtful have all the weaknesses inherent in those classified as substandard with the added characteristic that the weaknesses make collection or liquidation in full, on the basis of currently known facts, conditions and values, highly questionable and improbable. The possibility of loss is extremely high, but because of certain important and reasonably specific pending factors, which may work to the advantage and strengthening of the asset, its classification as an estimated loss is deferred until its more exact status may be determined. Pending factors include proposed merger, acquisition, or liquidation procedures, capital injection, perfecting liens on additional collateral, and refinancing plans. Doubtful classification is considered temporary and short term.

Loss — Loans classified as loss are considered uncollectible and charged off immediately.

The general reserve component of the allowance for loan losses also consists of reserve factors that are based on management's assessment of the following for each portfolio segment: (1) inherent credit risk, (2) historical losses and (3) other qualitative factors. Inherent credit risk and qualitative reserve factors are inherently subjective and are driven by the repayment risk associated with each class of loans described below.

Construction and Land Development - Land and construction loans generally possess a higher inherent risk of loss than other real estate portfolio segments. A major risk arises from the necessity to complete projects within specified cost and time lines. Trends in the construction industry significantly impact the credit quality of these loans, as demand drives construction activity. In addition, trends in real estate values significantly impact the credit quality of these loans, as property values determine the economic viability of construction projects.

Commercial Real Estate - Commercial real estate loans generally possess a higher inherent risk of loss than other real estate portfolio segments, except land and construction loans. Adverse economic developments or an overbuilt market impact commercial real estate projects and may result in troubled loans. Trends in vacancy rates of commercial properties impact the credit quality of these loans. High vacancy rates reduce operating revenues and the ability for properties to produce sufficient cash flows to service debt obligations.

Commercial and Industrial - Commercial and industrial loans generally possess a lower inherent risk of loss than real estate portfolio segments as these loans are generally underwritten to existing cash flows of operating businesses. Debt coverage is provided by business cash flows and economic trends influenced by unemployment rates and other key economic indicators are closely correlated to the credit quality of these loans.

Consumer - An installment loan portfolio is usually comprised of a large number of small loans scheduled to be amortized over a specific period. Most installment loans are made directly for consumer purchases, but business loans granted for the purchase of heavy equipment or industrial vehicles may also be included. Consumer loans included credit card and other open ended unsecured consumer receivables.

SECURITY CALIFORNIA BANCORP AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2014 AND 2013

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES, Continued

Although management believes the allowance for loan and lease losses to be adequate, ultimate losses may vary from its estimates. At least quarterly, the Board of Directors reviews the adequacy of the allowance for loan and lease losses, including consideration of the relative risks in the portfolio, current economic conditions and other factors. If the Board of Directors and management determine that changes are warranted based on those reviews, the allowance is adjusted. In addition, the Company's primary regulators, the FDIC and DBO as an integral part of their examination process, review the adequacy of the allowance for loan and lease losses. These regulatory agencies may require additions to the allowance for loan and lease losses based on their judgment about information available at the time of their examinations.

Foreclosed Assets:

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.

Premises and Equipment

Bank premises and equipment are stated at cost less accumulated depreciation and amortization. Depreciation is computed on a straight-line basis over the estimated useful lives of fixtures and equipment utilizing estimated useful lives of three to seven years. Leasehold improvements are amortized on a straight-line basis over the estimated useful lives of the improvements or the remaining lease term, whichever is shorter. When assets are sold or otherwise disposed of, the cost and related accumulated depreciation are removed from the accounts, and any resulting gain or loss is recognized in income for the period. The cost of maintenance and repairs is charged to expense as incurred. The Bank evaluates premises and equipment for financial impairment as events or changes in circumstances indicate that the carrying amount of such assets may not be fully recoverable.

Restricted Stock

As a member of Federal Home Loan Bank (FHLB), the Bank is required to maintain a minimum investment in the stock of the entity. The minimum FHLB investment is calculated as a percentage of aggregate outstanding loans, FHLB advances and other factors. In addition, the Bank has a minimal investment in stock of its main correspondent banks, Pacific Coast Bankers' Bank (PCBB) and The Independent Bankers' Bank (TIB), and receives specialized pricing on certain products in return. As of December 31, 2014 and 2013, the Bank owned stock totaling \$3,580,000 and \$3,042,400, respectively, from these entities. The ownership of the FHLB, TIB, and PCBB stock is restricted, lacks a market, and can only be sold at its par value to the issuer. Both cash and stock dividends are reported as income. Management periodically evaluates restricted stock for impairment based on ultimate recovery of par value.

SECURITY CALIFORNIA BANCORP AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2014 AND 2013

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES, Continued

Investment in Limited Partnerships

The Bank has invested funds in MIMS-1 Limited Partnership (the “Partnership”). The Partnership was organized under the Delaware Revised Uniform Limited Partnership Act on July 30, 2010 for the primary purpose of investing, reinvesting and trading in agency mortgage-backed and asset-backed securities issued by the United States GSEs. The investment objective of the partnership is to seek total return consisting of both current income and capital gains. The general partner is Manhattan Investment Management Services, Inc. (“MIMS”) The Partnership commenced operations on August 20, 2010. The Bank became a limited partner on August 1, 2012. The Partnership is recorded using the equity method of accounting and is recorded on the balance sheet as investment in limited partnerships. On July 31, 2014, the Limited Partnership was terminated.

Security California Bancorp (the “Holding Company”) has invested funds in Grayhawk Venture Fund II, L. P. This limited partnership was organized under the Delaware Revised Uniform Limited Partnership Act on September 12, 2011 for the purpose of investing in and supporting high-technology economic development. Grayhawk is licensed as a Small Business Investment Company (SBIC) by the U.S. Small Business Administration. The general partner is GVP Investments II, LLC, also a Delaware limited liability company. The Holding Company became a limited partner on February 26, 2013. The partnership is recorded using the cost method of accounting, and is recorded on the balance sheet as investment in limited partnerships.

Goodwill and Other Intangible Assets

Goodwill resulting from a branch acquisition which occurred in 2012 is generally determined as the excess of the fair value of the consideration transferred, plus the fair value of any non-controlling interests acquired, over the fair value of the net assets acquired and liabilities assumed as of the acquisition date. Goodwill and intangible assets acquired in a purchase business combination and determined to have an indefinite useful life are not amortized, but tested for impairment at least annually or more frequently if events and circumstances exists that indicate that a goodwill impairment test should be performed. The Company performs an annual impairment test on December 31 and there was no impairment identified during 2014 or 2013. Intangible assets with definite useful lives are amortized over their estimated useful lives to their estimated residual values. Goodwill is the only intangible asset with an indefinite life on our balance sheet. Core deposits intangibles totaled \$102,206 and \$199,001 at December 31, 2014 and 2013, respectively, and goodwill totaled \$175,761 at December 31, 2014 and 2013, respectively, and it is included in accrued interest receivable and other assets on the balance sheet.

Other intangible assets consist of core deposit and acquired customer relationship intangible assets arising from whole bank and branch acquisitions are amortized on an accelerated method over their estimated useful lives, which range from 7 to 10 years. Amortization expense totaled \$16,795 and \$17,155 for the year ended December 31, 2014 and 2013, respectively.

Retirement Plans

Employee 401(k) and profit sharing plan expense is the amount of matching contributions.

SECURITY CALIFORNIA BANCORP AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2014 AND 2013

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES, Continued

Income Taxes

Deferred income tax assets are computed using the balance sheet 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 consolidated 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 carry forwards depends on having sufficient taxable income of an appropriate character within the carry forward periods.

The Company has adopted guidelines 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 the audit by the taxing authorities. Management believes that all tax positions taken to date are highly certain and, accordingly, no accounting adjustment has been made to the financial statements.

Advertising Costs

The Bank expenses the cost of advertising in the period incurred.

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 12. Such financial instruments are recorded in the financial statements when they are funded or related fees are incurred or received.

