BANK OF
SANTA CLARITA

Bank of Santa Clarita | 2015 Annual Report

LETTER FROM THE CHAIRMAN OF THE BOARD

Dear Shareholders;

Bank of Santa Clarita recorded net income for 2015 of $1.22 million, which represents a 19% increase over 2014 results. Our Bank's growing profitability is largely attributable to loan growth in the market we serve, as our 2015 increase was $18 million, a growth rate of 11%. During 2015 we also enjoyed a $41 million growth in deposits, with that growth being primarily made up of core deposits. In addition, we had a significant reduction in noninterest expenses amounting to $619,000.

On October 24, 2015 Bank of Santa Clarita celebrated its eleven-year anniversary. Looking back, this community bank thrived and even improved during the recent Great Recession, the banking crisis, very significant increases in federal regulations, and, most recently, significant margin compression resulting from the longest period of near-zero interest rates in history. That being said, I feel that we are moving forward from a position of strength built upon our solid earnings and capital positions. Our net income has been growing in recent years and is built on core banking operations, not one-time events such as reversals of loan loss reserves or gains from the sale of investment securities. Our assets have now grown to nearly $300 million and the Bank has developed relationships with many loyal clients.

Moving forward, we remain committed to understanding and adapting to customers' changing needs, while maintaining a culture of stability and intelligent risk-taking, continuing to carefully execute on our long-term business strategies, and to working closely with our regulators in this highly-regulated banking environment. At the same time, we remain committed to delivering exceptional customer service. We believe that we provide a unique customer experience – that personal touch – that only a local community bank can consistently deliver.

Bank of Santa Clarita remains financially strong and committed to serving businesses, professionals, and consumer clients in our marketplace, and as the only commercial bank headquartered in the Santa Clarita Valley, we have a commitment to the community that has not wavered from the day we opened our doors. Our employees are passionate about the community they live in, and understand the positive impact they have in building a better environment for its residents, including businesses, non-profits and consumers.

The Bank's Board of Directors and I personally are fully committed to managing the Bank in a way that rewards the confidence placed in us by you, the Bank's shareholders.

Thank you very much for your confidence and ongoing support.

Frank D. Di Tomaso
Chairman and CEO

BANK OF SANTA CLARITA
Santa Clarita, California

FINANCIAL STATEMENTS
December 31, 2015 and 2014

BANK OF SANTA CLARITA
Santa Clarita, California

FINANCIAL STATEMENTS
December 31, 2015 and 2014

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Crowe Horwath LLP
Independent Member Crowe Horwath International

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 sheets as of December 31, 2015 and 2014, and the related statements of earnings, comprehensive income, changes in stockholders' equity, and cash flows for the years 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 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.

(Continued)

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, 2015 and 2014, and the results of its operations and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Crowe Horwath LLP

Crowe Horwath LLP

Sherman Oaks, California
March 18, 2016

BANK OF SANTA CLARITA
BALANCE SHEETS
December 31, 2015 and 2014
(Dollar amounts in thousands)

	2015	2014
ASSETS		
Cash and due from banks	$ 45,594	$ 42,445
Federal funds sold	3,000	3,000
Total cash and cash equivalents	48,594	45,445
Investment securities available for sale	25,118	29,415
Loans, net of allowance for loan losses of $2,126 and $1,919	183,221	165,169
Federal Home Loan Bank (FHLB) stock and The Independent BankersBank (TIB) stock, at cost	2,301	3,854
Premises and equipment, net	10,493	10,760
Bank-owned life insurance	6,204	4,067
Accrued interest receivable	676	642
Deferred tax asset	832	824
Other assets	347	849
Total assets	$ 277,786	$ 261,025
LIABILITIES AND STOCKHOLDERS' EQUITY		
Deposits		
Interest-bearing deposits		
Money market, savings and demand deposits	$ 90,329	$ 72,746
Time deposits	43,496	51,085
Total interest-bearing deposits	133,825	123,831
Noninterest-bearing demand deposits	87,028	56,054
Total deposits	220,853	179,885
Borrowings	30,000	55,000
Accrued interest payable	46	49
Other liabilities	1,401	2,073
Total liabilities	252,300	237,007
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; 2,344,635 shares issued and outstanding at December 31, 2015 and 2014	22,713	22,713
Additional paid in capital	528	440
Retained earnings	2,557	1,336
Unrealized loss on available-for-sale securities, net of taxes	(312)	(471)
Total stockholders' equity	25,486	24,018
Total liabilities and stockholders' equity	$ 277,786	$ 261,025

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

BANK OF SANTA CLARITA
STATEMENTS OF EARNINGS
For the years ended December 31, 2015 and 2014
(Dollar amounts in thousands)

