



Bank of Santa Clarita | 2012 Annual Report



LETTER FROM THE CHAIRMAN OF THE BOARD

An Open Letter to our Shareholders, Clients and Community:

In light of a challenging economy over the past several years, there's one thing that we should all take away from this experience...it's that we are all impacted by swings in the economy.

That being said, it is our belief that achieving one's financial goals by adopting a strategic plan designed to deliver strong earnings, focusing on core competencies, maintaining a solid capital position while managing risk, and then remaining committed to that plan over time, while making adjustments when necessary, success will be the outcome.

That's been our strategy since our inception and we are pleased to present to you the results for 2012, which was a rewarding year for Bank of Santa Clarita.

In 2012, the Bank's loan portfolio, net of allowance for loan losses, grew to \$154 million, representing a 14.0% growth rate over the prior year, deposits grew to \$168 million, an increase of 12% during the year, and net earnings totaled \$559,000. In addition, the Bank posted record level pre-tax earnings amounting to \$887,000 in 2012, exceeding the \$613,000 recorded in 2011 by approximately 45%. The Bank continued to experience excellent credit quality in its loan portfolio marked by minimal non-accruals.

In terms of products and services, the Bank stepped up its investment in the franchise through enhanced technology-based products and services this year. This strategy will allow the Bank to offer new products in the coming year and increase efficiencies to compete effectively in its marketplace.

The Bank also received the "2012 The Medium Size Business of the Year" award from the members of the Santa Clarita Valley Chamber of Commerce. This award is a testament to our employees' commitment to give back to the community through personal service to those we serve in many positive ways.

In closing, we have all worked very hard this last year, but I credit the Bank's success to our employees, who remain committed to our fundamental core values of integrity, quality of work and respect for one another, while delivering products and services to our customers and to a community that have overwhelmingly supported us.

We look forward to an even more successful 2013.

Sincerely,

Frank D. Di Tomaso
Chairman & CEO

BANK OF SANTA CLARITA
Santa Clarita, California

FINANCIAL STATEMENTS
December 31, 2012 and 2011

BANK OF SANTA CLARITA
Santa Clarita, California

FINANCIAL STATEMENTS
December 31, 2012 and 2011

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**These statements have not been reviewed, or confirmed for accuracy or relevance,
by the Federal Deposit Insurance Corporation.**

INDEPENDENT AUDITOR'S REPORT

Board of Directors
Bank of Santa Clarita
Santa Clarita, California

Report on the Financial Statements

We have audited the accompanying financial statements of Bank of Santa Clarita, which comprise the balance sheet as of December 31, 2012, and the related statements of earnings, comprehensive income, changes in stockholders' equity, and cash flows for the year then ended, and the related notes to 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 audit. We conducted our audit 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 Bank of Santa Clarita as of December 31, 2012, and the results of its operations and its cash flows for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Other Matter

The financial statements of Bank of Santa Clarita as of and for the year ended December 31, 2011, were audited by other auditors whose report dated March 15, 2012, expressed an unqualified opinion on those statements.

Crowe Horwath LLP
Crowe Horwath LLP

Sherman Oaks, California
April 23, 2013

BANK OF SANTA CLARITA
BALANCE SHEETS
December 31, 2012 and 2011
(Dollar amounts in thousands)

	<u>2012</u>	<u>2011</u>
ASSETS		
Cash and due from banks	\$ 29,487	\$ 26,961
Federal funds sold	<u>2,000</u>	<u>1,855</u>
Total cash and cash equivalents	31,487	28,816
Investment securities available for sale	31,945	32,507
Investment securities held to maturity (fair value 2012 - \$250; 2011 - \$250)	250	250
Loans, net of allowance for loan losses of \$2,001 and \$1,756	155,925	136,999
Federal Home Loan Bank ("FHLB") stock and The Independent Bankers Bank ("TIBB") stock, at cost	2,451	1,891
Premises and equipment, net	9,399	7,126
Accrued interest receivable	639	614
Deferred tax asset	570	936
Other assets	<u>651</u>	<u>866</u>
Total assets	<u>\$ 233,317</u>	<u>\$ 210,005</u>
LIABILITIES AND STOCKHOLDERS' EQUITY		
Deposits		
Noninterest bearing demand	\$ 49,232	\$ 43,308
Money market and savings	50,349	34,087
Interest bearing demand	7,861	7,493
Time deposits individually greater than \$100	33,002	46,137
Other time deposits	<u>27,420</u>	<u>19,506</u>
Total deposits	167,864	150,531
Borrowings		
Borrowings	42,000	36,500
Accrued interest payable	32	38
Other liabilities	<u>2,015</u>	<u>2,179</u>
Total liabilities	<u>211,911</u>	<u>189,248</u>
Stockholders' equity		
Preferred stock - no par value; 10,000,000 shares authorized; no shares issued or outstanding	-	-
Common stock - no par value; 12,500,000 shares authorized; 2,219,509 shares issued and outstanding at December 31, 2012 and 2011	21,712	21,712
Additional paid in capital	388	382
Accumulated deficit	(690)	(1,249)
Unrealized loss on available-for-sale securities, net of taxes	<u>(4)</u>	<u>(88)</u>
Total stockholders' equity	<u>21,406</u>	<u>20,757</u>
Total liabilities and stockholders' equity	<u>\$ 233,317</u>	<u>\$ 210,005</u>

The accompanying notes are an integral part of these financial statements

BANK OF SANTA CLARITA
STATEMENTS OF EARNINGS
For the years ended December 31, 2012 and 2011
(Dollar amounts in thousands, except per share amounts)

	<u>2012</u>	<u>2011</u>
Interest income		
Interest and fees on loans	\$ 7,792	\$ 7,664
Interest on Federal funds sold	2	2
Interest on investment securities	821	1,085
Interest on deposits at other financial institutions	<u>76</u>	<u>73</u>
Total interest income	8,691	8,824
Interest expense on deposits		
Money market and savings	200	206
Interest bearing demand	26	26
Time deposits of \$100 or greater	387	677
Time deposits less than \$100	<u>560</u>	<u>629</u>
Total interest expense on deposits	1,173	1,538
Interest expense on borrowings	<u>645</u>	<u>652</u>
Total interest expense	<u>1,818</u>	<u>2,190</u>
Net interest income	6,873	6,634
Provision for loan losses	<u>234</u>	<u>50</u>
Net interest income after provision for loan losses	<u>6,639</u>	<u>6,584</u>
Noninterest income		
Service charges on deposit accounts	279	344
Net gain on sale of investment securities	178	205
Customer fees and miscellaneous income	<u>164</u>	<u>110</u>
Total noninterest income	621	659
Noninterest expenses		
Salaries and employee benefits	3,819	3,394
Occupancy and equipment	868	1,318
Marketing and business development	117	168
Data processing	317	348
Professional and legal	616	508
Insurance and regulatory assessments	279	279
Office supplies and communications	149	166
Other operating expenses	<u>208</u>	<u>449</u>
Total noninterest expenses	<u>6,373</u>	<u>6,630</u>
Earnings before income taxes	887	613
Income tax expense	<u>328</u>	<u>232</u>
Net earnings	<u>\$ 559</u>	<u>\$ 381</u>
Basic earnings per common share	\$ 0.25	\$ 0.17
Diluted earnings per common share	\$ 0.25	\$ 0.17

The accompanying notes are an integral part of these financial statements

BANK OF SANTA CLARITA
STATEMENTS OF COMPREHENSIVE INCOME
For the years ended December 31, 2012 and 2011
(Dollar amounts in thousands)

	<u>2012</u>	<u>2011</u>
Net earnings	\$ 559	\$ 381
Other comprehensive income:		
Unrealized gains/losses on securities:		
Unrealized holding gains/ (losses) arising during the year	320	472
Reclassification adjustment for losses (gains) included in net income	<u>(178)</u>	<u>(205)</u>
Total	142	267
Tax effect	<u>58</u>	<u>107</u>
Total other comprehensive income	<u>84</u>	<u>160</u>
Comprehensive income	<u>\$ 643</u>	<u>\$ 541</u>

The accompanying notes are an integral part of these financial statements

BANK OF SANTA CLARITA
STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY
For the years ended December 31, 2012 and 2011
(Dollar amounts in thousands)