Comprehensive Income

Comprehensive income consists of net income and other comprehensive income. Other comprehensive income includes unrealized gains and losses on securities available for sale which are also recognized as separate components of equity.

Earnings Per Common Share (EPS)

The basic earnings per common share ratio excludes dilution and is computed by dividing income available to common shareholders by the weighted-average number of common shares outstanding for the period. As of December 31, 2014, diluted earnings per common share reflects the potential dilution that could occur if securities or other contracts to issue common stock were exercised or converted into common stock or resulted in the issuance of common stock that then shared in the earnings of the entity. Earnings and dividends per common share are restated for all stock splits and stock dividends through the date of issuance of the financial statements.

SECURITY CALIFORNIA BANCORP AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2014 AND 2013

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES, Continued

Share-Based Compensation

The Company recognizes the cost of employee services received in exchange for awards of stock options, or other equity instruments, based on the grant-date fair value of those awards. A Black-Scholes model is utilized to estimate the fair value of stock options. This cost is recognized over the period which an employee is required to provide services in exchange for the award, generally the vesting period.

Fair Value of Financial Instruments:

Fair values of financial instruments are estimated using relevant market information and other assumptions, as more fully disclosed in a separate note. Fair value estimates involve uncertainties and matters of significant judgment regarding interest rates, credit risk, prepayments, and other factors, especially in the absence of broad markets for particular items. Changes in assumptions or in market conditions could significantly affect these estimates.

Loss Contingencies

Loss contingencies, including claims and legal actions arising in the ordinary course of business, are recorded as liabilities when the likelihood of loss is probable and an amount or range of loss can be reasonably estimated. Management does not believe there now are such matters that will have a material effect on the consolidated financial statements.

Subsequent Events

The Company has evaluated subsequent events for recognition and disclosure through March 26, 2015, which is the date the financial statements were available to be issued.

Reclassifications

Certain prior year amounts have been reclassified to conform to the current year presentation.

NOTE 2 - INVESTMENT SECURITIES

The available-for-sale investment securities amortized cost, estimated fair value, and related gross unrealized gains and losses recognized in accumulated other comprehensive income (loss) are as follows:

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
December 31, 2014				
Securities Available-for-Sale				
U.S. agency securities	\$ 19,987,926	\$ 1,091	\$ (621,331)	\$ 19,367,686
Collateralized mortgage obligations (<i>Residential</i>)	22,416,963	73,086	(328,568)	22,161,481
Corporate securities	-	-	-	-
Mortgage backed securities (<i>Residential</i>)	73,795,557	51,631	(532,879)	73,314,309
Mortgage backed securities (<i>Commercial</i>)	10,386,870	21,758	(179,451)	10,229,177
Small Business Administration securities	12,597,727	-	(347,135)	12,250,592

SECURITY CALIFORNIA BANCORP AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2014 AND 2013

	<u>\$ 139,185,043</u>	<u>\$ 147,566</u>	<u>\$ (2,009,364)</u>	<u>\$ 137,323,245</u>
	<u>Amortized Cost</u>	<u>Gross Unrealized Gains</u>	<u>Gross Unrealized Losses</u>	<u>Estimated Fair Value</u>
December 31, 2013				
Securities Available-for-Sale:				
U.S. agency securities	\$ 27,760,612	\$ -	\$ (2,852,510)	\$ 24,908,102
Collateralized mortgage obligations (<i>Residential</i>)	22,364,565	26,809	(1,304,336)	21,087,038
Corporate securities	1,015,937	8,030	-	1,023,967
Mortgage backed securities (<i>Residential</i>)	69,689,737	1,456	(3,123,655)	66,567,538
Mortgage backed securities (<i>Commercial</i>)	11,570,602	-	(813,418)	10,757,184
Small Business Administration securities	<u>20,532,009</u>	<u>-</u>	<u>(1,222,763)</u>	<u>19,309,246</u>
	<u>\$ 152,933,462</u>	<u>\$ 36,295</u>	<u>\$ (9,316,682)</u>	<u>\$ 143,653,075</u>

The net unrealized loss on securities available-for-sale included in accumulated other comprehensive net of tax during 2014 and 2013 was \$1,098,461 and \$5,475,429, respectively.

SECURITY CALIFORNIA BANCORP AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2014 AND 2013

NOTE 2 - INVESTMENT SECURITIES, Continued

December 31, 2014	Less Than 12 Months		12 Months or Longer		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Securities Available-for-Sale						
U.S. agency securities	\$ -	\$ -	\$ 17,866,594	\$ (621,331)	\$ 17,866,594	\$ (621,331)
Collateralized mortgage obligations (<i>Residential</i>)	4,589,668	(43,022)	12,041,186	(285,546)	16,630,854	(328,568)
Mortgage backed securities (<i>Residential</i>)	13,594,172	(41,147)	40,100,945	(491,732)	53,695,117	(532,879)
Mortgage backed securities (<i>Commercial</i>)	-	-	10,207,419	(179,452)	10,207,419	(179,451)
Small Business Administration securities	-	-	12,250,592	(347,135)	12,250,592	(347,135)
	<u>\$ 18,183,840</u>	<u>\$ (84,169)</u>	<u>\$ 92,466,736</u>	<u>\$ (1,925,195)</u>	<u>\$ 110,650,576</u>	<u>\$ (2,009,364)</u>

December 31, 2013	Less Than 12 Months		12 Months or Longer		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Securities Available-for-Sale						
U.S. agency securities	\$ 21,440,943	\$ (2,319,669)	\$ 3,467,159	\$ (532,841)	\$ 24,908,102	\$ (2,852,510)
Collateralized mortgage obligations (<i>Residential</i>)	16,731,638	(1,190,933)	2,026,637	(113,403)	18,758,275	(1,304,336)
Mortgage backed securities (<i>Residential</i>)	58,133,210	(2,612,095)	7,622,079	(511,560)	65,755,289	(3,123,655)
Mortgage backed securities (<i>Commercial</i>)	10,757,184	(813,418)	-	-	10,757,184	(813,418)
Small Business Administration securities	15,677,900	(937,113)	3,631,346	(285,650)	19,309,246	(1,222,763)
	<u>\$ 122,740,875</u>	<u>\$ (7,873,228)</u>	<u>\$ 16,747,221</u>	<u>\$ (1,443,454)</u>	<u>\$ 139,488,096</u>	<u>\$ (9,316,682)</u>

The Bank had one hundred and twenty-six securities in a loss position as of December 31, 2014. The Bank had one hundred and seventy-one securities in a loss position as of December 31, 2013.

U.S. Agency Securities: The decline in fair value is attributable to changes in interest rates that occurred after these securities were purchased. Because the Bank has the ability and intent to hold these investments until a market price recovery or maturity, these investments are not considered other-than-temporarily impaired.

Mortgage-Backed Securities (residential and commercial): At December 31, 2014, all the mortgage-backed securities held by the Company were issued by U.S. government-sponsored entities and agencies, primarily Fannie Mae (FNMA), Freddie Mac (FHLMC) and Ginnie Mae (GNMA), institutions which the government has affirmed its commitment to support. Because the decline in fair value is attributable to changes in interest rates and illiquidity, and not credit quality, and because the Company does not have the intent to sell these mortgage-backed securities and it is likely that it will not be required to sell the securities before their anticipated recovery, the Company does not consider these securities to be other-than-temporarily impaired at December 31, 2014.

Collateralized Mortgage Obligations (all residential): These securities were issued by either FNMA, FHLMC, or GNMA and therefore the receipt of principal and interest as scheduled has not been an issue and is not projected to be an issue due to the implied guarantee from the government. Because the Bank has the ability and intent to hold these investments until a market price recovery or maturity, these investments are not considered other-than-temporarily impaired.

SECURITY CALIFORNIA BANCORP AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2014 AND 2013

NOTE 2 - INVESTMENT SECURITIES, Continued

Small Business Administration (SBA) Securities: These securities were issued by the SBA and therefore the receipt of principal and interest as scheduled has not been an issue and is not projected to be an issue due to the implied guarantee from the government.