	2015	2014
Interest income		
Interest and fees on loans	$ 8,033	$ 8,145
Interest on Federal funds sold	7	3
Interest on investment securities	404	660
Interest on deposits at other financial institutions	196	159
Total interest income	8,640	8,967
Interest expense on deposits		
Money market, savings and interest-bearing demand	344	314
Time deposits	633	754
Total interest expense on deposits	977	1,068
Interest expense on borrowings	343	482
Total interest expense	1,320	1,550
Net interest income	7,320	7,417
Provision for / (recovery of) loan losses	190	(180)
Net interest income after provision for / (recovery of) loan losses	7,130	7,597
Noninterest income		
Service charges on deposit accounts	240	214
Net gain on sale of investment securities	-	12
Customer fees and miscellaneous income	675	491
Total noninterest income	915	717
Noninterest expenses		
Salaries and employee benefits	3,448	3,444
Occupancy and equipment	848	1,080
Marketing and business development	77	84
Data processing	331	333
Professional and legal	563	493
Insurance and regulatory assessments	332	349
Office supplies and communications	185	175
Other operating expenses	230	675
Total noninterest expenses	6,014	6,633
Earnings before income taxes	2,031	1,681
Income tax expense	810	659
Net earnings	$ 1,221	$ 1,022

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, 2015 and 2014
(Dollar amounts in thousands)

	2015	2014
Net earnings	$ 1,221	$ 1,022
Other comprehensive income / (loss):		
Unrealized gains / (losses) on securities:		
Unrealized holding gains arising during the year	265	394
Reclassification adjustment for gains included in net earnings	-	(12)
Total	265	382
Tax effect	106	154
Total other comprehensive income	159	228
Comprehensive income	$ 1,380	$ 1,250

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, 2015 and 2014
(Dollar amounts in thousands)

Outstanding Stock	Number of Shares Outstanding	Common Stock	Additional Paid in Capital	Retained Earnings / (Accumulated Deficit)	Accumulated Other Comprehensive Income / (Loss)	Total
Balance, January 1, 2014	2,225,509	$ 21,760	$ 390	$ 314	$ (699)	$ 21,765
Exercise of common stock options, including tax benefit	119,126	953	-	-	-	953
Net earnings	-	-	-	1,022	-	1,022
Other comprehensive income	-	-	-	-	228	228
Share-based compensation expense	-	-	50	-	-	50
Balance, December 31, 2014	2,344,635	22,713	440	1,336	(471)	24,018
Net earnings	-	-	-	1,221	-	1,221
Other comprehensive income	-	-	-	-	159	159
Share-based compensation expense	-	-	88	-	-	88
Balance, December 31, 2015	2,344,635	$ 22,713	$ 528	$ 2,557	$ (312)	$ 25,486

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, 2015 and 2014
(Dollar amounts in thousands)

	2015	2014
Cash flows from operating activities		
Net earnings	$ 1,221	$ 1,022
Adjustment to reconcile net earnings to net cash provided by operating activities		
Provision for / (recovery of) loan losses	190	(180)
Depreciation and amortization of premises and equipment	423	500
Amortization of premiums and discounts on investment securities, net	708	638
Amortization of deferred loan costs and fees, net	246	142
FHLB and TIB stock dividends	(2)	(1)
Earnings on Bank-owned life insurance	137	67
Net gain on sale of investment securities	-	(12)
Share-based compensation expense	88	50
Net change in:		
Accrued interest receivable	(34)	(34)
Deferred tax asset	(8)	111
Other assets	502	(189)
Accrued interest payable	(3)	6
Other liabilities	(1,058)	1,494
Net cash provided by operating activities	2,410	3,614
Cash flows from investing activities		
Purchase of investment securities	-	(550)
Principal repayments on securities	3,854	2,157
Proceeds from sale of investment securities	-	3,314
Loan originations and principal collections, net	(18,488)	(3,229)
Purchase of Bank-owned life insurance	(2,000)	(4,000)
FHLB and TIB stock redemptions / (purchases), net	1,553	(836)
Purchase of premises and equipment	(148)	(41)
Net cash used in investing activities	(15,229)	(3,185)
Cash flows from financing activities		
Net increase / (decrease) in deposits	40,968	(1,288)
Net (decrease) / increase in short-term borrowings	(26,000)	10,000
Proceeds from long-term borrowings	8,000	2,000
Repayment of long-term borrowings	(7,000)	(3,000)
Net cash provided by financing activities	15,968	7,712
Net increase in cash and cash equivalents	3,149	8,141
Cash and cash equivalents, beginning of year	45,445	37,304
Cash and cash equivalents, end of year	$ 48,594	$ 45,445
Supplemental cash flow information:		
Interest paid	$ 1,323	$ 1,544
Income taxes paid	642	610

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

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 (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.

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 March 18, 2016, 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, 2015 and 2014.

Investment Securities: The Bank classifies its investments in securities as Available-for-Sale (AFS) securities and Held-to-Maturity (HTM) 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.

<u>Loans</u>: 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.

(Continued)

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Allowance for Loan Losses: The allowance for loan losses (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. The historical loss experience is based on the actual loss history experienced by the Bank over the most recent five years. 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)

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Portfolio segments identified by the Bank include loans secured by real estate, commercial loans 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 loans secured by commercial real estate. At December 31, 2015, real estate secured loans also included $2.36 million of residential real estate loans and $8.51 million 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.

