CAPITAL BANK

FINANCIAL STATEMENTS
WITH
INDEPENDENT AUDITOR'S REPORT

DECEMBER 31, 2016 AND 2015

CONTENTS

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

VALUE THE DIFFERENCE

Independent Auditor's Report

Board of Directors and Shareholders of
Capital Bank

Report on Financial Statements

We have audited the accompanying financial statements of Capital Bank, which are comprised of the statements of financial condition as of December 31, 2016 and 2015, 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 Capital Bank as of December 31, 2016 and 2015, 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 CA
January 24, 2017

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CAPITAL BANK

STATEMENTS OF FINANCIAL CONDITION
DECEMBER 31, 2016 AND 2015

ASSETS

	2016	2015
Cash and Due from Banks	$ 5,674,984	$ 4,300,719
Interest-Bearing Deposits at Other Banks	41,273,872	59,861,928
TOTAL CASH AND CASH EQUIVALENTS	46,948,856	64,162,647
Time Deposits in Other Banks	19,855,935	20,097,941
Investment Securities Available for Sale	2,778,637	3,021,622
Loans Held For Sale	875,552	41,257
Loans:		
Real Estate - Construction	24,996,204	29,454,205
Real Estate - Other	161,481,188	123,376,999
Commercial	45,695,429	42,827,272
Consumer	791,765	949,344
GROSS LOANS	232,964,586	196,607,820
Deferred Loan Costs, Net of Fees	44,709	79,883
Allowance for Loan Losses	(3,060,000)	(2,711,612)
NET LOANS	229,949,295	193,976,091
Restricted Stock, at Cost	1,389,300	1,410,450
Premises and Equipment, net	984,799	1,163,729
Deferred Tax Assets	1,335,000	1,344,000
Accrued Interest and Other Assets	1,492,070	1,758,791
TOTAL ASSETS	$305,609,444	$286,976,528

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

CAPITAL BANK

STATEMENTS OF FINANCIAL CONDITION
DECEMBER 31, 2016 AND 2015

LIABILITIES AND SHAREHOLDERS' EQUITY

	2016	2015
Deposits:		
Noninterest-Bearing Demand	$ 35,409,110	$ 28,094,199
Savings, NOW and Money Market Accounts	177,518,090	159,214,718
Time Deposits Under $250,000	48,611,540	37,911,083
Time Deposits $250,000 and Over	11,415,387	9,656,188
TOTAL DEPOSITS	272,954,127	234,876,188
Federal Home Loan Bank Advances	5,000,000	25,000,000
Accrued Interest and Other Liabilities	802,683	592,561
TOTAL LIABILITIES	278,756,810	260,468,749
Commitments and Contingencies - Notes D and I	-	-
Shareholders' Equity:		
Serial Preferred Stock - 10,000,000 Shares Authorized, No Par Value Series A Shares Issued and Outstanding None in 2016 and 3,132 in 2015	-	3,132,000
Common Stock - 20,000,000 Shares Authorized, No Par Value; 1,668,326 Shares Issued and Outstanding in 2016 and, 1,559,722 Shares Issued and Outstanding in 2015	15,572,502	13,814,630
Additional Paid-in Capital	426,014	352,337
Retained Earnings Since September 30, 2011	10,871,318	9,223,112
Accumulated Other Comprehensive Income - Unrealized Loss on Available-for-Sale Securities, Net of Taxes of ($12,000) in 2016 and ($10,000) in 2015	(17,200)	(14,300)
TOTAL SHAREHOLDERS' EQUITY	26,852,634	26,507,779
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	$305,609,444	$286,976,528

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

CAPITAL BANK

STATEMENTS OF INCOME
FOR THE YEARS ENDED DECEMBER 31, 2016 AND 2015

	2016	2015
INTEREST INCOME		
Interest and Fees on Loans	$ 13,323,928	$ 11,495,092
Interest on Investment Securities	41,109	45,204
Interest on Federal Funds Sold and Other	414,485	272,459
TOTAL INTEREST INCOME	13,779,522	11,812,755
INTEREST EXPENSE		
Interest on Savings, NOW and Money Market Accounts	919,953	835,816
Interest on Time Deposits	528,012	448,406
Interest on Borrowings	10,174	921
TOTAL INTEREST EXPENSE	1,458,139	1,285,143
NET INTEREST INCOME	12,321,383	10,527,612
Provision for Loan Losses	350,000	90,000
NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES	11,971,383	10,437,612
NONINTEREST INCOME		
Service Charges, Fees and Other	409,182	380,745
Loan Servicing Income	254,087	374,673
Gain on Sale of Loans	337,824	1,206,654
TOTAL NONINTEREST INCOME	1,001,093	1,962,072
NONINTEREST EXPENSE		
Salaries and Employee Benefits	4,371,232	4,295,964
Occupancy and Equipment Expenses	903,328	845,737
Other Expenses	2,196,510	2,041,751
TOTAL NONINTEREST EXPENSE	7,471,070	7,183,452
INCOME BEFORE INCOME TAXES	5,501,406	5,216,232
Income Taxes	2,320,200	2,202,000
NET INCOME	$ 3,181,206	$ 3,014,232
NET INCOME PER SHARE - BASIC	$ 1.88	$ 1.82
NET INCOME PER SHARE - DILUTED	$ 1.77	$ 1.72