The amortized cost and estimated fair value of debt securities by contractual maturity at December 31, 2014, are shown below. Expected maturities, primarily in the mortgage-backed investment securities will differ from contractual maturities because certain borrowers have the right to call or prepay obligations with or without call or prepayment penalties. The original contractual maturity of the Bank's mortgage-backed security is between 10 to 30 years, which would differ from the remaining average life or duration that tend to be shorter because of the effect of pre-payments.

	<u>Amortized Cost</u>	<u>Fair Value</u>
Due within one year	\$ 6,576,757	\$ 6,490,133
Due after one year through five years	28,056,192	27,362,827
Due after five years through ten years	18,737,558	18,290,701
Due after ten years	1,632,109	1,636,098
Mortgage backed securities	<u>84,182,427</u>	<u>83,543,486</u>
	<u>\$ 139,185,043</u>	<u>\$ 137,323,245</u>

Investment securities with estimated fair values totaling approximately \$16,970,809 and \$15,426,321 were pledged to secure public deposits and other contracted obligations at December 31, 2014 and 2013.

At year-end 2014 and 2013, there were no holdings of securities of any one issuer, other than the U.S. Government and its agencies, in an amount greater than 10% of shareholders' equity.

SECURITY CALIFORNIA BANCORP AND SUBSIDIARIES**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2014 AND 2013****NOTE 3 - LOANS AND ALLOWANCES FOR LOAN AND LEASES LOSSES**

Major classifications of loans are summarized as follows:

	<u>Years Ended December 31</u>	
	<u>2014</u>	<u>2013</u>
Construction and land development	\$ 20,525,538	\$ 8,830,204
Commercial real estate	229,175,598	186,947,576
Commercial and Industrial	147,175,164	139,452,150
Consumer	<u>24,635,638</u>	<u>29,156,713</u>
	421,511,938	364,386,643
Allowance for loan losses	<u>(6,680,402)</u>	<u>(5,742,482)</u>
Loans, net of deferred loan origination fees and costs	<u>\$ 414,831,536</u>	<u>\$ 358,644,161</u>

At December 31, 2014 and 2013, loans originated under Small Business Administration (SBA) programs totaling \$12,202,242 and \$12,760,963, respectively, were included in commercial real estate and commercial and industrial categories.

At December 31, 2014 and 2013, loans held for sale, which were SBA loans related, are \$1,332,768 and \$153,000, respectively.

Salaries and employee benefits totaling \$662,000 and \$551,000 have been deferred as loan origination costs for the years ended December 31, 2014 and 2013, respectively.

SECURITY CALIFORNIA BANCORP AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2014 AND 2013

NOTE 3 - LOANS AND ALLOWANCES FOR LOAN AND LEASE LOSSES, Continued

The following tables present the activities in the allowance for loan and lease losses for the years ended December 31, 2014 and 2013:

<u>December 31, 2014</u>	<u>Construction and Land Development</u>	<u>Commercial Real Estate</u>	<u>Commercial and Industrial</u>	<u>Consumer</u>	<u>Total</u>
Allowance for Loan Losses:					
Beginning of Year	\$ 67,666	\$ 1,502,572	\$ 2,692,574	\$ 1,479,670	\$ 5,742,482
Provisions	32,603	497,103	354,932	55,362	940,000
Charge-offs	-	-	(390,280)	(211)	(390,491)
Recoveries	-	114,000	274,411	-	388,411
End of year	<u>\$ 100,269</u>	<u>\$ 2,113,675</u>	<u>\$ 2,931,637</u>	<u>\$ 1,534,821</u>	<u>\$ 6,680,402</u>
Reserves:					
Specific	\$ -	\$ 47,425	\$ 1,201,318	\$ -	\$ 1,248,743
General	<u>100,269</u>	<u>2,066,250</u>	<u>1,730,319</u>	<u>1,534,821</u>	<u>5,431,659</u>
	<u>\$ 100,269</u>	<u>\$ 2,113,675</u>	<u>\$ 2,931,637</u>	<u>\$ 1,534,821</u>	<u>\$ 6,680,402</u>
Loans Evaluated for Impairment:					
Individually	\$ -	\$ 563,805	\$ 6,452,788	\$ 1,262,039	\$ 8,278,632
Collectively	<u>20,525,538</u>	<u>228,611,793</u>	<u>140,722,376</u>	<u>23,373,599</u>	<u>413,233,306</u>
	<u>\$ 20,525,538</u>	<u>\$ 229,175,598</u>	<u>\$ 147,175,164</u>	<u>\$ 24,635,638</u>	<u>\$ 421,511,938</u>
<u>December 31, 2013</u>					
Allowance for Loan Losses:					
Beginning of Year	\$ 59,600	\$ 1,246,075	\$ 3,371,687	\$ 1,081,237	\$ 5,758,599
Provisions	8,066	256,497	312,859	550,242	1,127,664
Charge-offs	-	-	(1,214,313)	(151,809)	(1,366,122)
Recoveries	-	-	222,341	-	222,341
End of year	<u>\$ 67,666</u>	<u>\$ 1,502,572</u>	<u>\$ 2,692,574</u>	<u>\$ 1,479,670</u>	<u>\$ 5,742,482</u>
Reserves:					
Specific	\$ -	\$ 136,725	\$ 754,631	\$ 38,259	\$ 929,615
General	<u>67,666</u>	<u>1,365,847</u>	<u>1,937,943</u>	<u>1,441,411</u>	<u>4,812,867</u>
	<u>\$ 67,666</u>	<u>\$ 1,502,572</u>	<u>\$ 2,692,574</u>	<u>\$ 1,479,670</u>	<u>\$ 5,742,482</u>
Loans Evaluated for Impairment:					
Individually	\$ -	\$ 609,455	\$ 4,815,781	\$ 2,192,340	\$ 7,617,576
Collectively	<u>8,830,204</u>	<u>186,338,121</u>	<u>134,636,369</u>	<u>26,964,373</u>	<u>356,769,067</u>
	<u>\$ 8,830,204</u>	<u>\$ 186,947,576</u>	<u>\$ 139,452,150</u>	<u>\$ 29,156,713</u>	<u>\$ 364,386,643</u>

SECURITY CALIFORNIA BANCORP AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2014 AND 2013

NOTE 3 - LOANS AND ALLOWANCES FOR LOAN AND LEASE LOSSES, Continued

The following tables show an aging analysis of the loan portfolio by class and the time past due at December 31, 2014 and December 31, 2013:

	30 – 59 Days <u>Past Due</u>	60 – 89 Days <u>Past Due</u>	Greater Than 89 Days <u>Past Due</u>	Loans Not <u>Past Due</u>	<u>Total</u>	<u>Nonaccrual</u>
December 31, 2014						
Construction and Land Development	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
Commercial Real Estate	-	-	-	-	-	466,645
Commercial and Industrial	-	188,193	-	-	188,193	3,811,683
Consumer	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>890,524</u>
	<u>\$ -</u>	<u>\$ 188,193</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 188,193</u>	<u>\$ 5,168,852</u>

	30 – 59 Days <u>Past Due</u>	60 – 89 Days <u>Past Due</u>	Greater Than 89 Days <u>Past Due</u>	Loans Not <u>Past Due</u>	<u>Total</u>	<u>Nonaccrual</u>
December 31, 2013						
Construction and Land Development	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
Commercial Real Estate	-	-	-	-	-	200,351
Commercial and Industrial	-	-	-	-	-	3,795,970
Consumer	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>1,697,220</u>
	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 5,693,541</u>

SECURITY CALIFORNIA BANCORP AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2014 AND 2013

NOTE 3 - LOANS AND ALLOWANCES FOR LOAN AND LEASE LOSSES, Continued

The following present by class, information related to the average recorded investment and interest income recognized on impaired loans for the twelve months ended December 31, 2014 and 2013. The recorded investment does not include deferred fees and accrued interest, both are deemed immaterial. The unpaid principal balance represents the outstanding commitment.