<u>Outstanding Stock</u>	<u>Number of Shares Outstanding</u>	<u>Common Stock</u>	<u>Additional Paid in Capital</u>	<u>Accumulated Deficit</u>	<u>Accumulated Other Comprehensive Income (Loss)</u>	<u>Total</u>
Balance, December 31, 2010	2,219,509	\$ 21,712	\$ 367	\$ (1,630)	\$ (248)	\$ 20,201
Net earnings	-	-	-	381	-	381
Other comprehensive income	-	-	-	-	160	160
Share-based compensation expense	-	-	15	-	-	15
Balance, December 31, 2011	2,219,509	21,712	382	(1,249)	(88)	20,757
Net earnings	-	-	-	559	-	559
Other comprehensive income	-	-	-	-	84	84
Share-based compensation expense	-	-	6	-	-	6
Balance, December 31, 2012	<u>2,219,509</u>	<u>\$ 21,712</u>	<u>\$ 388</u>	<u>\$ (690)</u>	<u>\$ (4)</u>	<u>\$ 21,406</u>

The accompanying notes are an integral part of these financial statements

BANK OF SANTA CLARITA
STATEMENTS OF CASH FLOWS
For the years ended December 31, 2012 and 2011
(Dollar amounts in thousands)

	<u>2012</u>	<u>2011</u>
Cash flows from operating activities		
Net earnings	\$ 559	\$ 381
Adjustment to reconcile net earnings to net cash provided by operating activities		
Provision for loan losses	234	50
Depreciation and amortization of premises and equipment	400	786
Amortization of premiums and discounts on investment securities, net	439	456
Amortization of deferred loan costs and fees, net	173	151
FHLB and TIBB stock dividends	(1)	(1)
Net gain on sale of investment securities	(178)	(205)
Share-based compensation expense	6	15
Net change in:		
Accrued interest receivable	(25)	128
Deferred tax asset	387	224
Other assets	194	371
Accrued interest payable	(6)	(16)
Other liabilities	(219)	(113)
Net cash provided by operating activities	<u>1,963</u>	<u>2,227</u>
Cash flows from investing activities		
Purchase of investment securities	(26,741)	(26,043)
Principal repayments on securities	2,026	1,907
Proceeds from sale of investment securities	25,156	34,684
Loan originations and principal collections, net	(19,333)	(7,369)
FHLB and TIBB stock purchases, net	(560)	(107)
Purchase of premises and equipment	(2,673)	(1,697)
Net cash (used in) provided by investing activities	<u>(22,125)</u>	<u>1,375</u>
Cash flows from financing activities		
Net increase (decrease) in deposits	17,333	(1,664)
Net increase (decrease) in short-term borrowings	(11,500)	750
Proceeds from long-term borrowings	20,000	3,000
Repayment of long-term borrowings	(3,000)	(3,000)
Net cash provided by (used in) financing activities	<u>22,833</u>	<u>(914)</u>
Net increase in cash and cash equivalents	2,671	2,688
Cash and cash equivalents, beginning of year	<u>28,816</u>	<u>26,128</u>
Cash and cash equivalents, end of year	<u>\$ 31,487</u>	<u>\$ 28,816</u>
Supplemental cash flow information:		
Interest paid	\$ 1,824	\$ 2,206
Income taxes paid	\$ -	\$ 40

The accompanying notes are an integral part of these financial statements

BANK OF SANTA CLARITA
NOTES TO FINANCIAL STATEMENTS
December 31, 2012 and 2011
(Dollar amounts in thousands)

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

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

Nature of Operations: The Bank commenced operations in October 2004. The Bank operates as a community oriented commercial bank that offers a variety of banking services to individuals and small- to medium-sized businesses in Santa Clarita and surrounding communities. Banking services include real estate, Small Business Administration ("SBA"), commercial and consumer loans, consumer and business checking accounts, savings accounts, certificates of deposit, trade finance, money transfers and other services. The Bank operates from its corporate headquarters and banking offices located in Santa Clarita, California. The Bank is a state chartered depository institution, the deposits of which are insured by the Federal Deposit Insurance Corporation (the "FDIC"). As an insured depository institution, the Bank is subject to the regulations of certain Federal and State agencies and undergoes periodic examination by those regulatory authorities.

Use of Estimates: In preparing financial statements in conformity with accounting principles generally accepted in the United States of America, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the dates of the balance sheets, and the reported amounts of revenues and expenses during the reporting periods covered. Actual results could differ from those estimates. Material estimates that are particularly susceptible to significant change in the near term relate to the determination of the allowance for loan losses and the valuation of deferred tax assets and liabilities.

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

Subsequent Events: The Bank has evaluated subsequent events for recognition and disclosure through April 23, 2013, which is the date the financial statements were available to be issued.

Cash and Cash Equivalents: For purposes of reporting cash flows, cash and cash equivalents include cash on hand, amounts due from correspondent banks with maturities fewer than 90 days, and Federal funds sold on a daily basis.

All depository institutions are required by law to maintain reserves on transaction accounts and non-personal time deposits in the form of cash balances at the Federal Reserve Bank. Cash balances held at the Bank can offset a portion the reserve requirements. The Bank complied with the reserve requirements as of December 31, 2012 and 2011.

Investment Securities: The Bank classifies its investments in securities as Held-to-Maturity ("HTM") securities and Available-for-Sale ("AFS") securities, as applicable. Debt securities that management has the positive intent and ability to hold to maturity are classified as held to maturity and recorded at amortized cost. Any securities not classified as held to maturity, including equity securities with readily determinable fair values, are classified as AFS securities and consist of its investments in mortgage backed securities and collateralized mortgage obligations.

Investments designated as AFS securities are recorded at fair value. Changes in the fair values of AFS securities are reported as an amount in stockholders' equity net of related income taxes until realized.

(Continued)

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Purchase premiums and discounts on investment securities are recognized in interest income using a method which approximates the interest method, over the estimated lives of the securities. Gains and losses on the sale of securities are recorded on the trade date and are determined using the specific identification method.

AFS securities are carried at fair value, with unrealized holding gains and losses reported in other comprehensive income, net of income taxes. 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: The Bank grants real estate secured (including construction) and consumer loans to borrowing customers. A substantial portion of the loan portfolio is represented by real estate loans in the Los Angeles metropolitan area. The ability of the Bank's borrowers to honor their contracts is dependent upon many factors, including the real estate market and general economic conditions in the Los Angeles metropolitan area. Loans that management has the intent and ability to hold for the foreseeable future, until maturity or until paid off, are generally reported at their outstanding unpaid principal balances. These loans, as reported, have been reduced by unadvanced loan funds, net deferred loan fees, and the allowance for loan losses.

Interest income is accrued daily as earned on all loans based on the loans' unpaid principal balances. Interest is generally not accrued on loans that are 90 days or more past due, which is generally based on the contractual terms of the respective loans. These loans are normally placed on non-accrual status unless they are well secured by collateral and in the process of collection. Interest income previously accrued on such loans is reversed against current period interest income. Interest income on non-accrual loans is generally recognized only to the extent of interest payments received. Discontinued interest accruals are resumed on loans only when they are brought fully current with respect to interest and principal payments due and when, in the judgment of management, the loans are determined to be fully collectible as to both principal and interest.

Loan origination fees and certain direct loan origination costs, net, are deferred and amortized as an adjustment of the loan's yield over the life of the loan using the interest method for amortizing loans (generally resulting in a constant rate of return), and the straight-line method for interest-only loans.

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NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Allowance for Loan Losses: The allowance for loan losses (the "ALL") is a valuation allowance for probable incurred credit losses. Loan losses are charged against the ALL when management believes the uncollectibility of a loan balance is confirmed. Subsequent recoveries, if any, are credited to the ALL. Management estimates the ALL 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 ALL may be made for specific loans, but the entire ALL 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 ALL 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. Loans for which the terms have been modified resulting in a concession and for which the borrower is experiencing financial difficulties are generally considered troubled debt restructurings and classified as impaired with measurement of impairment based on expected future cash flows discounted using the loan's effective rate immediately prior to the restructuring.

The Bank recognizes interest income on impaired loans based on its existing methods of recognizing interest income on nonaccrual loans.

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. Smaller balance, homogeneous loans are collectively evaluated for impairment.

General reserves cover non-impaired loans and are based on historical loss rates for each portfolio segment, 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.

