**SUNCREST BANK**

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

**DECEMBER 31, 2015 AND 2014**

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

# INDEPENDENT AUDITOR'S REPORT

Board of Directors and Shareholders of
Suncrest Bank

*Report on Financial Statements*

We have audited the accompanying financial statements of Suncrest Bank, which are comprised of the statements of financial condition as of December 31, 2015 and 2014, and the related statements of income, comprehensive income, changes in shareholders' equity and cash flows for the years then ended, and the related notes to the financial statements.

*Management's Responsibility for the Financial Statements*

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

*Auditor's Responsibility*

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

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

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

*Opinion*

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Suncrest Bank as of December 31, 2015 and 2014, and the results of its operations and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Vavrinek, Trine, Day & Co., LLP
Laguna Hills, California
February 24, 2016

**SUNCREST BANK**

**STATEMENTS OF FINANCIAL CONDITION**
**DECEMBER 31, 2015 AND 2014**

**ASSETS**

| | 2015 | 2014 |
|---|---|---|
| Cash and Due from Banks | 5,370,556 | 4,648,094 |
| Federal Funds Sold | 8,691,000 | 15,821,000 |
| Interest-Bearing Deposits in Other Banks | 10,000,000 | - |
| **TOTAL CASH AND CASH EQUIVALENTS** | 24,061,556 | 20,469,094 |
| Investment Securities Available for Sale | 54,342,949 | 40,516,442 |
| Loans: | | |
| Real Estate - Other | 163,553,994 | 93,374,513 |
| Construction and Land Development | 4,945,745 | 3,858,822 |
| Commercial and Industrial | 39,530,750 | 26,469,066 |
| Consumer | 807,079 | 1,534,781 |
| **TOTAL LOANS** | 208,837,568 | 125,237,182 |
| Deferred Loan Fees, Net of Costs | ( 458,940) | ( 359,393) |
| Allowance for Loan Losses | ( 2,245,566) | ( 1,723,391) |
| **NET LOANS** | 206,133,062 | 123,154,398 |
| Federal Home Loan Bank and Other Bank Stock, at Cost | 1,465,968 | 637,510 |
| Premises and Equipment | 2,770,478 | 583,396 |
| Other Real Estate Owned | 649,092 | - |
| Bank Owned Life Insurance | 2,080,857 | - |
| Net Deferred Tax Assets | 3,507,000 | 2,217,000 |
| Core Deposit Intangible | 428,000 | - |
| Accrued Interest and Other Assets | 1,444,149 | 1,059,812 |
| | $ 296,883,111 | $ 188,637,652 |

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

**SUNCREST BANK**

**STATEMENTS OF FINANCIAL CONDITION**
**DECEMBER 31, 2015 AND 2014**

## LIABILITIES AND SHAREHOLDERS' EQUITY

| | 2015 | 2014 |
|---|---|---|
| Deposits: | | |
| Noninterest-bearing Demand | $ 84,064,420 | $ 55,502,263 |
| Savings, NOW and Money Market Accounts | 114,593,224 | 69,994,695 |
| Time Deposits Under $250,000 | 31,588,069 | 19,355,396 |
| Time Deposits $250,000 and Over | 26,431,525 | 21,564,510 |
| **TOTAL DEPOSITS** | 256,677,238 | 166,416,864 |
| Accrued Interest and Other Liabilities | 874,392 | 342,596 |
| **TOTAL LIABILITIES** | 257,551,630 | 166,759,460 |
| Commitments and Contingencies - Notes E and K | | |
| Shareholders' Equity: | | |
| Preferred Stock - No par value, 10,000,000 Shares Authorized, None Outstanding | - | - |
| Common Stock - No par value, 25,000,000 Shares Authorized, Shares Issued and Outstanding, 4,999,895 in 2015 and 2,649,634 in 2014 | 40,653,892 | 24,126,478 |
| Additional Paid-in Capital | 1,703,561 | 1,614,538 |
| Accumulated Deficit | ( 2,942,986) | ( 3,851,640) |
| Accumulated Other Comprehensive Income Loss - Net Unrealized Loss on Securities Available for Sale, Net of Taxes of $57,668 in 2015 and $7,772 in 2014 | ( 82,986) | ( 11,184) |
| **TOTAL SHAREHOLDERS' EQUITY** | 39,331,481 | 21,878,192 |
| | $ 296,883,111 | $ 188,637,652 |

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

**SUNCREST BANK**

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

| | 2015 | 2014 |
|---|---|---|
| **INTEREST INCOME** | | |
| Interest and Fees on Loans | $ 8,196,445 | $ 5,988,234 |
| Interest on Investment Securities | 725,238 | 415,522 |
| Interest on Federal Funds Sold and Other | 118,602 | 76,308 |
| **TOTAL INTEREST INCOME** | 9,040,285 | 6,480,064 |
| **INTEREST EXPENSE** | | |
| Interest on Savings Deposits, NOW and Money Market Accounts | 161,343 | 176,515 |
| Interest on Time Deposits | 226,177 | 272,420 |
| Interest on Other Borrowings | 5 | 6 |
| **TOTAL INTEREST EXPENSE** | 387,525 | 448,941 |
| **NET INTEREST INCOME** | 8,652,760 | 6,031,123 |
| Provision for Loan Losses | 522,275 | 314,400 |
| **NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES** | 8,130,485 | 5,716,723 |
| **NONINTEREST INCOME** | | |
| Service Charges, Fees, and Other Income | 201,997 | 133,908 |
| Bargain Purchase Gain on Acquisition of Sutter Community Bank | 314,499 | - |
| Gain on Sale of Securities | - | 11,485 |
| Gain on Sale of Loans | 240,378 | 237,084 |
| | 756,874 | 382,477 |
| **NONINTEREST EXPENSE** | | |
| Salaries and Employee Benefits | 4,182,051 | 3,018,770 |
| Occupancy Expenses | 704,671 | 641,153 |
| Equipment Expenses | 180,299 | 175,592 |
| Other Expenses | 2,182,623 | 1,518,064 |
| | 7,249,644 | 5,353,579 |
| **INCOME BEFORE INCOME TAXES** | 1,637,715 | 745,621 |
| Income Taxes | 729,061 | 350,054 |
| **NET INCOME** | $ 908,654 | $ 395,567 |
| **NET INCOME PER SHARE - BASIC** | $ 0.25 | $ 0.18 |
| **NET INCOME PER SHARE - DILUTED** | $ 0.25 | $ 0.18 |

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

**SUNCREST BANK**

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

| | 2015 | 2014 |
|---|---|---|
| Net Income | $ 908,654 | $ 395,567 |
| **OTHER COMPREHENSIVE INCOME (LOSS):** | | |
| Unrealized Gains and Losses on Securities Available for Sale: | | |
| Change in Net Unrealized Gain (Loss) | ( 121,698) | 107,307 |
| Reclassification of Gain Recognized in Net Income, Net | - | ( 11,485) |
| | ( 121,698) | 95,822 |
| Income Taxes (Benefit): | | |
| Change in Net Unrealized Gain (Loss) | ( 49,896) | 43,996 |
| Reclassification of Gain Recognized in Net Income, Net | - | ( 4,709) |
| | ( 49,896) | 39,287 |
| **TOTAL OTHER COMPREHENSIVE INCOME (LOSS)** | ( 71,802) | 56,535 |
| **TOTAL COMPREHENSIVE INCOME** | $ 836,852 | $ 452,102 |