<u>December 31, 2014</u>	Unpaid Principal Balance	Recorded Investment	Related Allowance	Average Recorded Investment	Interest Income Recognized
With No Related Allowance Recorded					
Construction and Land Development	\$ -	\$ -	\$ -	\$ -	\$ -
Commercial Real Estate	214,153	214,153	-	276,761	52,322
Commercial and Industrial	5,790,472	5,600,445	-	652,679	200,873
Consumer	<u>1,262,524</u>	<u>1,262,039</u>	<u>-</u>	<u>1,522,949</u>	<u>10,199</u>
	<u>\$ 7,267,149</u>	<u>\$ 7,076,637</u>	<u>\$ -</u>	<u>\$ 2,452,389</u>	<u>\$ 263,394</u>
	Unpaid Principal Balance	Recorded Investment	Related Allowance	Average Recorded Investment	Interest Income Recognized
With an Allowance Recorded					
Construction and Land Development	\$ -	\$ -	\$ -	\$ -	\$ -
Commercial Real Estate	349,652	349,652	47,425	258,049	19,403
Commercial and Industrial	900,652	852,343	1,201,318	1,018,679	409
Consumer	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>
	<u>\$ 1,250,304</u>	<u>\$ 1,201,995</u>	<u>\$ 1,248,743</u>	<u>\$ 1,276,728</u>	<u>\$ 19,812</u>
	Unpaid Principal Balance	Recorded Investment	Related Allowance	Average Recorded Investment	Interest Income Recognized
<u>December 31, 2013</u>					
With No Related Allowance Recorded					
Construction and Land Development	\$ -	\$ -	\$ -	\$ -	\$ -
Commercial Real Estate	106,032	106,032	-	111,584	5,439
Commercial and Industrial	3,399,606	3,394,473	-	940,470	1,280
Consumer	<u>1,820,825</u>	<u>1,820,825</u>	<u>-</u>	<u>1,064,065</u>	<u>49,510</u>
	<u>\$ 5,326,463</u>	<u>\$ 5,321,330</u>	<u>\$ -</u>	<u>\$ 2,116,119</u>	<u>\$ 56,229</u>
	Unpaid Principal Balance	Recorded Investment	Related Allowance	Average Recorded Investment	Interest Income Recognized
With an Allowance Recorded					
Construction and Land Development	\$ -	\$ -	\$ -	\$ -	\$ -
Commercial Real Estate	503,465	503,422	136,725	116,236	10,534
Commercial and Industrial	1,421,480	1,421,309	754,631	717,633	16,794
Consumer	<u>372,000</u>	<u>371,515</u>	<u>38,259</u>	<u>30,960</u>	<u>1,025</u>
	<u>\$ 2,296,245</u>	<u>\$ 2,296,246</u>	<u>\$ 929,615</u>	<u>\$ 864,829</u>	<u>\$ 28,353</u>

SECURITY CALIFORNIA BANCORP AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2014 AND 2013

NOTE 3 - LOANS AND ALLOWANCES FOR LOAN AND LEASE LOSSES, Continued

If interest on non-accruing loans had been recognized at interest rates stipulated in the respective loan agreements, interest income would have increased by \$430,978 and \$167,123 for the years ended December 31, 2014 and 2013, respectively.

The Company 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, credit documentation, public information, and current economic trends, among other factors. The Company analyzes loans individually by classifying the loans as to credit risk. This analysis includes all loans classified as watch list, special mention, substandard and doubtful. This analysis is performed on a quarterly basis. The Company uses the definitions for risk ratings listed in Note 1.

The risk category by class of loans was as follows as of December 31:

<u>December 31, 2014</u>	<u>Pass</u>	<u>Special Mention</u>	<u>Substandard</u>	<u>Doubtful</u>	<u>Total</u>
Construction and Land Development	\$ 20,525,538	\$ -	\$ -	\$ -	\$ 20,525,538
Commercial Real Estate	227,239,941	256,911	1,678,746	-	229,175,598
Commercial and Industrial	133,964,339	4,850,432	8,360,393	-	147,175,164
Consumer	<u>22,631,990</u>	<u>741,609</u>	<u>1,262,039</u>	<u>-</u>	<u>24,635,638</u>
	<u>\$ 404,361,808</u>	<u>\$ 5,848,952</u>	<u>\$ 11,301,178</u>	<u>\$ -</u>	<u>\$ 421,511,938</u>
<u>December 31, 2013</u>	<u>Pass</u>	<u>Special Mention</u>	<u>Substandard</u>	<u>Doubtful</u>	<u>Total</u>
Construction and Land Development	\$ 8,830,204	\$ -	\$ -	\$ -	\$ 8,830,204
Commercial Real Estate	184,532,261	650,512	1,764,803	-	186,947,576
Commercial and Industrial	122,029,828	9,324,349	8,097,973	-	139,452,150
Consumer	<u>26,201,376</u>	<u>762,997</u>	<u>2,192,340</u>	<u>-</u>	<u>29,156,713</u>
	<u>\$ 341,593,669</u>	<u>\$ 10,737,858</u>	<u>\$ 12,055,116</u>	<u>\$ -</u>	<u>\$ 364,386,643</u>

There were nine loans classified as troubled debt restructurings (TDR's) at December 31, 2014, amounting to \$2,570,495, of which \$895,640 was on nonaccrual status. There were six loans classified as troubled debt restructurings (TDR's) at December 31, 2013, amounting to \$1,162,838, of which \$590,433 was on nonaccrual status. The Bank has allocated \$816,751 and \$403,116 of specific reserves to customers whose loan terms have been modified in troubled debt restructurings as of December 31, 2014 and 2013. The Bank has loaned \$100,000 to a customer with other outstanding loans that are classified as troubled debt restructuring as of December 31, 2014. The Bank has committed to lend no additional amounts to customers with outstanding loans that are classified as troubled debt restructurings as of December 31, 2014 and 2013.

SECURITY CALIFORNIA BANCORP AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2014 AND 2013

NOTE 3 - LOANS AND ALLOWANCES FOR LOAN AND LEASE LOSSES, Continued

For the years ended December 31, 2014 and 2013, the terms of certain loans were modified as troubled debt restructurings. The modification of the terms of such loans included one or a combination of the following: a reduction of the stated interest rate of the loan or an extension of the maturity date at a stated rate of interest lower than the current market rate for new debt with similar risk. During the same period, there was no troubled debt restructurings in which the amount of principal or accrued interest owed from the borrower were forgiven.

The following table presents loans by class modified as trouble debt restructurings that occurred during the years ended December 31, 2014 and 2013:

	<u>Number of Contracts</u>	<u>Pre- Modification Investment</u>	<u>Post- Modification Investment</u>
<u>December 31, 2014</u>			
TDR's			
Commercial and Industrial	<u>5</u>	<u>1,967,651</u>	<u>1,967,651</u>
	<u>5</u>	<u>\$ 1,967,651</u>	<u>\$ 1,967,651</u>

The TDR's described above increased the allowance for loan loss by \$533,618 and had no charge-offs during the year ended December 31, 2014.

	<u>Number of Contracts</u>	<u>Pre- Modification Investment</u>	<u>Post- Modification Investment</u>
<u>December 31, 2013</u>			
TDR's			
Commercial and Industrial	<u>3</u>	<u>605,651</u>	<u>605,651</u>
	<u>3</u>	<u>\$ 605,651</u>	<u>\$ 605,651</u>

The TDR's described above increased the allowance for loan loss by \$208,453 and had no charge-offs during the year ended December 31, 2013.

TDR's are considered to have defaulted when payments are over 90 days past due. During the years ended 2014 and 2013, there were no TDR's that defaulted within 12 months of the restructuring.