Commercial: Commercial loans are loans secured by equipment, accounts receivable and other forms of business-related assets as well as personal guarantees from principals participating in the respective businesses. Included in the Bank's commercial and industrial loans are $8.97 million of loans guaranteed in part by the Small Business Administration in levels ranging from 50% to 90% of the respective loan amounts. 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 their customers.

Consumer: 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.

(Continued)

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

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.

Bank-Owned Life Insurance: The Bank has purchased life insurance policies on certain key officers of the Bank. Bank-owned life insurance is recorded at the amount that can be realized under the insurance contracts as of the balance sheet date, which is generally the cash surrender value.

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 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.

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

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, 2015 and 2014.

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 these 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, 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.

(Continued)

(Dollar amounts in thousands, except per share amounts)

NOTE 2 – INTEREST BEARING DEPOSITS AT OTHER FINANCIAL INSTITUTIONS AND INVESTMENT SECURITIES AVAILABLE FOR SALE

As of December 31, 2015 and 2014, the Bank had invested $39.26 million and $39.08 million, 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, 2015 and 2014, had an average yield of approximately 0.67% and 0.44%, respectively. As of December 31, 2015, the Bank had invested $3.0 million in certificates of deposit at other financial institutions, of which $1.0 million was invested in a single financial institution and had a remaining term of three months and a yield of 1.0%, and $2.0 million of which had a remaining term of 1.4 years and an average yield of 0.93% and which was fully federally insured, and invested at several financial institutions.

The amortized cost and fair value of investment securities available for sale were as follows at December 31, 2015:

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Available-for-Sale				
Mortgaged-backed securities (MBSs):				
Single family residential loans	$ 17,044	$ 44	$ (276)	$ 16,812
Multifamily residential loans	8,597	-	(291)	8,306
Total	$ 25,641	$ 44	$ (567)	$ 25,118

The MBSs in the preceding table were tranches of GNMA collateralized mortgage obligations (CMOs) and other GNMA MBSs which have the full faith and credit guarantee of the U.S. Government. At December 31, 2015, the MBSs had a weighted average yield of 2.14%, contractual maturity dates between 2020 and 2063 and an estimated effective life of approximately 3.9 years. 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, 2014:

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Available-for-Sale				
Mortgaged-backed securities (MBSs):				
Single family residential loans	$ 19,307	$ 72	$ (428)	$ 18,951
Multifamily residential loans	10,896	-	(432)	10,464
Total	$ 30,203	$ 72	$ (860)	$ 29,415

The MBSs in the preceding table were tranches of GNMA collateralized mortgage obligations (CMOs) and other GNMA MBSs which have the full faith and credit guarantee of the U.S. Government. At December 31, 2014, the MBSs had a weighted average yield of 1.78%, contractual maturity dates between 2020 and 2063 and an estimated effective life of approximately 4.0 years. All of the MBSs included in the table above were pledged as collateral for FHLB borrowings.

(Continued)

(Dollar amounts in thousands, except per share amounts)

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

The following table summarizes securities with unrealized losses at December 31, 2015 and December 31, 2014, aggregated by major security type and length of time in a continuous unrealized loss position:

	Less Than 12 Months		12 Months or Longer		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
December 31, 2015						
Mortgaged-backed securities:						
Single family residential loans	$ 5,922	$ (69)	$ 7,546	$ (207)	$ 13,468	$ (276)
Multifamily residential loans	-	(-)	8,306	(291)	8,306	(291)
Total available-for-sale	$ 5,922	$ (69)	$ 15,852	$ (498)	$ 21,774	$ (567)
December 31, 2014						
Mortgaged-backed securities:						
Single family residential loans	$ -	$ (-)	$ 14,062	$ (428)	$ 14,062	$ (428)
Multifamily residential loans	-	(-)	10,463.	(432)	10,463	(432)
Total available-for-sale	$ -	$ (-)	$ 24,526	$ (860)	$ 24,526	$ (860)

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 (OTTI) at December 31, 2015 or 2014, and does not have the intent to sell the impaired securities, and it is considered likely that the Bank will not be required to sell these securities before the anticipated recovery. 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 proceeds from sales of securities and the associated gains and losses for the years ended December 31 are listed below:

	2015	2014
Proceeds	$ -	$ 3,314
Gross gains	-	13
Gross losses	-	1

The tax provision related to these net realized gains was approximately $0 and $5 for the years ended December 31 2015 and 2014, respectively.

Restricted stock consists of FHLB and TIB stock of $2.30 million at December 31, 2015 and $3.85 million at December 31, 2014.

At year-end 2015 and 2014, there were no holdings of investments of any one issuer, other than the U.S. Government and its agencies, in an amount greater than ten percent of stockholders' equity.