(Continued)

BANK OF SANTA CLARITA
NOTES TO FINANCIAL STATEMENTS
December 31, 2012 and 2011
(Dollar amounts in thousands)

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Portfolio segments identified by the Bank include loans secured by real estate 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 ratios, collateral type, and loan-to-value ratios for consumer loans.

Real estate secured: Real estate secured loans primarily consists of loan secured by commercial real estate. At December 31, 2012, real estate secured loans also included \$3,422 of residential real estate loans and \$1,702 of construction loans. These loans are also secured by real estate. Risk arises primarily due to a difference between expected and actual cash flows of the borrowers. However, the recoverability of the Bank's investment in these loans is also dependent on other factors primarily dictated by the type of collateral securing these loans. The fair value of the collateral securing these loans may fluctuate as market conditions change. In the case of loans secured by accounts receivable, the recovery of the Bank's investment is dependent upon the borrowers' ability to collect amounts due from its customers.

Consumer loans: Consumer loans consist of loans secured by underlying collateral, primarily automobiles. Repayment of these loans is dependent on the borrowers' ability to pay and the fair value of the underlying collateral.

Transfers of Financial Assets: Transfers of financial assets by the Bank are accounted for as sales when control over the assets has been surrendered. Control over transferred assets is deemed to be surrendered when: (1) the assets have been isolated from the Bank, (2) the transferee obtains the right (free of conditions that constrain it from taking advantage of that right) to pledge or exchange the transferred assets, and (3) the Bank does not maintain effective control over the transferred assets through an agreement to repurchase them before their maturity.

Premises and Equipment: Land is carried at cost. Premises and equipment are reported at cost less accumulated depreciation and amortization. Depreciation is provided for in amounts sufficient to relate the cost of depreciable assets to operations over their estimated effective service lives, which range from three years to 15 years for equipment and furniture. Leasehold improvements are amortized over the term of the lease or the effective service lives of the improvements, whichever is shorter. Buildings owned (excluding land) are depreciated over various lives, based on the nature of the asset, for 25 through 40 years. The straight-line method of depreciation is followed for financial reporting purposes, while both accelerated and straight-line methods are followed for income tax purposes.

Leasehold improvements include amounts paid by the property owners as lease incentives, and offsetting deferred rental income amounts are included in other liabilities. Both amounts are amortized over the life of the respective lease.

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 their level of borrowings and other factors. 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.

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NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Earnings Per Common Share: Basic earnings per common share represent income available to common stock divided by the weighted average number of common shares outstanding during the period. Diluted earnings per common share reflect additional common shares that would have been outstanding if dilutive potential common shares had been issued, as well as any adjustment to income that would result from their assumed conversion. Potential common shares issued by the Bank relate to outstanding stock options, and are determined using the treasury stock method. The weighted average numbers of common shares used to calculate basic and diluted earnings per common share for 2012 and for 2011 were 2,219,509 for both years, and were the same for both basic and diluted.

Off-Balance Sheet Financial Instruments: In the ordinary course of business, the Bank has entered into off-balance sheet financial instruments consisting of commitments to extend credit, commitments under credit card advancements, foreign trade instruments, and standby letters of credit as described in Note 9. Such financial instruments are recorded in the financial statements when they become payable. The credit risk associated with these agreements and commitments is considered by management and, where appropriate, reserved for at a level deemed adequate to provide for known and inherent losses.

Derivative Financial Instruments: The Bank has also utilized derivative financial instruments consisting of interest rate swap agreements in limited instances to assist in managing its overall exposure to fluctuations in interest rates as described in Note 17. These derivatives were designated by management as fair value hedges at inception. The Bank formally documents the nature and relationships between the hedging instruments and hedged items at inception, as well as its risk-management objectives, strategies for undertaking the various hedge transactions, and method of assessing hedge effectiveness. The fair value hedges meet the criteria for the shortcut method of accounting. The shortcut method presumes the hedge is completely effective, with all changes in fair value recognized as a basis adjustment on the hedged loans and the derivative liability account. Net cash settlements on derivatives that qualify for hedge accounting are recorded in interest income or interest expense, based on the item being hedged.

Comprehensive Income: Accounting principles generally require that recognized revenue, expenses, gains, and losses be included in net income. Although certain changes in assets and liabilities, such as unrealized gains and losses on AFS securities, are reported as a separate component of the equity section of the balance sheet, net of taxes; such items, along with net earnings, are components of comprehensive income.

Income Taxes: Deferred income taxes are recognized for estimated future tax effects attributable to income tax loss carryforwards as well as temporary differences between financial reporting and income tax purposes. Valuation allowances are established when necessary to reduce the deferred tax asset to the amount expected to be realized. Deferred tax assets and liabilities are reflected at currently enacted income tax rates applicable to the period in which the deferred tax assets or liabilities are expected to be realized or settled. As changes in tax laws or rates are enacted, deferred tax assets and liabilities are adjusted accordingly through the income tax expense.

(Continued)

BANK OF SANTA CLARITA
NOTES TO FINANCIAL STATEMENTS
December 31, 2012 and 2011
(Dollar amounts in thousands)

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

The Bank is subject to Federal income tax and income tax of the State of California. The Bank's Federal income tax returns for the years ended December 31, 2009 through 2011 have been filed, and the 2009, 2010 and 2011 returns are open to audit by the Internal Revenue Service. The Bank's California income tax returns for the years ended December 31, 2008 through 2011 have been filed, and the 2008, 2009, 2010 and 2011 returns are open to audit by the State of California.

The Bank has adopted guidance issued by the Financial Accounting Standards Board 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, with a tax examination being presumed to occur. The amount recognized is the largest amount of tax benefit that is greater than 50% likely of being realized upon examination. For tax positions not meeting the "more likely than not" test, no tax benefit is recorded. Interest and penalties related to tax matters are recorded as part of income tax expense; however, there was no penalty or interest expense recorded for the years ended December 31, 2012 and 2011.

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

Share-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, which is generally the vesting period. For additional information on the Bank's stock option plan see Note 10.

Dividend Restriction: Banking regulations require the Bank to maintain certain capital levels and may limit the amount of dividends paid by the Bank to its shareholders.

Fair Value Measurement: Fair value is the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. Current accounting guidance establishes a fair value hierarchy, which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. That guidance describes three levels of inputs that may be used to measure fair value:

Level 1: Quoted prices (unadjusted) for identical assets or liabilities in active markets that the entity has the ability to access as of the measurement date.

Level 2: Significant other observable inputs (other than Level 1 prices) such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data.

Level 3: Significant unobservable inputs that reflect an entity's own assumptions about the factors that market participants would use in pricing an asset or liability.

Fair values of financial instruments are estimated using relevant market information and other assumptions, as more fully disclosed in a separate note. Fair value estimates involve uncertainties and matters of significant judgment regarding interest rates, credit risk, prepayments, and other factors,

(Continued)

BANK OF SANTA CLARITA
NOTES TO FINANCIAL STATEMENTS
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NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

especially in the absence of broad markets for particular items. Changes in assumptions or in market conditions could significantly affect these estimates. See Note 16 for more information and disclosures relating to the Bank's fair value measurements.

NOTE 2 - INTEREST BEARING DEPOSITS AT OTHER FINANCIAL INSTITUTIONS AND OTHER INVESTMENT SECURITIES

As of December 31, 2012 and 2011, the Bank had invested \$25,852 and \$22,928, respectively, in money market deposit accounts ("MMDAs") at correspondent banking institutions. The Bank maintains balances in MMDAs that exceed federally insured limits and has not experienced any losses on such deposits. These MMDAs had no fixed maturity date, and at December 31, 2012 and 2011, had an average yield of approximately 0.31% and 0.33%, respectively.

The amortized cost and fair value of investment securities available for sale were as follows at December 31, 2012:

	<u>Amortized Cost</u>	<u>Gross Unrealized Gains</u>	<u>Gross Unrealized Losses</u>	<u>Fair Value</u>
<u>Available-for-Sale</u>				
Mortgaged-backed securities ("MBSs"):				
Single family residential loans	\$ 28,675	\$ 173	\$ 178	\$ 28,670
Multifamily residential loans	<u>3,275</u>	<u>-</u>	<u>-</u>	<u>3,275</u>
Total	<u>\$ 31,950</u>	<u>\$ 173</u>	<u>\$ 178</u>	<u>\$ 31,945</u>

The MBSs in the preceding table were tranches of GNMA collateralized mortgage obligations (the "CMOs") and other GNMA MBSs which have the full faith and credit guarantee of the U.S. Government. At December 31, 2012, the MBSs had a weighted average yield of 1.23%, contractual maturity dates between 2021 and 2062 and an estimated effective life of approximately 3.8 years. At December 31, 2012, there were seven securities with an amortized cost basis of \$11,795 which had aggregate fair values \$178 below such cost basis. As a result of having fair values below their respective cost basis, these securities were considered temporarily impaired; these securities had all been in an impaired status for less than twelve months. All of the MBSs included in the table above were pledged as collateral for FHLB borrowings.