SECURITY CALIFORNIA BANCORP AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2014 AND 2013

NOTE 4 - ACCRUED INTEREST RECEIVABLE AND OTHER ASSETS

Accrued interest receivable and other assets consist of the following at December 31, 2014 and 2013:

	<u>2014</u>	<u>2013</u>
Deferred tax asset	\$ 4,118,000	\$ 6,378,000
Accrued interest receivable	1,715,933	1,775,096
Servicing asset	856,364	734,457
Other assets	<u>249,563</u>	<u>315,297</u>
Total	<u>\$ 6,939,860</u>	<u>\$ 9,202,850</u>

NOTE 5 - PREMISES AND EQUIPMENT

Premises and equipment at December 31, 2014 and 2013, are as follows:

	<u>2014</u>	<u>2013</u>
Building	\$ 2,151,667	\$ 2,112,000
Land	704,000	704,000
Leasehold improvements	2,207,785	2,240,867
Furniture, fixes and equipment	1,371,303	1,305,760
Computer hardware and software	<u>1,008,396</u>	<u>979,252</u>
	7,443,151	7,341,879
Accumulated depreciation and amortization	<u>(3,800,681)</u>	<u>(3,332,714)</u>
	3,642,470	4,009,165
Construction in progress	<u>432,899</u>	<u>18,606</u>
	<u>\$ 4,075,369</u>	<u>\$ 4,027,771</u>

Depreciation and amortization expense on premises and equipment was \$499,383 and \$576,650 for the years ended December 31, 2014 and 2013, respectively.

During 2013, the Company acquired a commercial building through foreclosure and recorded it at fair value less selling costs totaling \$2,816,000. Upon foreclosure, the building was transferred to fixed assets and is used as an office building.

SECURITY CALIFORNIA BANCORP AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2014 AND 2013

NOTE 6 - DEPOSITS

Interest-bearing deposits at December 31, 2014 and 2013, consist of the following:

	<u>2014</u>	<u>2013</u>
NOW accounts	\$ 29,736,802	\$ 22,679,770
Savings and money market	171,321,525	148,369,862
Time certificate of deposit accounts \$250,000 and below	49,248,531	41,319,736
Time certificate of deposit accounts greater than \$250,000	<u>43,285,898</u>	<u>41,671,806</u>
	<u>\$ 293,592,756</u>	<u>\$ 254,041,174</u>

The maturity of time certificates of deposit at December 31, 2014 and 2013 is as follows:

	<u>2014</u>	<u>2013</u>
Due in 2015	\$ 87,362,266	\$ 79,655,810
Due in 2016 and 2017	4,999,910	3,334,645
Due in 2018 and 2019	<u>172,253</u>	<u>1,087</u>
	<u>\$ 92,534,429</u>	<u>\$ 82,991,542</u>

Interest expense recognized on interest-bearing deposits consisted of the following:

	<u>2014</u>	<u>2013</u>
Savings	\$ 27,556	\$ 25,550
Money market	857,763	732,535
NOW accounts	-	-
Time certificates of deposit	<u>595,860</u>	<u>571,186</u>
	<u>\$ 1,481,179</u>	<u>\$ 1,329,271</u>

As of December 31, 2014 and 2013, all noninterest-bearing deposits are demand deposits.

SECURITY CALIFORNIA BANCORP AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2014 AND 2013

NOTE 7 - INCOME TAXES

Income taxes for the years ended December 31, 2014 and 2013 consist of the following:

	<u>2014</u>	<u>2013</u>
Current Taxes:		
Federal	\$ 2,770,000	\$ 2,004,000
State	<u>970,000</u>	<u>681,000</u>
	<u>3,740,000</u>	<u>2,685,000</u>
Deferred Taxes:		
Federal	\$ (593,000)	\$ (455,000)
State	<u>(189,000)</u>	<u>(125,000)</u>
	<u>(782,000)</u>	<u>(580,000)</u>
 Total Provision (Benefit)	 <u>\$ 2,958,000</u>	 <u>\$ 2,105,000</u>

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 assets recognized in the accompanying consolidated balance sheets at December 31:

	<u>2014</u>	<u>2013</u>
Deferred Tax Assets:		
Organization costs and other expenses	\$ 100,000	\$ 119,000
Allowance for loan losses due to tax limitations	2,084,000	1,508,000
Stock-based compensation	389,000	385,000
Depreciation differences	95,000	71,000
Nonaccrual loan interest	180,000	138,000
Available for sale investment securities	763,000	3,805,000
Other	<u>893,000</u>	<u>656,000</u>
	4,504,000	6,682,000
Deferred Tax Liabilities:		
Loan costs	(263,000)	(242,000)
Amortization difference	(33,000)	(31,000)
FHLB dividends	(5,000)	(5,000)
Other	<u>(85,000)</u>	<u>(26,000)</u>
	<u>(386,000)</u>	<u>(304,000)</u>
 Net Deferred Tax Assets	 <u>\$ 4,118,000</u>	 <u>\$ 6,378,000</u>

SECURITY CALIFORNIA BANCORP AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2014 AND 2013

NOTE 7 - INCOME TAXES, Continued

A comparison of the Federal statutory income tax rates to the Company's effective income tax rate is as follows:

	<u>2014</u>	<u>2013</u>
Federal tax rate	34.0%	34.0%
State taxes, net of Federal tax benefits	7.3%	7.3%
Other	<u>0.3%</u>	<u>(1.4)%</u>
Provision (Benefit) for income tax	<u><u>41.6%</u></u>	<u><u>39.9%</u></u>

In assessing the reliability of deferred tax assets, management considers whether it is more likely than not that some portion or all of the deferred tax assets will be realized. The ultimate realization of deferred tax assets is dependent upon the generation of future taxable income during the periods in which those temporary differences become deductible. Management considers the scheduled reversal of deferred tax liabilities, projected future taxable income, and tax planning strategies in making this assessment. Based upon the level of historical taxable income and projections for future taxable income over the periods which the deferred tax assets are deductible, management believes it is more likely than not the Bank will realize the benefits of these deductible differences at December 31, 2014 and 2013.

The Company is subject to Federal income tax and income tax of the state of California. The Federal income tax returns for the years ended December 31, 2011 through 2013, are open to audit by the Federal authorities and the California State tax returns for the years ended December 2010 through 2013, are also open to audit by the State authorities.

At December 31, 2014 and 2013, the Company does not have any unrecognized tax benefits recorded. The Company recognizes interest and penalties related to uncertain tax positions as part of other operating expense. The Company recognized no interest expense as of December 31, 2014 and 2013. The Company does not expect the total amount of unrecognized tax benefits to significantly increase or decrease within the next twelve months.

NOTE 8 - EARNINGS PER COMMON SHARE (EPS)

The following is a reconciliation of net income and shares outstanding to the income and number of shares used to compute EPS:

Outstanding options and warrants of 705,716 and 707,466 were not factored into the calculation of dilutive stock options at December 31, 2014 and 2013, respectively, because they were anti-dilutive.

SECURITY CALIFORNIA BANCORP AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2014 AND 2013

NOTE 8 - EARNINGS PER COMMON SHARE (EPS), Continued

A reconciliation of the numerators and denominators of the basic and diluted earnings per common share computations is as follows:

	2014		2013	
	Income	Shares	Income	Shares
Net income as reported	\$ 4,149,591	-	\$ 3,165,470	-
Less: preferred stock dividends	(72,000)	-	(72,000)	-
Shares outstanding at year end	-	5,670,916	-	5,669,416
Impact of weighting shares purchased during the year	-	(555)	-	(858)
Used in Basic EPS	4,077,591	5,670,361	3,093,470	5,668,558
Dilutive effect of outstanding stock options	-	19,779	-	-
Used in Diluted EPS	<u>\$ 4,077,591</u>	<u>5,690,140</u>	<u>\$ 3,093,470</u>	<u>5,668,558</u>

NOTE 9 - SHARE-BASED COMPENSATION

Stock Options

Under the 2005 Equity Incentive Plan (the Plan), directors, officers and key employees may be granted both nonqualified and incentive stock options and directors and other consultants, who are not also an officer or employee, may only be granted nonqualified stock options. At December 31, 2014, 705,716 options were outstanding and 34,790 options were available for granting. At December 31, 2013, 707,466 options were outstanding and 65,304 options were available for granting. The exercise price of these options may not be less than the fair market value of the common stock on the date granted. Options expire no later than ten years from the date of grant and generally vest over three to five years. As of December 31, 2014 there was no share-based compensation cost for stock options.

