



California Bank of Commerce

...defined by the company we keep.sm

2011 Annual Report

Fellow Shareholders:

Your Bank's fourth full year of operations was distinctly positive. In 2011, the Bank finished the year just short of the \$300 million mark in total assets, up 25% over the year previous. We passed the \$240 million mark in total deposits and the \$200 million mark in total loans. This growth drove major improvements to net interest income, which was up in 2011 by 20%, to just over \$9 million. Significantly lower 2011 provisions to the Loan Reserve were made possible by improving economic conditions and borrower financial statements. These factors, together with careful control of overhead, made for impressive progress in pre-tax earnings, which in 2011 experienced an almost five-fold increase over the prior year, to just under \$1.5 million. Important details are to be found in the exhibits that follow.

As impressive as our financial achievements were in 2011, the Bank's progress in building and extending our reputation in the market was even more impressive. During the year, we added numerous new relationships through our existing product lines and we broadened the Bank's commercial lending capabilities, with the addition of an asset-based lending group, headquartered in San Jose, and with the addition of a team that provides term financing for the acquisition of dental and medical practices.

During the course of the year, we repaid our TARP-CPP preferred stock obligation and added non-dilutive new capital by issuing 1% preferred stock under the U.S. Treasury's Small Business Loan Fund.

We enter 2012 with strong momentum and a reputation for sound performance and good service. We continue to rely on three unique strengths:

- ◆ Our Bank is focused on a market niche that is rare among smaller banks and is often poorly served by larger banks: Closely-held businesses with \$5-50 million in sales and credit needs of \$1-5 million.
- ◆ Our Bay Area business focus sets us apart from community banks, enabling us to serve successful companies that have a broad geographic reach.
- ◆ Our operating strategy is unique because it is efficient from a cost perspective and effective with our clients: we are "branchless;" we have an upstairs location, we gather deposits electronically; and we invest our money in the best people. We are selective in our choice of clients so we can devote attention to each.

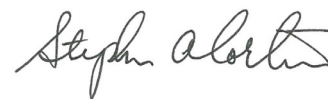
Our board and management believe the prospects for our Bank are bright. We occupy a growing position in the closely held business community that is the backbone of the Bay Area economy. We are truly defined by the company we keep – our friends in the referral community, our clients, and our bankers are all exceptional.

We thank you, our shareholders for the interest you take in our enterprise and for recognizing the potential this Bank has for creating significant shareholder value.

Sincerely,



John Rossell
President and Chief Executive Officer

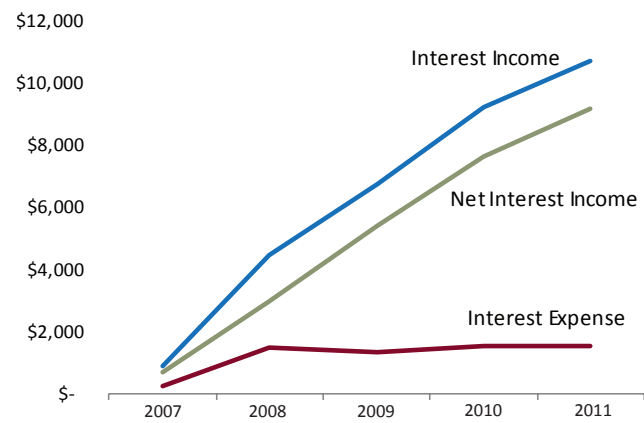
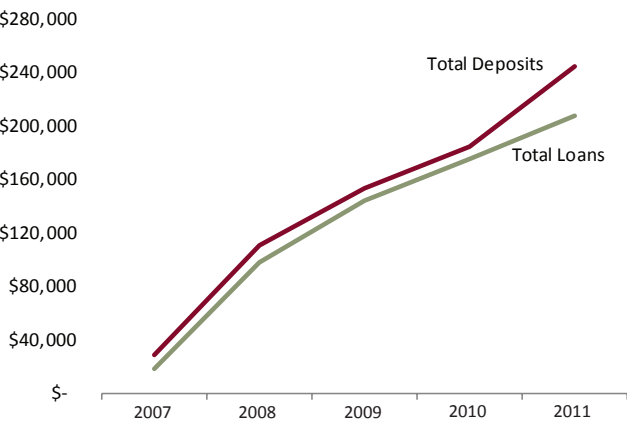


Stephen A. Cortese
Chairman of the Board

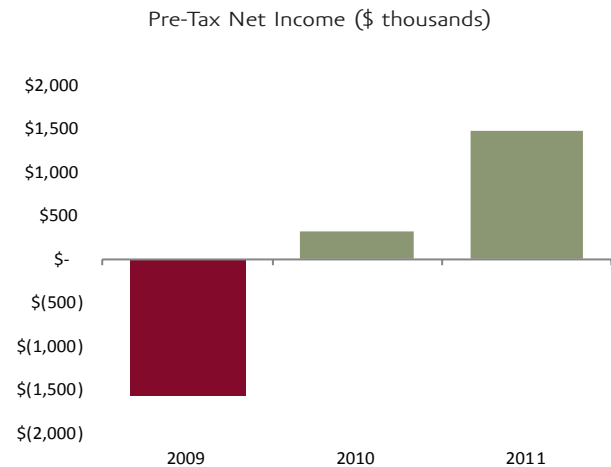
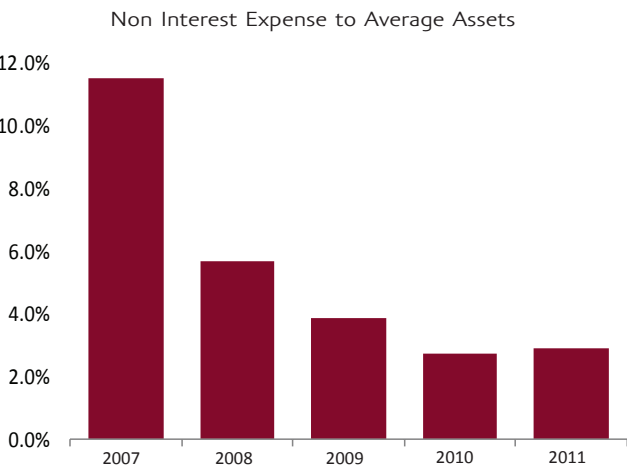