(Continued)

(Dollar amounts in thousands, except per share amounts)

NOTE 3 – LOANS AND ALLOWANCE FOR LOAN LOSSES

The composition of the Bank's loan portfolio at December 31, 2015 and 2014 was as follows:

	2015	2014
Real estate secured	$ 145,320	$ 128,670
Commercial	22,384	24,704
Consumer	17,047	13,195
	184,751	166,569
Allowance for loan losses	(2,126)	(1,919)
Deferred loan costs and fees, net	596	519
	$ 183,221	$ 165,169

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

	Real Estate - Secured	Commercial	Consumer	Total
December 31, 2015				
Allowance for loan losses:				
Beginning of year	$, 1,496	$ 315	$ 108	$ 1,919
Provisions for / (recovery of) loan losses	242	(52)	-	190
Charge-offs	-	-	-	-
Recoveries	-	17	-	17
End of year	$ 1,738	$ 280	$ 108	$ 2,126
Reserves:				
Specific	$ 68	$ 14	$ -	$ 82
General	1,679	266	108	2,044
	$ 1,738	$ 280	$ 108	$ 2,126
Loans evaluated for impairment:				
Individually	$ 919	$ 98	$ -	$ 1,017
Collectively	144,401	22,286	17,047	183,734
	$ 145,320	$ 22,384	$ 17,047	$ 184,751

(Continued)

(Dollar amounts in thousands, except per share amounts)

NOTE 3 – LOANS AND ALLOWANCE FOR LOAN LOSSES (Continued)

	Real Estate - Secured	Commercial	Consumer	Total
December 31, 2014				
Allowance for loan losses:				
Beginning of year	$, 1,534	$ 457	$ 87	$ 2,078
(Recovery of) / provisions for loan losses	(38)	(163)	21	(180)
Charge-offs	-	-	-	-
Recoveries	-	21	-	21
End of year	$ 1,496	$ 315	$ 108	$ 1,919
Reserves:				
Specific	$ 82	$ -	$ -	$ 82
General	1,414	315	108	1,837
	$ 1,496	$ 315	$ 108	$ 1,919
Loans evaluated for impairment:				
Individually	$ 1,125	$ -	$ -	$ 1,125
Collectively	127,545	24,704	13,195	165,444
	$ 128,670	$ 24,704	$ 13,195	$ 166,569

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.

(Continued)

(Dollar amounts in thousands, except per share amounts)

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, 2015:

	Pass	Special Mention	Sub-Standard	Impaired	Total
December 31, 2015					
Real estate secured	$ 143,117	$ 1,284	$ -	$ 919	$ 145,320
Commercial	22,137	149	-	98	22,384
Consumer	17,047	-	-	-	17,047
	$ 182,301	$ 1,433	$ -	$ 1,017	$ 184,751

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

	Pass	Special Mention	Sub-Standard	Impaired	Total
December 31, 2014					
Real estate secured	$ 125,101	$ 2,444	$ -	$ 1,125	$ 128,670
Commercial	24,596	108	-	-	24,704
Consumer	13,195	-	-	-	13,195
	$ 162,892	$ 2,552	$ -	$ 1,125	$ 166,569

The following table presents the aging of the loans past due and nonaccrual loans as of December 31, 2015 and 2014 by class of loans:

	Still Accruing						
	30-59 Days Past Due	60-89 Days Past Due	90 or More Days Past Due	Total Past Due	Loan Not Past Due	Total	Non-accrual
December 31, 2015							
Real estate secured	$ -	$ -	$ -	$ -	$ 145,320	$ 145,320	$ -
Commercial	-	-	-	-	22,384	22,384	-
Consumer	15	26	-	41	17,006	17,047	1
	$ 15	$ 26	$ -	$ 41	$ 184,710	$ 184,751	$ 1

(Dollar amounts in thousands, except per share amounts)

NOTE 3 – LOANS AND ALLOWANCE FOR LOAN LOSSES (Continued)

	Still Accruing 30-59 Days Past Due	Still Accruing 60-89 Days Past Due	Still Accruing 90 or More Days Past Due	Total Past Due	Loan Not Past Due	Total	Non-accrual
December 31, 2014							
Real estate secured	$ 501	$ -	$ -	$ 501	$ 128,169	$ 128,670	$ -
Commercial	108	-	-	108	24,596	24,704	-
Consumer	-	-	-	-	13,195	13,195	1
	$ 609	$ -	$ -	$ 609	$ 165,960	$ 166,569	$ 1

Troubled Debt Restructurings: As of December 31, 2015 and 2014, the Bank had a recorded investment in troubled debt restructurings (TDRs) of $98 and $190, respectively. The Bank allocated $14 and $32 of specific reserves for those loans at December 31, 2015 and 2014, respectively, and has not committed to lend any additional amounts under those respective loan agreements.

During the year ended December 31, 2015, the terms of one loan in the amount of $98 were modified as a TDR. The modification of this loan included a reduction of the stated interest rate and also a restructuring of the timing of required principal payments on the loan, but not a reduction of the principal balance of the loan. During the year ended December 31, 2014, there were no loans modified and designated as TDRs.