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

**SUNCREST BANK**

## STATEMENT OF CHANGES IN SHAREHOLDERS' EQUITY
## FOR THE YEARS ENDED DECEMBER 31, 2015 AND 2014

| | Common Stock | | Additional | | Accumulated Other | |
|---|---|---|---|---|---|---|
| | Number of Shares | Amount | Paid-in Capital | Accumulated Deficit | Comprehensive Income (Loss) | Total |
| **Balance January 1, 2014** | 1,915,902 | $ 19,146,645 | $ 1,519,254 | $( 4,247,207) | $( 67,719) | $ 16,350,973 |
| Net Income | | | | 395,567 | | 395,567 |
| Stock-based Compensation | | | 141,382 | | | 141,382 |
| Issuance of Stock to Employees in Exchange for Services Rendered | 6,980 | 46,098 | ( 46,098) | | | - |
| Issuance of Common Stock, net of Expenses of $153,529 | 726,752 | 4,933,735 | | | | 4,933,735 |
| Other Comprehensive Income, Net of Taxes | | | | | 56,535 | 56,535 |
| **Balance at December 31, 2014** | 2,649,634 | 24,126,478 | 1,614,538 | ( 3,851,640) | ( 11,184) | 21,878,192 |
| Net Income | | | | 908,654 | | 908,654 |
| Stock-based Compensation | | | 185,413 | | | 185,413 |
| Issuance of Stock to Employees in Exchange for Services Rendered | 13,770 | 96,390 | ( 96,390) | | | - |
| Issuance of Common Stock, net of Expenses of $324,959 | 1,192,075 | 8,019,566 | | | | 8,019,566 |
| Issuance of Stock in the Acquisition of Sutter Community Bank | 1,144,416 | 8,411,458 | | | | 8,411,458 |
| Other Comprehensive Loss, Net of Taxes | | | | | ( 71,802) | ( 71,802) |
| **Balance at December 31, 2015** | 4,999,895 | $ 40,653,892 | $ 1,703,561 | $( 2,942,986) | $( 82,986) | $ 39,331,481 |

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

**SUNCREST BANK**

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

| | 2015 | 2014 |
|---|---|---|
| **OPERATING ACTIVITIES** | | |
| Net Income | $ 908,654 | $ 395,567 |
| Adjustments to Reconcile Net Income to Net Cash | | |
| From Operating Activities: | | |
| Depreciation and Amortization | 242,997 | 218,299 |
| Stock-based Compensation | 185,413 | 141,382 |
| Provision for Loan Losses | 522,275 | 314,400 |
| Deferred Tax Expense | 332,000 | 345,000 |
| Gain on Sale of Securities | - | ( 11,485) |
| Gain on Sale of Loans | ( 240,378) | ( 237,084) |
| Loans Originated for Sale | ( 2,310,293) | ( 2,327,174) |
| Proceeds from Sale of Loans | 2,587,287 | 2,578,580 |
| Bargain Purchase Gain | ( 314,499) | - |
| Other Items | 354,114 | ( 433,553) |
| **NET CASH FROM OPERATING ACTIVITIES** | 2,267,570 | 983,932 |
| **INVESTING ACTIVITIES** | | |
| Purchase of Available-for-Sale Securities | ( 39,770,988) | ( 38,733,211) |
| Maturities of Available-for-Sale Securities | 27,548,880 | 10,934,781 |
| Proceeds from Sale of Available-for-Sale Securities | - | 1,993,315 |
| Net Increase in Loans | ( 37,381,921) | ( 30,764,740) |
| Purchase of Federal Home Loan Bank Stock | ( 427,700) | ( 43,800) |
| Cash Acquired in Acquisition | 14,489,998 | - |
| Purchase of Premises and Equipment | ( 2,353,093) | ( 103,091) |
| **NET CASH FROM INVESTING ACTIVITIES** | ( 37,894,824) | ( 56,716,746) |
| **FINANCING ACTIVITIES** | | |
| Net Increase in Demand Deposits and Savings Accounts | 31,374,390 | 43,550,419 |
| Net Change in Time Deposits | ( 174,240) | 13,336,697 |
| Proceeds from Issuance of Common Stock, Net | 8,019,566 | 4,933,735 |
| **NET CASH FROM FINANCING ACTIVITIES** | 39,219,716 | 61,820,851 |
| **NET INCREASE IN CASH AND CASH EQUIVALENTS** | 3,592,462 | 6,088,037 |
| Cash and Cash Equivalents at Beginning of Year | 20,469,094 | 14,381,057 |
| **CASH AND CASH EQUIVALENTS AT END OF YEAR** | $ 24,061,556 | $ 20,469,094 |
| **Supplemental Disclosures of Cash Flow Information:** | | |
| Interest Paid | $ 371,072 | $ 450,025 |
| Taxes Paid | $ 455,000 | $ - |

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

## NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Nature of Operations

The Bank has been incorporated in the State of California and organized as a single operating segment that operates four full-service branches in Visalia, Porterville, Kingsburg and Yuba City, California. The Bank's primary source of revenue is providing loans to customers, who are predominately small and middle-market businesses and individuals located primarily in the Central Valleys of California.

Subsequent Events

The Bank has evaluated subsequent events for recognition and disclosure through February 24, 2016, which is the date the financial statements were available to be issued.

Use of Estimates in the Preparation of Financial Statements

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

Cash and Cash Equivalents

For purposes of reporting cash flows, cash and cash equivalents include cash, due from banks and federal funds sold. Generally, federal funds are sold for periods of less than ninety days.

Cash and Due from Banks

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

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

Investment Securities

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

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

Investment Securities - Continued

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

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

Loans Held for Sale

Government Guaranteed loans originated and intended for sale in the secondary market are carried at the lower of cost or estimated market value in the aggregate. Net unrealized losses are recognized through a valuation allowance by charges to income. Gains or losses realized on the sales of loans are recognized at the time of sale and are determined by the difference between the net sales proceeds and the carrying value of the loans sold, adjusted for any servicing asset or liability. Gains and losses on sales of loans are included in noninterest income.

Loans

Loans receivable that management has the intent and ability to hold for the foreseeable future or until maturity or payoff are reported at their outstanding unpaid principal balances reduced by any charge-offs or specific valuation accounts and net of deferred fees or costs on originated loans, or unamortized premiums or discounts on purchased loans. Loan origination fees and certain direct origination costs are capitalized and recognized as an adjustment of the yield of the related loan.

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

Loans - Continued

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

Allowance for Loan Losses

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

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

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

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

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

Allowance for Loan Losses - Continued

General reserves cover non-impaired loans and are based on peer bank historical loss rates for each portfolio segment, adjusted for the effects of qualitative or environmental factors that are likely to cause estimated credit losses as of the evaluation date to differ from the portfolio segment's 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.