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

CAPITAL BANK

STATEMENTS OF COMPREHENSIVE INCOME
FOR THE YEARS ENDED DECEMBER 31, 2016 AND 2015

	2016	2015
Net Income	$ 3,181,206	$ 3,014,232
OTHER COMPREHENSIVE INCOME (LOSS):		
Unrealized Gains (Losses) on Securities Available for Sale		
Change in Net Unrealized Gain (Loss)	(4,900)	10,400
	(4,900)	10,400
Related Income Tax Expense (Benefit):		
Change in Net Unrealized Gain (Loss)	(2,000)	4,200
	(2,000)	4,200
TOTAL OTHER COMPREHENSIVE INCOME (LOSS)	(2,900)	6,200
TOTAL COMPREHENSIVE INCOME	$ 3,178,306	$ 3,020,432

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

CAPITAL BANK

STATEMENT OF CHANGES IN SHAREHOLDERS' EQUITY
FOR THE YEARS ENDED DECEMBER 31, 2016 AND 2015

	Preferred Stock		Common Stock				Accumulated Other	
	Number of Shares	Amount	Number of Shares	Amount	Additional Paid-in Capital	Retained Earnings	Comprehensive Income (Loss)	Total
Balance at January 1, 2015	3,132	$ 3,132,000	1,554,097	$ 13,758,380	$ 270,679	$ 6,240,200	$(20,500)	$ 23,380,759
Net Income						3,014,232		3,014,232
Stock-Based Compensation					66,013			66,013
Exercise of Stock Options, Including the Realization of Tax Benefits of $15,645			5,625	56,250	15,645			71,895
Dividends Paid on Preferred Stock						(31,320)		(31,320)
Other Comprehensive Income, Net of Taxes							6,200	6,200
Balance at December 31, 2015	3,132	3,132,000	1,559,722	13,814,630	352,337	9,223,112	(14,300)	26,507,779
Net Income						3,181,206		3,181,206
Stock-Based Compensation					56,296			56,296
Exercise of Stock Options, Including the Realization of Tax Benefits of $17,381			30,265	306,250	17,381			323,631
Dividends Paid on Preferred Stock						(81,084)		(81,084)
Redemption of Preferred Stock	(3,132)	(3,132,000)						(3,132,000)
5% Stock Dividend			78,339	1,451,622		(1,451,916)		(294)
Other Comprehensive Loss, Net of Taxes							(2,900)	(2,900)
Balance at December 31, 2016	-	$ -	1,668,326	$ 15,572,502	$ 426,014	$ 10,871,318	$(17,200)	$ 26,852,634

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

CAPITAL BANK

STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED DECEMBER 31, 2016 AND 2015

	2016	2015
OPERATING ACTIVITIES		
Net Income	$ 3,181,206	$ 3,014,232
Adjustments to Reconcile Net Income to Net Cash		
From Operating Activities:		
Depreciation and Amortization	242,775	211,337
Provision for Loan Losses	350,000	90,000
Stock-Based Compensation	56,296	66,013
Deferred Income Taxes	11,000	245,000
Proceeds from Loans Sold	4,936,775	17,965,522
Originations of Loans Held for Sale	(5,247,970)	(16,323,008)
Gain on Sale of Loans	(337,824)	(1,206,654)
Other Items	573,685	(384,028)
NET CASH FROM OPERATING ACTIVITIES	3,765,943	3,678,414
INVESTING ACTIVITIES		
Net Change in Time Deposits in Other Banks	242,006	(12,402,941)
Net Increase in Loans	(36,585,607)	(19,589,040)
Maturity of Securities Available for Sale	218,076	235,921
Purchase (Redemption) of Restricted Stock	21,150	(51,000)
Purchases of Premises and Equipment	(63,845)	(577,717)
NET CASH FROM INVESTING ACTIVITIES	(36,168,220)	(32,384,777)
FINANCING ACTIVITIES		
Net Change in Demand Deposits and Savings Accounts	25,618,283	49,340,449
Net Change in Time Deposits	12,459,656	(24,759,559)
Net Change in Federal Home Loan Bank Advances	(20,000,000)	7,000,000
Redemption of Preferred Stock	(3,132,000)	-
Dividends Paid on Preferred Stock	(81,084)	(31,320)
Proceeds from Exercise of Stock Options	323,631	71,895
NET CASH FROM FINANCING ACTIVITIES	15,188,486	31,621,465
(DECREASE) INCREASE IN CASH AND CASH EQUIVALENTS	(17,213,791)	2,915,102
Cash and Cash Equivalents at Beginning of Period	64,162,647	61,247,545
CASH AND CASH EQUIVALENTS AT END OF YEAR	$ 46,948,856	$ 64,162,647
Supplemental Disclosures of Cash Flow Information:		
Interest Paid	$ 1,446,086	$ 1,283,743
Taxes Paid	$ 1,920,000	$ 2,420,000

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

NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Nature of Operations

Capital Bank (the "Bank") was incorporated in the State of California and organized as a single operating segment that operates two full-service offices in San Juan Capistrano and Encinitas, California. The Bank's primary source of revenue is providing loans to customers, who are predominately small and middle-market businesses and individuals. On September 30, 2011 the Bank completed quasi-reorganization by eliminating its accumulated deficit of $4,413,507 and additional paid in capital of $909,653 through a reduction of its common stock account.