Financial Highlights

Loan and Deposit Growth Fuels Net Interest Income Growth

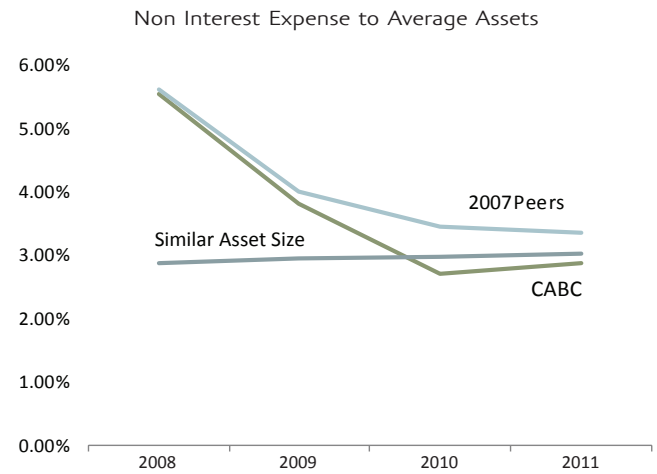
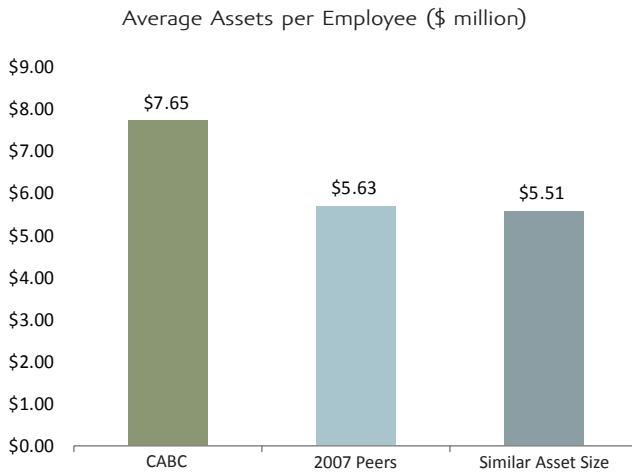


Managing Overhead to Drive Profitability

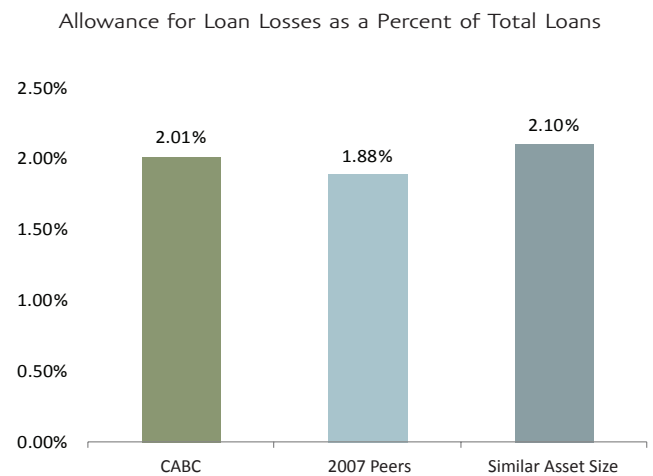
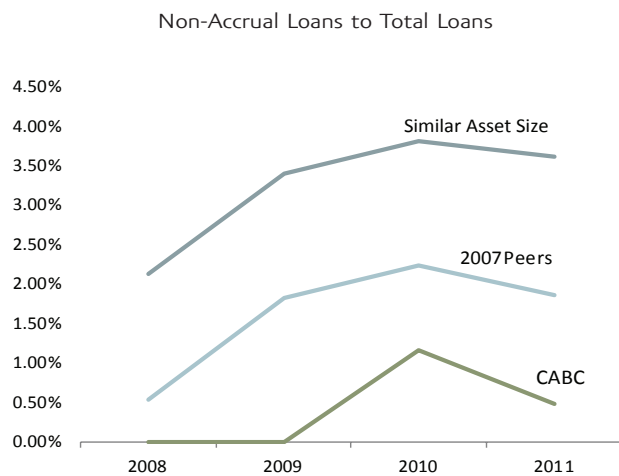


California Bank of Commerce Versus Other Bank Groups*

Productivity



Quality of Loan Portfolio and Reserves



* "2007 Peers" is all U.S. de novo banks who commenced operations in 2007. "Similar Asset Size" is U.S. banks with \$100 to \$300 million in assets.



...defined by the



ARMANINO McKENNA LLP

Certified Public Accountants & Consultants



Bay Cities
Paving &
Grading



W.E. LYONS
CONSTRUCTION CO.
Since 1926

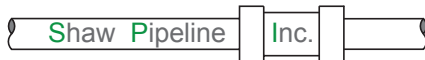
HUNSUCKER
GOODSTEIN
& NELSON PC
HGNLAW.COM



Stacy and Witbeck, Inc.
GENERAL ENGINEERING CONTRACTORS



Bayview
Environmental



ELLWOOD COMMERCIAL REAL ESTATE

TAHOE ASPHALT

RUBENS | NUNNEMAKER LLP
Certified Public Accountants and Consultants



company we keep.sm



FLEENOR PAPER COMPANY



Suprema Meat Company

Biscotti®



FITZGERALD ABBOTT & BEARDSLEY LLP
ATTORNEYS AT LAW



B C McCosker Construction Company, Inc.
GENERAL ENGINEERING CONTRACTOR



Board of Directors

Stephen A. Cortese
*Chairman of the Board,
California Bank of Commerce
Managing Partner, Cortese Investment Company*

John E. Rossell III
President and CEO, California Bank of Commerce

Peter W. Branagh
President, Branagh Development, Inc.

Edward B. Collins
Retired, Partner and Managing Director ChinaVest

Kevin J. Cullen
Chief Financial Officer, Guarantee Glass, Inc.

Stephen R. Dathe
*Vice President and General Manager
A & B Die Casting Company*

Rochelle G. Klein
Advisory Director, Ocean Gate Capital Management

John E. Lindstedt
Chief Credit Officer, California Bank of Commerce

Thomas R. Morehouse
Retired President, Filesafe Inc.

John H. Sears
*Retired, Special Counsel
Sheppard, Mullin, Richter & Hampton*

Edmond E. Traille
CEO and Partner, GALLINA LLP

Executive Committee

John E. Rossell III
President and Chief Executive Officer

Thomas M. Park
Executive Vice President

Steven E. Shelton
Executive Vice President

Stephen P. Tessler
Executive Vice President

Virginia M. Robbins
Chief Operating Officer

Randall D. Greenfield
Chief Financial Officer

John E. Lindstedt
Chief Credit Officer

Mark A. DeVincenzi
*Chief Marketing Officer
& EVP Investor Relations*

Vivian Z. Mui
*Senior Credit Officer
Senior Vice President*



Organizers

In 2006 and 2007, our Organizers shared a vision of California Bank of Commerce and they put their time, money, and reputations on the line to make the Bank a reality. We thank them for their contribution and commitment.