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

Certain Acquired Loans

As part of business acquisition, the Bank acquired certain loans that have shown evidence of credit deterioration since origination. These acquired loans are recorded at the allocated fair value, such that there is no carryover of the seller's allowance for loan losses. Such acquired loans are accounted for individually. The Bank estimates the amount and timing of expected cash flows for each purchased loan, and the expected cash flows in excess of the allocated fair value is recorded as interest income over the remaining life of the loan (accretable yield). The excess of the loan's contractual principal and interest over expected cash flows is not recorded (non-accretable difference). Over the life of the loan, expected cash flows continue to be estimated. If the present value of expected cash flows is less than the carrying amount, a loss is recorded through the allowance for loan losses. If the present value of expected cash flows is greater than the carrying amount, it is recognized as part of future interest income.

Federal Home Loan Bank ("FHLB") Stock

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

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

Other Real Estate Owned

Real estate acquired by foreclosure or deed in lieu of foreclosure is recorded at fair value at the date of foreclosure, establishing a new cost basis by a charge to the allowance for loan losses, if necessary. Other real estate owned is carried at the lower of cost or fair value, less estimated costs to sell. Fair value is based on current appraisals less estimated selling costs. Any subsequent write-downs are charged against operating expenses. Operating expenses of such properties, net of related income, and gains and losses on their disposition are included in other operating expenses. As of December 31, 2015 other real estate owned consisted of vacant land. The Bank did not have any foreclosures in process as of December 31, 2015.

Premises and Equipment

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

Other Intangible Assets

Other intangible assets consist of core deposit intangible assets arising from a whole bank acquisition. They are initially measured at fair value and then amortized over their estimated useful lives of approximately seven years. Amortization expense in 2015 was $0. Future amortization expense for the next five years is approximately $54,000 per year.

Transfers of Financial Assets

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

Stock-Based Compensation

The Bank 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. This cost is recognized over the period which an employee is required to provide services in exchange for the award, generally the vesting period. See Note L for additional information on the Bank's stock option plan.

Advertising Costs

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

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

Income Taxes

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

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

Earnings Per Share ("EPS")

Basic EPS excludes dilution and is computed by dividing income available to common stockholders by the weighted-average number of common shares outstanding for the period. Diluted EPS 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.

Comprehensive Income

Changes in unrealized gains and losses on available-for-sale securities is the only component of accumulated other comprehensive income for the Bank.

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

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

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. The 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 a Bank's own assumptions about the assumptions that market participants would use in pricing an asset or liability.

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

Reclassifications

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

Adopted Accounting Guidance

In January 2014, the FASB issued Accounting Standards Update (ASU) No. 2014-04, *Receivables—Troubled Debt Restructurings by Creditors (Subtopic 310-40): Reclassification of Residential Real Estate Collateralized Consumer Mortgage Loans upon Foreclosure,* a consensus of the FASB Emerging Issues Task Force. This Update provides clarification as to when an in-substance repossession or foreclosure has occurred, i.e., the creditor is considered to have received physical possession of residential real estate property collateralizing a consumer mortgage loan and, therefore, the loan receivable should be derecognized and the real estate property should be recognized. Under ASU No. 2014-04, a creditor has received physical possession of residential real estate property collateralizing a consumer mortgage loan upon either (1) the creditor obtaining legal title to the property upon completion of a foreclosure or (2) the borrower conveying all interest in the property to the creditor to satisfy the loan through completion of a deed in lieu of foreclosure or a similar legal agreement. The Update also will require disclosure in annual and interim financial statements of both (1) the amount of foreclosed residential real estate property held by the creditor and (2) the recorded investment in consumer mortgage loans collateralized by residential real estate property that are in the process of foreclosure according to local requirements of the applicable jurisdiction. The amendments in this Update are effective for interim and annual periods beginning after December 15, 2014. Adoption of this Update did not have a material impact on the Bank's financial statements.

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

Recent Accounting Guidance Not Yet Effective

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

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

## NOTE B - ACQUISITION

The Bank accounted for the following acquisition under the acquisition method of accounting. The acquired assets, assumed liabilities and identifiable intangible assets were recorded at their respective acquisition date fair values. The Bank determined the fair value of the securities, loans, core deposit intangible and deposits with the assistance of third party valuations. The fair value of other real estate owned ("OREO") was based on appraisals.

The estimated fair value in this acquisition is subject to refinement as additional information relative to the closing date fair values become available through the measurement period, which can extend for up to one year after the closing date of the transaction. While additional significant changes to the closing date fair values are not expected, any information relative to the changes in these fair values will be evaluated to determine if such changes are due to events and circumstances that existed as of the acquisition date.

On December 11, 2015, the Bank acquired all the assets and assumed all the liabilities of Sutter Community Bank ("SCB") in exchange for Bank stock. The Bank issued 1,144,416 shares of Bank common stock with a fair value of $7.35 per share total transaction value of approximately $8,411,000. SCB operated one branch in Yuba City, California. The Bank acquired SCB as the location and culture fit within the Bank's strategic plans for expansion.

A bargain purchase gain totaling $314,499 resulted from the acquisition and is included as a component of noninterest income in the statements of income.

For loans acquired from SCB, the contractual amounts due, expected cash flows to be collected and fair value as of December 11, 2015 were as follows (dollar amounts in thousands):

| | Purchased Credit-Impaired | All Other Acquired Loans |
|---|---|---|
| Contractual Amounts Due | $ 2,554 | $ 60,193 |
| Cash Flows not Expected to be Collected | 364 | - |
| Expected Cash Flows | 2,190 | 60,193 |
| Interest Component of Expected Cash Flows | 237 | 15,945 |
| Fair Value of Acquired Loans | $ 1,953 | $ 44,248 |

In accordance with generally accepted accounting principles there was no carryover of the allowance for loan losses that had been previously recorded by SCB.

**NOTE B – ACQUISITION - Continued**

The following table represents the assets acquired and liabilities assumed of SCB as of December 11, 2015 and the fair value adjustments and the amounts recorded by the Bank in 2015 under the acquisition method of accounting (dollar amounts in thousands):

| | SCB Book Value | Fair Value Adjustments | Fair Value |
|---|---|---|---|
| **ASSETS ACQUIRED** | | | |
| Cash and Cash Equivalents | $ 14,490 | $ - | $ 14,490 |
| Investment Securities | 1,906 | ( 81) | 1,825 |
| Loans, Gross | 47,538 | ( 1,337) | 46,201 |
| Allowance for Loan Losses | ( 1,493) | 1,493 | - |
| Other Bank Stock | 398 | - | 398 |
| Premises and Equipment | 86 | - | 86 |
| Bank Owned Life Insurance | 2,076 | - | 2,076 |
| Other Real Estate Owned | 1,171 | ( 522) | 649 |
| Deferred Tax Assets | 1,495 | 77 | 1,572 |
| Core Deposit Intangible | - | 428 | 428 |
| Accrued Interest and Other Assets | 558 | ( 219) | 339 |
| **Total Assets Acquired** | $ 68,225 | $( 161) | $ 68,064 |
| **LIABILITIES ASSUMED** | | | |
| Deposits | $ 58,977 | $ 84 | $ 59,061 |
| Other Liabilities | 287 | ( 10) | 277 |
| **Total Liabilities Assumed** | 59,264 | 74 | 59,338 |
| Excess of Assets Acquired Over Liabilities Assumed | 8,961 | ( 235) | 8,726 |
| | $ 68,225 | $( 161) | |
| Stock Consideration | | | 8,411 |
| Recorded Gain on Acquisition | | | $ 315 |