Subsequent Events

The Bank has evaluated subsequent events for recognition and disclosure through January 24, 2017, 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, federal funds sold and time deposits in other bank’s with original maturity of three months or less. Generally, federal funds are sold for one-day periods.

Cash and Due from Banks

Banking regulations require that banks maintain a percentage of their deposits as reserves in cash or on deposit with the Federal Reserve Bank. The Bank complied with the reserve requirements as of December 31, 2016 and 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

SBA 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 sale 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 sale 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 any 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. Amortization of deferred loan fees is discontinued when a loan is placed on nonaccrual status.

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

Restricted Stock

The Bank is a member of the Federal Home Loan Bank ("FHLB") and Federal Reserve Bank ("FRB") 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 and FRB 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.

Premises and Equipment

Premises and equipment are carried at cost less accumulated depreciation and amortization. Depreciation is computed using the straight-line method over the estimated useful lives, which ranges from three to seven years for furniture, equipment and computer equipment. 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.

Financial Instruments

In the ordinary course of business, the Bank has entered into off-balance sheet financial instruments consisting of commitments to extend credit as described in Note I. 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

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.

Loan Sales and Servicing of Financial Assets

The Bank originates SBA loans for sale in the secondary market. Servicing rights are recognized separately when they are acquired through sale of loans. Servicing rights are initially recorded at fair value with the income statement effect recorded in gain on sale of loans. Fair value is based on a valuation model that calculates the present value of estimated future cash flows from the servicing assets. The valuation model uses assumptions that market participants would use in estimating cash flows from servicing assets, such as the cost to service, discount rates and prepayment speeds. The Bank compares the valuation model inputs and results to published industry data in order to validate the model results and assumptions. Servicing assets are subsequently measured using the amortization method which requires servicing rights to be amortized into noninterest income in proportion to, and over the period of, the estimated future net servicing income of the underlying loans.

Servicing assets are evaluated for impairment based upon the fair value of the rights as compared to the carrying amount. Impairment is determined by stratifying rights into groupings based on predominant risk characteristics, such as interest rate, loan type and investor type. For purposes of measuring impairment, the Bank has identified each servicing asset with the underlying loan being serviced. A valuation allowance is recorded where the fair value is below the carrying amount of the asset. If the Bank later determines that all or a portion of the impairment no longer exists for a particular grouping, a reduction of the allowance may be recorded as an increase in income. The fair values of servicing rights are subject to significant fluctuations as a result of changes in estimated and actual prepayments speeds and changes in the discount rates.

Servicing fee income which is reported on the income statement in loan servicing income is recorded for fees earned for servicing loans. The fees are based on a contractual percentage of the outstanding principal and recorded as income when earned. The amortization of servicing rights and changes in the valuation allowance are netted against loan servicing income.

Advertising Costs

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

Stock-Based Compensation

Compensation cost is recognized for stock options issued to employees, based on the fair value of these awards at the date of grant. 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 K for additional information on the Bank's stock option plan.

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 carry forwards depends on having sufficient taxable income of an appropriate character within the carry forward periods.

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

Comprehensive Income

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

Fair Value Measurement

Fair value is the exchange price that would be received for an asset or paid to transfer a liability (exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. 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.

There are three levels of inputs that may be used to measure fair values:

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

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

NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued

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.

Reclassifications

Certain reclassifications have been made to the 2015 financial statements to conform to the presentation used in 2016. These reclassifications had no impact on the Bank's previously reported financial statements.

Accounting Guidance Not Yet Effective

In May 2014, the Financial Accounting Standards Board (“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 public business entities for annual reporting periods beginning after December 15, 2017, including interim periods within that reporting period and one year later for nonpublic business entities. 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.

In January 2016, the FASB issued ASU 2016-01, *Financial Instruments-Overall: Recognition and Measurement of Financial Assets and Financial Liabilities (Subtopic 825-10).* Changes made to the current measurement model primarily affect the accounting for equity securities and 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 and one year later for nonpublic business entities. The Bank is currently evaluating the effects of ASU 2016-01 on its financial statements and disclosures.

NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued

Accounting Guidance Not Yet Effective - Continued

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

In March 2016, the FASB issued ASU 2016-09, *Improvements to Employee Share-Based Payment Accounting (Topic 718.)* ASU 2016-09 includes provisions intended to simplify various aspects related to how share-based payments are accounted for and presented in the financial statements. Under ASU 2016-09, excess tax benefits and certain tax deficiencies will no longer be recorded in additional paid-in capital ("APIC"). Instead, they will record all excess tax benefits and tax deficiencies as income tax expense or benefit in the income statement, and APIC pools will be eliminated. In addition, the guidance requires excess tax benefits be presented as an operating activity on the statement of cash flows rather than as a financing activity. ASU 2016-09 also permits an accounting policy election for the impact of forfeitures on the recognition of expense for share-based payment awards. Forfeitures can be estimated, as required today, or recognized when they occur. This guidance is effective for public business entities for interim and annual reporting periods beginning after December 15, 2016 and for nonpublic business entities annual reporting periods beginning after December 15, 2017 and interim periods within the reporting periods beginning after December 15, 2018. Early adoption is permitted, but all of the guidance must be adopted in the same period. The Bank is currently evaluating the provisions of ASU 2016-09 to determine the potential impact on its financial statements and disclosures.

NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued

Accounting Guidance Not Yet Effective - Continued

In June 2016, the FASB issued ASU No. 2016-13, *Measurement of Credit Losses on Financial Instruments (Topic 326).* This ASU significantly changes how entities will measure credit losses for most financial assets and certain other instruments that aren't measured at fair value through net income. In issuing the standard, the FASB is responding to criticism that today's guidance delays recognition of credit losses. The standard will replace today's "incurred loss" approach with an "expected loss" model. The new model, referred to as the current expected credit loss ("CECL") model, will apply to: (1) financial assets subject to credit losses and measured at amortized cost, and (2) certain off-balance sheet credit exposures. This includes, but is not limited to, loans, leases, held-to-maturity securities, loan commitments, and financial guarantees. The CECL model does not apply to available-for-sale ("AFS") debt securities. For AFS debt securities with unrealized losses, entities will measure credit losses in a manner similar to what they do today, except that the losses will be recognized as allowances rather than reductions in the amortized cost of the securities. As a result, entities will recognize improvements to estimated credit losses immediately in earnings rather than as interest income over time, as they do today. The ASU also simplifies the accounting model for purchased credit-impaired debt securities and loans. ASU 2016-13 also expands the disclosure requirements regarding an entity's assumptions, models, and methods for estimating the allowance for loan and lease losses. In addition, public business entities will need to disclose the amortized cost balance for each class of financial asset by credit quality indicator, disaggregated by the year of origination. ASU No. 2016-13 is effective for interim and annual reporting periods beginning after December 15, 2019 for SEC filers, one year later for non SEC filing public business entities and annual reporting periods beginning after December 15, 2020 for nonpublic business entities and interim periods within the reporting periods beginning after December 15, 2021. Early adoption is permitted for interim and annual reporting periods beginning after December 15, 2018. Entities will apply the standard's provisions as a cumulative-effect adjustment to retained earnings as of the beginning of the first reporting period in which the guidance is effective (i.e., modified retrospective approach). The Bank is currently evaluating the provisions of ASU No. 2016-13 for potential impact on its financial statements and disclosures.

NOTE B - INVESTMENT SECURITIES

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

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Available-for-Sale Securities				
December 31, 2016				
U.S. Government and Agency Securities	$1,000,000	$ 1,779	$ -	$1,001,779
Mortgage-Backed Securities	759,592	-	(12,081)	747,511
Obligations of State and Political Subdivisions	1,048,245	-	(18,898)	1,029,347
	$2,807,837	$ 1,779	$(30,979)	$2,778,637
December 31, 2015				
U.S. Government and Agency Securities	$1,000,000	$ -	$(2,197)	$ 997,803
Mortgage-Backed Securities	985,811	-	(10,284)	975,527
Obligations of State and Political Subdivisions	1,060,111	-	(11,819)	1,048,292
	$3,045,922	$ -	$(24,300)	$3,021,622

The amortized cost and estimated fair value of all investment securities as of December 31, 2016 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	
	Amortized Cost	Fair Value
Due in One Year or Less	$ 198,319	$ 195,320
Due From One Year to Five Years	2,493,989	2,470,029
Due From Five to Ten Years	112,234	110,062
Due After Ten Years	3,295	3,226
	$ 2,807,837	$ 2,778,637

NOTE B - INVESTMENT SECURITIES - Continued

As of December 31, unrealized losses and fair value, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position, are summarized as follows:

	Less than Twelve Months		Twelve Months or More		Total	
	Unrealized Losses	Estimated Fair Value	Unrealized Losses	Estimated Fair Value	Unrealized Losses	Estimated Fair Value
December 31, 2016						
U.S. Government and Agency Securities	$ -	$ -	$ -	$ -	$ -	$ -
Mortgage-Backed Securities	(12,081)	747,511	-	-	(12,081)	747,511
Obligations of State and Political Subdivisions	(18,898)	1,029,347	-	-	(18,898)	1,029,347
	$(30,979)	$ 1,776,858	$ -	$ -	$(30,979)	$ 1,776,858
December 31, 2015						
U.S. Government and Agency Securities	$(2,197)	$ 997,803	$ -	$ -	$(2,197)	$ 997,803
Mortgage-Backed Securities	(10,284)	975,527	-	-	(10,284)	975,527
Obligations of State and Political Subdivisions	-	-	(11,819)	1,048,292	(11,819)	1,048,292
	$(12,481)	$ 1,973,330	$(11,819)	$1,048,292	$(24,300)	$ 3,021,622

As of December 31, 2016, the Bank had seven securities where estimated fair value had decreased from the Bank's amortized cost. Unrealized losses on debt securities have not been recognized into income because the issuers' bonds are above investment grade, 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 due to changes in interest rates. The fair value is expected to recover as the bonds approach maturity.