The amortized cost and fair value of investment securities available for sale were as follows at December 31, 2011:

	<u>Amortized Cost</u>	<u>Gross Unrealized Gains</u>	<u>Gross Unrealized Losses</u>	<u>Fair Value</u>
<u>Available-for-Sale</u>				
Mortgaged-backed securities (MBSs):				
Single family residential loans	\$ 32,654	\$ 124	\$ 271	\$ 32,507
Total	<u>\$ 32,654</u>	<u>\$ 124</u>	<u>\$ 271</u>	<u>\$ 32,507</u>

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BANK OF SANTA CLARITA
NOTES TO FINANCIAL STATEMENTS
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NOTE 2 – INTEREST-BEARING DEPOSITS AT OTHER FINANCIAL INSTITUTIONS AND OTHER INVESTMENT SECURITIES (Continued)

The MBSs in the preceding table were CMOs as described above. At December 31, 2011, they had a weighted average yield of 2.65%, contractual maturity dates between 2032 and 2040, and an estimated effective life of approximately 5.2 years. At December 31, 2011, there were eleven securities with an amortized cost basis of \$23,189 which had aggregate fair values \$271 below such cost basis. As a result of having fair values below their respective cost bases, these securities were considered temporarily impaired; these securities had been in an impaired status for less than twelve months. All of the MBSs included in the table above were pledged as collateral for FHLB borrowings, and the U.S. Treasury security described below was pledged as collateral for public agency certificates of deposit.

Expected maturities of MBSs may differ from contractual maturities because borrowers generally have the right to call or prepay the mortgage loans which are the collateral for these securities and are, therefore, classified separately with no specific maturity date.

The Bank does not consider these investments to be other-than-temporarily impaired at December 31, 2012 or 2011. Should the impairment of any of these investments become other than temporary, the cost basis of the investment will be reduced and the resulting loss will be recognized in the period in which the OTTI is identified.

The amortized cost and fair value of investment securities held to maturity were as follows at December 31, 2012 and 2011:

	<u>Amortized Cost</u>	<u>Gross Unrecognized Gains</u>	<u>Gross Unrecognized Losses</u>	<u>Fair Value</u>
<u>December 31, 2012</u>				
Held-to-maturity				
U.S. Treasury securities	\$ 250	\$ -	\$ -	\$ 250
<u>December 31, 2011</u>				
Held-to-maturity				
U.S. Treasury securities	\$ 250	\$ -	\$ -	\$ 250

The proceeds from sales of securities and the associated gains and losses for the years ended December 31 are listed below:

	<u>2012</u>	<u>2011</u>
Proceeds	\$ 25,156	\$ 34,684
Gross gains	183	221
Gross losses	(5)	(16)

The tax provision related to these net realized gains was \$71 and \$82 for the years ended December 31 2012 and 2011, respectively.

Restricted stock consists of FHLB and TIBB stock of \$2,451 at December 31, 2012 and \$1,891 at December 31, 2011.

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BANK OF SANTA CLARITA
NOTES TO FINANCIAL STATEMENTS
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(Dollar amounts in thousands)

NOTE 2 – INTEREST-BEARING DEPOSITS AT OTHER FINANCIAL INSTITUTIONS AND OTHER INVESTMENT SECURITIES (Continued)

At year-end 2012 and 2011, there were no holdings of investments of any one issuer, other than the U.S. Government and its agencies, in an amount greater than 10 percent of stockholders' equity.

NOTE 3 - LOANS AND ALLOWANCE FOR LOAN LOSSES

The composition of the Bank's loan portfolio at December 31, 2012 and 2011 was as follows:

	<u>2012</u>	<u>2011</u>
Real estate secured	\$ 146,242	\$ 125,265
Consumer	10,079	11,867
Allowance for loan losses	(2,001)	(1,756)
Deferred loan costs and fees, net	<u>1,605</u>	<u>1,623</u>
	<u>\$ 155,925</u>	<u>\$ 136,999</u>

The following tables present the activity in the allowance for loan losses for the years 2012 and 2011, and the recorded investment in loans and impairment method as of December 31, 2012 and 2011, by portfolio segment:

<u>December 31, 2012</u>	<u>Real Estate - Secured</u>	<u>Consumer</u>	<u>Total</u>
Allowance for loan losses:			
Beginning of year	\$ 1,649	\$ 107	\$ 1,756
Provisions for loan losses	252	(18)	234
Charge-offs	-	-	-
Recoveries	-	11	11
	<u>1,901</u>	<u>100</u>	<u>2,001</u>
End of year	<u>\$ 1,901</u>	<u>\$ 100</u>	<u>\$ 2,001</u>
Reserves:			
Specific	\$ 88	\$ -	\$ 88
General	<u>1,813</u>	<u>100</u>	<u>1,913</u>
	<u>\$ 1,901</u>	<u>\$ 100</u>	<u>\$ 2,001</u>
<u>December 31, 2012</u>			
Loans evaluated for impairment:			
Individually	\$ 831	\$ -	\$ 831
Collectively	<u>145,411</u>	<u>10,079</u>	<u>155,490</u>
	<u>\$ 146,242</u>	<u>\$ 10,079</u>	<u>\$ 156,321</u>

(Continued)

BANK OF SANTA CLARITA
NOTES TO FINANCIAL STATEMENTS
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NOTE 3 - LOANS AND ALLOWANCE FOR LOAN LOSSES (Continued)

<u>December 31, 2011</u>	<u>Real Estate - Secured</u>	<u>Consumer</u>	<u>Total</u>
Allowance for loan losses:			
Beginning of year	\$ 1,523	\$ 179	\$ 1,702
Provisions for loan losses	126	(76)	50
Charge-offs	-	-	-
Recoveries	-	4	4
	<u> </u>	<u> </u>	<u> </u>
End of year	<u>\$ 1,649</u>	<u>\$ 107</u>	<u>\$ 1,756</u>
Reserves:			
Specific	\$ 84	\$ 1	\$ 85
General	<u>1,565</u>	<u>106</u>	<u>1,671</u>
	<u>\$ 1,649</u>	<u>\$ 107</u>	<u>\$ 1,756</u>
Loans evaluated for impairment:			
Individually	\$ 850	\$ 15	\$ 865
Collectively	<u>124,415</u>	<u>11,852</u>	<u>136,267</u>
	<u>\$ 125,265</u>	<u>\$ 11,867</u>	<u>\$ 137,132</u>

The Bank categorized 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 real estate secured loans individually by classifying the loans as to credit risk. This analysis is performed on an ongoing basis as new information is obtained. The Bank uses the following definitions for risk ratings:

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 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.

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BANK OF SANTA CLARITA
NOTES TO FINANCIAL STATEMENTS
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NOTE 3 - LOANS AND ALLOWANCE FOR LOAN LOSSES (Continued)

Loans listed as pass include larger non-homogeneous loans not meeting the risk rating definitions above and smaller, homogeneous loans which are not assessed on an individual basis. Consumer loans generally consist of a large number of relatively small balance loans that are not classified on a loan-by-loan basis, but are included in homogeneous groups of loans which are graded "pass" unless there is a specific issue (such as delinquency status) present for a loan, in which case that loan is graded accordingly. Consumer loans past due 90 days from the contractual due date are risk graded and classified as substandard or impaired. Consumer loans that are performing based on contractual loan terms are classified as pass graded loans.

