



FINANCIAL STATEMENTS

AS OF DECEMBER 31, 2012 AND 2011

AND FOR THE YEARS THEN ENDED

AND

INDEPENDENT AUDITOR'S REPORT

INDEPENDENT AUDITOR'S REPORT

The Shareholders and
Board of Directors
California Bank of Commerce
Lafayette, California

Report on the Financial Statements

We have audited the accompanying financial statements of California Bank of Commerce, which comprise the balance sheets as of December 31, 2012 and 2011, and the related statements of income, comprehensive income, changes in shareholders' equity, and cash flows for the years then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

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

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

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

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of California Bank of Commerce as of December 31, 2012 and 2011, 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

San Francisco, California
March 27, 2013

California Bank of Commerce

BALANCE SHEETS December 31, 2012 and 2011

ASSETS	2012	2011
Cash and due from banks	\$ 5,776,321	\$ 3,093,294
Interest bearing deposits in banks	38,374,829	43,868,788
Total cash and cash equivalents	44,151,150	46,962,082
Investment securities (Note 3)		
Available-for-sale, at estimated fair value	46,718,089	36,349,666
Held-to-maturity, at amortized cost (estimated fair value of \$3,821,629 at December 31, 2012)	3,810,895	-
Loans held for sale	-	372,173
Loans, less allowance for loan losses of \$4,675,000 in 2012 and \$4,175,000 in 2011 (Notes 4, 5, 9 and 10)	241,473,981	203,572,096
Premises and equipment, net (Note 6)	195,679	319,749
Bank owned life insurance (BOLI)	7,391,725	4,939,253
Deferred income taxes, net	2,019,607	2,704,410
Accrued interest receivable and other assets	3,835,463	3,325,821
Total assets	\$ 349,596,589	\$ 298,545,250
LIABILITIES AND SHAREHOLDERS' EQUITY		
Deposits:		
Non-interest bearing	\$ 83,181,730	\$ 55,465,028
Interest bearing (Note 7)	198,300,033	188,438,362
Total deposits	281,481,763	243,903,390
Other borrowings (Note 9)	29,000,000	18,000,000
Accrued interest payable and other liabilities (Note 14)	2,418,446	1,998,984
Total liabilities	312,900,209	263,902,374
Commitments and contingencies (Note 10)		
Shareholders' equity (Notes 11 and 12):		
Preferred Stock – no par value: 10,000,000 shares authorized Series C, noncumulative, \$1,000 per share liquidation value, 11,000 shares issued and outstanding at December 31, 2012 and 2011 (Note 16)	10,949,443	10,949,443
Common stock - no par value; 40,000,000 shares authorized; 2,757,243 issued and outstanding in 2012 and 2,750,000 in 2011	30,342,414	30,056,339
Accumulated deficit	(5,017,814)	(6,581,703)
Accumulated other comprehensive income, net of taxes (Note 3)	422,337	218,797
Total shareholders' equity	36,696,380	34,642,876
Total liabilities and shareholders' equity	\$ 349,596,589	\$ 298,545,250

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

California Bank of Commerce

STATEMENTS OF INCOME For the Years Ended December 31, 2012 and 2011

	<u>2012</u>	<u>2011</u>
Interest income:		
Interest and fees on loans	\$ 12,386,016	\$ 10,145,984
Interest on investment securities	553,138	452,533
Interest on Federal funds sold	-	1,903
Interest on interest bearing deposits in banks	<u>108,624</u>	<u>88,639</u>
Total interest income	13,047,778	10,689,059
Interest expense:		
Interest on deposits (Note 7)	1,167,674	1,149,344
Interest on borrowings (Note 9)	<u>443,911</u>	<u>406,105</u>
Total interest expense	<u>1,611,585</u>	<u>1,555,449</u>
Net interest income before provision for loan losses	11,436,193	9,133,610
Provision for loan losses (Note 5)	<u>1,249,688</u>	<u>1,328,061</u>
Net interest income after provision for loan losses	<u>10,186,505</u>	<u>7,805,549</u>
Non-interest income:		
Service charges and other fees	794,694	384,445
Net gains on sales of loans	362,161	240,640
Net gains on sales of investment securities (Note 3)	286,314	124,100
Earnings on BOLI	252,472	81,234
Other	<u>44,519</u>	<u>3,399</u>
Total non-interest income	<u>1,740,160</u>	<u>833,818</u>
Non-interest expenses:		
Salaries and employee benefits (Notes 4 and 14)	5,930,106	4,597,721
Occupancy and equipment (Notes 6 and 10)	708,068	634,498
Other (Note 15)	<u>2,168,671</u>	<u>1,931,384</u>
Total non-interest expenses	<u>8,806,845</u>	<u>7,163,603</u>
Income before provision for income taxes	3,119,820	1,475,764
Provision for income taxes (Note 8)	<u>1,354,264</u>	<u>682,616</u>
Net Income	1,765,556	793,148
Preferred stock dividend	<u>(201,667)</u>	<u>(159,556)</u>
Income to common shareholders	<u>\$ 1,563,889</u>	<u>\$ 633,592</u>
Earnings per common share:		
Basic	<u>\$ 0.57</u>	<u>\$ 0.23</u>
Diluted	<u>\$ 0.57</u>	<u>\$ 0.23</u>
Weighted average number of shares outstanding – basic	<u>2,750,217</u>	<u>2,750,000</u>
Weighted average number of shares outstanding – diluted	<u>2,750,252</u>	<u>2,750,000</u>

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

California Bank of Commerce

STATEMENTS OF COMPREHENSIVE INCOME

For the Years Ended December 31, 2012 and 2011

	<u>2012</u>	<u>2011</u>
Net Income	\$ 1,765,556	\$ 793,148
Other comprehensive income:		
Unrealized gains on available-for-sale Investment securities	344,982	82,844
Tax effect	<u>(141,442)</u>	<u>(33,966)</u>
Total other comprehensive income	203,540	48,878
Total comprehensive income	<u>\$ 1,969,096</u>	<u>\$ 842,026</u>

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

California Bank of Commerce

STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY For the Years Ended December 31, 2012 and 2011

	<u>Preferred Stock – Series A</u>		<u>Preferred Stock – Series B</u>		<u>Preferred Stock – Series C</u>		<u>Common Stock</u>		<u>Accumulated Deficit</u>	<u>Accumulated Other Comprehensive Income</u>	<u>Total Shareholders' Equity</u>
	<u>Shares</u>	<u>Amount</u>	<u>Shares</u>	<u>Amount</u>	<u>Shares</u>	<u>Amount</u>	<u>Shares</u>	<u>Amount</u>			
Balance, January 1, 2011	4,000	\$ 3,825,134	200	\$ 193,970		\$ -	2,750,000	\$29,804,008	\$ (7,034,399)	\$ 169,919	\$26,958,632
Amortization of discount on Series A and discount accretion on Series B preferred stock (Note 16)		120,636		6,030					(126,666)		
Redemption of Series A and B Preferred stock (Note 16)	(4,000)	(3,945,770)	(200)	(200,000)					(54,230)		(4,200,000)
Issuance of Series C Preferred Stock, net of Offering costs of \$50,557 (Note 16)					11,000	10,949,443					10,949,443
Share-based compensation expense (Note 11)								252,331			252,331
Preferred stock dividends (Note 16)									(159,556)		(159,556)
Net income									793,148		793,148
Other comprehensive income										48,878	48,878
Balance, December 31, 2011	-	\$ -	-	\$ -	11,000	\$10,949,443	2,750,000	\$30,056,339	\$ (6,581,703)	\$ 218,797	\$34,642,876
Repurchase of unexercised option award								(100,000)			(100,000)
Share-based compensation expense (Note 11)								358,675			358,675
Preferred stock dividends (Note 16)									(201,667)		(201,667)
Net income									1,765,556		1,765,556
Stock options exercised							4,000	27,400			27,400
Restricted stock issued							3,243				
Other comprehensive income										203,540	203,540
Balance, December 31, 2012	-	\$ -	-	\$ -	11,000	\$10,949,443	\$ 2,757,243	\$30,342,414	\$ (5,017,814)	\$ 422,337	\$36,696,380

The accompanying notes are an integral part of these financial statements

California Bank of Commerce

STATEMENTS OF CASH FLOWS For the Years Ended December 31, 2012 and 2011

	<u>2012</u>	<u>2011</u>
Cash flows from operating activities:		
Net Income	\$ 1,765,556	\$ 793,148
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for loan losses	1,249,688	1,328,061
Deferred tax provision	543,361	440,021
Depreciation	156,113	129,072
Deferred loan origination costs, net	(91,605)	(79,648)
Amortization of premiums on investment securities, net	633,386	419,811
Share-based compensation expense, net	358,675	252,331
Increase in cash surrender value of life insurance	(252,472)	(81,234)
Discount on retained portion of sold loans, net	90,199	2,613
Gain on sale of investment securities, net	(286,314)	(124,100)
Decrease in loans held for sale	372,173	1,017,927
Increase in accrued interest receivable and other assets	(324,842)	(168,688)
Increase in accrued interest payable and other liabilities	424,351	913,157
	<u>4,638,269</u>	<u>4,842,471</u>
Net cash provided by operating activities		
Cash flows from investing activities:		
Purchase of available-for-sale investment securities	(34,921,498)	(24,612,086)
Purchase of held-to-maturity investment securities	(3,838,240)	
Proceeds from sales and maturities of available-for-sale investment securities	15,848,543	31,876,983
Proceeds from principal payments on available-for-sale investment securities	8,706,545	6,532,188
Proceeds from principal payments on held-to-maturity investment securities	23,242	
Net increase in loans	(39,150,167)	(34,749,589)
Purchases of premises and equipment	(32,043)	(173,478)
Purchase of bank-owned life insurance policies	(2,200,000)	(3,500,000)
Purchase of Federal Home Loan Bank stock	(184,800)	(332,200)
	<u>(55,748,418)</u>	<u>(24,958,182)</u>
Net cash used in investing activities		

(Continued)

California Bank of Commerce

STATEMENTS OF CASH FLOWS (Continued) For the Years Ended December 31, 2012 and 2011

	2012	2011
Cash flows from financing activities:		
Net increase in demand, interest bearing and savings deposits	\$ 20,534,730	\$ 53,581,476
Net increase in time deposits	17,043,643	6,705,250
Proceeds from sale of preferred stock, net of redemption of preferred stock		6,749,443
Proceeds from exercised stock options	27,400	
Repurchase of unexercised option award	(100,000)	
Payment of dividends on preferred stock	(206,556)	(181,667)
Proceeds (repayment) of other borrowings	11,000,000	(10,000,000)
Net cash provided by financing activities	48,299,217	56,854,502
Decrease (increase) in cash and cash equivalents	(2,810,932)	36,738,791
Cash and cash equivalents at beginning of period	46,962,082	10,223,291
Cash and cash equivalents at end of period	\$ 44,151,150	\$ 46,962,082
Supplemental disclosure of cash flow information:		
Cash paid during the year for:		
Interest	\$ 1,654,673	\$ 1,503,558
Income taxes	\$ 329,538	\$ 495,350

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

California Bank of Commerce

NOTES TO FINANCIAL STATEMENTS

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

General

California Bank of Commerce (the "Bank") was approved as a state-chartered non-member bank on March 23, 2007, and commenced operations on July 17, 2007. The Bank is subject to regulation by the California Department of Financial Institutions (the "DFI") and the Federal Deposit Insurance Corporation (the "FDIC"). The Bank is headquartered in Lafayette, California and provides products and services to customers who are predominately small to middle-market businesses, professionals and not-for-profit organizations located in Contra Costa, Alameda and surrounding counties.