The fair value of each option grant is estimated on the date of grant using the Black-Scholes option-pricing model. There were no options granted during 2014 and 2013.

Future expense recognized related to stock option awards may be impacted by new awards and/or modifications, repurchases and cancellations of existing awards after the adoption of this standard.

SECURITY CALIFORNIA BANCORP AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2014 AND 2013

NOTE 9 - SHARE-BASED COMPENSATION, Continued

A summary of the activity in the Company stock option plan for the years ended December 31 are as follows:

	2014		2013	
	Shares	Weighted Average Exercise Price	Shares	Weighted Average Exercise Price
Balance, beginning of year	707,466	\$ 12.21	730,316	\$ 12.17
Options granted	-	-	-	-
Options exercise	(1,500)	-	-	-
Options cancelled	(250)	-	(22,850)	-
Outstanding, end of year	<u>705,716</u>	12.22	<u>707,466</u>	12.21
Options exercisable at year-end	<u>705,716</u>	\$ 12.22	<u>707,466</u>	\$ 12.21

During 2014, 1,500 options were exercised with an aggregate intrinsic value of \$2,430, which represents the difference between the exercise price and the value of our common stock at the time of exercise. During 2013, there were no options exercised.

The weighted-average remaining contractual life of options outstanding at December 31, 2014 and 2013 are 1.14 years and 2.14 years, respectively. The weighted average remaining contractual life of options currently exercisable at both December 31, 2014 and 2013 is 1.14 years and 2.14 years, respectively.

As of December 31, 2014, there was no unrecognized compensation cost related to the outstanding stock options.

In 2013, the Company did not forfeit the grants of 24,468 fully vested share options held by two directors upon termination of service who were given emeritus status.

Restricted Stock Awards

The Company may also grant restricted stock, as part of the 2005 Plan, to directors, officers, and key employees. At December 31, 2014, 34,791 non-vested restricted shares were outstanding. Restricted shares issued vest on their anniversary dates for a period of five years. The Bank recognized restricted stock award compensation costs of \$162,705 and \$177,327 in 2014 and 2013, respectively.

SECURITY CALIFORNIA BANCORP AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2014 AND 2013

NOTE 9 - SHARE-BASED COMPENSATION, Continued

A summary of the activity with respect to restricted share-based compensation for the period ended December 31, 2014:

	<u>Shares</u>	<u>Weighted Average Grant Date Fair Value</u>
Non-vested restricted shares at December 31, 2013	54,537	8.92
Granted	-	-
(Vested)	(19,026)	8.96
Forfeited/expired	<u>(720)</u>	<u>7.50</u>
Non-vested restricted shares at December 31, 2014	<u>34,791</u>	<u>8.89</u>

As of December 31, 2014, there was \$196,573 of total unrecognized compensation cost related to nonvested shares granted under the Plan. The cost is expected to be recognized over a weighted-average period of 1.71 years. The total fair value of shares vested during the years ended, December 31, 2014 and 2013, was \$170,396 and \$167,932, respectively.

NOTE 10 - COMMITMENTS AND CONTINGENCIES

Cash and Due from Banks

Banking regulations require that all 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 requirements as of December 31, 2014 and 2013.

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

Premises Lease Rental Agreements

The Bank leases office facilities and equipment under operating leases which expire through 2019. Rental expense was \$752,233 in 2014 and \$886,110 in 2013. Future minimum rental payments under the operating leases as of December 31, 2014, are as follows:

<u>Year Ending</u>	<u>Amount</u>
2015	\$ 754,392
2016	764,791
2017	775,248
2018	786,793
2019	808,122
Total	<u>\$ 3,889,346</u>

SECURITY CALIFORNIA BANCORP AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2014 AND 2013

NOTE 11 - OTHER BORROWINGS

Federal Funds Arrangements with Commercial Banks

To manage liquidity, the Bank has unsecured Federal Funds purchased lines of credit outstanding with four correspondent banks. The terms and conditions of the credit facilities allow the Bank to borrow funds, for short periods of time, and are subject to the availability of funds from the correspondent banks. The combined maximum limit for the unsecured Federal Funds purchased lines of credit at December 31, 2014 and 2013 was \$41,000,000.

Federal Home Loan Bank Lines of Credit

The Bank is also a member of the Federal Home Loan Bank (FHLB). FHLB has underwritten the Bank to allow for a maximum borrowing limit of 25 percent of assets with terms to 84 months, subject to certain terms and conditions and require sufficient collateral be pledged. Collateral pledged can be in the form of qualified loans or qualified investment securities. At December 31, 2014, the Bank's borrowing limit from the FHLB was \$149,782,000, of which \$19,000,000 was outstanding at December 31, 2014. All outstanding advances represent overnight borrowings at December 31, 2014. At December 31, 2013, the Bank's borrowing limit from the FHLB was \$111,064,175 of which there was no balance outstanding at December 31, 2013. The average balance outstanding for short-term advances, defined as overnight borrowings plus term advances having a maturity of less than one year, was \$33,386,435 in 2014. The average rate paid was 0.13% percent. The highest balance of short-term advances at any month-end during 2014 was \$63,900,000.

Federal Reserve Bank

As of December 31, 2014, the Bank had unused borrowing capacity equivalent to the amount of investment pledged, which is \$3,096,749, as collateral to the Federal Reserve Bank.

NOTE 12 - FINANCIAL INSTRUMENTS WITH OFF-BALANCE SHEET RISK

The Bank is a party to financial instruments with off-balance sheet risk in the normal course of business to meet the financing needs of its customers. These financial instruments include commitments to extend credit in the form of loans, lines of credit and standby letters of credit. Those instruments involve, to varying degrees, elements of credit and interest rate risk in excess of the amount recognized in the accompanying balance sheet.

The Bank's exposure to credit losses in the event of nonperformance by the other parties for commitments to extend credit and standby letters of credit is represented by the contractual amount of these instruments. The Bank uses the same credit policies in making commitments and conditional obligations as it does for on-balance-sheet instruments.

SECURITY CALIFORNIA BANCORP AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2014 AND 2013

NOTE 12 - FINANCIAL INSTRUMENTS WITH OFF-BALANCE SHEET RISK, Continued

The following is a summary of contractual or notional amounts of off-balance sheet financial instruments that represent credit risk at December 31, 2014 and 2013:

Financial instruments whose contracts amounts represent credit risks:

Commitments to extend:	<u>2014</u>	<u>2013</u>
Loans	\$ 134,532,785	\$ 95,996,924
Lines of credit	15,950,563	11,343,562
Letters of credit	<u>6,308,695</u>	<u>760,000</u>
	<u>\$ 156,792,043</u>	<u>\$ 108,100,486</u>

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any conditions established in the contract. Commitments generally have fixed expiration dates of not more than 12 months and may require payment of a fee. Since many of the commitments are not expected to be drawn upon, the total commitment amounts may not represent future cash requirements. The Bank evaluates each customer's creditworthiness on a case-by-case basis. The amount of collateral obtained, if deemed necessary by the Bank upon extension of credit, is based on management's credit evaluation. Collateral held varies but may include marketable investment securities, accounts receivable, inventory, property, plant, and equipment, and real properties.