## NOTE C - INVESTMENT SECURITIES

Debt and equity securities have been classified in the statements of financial condition according to management's intent. The amortized cost of securities and their approximate fair values at December 31 were as follows:

| | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Fair Value |
|---|---|---|---|---|
| **December 31, 2015** | | | | |
| **Available-for-Sale Securities:** | | | | |
| U.S. Government and Agency Securities | $ 27,505,350 | $ 15,261 | $( 76,102) | $ 27,444,509 |
| Mortgaged-Backed Securities | 26,978,253 | 116,815 | ( 196,628) | 26,898,440 |
| | $ 54,483,603 | $ 132,076 | $( 272,730) | $ 54,342,949 |
| **December 31, 2014** | | | | |
| **Available-for-Sale Securities:** | | | | |
| U.S. Government and Agency Securities | $ 28,742,398 | $ 28,941 | $( 84,452) | $ 28,686,887 |
| Mortgaged-Backed Securities | 11,793,000 | 41,983 | ( 5,428) | 11,829,555 |
| | $ 40,535,398 | $ 70,924 | $( 89,880) | $ 40,516,442 |

The amortized cost and estimated fair value of all investment securities as of December 31, 2015 by expected maturities are shown below. Expected maturities may differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

| | Available-for-Sale Securities | |
|---|---|---|
| | Amortized Cost | Fair Value |
| Due within One Year | $ 15,868,339 | $ 15,858,293 |
| Due from One Year to Five Years | 12,574,643 | 12,530,696 |
| Due from Five to Ten Years | 4,636,520 | 4,695,174 |
| Due after Ten Years | 21,404,101 | 21,258,786 |
| | $ 54,483,603 | $ 54,342,949 |

No securities were sold in 2015. Gross realized gains in 2014 on sales of available-for-sale securities were $11,485.

**NOTE C - INVESTMENT SECURITIES - Continued**

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

| | Less than Twelve Months | | Over Twelve Months | | Total | |
|---|---|---|---|---|---|---|
| **December 31, 2015:** | Unrealized Losses | Fair Value | Unrealized Losses | Fair Value | Unrealized Losses | Fair Value |
| U.S. Government and Agency Securities | $( 64,634) | $ 13,176,698 | $( 11,468) | $ 1,488,330 | $( 76,102) | $ 14,665,028 |
| Mortgaged-Backed Securities | (196,628) | 20,970,132 | - | - | (196,628) | 20,970,132 |
| | $( 261,262) | $ 34,146,830 | $( 11,468) | $ 1,488,330 | $( 272,730) | $ 35,635,160 |
| **December 31, 2014:** | | | | | | |
| U.S. Government and Agency Securities | $( 40,533) | $ 10,208,813 | $( 43,919) | $ 4,955,780 | $( 84,452) | $ 15,164,593 |
| Mortgaged-Backed Securities | (5,428) | 2,131,386 | - | - | (5,428) | 2,131,386 |
| | $( 45,961) | $ 12,340,199 | $( 43,919) | $ 4,955,780 | $( 89,880) | $ 17,295,979 |

As of December 31, 2015, the Bank has three U.S. government agency securities that have been in an unrealized loss position over 12 months. Unrealized losses on these investment securities have not been recognized into income as management does not intend to sell, and it is not "more likely than not" that management would be required to sell the securities prior to their anticipated recovery, and the decline in fair value is largely due to change in interest rates. The fair value is expected to recover as the bonds approach maturity.

Securities with a fair value of approximately $7.3 million were pledged to the Federal Home Loan Bank as discussed in Note G. Securities with a fair value of $17.5 million were pledged to secure public monies and for other purposes as required by law.

## NOTE D - LOANS

The Bank's loan portfolio consists primarily of loans to borrowers within the Central Valleys of California. Although the Bank seeks to avoid concentrations of loans to a single industry or based upon a single class of collateral, real estate and real estate associated businesses are among the principal industries in the Bank's market area and, as a result, the Bank's loan and collateral portfolios are, to some degree, concentrated in those industries.

A summary of the changes in the allowance for loan losses as of December 31 follows:

| | 2015 | 2014 |
|---|---|---|
| Balance at Beginning of Year | $ 1,723,391 | $ 1,417,381 |
| Additions to the Allowance Charged to Expense | 522,275 | 314,400 |
| Recoveries on Loans Charged-Off | - | - |
| | 2,245,666 | 1,731,781 |
| Less Loans Charged-Off | ( 100) | ( 8,390) |
| | $ 2,245,566 | $ 1,723,391 |

## NOTE D - LOANS - Continued

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

| December 31, 2015 | Real Estate - Other | Construction and Land Development | Commercial and Industrial | Consumer | Total |
|---|---|---|---|---|---|
| Allowance for Loan Losses: | | | | | |
| Beginning of Year | $ 1,167,486 | $ 48,676 | $ 474,196 | $ 33,033 | $ 1,723,391 |
| Provisions | 353,698 | ( 1,539) | 138,809 | 31,307 | 522,275 |
| Charge-offs | - | - | (100) | - | (100) |
| Recoveries | - | - | - | - | - |
| End of Year Reserves: | $ 1,521,184 | $ 47,137 | $ 612,905 | $ 64,340 | $ 2,245,566 |
| Specific | $ - | $ - | $ - | $ - | $ - |
| General | 1,521,184 | 47,137 | 612,905 | 64,340 | 2,245,566 |
| Purchased Credit Impaired Loans | - | - | - | - | - |
| | $ 1,521,184 | $ 47,137 | $ 612,905 | $ 64,340 | $ 2,245,566 |
| Loans Evaluated for Impairment: | | | | | |
| Individually | $ 3,313,570 | $ 241,563 | $ 83,534 | $ 4,541 | $ 3,643,208 |
| Collectively | 158,612,919 | 4,704,182 | 39,350,625 | 802,538 | 203,470,264 |
| Purchased Credit Impaired Loans | 1,627,505 | - | 96,591 | - | 1,724,096 |
| | $ 163,553,994 | $ 4,945,745 | $ 39,530,750 | $ 807,079 | $ 208,837,568 |
| **December 31, 2014** | | | | | |
| Allowance for Loan Losses: | | | | | |
| Beginning of Year | $ 1,094,629 | $ 34,659 | $ 275,196 | $ 12,897 | $ 1,417,381 |
| Provisions | 72,857 | 14,017 | 207,390 | 20,136 | 314,400 |
| Charge-offs | - | - | (8,390) | - | (8,390) |
| Recoveries | - | - | - | - | - |
| End of Year Reserves: | $ 1,167,486 | $ 48,676 | $ 474,196 | $ 33,033 | $ 1,723,391 |
| Specific | $ - | $ - | $ 35,100 | $ - | $ 35,100 |
| General | 1,167,486 | 48,676 | 439,096 | 33,033 | 1,688,291 |
| | $ 1,167,486 | $ 48,676 | $ 474,196 | $ 33,033 | $ 1,723,391 |
| Loans Evaluated for Impairment: | | | | | |
| Individually | $ - | $ 313,322 | $ 35,100 | $ - | $ 348,422 |
| Collectively | 93,374,513 | 3,545,500 | 26,433,966 | 1,534,781 | 124,888,760 |
| | $ 93,374,513 | $ 3,858,822 | $ 26,469,066 | $ 1,534,781 | $ 125,237,182 |