The accounting and reporting policies of the Bank conform with accounting principles generally accepted in the United States of America and prevailing practices within the banking industry.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions. These estimates and assumptions affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from these estimates. The allowance for loan losses, taxes and fair value estimates are particularly subject to change.

Reclassifications

Certain reclassifications have been made to prior year balances to conform to classifications used in the current year. These reclassifications had no effect on prior year net income or shareholder's equity.

Cash and Cash Equivalents

For the purpose of the statement of cash flows, cash and cash equivalents consist of cash and due from banks, interest bearing deposits in banks with original maturities of 90 days or less and Federal funds sold. Generally, Federal funds are sold for one day periods. Cash flows from loans, deposits and other borrowings are presented on a net basis.

Investment Securities

Investment securities are classified into the following categories:

- Available-for-sale securities, reported at fair value, with unrealized gains and losses excluded from earnings and reported, net of taxes, as accumulated other comprehensive income (loss) within shareholders' equity.
- Held-to-maturity securities, which management has the positive intent and ability to hold, reported at amortized cost, adjusted for the accretion of discounts and amortization of premiums.

California Bank of Commerce
NOTES TO FINANCIAL STATEMENTS
(Continued)

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Investment Securities (Continued)

Management determines the appropriate classification of its investments at the time of purchase. Subsequent transfers between categories are accounted for at fair value.

Gains and losses on the sale of investment securities are computed using the specific identification method. Interest earned on investment securities is reported in interest income, net of applicable adjustments for accretion of discounts and amortization of premiums using the level yield method adjusted for changes in principal prepayment speeds.

An investment security is impaired when its carrying value is greater than its fair value. Investment securities that are impaired are evaluated on at least a quarterly basis and more frequently when economic or market conditions warrant such an evaluation to determine whether such a decline in their fair value is other than temporary. Management utilizes criteria such as the magnitude and duration of the decline and the intent and ability of the Bank to retain its investment in the securities for a period of time sufficient to allow for an anticipated recovery in fair value, in addition to the reasons underlying the decline, to determine whether the loss in value is other than temporary. The term "other than temporary" is not intended to indicate that the decline is permanent, but indicates that the prospects for a near-term recovery of value is not necessarily favorable, or that there is a lack of evidence to support a realizable value equal to or greater than the carrying value of the investment. Once a decline in value is determined to be other than temporary, and management does not intend to sell the security or it is more likely than not that the Bank will not be required to sell the security before recovery, only the portion of the impairment loss representing credit exposure is recognized as a charge to earnings, with the balance recognized as a charge to other comprehensive income. If management intends to sell the security or it is more likely than not that the Bank will be required to sell the security before recovering its forecasted cost, the entire impairment loss is recognized as a charge to earnings.

Investment in Federal Home Loan Bank Stock

As a member of the Federal Home Loan Bank of San Francisco, the Bank is required to maintain an investment in the capital stock of the Federal Home Loan Bank (the "FHLB"). The investment is carried at cost, classified as a restricted security, and periodically evaluated for impairment based on the ultimate recovery of par value.

At December 31, 2012 and 2011, the Bank's investment in FHLB stock totaled \$1,363,000 and \$1,178,200, respectively, and is included on the balance sheet in accrued interest receivable and other assets. Both cash and stock dividends are reported as income.

California Bank of Commerce
NOTES TO FINANCIAL STATEMENTS
(Continued)

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Investment in Other Bank Stocks

Independent Bankers Financial Corporation

The Independent Bankers Financial Corporation (the "IBFC"), the holding company for The Independent Banker's Bank, provides services exclusively to banks. At December 31, 2012 and 2011, the Bank's investment in IBFC stock totaled \$50,419. The investment is carried at cost and is included on the balance sheet in accrued interest receivable and other assets.

Pacific Coast Bankers' Bancshares

The Pacific Coast Bankers' Bancshares ("PCBB"), the holding company for The Pacific Coast Banker's Bank, provides services exclusively to banks. At December 31, 2012 and 2011, the Bank's investment in PCBB stock totaled \$190,000. The investment is carried at cost and is included on the balance sheet in accrued interest receivable and other assets.

Bank Owned Life Insurance

The Bank has purchased life insurance policies on certain current and former executives. Bank owned life insurance is recorded at the amount that can be realized under the insurance contract at the balance sheet date, which is the cash surrender value adjusted for other charges, or other amounts due that are probable at settlement.

Loans

Loans that management has the intent and ability to hold for the foreseeable future, or until maturity or payoff, are reported at the principal balances outstanding, net of deferred fees and costs and the allowance for loan losses. Loans transferred from loans held for sale are carried at the lower of principal balance or market value at the date of transfer adjusted for accretion of discounts. Interest is accrued daily based upon outstanding loan balances. However, when, in the opinion of management, loans are considered to be impaired and the future collectability of interest and principal is in serious doubt, loans are placed on nonaccrual status and the accrual of interest income is suspended. Any interest accrued but unpaid is charged against income. Payments received are applied to reduce principal to the extent necessary to ensure collection. Subsequent payments on these loans, or payments received on nonaccrual loans for which the ultimate collectability of principal is not in doubt, are applied first to earned but unpaid interest and then to principal.

California Bank of Commerce
NOTES TO FINANCIAL STATEMENTS
(Continued)

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Loans (Continued)

Generally, loans are restored to accrual status when the obligation is brought current and has performed in accordance with the contractual terms for a reasonable period of time and the ultimate collectability of the total contractual principal and interest is no longer in doubt. The policy for placing loans on nonaccrual status, recording payments received on nonaccrual loans, resuming the accrual of interest and determining past due or delinquency status, does not differ by portfolio segment or class of financing receivable.

An impaired loan is measured based on the present value of expected future cash flows discounted at the loan's effective rate or, as a practical matter, at the loan's observable market price or the fair value of collateral less estimated costs to sell if the loan is collateral dependent. A loan is collateral dependent if the repayment of the loan is expected to be provided solely by the underlying collateral. All loans are evaluated and considered impaired when, based on current information and events, it is probable that the Bank will be unable to collect all amounts due (including both principal and interest) in accordance with the contractual terms of the loan agreement. The policy for accounting for impaired loans, recognizing interest on impaired loans and recording payments on impaired loans is generally the same as that described above for nonaccrual loans, and does not differ by portfolio segment or class of financing receivable.

Substantially all loan origination fees, commitment fees, direct loan origination costs and purchase premiums and discounts on loans are deferred and recognized as an adjustment of yield, to be amortized to interest income over the contractual term of the loan. The unamortized balance of deferred fees and costs is reported as a component of net loans.

The Bank services loans that have been participated with other financial institutions totaling approximately \$7,301,000 and \$6,879,000, respectively, as of December 31, 2012 and 2011. The participated balances of these loans were sold without recourse and are not included on the Bank's balance sheet.

Allowance for Loan Losses

The allowance for loan losses is an estimate of probable credit losses inherent in the Bank's loan portfolio that have been incurred as of the balance-sheet date. The allowance is established through a provision for loan losses which is charged to expense. Additions to the allowance are expected to maintain the adequacy of the total allowance after credit losses and loan growth. Credit exposures determined to be uncollectible are charged against the allowance. Cash received on previously charged off amounts is recorded as a recovery to the allowance. The policy for charging off loans and recording recoveries does not differ by portfolio segment or class of financing receivable. The overall allowance consists of two primary components, specific reserves related to individually identified impaired loans and general reserves for inherent losses related to loans that are collectively evaluated for impairment.

California Bank of Commerce
NOTES TO FINANCIAL STATEMENTS
(Continued)

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Allowance for Loan Losses (Continued)

A restructuring of a debt constitutes a troubled debt restructuring (TDR) if the Bank for economic or legal reasons related to the debtor's financial difficulties grants a concession to the debtor that it would not otherwise consider. Restructured workout loans typically present an elevated level of credit risk as the borrowers are not able to perform according to the original contractual terms. Loans that are reported as TDRs are considered impaired and measured for impairment as described above.

The determination of the general reserve for loans that are collectively evaluated for impairment is based on estimates made by management, to include, but not limited to, consideration of historical losses by portfolio segment, the loan risk rating, internal asset classifications, and qualitative factors to include economic trends in the Bank's service areas, industry experience and trends, geographic concentrations, estimated collateral values, the Bank's underwriting policies, the character of the loan portfolio, and probable losses inherent in the portfolio taken as a whole.

The Bank maintains a separate allowance for each portfolio segment (loan type). These portfolio segments include commercial & industrial, real estate - construction & land, real estate, real estate - home equity lines of credit ("HELOC") and installment. The allowance for loan losses attributable to each portfolio segment, which includes both impaired loans and loans that are not impaired, is combined to determine the Bank's overall allowance, which is included on the balance sheet.

The Bank assigns a risk rating to all loans and periodically, but not less than annually, performs reviews of all such loans to identify credit risks and to assess the overall collectability of the portfolio. These risk ratings are also subject to examination by independent specialists engaged by the Bank and the Bank's regulators. During these internal reviews, management monitors and analyzes the financial condition of borrowers and guarantors, trends in the industries in which borrowers operate and the fair values of collateral securing these loans. These credit quality indicators are used to assign a risk rating to each individual loan. The risk ratings can be grouped into five major categories, defined as follows:

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

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

California Bank of Commerce
NOTES TO FINANCIAL STATEMENTS
(Continued)

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Allowance for Loan Losses (Continued)

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

Doubtful – Loans classified doubtful have all the weaknesses inherent in those classified as substandard with the added characteristic that the weaknesses make collection or liquidation in full, on the basis of currently known facts, conditions and values, highly questionable and improbable.

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

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

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

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

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

California Bank of Commerce
NOTES TO FINANCIAL STATEMENTS
(Continued)

1. **SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES** (Continued)

Allowance for Loan Losses (Continued)

Real Estate - HELOC – The degree of risk in residential real estate lending depends primarily on the loan amount in relation to collateral value, the interest rate and the borrower's ability to repay in an orderly fashion. These loans generally possess a lower inherent risk of loss than other real estate portfolio segments. Economic trends determined by unemployment rates and other key economic indicators are closely correlated to the credit quality of these loans. Weak economic trends indicate that the borrowers' capacity to repay their obligations may be deteriorating.