Andy and Denise Armanino	Danville, CA	Stu and Sally Kahn	Orinda, CA
Charles and Judith Bellig	Danville, CA	Brad and Jeanne Kisner	Lafayette, CA
John and Susan Bellig	Danville, CA	Ken Kisner	Lafayette, CA
Mike and Patrice Botto	Moraga, CA	Paul and Vicki Klapper	Hillsborough, CA
Peter and Mona Branagh	Lafayette, CA	Roxy and Steve Klein	Lafayette, CA
Joe and Jodie Brescia	Alamo, CA	Bob and Judy Locker	Lafayette, CA
Ray Brown	Newport Beach, CA	David and Marsha Maiero	Belmont, CA
Jeff and Patty Calder	Orinda, CA	John and Nancy Montgomery	Orinda, CA
Sandy and Jean Colen	Orinda, CA	Tom and Carol Morehouse	Orinda, CA
Ted and Margaret Collins	San Francisco, CA	Terry and Linda Murray	Lafayette, CA
Jerry Condon	Orinda, CA	Guy and Maria Muzio	San Francisco, CA
Michael and Darcy Cookson	Walnut Creek, CA	J.P. and Jane Oosterbaan	Mill Valley, CA
Steve and Ann Cortese	Orinda, CA	Tom and Sue Park	Orinda, CA
Jack and Jackie Cullen	Orinda, CA	Paul Remack	Walnut Creek, CA
Kevin and Amy Cullen	Lafayette, CA	Dave and Lori Sanson	Walnut Creek, CA
Steve and Elaine Dathe	Orinda, CA	Hans Schroeder	San Francisco, CA
Richard and Nancy Doyle	Lafayette, CA	Dan and Denise Siri	Orinda, CA
Joe and Jackie Duffel	Orinda, CA	Randy and Kathryn Soso	Orinda, CA
Doug and Lori Fowler	Lafayette, CA	Bill and Sherry Stevenson	Orinda, CA
John and Leslie French	Orinda, CA	Mark and Kristi Swimmer	Orinda, CA
Rob and Laurie Fuller	Orinda, CA	Steve and Trish Thomas	Walnut Creek, CA
Claude and Jackie Gaubert	Lafayette, CA	Ed and Mary Traille	Moraga, CA
Barry and Mary Gilbert	Alameda, CA	Bruce and Patti Westphal	Oakland, CA
Mollie and Greg Gilbert	Oakland, CA	Dick and Lorraine Whitehurst	Alamo, CA
		Steve and Linda Wight	Lafayette, CA



INDEPENDENT AUDITOR'S REPORT



Crowe Horwath LLP
Independent Member Crowe Horwath International

REPORT OF INDEPENDENT AUDITORS

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

We have audited the accompanying balance sheet of California Bank of Commerce, (the "Bank") as of December 31, 2011 and the related statements of income, changes in shareholders' equity and comprehensive income and cash flows for the year then ended. These financial statements are the responsibility of the Bank's management. Our responsibility is to express an opinion on these financial statements based on our audit. The 2010 financial statements of California Bank of Commerce were audited by Perry-Smith LLP, who combined with Crowe Horwath LLP as of November 1, 2011, and whose report dated March 21, 2011, expressed an unqualified opinion on those statements.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our 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, 2011 and the results of its operations and its cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

Crowe Horwath LLP

Crowe Horwath LLP

San Francisco, California
March 19, 2012



BALANCE SHEET

December 31, 2011 and 2010

	<u>2011</u>	<u>2010</u>
ASSETS		
Cash and due from banks	\$ 46,962,082	\$ 4,458,291
Federal funds sold	-	5,765,000
Total cash and cash equivalents	46,962,082	10,223,291
Investment securities (Note 3)		
Available-for-sale, at estimated fair value	36,349,666	50,359,618
Loans held for sale (Note 1)	372,173	1,390,100
Loans, less allowance for loan losses of \$4,175,000 in 2011 and \$4,327,000 in 2010 (Notes 4, 5, 9 and 10)	203,572,096	170,073,533
Premises and equipment, net (Note 6)	319,749	275,343
Bank owned life insurance (BOLI)	4,939,253	1,358,019
Deferred taxes, net	2,704,410	3,178,397
Accrued interest receivable and other assets	3,325,821	2,824,933
Total assets	<u>\$ 298,545,250</u>	<u>\$ 239,683,234</u>
LIABILITIES AND SHAREHOLDERS' EQUITY		
Deposits:		
Noninterest bearing	\$ 55,465,028	\$ 41,090,677
Interest bearing (Note 7)	188,438,362	142,525,987
Total deposits	243,903,390	183,616,664
Other borrowings (Note 9)	18,000,000	28,000,000
Accrued interest payable and other liabilities (Note 14)	1,998,984	1,107,938
Total liabilities	263,902,374	212,724,602
Commitments and contingencies (Note 10)		
Shareholders' equity (Notes 11 and 12):		
Preferred stock – no par value; 10,000,000 shares authorized		
Series A, noncumulative, \$1,000 per share liquidation value, no shares issued or outstanding at December 31, 2011; 4,000 shares issued and outstanding at December 31, 2010 (Note 16)	-	3,825,134
Series B, noncumulative, \$1,000 per share liquidation value, no shares issued or outstanding at December 31, 2011; 200 shares issued and outstanding at December 31, 2010 (Note 16)	-	193,970
Series C, noncumulative, \$1,000 per share liquidation value, 11,000 shares issued and outstanding at December 31, 2011; no shares issued and outstanding at December 31, 2010 (Note 16)	10,949,443	-
Common stock no par value; 40,000,000 shares authorized; 2,750,000 issued and outstanding in 2011 and 2010	30,056,339	29,804,008
Accumulated deficit	(6,581,703)	(7,034,399)
Accumulated other comprehensive income, net of taxes (Note 3)	218,797	169,919
Total shareholders' equity	34,642,876	26,958,632
Total liabilities and shareholders' equity	<u>\$ 298,545,250</u>	<u>\$ 239,683,234</u>

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



STATEMENT OF INCOME

For the Years Ended December 31, 2011 and 2010

	<u>2011</u>	<u>2010</u>
Interest income:		
Interest and fees on loans	\$ 10,145,984	\$ 8,320,135
Interest on investment securities	452,533	788,149
Interest on Federal funds sold	1,903	119
Interest on deposits in banks	88,639	87,600
Total interest income	10,689,059	9,196,003
Interest expense:		
Interest on deposits (Note 7)	1,149,344	1,227,546
Interest on borrowings (Note 9)	406,105	328,369
Total interest expense	1,555,449	1,555,915
Net interest income before provision for loan losses	9,133,610	7,640,088
Provision for loan losses (Note 5)	1,328,061	2,094,697
Net interest income after provision for loan losses	7,805,549	5,545,391
Noninterest income:		
Service charges and fees	233,926	188,676
Net gains on sales of loans	240,640	-
Net gains on sales of investment securities (Note 3)	124,100	372,895
Other	235,152	145,400
Total non-interest income	833,818	706,971
Non-interest expenses:		
Salaries and employee benefits (Notes 4 and 14)	4,597,721	3,589,139
Occupancy and equipment (Notes 6 and 10)	634,498	630,254
Other (Note 15)	1,931,384	1,717,747
Total non-interest expenses	7,163,603	5,937,140
Income before provision for income taxes	1,475,764	315,222
Provision for income taxes (Note 8)	682,616	(3,050,674)
Net Income	793,148	3,365,896
Preferred stock dividend	(159,556)	(218,000)
Income to common shareholders	\$ 633,592	\$ 3,147,896
Basic and diluted earnings per common share	\$ 0.23	\$ 1.14
Weighted average number of shares outstanding – basic and diluted	2,750,000	2,750,000