The risk category of loans by class of loans was as follows as of December 31, 2012:

	<u>Pass</u>	<u>Special Mention</u>	<u>Sub- Standard</u>	<u>Impaired</u>	<u>Total</u>
<u>December 31, 2012</u>					
Real estate secured	\$ 140,728	\$ 3,067	\$ 1,616	\$ 831	\$ 146,242
Consumer	<u>10,079</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>10,079</u>
	<u>\$ 150,807</u>	<u>\$ 3,067</u>	<u>\$ 1,616</u>	<u>\$ 831</u>	<u>\$ 156,321</u>

The risk category of loans by class of loans was as follows as of December 31, 2011:

	<u>Pass</u>	<u>Special Mention</u>	<u>Sub- Standard</u>	<u>Impaired</u>	<u>Total</u>
<u>December 31, 2011</u>					
Real estate secured	\$ 120,932	\$ 1,423	\$ 2,060	\$ 850	\$ 125,265
Consumer	<u>11,852</u>	<u>-</u>	<u>-</u>	<u>15</u>	<u>11,867</u>
	<u>\$ 132,784</u>	<u>\$ 1,423</u>	<u>\$ 2,060</u>	<u>\$ 865</u>	<u>\$ 137,132</u>

The following table presents the aging of the loans past due and nonaccrual loans as of December 31, 2012 and 2011 by class of loans:

	<u>Still Accruing</u>			<u>Total Past Due</u>	<u>Loan Not Past Due</u>	<u>Total</u>	<u>Non- accrual</u>
	<u>30-59 Past Due</u>	<u>60-89 Days Past Due</u>	<u>90 or More Days Past Due</u>				
<u>December 31, 2012</u>							
Real estate secured	\$ -	\$ -	\$ 362	\$ 362	\$145,880	\$146,242	\$ -
Consumer	<u>44</u>	<u>-</u>	<u>-</u>	<u>44</u>	<u>10,035</u>	<u>10,079</u>	<u>5</u>
	<u>\$ 44</u>	<u>\$ -</u>	<u>\$ 362</u>	<u>\$ 406</u>	<u>\$155,915</u>	<u>\$156,321</u>	<u>\$ 5</u>

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BANK OF SANTA CLARITA
NOTES TO FINANCIAL STATEMENTS
December 31, 2012 and 2011
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NOTE 3 - LOANS AND ALLOWANCE FOR LOAN LOSSES (Continued)

	Still Accruing			Total Past Due	Loan Not Past Due	Total	Non- accrual
	30-59 Past Due	60-89 Days Past Due	90 or More Days Past Due				
<u>December 31, 2011</u>							
Real estate secured	\$ 397	\$ 10	\$ -	\$ 407	\$124,858	\$125,265	\$ -
Consumer	-	-	-	-	11,867	11,867	15
	<u>\$ 397</u>	<u>\$ 10</u>	<u>\$ -</u>	<u>\$ 407</u>	<u>\$136,725</u>	<u>\$137,132</u>	<u>\$ 15</u>

Troubled Debt Restructurings: As of December 31, 2012 and 2011, the Bank had a recorded investment in troubled debt restructurings ("TDRs") of \$831 and \$845, respectively. The Bank allocated \$88 and \$84 of specific reserves for those loans at December 31, 2012 and 2011, respectively, and has not committed to lend any additional amounts under those respective loan agreements.

During the year ending December 31, 2011, the terms of two loans were modified as TDRs. The modification of the terms of such loans included one of the following: a reduction of the stated interest rate of the loan; or a restructuring of the timing of required principal payments on the loan.

A modification involving a reduction of the stated interest rate of a loan was for two years. A modification involving a restructuring of the timing of required principal payments on the loan was for a period of six years.

During the year ended December 31, 2012, there were no loans modified and designated as TDRs. The following table presents loans by class modified and designated as troubled debt restructurings that occurred during the year ending December 31, 2011:

	Number of Loans	Pre-modification Outstanding Recorded Investment	Post-modification Outstanding Recorded Investment
Troubled debt restructurings:			
Real estate secured	2	\$ 850	\$ 850
Total	<u>2</u>	<u>\$ 850</u>	<u>\$ 850</u>

The TDRs described above required an increase in the allowance for loan losses of \$84 in 2011, and resulted in no charge-offs during 2012 or 2011.

The Bank did not have any loans classified as TDRs that subsequently defaulted.

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BANK OF SANTA CLARITA
NOTES TO FINANCIAL STATEMENTS
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NOTE 3 - LOANS AND ALLOWANCE FOR LOAN LOSSES (Continued)

Information relating to individually impaired loans presented by class of loans was as follows as of December 31, 2012 and 2011:

	<u>Unpaid Principal Balance</u>	<u>Recorded Investment</u>	<u>Related Allowance</u>	<u>Average Recorded Investment</u>	<u>Interest Income Recognized</u>
<u>December 31, 2012</u>					
With a related allowance recorded:					
Real estate secured	\$ 829	\$ 831	\$ 88	\$ 840	\$ 63
	<u>\$ 829</u>	<u>\$ 831</u>	<u>\$ 88</u>	<u>\$ 840</u>	<u>\$ 63</u>
<u>December 31, 2011</u>					
With a related allowance recorded:					
Real estate secured	\$ 845	\$ 850	\$ 84	\$ 852	\$ 71
Consumer	<u>15</u>	<u>15</u>	<u>1</u>	<u>15</u>	<u>-</u>
	<u>\$ 860</u>	<u>\$ 865</u>	<u>\$ 85</u>	<u>\$ 867</u>	<u>\$ 71</u>

The unpaid principal balance reported above is not reduced for partial charge-offs.

The recorded investment in loans reported above excludes accrued interest receivable but includes the net remaining unamortized balances of capitalized direct loan origination costs net of any deferred loan fees.

The Bank did not recognize any interest income on the cash basis during 2012 or 2011.

Loans sold and serviced for others, which were not included in the accompanying balance sheets, had unpaid principal balances totaling \$4.13 million and \$2.24 million at December 31, 2012 and 2011, respectively.

The Bank generally pledges all of its first mortgage loans as potential collateral at either the Federal Home Loan Bank of San Francisco (the "FHLB") or the Federal Reserve Bank (the "FRB") in order to be able to obtain borrowings from those entities.

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BANK OF SANTA CLARITA
NOTES TO FINANCIAL STATEMENTS
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NOTE 4 - RELATED PARTY TRANSACTIONS

In the ordinary course of business, the Bank grants loans to "Related Parties," which are executive officers, directors and companies with which they are associated.

The outstanding balances of such loans at December 31, 2012 and 2011 were as follows:

	<u>2012</u>	<u>2011</u>
Balance, beginning of year	\$ 2,375	\$ 2,432
New loans and advances	-	-
Principal repayments	<u>(780)</u>	<u>(57)</u>
Balance at end of year	<u>\$ 1,595</u>	<u>\$ 2,375</u>

The Bank does not have outstanding commitments to lend additional amounts to these officers, directors and their related companies.

As of December 31, 2012 and 2011, the Bank had \$1.72 million and \$1.51 million, respectively, in deposits from executive officers, directors and companies with which they are associated.

NOTE 5 - PREMISES AND EQUIPMENT

Premises and equipment consisted of the following at December 31, 2012 and 2011:

	<u>2012</u>	<u>2011</u>
Land and building owned	\$ 8,185	\$ 5,581
Equipment and furniture	2,831	2,762
Leasehold improvements	<u>717</u>	<u>717</u>
	11,733	9,060
Less accumulated depreciation and amortization	<u>(2,334)</u>	<u>(1,934)</u>
	<u>\$ 9,399</u>	<u>\$ 7,126</u>

Depreciation and amortization expense for the years ended December 31, 2012 and 2011 were \$400 and \$786, respectively.

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BANK OF SANTA CLARITA
NOTES TO FINANCIAL STATEMENTS
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NOTE 6 - TIME DEPOSITS

As of December 31, 2012, the schedule of maturities for time deposits was as follows:

2013		\$ 29,325
2014		9,989
2015		4,097
2016		120
2017		7,287
Thereafter		<u>9,604</u>
Total		<u>\$ 60,422</u>

NOTE 7 - BORROWINGS

Overnight borrowings from the FHLB as of December 31, 2012 were \$4,500 with an interest rate of 0.28%. Overnight borrowings from the FHLB as of December 31, 2011 were \$16,000 with an interest rate of 0.07%.