Installment & Other – An installment loan portfolio is usually comprised of a number of small loans scheduled to be amortized over a specific period. Most installment loans are made directly for consumer purchases, but business loans granted for the purchase of heavy equipment or industrial vehicles may also be included. Economic trends determined by unemployment rates and other key economic indicators are closely correlated to the credit quality of these loans. Weak economic trends indicate that the borrowers' capacity to repay their obligations may be deteriorating. Loans in the "Other" category are typically inconsequential and typically include overdrafts on deposit accounts.

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

Allowance for Credit Losses on Off-Balance-Sheet Credit Exposures

The Bank also maintains a separate allowance for off-balance-sheet commitments. Management estimates anticipated losses using historical data and utilization assumptions. The allowance for off-balance-sheet commitments is included in accrued interest payable and other liabilities on the balance sheet, and totaled \$45,000 and \$120,000 at December 31, 2012 and 2011, respectively.

Transfer of Financial Assets

Transfers of financial assets are accounted for as sales, when control over the assets has been surrendered. Control over transferred assets is deemed 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.

California Bank of Commerce
NOTES TO FINANCIAL STATEMENTS
(Continued)

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Sales and Servicing of Government Guaranteed Loans

Included in the portfolio are loans which, in general, are 70 to 90 percent guaranteed by either the U.S. Department of Agriculture (the "USDA") or the Small Business Administration (the "SBA"). The guaranteed portion of these loans may be sold to a third party, with the Bank retaining the unguaranteed portion. The Bank generally receives a premium in excess of the adjusted carrying value of the loan at the time of sale. The Bank may be required to refund a portion of the sales premium if the borrower defaults or the loan prepays within ninety days of the settlement date. However, none of the premiums the Bank had received were subject to these recourse provisions as of December 31, 2012 or 2011. There were no USDA and SBA loans held for sale at December 31, 2012 and \$372,173 held for sale as of December 31, 2011. The guaranteed portion of USDA and SBA loans sold, totaling approximately \$9,034,000 and \$4,785,000 were being serviced for others at December 31, 2012 and 2011, respectively.

Servicing rights acquired through 1) a purchase or 2) the origination of loans which are sold with servicing rights retained are recognized as separate assets or liabilities. Servicing assets or liabilities are initially recorded at fair value and are subsequently amortized in proportion to, and over the period of the related net servicing income or expense. Servicing assets are periodically evaluated for impairment. Fair values are estimated using discounted cash flows based on current market interest rates. For purposes of measuring impairment, servicing assets are stratified based on note rate and term. The amount of impairment recognized is the amount by which the servicing assets for a stratum exceed their fair value. Servicing assets totaling \$65,996 and \$11,688 associated with loans previously sold which were included in accrued interest receivable and other assets at December 31, 2012 and 2011, respectively.

In addition, assets (accounted for as interest-only (IO) strips) are recorded at the fair value of the difference between note rates and rates paid to purchasers (the interest spread) and contractual servicing fees, if applicable. IO strips are carried at fair value with gains or losses recorded as a component of shareholders' equity, similar to available-for-sale investment securities. At December 31, 2012 and 2011 no IO strips were outstanding.

The Bank's investment in the loan is allocated between the retained portion of the loan, the servicing asset, the IO strip, and the sold portion of the loan based on their relative fair values on the date the loan is sold. The gain on the sold portion of the loan is recognized as income at the time of sale. The carrying value of the retained portion of the loan is discounted based on the estimated yield of a comparable non-guaranteed loan. Significant future prepayments of these loans will result in the recognition of additional amortization of related servicing assets and an adjustment to the carrying value of related IO strips.

California Bank of Commerce
NOTES TO FINANCIAL STATEMENTS
(Continued)

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Bank Premises and Equipment

Bank premises and equipment are carried at cost, less accumulated depreciation. Depreciation is determined using the straight-line method over the estimated useful lives of the related assets. The useful lives of furniture, fixtures and equipment are estimated to be 3 to 5 years. Leasehold improvements are amortized over the lesser of the respective lease term (including renewal periods that are reasonably assured) or their useful lives, which are generally 7 to 14 years.

Certain operating leases contain scheduled and specified rent increases or incentives in the form of tenant improvement allowances or credits. The scheduled rent increases are recognized on a straight-line basis over the lease term as an increase in the amount of rental expense recognized each period. Lease incentives are capitalized at the inception of the lease and amortized on a straight-line basis over the lease term as a reduction of rental expense. Amounts accrued in excess of amounts paid related to the scheduled rent increases and the unamortized deferred credits are included in accrued interest payable and other liabilities on the balance sheet.

When assets are sold or otherwise disposed of, the cost and related accumulated depreciation or amortization are removed from the accounts, and any resulting gain or loss is recognized in income for the period. The cost of maintenance and repairs is charged to expense as incurred. The Bank evaluates premises and equipment for financial impairment as events or changes in circumstances indicate that the carrying amount of such assets may not be fully recoverable.

Income Taxes

Deferred tax assets and liabilities are recognized for the tax consequences of temporary differences between the reported amount of assets and liabilities and their tax basis. Deferred tax assets and liabilities are adjusted for the effects of changes in tax laws and rates on the date of enactment. A valuation allowance is recognized if, based on the weight of available evidence, management believes it is more likely than not that some portion or all of the deferred tax assets will not be realized.

Accounting for Uncertainty in Income Taxes

The Bank considers all tax positions recognized in its financial statements for the likelihood of realization. When tax returns are filed, it is highly certain that some positions taken would be sustained upon examination by the taxing authorities, while others are subject to uncertainty about the merits of the position taken or the amount of the position that would be ultimately sustained. The benefit of a tax position is recognized in the financial statements in the period during which, based on all available evidence, management believes it is more likely than not that the position will be sustained upon examination, including the resolution of appeals or litigation processes, if any. Tax positions taken are not offset or aggregated with other positions. Tax positions that meet the more-likely-than-not recognition threshold are measured as the largest amount of the tax benefit that is more than 50 percent likely of being realized upon settlement with the applicable taxing authority.

California Bank of Commerce
NOTES TO FINANCIAL STATEMENTS
(Continued)

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Accounting for Uncertainty in Income Taxes (Continued)

The portion of the benefits associated with tax positions taken that exceeds the amount measured as described above is reflected as a liability for unrecognized tax benefits in the accompanying balance sheet along with any associated interest and penalties that would be payable to the taxing authorities upon examination. Interest expense and penalties associated with unrecognized tax benefits, if any, are classified as income tax expense in the statement of income.

Earnings Per Share

Basic earnings per share (EPS), which excludes dilution, is computed by dividing net income by the weighted-average number of common shares outstanding for the period. Diluted earnings per share reflects the potential dilution that could occur if securities or other contracts to issue common stock, such as stock options, result in the issuance of common stock which share in the earnings of the Bank. The treasury stock method is applied to determine the dilutive effect of stock options and restricted stock in computing diluted earnings per share. There were 688,417 and 715,892 stock options outstanding at December 31, 2012 and 2011, respectively, and no shares of restricted stock at December 31, 2012 and 2011 that were considered anti-dilutive because the assumed proceeds from the exercise price, tax benefits and average future compensation were greater than the average market price of the Bank's common stock.

Share-Based Compensation

The Bank has one share-based compensation plan, the California Bank of Commerce 2007 Equity Incentive Plan (the "Plan"), which has been approved by its shareholders and permits the grant of stock options and restricted stock for up to 825,000 shares of the Bank's common stock, of which 127,590 shares were available for grant at December 31, 2012. The Plan is designed to attract and retain employees and directors. The amount, frequency, and terms of share-based awards may vary based on competitive practices, the Bank's operating results and government regulations. New shares are issued upon option exercise or restricted share grants. The Plan does not provide for the settlement of awards in cash.

For options, the Plan requires that the option price may not be less than the fair market value of the stock at the date the option is granted, and that the stock must be paid in full at the time the option is exercised.

Restricted stock awards are grants of shares of common stock that are subject to forfeiture until specific conditions or goals are met. Conditions may be based on continuing employment or achieving specified performance goals. During the period of restriction, participants holding restricted stock may have full voting and dividend rights. The restrictions lapse in accordance with a schedule or with other conditions determined by the Board of Directors.

California Bank of Commerce
NOTES TO FINANCIAL STATEMENTS
(Continued)

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Share-Based Compensation (Continued)

The Bank recognizes share-based compensation expense for the fair value of all stock options and restricted stock that are ultimately expected to vest as the requisite service is rendered and considering the probability of any performance criteria being achieved.

Management estimates the fair value of each option award as of the date of grant using a Black-Scholes-Merton option pricing formula. Expected volatility is based on historical volatility of similar entities over a preceding period commensurate with the expected term of the option because the Bank's common stock has been publicly traded for a shorter period than the expected term for the options. The "simplified" method described in the Securities and Exchange Commission's Staff Accounting Bulletin No. 110 is used to determine the expected term of option awards. The risk-free rate for the expected term of the option is based on the U.S. Treasury yield curve in effect at the time of grant. Expected dividend yield was not considered in the option pricing formula since the Bank has not paid common stock dividends and has no current plans to do so in the future. The fair value of restricted stock awards is based on the value of the underlying shares at the date of the grant. Management makes estimates regarding pre-vesting forfeitures that will impact total compensation expense recognized under the Plan.

Comprehensive Income

Comprehensive income is a more inclusive financial reporting methodology that includes disclosure of other comprehensive income or loss that historically has not been recognized in the calculation of net income. Sources of other comprehensive income or loss include unrealized gains and losses on available-for-sale investment securities. Total comprehensive income and components of other comprehensive income, or loss, are presented in the statement of comprehensive income.

Fair Value of Financial Instruments

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

Adoption of New Accounting Standards

In May, 2011, the FASB issued an amendment to achieve common fair value measurement and disclosure requirements between U.S. and International accounting principles. Overall, the guidance is consistent with existing U.S. accounting principles; however, there are some amendments that change a particular principle or requirement for measuring fair value or for disclosing information about fair value measurements. The adoption of this amendment did not have a material impact on the Bank's operating results or financial condition.

California Bank of Commerce
NOTES TO FINANCIAL STATEMENTS
(Continued)

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Adoption of New Accounting Standards (Continued)

In June 2011, the FASB amended existing guidance and eliminated the option to present the components of other comprehensive income as part of the statement of changes in shareholder's equity. The amendment requires that comprehensive income be presented in either a single continuous statement or in two separate consecutive statements. The adoption of this amendment changed the presentation of comprehensive income and the components of other comprehensive income by adding the statement of comprehensive income.