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



STATEMENT OF CHANGES IN SHAREHOLDER'S EQUITY AND COMPREHENSIVE INCOME

For the Years Ended December 31, 2011 and 2010

	<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, 2010	4,000	\$ 3,787,039	200	\$ 192,065		\$	2,750,000	\$29,269,174	\$(10,142,295)	\$ 224,150	\$23,330,133
Amortization of discount on Series A and discount accretion on Series B preferred stock (Note 16)		38,095		1,905					(40,000)		
Share-based compensation expense (Note 11)								534,834			534,834
Preferred stock dividends (Note 16)									(218,000)		(218,000)
Comprehensive earnings: Net income									3,365,896		3,365,896
Other Comprehensive income (loss): Net change in unrealized gains on available-for-sale investment securities, net of taxes										(54,231)	(54,231)
Balance, December 31, 2010	4,000	\$ 3,825,134	200	\$ 193,970		\$	2,750,000	\$29,804,008	\$(7,034,399)	\$ 169,919	\$26,958,632

(Continued)



STATEMENT OF CHANGES IN SHAREHOLDER'S EQUITY AND COMPREHENSIVE INCOME (Continued)

For the Years Ended December 31, 2011 and 2010

	Preferred Stock – Series A		Preferred Stock – Series B		Preferred Stock – Series C		Common Stock		Accumulated Deficit	Accumulated Other Comprehensive Income	Total Shareholders' Equity
	Shares	Amount	Shares	Amount	Shares	Amount	Shares	Amount			
Balance, December 31, 2010	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)
Comprehensive earnings: Net income									793,148		793,148
Other Comprehensive income (loss): Net change in unrealized gains on available-for-sale investment securities, net of taxes										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
December 31,											
2011											
2010											
Comprehensive Income: Net income										\$ 793,148	\$ 3,365,896
Net change in unrealized gains on available-for-sale investment securities, net of taxes										48,878	(54,231)
										\$ 842,026	\$ 3,311,665

The accompanying notes are an integral part of these financial statements



STATEMENT OF CASH FLOWS

For the Years Ended December 31, 2011 and 2010

	<u>2011</u>	<u>2010</u>
Cash flows from operating activities:		
Net Income	\$ 793,148	\$ 3,365,896
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for loan losses	1,328,061	2,094,697
Deferred tax provision	440,021	143,241
Change in valuation allowance on deferred tax asset	-	(3,439,718)
Depreciation	129,072	144,933
Deferred loan origination costs, net	(79,648)	(201,541)
Change in amortization (accretion) of investment security premiums (discounts), net	419,811	172,303
Share-based compensation expense	252,331	534,834
Increase in cash surrender value of life insurance	(81,234)	(39,967)
Change in amortization of discount on retained portion of sold loans	2,613	(7,290)
Gain on sale of investment securities, net	(124,100)	(372,895)
Decrease (increase) in loans held for sale	1,017,927	(481,100)
Increase in accrued interest receivable and other assets	(168,688)	90,612
Increase in accrued interest payable and other liabilities	913,157	385,695
Net cash provided by operating activities	<u>4,842,471</u>	<u>2,389,700</u>
Cash flows from investing activities:		
Purchase of available-for-sale investment securities	(24,612,086)	(53,309,065)
Proceeds from sales and maturities of available-for-sale investment securities	31,876,983	12,458,735
Proceeds from principal payments on available-for-sale investment securities	6,532,188	7,914,836
Net increase in loans	(34,749,589)	(31,270,375)
Purchases of premises and equipment	(173,478)	(34,573)
Purchase of bank-owned life insurance policies	(3,500,000)	-
Purchase of Federal Home Loan Bank stock	(332,200)	(218,700)
Net cash used in investing activities	<u>(24,958,182)</u>	<u>(64,459,142)</u>

(Continued)



STATEMENT OF CASH FLOWS (Continued)

For the Years Ended December 31, 2011 and 2010

	<u>2011</u>	<u>2010</u>
Cash flows from financing activities:		
Increase in demand, interest bearing and savings deposits	\$ 53,581,476	\$ 24,247,569
Net (decrease) increase in time deposits	6,705,250	6,695,059
Proceeds from sale of preferred stock, net of redemption of preferred stock	6,749,443	-
Payment of dividends on preferred stock	(181,667)	(218,000)
(Repayment) proceeds from other borrowings	<u>(10,000,000)</u>	<u>11,000,000</u>
Net cash provided by financing activities	<u>56,854,502</u>	<u>41,724,628</u>
Increase (decrease) in cash and cash equivalents	36,738,791	(20,344,814)
Cash and cash equivalents at beginning of period	<u>10,223,291</u>	<u>30,568,105</u>
Cash and cash equivalents at end of period	<u>\$ 46,962,082</u>	<u>\$ 10,223,291</u>
Supplemental disclosure of cash flow information:		
Cash paid during the year for:		
Interest	\$ 1,503,558	\$ 1,578,921
Income taxes	\$ 495,350	\$ 800
Non-cash investing activities:		
Net change in unrealized gains on available-for-sale investment securities	\$ 82,844	\$ (91,917)

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



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 Bank’s deposits are insured by the FDIC up to applicable legal limits. Additionally, during 2010, the Bank participated in the FDIC’s Transaction Account Guarantee Program (“TAGP”) under which all noninterest-bearing transaction accounts were fully guaranteed by the FDIC for the entire amount in the account and the Bank was assessed an annual fee of 15 basis points for all deposit amounts exceeding the existing deposit insurance limit of \$250,000. The TAGP program expired December 31, 2010 when it was replaced by provisions of the Dodd-Frank Act, which provides that all funds in noninterest-bearing transaction accounts will be fully insured from December 31, 2010 through December 31, 2012. The FDIC will not charge a separate assessment or premium for the insurance of noninterest-bearing transaction accounts under the Dodd-Frank Act.

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 2011. 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 and Federal funds sold. Generally, Federal funds are sold for one day periods. Loans, deposits and other borrowings are presented on a net basis.



NOTES TO FINANCIAL STATEMENTS**1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)**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.

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.



NOTES TO FINANCIAL STATEMENTS**1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)**Investment in Federal Home Loan Bank Stock (Continued)

At December 31, 2011 and 2010, the Bank's investment in FHLB stock totaled \$1,178,200 and \$846,000, respectively, and is included on the balance sheet in accrued interest receivable and other assets. Both cash and stock dividends are reported as income.

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, 2011 and 2010, 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, 2011 and 2010, 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 key 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.



NOTES TO FINANCIAL STATEMENTS

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 \$6,879,000 and \$3,856,000, respectively, as of December 31, 2011 and 2010. 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 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.



NOTES TO FINANCIAL STATEMENTS

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.



NOTES TO FINANCIAL STATEMENTS

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.



NOTES TO FINANCIAL STATEMENTS

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 \$120,000 and \$35,000 at December 31, 2011 and 2010, 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.