**NOTE D - LOANS - Continued**

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

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

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

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

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

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

| **December 31, 2015** | Pass | Special Mention | Substandard | Impaired | Total |
|---|---|---|---|---|---|
| Real Estate Other: | | | | | |
| Commercial | $ 63,087,928 | $ 432,121 | $ 2,002,513 | $ 3,313,570 | $ 68,836,132 |
| Farmland | 57,045,546 | - | - | - | 57,045,546 |
| 1-4 Family Residential | 26,575,768 | - | 619,303 | - | 27,195,071 |
| Multifamily Residential | 10,477,245 | - | - | - | 10,477,245 |
| Construction and Land Development | 4,661,388 | - | 42,794 | 241,563 | 4,945,745 |
| Commercial and Industrial | 39,324,577 | 10,456 | 112,183 | 83,534 | 39,530,750 |
| Consumer | 802,538 | - | - | 4,541 | 807,079 |
| | $201,974,990 | $ 442,577 | $ 2,776,793 | $ 3,643,208 | $ 208,837,568 |

**NOTE D - LOANS - Continued**

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

| December 31, 2014 | Pass | Special Mention | Substandard | Impaired | Total |
|---|---|---|---|---|---|
| Real Estate Other: | | | | | |
| Commercial | $ 44,602,318 | $ 156,158 | $ 2,005,088 | $ - | $ 46,763,564 |
| Farmland | 26,836,159 | - | - | - | 26,836,159 |
| 1-4 Family Residential | 14,549,706 | - | | - | 14,549,706 |
| Multifamily Residential | 5,225,084 | - | - | - | 5,225,084 |
| Construction and Land Development | 3,545,500 | - | - | 313,322 | 3,858,822 |
| Commercial and Industrial | 26,423,240 | - | 10,726 | 35,100 | 26,469,066 |
| Consumer | 1,534,781 | - | - | - | 1,534,781 |
| | $ 122,716,788 | $ 156,158 | $ 2,015,814 | $ 348,422 | $ 125,237,182 |

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

| | Still Accruing | | | |
|---|---|---|---|---|
| December 31, 2015 | 30-59 Days Past Due | 60-89 Days Past Due | Over 90 Days Past Due | Nonaccrual |
| Real Estate Other: | | | | |
| Commercial | $ - | $ - | $ - | $ 2,566,890 |
| Farmland | | - | - | - |
| 1-4 Family Residential | - | - | - | 33,201 |
| Multifamily Residential | - | - | - | - |
| Construction and Land Development | - | - | - | 241,563 |
| Commercial and Industrial | 39,125 | - | - | 185,896 |
| Consumer | - | - | - | 4,541 |
| | $ 39,125 | $ - | $ - | $ 3,032,091 |
| **December 31, 2014** | | | | |
| Real Estate Other: | | | | |
| Commercial | $ - | $ - | $ - | $ - |
| Farmland | | - | - | - |
| 1-4 Family Residential | - | 180,000 | - | - |
| Multifamily Residential | - | - | - | - |
| Construction and Land Development | - | - | - | 313,322 |
| Commercial and Industrial | 23,947 | - | - | 35,100 |
| Consumer | - | - | - | - |
| | $ 23,947 | $ 180,000 | $ - | $ 348,422 |

**NOTE D - LOANS - Continued**

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

| | | | Impaired Loans | | | | |
|---|---|---|---|---|---|---|---|
| **December 31, 2015** | Unpaid Principal Balance | Recorded Investment | Without Specific Allowance | With Specific Allowance | Related Allowance | Average Recorded Investment | Interest Income Recognized |
| Real Estate Other: | | | | | | | |
| Commercial | $ 3,910,827 | $ 3,313,570 | $ 3,313,570 | $ - | $ - | $ 2,059,000 | $ 138,708 |
| Farmland | - | - | - | - | - | - | - |
| 1-4 Family Residential | - | - | - | - | - | - | - |
| Multifamily Residential | - | - | - | - | - | - | - |
| Construction and Land Development | 331,898 | 241,563 | 241,563 | - | - | 20,000 | - |
| Commercial and Industrial | 141,960 | 83,534 | 83,534 | - | - | 7,000 | - |
| Consumer | 6,470 | 4,541 | 4,541 | - | - | 500 | - |
| | $ 4,391,155 | $ 3,643,208 | $ 3,643,208 | $ - | $ - | $ 2,086,500 | $ 138,708 |
| **December 31, 2014** | | | | | | | |
| Real Estate Other: | | | | | | | |
| Commercial | $ - | $ - | $ - | $ - | $ - | $ - | $ - |
| Farmland | - | - | - | - | - | - | - |
| 1-4 Family Residential | - | - | - | - | - | - | - |
| Multifamily Residential | - | - | - | - | - | - | - |
| Construction and Land Development | 486,434 | 313,322 | 313,322 | - | - | 359,000 | - |
| Commercial and Industrial | 43,490 | 35,100 | - | 35,100 | 35,100 | 30,000 | - |
| Consumer | - | - | - | - | - | - | - |
| | $ 529,924 | $ 348,422 | $ 313,322 | $ 35,100 | $ 35,100 | $ 389,000 | $ - |

The outstanding balance and carrying amount of purchased credit impaired loans as of December 31, 2015 were as follows:

| | 2015 |
|---|---|
| Outstanding Balance | $ 2,511,906 |
| Carrying Amount | $ 1,724,096 |

**NOTE D - LOANS - Continued**

The change in accretable discount on purchased credit impaired loans during the period was as follows:

| | 2015 |
|---|---|
| Balance at January 1 | $ - |
| New Loans Purchased | 236,707 |
| Accretion of Income | - |
| Reversals (Sales and Foreclosures) | - |
| Restructuring as TDR | - |
| Transfer to Nonaccretable Discount | ( 215,070) |
| Balance at December 31 | $ 21,637 |

Income is not recognized on certain purchased loans if the Bank cannot reasonably estimate cash flows expected to be collected. The carrying amount of such loans was $1,297,746 at December 31, 2015.