NOTE C - LOANS

The Bank's loan portfolio consists primarily of loans to borrowers within 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.

The Bank has pledged loans totaling approximately $165.8 million to secure a line of credit with the Federal Home Loan Bank as discussed in Note F.

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

	2016	2015
Beginning Balance	$ 2,711,612	$ 2,666,305
Additions to the Allowance Charged to Expense	350,000	90,000
Recoveries on Loans Charged Off	4,437	9,202
	3,066,049	2,765,507
Less Loans Charged Off	(6,049)	(53,895)
Ending Balance	$ 3,060,000	$ 2,711,612

The Bank also originates SBA loans for potential sale to institutional investors. A portion of the Bank's revenues are from origination of loans guaranteed by the Small Business Administration under its various programs and sale of the guaranteed portions of the loans. Funding for these loans depends on annual appropriations by the U.S. Congress. The Bank was servicing approximately $55,462,000 and $72,488,000 in SBA loans previously sold as of December 31, 2016 and 2015, respectively.

NOTE C - LOANS - Continued

The following table presents the activity in the allowance for loan losses for the year 2016 and 2015, and the recorded investment in loans and impairment method as of December 31, 2016 and 2015 by portfolio segment:

December 31, 2016	Real Estate - Construction	Real Estate - Other	Commercial	Consumer	Total
Allowance for Loan Losses:					
Beginning of Year	$ 436,661	$ 1,474,738	$ 785,887	$ 14,326	$ 2,711,612
Provisions	(81,195)	359,648	74,375	(2,828)	350,000
Charge-offs	-	-	(6,049)	-	(6,049)
Recoveries	-	-	4,437	-	4,437
End of Year	$ 355,466	$ 1,834,386	$ 858,650	$ 11,498	$ 3,060,000
Reserves:					
Specific	$ -	$ -	$ -	$ -	$ -
General	355,466	1,834,386	858,650	11,498	3,060,000
	$ 355,466	$ 1,834,386	$ 858,650	$ 11,498	$ 3,060,000
Loans Evaluated for Impairment:					
Individually	$ -	$ -	$ 51,731	$ -	$ 51,731
Collectively	24,996,204	161,481,188	45,643,698	791,765	232,912,855
	$24,996,204	$161,481,188	$45,695,429	$ 791,765	$232,964,586
December 31, 2015					
Allowance for Loan Losses:					
Beginning of Year	$ 422,744	$ 1,546,121	$ 681,508	$ 15,932	$ 2,666,305
Provisions	13,917	(71,383)	149,072	(1,606)	90,000
Charge-offs	-	-	(53,895)	-	(53,895)
Recoveries	-	-	9,202	-	9,202
End of Year	$ 436,661	$ 1,474,738	$ 785,887	$ 14,326	$ 2,711,612
Reserves:					
Specific	$ -	$ -	$ -	$ -	$ -
General	436,661	1,474,738	785,887	14,326	2,711,612
	$ 436,661	$ 1,474,738	$ 785,887	$ 14,326	$ 2,711,612
Loans Evaluated for Impairment:					
Individually	$ -	$ -	$ -	$ -	$ -
Collectively	29,454,205	123,376,999	42,827,272	949,344	196,607,820
	$29,454,205	$123,376,999	$42,827,272	$ 949,344	$196,607,820

NOTE C - 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, 2016:

December 31, 2016	Pass	Special Mention	Substandard	Impaired	Total
Real Estate - Construction	$ 24,996,204	$ -	$ -	$ -	$ 24,996,204
Real Estate - Other:					
Farmland	1,384,068	-	-	-	1,384,068
1-4 Residential	35,826,911	-	-	-	35,826,911
Multifamily	9,635,081	-	-	-	9,635,081
Commercial	114,635,128	-	-	-	114,635,128
Commercial	44,887,690	463,925	292,083	51,731	45,695,429
Consumer	791,765	-	-	-	791,765
	$232,156,847	$ 463,925	$ 292,083	$ 51,731	$232,964,586

NOTE C - LOANS - Continued

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 - Construction	$ 29,454,205	$ -	$ -	$ -	$ 29,454,205
Real Estate - Other:					
Farmland	1,415,264	-	-	-	1,415,264
1-4 Residential	29,796,942	-	-	-	29,796,942
Multifamily	1,998,643	-	-	-	1,998,643
Commercial	90,166,150	-	-	-	90,166,150
Commercial	42,123,671	536,769	166,832	-	42,827,272
Consumer	949,344	-	-	-	949,344
	$195,904,219	$ 536,769	$ 166,832	$ -	$196,607,820