2. FAIR VALUE MEASUREMENTS

Fair Value Hierarchy

The Bank groups its assets and liabilities measured at fair value in three levels, based on the markets in which the assets and liabilities are traded and the reliability of the assumptions used to determine fair value. Valuations within these levels are based upon:

Level 1 – Quoted market prices for identical instruments traded in active exchange markets.

Level 2 – Quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active, and model-based valuation techniques for which all significant assumptions are observable or can be corroborated by observable market data.

Level 3 – Model-based techniques that use at least one significant assumption not observable in the market. These unobservable assumptions reflect the Bank's estimates of assumptions that market participants would use on pricing the asset or liability. Valuation techniques include management judgment and estimation which may be significant.

Management monitors the availability of observable market data to assess the appropriate classification of financial instruments within the fair value hierarchy. Changes in economic conditions or model-based valuation techniques may require the transfer of financial instruments from one fair value level to another. In such instances, the transfer is reported at the beginning of the reporting period.

Management evaluates the significance of transfers between levels based upon the nature of the financial instrument and size of the transfer relative to total assets, total liabilities or total earnings.

California Bank of Commerce
NOTES TO FINANCIAL STATEMENTS
(Continued)

2. FAIR VALUE MEASUREMENTS (Continued)

Fair Value of Financial Instruments

The carrying amounts and estimated fair values of financial instruments, at December 31, 2012 and December 31, 2011 are as follows:

	Carrying Amount	Fair Value Measurements at December 31, 2012 Using:			Total
		Level 1	Level 2	Level 3	
Financial assets					
Cash and cash equivalents	\$ 44,151,150	\$ 44,151,150			\$ 44,151,150
Securities available-for-sale	46,718,089		\$ 46,718,089		46,718,089
Securities held-to-maturity	3,810,895		3,821,629		3,821,629
Loans, net	241,473,981			\$ 279,000,000	279,000,000
FHLB stock	1,363,000	N/A	N/A	N/A	N/A
IBFC stock	50,419	N/A	N/A	N/A	N/A
PCBB stock	190,000	N/A	N/A	N/A	N/A
Accrued interest receivable	1,139,469		225,740	913,729	1,139,469
Financial liabilities					
Deposits	\$ 281,481,763		\$ 281,042,000		\$ 281,042,000
Other borrowings	29,000,000		28,653,000		28,653,000
Accrued interest payable	16,765		16,765		16,765

<u>December 31, 2011</u>	<u>Carrying Amount</u>	<u>Fair Value</u>
Financial assets		
Cash and cash equivalents	\$ 46,962,082	\$ 46,962,082
Securities available-for-sale	36,349,666	36,349,666
Loans held for sale, at fair value	372,173	373,000
Loans, net	203,572,096	230,721,000
FHLB stock	1,178,200	N/A
IBFC stock	50,419	N/A
PCBB stock	190,000	N/A
Accrued interest receivable	979,809	979,809
Financial liabilities		
Deposits	\$ 243,903,390	\$ 243,685,000
Other borrowings	18,000,000	17,462,000
Accrued interest payable	59,853	59,853

These estimates do not reflect any premium or discount that could result from offering the Bank's entire holdings of a particular financial instrument for sale at one time, nor do they attempt to estimate the value of anticipated future business related to the instruments. In addition, the tax ramifications related to the realization of unrealized gains and losses can have a significant effect on fair value estimates and have not been considered in any of these estimates.

California Bank of Commerce
NOTES TO FINANCIAL STATEMENTS
(Continued)

2. FAIR VALUE MEASUREMENTS (Continued)

Fair Value of Financial Instruments (Continued)

The methods and assumptions used to estimate fair values are described as follows:

Cash and Cash Equivalents – The carrying amounts of cash and short-term instruments approximate fair values and are classified as Level 1.

Investment Securities – Since quoted prices are generally not available for identical securities, fair values are calculated based on market prices of similar securities, resulting in Level 2 classification.

FHLB, IBFC, PCBB Stocks – It is not practical to determine the fair value of these correspondent bank stocks due to restrictions placed on their transferability.

Loans and Loans Held for Sale – Fair values of loans are estimated as follows: For variable rate loans that reprice frequently and with no significant change in credit risk, fair values are based on carrying values resulting in Level 3 classification. Fair values for other loans are estimated using discounted cash flow analyses, using interest rates currently being offered for loans with similar terms to borrowers of similar credit quality resulting in Level 3 classification. The fair value of impaired loans with specific allocations of the allowance for loan losses is generally based on recent real estate appraisals. These appraisals may utilize a single valuation approach or a combination of approaches including comparable sales and the income approach. Adjustments are routinely made in the appraisal process by the independent appraisers to adjust for differences between the comparable sales and income data available. Such adjustments are usually significant and typically result in a Level 3 classification of the inputs for determining fair value. Non-real estate collateral may be valued using an appraisal, net book value per the borrower's financial statements, or aging reports, adjusted or discounted based on management's historical knowledge, changes in market conditions from the time of the valuation, and management's expertise and knowledge of the client and client's business, resulting in a Level 3 fair value classification. Impaired loans are evaluated on a quarterly basis for additional impairment and adjusted accordingly. The methods utilized to estimate the fair value of loans do not necessarily represent an exit price.

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

Other Borrowings – Fair values for other borrowings are estimated using discounted cash flow analyses using interest rates offered at each reporting date by correspondent banks for advances with similar maturities resulting in Level 2 classification.

California Bank of Commerce
NOTES TO FINANCIAL STATEMENTS
(Continued)

2. FAIR VALUE MEASUREMENTS (Continued)

Fair Value of Financial Instruments (Continued)

Accrued Interest Receivable – The carrying amounts of accrued interest receivable approximate fair value resulting in a Level 2 classification for accrued interest receivable on investment securities and a Level 3 classification for accrued interest receivable on loans since investment securities are generally classified using Level 2 inputs and loans are generally classified using Level 3 inputs.

Accrued Interest Payable – The carrying amounts of accrued interest payable approximate fair value resulting in a Level 2 classification, since accrued interest payable is from deposits that are generally classified using Level 2 inputs.

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

Assets Recorded at Fair Value

The following tables present information about the Bank's assets and liabilities measured at fair value on a recurring and nonrecurring basis:

Recurring Basis

The Bank is required or permitted to record the following assets at fair value on a recurring basis.

<u>Description</u>	<u>Fair Value</u>	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>
<u>December 31, 2012</u>				
Available-for-sale investment securities				
Debt securities:				
U.S. government sponsored agency securities	\$ 2,008,604		\$ 2,008,604	
Mortgage-backed securities - residential	30,639,877		30,639,877	
Corporate bonds	<u>14,069,608</u>		<u>14,069,608</u>	
Total assets measured at fair value on a recurring basis	<u>\$ 46,718,089</u>	<u>\$ -</u>	<u>\$ 46,718,089</u>	<u>\$ -</u>

California Bank of Commerce
NOTES TO FINANCIAL STATEMENTS
(Continued)

2. FAIR VALUE MEASUREMENTS (Continued)

Assets Recorded at Fair Value (Continued)

Recurring Basis (Continued)

Description	Fair Value	Level 1	Level 2	Level 3
<u>December 31, 2011</u>				
Available-for-sale investment securities				
Debt securities:				
Mortgage-backed securities - residential	\$ 36,349,666		\$ 36,349,666	
Total assets measured at fair value on a recurring basis	\$ 36,349,666	\$ -	\$ 36,349,666	\$ -

Fair values for available-for-sale investment securities are based on quoted market prices for exact or similar securities. During the years ended December 31, 2012 and 2011, there were no significant transfers in or out of Levels 1 and 2 and there were no changes in the valuation techniques used.

Non-recurring Basis

The Bank may be required, from time to time, to measure certain assets at fair value on a non-recurring basis. These include assets that are measured at the lower of cost or market value that were recognized at fair value which was below cost at the reporting date.

Description	Fair Value	Level 1	Level 2	Level 3
<u>December 31, 2012</u>				
Impaired loans:				
Commercial and industrial	\$ 434,000	\$ -	\$ -	\$ 434,000

Description	Fair Value	Level 1	Level 2	Level 3
<u>December 31, 2011</u>				
Impaired loans:				
Commercial and industrial	\$ 424,172			\$ 424,172
Real estate - other	853,911			853,911
Total assets measured at fair value on a non-recurring basis	\$ 1,278,083	\$ -	\$ -	\$ 1,278,083

California Bank of Commerce
NOTES TO FINANCIAL STATEMENTS
(Continued)

2. FAIR VALUE MEASUREMENTS (Continued)

Assets Recorded at Fair Value (Continued)

Non-recurring Basis (Continued)

The impaired loans in the table above were determined to be collateral dependent and categorized as Level 3 due to ongoing real estate market conditions resulting in inactive market data, which in turn required the use of unobservable inputs and assumptions in fair value measurements. Losses totaling \$13,000 were recognized as impairment charges during the year ended December 31, 2012 related to the above impaired commercial and industrial loans. Losses totaling \$446,000 were recognized as impairment charges during the year ended December 31, 2011 related to the above impaired loans, of which \$313,000 related to impaired commercial and industrial loans and \$133,000 related to impaired real estate loans.

For the impaired loan included in Level 3 at December 31, 2012 in table above, management discounted the underlying accounts receivable collateral and guarantee secured by real estate. The unobservable inputs used included a 10% market factor adjustment to the value of the real estate collateral and a liquidation factor of 25% for the accounts receivable collateral.

3. INVESTMENT SECURITIES

The following table summarizes the amortized cost and fair value of securities available-for-sale and securities held-to-maturity at December 31, 2012 and 2011 and the corresponding amounts of gross unrealized gains and losses recognized in accumulated other comprehensive income and gross unrecognized gains and losses:

2012

<i>Available-for-Sale</i>	<u>Amortized Cost</u>	<u>Gross Unrealized Gains</u>	<u>Gross Unrealized Losses</u>	<u>Estimated Fair Value</u>
U.S. government-sponsored agency securities	\$ 2,008,843		\$ (239)	\$ 2,008,604
Mortgage-backed securities - residential	29,878,193	\$ 761,684		30,639,877
Corporate bonds	<u>14,115,228</u>		<u>(45,620)</u>	<u>14,069,608</u>
Total available-for-sale	<u>\$ 46,002,264</u>	<u>\$ 761,684</u>	<u>\$ (45,859)</u>	<u>\$ 46,718,089</u>

<i>Held-to-Maturity</i>	<u>Amortized Cost</u>	<u>Gross Unrecognized Gains</u>	<u>Gross Unrecognized Losses</u>	<u>Estimated Fair Value</u>
Mortgage-backed securities - residential	<u>\$ 3,810,895</u>	<u>\$ 10,734</u>	<u>\$ -</u>	<u>\$ 3,821,629</u>

California Bank of Commerce
NOTES TO FINANCIAL STATEMENTS
(Continued)

3. INVESTMENT SECURITIES (Continued)

2011

<i>Available-for-Sale</i>	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Debt securities:				
Mortgage-backed securities - residential	\$ 35,978,823	\$ 461,911	\$ (91,068)	\$ 36,349,666

There were no held-to-maturity securities as of December 31, 2011.