**NOTE E - PREMISES AND EQUIPMENT**

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

| | 2015 | 2014 |
|---|---|---|
| Land | $ 600,000 | $ - |
| Building | 1,317,517 | - |
| Leasehold Improvements | 1,362,552 | 1,195,113 |
| Furniture, Fixtures, and Equipment | 1,262,844 | 917,743 |
| | 4,542,913 | 2,112,856 |
| Less Accumulated Depreciation and Amortization | ( 1,772,435) | ( 1,529,460) |
| | $ 2,770,478 | $ 583,396 |

The Bank has operating leases for branches than will expire at various dates through June 2035. The leases include provisions for periodic rent increases as well as payment by the lessee of certain operating expenses. The leases also include provisions for options to extend the lease. The rental expense relating to the leases and other short term rentals was approximately $344,000 and $316,000 for the years ended December 31, 2015 and 2014, respectively.

**NOTE E - PREMISES AND EQUIPMENT - Continued**

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

| | |
|---|---|
| 2016 | $ 392,000 |
| 2017 | 190,000 |
| 2018 | 172,000 |
| 2019 | 173,000 |
| 2020 | 174,000 |
| Thereafter | 2,002,000 |
| | $ 3,103,000 |

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

**NOTE F - DEPOSITS**

At December 31, 2015, the scheduled maturities of time deposits are as follows:

| | |
|---|---|
| 2016 | $ 51,131,035 |
| 2017 | 1,616,204 |
| 2018 | 1,241,526 |
| 2019 | 3,509,731 |
| 2020 | 521,098 |
| | $ 58,019,594 |

**NOTE G - OTHER BORROWINGS**

The Bank may borrow up to $9.4 million overnight on an unsecured basis from its correspondent banks. As of December 31, 2015, the Bank has no amounts outstanding under these arrangements.

In addition, the Bank is also a member of the Federal Home Loan Bank ("FHLB") and has arranged a secured borrowing line with that institution, secured by the assets of the Bank. Under this line, the Bank may borrow up to approximately $22.0 million subject to providing adequate collateral and continued compliance with the Advances and Security Agreement and other eligibility requirements established by the FHLB. The Bank has pledged $7.3 million of investment securities as collateral for this line. As of December 31, 2015 the Bank had no amounts outstanding under this arrangement.

## NOTE H - OTHER EXPENSES

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

| | 2015 | 2014 |
|---|---|---|
| Professional Fees | $ 817,560 | $ 524,181 |
| Data Processing | 533,983 | 279,750 |
| Office Expenses | 213,832 | 177,370 |
| Marketing and Business Promotion | 170,806 | 174,338 |
| Insurance | 47,533 | 43,416 |
| Regulatory Assessments | 150,418 | 126,283 |
| Other Expenses | 248,491 | 192,726 |
| | $ 2,182,623 | $ 1,518,064 |

## NOTE I - INCOME TAXES

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

| | 2015 | 2014 |
|---|---|---|
| Current: | | |
| Federal | $ 296,019 | $ - |
| State | 101,042 | 5,054 |
| | 397,061 | 5,054 |
| Deferred | 332,000 | 345,000 |
| | $ 729,061 | $ 350,054 |

The Bank is subject to federal income tax and franchise tax of the state of California. Income tax returns for the years ending after December 31, 2011 are open to audit by the federal authorities and income tax returns for the years ending after December 31, 2010 are open to audit by state authorities. The Bank does not expect the total amount of unrecognized tax benefits to significantly increase or decrease within the next twelve months.

As of December 31, 2015, the Bank has net operating loss carryforwards of approximately $1,771,000 for California franchise tax purposes. The use of the net operating loss carryforwards is limited by Section 382 of the Internal Revenue Service Code to $219,000 per year. California net operating loss carryforwards, to the extent not used will begin to expire in 2028.

**NOTE I - INCOME TAXES - Continued**

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

| | 2015 | | 2014 | |
|---|---|---|---|---|
| | Amount | Rate | Amount | Rate |
| Statutory Federal Tax | $ 557,000 | 34.0% | $ 254,000 | 34.1% |
| State Tax, Net of Federal Benefit | 117,000 | 7.1% | 59,000 | 7.9% |
| Stock-based Compensation | 30,000 | 1.8% | 18,000 | 2.4% |
| Merger Expenses | 70,000 | 4.3% | - | - |
| Bargain Purchase Gain | ( 107,000) | ( 6.5%) | - | - |
| Other Items, Net | 62,061 | 3.8% | 19,054 | 2.6% |
| Actual Tax Expense (Benefit) | $ 729,061 | 44.5% | $ 350,054 | 47.0% |

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

| | 2015 | 2014 |
|---|---|---|
| Deferred Tax Assets: | | |
| Pre-Opening Expenses | $ 432,000 | $ 367,000 |
| Allowance for Loan Losses Due to Tax Limitations | 756,000 | 694,000 |
| Depreciation Differences | 252,000 | 192,000 |
| Other Real Estate Owned Differences | 713,000 | - |
| Operating Loss Carryforwards | 149,000 | 481,000 |
| Unrealized Loss on Available-for-Sale Securities | 58,000 | 8,000 |
| Stock-Based Compensation | 352,000 | 352,000 |
| Purchase Accounting Adjustments | 469,000 | - |
| Other Assets and Liabilities | 510,000 | 233,000 |
| | 3,691,000 | 2,327,000 |
| Deferred Tax Liabilities: | | |
| Other Assets and Liabilities | ( 184,000) | ( 110,000) |
| | ( 184,000) | ( 110,000) |
| Net Deferred Tax Assets | $ 3,507,000 | $ 2,217,000 |

## NOTE J - RELATED PARTY TRANSACTIONS

In the ordinary course of business, the Bank has granted loans to certain directors and the companies with which they are associated. The total outstanding principal and commitment of these loans at December 31, 2015 and 2014 was approximately $5,383,000 and $4,707,000, respectively.

Also, in the ordinary course of business, certain executive officers, directors and companies with which they are associated have deposits with the Bank. The balances of these deposits at December 31, 2015 and 2014 amounted to approximately $26,512,000 and $25,547,000, respectively.

## NOTE K - COMMITMENTS

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

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

As of December 31, 2015 and 2014, the Bank had the following outstanding financial commitments whose contractual amount represents credit risk:

| | 2015 | 2014 |
|---|---|---|
| Commitments to Extend Credit | $ 33,130,000 | $ 17,072,000 |

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

The Bank is involved in various litigation, which has arisen in the ordinary course of its business. In the opinion of management, the disposition of such pending litigation will not have material effect on the Bank’s financial statements.

## NOTE L - STOCK-BASED COMPENSATION PLANS

The Bank's 2007 Stock Option Plan was approved by its shareholders in July 2008. Under the terms of the 2007 Stock Option Plan, officers and key employees may be granted both nonqualified and incentive stock options and directors and organizers, who are not also an officer or employee, may only be granted nonqualified stock options. This plan was replaced by the 2013 Omnibus Stock Incentive Plan.