There were no past due or nonaccrual loans as of December 31, 2015. Past due and nonaccrual loans presented by loan class were as follows as of December 31, 2016:

	Still Accruing			
December 31, 2016	30-59 Days Past Due	60-89 Days Past Due	Over 90 Days Past Due	Nonaccrual
Real Estate - Construction	$ -	$ -	$ -	$ -
Real Estate - Other:				
Farmland	-	-	-	-
1-4 Residential	-	-	-	-
Multifamily	-	-	-	-
Commercial	-	-	-	-
Commercial	-	-	-	51,731
Consumer	-	-	-	-
	$ -	$ -	$ -	$ 51,731

At December 31, 2016 the Bank had an impaired loan with unpaid principal and a recorded investment that amounted to $51,731, and no specific reserve. Average balance on impaired loans during 2016 amounted to $41,130 and no interest income was recognized. The Bank did not have any impaired loans during 2015.

NOTE D - PREMISES AND EQUIPMENT

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

	2016	2015
Leasehold Improvements	$ 936,106	$ 936,106
Furniture, Fixtures, and Equipment	1,517,679	1,453,834
	2,453,785	2,389,940
Less Accumulated Depreciation and Amortization	(1,468,986)	(1,226,211)
	$ 984,799	$ 1,163,729

The Bank has entered into leases for its main banking office and its Encinitas banking office. The Bank is responsible for common area maintenance, taxes and insurance. The leases expire on October 31, 2021 and April 1, 2022, respectively. At December 31, 2016, the future lease rental payable under the above operating leases are as follows:

2017	$ 462,319
2018	479,162
2019	496,190
2020	513,559
2021	478,586
Thereafter	55,828
Total	$ 2,485,644

The minimum rental payments shown above are given for the existing lease obligations and are not a forecast of future rental expense. Total rental expense, recognized on a straight line basis, was approximately $505,000 and $463,000 for the years ended December 31, 2016 and 2015, respectively.

NOTE E - DEPOSITS

At December 31, 2016, the scheduled maturities of time deposits are as follows:

Due in One Year or Less	$ 53,541,402
Due in One to Three Years	6,485,525
	$ 60,026,927

As of December 31, 2016 the Bank had six deposit relationships that each exceeded 2% of total deposits and aggregated approximately $94,944,000.

NOTE F - OTHER BORROWINGS

The Bank may borrow up to $7.5 million overnight on an unsecured basis from three correspondent banks. As of December 31, 2016 and 2015, no amounts were outstanding under these arrangements.

As of December 31, 2016, the Bank had an available line of credit with the Federal Home Loan Bank of San Francisco ("FHLBSF") secured by loans totaling approximately $165.8 million resulting in a secured borrowing capacity of approximately $99.7 million. As of December 31, 2016, the Bank borrowed $5,000,000 from the FHLBSF at a rate of 0.55%, with no stated maturity date. As of December 31, 2015, the Bank borrowed $25,000,000 from the FHLBSF at a rate of 0.27%, maturing January 4, 2016.

NOTE G - INCOME TAXES

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

	2016	2015
Current:		
Federal	$ 1,709,567	$ 1,405,913
State	599,633	551,087
	2,309,200	1,957,000
Deferred	11,000	245,000
	$ 2,320,200	$ 2,202,000

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

	2016		2015	
	Amount	Rate	Amount	Rate
Statutory Federal Tax	$ 1,870,000	34.0%	$ 1,774,000	34.0%
State Franchise Tax, net of Federal Benefit	402,000	7.3%	382,000	7.3%
Stock-Based Compensation	19,000	0.3%	22,000	0.4%
Other Items, net	29,200	0.6%	24,000	0.5%
Tax Expense	$ 2,320,200	42.2%	$ 2,202,000	42.2%

The Bank records interest and penalties related to uncertain tax positions as part of income tax expense. There was no penalty or interest expense recorded as of December 31, 2016 and 2015 The Bank does not expect the total amount of unrecognized tax benefits to significantly increase or decrease within the next twelve months.

The Bank is subject to federal income tax and franchise tax of the state of California. Income tax returns for the years ended after December 31, 2012 are open to audit by the federal authorities and for the years ended after December 31, 2011 are open to audit by California state authorities.

NOTE G - INCOME TAXES - Continued

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

	2016	2015
Deferred Tax Assets:		
Pre-Opening Expenses	$ 310,000	$ 359,000
Allowance for Loan Losses Due to Tax Limitations	1,093,000	949,000
Stock-Based Compensation	156,000	165,000
Reserves	275,000	293,000
Unrecognized Loss on AFS Securities	12,000	10,000
Other Items	79,000	88,000
	1,925,000	1,864,000
Valuation Allowance	-	-
Deferred Tax Liabilities:		
Depreciation Differences	(187,000)	(245,000)
Deductible Prepaid Items	(129,000)	(101,000)
Deferred Loan Costs	(274,000)	(174,000)
	(590,000)	(520,000)
Net Deferred Tax Assets	$ 1,335,000	$ 1,344,000