The Bank did not have any loans classified as TDRs that subsequently defaulted in 2015 or 2014.

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

	Unpaid Principal Balance	Recorded Investment	Related Allowance	Average Recorded Investment	Interest Income Recognized
December 31, 2015					
With a related allowance recorded:					
Real estate secured	$ 919	$ 919	$ 68	$ 927	$ 47
Commercial	98	98	14	20	5
	$ 1,017	$ 1,017	$ 82	$ 947	$ 52
December 31, 2014					
With a related allowance recorded:					
Real estate secured	$ 1,125	$ 1,125	$ 82	$ 1,131	$ 43
	$ 1,125	$ 1,125	$ 82	$ 1,131	$ 43

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.

(Continued)

(Dollar amounts in thousands, except per share amounts)

NOTE 3 – LOANS AND ALLOWANCE FOR LOAN LOSSES (Continued)

The Bank did not recognize any interest income on the cash basis during 2015 or 2014.

Loans sold and serviced for others, which were not included in the accompanying balance sheets, had unpaid principal balances totaling $8.97 million and $8.63 million at December 31, 2015 and 2014, respectively.

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

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, 2015 and 2014 were as follows:

	2015	2014
Balance, beginning of year	$ 517	$ 760
New loans and advances	-	-
Principal repayments	(13)	(243)
Balance at end of year	$ 504	$ 517

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

As of December 31, 2015 and 2014, the Bank had $1.12 million and $1.18 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, 2015 and 2014:

	2015	2014
Land and buildings owned	$ 10,612	$ 10,474
Equipment and furniture	2,978	2,944
Leasehold improvements	551	559
	14,141	13,977
Less accumulated depreciation and amortization	(3,648)	(3,217)
	$ 10,493	$ 10,760

Depreciation and amortization expense for the years ended December 31, 2015 and 2014 were $423 and $500, respectively.

(Continued)

(Dollar amounts in thousands, except per share amounts)

NOTE 6 – TIME DEPOSITS

As of December 31, 2015, the schedule of maturities for time deposits was as follows:

2016	$ 18,308
2017	8,690
2018	5,651
2019	1,398
2020	1,878
Thereafter	7,571
Total	$ 43,496

The amounts of time deposits that meet or exceed the FDIC insurance of accounts limit of $250 per account were, as of December 31, 2015 and 2014, $4.48 million and $5.82 million, respectively.

NOTE 7 – BORROWINGS

Overnight borrowings from the FHLB as of December 31, 2015 were $12.00 million with an interest rate of 0.25%. Overnight borrowings from the FHLB as of December 31, 2014 were $38.00 million with an interest rate of 0.26%.

At the year-end dates noted, long-term borrowings from the FHLB were as follows:

	Balance	Rates	Weighted Average Rate	Maturity Year
December 31, 2015				
Long-term borrowings	$ 3,000	0.59% – 0.89%	0.77%	2016
	3,000	0.91% – 1.29%	1.06	2017
	4,000	1.32% – 1.87%	1.67	2018
	1,000	1.82%	1.82	2019
	6,000	1.64% – 2.78%	2.27	2020
	1,000	2.20%	2.20	2022
	$ 18,000		1.65%	

	Balance	Rates	Weighted Average Rate	Maturity Year
December 31, 2014				
Long-term borrowings	$ 6,000	0.52% – 4.27%	3.52%	2015
	2,000	0.82% – 0.89%	0.86	2016
	2,000	0.91% – 1.29%	1.10	2017
	3,000	1.74% – 1.87%	1.78	2018
	1,000	1.82%	1.82	2019
	3,000	2.68% – 2.78%	2.75	2020
	$ 17,000		2.38%	

(Continued)

(Dollar amounts in thousands, except per share amounts)

NOTE 7 – BORROWINGS (Continued)

FHLB long-term borrowings are fixed rate. Each borrowing is payable at its maturity date, with a required penalty payment in the event of a payoff prior to its maturity. The borrowings were collateralized by $82.43 million and $97.15 million of first mortgage loans under a blanket lien arrangement as of December 31, 2015 and 2014, respectively. Based on this collateral and the pledged investment securities which are described in Note 2, the Bank would be eligible to borrow up to a total of $86.22 million; however, the FHLB also limits the amount that a member institution can borrow based on that institution's total assets; that limit for the Bank was $83.66 million as of December 31, 2015.

At December 31, 2015, future minimum repayments on the long-term FHLB borrowings were as follows:

2016	$ 3,000
2017	3,000
2018	4,000
2019	1,000
2020	6,000
2022	1,000
Total	$ 18,000

NOTE 8 – INCOME TAXES

Income tax expense for the years ended December 31, 2015 and 2014 consisted of the following components:

	2015	2014
Current expense:		
Federal	$ 725	$ 667
State	199	35
	924	702
Deferred expense:		
Federal	(112)	(136)
State	(2)	93
	(114)	(43)
Total income tax expense	$ 810	$ 659

The Bank's effective income tax rate of 39.9% and 39.2% for the years ended December 31, 2015 and 2014, 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.