NOTES TO FINANCIAL STATEMENTS

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, 2011 or 2010. USDA and SBA loans held for sale at December 31, 2011 or 2010 totaled \$372,173 and \$1,390,100, respectively. The guaranteed portion of USDA and SBA loans sold, totaling approximately \$4,785,000 and \$4,053,000 were being serviced for others at December 31, 2011 and 2010, 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 recorded at the difference between the contractual servicing fees and adequate compensation for performing the servicing, 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 \$11,688 and \$1,731 associated with loans previously sold which were included in accrued interest receivable and other assets at December 31, 2011 and 2010, 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, 2011 and 2010 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.



NOTES TO FINANCIAL STATEMENTS

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)Bank Premises and Equipment

Bank premises and equipment are carried at cost. 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.



NOTES TO FINANCIAL STATEMENTS

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 (Loss) 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 719,135 and 677,790 stock options outstanding at December 31, 2011 and 2010, respectively, and 3,243 shares of restricted stock at December 31, 2011 and 2010 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 105,865 shares were available for grant at December 31, 2011. 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. 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.



NOTES TO FINANCIAL STATEMENTS

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. In addition to these assumptions, management makes estimates regarding pre-vesting forfeitures that will impact total compensation expense recognized under the Plan. The fair value of restricted stock awards is based on the value of the underlying shares at the date of the grant.

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 accumulated other comprehensive income, or loss, are presented in the statement of changes in shareholders' equity and comprehensive income.

Adoption of New Accounting Standards

In April 2011, the FASB amended existing guidance for assisting a creditor in determining whether a restructuring is a troubled debt restructuring. The amendments clarify the guidance for a creditor's evaluation of whether it has granted a concession and whether a debtor is experiencing financial difficulties. With regard to determining whether a concession has been granted, the ASU clarifies that creditors are precluded from using the effective interest method to determine whether a concession has been granted. In the absence of using the effective interest method, a creditor must now focus on other considerations such as the value of the underlying collateral, evaluation of other collateral or guarantees, the debtor's ability to access other funds at market rates, interest rate increases and whether the restructuring results in a delay in payment that is insignificant. The Bank adopted this new accounting standard as of January 1, 2011 and adoption did not have a material effect on the Bank's operating results or financial condition.



NOTES TO FINANCIAL STATEMENTS

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Adoption of New Accounting Standards (Continued)

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 Bank will adopt this guidance effective for the year ended December 31, 2012, and its adoption is not expected to have a material impact on the Bank's operating results or financial condition.

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. Early adoption is permitted. The adoption of this amendment will change the presentation of the components of comprehensive income for the Bank as part of the statement of changes in shareholder's equity and comprehensive income. The guidance will be adopted by the Bank effective for the year ended December 31, 2012.

2. FAIR VALUE MEASUREMENTS

Fair Value of Financial Instruments

The estimated carrying and fair values of the Bank's financial instruments are as follows:

	<u>December 31, 2011</u>		<u>December 31, 2010</u>	
	<u>Carrying Amount</u>	<u>Fair Value</u>	<u>Carrying Amount</u>	<u>Fair Value</u>
Financial assets:				
Cash and cash equivalents	\$ 46,962,082	\$ 46,962,082	\$ 10,223,291	\$ 10,223,291
Investment securities	36,349,666	36,349,666	50,359,618	50,359,618
Loans held for sale	372,173	373,062	1,390,100	1,395,653
Loans, net	203,572,096	230,720,589	170,073,533	189,012,475
Federal Home Loan Bank stock	1,178,200	N/A	846,000	N/A
The Independent Banker's Bank stock	50,419	N/A	50,419	N/A
Pacific Coast Banker's Bank stock	190,000	N/A	190,000	N/A
Accrued interest receivable	979,809	979,809	795,475	795,475
Financial liabilities:				
Deposits	243,903,390	243,684,501	183,616,664	183,524,127
Other borrowings	18,000,000	17,462,090	28,000,000	27,641,054
Accrued interest payable	59,853	59,853	7,962	7,962



NOTES TO FINANCIAL STATEMENTS

2. FAIR VALUE MEASUREMENTS (Continued)Fair Value of Financial Instruments (Continued)

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.

The following methods and assumptions were used to estimate the fair value of financial instruments. For cash and cash equivalents, accrued interest receivable and payable, demand deposits, short-term borrowings and fixed-rate long-term borrowings, the carrying amount is estimated to be fair value.

For investment securities, fair values are based on quoted market prices, quoted market prices for similar securities and indications of value provided by brokers. The fair values for loans and leases, including loans held-for-sale, are estimated using discounted cash flow analyses, using interest rates currently being offered at each reporting date for loans with similar terms to borrowers of comparable creditworthiness. It was not practicable to determine the fair value of FHLB, IBFC and PCBB stock due to restrictions placed on their transferability. Fair values for fixed-rate certificates of deposit are estimated using discounted cash flow analyses using interest rates offered at each reporting date by the Bank for certificates with similar remaining maturities.

The fair values of commitments are estimated using the fees currently charged to enter into similar agreements and are not significant and, therefore, not included in the above table.

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.



NOTES TO FINANCIAL STATEMENTS

2. FAIR VALUE MEASUREMENTS (Continued)

Fair Value Hierarchy (Continued)

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.

Assets Recorded at Fair Value

The following table's 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, 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	<u>\$ 36,349,666</u>	<u>\$ -</u>	<u>\$ 36,349,666</u>	<u>\$ -</u>
<u>December 31, 2010</u>				
Available-for-sale investment securities				
Debt securities:				
U.S. Government agencies	\$ 2,001,638	\$ -	\$ 2,001,638	\$ -
Mortgage-backed securities - residential	20,857,980	-	20,857,980	-
Money Market mutual funds	<u>27,500,000</u>	<u>27,500,000</u>	<u>-</u>	<u>-</u>
Total assets measured at fair value on a recurring basis	<u>\$ 50,359,618</u>	<u>\$ 27,500,000</u>	<u>\$ 22,859,618</u>	<u>\$ -</u>

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

Fair values for debt securities of U.S. Governmental Agencies and residential mortgage-backed securities are based on quoted market prices for similar securities. Fair values for money market mutual funds are based on quoted market prices for exact securities.

There were no changes in the valuation techniques used during the years ended December 31, 2011 or 2010.



NOTES TO FINANCIAL STATEMENTS

2. FAIR VALUE MEASUREMENTS (Continued)

Assets Recorded at Fair Value (Continued)*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, 2011</u>				
Impaired loans:				
Commercial and Industrial	\$ 3,307,286	\$ -	\$ -	\$ 3,307,286
Real Estate - Other	2,194,373	-	-	2,194,373
Total assets measured at fair value on a non-recurring basis	<u>\$ 5,501,659</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 5,501,659</u>

Description	Fair Value	Level 1	Level 2	Level 3
<u>December 31, 2010</u>				
Impaired loans:				
Commercial and industrial	\$ 582,717	\$ -	\$ -	\$ 582,717
Real Estate - Other	2,339,259	-	-	2,339,259
Total assets measured at fair value on a non-recurring basis	<u>\$ 2,921,976</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 2,921,976</u>

The fair value of impaired commercial and industrial loans and real estate loans is based on the fair value to the collateral for all collateral dependent loans and for other impaired loans is estimated using a discounted cash flow model.