**NOTE L - STOCK-BASED COMPENSATION PLANS - Continued**

The Bank's 2013 Omnibus Stock Incentive Plan ("2013 Plan") was approved by its shareholders in May 2013. Under the terms of the 2013 Plan, 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. The 2013 Plan also permits the grant of stock appreciation rights ("SARs"), restricted shares, deferred shares, performance shares and performance unit awards. The 2013 Plan provides for the total number of awards of common stock that may be issued over the term of the plan not to exceed 573,533 shares, of which a maximum of 400,000 shares may be granted as incentive stock options. The aggregated number of awards that may be granted to an individual participant may not exceed 100,000 shares per year. Stock options and performance share and unit awards are granted at a price not less than 100% of the fair market value of the stock on the date of grant. The 2013 plan provides for accelerated vesting if there is a change of control as defined in the 2013 Plan. Equity awards generally vest over three to five years. Stock options expire no later than ten years from the date of grant.

The Bank recognized stock-based compensation cost of $185,413 and $141,382 for the periods ended December 31, 2015 and 2014. The Bank also recognized income tax benefits related to stock-based compensation of $40,263 in 2015 and $35,876 in 2014.

The fair value of each option grant was estimated on the date of grant using the Black-Scholes option pricing model with the weighted-average assumptions presented below:

| | 2015 | 2014 |
|---|---|---|
| Expected Volatility | 43.28% | 42.50% |
| Expected Term | 6.04 Years | 6.06 Years |
| Expected Dividends | None | None |
| Risk Free Rate | 1.23% | 1.21% |
| Grant Date Fair Value | $ 3.00 | $ 2.85 |

Since the Bank has a limited amount of historical stock activity the expected volatility is based on the historical volatility of similar banks that have a longer trading history. The expected term represents the estimated average period of time that the options remain outstanding. Since the Bank does not have sufficient historical data on the exercise of stock options, the expected terms is based on the "simplified" method that measures the expected term as the average of the vesting period and the contractual term. The risk free rate of return reflects the grant date interest rate offered for a comparable U.S. Treasury bonds over the expected term of the options.

**NOTE L - STOCK-BASED COMPENSATION PLANS - Continued**

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

| | Shares | Weighted-Average Exercise Price | Weighted-Average Remaining Contractual Term | Aggregate Intrinsic Value |
|---|---|---|---|---|
| Outstanding at Beginning of Year | 371,980 | $ 9.51 | | |
| Cancelled | ( 90,000) | $ 10.00 | | |
| Granted | 134,000 | $ 7.05 | | |
| Exercised | - | $ - | | |
| Forfeited | ( 6,250) | $ 10.00 | | |
| Outstanding at End of Year | 409,730 | $ 8.59 | 5.51 Years | $ 69,000 |
| Options Exercisable | 250,380 | $ 9.57 | 3.10 Years | $ 19,000 |

As of December 31, 2015, there was approximately $292,000 of total unrecognized compensation cost related to the outstanding stock options that will be recognized over a weighted-average period of 2.1 years.

During 2015 the Bank cancelled 90,000 options with a weighted-average exercise price of $10.00 held by directors and granted 90,000 options that expire in ten years and vest over three years. This is treated as a modification and the incremental increase in the fair value was $1.83 per option. Additional compensation expense of $13,725 was recognized in 2015 as a result of the modification.

## NOTE L - STOCK-BASED COMPENSATION PLANS - Continued

A summary of the status of the Bank's deferred share awards as of December 31, 2015 and changes during the year ended thereon is presented below:

| | Shares | Weighted-Average Grant-Date Fair Value |
|---|---|---|
| Nonvested at January 1, 2015 | 30,155 | $ 7.00 |
| New Deferred Share Awards | 2,408 | $ 7.00 |
| Shares Vested and Issued | ( 13,770) | $ 6.60 |
| Shares Forfeited | ( 385) | $ 7.00 |
| Nonvested at December 31, 2015 | 18,408 | $ 7.00 |

As of December 31, 2015 there was approximately $54,000 of unrecognized compensation cost related to the restricted stock grants that will be recognized over a weighted-average period of 1 year. The fair value of shares issued in 2015 and 2014 was approximately $111,000 and $51,000, respectively.

## NOTE M - EARNINGS PER SHARE ("EPS")

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

| | 2015 | | 2014 | |
|---|---|---|---|---|
| | Income | Shares | Income | Shares |
| Net Income as Reported | $ 908,654 | | $ 395,567 | |
| Shares Outstanding at Year-End | | 4,999,895 | | 2,649,634 |
| Impact of Weighting Shares Issued During the Year | | (1,304,389) | | (446,025) |
| Used in Basic EPS | 908,654 | 3,695,506 | 395,567 | 2,203,609 |
| Dilutive Effect of Outstanding Deferred Shares | | 12,252 | | 4,082 |
| Used in Dilutive EPS | $ 908,654 | 3,707,758 | $ 395,567 | 2,207,691 |

As of December 31, 2015 and 2014 there were 385,730 and 371,930, respectively, stock options that could potentially dilute earnings per share in the future that were not included in the computation of diluted earnings per shares because to do so would have been antidilutive.

## NOTE N - FAIR VALUE MEASUREMENT

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

*Securities*

The fair values of securities available for sale are determined by matrix pricing, which is a mathematical technique used widely in the industry to value debt securities without relying exclusively on quoted prices for specific securities but rather by relying on the securities' relationship to other benchmark quoted securities (Level 2).

*Collateral-Dependent Impaired Loans:*

The Bank does not record loans at fair value on a recurring basis. However, from time to time, fair value adjustments are recorded on these loans to reflect partial write-downs, through charge-offs or specific reserve allowances, that are based on the current appraised or market-quoted value of the underlying collateral. The fair value estimates for collateral-dependent impaired loans are generally based on recent real estate appraisals or broker opinions, obtained from independent third parties, which are frequently adjusted by management to reflect current conditions and estimated selling costs (Level 3).

*Other Real Estate Owned:*

Nonrecurring adjustments to certain commercial and residential real estate properties classified as other real estate owned ("OREO") are measured at the lower of carrying amount or fair value, less costs to sell. Fair values are generally based on third party appraisals or broker opinions, which are frequently adjusted by management to reflect current conditions and estimated selling costs, resulting in a Level 3 classification. In cases where the carrying amount exceeds the fair value, less costs to sell, an impairment loss is recognized.

Appraisals for other real estate owned are performed by certified general appraisers whose qualifications and licenses have been reviewed and verified by the Bank. Once received, a member of the loan department reviews the assumptions and approaches utilized in the appraisal as well as the overall resulting fair value. The Bank also determines what additional adjustments, if any, should be made to the appraisal values on any remaining other real estate owned to arrive at fair value. No significant adjustments to appraised values have been made as a result of this process as of December 31, 2015.