(Continued)

(Dollar amounts in thousands, except per share amounts)

NOTE 8 – INCOME TAXES (Continued)

The components of the net deferred tax asset were as follows at December 31, 2015 and 2014:

	2015	2014
Deferred tax assets:		
Allowance for loan losses	$ 834	$ 756
Accrued compensation	159	142
Accrued expenses	137	158
Deferred rent expense	5	7
Unrealized loss on AFS investments	211	317
Nonqualified stock options	27	20
Unfunded commitment liability	12	15
Other	83	16
Total deferred tax assets	1,468	1,431
Deferred tax liabilities:		
Accumulated depreciation	(235)	(298)
Loan origination costs	(309)	(239)
FHLB stock dividends	(16)	(16)
Other	(76)	(54)
Total deferred tax liabilities	(636)	(607)
Net deferred tax asset	$ 832	$ 824

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 2011 and for state taxing authorities for tax years prior to 2010.

At December 31, 2015 and December 31, 2014, 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, 2015 and 2014.

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.

(Continued)

(Dollar amounts in thousands, except per share amounts)

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, 2015 and 2014, the following lending commitments were outstanding whose contract amounts represent potential credit risk:

	2015	2014
Unadvanced lines of credit	$ 11,078	$ 13,652
Standby letters of credit	643	894

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, 2015 and 2014, the amount of the liability related to guarantees was not considered to be material.

(Continued)

NOTE 10 – SHARE-BASED COMPENSATION

Under the October 2004 Stock Option Plan (the "2004 Option Plan"), the Bank could 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. At December 31, 2015, 123,000 options issued under the 2004 Option Plan were outstanding; the options all carry provisions which provide that they become fully vested (exercisable) if a change in control (as defined) of the Bank were to occur. Based on the terms of the 2004 Option Plan, it terminated in October 2014, although options granted under the 2004 Option Plan remain in effect under the terms of the options granted.

During 2014 the shareholders of the Bank approved the 2014 Stock Incentive Plan (the "2014 Incentive Plan"). Under the terms of the 2014 Incentive Plan, incentive stock options and non-qualified stock options as well as restricted stock shares may be granted, with the aggregate maximum number of shares available for grant totaling 306,939. At December 31, 2015, 112,000 options had been granted under the 2014 Incentive Plan, and 195,939 options or restricted shares were available for grant. 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 ten years after the date of grant and vest as determined by the Bank's Board of Directors (the "Board"); however, the options all carry provisions which provide that they become fully vested (exercisable) if a change in control (as defined) of the Bank were to occur. The terms of issuance of the restricted stock, including the issuance price and any restrictions as to the vesting of the restricted shares, will be determined by the Board when those restricted shares are granted. The Bank recognized share-based compensation costs of $88 and $50 in 2015 and 2014, respectively.

The fair value of each option grant is estimated on the date of grant using the Black-Scholes option-pricing model. During 2015 there were three grants of options under the 2014 Incentive Plan, as follows:

- 52,500 options were granted on January 28, and the assumptions used in determining the $2.78 per share fair value of each option were as follows: the exercise price of the options was $9.30 per share, the dividend yield was 0%, the risk-free rate was 1.73%, and the term of the options was ten years,
- 2,000 options were granted on April 1, and the assumptions used in determining the $2.79 per share fair value of each option were as follows: the exercise price of the options was $9.20 per share, the dividend yield was 0%, the risk-free rate was 1.87%, and the term of the options was ten years, and
- 58,500 options were granted on August 3, and the assumptions used in determining the $2.93 per share fair value of each option were as follows: the exercise price of the options was $9.70 per share, the dividend yield was 0%, the risk-free rate was 2.16%, and the term of the options was ten years.

Based on the share-based compensation awards outstanding as of December 31, 2015, the Bank expects to recognize additional pre-tax compensation costs amounting to $111 in each of the years 2016 through 2018, $110 in 2019, $63 in 2020 and $17 thereafter. 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.

(Continued)

(Dollar amounts in thousands, except per share amounts)

NOTE 10 – SHARE-BASED COMPENSATION (Continued)

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

	2015			2014		
	Options	Weighted Average Exercise Price Per Share	Aggregate Intrinsic Value	Options	Weighted Average Exercise Price Per Share	Aggregate Intrinsic Value
Outstanding at beginning of year	128,750	$ 9.09	$ -	186,189	$ 8.25	$ -
Granted	113,000	9.51	-	104,500	8.90	-
Exercised	-	-	-	(119,126)	8.00	-
Expired	(6,750)	10.90	-	(42,813)	8.00	-
Outstanding at end of year	235,000	$ 9.24	$ 155	128,750	$ 9.09	$ 8
Options exercisable at year end	18,100	$ 9.56	$ 6	21,850	$ 10.05	$ -

The weighted average remaining contractual life of options outstanding at December 31, 2015 and 2014, were 8.3 years and 8.0 years, respectively, and the weighted average remaining contractual life of options currently exercisable at December 31, 2015 and 2014, was 2.3 years and 2.8 years, respectively.