Net unrealized gains on available-for-sale investment securities totaling \$715,825 were recorded, net of \$293,488 in tax liabilities, as accumulated other comprehensive income within shareholders' equity at December 31, 2012. Unrealized holding gains arising during the year ended December 31, 2012 totaled \$631,296. Net unrealized gains on available-for-sale investment securities totaling \$370,843 were recorded, net of \$152,046 in tax liabilities, as accumulated other comprehensive income within shareholders' equity at December 31, 2011. Unrealized holding gains arising during the year ended December 31, 2011 totaled \$206,944.

There were no maturities of available-for-sale investment securities for the year ended December 31, 2012. Proceeds and gross realized gains from the sale of available-for-sale investment securities for the year ended December 31, 2012 totaled \$15,848,543 and \$286,314, respectively. Proceeds from the maturity of available-for-sale investment securities for the year ended December 31, 2011 totaled \$27,926,462. Proceeds and gross realized gains from the sale of available-for-sale investment securities for the year ended December 31, 2011 totaled \$3,950,521 and \$124,100, respectively.

There were no sales or calls of held-to-maturity investment securities for the year ended December 31, 2012 and there were no transfers of available-for-sale or held-to-maturity investment securities for the years ended December 31, 2012 and 2011.

The amortized cost and fair value of debt securities as of December 31, 2012 are shown by contractual maturity. Expected maturities may differ from contractual maturities if borrowers have the right to call or prepay obligations with or without call or prepayment penalties. Securities not due at a single maturity date are shown separately.

California Bank of Commerce
NOTES TO FINANCIAL STATEMENTS
(Continued)

3. INVESTMENT SECURITIES (Continued)

	<u>Amortized Cost</u>	<u>Fair Value</u>
Available-for-sale		
Within one year	\$ -	\$ -
One to five years	14,115,228	14,069,608
Five to ten years	2,008,843	2,008,604
Beyond ten years		
 Mortgage-backed securities not due at a single maturity date	 <u>29,878,193</u>	 <u>30,639,877</u>
 Total	 <u>\$ 46,002,264</u>	 <u>\$ 46,718,089</u>
 Held-to-maturity		
Beyond ten years	<u>\$ 3,810,895</u>	<u>\$ 3,821,629</u>
 Total	 <u>\$ 3,810,895</u>	 <u>\$ 3,821,629</u>

At December 31, 2012, investment securities with amortized costs totaling \$26,327,056 and estimated fair values totaling \$26,917,371 were pledged to secure State Treasury funds on deposit with the Bank. At December 31, 2012, investment securities with amortized costs totaling \$19,754,797 and estimated fair values totaling \$19,905,249 were pledged to secure borrowing arrangements in place with the Federal Reserve Bank of San Francisco. (See Note 9)

At year-end 2012, there were no holdings of securities of any one issuer, other than the U.S. Government and agencies, in an amount greater than 10% of shareholder's equity.

At December 31, 2012, the Bank's investment security portfolio consisted of 36 securities, 11 of which were in an unrealized loss position at year end. Of the securities in a loss position at year-end, one was a U.S. government-sponsored agency security and the other ten were corporate bonds. These securities were purchased during 2012 and therefore had been in an unrealized loss position for less than twelve months. At December 31, 2011, the Bank held 28 mortgage-backed securities, of which 10 were in a loss position at year end, all of which had been in a continuous loss position for less than twelve months. Management believes that changes in the market value of its U.S. government agency security and its other corporate securities are primarily attributable to changes in interest rates and relative illiquidity and not credit quality. Because the Bank has the ability and intent to hold those investments until a recovery of fair value, which may be at maturity, the Bank does not consider those investments to be other-than-temporarily impaired at December 31, 2012.

California Bank of Commerce
NOTES TO FINANCIAL STATEMENTS
(Continued)

4. LOANS

Outstanding loans are summarized below:

	December 31,	
	2012	2011
Commercial & Industrial	\$ 123,179,002	\$ 94,412,665
Real estate - Construction & Land	4,333,159	3,761,769
Real Estate - Other	111,056,754	101,323,177
Real Estate - HELOC	5,122,280	4,067,094
Installment and Other	1,768,731	3,584,941
	245,459,926	207,149,646
Deferred loan origination costs, net	689,055	597,450
Allowance for loan losses	(4,675,000)	(4,175,000)
	\$ 241,473,981	\$ 203,572,096

Salaries and employee benefits totaling \$1,257,269 and \$1,120,130 were deferred as loan origination costs for the years ended December 31, 2012 and 2011, respectively.

Loans with carrying values totaling approximately \$197,187,000 were pledged to secure borrowing arrangements at December 31, 2012 (see Note 9).

5. ALLOWANCE FOR LOAN LOSSES

The following table shows the changes in and allocation of the allowance for loan losses as of and for the years ended December 31, 2012 and 2011 by portfolio segment and by impairment methodology:

	Commercial & Industrial	Real Estate Construction & Land	Real Estate - Other	Real Estate HELOC	Installment & Other	Total
<u>Allowance for Loan Losses – December 31, 2012</u>						
Balance at beginning of year	\$ 2,195,324	\$ 234,324	\$ 1,635,133	\$ 65,966	\$ 44,253	\$ 4,175,000
Provision for loan losses	855,976	(25,586)	58,180	2,929	358,189	1,249,688
Loans charged-off	(614,252)	-	(150,000)	-	(92,623)	(856,875)
Recoveries of loans previously charged-off	92,175	-	15,012	-	-	107,187
Ending balance allocated to portfolio segments	\$ 2,529,223	\$ 208,738	\$ 1,558,325	\$ 68,895	\$ 309,819	\$ 4,675,000
Ending balance: individually evaluated for impairment	\$ 13,000	\$ -	\$ -	\$ -	\$ 200,000	\$ 213,000
Ending balance: collectively evaluated for impairment	\$ 2,516,223	\$ 208,738	\$ 1,558,325	\$ 68,895	\$ 109,819	\$ 4,462,000

California Bank of Commerce
NOTES TO FINANCIAL STATEMENTS
(Continued)

5. ALLOWANCE FOR LOAN LOSSES (Continued)

	Commercial & Industrial	Real Estate Construction & Land	Real Estate - Other	Real Estate HELOC	Installment & Other	Total
<u>Loans – December 31, 2012</u>						
Ending balance	\$123,179,002	\$ 4,333,159	\$111,056,754	\$ 5,122,280	\$ 1,768,731	\$245,459,926
Ending balance: individually evaluated for impairment	\$ 1,450,858	\$ -	\$ 2,760,737	\$ -	\$ 200,000	\$ 4,411,595
Ending balance: collectively evaluated for impairment	\$121,728,144	\$ 4,333,159	\$108,296,017	\$ 5,122,280	\$ 1,568,731	\$241,048,331
<u>Allowance for Loan Losses – December 31, 2011</u>						
Balance at beginning of year	\$ 2,642,951	\$ 271,541	\$ 1,339,190	\$ 47,570	\$ 25,748	\$ 4,327,000
Provision for loan losses	625,769	(37,217)	702,608	18,396	18,505	1,328,061
Loans charged-off	(1,086,936)	-	(418,000)	-	-	(1,504,936)
Recoveries of loans previously charged-off	13,540	-	11,335	-	-	24,875
Ending balance allocated to portfolio segments	\$ 2,195,324	\$ 234,324	\$ 1,635,133	\$ 65,966	\$ 44,253	\$ 4,175,000
Ending balance: individually evaluated for impairment	\$ 313,000	\$ -	\$ 133,000	\$ -	\$ -	\$ 446,000
Ending balance: collectively evaluated for impairment	\$ 1,882,324	\$ 234,324	\$ 1,502,133	\$ 44,253	\$ 65,966	\$ 3,729,000
<u>Loans – December 31, 2011</u>						
Ending balance	\$94,412,665	\$ 3,761,769	\$101,323,177	\$ 4,067,094	\$ 3,584,941	\$207,149,646
Ending balance: individually evaluated for impairment	\$ 3,620,286	\$ -	\$ 2,327,373	\$ -	\$ -	\$ 5,947,659
Ending balance: collectively evaluated for impairment	\$90,792,379	\$ 3,761,769	\$98,995,804	\$ 4,067,094	\$ 3,584,941	\$201,201,987

The following table shows the loan portfolio allocated by management's internal risk ratings at December 31, 2012:

	Credit Exposure					Total
	Credit Risk Profile by Internally Assigned Grade					
	Commercial & Industrial	Real Estate Construction & Land	Real Estate - Other	Real Estate HELOC	Installment & Other	
Grade:						
Pass	\$119,255,669	\$ 2,793,072	\$108,588,167	\$ 5,122,280	\$ 1,566,281	\$237,325,469
Special Mention	2,472,475	-	1,100,000	-	2,450	3,574,925
Substandard	1,450,858	1,540,087	1,368,587	-	200,000	4,559,532
Total	\$123,179,002	\$ 4,333,159	\$111,056,754	\$ 5,122,280	\$ 1,768,731	\$245,459,926

California Bank of Commerce
NOTES TO FINANCIAL STATEMENTS
(Continued)

5. ALLOWANCE FOR LOAN LOSSES (Continued)

The following table shows the loan portfolio allocated by management's internal risk ratings at December 31, 2011:

	Credit Exposure					Total
	Credit Risk Profile by Internally Assigned Grade					
	Commercial & Industrial	Real Estate Construction & Land	Real Estate - Other	Real Estate HELOC	Installment & Other	
Grade:						
Pass	\$88,321,492	\$ 3,155,102	\$94,340,367	\$ 4,067,094	\$ 3,486,941	\$193,370,996
Special Mention	1,270,887	-	-	-	-	1,270,887
Substandard	4,820,286	606,667	6,982,810	-	98,000	12,507,763
Total	<u>\$94,412,665</u>	<u>\$ 3,761,769</u>	<u>\$101,323,177</u>	<u>\$ 4,067,094</u>	<u>\$ 3,584,941</u>	<u>\$207,149,646</u>

The following table shows an aging analysis of the loan portfolio by the time past due at December 31, 2012:

	30-89 Days Past Due	90 Days and Still Accruing	Nonaccrual	Total Past Due	Current	Total
Commercial & Industrial	\$ -	\$ -	\$ -	\$ -	\$123,179,002	\$123,179,002
Real Estate - Construction & Land	-	-	-	-	4,333,159	4,333,159
Real Estate - Other	-	-	1,368,587	1,368,587	109,688,167	111,056,754
Real Estate - HELOC	-	-	-	-	5,122,280	5,122,280
Installment & Other	-	-	200,000	200,000	1,568,731	1,768,731
Total	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 1,568,587</u>	<u>\$ 1,568,587</u>	<u>\$243,891,339</u>	<u>\$245,459,926</u>