NOTE H - OTHER EXPENSES

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

	2016	2015
Data Processing and Computer Support	$ 482,565	$ 417,297
Legal and Professional	291,834	208,996
Marketing and Business Promotion	328,369	314,868
Regulatory Assessments	195,941	168,875
Director Expenses and Stock-Based Compensation	195,868	202,450
Office Expenses	180,782	149,933
Other	521,151	579,332
	$ 2,196,510	$ 2,041,751

NOTE I - COMMITMENTS

In the ordinary course of business, the Bank enters into financial commitments to meet the financing needs of its customers. These financial commitments include commitments to extend credit. 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, 2016 and 2015, the Bank had the following approximate outstanding financial commitments whose contractual amount represents credit risk:

	2016	2015
Commitments to Extend Credit	$ 66,401,000	$ 57,537,000

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 generally are secured by real estate.

NOTE J - RELATED PARTY TRANSACTIONS

In the ordinary course of business, the Bank has granted loans to certain officers and directors and the companies with which they are associated. The total commitment of these loans at December 31, 2016 and 2015 was approximately $1,615,000 and $419,000, 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 balance of these deposits at December 31, 2016 and 2015 was approximately $10,275,000 and $4,109,000, respectively.

NOTE K - STOCK OPTION PLAN

The Bank's 2008 Stock Option Plan was approved by its shareholders on June 12, 2008. Under the terms of the 2008 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. The Plan provides for options to purchase 450,096 shares of common stock at a price not less than 100% of the fair market value of the stock on the date of the grant. Stock options expire no later than ten years from the date of the grant and generally vest over four to five years. The Plan provides for accelerated vesting if there is a change of control, as defined in the Plan. The Bank recognized stock-based compensation cost of $56,296 in 2016 and $66,013 in 2015.

There were no options granted in 2016 and 2015.

As of December 31, 2016 there was $146,189 of total unrecognized compensation cost related to the outstanding stock options that will be recognized over a weighted average period of 2.6 years. The intrinsic value of options exercised during 2016 and 2015 was approximately $238,000 and $45,000, respectively.

A summary of the status of the Bank's stock option plan as of December 31, 2016 and changes during the year ending thereon is presented below:

	Shares	Weighted-Average Exercise Price	Weighted-Average Remaining Contractual Term	Aggregate Intrinsic Value
Outstanding at Beginning of Year	352,336	$ 10.65		
Granted	-	$ -		
Exercised	(30,633)	$ 10.00		
Forfeited or Expired	-	$ -		
Outstanding at End of Year	321,703	$ 10.71	1.9 Years	$ 3,793,000
Options Exercisable	300,703	$ 10.22	1.6 Years	$ 3,693,000

NOTE L - EMPLOYEE 401K PLAN

The Bank has adopted a 401(k) for its employees. Under the plan, eligible employees may defer a portion of their salaries. The plan also provides for matching contributions up to 100% of any deferrals not exceeding 6% of compensation. The Bank contributed and expensed approximately $149,000 and $150,000 in the years ended December 31, 2016 and 2015, 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:

	2016		2015	
	Income	Shares	Income	Shares
Net Income as Reported	$3,181,206		$3,014,232	
Dividends Paid on Preferred Stock	(81,084)		(31,320)	
Shares Outstanding at Year End		1,668,326		1,637,708
Impact of Weighting Shares Issued During the Year		(22,804)		(674)
Used in Basic EPS	3,100,122	1,645,522	2,982,912	1,637,034
Dilutive Effect of Outstanding Stock Options		101,759		102,221
Used in Diluted EPS	$3,100,122	1,747,281	$2,982,912	1,739,255

At December 31, 2016 and 2015 there were 5,250 and 10,500 stock options, respectively, that could potentially dilute earnings per share in the future that were not included in the computation of diluted earnings per share because to do so would have been antidilutive.

NOTE N - 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.

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 (Basel III rules). 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. Under the Basel III rules, the Bank must hold a capital conservation buffer above the adequately capitalized risk-based capital ratios. The capital conservation buffer is being phased in from 0.0% for 2015 to 2.50% by 2019. The capital conservation buffer for 2016 is 0.625%. The net unrealized gain or loss on available for sale securities is not included in computing regulatory capital.

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, 2016, that the Bank meets all capital adequacy requirements to which it is subject.