At year end, long-term advances from the Federal Home Loan Bank were as follows:

	<u>Balance</u>	<u>Rates</u>	<u>Weighted Average Rate</u>	<u>Maturity Year</u>
<u>December 31, 2012</u>				
Long-term borrowings	\$ 29,500	0.24% - 3.86%	1.29%	2013
	3,000	0.91%	0.91	2014
	<u>5,000</u>	3.99% - 4.27%	4.12	2015
	<u>\$ 37,500</u>		<u>1.64%</u>	
<u>December 31, 2011</u>				
Long-term borrowings	\$ 3,000	1.81%	1.81%	2012
	9,500	2.30% - 3.86%	3.50	2013
	3,000	0.91%	0.91	2014
	<u>5,000</u>	3.99% - 4.27%	4.12	2015
	<u>\$ 20,500</u>		<u>3.02%</u>	

The Bank has never borrowed any floating rate advances. Each advance is payable at its maturity date, with a required penalty payment in the event of a payoff prior to its maturity. The advances were collateralized by \$56,200 and \$51,104 of first mortgage loans under a blanket lien arrangement as of December 31, 2012 and 2011, respectively. Based on this collateral and the Bank's holdings of FHLB stock, the Bank would be eligible to borrow up to a total of \$62,279; however, the FHLB also limits the amount that the Bank can borrow based on the Bank's total assets, and that limit was \$54,761 as of December 31, 2012.

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NOTE 7 – BORROWINGS (Continued)

At December 31, 2012, future minimum repayments on the long-term FHLB advances were as follows:

2013	\$ 29,500
2014	3,000
2015	<u>5,000</u>
Total	<u>\$ 37,500</u>

NOTE 8 - INCOME TAXES

Income tax expense for the years ended December 31, 2012 and 2011 consisted of the following components:

	<u>2012</u>	<u>2011</u>
Current expense:		
Federal	\$ 18	\$ 7
State	<u>1</u>	<u>1</u>
	<u>19</u>	<u>8</u>
Deferred expense:		
Federal	305	252
State	<u>4</u>	<u>(28)</u>
	<u>309</u>	<u>224</u>
Total income tax expense	<u>\$ 328</u>	<u>\$ 232</u>

The Bank's effective income tax rate of 37.0% and 37.8% for the years ended December 31, 2012 and 2011, respectively, differs from the 34.0% Federal statutory income tax rate due to the effects of State income taxes, offset by the State tax benefits from Enterprise Zone deductions and credits and by other items.

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NOTE 8 - INCOME TAXES (Continued)

The components of the net deferred tax asset were as follows at December 31, 2012 and 2011:

	<u>2012</u>	<u>2011</u>
Deferred tax assets:		
Allowance for loan losses	\$ 793	\$ 696
Donations	43	73
Deferred rent expense	19	14
Unrealized gain on AFS investments	2	59
Nonqualified stock options	41	56
Unfunded commitment liability	15	7
Net operating loss carryforwards	149	601
Tax credit carryforwards	93	51
Other	12	-
Total deferred tax assets	<u>1,167</u>	<u>1,557</u>
Deferred tax liabilities:		
Accumulated depreciation	(343)	(374)
Loan origination costs	(193)	(157)
FHLB dividends	(16)	(16)
Cash basis of reporting for tax purposes	-	(74)
Other	(45)	-
Total deferred tax liabilities	<u>(597)</u>	<u>(621)</u>
Net deferred tax asset	<u>\$ 570</u>	<u>\$ 936</u>

As of December 31, 2012, the Bank had net operating loss carryforwards of approximately \$0.2 million and \$1.2 million for Federal and State tax purposes, respectively, which are available to offset future taxable income. The Federal and State net operating loss carryforwards will begin to expire in tax years 2031 and 2015, respectively. These net operating loss carryforwards include alternative minimum tax credits and State Enterprise Zone hiring tax credits and net interest deductions which do not expire.

The Bank is subject to Federal income tax and income tax of the State of California. The Bank is no longer subject to examination by federal taxing authorities for tax years prior to 2009 and for state taxing authorities for tax years prior to 2008.

At December 31, 2012 and December 31, 2011, the Bank had no unrecognized tax benefits recorded. The Bank does not expect the amount of unrecognized tax benefits to significantly change within the next twelve months. Additionally, the Bank had no amounts recorded for interest and penalties related to unrecognized tax benefits in the tax years ended December 31, 2012 and 2011.

NOTE 9 - OFF-BALANCE SHEET ACTIVITIES

Credit-Related Financial Instruments: The Bank is a party to financial instruments with off-balance sheet risk to meet the financing needs of its customers in the normal course of business. These financial instruments generally include commitments to grant loans, unadvanced lines of credit, standby letters of credit, and commercial letters of credit. Such commitments involve, to varying degrees, elements of credit and interest rate risk in excess of the amount recognized in the balance sheets.

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NOTE 9 - OFF-BALANCE SHEET ACTIVITIES (Continued)

The Bank's exposure to potential credit loss is represented by the contractual amount of these commitments. The Bank uses the same credit policies in making commitments as it does for other lending activities.

At December 31, 2012 and 2011, the following lending commitments were outstanding whose contract amounts represent potential credit risk:

	<u>2012</u>	<u>2011</u>
Unadvanced lines of credit	\$ 13,493	\$ 5,794
Standby letters of credit	1,396	1,047

Commitments to grant loans are agreements to lend to customers as long as there is no default of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Since some of the commitments may expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. The Bank evaluates each customer's creditworthiness on a case-by-case basis. The amount of collateral obtained if deemed necessary by the Bank upon extension of credit is based on management's credit analysis. Collateral held varies but may include cash on deposit, accounts receivable, inventory, equipment, income-producing commercial properties, residential properties, and properties under construction.

Unadvanced lines of credit are commitments for possible future extensions of credit to existing borrowers. These lines of credit are sometimes unsecured and may not necessarily be drawn upon to the total extent to which the Bank is committed.

Standby and commercial letters of credit are conditional commitments issued by the Bank to guarantee the performance of a customer to a third party. All letters of credit issued have expiration dates within one year. The credit risk involved in issuing letters of credit is generally less than that involved in extending loans to existing Bank borrowers.

Requirements contained within accounting principles generally accepted in the United States of America ("GAAP") require a guarantor to recognize, at the inception of a guarantee, a liability equal to the fair value of the obligation undertaken in issuing the guarantee. Newly issued or modified guarantees that are not derivative contracts would be recorded on the Bank's balance sheet at their fair value at inception. The Bank considers standby letters of credit to be guarantees as defined within GAAP and, at December 31, 2012 and 2011, the amount of the liability related to guarantees was not considered to be material.

NOTE 10 - SHARE-BASED COMPENSATION

Under the October 2004 Stock Option Plan, the Bank may grant options to its directors, officers and employees for up to 30 percent of the number of shares of common stock outstanding at the time of grant. Both incentive stock options and non-qualified stock options may be granted under the plan. At December 31, 2012, 189,189 options were outstanding and 414,439 options were available for granting. The exercise price of these options may not be less than the fair market value of the common stock on the date granted. Options expire 10 years after the date of grant and vest as determined by the Bank's Board of Directors; however, the options all carry provisions which provide that they become fully vested (exercisable) if a change in control of the Bank (as defined) were to occur. The Bank recognized share-based compensation costs of \$6 and \$15 in 2012 and 2011, respectively.

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NOTE 10 - SHARE-BASED COMPENSATION (Continued)

The fair value of each option grant is estimated on the date of grant using the Black-Scholes option-pricing model. There were no options granted in 2012 or 2011.

Based on the share-based compensation awards outstanding as of December 31, 2012, the Bank expects to recognize additional pre-tax compensation costs amounting to \$2 during 2013. The after-tax cost of these options cannot currently be predicted since the Bank's ability to record the related income tax benefits depends on the amount and timing of future taxable income.

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

A summary of the activity in the Bank's stock option plan for the years ended December 31 is as follows:

	2012			2011		
	Options	Weighted Average Exercise Price (in dollars)	Aggregate Intrinsic Value	Options	Weighted Average Exercise Price (in dollars)	Aggregate Intrinsic Value
Outstanding at beginning of year	297,471	\$ 8.34	\$ -	297,596	\$ 8.34	\$ -
Granted	-	-	-	-	-	-
Exercised	-	-	-	-	-	-
Forfeited	<u>(108,282)</u>	8.51	-	<u>(125)</u>	8.00	-
Outstanding at end of year	<u>189,189</u>	\$ 8.23	\$ -	<u>297,471</u>	\$ 8.34	\$ -
Options exercisable at year end	<u>183,702</u>	\$ 8.24	\$ -	<u>278,771</u>	\$ 8.27	\$ -

The weighted average remaining contractual life of options outstanding at December 31, 2012 and 2011, were 2.1 years and 3.2 years, respectively, and the weighted average remaining contractual life of options currently exercisable at December 31, 2012 and 2011, was 2.0 years and 3.1 years, respectively.