NOTE 13 - RELATED-PARTY TRANSACTIONS

As of December 31, 2014 and 2013, the Company's balance sheet included deposits from executive officers and directors totaling \$24,285,296 and \$26,421,064, respectively, and loans to officers and directors which are as follows:

	<u>2014</u>	<u>2013</u>
Outstanding balance, beginning of year	\$ 6,997,976	\$ 8,305,879
Credit granted, including renewals	86,912	840,730
Repayments	<u>(2,939,930)</u>	<u>(2,148,633)</u>
Outstanding balance, end of year	<u>\$ 4,144,958</u>	<u>\$ 6,997,976</u>
Undisbursed commitments, end of year	<u>\$ 3,605,042</u>	<u>\$ 5,852,024</u>

SECURITY CALIFORNIA BANCORP AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2014 AND 2013

NOTE 14 - RETIREMENT PLAN

401(k) Plan

A 401(k) benefit plan allows employee contributions up to 100% of their compensation, up to the limitations determined by the Internal Revenue Code. These contributions are matched equal to 100% of the first 3% of compensation and an additional 50% for contributions in excess of 3%, not to exceed 5% of total compensation contributed. Expense for 2014 and 2013 were \$270,551 and \$210,899, respectively.

NOTE 15 - 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 the Bank's assets, liabilities, and certain off-balance-sheet items, as calculated under regulatory accounting practices. The Bank's capital amounts and classification 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 Bank to maintain minimum amounts and ratios of total and Tier 1 capital (primarily common stock and retained earnings less goodwill) to risk-weighted assets, and of Tier 1 capital to average assets. Management believes that the Bank meets all capital adequacy requirements to which it is subject as of December 31, 2014.

Prompt corrective action regulations provide five classifications: well capitalized, adequately capitalized, undercapitalized, significantly undercapitalized, and critically undercapitalized, although these terms are not used to represent overall financial condition. If adequately capitalized, regulatory approval is required to accept brokered deposits. If undercapitalized, capital distributions are limited, as is asset growth and expansion, and capital restoration plans are required. At year-end 2014 and 2013, the most recent regulatory notifications 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 institution's category.

SECURITY CALIFORNIA BANCORP AND SUBSIDIARIES

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2014 AND 2013**

NOTE 15 - REGULATORY MATTERS, Continued

	<u>Actual</u>		<u>For Capital Adequacy Purposes</u>		<u>To Be Well- Capitalized Under Prompt Corrective Provisions</u>	
	<u>Amount</u>	<u>Ratio</u>	<u>Amount</u>	<u>Ratio</u>	<u>Amount</u>	<u>Ratio</u>
As of December 31, 2014:						
Total capital (to risk-weighted assets)						
Consolidated	\$ 77,780,058	16.02%	38,841,477	8.0%	\$ N/A	N/A
Bank	65,661,401	13.58%	38,681,238	8.0%	48,351,547	10.0%
Tier 1 capital (to risk-weighted assets)						
Consolidated	71,702,085	14.77%	19,418,303	4.0%	N/A	N/A
Bank	59,604,705	12.32%	19,352,177	4.0%	29,028,266	6.0%
Tier 1 capital (to average assets)						
Consolidated	71,702,085	11.84%	24,223,677	4.0%	N/A	N/A
Bank	59,604,705	9.96%	23,937,633	4.0%	29,922,041	5.0%
	<u>Actual</u>		<u>For Capital Adequacy Purposes</u>		<u>To Be Well- Capitalized Under Prompt Corrective Provisions</u>	
	<u>Amount</u>	<u>Ratio</u>	<u>Amount</u>	<u>Ratio</u>	<u>Amount</u>	<u>Ratio</u>
As of December 31, 2013:						
Total capital (to risk-weighted assets)						
Bank	60,555,768	14.40%	33,642,093	8.0%	42,052,617	10.0%
Tier 1 capital (to risk-weighted assets)						
Bank	55,288,985	13.14%	16,830,741	4.0%	25,246,122	6.0%
Tier 1 capital (to average assets)						
Bank	55,288,985	10.28%	21,513,224	4.0%	26,891,530	5.0%

SECURITY CALIFORNIA BANCORP AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2014 AND 2013

NOTE 16 - FAIR VALUE MEASUREMENT

Fair value is the exchange price that would be received for an asset or paid to transfer a liability (an 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. Current accounting guidance establishes a fair value hierarchy, which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. That guidance describes three levels of inputs that may be used to measure fair value:

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 an entity's own assumptions about the factors that market participants would use in pricing an asset or liability.

The Bank used the following methods and significant assumptions to estimate fair value:

Securities: The fair value of securities available for sale are determined by obtaining quoted prices on nationally recognized exchanges or matrix pricing which is a mathematical technique used widely in the industry to value debt securities without relying exclusively on quoted prices for the specific securities but rather relying on the security's relationship to other benchmark quoted securities. At December 31, 2014 and 2013, the fair value of AFS investment securities was determined based on Level 2 inputs.

Impaired Loans: The fair value of impaired loans with specific allocations of the allowance for loan and lease losses is generally based on recent real estate appraisals. These appraisals may utilize a single valuation approach or a combination of approaches including comparable sales and the income approach. Adjustments are routinely made in the appraisal process by the independent appraisers to adjust for differences between the comparable sales and income data available. Such adjustments are usually significant and typically result in a Level 3 classification of the inputs for determining fair value. Non-real estate collateral may be valued using an appraisal, net book value per the borrower's financial statements, or aging reports, adjusted or discounted based on management's historical knowledge, changes in market conditions from the time of the valuation, and management's expertise and knowledge of the client and client's business, resulting in a Level 3 fair value classification. Impaired loans are evaluated on a quarterly basis for additional impairment and adjusted accordingly.

The following table presents information about the Company's assets and liabilities measured at fair value on a recurring basis as of December 31, 2014 and 2013, and indicate the fair value hierarchy of the valuation techniques utilized by the Company to determine such fair value.

SECURITY CALIFORNIA BANCORP AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2014 AND 2013

NOTE 16 - FAIR VALUE MEASUREMENT, Continued

Assets measured at fair value on a recurring basis are summarized below:

December 31, 2014	Total	Fair Value Measurements Using:		
		Level 1	Level 2	Level 3
Securities Available-for-Sale:				
U.S. agency securities	\$ 19,367,685	\$ -	\$ 19,367,685	\$ -
Collateralized mortgage obligations (<i>residential</i>)	22,161,482	-	22,161,482	-
Corporate securities	-	-	-	-
Mortgage backed securities (<i>residential</i>)	73,314,309	-	73,314,309	-
Mortgage backed securities (<i>commercial</i>)	10,229,177	-	10,229,177	-
Small Business Administration securities	12,250,592	-	12,250,592	-
	<u>\$ 137,323,245</u>	<u>\$ -</u>	<u>\$ 137,323,245</u>	<u>\$ -</u>
December 31, 2013	Total	Fair Value Measurements Using:		
		Level 1	Level 2	Level 3
Securities Available-for-Sale:				
U.S. agency securities	\$ 24,908,102	\$ -	\$ 24,908,102	\$ -
Collateralized mortgage obligations (<i>residential</i>)	21,087,038	-	21,087,038	-
Corporate securities	1,023,967	-	1,023,967	-
Mortgage backed securities (<i>residential</i>)	66,567,538	-	66,567,538	-
Mortgage backed securities (<i>commercial</i>)	10,757,184	-	10,757,184	-
Small Business Administration securities	19,309,246	-	19,309,246	-
	<u>\$ 143,653,075</u>	<u>\$ -</u>	<u>\$ 143,653,075</u>	<u>\$ -</u>

There were no transfers between Level 1, Level 2 or Level 3 during 2014 or 2013.

SECURITY CALIFORNIA BANCORP AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2014 AND 2013

NOTE 16 - FAIR VALUE MEASUREMENT, Continued

There are no assets measured at fair value on a non-recurring basis at December 31, 2014. Assets measured at fair value on a non-recurring basis at December 31, 2013 are summarized below:

		Fair Value Measurements Using:		
		Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
	Total at December 31, 2013			
Impaired loans:				
Consumer, (secured home equity line of credit)	\$ 1,697,220	\$ -	\$ -	\$ 1,697,220
	<u>\$ 1,697,220</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 1,697,220</u>

Appraisals for collateral-dependent impaired loans are performed by certified general appraisers (for commercial properties) or certified residential appraisers (for residential properties) whose qualifications and licenses have been reviewed and verified by the Company. Once received, a member of the Appraisal Department reviews the assumptions and approaches utilized in the appraisal as well as the overall resulting fair value in comparison with independent data sources such as recent market data or industry-wide statistics. On a quarterly basis, impaired loans are reviewed for correctness of the impairment valuation methodology. If collateral dependent in nature, appraisal valuations are reviewed. Should analysis reveal that there are material changes (i.e., economic conditions, decrease in rents, increased vacancy, etc.); the Company makes a determination if an updated appraisal is warranted.