The following table shows an aging analysis of the loan portfolio by the time past due at December 31, 2011:

	30-89 Days Past Due	90 Days and Still Accruing	Nonaccrual	Total Past Due	Current	Total
Commercial & Industrial	\$ -	\$ -	\$ -	\$ -	\$ 94,412,665	\$ 94,412,665
Real Estate - Construction & Land	-	-	-	-	3,761,769	3,761,769
Real Estate - Other	-	-	986,911	986,911	100,336,266	101,323,177
Real Estate - HELOC	-	-	-	-	4,067,094	4,067,094
Installment & Other	-	-	-	-	3,584,941	3,584,941
Total	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 986,911</u>	<u>\$ 986,911</u>	<u>\$206,162,735</u>	<u>\$207,149,646</u>

California Bank of Commerce
NOTES TO FINANCIAL STATEMENTS
(Continued)

5. ALLOWANCE FOR LOAN LOSSES (Continued)

The following table shows information related to impaired loans at and for the year ended December 31, 2012:

	<u>Recorded Investment</u>	<u>Unpaid Principal Balance</u>	<u>Related Allowance</u>	<u>Average Recorded Investment</u>	<u>Interest Income Recognized</u>
With no related allowance recorded:					
Commercial & Industrial	\$ 1,003,858	\$ 1,003,858	\$ -	\$ 1,003,858	\$ 99,476
Real Estate - Other	2,760,737	3,328,737	-	2,629,639	81,400
With an allowance recorded:					
Commercial & Industrial	447,000	447,000	13,000	447,000	28,974
Installment & Other	<u>200,000</u>	<u>292,623</u>	<u>200,000</u>	<u>59,178</u>	<u>14,616</u>
Total:					
Commercial & Industrial	\$ 1,450,858	\$ 1,450,848	\$ 13,000	\$ 1,450,858	\$ 128,450
Real Estate - Other	\$ 2,760,737	\$ 3,328,737	\$ -	\$ 2,629,639	\$ 81,400
Installment & Other	\$ 200,000	\$ 292,623	\$ 200,000	\$ 59,178	\$ 14,616

Interest forgone on nonaccrual loans totaled \$53,281 and \$106,809 for the years ended December 31, 2012 and 2011, respectively. There was no interest recognized on a cash-basis on impaired loans for the years ended December 31, 2012 or 2011.

The following table shows information related to impaired loans at and for the year ended December 31, 2011:

	<u>Recorded Investment</u>	<u>Unpaid Principal Balance</u>	<u>Related Allowance</u>	<u>Average Recorded Investment</u>	<u>Interest Income Recognized</u>
With no related allowance recorded:					
Commercial & Industrial	\$ 2,883,114	\$ 2,883,114	\$ -	\$ 435,799	\$ 154,830
Real Estate - Other	1,340,462	1,758,462	-	1,340,462	127,510
With an allowance recorded:					
Commercial & Industrial	737,172	737,172	313,000	43,269	48,947
Real Estate	<u>986,911</u>	<u>986,911</u>	<u>133,000</u>	<u>986,911</u>	<u>-</u>
Total:					
Commercial & Industrial	\$ 3,620,286	\$ 3,620,286	\$ 313,000	\$ 479,068	\$ 203,777
Real Estate - Other	\$ 2,327,373	\$ 2,745,373	\$ 133,000	\$ 2,327,373	\$ 127,510

The recorded investment in impaired loans in the tables above excludes accrued interest receivable and net deferred loan origination costs due to immateriality.

California Bank of Commerce
NOTES TO FINANCIAL STATEMENTS
(Continued)

5. ALLOWANCE FOR LOAN LOSSES (Continued)

Troubled Debt Restructurings

At December 31, 2012, the Bank had a recorded investment of \$4,211,595 and had allocated specific reserves totaling \$13,000 related to loans with terms that had been modified in troubled debt restructurings. At December 31, 2011, the Bank had a recorded investment of \$5,947,659 and had allocated specific reserves totaling \$446,000 related to loans that had terms that had been modified in troubled debt restructurings. The Bank has committed to lend additional amounts totaling up to \$1,838,562 as of December 31, 2012 to customers with outstanding loans that are classified as troubled debt restructurings, all of which were in the commercial and industrial loan segment.

During the year ending December 31, 2012 and 2011, the terms of certain loans were modified as troubled debt restructurings. The modification of the terms of such loans included either a reduction of the stated interest rate of the loan, an extension of the maturity date at a stated rate of interest lower than the current market rate for new debt with similar risk, or a combination thereof.

During the year ending December 31, 2012 three modifications were made involving a reduction of the stated interest rate of the loan. The remaining five modifications involved an extension of the maturity date and were for periods ranging from 3 months to 12 months.

During the year ending December 31, 2011 one modification was made involving a reduction of the stated interest rate of the loan for a period of 14 months. The remaining nine modifications involved an extension of the maturity date and were for periods ranging from 3 months to 12 months.

The following table presents loans by class modified as troubled debt restructurings that occurred during the years ending December 31, 2012 and 2011:

	<u>Number of Loans</u>	<u>Pre-Modification Outstanding Recorded Investment</u>	<u>Post-Modification Outstanding Recorded Investment</u>
<u>2012</u>			
Troubled Debt Restructurings:			
Commercial & industrial	6	\$ 1,567,641	\$ 1,567,641
Real estate – other	<u>3</u>	<u>2,704,802</u>	<u>2,768,587</u>
Total	<u>9</u>	<u>\$ 4,272,443</u>	<u>\$ 4,336,228</u>
<u>2011</u>			
Troubled Debt Restructurings:			
Commercial & industrial	8	\$ 3,620,286	\$ 3,620,286
Real estate – other	<u>2</u>	<u>2,745,373</u>	<u>2,327,373</u>
Total	<u>10</u>	<u>\$ 6,365,659</u>	<u>\$ 5,947,659</u>

California Bank of Commerce
NOTES TO FINANCIAL STATEMENTS
(Continued)

5. ALLOWANCE FOR LOAN LOSSES (Continued)

Troubled Debt Restructurings (Continued)

The 2012 troubled debt restructurings described above increased the allowance for loan losses by \$266,000 and resulted in charge offs of \$368,000 during the year ending December 31, 2012.

The 2011 troubled debt restructurings described above increased the allowance for loan losses by \$446,000 and resulted in charge offs of \$418,000 during the year ending December 31, 2011.

There were no loans modified as troubled debt restructurings for which there was a payment default within twelve months following the modification during the year ending December 31, 2012 and 2011.

A loan is considered to be in payment default once it is 90 days contractually past due under the modified terms.

Purchased Loans

Although the Bank purchased various loans under loan participation agreements with other banks during 2012, none were purchased for which there was at acquisition evidence of deterioration of credit quality or, with knowledge that all contractually required payments would not be collected.

6. PREMISES AND EQUIPMENT

Premises and equipment consisted of the following:

	December 31,	
	2012	2011
Furniture, fixtures and equipment	\$ 793,507	\$ 761,464
Leasehold improvements	164,501	164,501
	958,008	925,965
Less accumulated depreciation and amortization	(762,329)	(606,216)
	\$ 195,679	\$ 319,749

Depreciation and amortization included in occupancy and equipment expense totaled \$156,113 and \$129,072, respectively, for 2012 and 2011.

California Bank of Commerce
NOTES TO FINANCIAL STATEMENTS
(Continued)

7. INTEREST-BEARING DEPOSITS

Interest-bearing deposits consisted of the following:

	December 31,	
	2012	2011
Savings	\$ 43,337,476	\$ 26,832,732
Money market	72,894,126	87,898,237
Interest-bearing demand accounts	18,602,964	27,285,569
Time, \$100,000 or more	61,390,794	44,953,649
Other time	2,074,673	1,468,175
	<u>\$ 198,300,033</u>	<u>\$ 188,438,362</u>

Aggregate annual maturities of time deposits are as follows:

Year Ending December 31,	
2013	\$ 49,594,014
2014	10,516,044
2015	125,212
2016	2,274,426
2017	955,771
	<u>\$ 63,465,467</u>

Interest expense recognized on interest-bearing deposits for the years ended December 31, 2012 and 2011 consisted of the following:

	Year Ended December 31,	
	2012	2011
Savings	\$ 293,485	\$ 132,902
Money market	498,015	689,157
Interest-bearing demand accounts	44,227	32,155
Time, \$100,000 or more	319,518	286,254
Other time	12,430	8,876
	<u>\$ 1,167,674</u>	<u>\$ 1,149,344</u>

California Bank of Commerce
NOTES TO FINANCIAL STATEMENTS
(Continued)

8. INCOME TAXES

The provision for income taxes for the years ended December 31, 2012 and 2011 consisted of the following:

	<u>Federal</u>	<u>State</u>	<u>Total</u>
<u>2012</u>			
Current	\$ 702,780	\$ 108,123	\$ 810,903
Deferred	<u>294,773</u>	<u>248,588</u>	<u>543,361</u>
Provision for income taxes	<u>\$ 997,553</u>	<u>\$ 356,771</u>	<u>\$ 1,354,264</u>
<u>2011</u>			
Current	\$ 80,549	\$ 162,046	\$ 242,595
Deferred	<u>422,267</u>	<u>17,754</u>	<u>440,021</u>
Provision for income taxes	<u>\$ 502,816</u>	<u>\$ 179,800</u>	<u>\$ 682,616</u>

The Bank's reported amount of income tax expense differs from federal statutory rates due principally to California franchise taxes and nondeductible stock based compensation.

Deferred tax assets (liabilities) consisted of the following:

	<u>December 31,</u>	
	<u>2012</u>	<u>2011</u>
Deferred tax assets:		
Allowance for loan losses	\$ 1,413,419	\$ 1,301,339
State deferred tax asset	588,979	774,068
Accrued expenses	373,604	42,296
Organization costs	291,771	322,350
Share-based compensation	201,809	186,303
Deferred compensation	185,558	87,266
Net operating losses		823,067
Other	<u>15,300</u>	<u>40,800</u>
Deferred tax assets before valuation allowance	3,070,440	3,577,489
Valuation allowance	<u>(141,979)</u>	<u>(141,979)</u>
Total deferred tax assets	<u>2,928,461</u>	<u>3,435,510</u>

California Bank of Commerce
NOTES TO FINANCIAL STATEMENTS
(Continued)

8. INCOME TAXES (Continued)

Deferred tax liabilities:		
Deferred loan origination costs	(468,890)	(413,765)
Unrealized gain on available-for-sale investment securities	(293,488)	(152,046)
Other	<u>(146,476)</u>	<u>(165,289)</u>
 Total deferred tax liabilities	 <u>(908,854)</u>	 <u>(731,100)</u>
 Net deferred tax assets	 <u>\$ 2,019,607</u>	 <u>\$ 2,704,410</u>

Included in the valuation allowance against the deferred tax assets is the 2009 loss on sale of FNMA Preferred Stock. The loss on the preferred shares is accorded ordinary treatment for federal income tax purposes, but treated as a capital loss for California tax purposes. For California, capital losses are deductible only to the extent they offset capital gains within five years of the date that the loss is realized for tax. Management believes that a valuation allowance is appropriate against the California capital loss exposure in the amount of \$141,979 at December 31, 2012 and 2011.