There were no options exercised during the years ended December 31, 2012 or 2011. As of December 31, 2012, there was \$2 of total unrecognized compensation cost related to the outstanding stock options that will be recognized over a weighted average period of 1.2 years.

NOTE 11 - OTHER COMMITMENTS AND CONTINGENCIES

Operating Lease Commitments: The Bank leases its Golden Valley branch office under an operating lease through 2019, with an option to extend the lease term for two five-year periods.

At December 31, 2012, future minimum rental payments under the lease described above were as follow:

2013	\$ 194
2014	215
2015	217
2016	217
2017	217
Thereafter	<u>236</u>
	<u>\$ 1,296</u>

(Continued)

BANK OF SANTA CLARITA
NOTES TO FINANCIAL STATEMENTS
December 31, 2012 and 2011
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NOTE 11 - OTHER COMMITMENTS AND CONTINGENCIES (Continued)

For the years ended December 31, 2012 and 2011, total rental expense was \$209 and \$527, respectively.

NOTE 12 - CONCENTRATION RISK

The Bank grants commercial, real estate, construction and installment loans to businesses and individuals primarily in Santa Clarita and surrounding communities. Most loans are secured by business assets, commercial real estate, and/or residential real estate. At December 31, 2012 and 2011, loans secured by real estate represented 76% and 74%, respectively, of the Bank's total gross loan balances.

At December 31, 2012 and 2011, the Bank had \$27,852 and \$24,783, respectively, of money market deposit accounts and Federal funds sold balances at commercial banks. It also had \$414 and \$519 on deposit with correspondent commercial banks at those respective dates, which balances were FDIC insured.

NOTE 13 - EMPLOYEE BENEFIT PLANS

The Bank has established a Section 401(k) Plan for the benefit of eligible employees, whereby each employee who is at least 18 years of age may become a participant at specified intervals. Employees may contribute up to 50% of their annual compensation into the 401(k) Plan each year, subject to certain limits as established in Federal tax laws. The Bank matches employee contributions to the plan at a level determined from time to time, which level as of December 31, 2012, was two percent of eligible annual compensation as defined. Matching contributions for the years ended December 31, 2012 and 2011 totaled \$44 and \$51, respectively.

The Bank established an Employee Stock Ownership Plan (the "ESOP"), a defined contribution plan, effective January 1, 2006. All employees completing an eligibility computation period are eligible to participate in the ESOP. Contributions shall be determined by the Bank's Board of Directors (the "Board") not to exceed the amounts allowable under law. Contributions may be paid in cash or shares of Bank stock as determined by the Board. Cash contributions totaling \$15 and \$30 were made into the ESOP during the years ended December 31, 2012 and 2011, respectively.

(Continued)

BANK OF SANTA CLARITA
NOTES TO FINANCIAL STATEMENTS
December 31, 2012 and 2011
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NOTE 14 - MINIMUM REGULATORY CAPITAL REQUIREMENTS

Banks are subject to regulatory capital requirements administered by federal banking agencies. Capital adequacy guidelines and prompt corrective action regulations involve quantitative measures of assets, liabilities, and certain off-balance-sheet items calculated under regulatory accounting practices. Capital amounts and classifications are also subject to qualitative judgments by regulators. Failure to meet capital requirements can initiate regulatory action. Management believes that as of December 31, 2012, the Bank met all capital adequacy requirements to which it was subject.

Prompt corrective action regulations provide five capital-related classifications: well capitalized, adequately capitalized, undercapitalized, significantly undercapitalized, and critically undercapitalized, although these terms are not used to represent overall financial condition. If only adequately capitalized, regulatory approval is required to accept brokered deposits. If undercapitalized, capital distributions are limited, as is asset growth and expansion, and capital restoration plans are required. As of December 31, 2012 and 2011, the most recent regulatory notifications categorized the Bank as well capitalized under the regulatory framework for prompt corrective action. There are no conditions or events since that notification that management believes would have changed the Bank's capital classification.

The Bank's actual and required capital amounts and ratios as of December 31, 2012 and 2011, are presented in the table below:

	<u>Actual</u>		<u>Minimum Capital Requirement</u>		<u>Minimum To Be Well Capitalized</u>	
	<u>Amount</u>	<u>Ratio</u>	<u>Amount</u>	<u>Ratio</u>	<u>Amount</u>	<u>Ratio</u>
<u>December 31, 2012</u>						
Total capital to risk-weighted assets	\$ 23,448	13.52%	\$ 13,875	8.00%	\$ 17,343	10.00%
Tier 1 capital to risk-weighted assets	21,410	12.34%	6,940	4.00%	10,410	6.00%
Tier 1 capital to average assets	21,410	9.44%	9,072	4.00%	11,340	5.00%
	<u>Actual</u>		<u>Minimum Capital Requirement</u>		<u>Minimum To Be Well Capitalized</u>	
	<u>Amount</u>	<u>Ratio</u>	<u>Amount</u>	<u>Ratio</u>	<u>Amount</u>	<u>Ratio</u>
<u>December 31, 2011</u>						
Total capital to risk-weighted assets	\$ 22,618	15.15%	\$ 11,943	8.00%	\$ 14,929	10.00%
Tier 1 capital to risk-weighted assets	20,845	13.96%	5,973	4.00%	8,959	6.00%
Tier 1 capital to average assets	20,845	9.93%	8,397	4.00%	10,496	5.00%

(Continued)

NOTE 15 - RESTRICTIONS ON DIVIDENDS

Federal and state banking regulations place certain restrictions on dividends paid to shareholders. The total amount of dividends that may be paid at any date is generally limited to the lesser of the Bank's retained earnings or net income for the last three years, subject to minimum capital requirements. As of December 31, 2012 and 2011, the Bank was restricted from paying dividends.

NOTE 16 - FAIR VALUE MEASUREMENT OF FINANCIAL INSTRUMENTS

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.

Fair Value Measurements: The Bank used the following methods and significant assumptions to estimate fair value for assets carried at fair value:

Securities - The fair value of investment securities available for sale ("AFS Securities") are determined by obtaining quoted prices on nationally recognized exchanges (Level 1 inputs) or matrix pricing which is a mathematical technique used widely in the industry to value debt securities without relying exclusively on quoted prices for the specific securities but rather relying on the security's relationship to other benchmark quoted securities (Level 2 inputs). At December 31, 2012 and 2011, the fair values of AFS Securities were determined based on Level 2 inputs.

Derivatives -- The fair values of derivatives are based on valuation models using observable market data as of the measurement date. At December 31, 2012 and 2011, the fair values of derivatives were determined based on Level 2 inputs.

Impaired Loans – When a loan is deemed impaired, there are three acceptable methods for measuring the level of impairment used to derive the fair value of such impaired loans and thereby determine any required amount of the ALL which would be needed to be specifically allocated for that loan, which required amount is commonly referred to as a specific reserve. The three methods used are (i) the present value of expected future cash flows; (ii) the loan's observable market price or value; and (iii) the fair value of the underlying collateral property. Impairment of collateral-dependent loans is measured using the fair value of collateral method and are generally based on recent real estate or other appraisals. These real estate appraisals may utilize a single valuation approach or a combination of approaches including comparable sales and the income approach. Adjustments are routinely made in the appraisal process by the Bank's independent appraisers to adjust for differences between the comparable sales and income data available. Such adjustments are usually significant and typically result in a Level 3 classification of the inputs for determining fair value. Non-real estate collateral may be valued using an appraisal, net book value per the borrower's financial statements or aging reports, adjusted, or discounted based on management's historical knowledge, changes in market conditions from the time of the valuation, and management's expertise and knowledge of the client and the client's business, resulting in a Level 3 fair value classification. Impaired loans are evaluated on a quarterly basis for additional impairment and adjusted accordingly.