NOTE N - REGULATORY MATTERS - Continued

As of December 31, 2016, the most recent notification from the Federal Reserve Bank categorized the Bank as well capitalized under the regulatory framework for prompt corrective action (there are no conditions or events since that notification that management believes have changed the Bank's category). To be categorized as well capitalized, the Bank must maintain minimum ratios as set forth in the table below. The following table also sets forth the Bank's actual capital amounts and ratios (dollar amounts in thousands):

	Actual		Amount of Capital Required: For Capital Adequacy Purposes		Amount of Capital Required: To Be Well-Capitalized Under Prompt Corrective Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
As of December 31, 2016:						
Total Capital (to Risk-Weighted Assets)	$29,723	12.1%	$19,710	8.0%	$24,637	10.0%
Tier 1 Capital (to Risk-Weighted Assets)	$26,643	10.8%	$14,782	6.0%	$19,710	8.0%
CET1 Capital (to Risk-Weighted Assets)	$26,643	10.8%	$11,087	4.5%	$16,014	6.5%
Tier 1 Capital (to Average Assets)	$26,643	8.8%	$12,084	4.0%	$15,105	5.0%
As of December 31, 2015:						
Total Capital (to Risk-Weighted Assets)	$28,849	13.9%	$16,543	8.0%	$20,679	10.0%
Tier 1 Capital (to Risk-Weighted Assets)	$26,262	12.7%	$12,408	6.0%	$16,543	8.0%
CET1 Capital (to Risk-Weighted Assets)	$23,130	11.2%	$ 9,306	4.5%	$13,441	6.5%
Tier 1 Capital (to Average Assets)	$26,262	10.0%	$10,533	4.0%	$13,166	5.0%

The California Financial Code also 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 by the bank's shareholders during the same period.

NOTE O - 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 obtaining quoted prices on nationally recognized securities exchanges (Level 1) or 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 resulting in a level 2 classification.

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

	Fair Value Measurements Using			
December 31, 2016	Level 1	Level 2	Level 3	Total
Assets measured at fair value on a recurring basis				
Securities Available for Sale	$ -	$ 2,779,000	$ -	$ 2,779,000
December 31, 2015				
Assets measured at fair value on a recurring basis				
Securities Available for Sale	$ -	$ 3,022,000	$ -	$ 3,022,000

NOTE P - 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 potential effect on fair value estimates and have not been considered in many of the estimates.

NOTE P - FAIR VALUE OF FINANCIAL INSTRUMENTS - Continued

The following methods and assumptions were used to estimate the fair value of significant financial instruments:

Cash and Short-term Investments

The carrying amounts reported in the balance sheets for cash and due from banks, interest-bearing deposits and time deposits in other banks approximate their fair value.

Investment Securities

Fair value for securities is based on quoted market prices, when available, or on quoted market process for similar instruments. See Note O for the fair value of securities.

Loans

For variable-rate loans that re-price frequently and have experienced no significant change in credit risk, fair value is based on carrying value. Fair value for all other loans is estimated based on discounted cash flows using interest rates currently being offered for loans with similar terms to borrowers with similar credit quality resulting in a Level 3 classification. Prepayments prior to the re-pricing date are not expected to be significant. The methods utilized to estimate the fair value of loans do not necessarily represent an exit price.

Deposits

The fair values disclosed for demand deposits, including interest and non-interest demand accounts, savings, and certain types of money market accounts are, by definition based on carrying values resulting in a Level 1 classification. Fair value for fixed-rate certificates of deposit is estimated using a discounted cash flow calculation that applies interest rates currently being offered on certificates to a schedule of aggregate expected monthly maturities on time deposits resulting in a Level 2 classification. Early withdrawal of fixed-rate certificates of deposit is not expected to be significant.

Borrowings

The fair values of Federal Home Loan Bank Advances are based on discounted cash flows. The discount rate is equal to the market rate currently offered by similar products.

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.

NOTE P - FAIR VALUE OF FINANCIAL INSTRUMENTS - Continued

The fair value hierarchy level and estimated fair value of the Bank's significant financial instruments at December 31, 2016 and 2015 are summarized as follows (dollar amounts in thousands):

		2016		2015	
	Fair Value Hierarchy	Carrying Value	Fair Value	Carrying Value	Fair Value
Financial Assets:					
Cash and Cash Equivalents	Level 1	$ 46,949	$ 46,949	$ 64,163	$ 64,163
Time Deposits in Other Banks	Level 1	19,856	19,856	20,098	20,098
Investment Securities	Level 2	2,779	2,779	3,022	3,022
Loans Held For Sale	Level 2	876	876	41	41
Loans, net	Level 3	229,949	236,759	193,976	200,550
Financial Liabilities:					
Demand Deposits	Level 1	212,927	212,927	187,309	187,309
Time Deposits	Level 2	60,027	60,291	47,567	47,693
Borrowings	Level 1	5,000	5,000	25,000	25,000

NOTE Q - PREFERRED STOCK

On September 27, 2011, as part of the Small Business Lending Fund ("SBLF"), the Bank entered into a Small Business Lending Fund Securities Purchase Agreement ("SBLF Purchase Agreement") with the United States Department of the Treasury ("Treasury"). Under the SBLF Purchase Agreement, the Bank issued 3,132 shares of preferred stock series A to the Treasury and received $3,132,000 from the Treasury. The preferred stock series A shares qualify as Tier 1 capital and will pay quarterly dividends. The dividend rate is fixed at 1% and will increase to 9% on June 1, 2016 if not repaid at that time. The SBLF preferred stock was redeemed during 2016.

NOTE R - STOCK DIVIDEND

The Bank issued a 5% stock dividend in 2016. The per share data in the statements of income and the footnotes have been adjusted to give retroactive effect to this dividend.