The Bank files income tax returns in the U.S federal and California jurisdictions. There are currently no pending U.S. federal or state income tax or non-U.S. income tax examinations by tax authorities. The Bank is subject to tax examinations by U.S. Federal and state taxing authorities for all tax returns filed since 2008 for Federal purposes and 2007 for California purposes.

As of December 31, 2012 and 2011, there were no unrecognized tax benefits or interest and penalties accrued by the Bank.

9. BORROWING ARRANGEMENTS

Under agreements with four correspondent banks, the Bank can borrow up to the lesser of \$18,000,000, or the total market value of securities pledged to the correspondent banks under a repurchase agreement. At December 31, 2012 and 2011, there were no investment securities pledged to the correspondent banks under these agreements. There were no borrowings outstanding under these arrangements at December 31, 2012 or 2011.

The Bank has a borrowing arrangement with the Federal Reserve Bank of San Francisco (FRB) under which advances are secured by portions of the Bank's loan and investment securities portfolios. The Bank's credit limit varies according to the amount and composition of the assets pledged as collateral. At December 31, 2012, amounts pledged and available borrowing capacity under such limits were approximately \$114,005,000 and \$96,782,000, respectively. There were no borrowings outstanding under this arrangement as of December 31, 2012 or 2011.

California Bank of Commerce
NOTES TO FINANCIAL STATEMENTS
(Continued)

9. BORROWING ARRANGEMENTS (Continued)

The Bank has a borrowing arrangement with the Federal Home Loan Bank (FHLB) under which advances are secured by portions of the Bank's loan portfolio. The Bank's credit limit varies according to its total assets and the amount and composition of the loan portfolio pledged as collateral. At December 31, 2012, amounts pledged and available borrowing capacity under such limits were approximately \$100,250,000 and \$57,943,000, respectively.

At December 31, 2012, there were \$29,000,000 in borrowings outstanding under this arrangement at fixed interest rates ranging from 1.11% to 1.16% with a weighted average maturity of approximately 4.1 years. The weighted average interest rate on these borrowings was 1.13% at December 31, 2012.

There were \$18,000,000 in borrowings outstanding under this arrangement at fixed interest rates ranging from 1.20% to 2.79% at December 31, 2011, with a weighted average maturity of approximately 2.1 years. The weighted average interest rate on these borrowings was 2.06% at December 31, 2011.

10. COMMITMENTS AND CONTINGENCIES

Operating Leases

The Bank leases its headquarters facility in Lafayette, California from an affiliated party under a non-cancelable operating lease. The lease expires on May 30, 2015 and has one 7 1/2 year renewal option. The lease includes annual rent adjustments during the initial lease term and increases to the then current fair-market rent commencing the first year of the option. It is management's intention to exercise the renewal option.

The Bank leases space in San Jose, California for its Loan Production Office. This one-year lease, which initially expired August 31, 2012, had a one 1 year renewal option that was executed. There are no additional renewal options.

Future minimum lease payments are as follows:

Year Ending December 31,	
2013	\$ 570,138
2014	562,324
2015	<u>239,344</u>
	<u>\$ 1,371,806</u>

Rental expense included in occupancy and equipment expense totaled \$439,091 and \$419,030 for the years ended December 31, 2012 and 2011, respectively.

California Bank of Commerce
NOTES TO FINANCIAL STATEMENTS
(Continued)

10. COMMITMENTS AND CONTINGENCIES (Continued)

Financial Instruments with Off-Balance-Sheet Risk

The Bank is a party to financial instruments with off-balance-sheet risk in the normal course of business in order to meet the financing needs of its customers and to reduce its own exposure to fluctuations in interest rates.

The following financial instruments represent off-balance-sheet credit risk:

	December 31,	
	2012	2011
Commitments to extend credit	\$ 73,668,000	\$ 73,746,000
Standby letters of credit	\$ 2,596,000	\$ 2,265,000

The Bank's exposure to credit loss in the event of nonperformance by the other party for commitments to extend credit is represented by the contractual amount of those instruments. The Bank uses the same credit policies in making commitments as it does for loans included on the balance sheet.

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee.

Since some of the commitments are expected to 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 evaluation of the borrower. Collateral held varies, but may include accounts receivable, inventory, and deeds of trust on residential real estate and income-producing commercial properties.

Standby letters of credit are conditional commitments issued to guarantee the performance of a client to a third party. The credit risk involved in issuing standby letters of credit is essentially the same as that involved in extending loans to clients. The fair value of the liability related to these standby letters of credit, which represents the fees received for issuing the guarantees, was not significant at December 31, 2012 and 2011. The Bank recognizes these fees as revenue over the term of the commitment or when the commitment is used.

California Bank of Commerce
NOTES TO FINANCIAL STATEMENTS
(Continued)

10. COMMITMENTS AND CONTINGENCIES (Continued)

Financial Instruments with Off-Balance-Sheet Risk (Continued)

Commercial loan commitments represent approximately 93% of total commitments and are generally unsecured or secured by collateral other than real estate and have variable interest rates. Real estate loan commitments represent approximately 3% of total commitments and are generally secured by property with a loan-to-value ratio not to exceed 75%. The majority of real estate commitments also have variable interest rates. Home equity and personal lines of credit represent the remaining 4% of total commitments and are generally secured by residential real estate and have both variable and fixed interest rates.

Significant Concentrations of Credit Risk

The Bank grants real estate mortgage, real estate construction, commercial and installment loans to customers in the Bank's geographic service area. Commercial & industrial loans and real estate loans represented 50.2% and 49.1% of total loans, respectively, at December 31, 2012. Although management believes such concentrations to have no more than the normal risk of collectability, a substantial decline in the economy in general, or a decline in real estate values in the Bank's primary market area in particular, could have an adverse impact on collectability of these loans. Personal and business income represents the primary source of repayment for a majority of these loans.

Deposit Concentrations

At December 31, 2012, three deposit relationships, including two time deposit relationships and a primarily savings account relationship exceeded 5.0% of total deposits. The two time deposit relationships total \$20,000,000 and \$16,117,000, or 7.1% and 5.7% of total deposits, respectively, and the savings relationship totals \$14,301,000, or 5.1% of total deposits.

If the larger time deposit, which is collateralized, were not renewed, the underlying investment securities providing the collateral would become available to pledge as collateral elsewhere. The second time deposit relationship, which is a cash management account invested as a CDAR's reciprocal deposit, is comprised of 6, two-year time certificates of deposits of varying maturities. The primarily savings account relationship is a corporate cash management account.

Contingencies

The Bank may be subject to legal proceedings and claims which arise in the ordinary course of business. In the opinion of management, the amount of ultimate liability with respect to such actions will not materially affect the financial position or results of operations of the Bank.

California Bank of Commerce
NOTES TO FINANCIAL STATEMENTS
(Continued)

10. COMMITMENTS AND CONTINGENCIES (Continued)

Correspondent Banking Agreements

The Bank maintains funds on deposit with other federally insured financial institutions under correspondent banking agreements. Insured financial institution deposits up to \$250,000 are fully insured by the FDIC under the FDIC's general deposit insurance rules. There was only one interest-bearing correspondent bank balance totaling \$2,000,000, which was not fully insured as of December 31, 2012 and 2011.

11. SHARE-BASED COMPENSATION

Stock Option Awards

The California Bank of Commerce 2007 Equity Incentive Plan (the "Plan") permits the grant of stock options to directors, organizers and employees of the Bank. Grants of options to the organizers during the start up phase of the Bank and to the Directors are considered non-qualified stock option awards. All other option grants are considered incentive stock option awards. A group of incentive stock options for 23 employees were re-priced and exchanged in 2011 for existing vested incentive stock options under the terms of a Tender Offer.

These exchanged options, which were issued with an exercise price at the fair market value of the underlying shares at the date of exchange, have a weighted average term of 7.5 years and ratably vest over 18 months from the option grant date. All other options granted under the Plan have a 10 year term and have been issued with exercise prices at the fair market value of the underlying shares at the date of grant. The non-qualified stock option awards to the organizers vested 100% immediately, whereas regular stock option awards to directors and employees generally vest over a three year period from the date the options were granted. The share-based compensation expense related to awards granted to organizers was included in pre-opening expenses.

For the years ended December 31, 2012 and 2011, the compensation cost recognized for stock option awards was \$352,809 and \$248,419, respectively. Of the compensation cost recognized for the years ended December 31, 2012 and 2011, \$84,630 and \$105,728, respectively, was for incremental compensation cost resulting from the exchanged options described above.

California Bank of Commerce
NOTES TO FINANCIAL STATEMENTS
(Continued)

11. SHARE-BASED COMPENSATION

Stock Option Awards (Continued)

A summary of option activity under the Plan for the years ended December 31, 2012 and 2011 is presented below:

<u>Options</u>	<u>Shares</u>	<u>Weighted Average Exercise Price</u>	<u>Weighted Average Remaining Contractual Term (Years)</u>
Outstanding at January 1, 2011	674,547	\$ 9.68	6.91
Granted or exchanged	411,650	\$ 7.81	
Forfeited or canceled	<u>(370,305)</u>	\$ 9.90	
Outstanding at December 31, 2011	715,892	\$ 8.49	6.91
Granted	53,000	\$ 6.90	
Exercised	(4,000)	\$ 6.85	
Forfeited or canceled	<u>(74,725)</u>	\$ 9.89	
Outstanding December 31, 2012	<u>690,167</u>	<u>\$ 8.24</u>	<u>6.08</u>
Vested or expected to vest at December 31, 2012	<u>687,074</u>	<u>\$ 8.24</u>	<u>6.06</u>
Exercisable at December 31, 2012	<u>607,555</u>	<u>\$ 8.42</u>	<u>5.69</u>

At December 31, 2012, the aggregate intrinsic value of options outstanding, vested and expected to vest and exercisable totaled \$100,700, \$98,431 and \$36,043, respectively. As of December 31, 2012, the unrecognized compensation cost related to non-vested stock option awards totaled \$249,951. That cost is expected to be amortized on a straight-line basis over a weighted average period of 0.93 years and will be adjusted for subsequent changes in estimated forfeitures. The intrinsic value of options exercised during the year ended December 31, 2012 totaled \$2,200.