BANK OF SANTA CLARITA
NOTES TO FINANCIAL STATEMENTS
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NOTE 16 - FAIR VALUE MEASUREMENT OF FINANCIAL INSTRUMENTS (Continued)

The following table presents information about the Bank's financial instruments measured at fair value on a recurring basis as of December 31, 2012, and indicates the fair value hierarchy of the valuation techniques utilized by the Bank to determine such fair value. In general, fair values determined by Level 1 inputs utilize quoted prices (unadjusted) for identical assets or liabilities in active markets that the Bank has the ability to access as of the measurement date. Fair values determined by Level 2 inputs utilize information other than the quoted prices included in Level 1 that are observable for the asset or liability, either directly or indirectly. Level 2 inputs include quoted prices for similar assets and liabilities in active markets, and inputs other than quoted prices that are observable for the asset or liability, such as interest rates and yield curves that are observable at commonly quoted intervals. Level 3 inputs are unobservable inputs for the asset or liability, and include situations where there is little, if any, market activity for the asset or liability. Such unobservable inputs reflect the Bank's own assumptions about the factors that market participants would use in pricing or valuing an asset or liability.

In certain cases, the inputs used to measure fair value may fall into different levels of the fair value hierarchy. In such cases, the fair value hierarchy within which the fair value measurement, in its entirety, falls has been determined based on the lowest level input that is significant to the fair value measurement. The Bank's assessment of the significance of a particular input to the fair value measurement, in its entirety, requires judgment and considers factors specific to the asset or liability.

	Fair Value Measurements at December 31, Using:			
	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Fair Value
<u>December 31, 2012</u>				
Financial assets:				
Assets measured on a recurring basis:				
Securities available for sale				
MBS's: single family loans	\$ -	\$ 28,670	\$ -	\$ 28,670
Multi-family loans	-	3,275	-	3,275
	\$ -	\$ 31,945	\$ -	\$ 31,945
Financial liabilities:				
Derivatives				
	\$ -	\$ 1,519	\$ -	\$ 1,519
<u>December 31, 2011</u>				
Financial assets:				
Assets measured on a recurring basis:				
Securities available for sale				
MBS's: single family loans	\$ -	\$ 32,507	\$ -	\$ 32,507
	\$ -	\$ 32,507	\$ -	\$ 32,507
Financial liabilities:				
Derivatives				
	\$ -	\$ 1,519	\$ -	\$ 1,519

(Continued)

BANK OF SANTA CLARITA
 NOTES TO FINANCIAL STATEMENTS
 December 31, 2012 and 2011
 (Dollar amounts in thousands)

NOTE 16 - FAIR VALUE MEASUREMENT OF FINANCIAL INSTRUMENTS (Continued)

At December 31, 2012 and 2011, the Bank did not have any impaired loans held at fair value on a non-recurring basis.

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

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

Investment Securities: The methods for determining the fair values for investment securities are described previously.

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

FHLB and TIBB Stock: It is not practical to determine the fair value of the FHLB and TIBB stock due to restrictions placed on their transferability.

Accrued Interest Receivable and Payable: The recorded carrying value approximates the estimated fair value due to the short-term nature of these assets and liabilities.

Deposits: The carrying values of demand, money market and savings deposits are assumed to be fair value since they have no stated maturities. The fair values of time deposits are estimated by discounting the expected cash flows at current rates for instruments with similar maturities.

Borrowings: The fair values of FHLB advances with maturities greater than one week are estimated by discounting the expected cash flows at current rates for FHLB advances with similar maturities. Borrowings with maturities of less than one week are assumed to be at fair value due to the short-term nature of those liabilities.

The carrying amounts and estimated fair values of the Bank's financial instruments were as follows at year-end:

	2012		2011	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
<u>Financial assets:</u>				
Cash and cash equivalents	\$ 31,487	\$ 31,487	\$ 28,816	\$ 28,816
MBSs available-for-sale	31,945	31,945	32,507	32,507
Investment securities held to maturity	250	250	250	250
Loans, net of the ALL	155,925	158,516	136,999	140,230
FHLB and TIBB stock	2,451	N/A	1,891	N/A
Accrued interest receivable	639	639	614	614

(Continued)

BANK OF SANTA CLARITA
NOTES TO FINANCIAL STATEMENTS
December 31, 2012 and 2011
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NOTE 16 - FAIR VALUE MEASUREMENT OF FINANCIAL INSTRUMENTS (Continued)

	2012		2011	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
<u>Financial liabilities:</u>				
Demand, money market and savings deposits	\$ 107,442	\$ 107,442	\$ 84,888	\$ 84,888
Time deposits	60,422	62,175	65,643	66,981
Borrowings	42,000	42,405	36,500	37,243
Accrued interest payable	32	32	38	38

NOTE 17 - DERIVATIVE FINANCIAL INSTRUMENTS

The Bank utilizes interest rate swap agreements as part of its asset liability management strategy to help manage its interest rate risk position. During 2008, the Bank entered into certain derivative financial instrument transactions for the purpose of hedging the interest rate risk associated with specific, identified loan transactions. These interest rates swaps are designated as fair value hedges.

In general, the types of risks hedged in these transactions are those relating to the variability of future earnings and cash flows caused by movements in interest rates. In these transactions the Bank, in the normal course of business, holds interest rate swaps (the "Swaps") which hedge the interest rate risk associated with specific long-term, fixed-rate commercial real estate loans. These Swaps are held solely for the purpose of hedging such interest rate risk, and not for speculation.

As of December 31, 2012 and 2011, the notional balance of these financial instruments was approximately \$9.0 million and \$9.2 million, respectively. The notional amount of interest rate swaps does not represent amounts exchanged by the parties. The amount exchanged is determined by reference to the notional amount and the other terms of the individual interest rate swap agreements. The loans and associated Swaps have fixed interest rates ranging from 6.0% to 6.85%, and the floating rates on the Swaps are determined each month based on the One-Month LIBOR index plus a fixed margin ranging from 1.39% to 2.42%. The swaps mature in 2018.

There is expected to be no ineffectiveness as to cash flows or values with respect to each specific loan and the associated swap with which it has been hedged, due to the following factors present in each hedging transaction:

1. The current and forecasted principal balances on both instruments are identical,
2. The fixed interest rates on both instruments are identical,
3. The maturity dated on both instruments are identical, and
4. The embedded optionality inherent in each transaction is identical (e.g. the loan's prepayment penalty provision is essentially identical to the associated interest rate swap's early termination provision).

The Bank accounts for these Swaps as fair value hedges using the short-cut method pursuant to the rules contained within GAAP; therefore, the Bank does not record any ineffectiveness within its accompanying financial statements. As of December 31, 2012 and 2011, the fair value of the hedges was approximately \$1.5 million and \$1.5 million. Any changes in the fair value of the derivative are recorded as a basis adjustment on the hedged loans and the derivative liability account.

Corporate Officers

EXECUTIVE OFFICE

Frank D. Di Tomaso, Jr.
Chairman of the Board & CEO

ADMINISTRATION

Finance

Walter Purdy
Senior Vice President
Chief Financial Officer

Stephanie M. Stephens
First Vice President
Controller

Risk Management

John Vescovo
Senior Vice President
Director of Enterprise Risk Management

Centralized Operations Department

Carol Morrissey
First Vice President
Centralized Operations Manager

Information Technology

Eric Jensen
First Vice President
Manager of Information Services

LENDING

Gregory Weinberg
Senior Vice President
Chief Credit Officer

Commercial Loans

John Carlson
Vice President
Commercial Loan Officer

William McCloskey
First Vice President
Commercial Real Estate Officer

Donna Reller
Assistant Vice President
Commercial Loan Officer

SBA Loans

Craig Conner
First Vice President
SBA Manager

Consumer Loans

Barbara Andriuzzo
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Consumer Loan Manager

Note Department

Mary Hernandez First
Vice President
Note Department Manager

MAIN OFFICE

Elizabeth Hopp
Senior Vice President
Regional Manager

Brenda Neilson
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Chairman of the Board

Shawn C. Shambaugh, Vice Chairman
Physician, Private Practice

James Bryan Batey
President & Principal
Richland Homes, Inc.

David J. Di Tomaso
President, 3H Network

Paul R. Di Tomaso
President, Di Tomaso & Di Tomaso, Inc

David Finkelstein
President & CEO, F & W Foodservices

Rick Graniere
Chief Financial Officer,
MemorialCare Health System

Dwight D. Ham
Assistant Professor of Business,
The Master's College
Chief Financial Officer, KBI

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President, BizInk

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SVP/Marketing & Communication,
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Stock Listing

Bank of Santa Clarita common stock is
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