There were no options exercised during the year ended December 31, 2015, and 119,126 options were exercised during the year ended December 31, 2014. As of December 31, 2015, there was $523 of total unrecognized compensation cost related to the outstanding stock options that will be recognized over a period of six 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, 2015, future minimum rental payments under the lease described above were as follow:

2016	$ 217
2017	217
2018	217
2019	19
	$ 670

For the years ended December 31, 2015 and 2014, total rental expense was $141 and $206, respectively.

NOTE 11 – OTHER COMMITMENTS AND CONTINGENCIES (Continued)

During 2014 the Bank analyzed the operations of the Golden Valley branch (the “GVB”) which operated in the property covered by the operating lease described above and concluded that the GVB’s contribution to Bank operations and earnings did not warrant remaining a full-service branch, and thus discontinued the full-service retail banking services and operations offered at the GVB; after obtaining regulatory approval, the Bank re-designated the GVB a limited-services branch as of December 31, 2014. The Bank included $538 of costs related to this discontinuance in its 2014 earnings as follows:

- The recognition of contract termination costs (e.g., the write-off of a portion of the remaining lease obligation described above), which resulted in a cost of $348 that is an accrued expense included in “Other liabilities” in the accompanying BALANCE SHEETS, and which is included in “Other operating expenses” in the accompanying STATEMENTS OF EARNINGS,
- The write-off of the GVB tenant improvements and also furniture and fixtures that could not be utilized elsewhere within the Bank totaling $174, which is reflected as a reduction in “Premises and equipment, net” in the accompanying BALANCE SHEETS and as a cost included in “Other operating expenses” in the accompanying STATEMENTS OF EARNINGS,
- Severance compensation of $10 which was paid to the terminated staff, which amount is included in “Salaries and employee benefits” in the accompanying STATEMENTS OF EARNINGS, and
- The accrual for miscellaneous estimated remediation costs ultimately required of the Bank totaling $6, which is an accrued expense included in “Other liabilities” in the accompanying BALANCE SHEETS, and which is included in “Other operating expenses” in the accompanying STATEMENTS OF EARNINGS.

During 2015 the Bank determined that the GVB’s ongoing contribution to the Bank’s operations and earnings did not warrant remaining a limited services branch, and after obtaining regulatory approval, the Bank re-designated this facility as an administrative facility, being utilized solely as a remote office and general storage facility. The Bank has included $29 of costs related to this further discontinuance in its 2015 earnings as follows:

- The recognition of contract termination costs (e.g., the write-off of a portion of the remaining lease obligation described above), which resulted in a cost of $21 that is an accrued expense included in “Other liabilities” in the accompanying BALANCE SHEETS, and which is included in “Other operating expenses” in the accompanying STATEMENTS OF EARNINGS, and
- The write-off of the GVB tenant improvements amounting to $8, which is reflected as a reduction in “Premises and equipment, net” in the accompanying BALANCE SHEETS and as a cost included in “Other operating expenses” in the accompanying STATEMENTS OF EARNINGS.

Following the discontinuance described above, and including both 2014 and 2015 components, the Bank had accrued $369 of contract termination costs, written off $182 of premises and equipment and paid $10 in severance compensation. For the year ending December 31, 2015, the Bank had remaining accrued liability totaling $313.

(Continued)

NOTE 12 – CONCENTRATION RISK

The Bank grants commercial, real estate, construction and installment loans to businesses and individuals primarily in Santa Clarita and the surrounding communities. Most loans are secured by business assets, commercial real estate, and/or residential real estate. At December 31, 2015 and 2014, loans secured by real estate represented 79% and 77%, respectively, of the Bank's total gross loan balances.

At December 31, 2015 and 2014, the Bank had $42.26 million and $42.08 million, respectively, of money market deposit account and Federal funds sold balances at commercial banks. It also had $747 and $621 on deposit with correspondent commercial banks at those respective dates, of which balances of $735 and $621, respectively, were FDIC insured, and $12 and $0, respectively, exceeded the applicable FDIC insurance coverage.

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’s contributions to the plan are considered “profit sharing” in nature, and the contribution rate that the Bank’s Board of Directors (the “Board”) approved for both 2015 and 2014 was three percent of every employee’s eligible annual compensation, as defined. Bank contributions for the years ended December 31, 2015 and 2014 totaled $82 and $81, respectively.

The Bank established an Employee Stock Ownership Plan (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 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 $6 were made into the ESOP during the years ended December 31, 2015 and 2014, respectively.

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. The final rules implementing Basel Committee on Banking Supervision’s capital guidelines for U.S. Banks (the “Basel III Rules”) became effective for the Bank on January 1, 2015; full compliance with all of the requirements of the Basel III Rules is being phased in over a multi-year schedule, and will be fully phased-in by January 1, 2019. The net unrealized gain or loss on Available-for-Sale securities is not included in computing regulatory capital. Capital amounts and ratios for December 31, 2014 are calculated using Basel I rules. Management believes that as of December 31, 2015, the Bank met all capital adequacy requirements to which it was subject.