The following information relates to stock option grants granted during the years ended December 31, 2012 and 2011:

	<u>2012</u>	<u>2011</u>
Weighted average grant date fair value per share of options granted	\$ 4.15	\$ 3.94
Significant fair value assumptions:		
Expected term in years	6 years	6 years
Expected annual volatility	67.35%	66.98%
Expected annual dividend yield	0%	0%
Risk-free interest rate	0.86%	1.32%

California Bank of Commerce
NOTES TO FINANCIAL STATEMENTS
(Continued)

11. SHARE-BASED COMPENSATION

Stock Option Awards (Continued)

The weighted average grant date fair value and significant fair value assumptions above are for 53,000 and 64,400 shares of new options granted during the years ended December 31, 2012 and 2011, respectively. There were also 347,250 shares of exchanged options during the year ended December 31, 2011 as described on the previous page. The exchanged options had a weighted average incremental fair value of \$0.55 per share over the awards' original grant date fair values.

Restricted Stock Award

There were no restricted stock awards granted during the years ended December 31, 2012 or 2011. There was one restricted stock award of 3,243 shares that was nonvested at December 31, 2011 and became fully vested during the year ended December 31, 2012. The grant date fair value of this award was \$7.00 per share, or \$22,701. The fair value of the award at the time of vesting was \$7.40 per share, or 23,998. Compensation cost of \$5,866 and \$5,837 was recognized for this award for the years ended December 31, 2012 and 2011, respectively. There was no unrecognized compensation expense at December 31, 2012, as the award was fully vested.

12. SHAREHOLDERS' EQUITY

Dividends

Upon declaration by the Board of Directors, all shareholders of record will be entitled to receive dividends. The California Financial Code restricts the total dividend payment of any state banking association in any calendar year to the lesser of (1) the bank's retained earnings or (2) the bank's net income for its last three fiscal years, less distributions made to shareholders during the same three-year period. At December 31, 2012, no amounts were free of such restrictions, however, the Bank has received regulatory approval from the State of California Department of Financial Institutions to pay quarterly dividends on its Series C Preferred Stock issued under the Small Business Lending Fund, without restriction.

Regulatory Capital

The Bank is subject to certain regulatory capital requirements administered by the Federal Deposit Insurance Corporation (FDIC). Failure to meet these minimum capital requirements can initiate certain mandatory and possibly additional discretionary, actions by regulators that, if undertaken, could have a direct material effect on the Bank's financial statements.

Under capital adequacy guidelines, the Bank must meet specific capital guidelines that involve quantitative measures of their assets, liabilities and certain off-balance-sheet items as calculated under regulatory accounting practices. These quantitative measures are established by regulation and require that minimum amounts and ratios of total and Tier 1 capital to risk-weighted assets and of Tier 1 capital to average assets be maintained. Capital amounts and classification are also subject to qualitative judgments by the regulators about components, risk weightings and other factors.

California Bank of Commerce
NOTES TO FINANCIAL STATEMENTS
(Continued)

12. SHAREHOLDERS' EQUITY (Continued)

Regulatory Capital (Continued)

The Bank is also subject to additional capital guidelines under the regulatory framework for prompt corrective action. To be categorized as well capitalized, the Bank must maintain minimum total risk-based, Tier 1 risk-based and Tier 1 leverage ratios as set forth in the table on the following page. As of December 31, 2012 and 2-11, the most recent notification from the FDIC categorized the Bank as well capitalized under these guidelines. There are no conditions or events since that notification that management believes have changed the Bank's category.

Management believes that the Bank met all capital adequacy requirements as of December 31, 2012 and 2011.

	2012		2011	
	Amount	Ratio	Amount	Ratio
<u>Leverage Ratio</u>				
California Bank of Commerce	\$ 36,274,000	10.37%	\$ 33,119,000	11.43%
Minimum requirement for "Well-Capitalized" institution under prompt corrective action provisions	\$ 17,485,000	5.00%	\$ 14,490,000	5.00%
Minimum regulatory requirement	\$ 13,988,000	4.00%	\$ 11,592,000	4.00%
<u>Tier 1 Risk-Based Capital Ratio</u>				
California Bank of Commerce	\$ 36,274,000	12.27%	\$ 33,119,000	13.99%
Minimum requirement for "Well-Capitalized" institution under prompt corrective action provisions	\$ 17,734,000	6.00%	\$ 14,205,000	6.00%
Minimum regulatory requirement	\$ 11,822,000	4.00%	\$ 9,470,000	4.00%
<u>Total Risk-Based Capital Ratio</u>				
California Bank of Commerce	\$ 39,981,000	13.53%	\$ 36,094,000	15.25%
Minimum requirement for "Well-Capitalized" institution under prompt corrective action provisions	\$ 29,556,000	10.00%	\$ 23,674,000	10.00%
Minimum regulatory requirement	\$ 23,645,000	8.00%	\$ 18,940,000	8.00%

California Bank of Commerce
NOTES TO FINANCIAL STATEMENTS
(Continued)

13. RELATED PARTY TRANSACTIONS

During the normal course of business, the Bank enters into transactions with related parties, including Directors, executive officers and affiliates.

The following is a summary of the aggregate activity involving related party borrowers during the years ended December 31, 2012 and 2011:

Balance, January 1, 2011	<u>\$ 2,096,643</u>
Disbursements	2,267,679
Amounts repaid	<u>(1,233,726)</u>
Balance, December 31, 2011	<u>\$ 3,130,596</u>
Disbursements	2,161,954
Amounts repaid	<u>(585,259)</u>
Balance, December 31, 2012	<u>\$ 4,707,291</u>
Undisbursed commitments to related parties, December 31, 2012	<u>\$ 1,040,228</u>

At December 31, 2012, the Bank's deposits from related parties totaled \$3,775,000.

The Bank also leases its head office from a company owned by a member of the Board of Directors. Rental payments under this agreement totaled \$444,037 for the year ended December 31, 2012 and \$434,357 for the year ended December 31, 2011.

14. EMPLOYEE BENEFIT PLANS

Profit Sharing Plan

In 2007, the Bank adopted the California Bank of Commerce Profit Sharing 401(k) Plan. All full-time employees 21 years of age or older with 3 months of service are eligible to participate in the 401(k) Plan. Eligible employees may elect to make tax deferred contributions up to the maximum amount allowed by law. The Bank may make additional contributions to the plan at the discretion of the Board of Directors. Bank contributions vest at a rate of 20% annually for all employees. The Bank did not make a contribution to the 401(k) Plan during the years ended December 31, 2012 or 2011.

California Bank of Commerce
NOTES TO FINANCIAL STATEMENTS
(Continued)

14. EMPLOYEE BENEFIT PLANS (Continued)

Salary Continuation and Retirement Plan

The Board of Directors approved a salary continuation plan for the Chief Executive Officer (CEO) during 2007. Under the Plan, once the CEO reaches age 65, the Bank is obligated to provide the CEO with annual benefits for twenty years after retirement. The estimated present value of these future benefits is accrued from the effective date of the plan until the CEO's expected retirement date based on a discount rate of 4.0%. The expense recognized under this plan for the years ended December 31, 2012 and 2011 totaled \$83,095 and \$63,864, respectively. Accrued compensation payable under the salary continuation plan totaled \$339,758 and \$256,663 at December 31, 2012 and 2011, respectively, and is included in accrued interest payable and other liabilities on the Bank's balance sheet.

15. OTHER EXPENSES

Other expenses for the years ended December 31, 2012 and 2011 consisted of the following:

	<u>2012</u>	<u>2011</u>
Outsourced data processing and electronic banking	\$ 296,948	\$ 287,320
Computer network and internet support	242,870	181,274
Director's stock-based and other compensation	142,060	112,885
Professional fees	401,994	246,333
Bank Insurance	60,574	53,220
Advertising, promotion and business development	293,477	233,650
Regulatory fees	296,137	285,413
Provision for unfunded loan commitments	(75,000)	85,000
Correspondent Bank service charges	145,590	93,177
Other operating expenses	<u>364,021</u>	<u>353,112</u>
	<u>\$ 2,168,671</u>	<u>\$ 1,931,384</u>

16. PREFERRED STOCK

Small Business Lending Fund ("SBLF")

On September 15, 2011, as part of the Small Business Lending Fund ("SBLF"), the Bank entered into a Small Business Lending Fund Securities Purchase Agreement ("SBLF Purchase Agreement") with the United States Department of the Treasury ("Treasury"). Under the SBLF Purchase Agreement, the Company issued 11,000 shares of Senior Non-Cumulative Perpetual Preferred Stock, Series C (the "Series C Preferred") to the Treasury. The preferred stock series C shares qualify as Tier 1 capital and will pay quarterly dividends. The initial and current dividend as of December 31, 2012 is 1%. The dividend rate can fluctuate between 1% and 5% during the next 14 quarters based on the growth in qualified small business loans.

California Bank of Commerce
NOTES TO FINANCIAL STATEMENTS
(Continued)

16. PREFERRED STOCK (Continued)

Small Business Lending Fund (“SBLF”) (Continued)

On September 15, 2011, as part of the SBLF Purchase Agreement and funding, the Bank redeemed its outstanding Series A and B Preferred shares, issued to the U.S. Treasury under the Capital Purchase Program, in the amount of \$4,200,000 plus accrued interest to that date.

Capital Purchase Program (“CPP”)

On February 27, 2009, the Bank entered into a Letter Agreement (the “Purchase Agreement”) with the United States Department of the Treasury (the “Treasury”), pursuant to which the Bank issued and sold 4,000 shares of the Bank’s Fixed Rate Non-cumulative Perpetual Preferred Stock, Series A (the “Series A Preferred”) for a purchase price of \$4,000,000. Additionally, the Bank created and authorized 200.002 shares of the Bank’s Fixed Rate Non-cumulative Perpetual Preferred Stock, Series B stock, (the “Series B Preferred”), which were issued to the United States Department of the Treasury in exchange for warrants to purchase 200.002 shares of Preferred Stock with a liquidation value of \$1,000 per share.

Costs incurred by the Bank for the issuance of the Series A and Series B Preferred Stock totaled \$54,230, and upon redemption are shown as an increase to accumulated deficit within shareholder’s equity for the year ended December 31, 2011.

The Series A Preferred Stock qualified as Tier 1 capital and paid non-cumulative dividends quarterly at a rate of 5% per annum until redemption. The Series B Preferred Stock qualified as Tier 1 capital and paid non-cumulative dividends quarterly at a rate of 9% per annum until redemption.

17. SUBSEQUENT EVENTS

Management has reviewed all events occurring from December 31, 2012 through March 27, 2013, the date the financial statements were available to be issued, and no subsequent events occurred requiring accrual or disclosure.