**NOTE N - FAIR VALUE MEASUREMENT - Continued**

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

| | Fair Value Measurements Using: | | | | Total |
|---|---|---|---|---|---|
| | Level 1 | Level 2 | Level 3 | Total | Losses |
| **December 31, 2015** | | | | | |
| **Assets measured at fair value on a recurring basis** | | | | | |
| Securities Available for Sale | $ - | $ 54,342,949 | $ - | $ 54,342,949 | $ - |
| **Value on a Non-recurring Basis** | | | | | |
| Other Real Estate Owned, Net | $ - | $ - | $ 649,092 | $ 649,092 | $ - |
| **December 31, 2014** | | | | | |
| **Assets measured at fair value on a recurring basis** | | | | | |
| Securities Available for Sale | $ - | $ 40,516,442 | $ - | $ 40,516,442 | $ - |

Quantitative information about the Bank's nonrecurring Level 3 fair value measurements as of December 31, 2015 is as follows:

| **December 31, 2015** | Fair Value Amount | Valuation Technique | Unobservable Input | Range |
|---|---|---|---|---|
| Other Real Estate Owned | $ 649,092 | Third Party Appraisals | Liquidation and Selling Costs | 8% to 50% |

## NOTE O - FAIR VALUE OF FINANCIAL INSTRUMENTS

The fair value of a financial instrument is the amount at which the asset or obligation could be exchanged in a current transaction between willing parties, other than in a forced or liquidation sale. Fair value estimates are made at a specific point in time based on relevant market information and information about the financial instrument. These estimates do not reflect any premium or discount that could result from offering for sale at one time the entire holdings of a particular financial instrument. Because no market value exists for a significant portion of the financial instruments, fair value estimates are based on judgments regarding future expected loss experience, current economic conditions, risk characteristics of various financial instruments, and other factors. These estimates are subjective in nature, involve uncertainties and matters of judgment and, therefore, cannot be determined with precision. Changes in assumptions could significantly affect the estimates.

Fair value estimates are based on financial instruments both on and off the balance sheet without attempting to estimate the value of anticipated future business and the value of assets and liabilities that are not considered financial instruments. Additionally, tax consequences related to the realization of the unrealized gains and losses can have a potential effect on fair value estimates and have not been considered in many of the estimates.

The following methods and assumptions were used to estimate the fair value of significant financial instruments not previously presented:

*Cash and Cash Equivalents*

The carrying amounts reported in the balance sheet for cash and cash equivalents approximate the fair values of those assets due to the short-term nature of the assets.

*Loans*

For variable rate loans that re-price frequently and with no significant change in credit risk, fair values are based on carrying amounts. The fair values for all other loans are estimated using discounted cash flow analyses, using interest rates currently being offered for loans with similar terms to borrowers with similar credit quality.

*Federal Home Loan Bank Stock and Other Bank Stock*

The fair value of Federal Home Loan Bank Stock and other Bank stock is not readily determinable due to the lack of its transferability.

*Noninterest-Bearing and Interest Bearing Demand Deposits*

The fair values for noninterest-bearing deposits and interest-bearing demand deposits are equal to the amount payable on demand at the reporting date, which is the carrying amount.

*Interest-Bearing Time Deposits*

The fair values for fixed rate certificates of deposits are estimated using a cash flow analysis, discounted at interest rates being offered at each reporting date by the Bank for certificates with similar remaining maturities.

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

*Off-Balance Sheet Financial Instruments*

The fair value of commitments to extend credit and standby letters of credit is estimated using the fees currently charged to enter into similar agreements. The fair value of these financial instruments is not material.

The fair value hierarchy level and estimated fair value of significant financial instruments at December 31, 2015 and 2014 are summarized as follows (dollar amounts in thousands):

| | | 2015 | | 2014 | |
|---|---|---|---|---|---|
| | Fair Value Hierarchy | Carrying Value | Fair Value | Carrying Value | Fair Value |
| **Financial Assets:** | | | | | |
| Cash and Cash Equivalents | Level 1 | $ 24,062 | $ 20,062 | $ 20,469 | $ 20,469 |
| Investment Securities | Level 2 | 54,343 | 54,343 | 40,516 | 40,516 |
| Loans, net | Level 2 | 206,133 | 205,266 | 123,154 | 123,019 |
| FHLB and Other Bank Stock | | 1,466 | N/A | 638 | N/A |
| **Financial Liabilities:** | | | | | |
| Noninterest-Bearing and Interest-Bearing Demand Deposits | Level 1 | 198,658 | 198,658 | 125,497 | 125,497 |
| Interest-Bearing Time Deposits | Level 2 | 58,019 | 57,918 | 40,920 | 40,901 |

## NOTE P - EMPLOYEE BENEFIT PLAN

The Bank adopted a 401(k) Plan for its employees in 2008. Under the plan, eligible employees may defer a portion of their salaries. The plan also provides for a non-elective discretionary contribution by the Bank. The Bank made no contributions for 2015 or 2014.

## NOTE Q - REGULATORY MATTERS

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

In July, 2013, the federal bank regulatory agencies approved the final rules implementing the Basel Committee on Banking Supervision's capital guidelines for U.S. banks. The new rules became effective on January 1, 2015, with certain of the requirements phased-in over a multi-year schedule, and fully phased in by January 1, 2019. The rules include a new common equity Tier 1 ("CET1") capital to risk-weighted assets ratio with minimums for capital adequacy and prompt corrective action purposes of 4.5% and 6.5%, respectively. The net unrealized gain or loss on available for sale securities is not included in computing regulatory capital. Capital amounts and ratios for December 31, 2014 are calculated using Basel I rules.

Quantitative measures established by regulation to ensure capital adequacy require the Bank to maintain minimum amounts and ratios (set forth in the table below) of total, Tier 1 and CET1 capital (as defined in the regulations) to risk-weighted assets (as defined), and of Tier 1 capital (as defined) to average assets (as defined). Management believes, as of December 31, 2015 and 2014, that the Bank meets all capital adequacy requirements.

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

**NOTE Q - REGULATORY MATTERS - Continued**

The following table also sets forth the Bank's actual capital amounts and ratios (dollar amounts in thousands):

| | Actual | | Amount of Capital Required For Capital Adequacy Purposes | | Amount of Capital Required To Be Well-Capitalized Under Prompt Corrective Provisions | |
|---|---|---|---|---|---|---|
| | Amount | Ratio | Amount | Ratio | Amount | Ratio |
| **As of December 31, 2015:** | | | | | | |
| Total Capital (to Risk-Weighted Assets) | $38,237 | 15.7% | $19,464 | 8.0% | $24,330 | 10.0% |
| Tier 1 Capital (to Risk-Weighted Assets) | $35,983 | 14.8% | $14,598 | 6.0% | $19,464 | 8.0% |
| CET1 Capital (to Risk-Weighted Assets) | $35,983 | 14.8% | $10,949 | 4.5% | $15,815 | 6.5% |
| Tier 1 Capital (to Average Assets) | $35,983 | 12.2% | $11,816 | 4.0% | $14,770 | 5.0% |
| **As of December 31, 2014:** | | | | | | |
| Total Capital (to Risk-Weighted Assets) | $21,860 | 14.7% | $11,914 | 8.0% | $14,893 | 10.0% |
| Tier 1 Capital (to Risk-Weighted Assets) | $20,129 | 13.5% | $5,957 | 4.0% | $8,936 | 6.0% |
| Tier 1 Capital (to Average Assets) | $20,129 | 11.1% | $7,281 | 4.0% | $9,101 | 5.0% |

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