If the Bank determines that the value of an impaired loan is less than the recorded investment in the loan, the carrying value is adjusted through a specific provision for loan losses or a charge-off recorded through the allowance for loan losses. Losses totaling \$964,000 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 \$551,000 related to impaired real estate loans.

Losses totaling \$1,142,000 were recognized as impairment charges during the year ended December 31, 2010 related to the above impaired loans, of which \$724,000 related to impaired commercial and industrial loans and \$418,000 related to impaired real estate loans.



NOTES TO FINANCIAL STATEMENTS

3. INVESTMENT SECURITIES

Available-for-Sale

The amortized cost and estimated fair value of available-for-sale investment securities at December 31, 2011 and 2010 consisted of the following:

	2011			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Debt securities:				
Mortgage-backed securities - residential	<u>\$ 35,978,823</u>	<u>\$ 461,911</u>	<u>\$ (91,068)</u>	<u>\$ 36,349,666</u>
	2010			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Debt securities:				
U.S. Government agencies	\$ 2,000,000	\$ 1,638	\$ -	\$ 2,001,638
Mortgage-backed securities - residential	20,571,619	287,369	(1,008)	20,857,980
Other securities:				
Money Market mutual funds	27,500,000	-	-	27,500,000
	<u>\$ 50,071,619</u>	<u>\$ 289,007</u>	<u>\$ (1,008)</u>	<u>\$ 50,359,618</u>

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.

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.

Net unrealized gains on available-for-sale investment securities totaling \$287,999 were recorded, net of \$118,080 in tax liabilities, as accumulated other comprehensive income within shareholders' equity at December 31, 2010. Unrealized holding gains arising during the year ended December 31, 2010 totaled \$280,978. Proceeds from the maturity of available-for-sale investment securities for the year ended December 31, 2010 totaled \$1,595,953. Proceeds and gross realized gains from the sale of available-for-sale investment securities for the year ended December 31, 2010 totaled \$10,862,782 and \$372,895 respectively.



NOTES TO FINANCIAL STATEMENTS

3. INVESTMENT SECURITIES (Continued)Available-for-Sale (Continued)

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. At December 31, 2010, the Bank held 1 U.S. Government agency security and 20 mortgage-backed securities, of which 2 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 mortgage-backed securities are primarily attributable to changes in interest rates, underlying pool characteristics and relative illiquidity and not credit quality, and because the Bank has the ability and intent to hold those investments until a recovery of fair value, which may be maturity, the Bank does not consider those investments to be other-than-temporarily impaired at December 31, 2011.

At December 31, 2011, investment securities were comprised of U.S. Government agency collateralized mortgage-backed securities with no single maturity dates. Expected maturities will differ from contractual maturities because the issuers of the securities may have the right to call or prepay obligations with or without call or prepayment penalties.

At December 31, 2011, most investment securities were pledged to secure State Treasury funds on deposit and borrowing arrangements in place at the Federal Reserve Bank of San Francisco. (See Note 9)

4. LOANS

Outstanding loans are summarized below:

	December 31,	
	2011	2010
Commercial & Industrial	\$ 94,412,665	\$ 74,546,021
Real estate - Construction & Land	3,761,769	6,837,451
Real Estate - Other	101,323,177	86,901,318
Real Estate - HELOC	4,067,094	4,598,076
Installment and Other	3,584,941	999,865
	<u>207,149,646</u>	<u>173,882,731</u>
Deferred loan origination costs, net	597,450	517,802
Allowance for loan losses	<u>(4,175,000)</u>	<u>(4,327,000)</u>
	<u>\$ 203,572,096</u>	<u>\$ 170,073,533</u>

Salaries and employee benefits totaling \$1,120,130 and \$1,039,003 were deferred as loan origination costs for the years ended December 31, 2011 and 2010, respectively.

Loans with carrying values totaling approximately \$165,412,000 were pledged to secure borrowing arrangements at December 31, 2011 (see Note 9).



NOTES TO FINANCIAL STATEMENTS

5. ALLOWANCE FOR LOAN LOSSES

Changes in the allowance for loan and lease losses were as follows:

	Years Ended December 31,	
	2011	2010
Balance at beginning of year	\$ 4,327,000	\$ 2,565,000
Provision for loan losses	1,328,061	2,094,697
Loans charged-off	(1,504,936)	(419,297)
Recoveries of loans previously charged-off	24,875	86,600
Balance at end of year	<u>\$ 4,175,000</u>	<u>\$ 4,327,000</u>

The following table shows the changes in and allocation of the allowance for loan losses at December 31, 2011 and 2010 and, for the year ended December 31, 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, 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	<u>\$ 2,195,324</u>	<u>\$ 234,324</u>	<u>\$ 1,635,133</u>	<u>\$ 65,966</u>	<u>\$ 44,253</u>	<u>\$ 4,175,000</u>
Ending balance: individually evaluated for impairment	<u>\$ 313,000</u>	<u>\$ -</u>	<u>\$ 133,000</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 446,000</u>
Ending balance: collectively evaluated for impairment	<u>\$ 1,882,324</u>	<u>\$ 234,324</u>	<u>\$ 1,502,133</u>	<u>\$ 44,253</u>	<u>\$ 65,966</u>	<u>\$ 3,729,000</u>

Loans – December 31, 2011

Ending balance	<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>
Ending balance: individually evaluated for impairment	<u>\$ 3,620,286</u>	<u>\$ -</u>	<u>\$ 2,327,373</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 5,947,659</u>
Ending balance: collectively evaluated for impairment	<u>\$90,792,379</u>	<u>\$ 3,761,769</u>	<u>\$ 98,995,804</u>	<u>\$ 4,067,094</u>	<u>\$ 3,584,941</u>	<u>\$201,201,987</u>

Allowance for Loan Losses – December 31, 2010

Ending balance allocated to portfolio segments	<u>\$ 2,839,300</u>	<u>\$ 253,589</u>	<u>\$ 1,176,655</u>	<u>\$ 34,160</u>	<u>\$ 23,296</u>	<u>\$ 4,327,000</u>
Ending balance: individually evaluated for impairment	<u>\$ 724,000</u>	<u>\$ -</u>	<u>\$ 418,000</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 1,142,000</u>
Ending balance: collectively evaluated for impairment	<u>\$ 2,115,300</u>	<u>\$ 253,589</u>	<u>\$ 758,655</u>	<u>\$ 34,160</u>	<u>\$ 23,296</u>	<u>\$ 3,185,000</u>

Loans – December 31, 2010

Ending balance	<u>\$74,546,021</u>	<u>\$ 6,837,451</u>	<u>\$ 86,901,318</u>	<u>\$ 4,598,076</u>	<u>\$ 999,865</u>	<u>\$173,882,731</u>
Ending balance: individually evaluated for impairment	<u>\$ 1,306,717</u>	<u>\$ -</u>	<u>\$ 2,757,259</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 4,063,976</u>
Ending balance: collectively evaluated for impairment	<u>\$73,239,304</u>	<u>\$ 6,837,451</u>	<u>\$ 84,144,059</u>	<u>\$ 4,598,076</u>	<u>\$ 999,865</u>	<u>\$169,818,755</u>