The following table presents qualitative information about Level 3 fair value measurements for financial instruments measured at fair value on a non-recurring basis at December 31, 2013:

Description	Fair Value	Significant Valuation Technique	Unobservable Input	Weighted Average
Impaired Loans:				
Consumer, (secured home equity line of credit)	\$ 1,697,220	Sales Approach Method	Appraiser adjustments on sales comp data	(18)%- 27% (8%)

In accordance with the provision of ASC 360-10, collateral dependent impaired loans with a carrying value of \$2,044,627 were written down to their fair value of \$1,697,220 resulting in an impairment charge of \$347,406. The valuation allowance represents specific allocation for the allowance for credit losses for impaired loans. Impaired loans were determined to be collateral dependent and categorized as Level 3 due to ongoing real estate market conditions resulting in inactive market data, which in turn required the use of unobservable inputs and assumptions in fair value measurements. There were no changes in valuation techniques used during the year ended December 31, 2013.

There were no liabilities measured at fair value on a non-recurring basis at December 31, 2014 or December 31, 2013.

SECURITY CALIFORNIA BANCORP AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2014 AND 2013

NOTE 16 - FAIR VALUE MEASUREMENT, Continued

The carrying amounts and estimated fair values of financial instruments, at December 31, 2014 and December 31, 2013 are as follows:

	<u>Carrying Amount</u>	<u>Fair Value Measurements at December 31, 2014 Using:</u>			
		<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Total</u>
Financial assets					
Cash and due from banks	\$ 13,233,257	\$ 13,233,257	\$ -	\$ -	\$ 13,233,257
Deposits with other financial institutions	37,011,578	37,011,578	-	-	37,011,578
Federal funds sold	497,042	497,042	-	-	497,042
Securities available-for-sale	137,323,245	-	137,323,245	-	137,323,245
Restricted stock	3,580,000	-	-	-	N/A
Loans, net	414,831,536	-	-	406,298,000	406,298,000
Accrued interest receivable	1,715,933	3,372	439,056	1,273,505	1,715,933
Financial liabilities					
Deposits	525,780,156	420,363,000	92,478,000	-	512,841,000
Accrued interest payable	34,608	552	34,056	-	34,608
FHLB advances	19,000,000	19,000,000	-	-	19,000,000

	<u>Carrying Amount</u>	<u>Fair Value Measurements at December 31, 2013 Using:</u>			
		<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Total</u>
Financial assets					
Cash and due from banks	\$ 11,192,509	\$ 11,192,509	\$ -	\$ -	\$ 11,192,509
Federal funds sold	497,951	497,951	-	-	497,951
Deposits with other financial institutions	20,701,028	20,701,028	-	-	20,701,028
Securities available-for-sale	143,653,075	-	143,653,075	-	143,653,075
Restricted stock	3,042,400	-	-	-	N/A
Loans, net	358,644,161	-	-	352,006,000	352,006,000
Accrued interest receivable	1,775,096	13,413	616,668	1,145,015	1,775,096
Financial liabilities					
Deposits	444,909,031	350,936,000	82,940,000	-	433,876,000
Accrued interest payable	21,183	537	20,646	-	21,183
FHLB Advances	48,050,000	48,050,000	-	-	48,050,000

SECURITY CALIFORNIA BANCORP AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2014 AND 2013

NOTE 16 - FAIR VALUE MEASUREMENT, Continued

The methods and assumptions, not previously presented, used to estimate fair values are described as follows:

(a) Cash, due from banks, Federal Funds Sold, and deposits with other financial institutions

The carrying amounts of cash and short-term instruments approximate fair values and are classified as either Level 1 or Level 2.

(b) Restricted Stocks

It is not practical to determine the fair value of restricted stocks due to restrictions placed on its transferability.

(c) Loans

Fair values of loans are estimated as follows: For variable rate loans that reprice frequently and with no significant change in credit risk, fair values are based on carrying values resulting in a Level 3 classification. Fair values for other loans are estimated using discounted cash flow analyses, using interest rates currently being offered for loans with similar terms to borrowers of similar credit quality resulting in a Level 3 classification. Impaired loans are valued at the lower of cost or fair value as described previously. The methods utilized to estimate the fair value of loans do not necessarily represent an exit price.

(d) Deposits

The fair values disclosed for demand deposits (e.g., interest and non-interest checking, passbook savings, and certain types of money market accounts) are, by definition, equal to the amount payable on demand at the reporting date (i.e., their carrying amount) resulting in either a Level 1 or Level 2 classification. The carrying amounts of variable rate, fixed-term money market accounts and certificates of deposit approximate their fair values at the reporting date resulting in either a Level 1 or Level 2 classification. Fair values for fixed rate certificates of deposit are estimated using a discounted cash flows calculation that applies interest rates currently being offered on certificates to a schedule of aggregated expected monthly maturities on time deposits resulting in a Level 2 classification.

(e) Accrued Interest Receivable/Payable

The carrying amounts of accrued interest approximate the fair value of the related asset or liability.

(f) Other Borrowings

The fair values of the Company's overnight borrowings are estimated using discounted cash flow analyses based on the current borrowing rates for similar types of borrowing arrangements resulting in a Level 1 classification. FHLB advances represent overnight borrowing thus their fair value is their carrying value.

(g) Off-balance Sheet Instruments

Fair values for off-balance sheet, credit-related financial instruments are based on fees currently charged to enter into similar agreements, taking into account the remaining terms of the agreements and the counterparties' credit standing. The fair value of commitments is not material.

SECURITY CALIFORNIA BANCORP AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2014 AND 2013

NOTE 17 - ISSUANCE/REPURCHASE OF PREFERRED STOCK

On January 9, 2009, the Company, in connection with the Troubled Assets Relief Program (TARP) Capital Purchase Program, entered into a Securities Purchase Agreement with the United States Department of Treasury (the Treasury), pursuant to which the Company issued and sold 6,815 shares of its Fixed Rate Cumulative Perpetual Preferred Stock, Series A (Series A) and a warrant to purchase 341 shares of Fixed Rate Cumulative Perpetual Preferred Stock, Series B (Series B) for an aggregate purchase price of \$6,815,000 in cash. The Treasury immediately exercised the warrant, purchasing 341 shares of Series B at \$0.01 per share. The Series A and Series B shares are redeemable at the price of \$1,000 per share, plus any accrued but unpaid dividends. The discount of \$341,000 was accreted against retained earnings over the estimated five year life of the Series B reducing the reported income available for common shareholders.

On September 15, 2011 the TARP was repurchased and was exchanged with the Small Business Lending Fund Program ("SBLF") of the US Department of the Treasury.

The TARP repurchase totaled \$7,156,000, and consisted of \$6,815,000 of Senior Preferred Shares Series A and \$341,000 Preferred Shares Series B for the Warrants plus unpaid accrued interest of \$30,953 or for total amount of \$7,186,953.

The SBLF capital infusion was \$7,200,000 and the Company issued 7,200 shares of Preferred Non-Cumulative Series C shares with a \$1,000 liquidation preference. In September 2011, the SBLF capital infusion that was recorded at \$7,133,447 net of issuance costs, and was down streamed as capital investment from the Company to Security Bank of California, its sole and wholly owned subsidiaries.

The Series C non-cumulative dividend rate is determined on the level of growth of the small business lending portfolio of the Company as defined in the SBLF program, the range of which is 1.00 percent to 7.00 percent.