(Continued)

(Dollar amounts in thousands, except per share amounts)

NOTE 14 – MINIMUM REGULATORY CAPITAL REQUIREMENTS (Continued)

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, 2015 and 2014, 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, 2015 and 2014, are presented in the table below:

	Actual		Minimum Capital Requirement		Minimum to be Well Capitalized	
December 31, 2015	Amount	Ratio	Amount	Ratio	Amount	Ratio
Total capital to risk-weighted assets (Total Capital Ratio)	$ 27,952	13.62%	$ 16,418	8.00%	$ 20,523	10.00%
Tier 1 capital to risk-weighted assets (Tier 1 Capital Ratio)	25,798	12.57	12,314	6.00	16,419	8.00
Common equity tier 1 capital to risk-weighted assets (Common Equity Tier 1 Capital Ratio)	25,798	12.57	9,236	4.50	13,340	6.50
Tier 1 capital to average assets (Tier 1 Leverage Ratio)	25,798	9.35	11,037	4.00	13,796	5.00

	Actual		Minimum Capital Requirement		Minimum to be Well Capitalized	
December 31, 2014	Amount	Ratio	Amount	Ratio	Amount	Ratio
Total capital to risk-weighted assets	$ 26,444	14.03%	$ 15,079	8.00%	$ 18,848	10.00%
Tier 1 capital to risk-weighted assets	24,489	13.00	7,535	4.00	11,303	6.00
Tier 1 capital to average assets	24,489	9.37	10,454	4.00	13,068	5.00

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.

(Continued)

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, 2015 and 2014, 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, 2015 and 2014, 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.

The following table presents information about the Bank's financial instruments measured at fair value on a recurring basis as of December 31, 2015 and 2014, 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.

(Continued)

(Dollar amounts in thousands, except per share amounts)

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

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, Using:			
	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Fair Value
December 31, 2015				
Financial assets:				
Assets measured on a recurring basis:				
Securities available-for-sale				
MBSs:				
Single family residential loans	$ -	$ 16,812	$ -	$ 16,812
Multifamily residential loans	-	8,306	-	8,306
	$ -	$ 25,118	$ -	$ 25,118
Financial liabilities:				
Derivatives	$ -	$ 198	$ -	$ 198
December 31, 2014				
Financial assets:				
Assets measured on a recurring basis:				
Securities available-for-sale				
MBSs:				
Single family residential loans	$ -	$ 18,951	$ -	$ 18,951
Multifamily residential loans	-	10,464	-	10,464
	$ -	$ 29,415	$ -	$ 29,415
Financial liabilities:				
Derivatives	$ -	$ 334	$ -	$ 334

At December 31, 2015 and 2014, 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 balance 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.

(Dollar amounts in thousands, except per share amounts)

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

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 TIB Stock: It is not practical to determine the fair value of the FHLB and TIB 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 are 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:

	2015		2014	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
Financial assets				
Cash and cash equivalents	$ 48,594	$ 48,594	$ 45,445	$ 45,445
Investment securities available for sale	25,118	25,118	29,415	29,415
Loans, net of the ALL	183,221	184,516	165,169	167,609
FHLB and TIB stock	2,301	N/A	3,854	N/A
Accrued interest receivable	676	676	642	642

	2015		2014	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
Financial liabilities				
Demand, money market and savings deposits	$ 177,357	$ 177,357	$ 128,800	$ 128,800
Time deposits	43,496	44,135	51,085	51,768
Borrowings	30,000	30,099	55,000	55,055
Accrued interest payable	46	46	49	49
Derivatives	198	198	334	334

(Continued)

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, 2015 and 2014, the notional balance of these financial instruments was approximately $2.83 million and $4.24 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 6.00% to 6.50%, 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, 2015 and 2014, the fair value of the hedges was approximately $198 and $334, respectively. Any changes in the fair value of the derivative are recorded as a basis adjustment on the hedged loans and the derivative liability account.

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Chief Executive Officer

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Chief Financial Officer

Stephanie M. Stephens
Senior Vice President
Controller

Risk Management
John Vescovo
Executive Vice President
Chief Risk Officer

Centralized Operations
Carol Morrissey
First Vice President
Centralized Operations Manager

Information Technology
Eric Jensen
Senior Vice President
Manager of Information Services

LENDING

Gregory Weinberg
Executive Vice President
Chief Credit Officer

Commercial Loans
John Carlson
First Vice President
Commercial Loan Officer

Robert Kaplan
Senior Vice President
Commercial Loan Officer

William McCloskey First
Senior President
Commercial Real Estate Officer

SBA Loans
Craig Conner
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SBA Loan Manager

Consumer Loans
Barbara Andriuzzo
Senior Vice President
Consumer Loan Manager

Note Department
Mary Hernandez
First Vice President
Note Department Manager

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David Finkelstein
President & CEO, F & W Foodservices

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