NOTES TO FINANCIAL STATEMENTS

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					
	Credit Risk Profile by Internally Assigned Grade					
	Commercial & Industrial	Real Estate Construction & Land	Real Estate - Other	Real Estate HELOC	Installment & Other	Total
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	\$94,412,665	\$ 3,761,769	\$101,323,177	\$ 4,067,094	\$ 3,584,941	\$207,149,646

The following table shows the loan portfolio allocated by management's internal risk ratings at December 31, 2010:

	Credit Exposure					
	Credit Risk Profile by Internally Assigned Grade					
	Commercial & Industrial	Real Estate Construction & Land	Real Estate - Other	Real Estate HELOC	Installment & Other	Total
Grade:						
Pass	\$68,609,384	\$ 5,239,031	\$ 78,730,518	\$ 4,598,076	\$ 999,865	\$158,176,874
Special Mention	2,647,349	-	4,626,536	-	-	7,273,885
Substandard	3,289,288	1,598,420	3,544,264	-	-	8,431,972
Total	\$74,546,021	\$ 6,837,451	\$ 86,901,318	\$ 4,598,076	\$ 999,865	\$173,882,731

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>



NOTES TO FINANCIAL STATEMENTS

5. ALLOWANCE FOR LOAN LOSSES (Continued)

The following table shows an aging analysis of the loan portfolio by the time past due at December 31, 2010:

	30-89 Days Past Due	90 Days and Still Accruing	Nonaccrual	Total Past Due	Current	Total
Commercial & Industrial	\$ -	\$ -	\$ 1,042,000	\$ 1,042,000	\$ 73,504,021	\$ 74,546,021
Real Estate - Construction & Land	-	-	-	-	6,837,451	6,837,451
Real Estate - Other	1,770,348	-	986,911	2,757,259	84,144,059	86,901,318
Real Estate - HELOC	-	-	-	-	4,598,076	4,598,076
Installment & Other	-	-	-	-	999,865	999,865
Total	<u>\$ 1,770,348</u>	<u>\$ -</u>	<u>\$ 2,028,911</u>	<u>\$ 3,799,259</u>	<u>\$170,083,472</u>	<u>\$173,882,731</u>

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

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

Interest forgone on nonaccrual loans totaled \$106,809 and \$128,248 for the years ended December 31, 2011 and 2010, respectively. There was no interest recognized on a cash-basis on impaired loans for the years ended December 31, 2011 or 2010.

The following table shows information related to impaired loans at and for the year ended December 31, 2010:

	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized
With no related allowance recorded:					
Commercial & Industrial	\$ 292,000	\$ 292,000	\$ -	\$ 164,000	\$ -
Real Estate - Other	986,911	986,911	-	-	-
With an allowance recorded:					
Commercial & Industrial	1,014,717	1,014,717	724,000	603,507	44,664
Real Estate	1,770,348	1,770,348	418,000	446,225	98,578
Total:					
Commercial & Industrial	\$ 1,306,717	\$ 1,306,717	\$ 724,000	\$ 767,507	\$ 44,664
Real Estate - Other	\$ 2,757,259	\$ 2,757,259	\$ 418,000	\$ 446,225	\$ 98,578

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



NOTES TO FINANCIAL STATEMENTS

5. ALLOWANCE FOR LOAN LOSSES (Continued)

Troubled Debt Restructurings

The Bank has allocated \$446,000 of specific reserves to customers whose loan terms have been modified in troubled debt restructurings as of December 31, 2011. No specific reserves were allocated to troubled debt restructurings at December 31, 2010. The Bank has committed to lend additional amounts totaling up to \$495,231 as of December 31, 2011 to customers with outstanding loans that are classified as troubled debt restructurings.

During the year ending December 31, 2011, the terms of certain loans were modified as troubled debt restructurings. The modification of the terms of such loans included one or a combination of the following: 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 permanent reduction of the recorded investment in the loan.

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 year ending December 31, 2011:

	<u>Number of Loans</u>	<u>Pre-Modification Outstanding Recorded Investment</u>	<u>Post-Modification Outstanding Recorded Investment</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>

The 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, 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 2011, 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.



NOTES TO FINANCIAL STATEMENTS

6. PREMISES AND EQUIPMENT

Premises and equipment consisted of the following:

	<u>December 31,</u>	
	<u>2011</u>	<u>2010</u>
Furniture, fixtures and equipment	\$ 761,464	\$ 608,452
Leasehold improvements	<u>164,501</u>	<u>144,035</u>
	925,965	752,487
Less accumulated depreciation and amortization	<u>(606,216)</u>	<u>(477,144)</u>
	<u>\$ 319,749</u>	<u>\$ 275,343</u>

Depreciation and amortization included in occupancy and equipment expense totaled \$129,072 and \$144,933, respectively, for 2011 and 2010.

7. INTEREST-BEARING DEPOSITS

Interest-bearing deposits consisted of the following:

	<u>December 31,</u>	
	<u>2011</u>	<u>2010</u>
Savings	\$ 26,832,732	\$ 9,625,224
Money market	87,898,237	88,167,095
Interest-bearing demand accounts	27,285,569	5,017,094
Time, \$100,000 or more	44,953,649	38,694,223
Other time	<u>1,468,175</u>	<u>1,022,351</u>
	<u>\$ 188,438,362</u>	<u>\$ 142,525,987</u>

Aggregate annual maturities of time deposits are as follows:

<u>Year Ending</u> <u>December 31,</u>	
2012	\$ 36,968,113
2013	7,031,163
2014	204,903
2015	-
2016	<u>2,217,645</u>
	<u>\$ 46,421,824</u>



NOTES TO FINANCIAL STATEMENTS

7. INTEREST-BEARING DEPOSITS (Continued)

Interest expense recognized on interest-bearing deposits for the years ended December 31, 2011 and 2010 consisted of the following:

	<u>Year Ended December 31,</u>	
	<u>2011</u>	<u>2010</u>
Savings	\$ 132,902	\$ 91,674
Money market	689,157	830,122
Interest-bearing demand accounts	32,155	22,235
Time, \$100,000 or more	286,254	270,701
Other time	8,876	12,814
	<u>\$ 1,149,344</u>	<u>\$ 1,227,546</u>

8. INCOME TAXES

The provision for income taxes for the years ended December 31, 2011 and 2010 consisted of the following:

	<u>Federal</u>	<u>State</u>	<u>Total</u>
<u>2011</u>			
Current	\$ 80,549	\$ 162,046	\$ 242,595
Deferred	422,267	17,754	440,021
Provision for income taxes	<u>\$ 502,816</u>	<u>\$ 179,800</u>	<u>\$ 682,616</u>
	<u>Federal</u>	<u>State</u>	<u>Total</u>
<u>2010</u>			
Current	\$ -	\$ 245,803	\$ 245,803
Deferred	307,851	(164,610)	143,241
Decrease in valuation allowance	(2,711,967)	(727,751)	(3,439,718)
Benefit from income taxes	<u>\$ (2,404,116)</u>	<u>\$ (646,558)</u>	<u>\$ (3,050,674)</u>

The Bank's reported amount of income tax expense differs from federal statutory rates due principally to California franchise taxes and the decrease in the valuation allowance on its deferred tax assets.



NOTES TO FINANCIAL STATEMENTS

8. INCOME TAXES (Continued)

Deferred tax assets (liabilities) consisted of the following:

	December 31,	
	2011	2010
Deferred tax assets:		
Net operating losses	\$ 823,067	\$ 1,195,390
Share-based compensation	186,303	166,824
Organization costs	322,350	352,928
Allowance for loan losses	1,301,339	1,421,193
State deferred tax asset	774,068	731,209
Other	170,362	19,266
Deferred tax assets before valuation allowance	3,577,489	3,886,810
Valuation allowance	(141,979)	(141,979)
Total deferred tax assets	3,435,510	3,744,831
Deferred tax liabilities:		
Accrual to cash conversion	(86,023)	(102,797)
Deferred loan origination costs	(413,765)	(344,571)
Premises and equipment	(31,530)	-
Unrealized gain on available-for-sale investment securities	(152,046)	(118,080)
Other	(47,736)	(986)
Total deferred tax liabilities	(731,100)	(566,434)
Net deferred tax assets (liabilities)	\$ 2,704,410	\$ 3,178,397

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, 2011 and 2010. This valuation allowance is included as a component in the full valuation allowance against the Bank's deferred tax assets.

At December 31, 2011, the Bank had Federal and State net operating loss carry-forwards (NOLs) of \$2,421,000 and \$3,782,000, respectively. The Federal and State NOLs begin to expire in 2027 and 2019, respectively.

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 its inception.

As of December 31, 2011 and 2010, there were no unrecognized tax benefits or interest and penalties accrued by the Bank.



NOTES TO FINANCIAL STATEMENTS**9. BORROWING ARRANGEMENTS**

Under an agreement with a correspondent bank, the Bank can borrow up to the lesser of \$8,000,000, or the total market value of securities pledged to the bank under a repurchase agreement. At December 31, 2011 and 2010, there were no investment securities pledged to the correspondent bank under this agreement. There were no borrowings outstanding under these arrangements at December 31, 2011 or 2010.

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, 2011, amounts pledged and available borrowing capacity under such limits were approximately \$85,012,000 and \$70,583,000, respectively. There were no borrowings outstanding under this arrangement as of December 31, 2011 and \$10,000,000 in over-night borrowings outstanding under this arrangement at a fixed interest rate of 0.75% at December 31, 2010.

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, 2011, amounts pledged and available borrowing capacity under such limits were approximately \$53,213,000 and \$35,213,000, respectively.

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.

At December 31, 2010, there were \$18,000,000 in borrowings outstanding under this arrangement at fixed interest rates ranging from 0.69% to 2.79%, with a weighted average maturity of approximately 2.2 years. The weighted average interest rate on these borrowings was 2.00% at December 31, 2010.

10. COMMITMENTS AND CONTINGENCIESOperating 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.

During 2011, the Bank leased space in San Jose California for its Loan Production Office. This one-year lease expires August 31, 2012 and has one 1 year renewal option. If renewed, the rent will be increased to reflect the then current fair-market value rents.



NOTES TO FINANCIAL STATEMENTS

10. COMMITMENTS AND CONTINGENCIES (Continued)Operating Leases (Continued)

Future minimum lease payments are as follows:

Year Ending December 31, _____	
2012	\$ 435,050
2013	424,755
2014	434,970
2015	184,950
2016	-
Thereafter	-
	\$ 1,479,725

Rental expense included in occupancy and equipment expense totaled \$419,030 and \$408,276 for the years ended December 31, 2011 and 2010, respectively.

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, _____	
	2011	2010
Commitments to extend credit	\$ 73,746,000	\$ 60,141,000
Standby letters of credit	\$ 2,265,000	\$ 2,960,000

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.



NOTES TO FINANCIAL STATEMENTS

10. COMMITMENTS AND CONTINGENCIES (Continued)Financial Instruments with Off-Balance-Sheet Risk (Continued)

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, 2011 and 2010. The Bank recognizes these fees as revenue over the term of the commitment or when the commitment is used.

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. In management's judgment, with a nearly even balance between Commercial & Industrial Loans and Real Estate Loans at 46% and 53% of total loans, respectively, no specific concentration existed in the Bank's loan portfolio at December 31, 2011. At December 31, 2010, Real Estate loans were approximately 58% of total loans, representing a modest concentration. 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, 2011, only two deposit relationships, a time deposit in the amount of \$15,000,000, or 6.2% of total deposits and, a checking account in the amount of \$19,776,627, or 8.4% of total deposits, exceeded 5% of total deposits.

If the time deposit, which is collateralized, were not renewed, the underlying investment securities providing the collateral would become available to pledge as collateral elsewhere. The majority of the funds in the checking account are expected to be disbursed during the first quarter of 2012.

At December 31, 2010, only one deposit relationship, a time deposit in the amount of \$15,000,000, or 8.2% of total deposits, exceeded 5% of total deposits. If this time deposit, which is collateralized, were not renewed, the underlying investment securities providing the collateral would become available to pledge as collateral elsewhere.



NOTES TO FINANCIAL STATEMENTS

10. COMMITMENTS AND CONTINGENCIES (Continued)

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.

Correspondent Banking Agreements

The Bank maintains funds on deposit with other federally insured financial institutions under correspondent banking agreements. Although not all of the Bank's correspondent banks have elected to participate in the FDIC sponsored Transaction Account Guarantee Program ("TAGP"), insured financial institution deposits up to \$250,000 are fully insured by the FDIC under the FDIC's general deposit insurance rules. Under the Dodd-Frank Act (see p.15), through December 31, 2012, all noninterest-bearing transaction accounts were fully guaranteed by the FDIC for the entire balance in the account above \$250,000. As a result of these coverage limitations there were no correspondent bank balances, which were not fully insured as of December 31, 2011.

As of December 31, 2010 as a result of these coverage limitations, deposits at one correspondent bank totaling about \$352,000 were not fully insured. Coverage under the Transaction Account Guarantee Program is in addition to and separate from the coverage available under the FDIC's general deposit insurance rules.

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 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, 2011 and 2010, the compensation cost recognized for stock option compensation was \$248,439 and \$532,886, respectively. Of the compensation cost recognized for the year ended December 31, 2011, \$95,375 was for incremental compensation cost resulting from the exchanged options described above.



NOTES TO FINANCIAL STATEMENTS

11. SHARE-BASED COMPENSATION (Continued)

Stock Option Awards (Continued)

A summary of option activity under the Plan for the years ended December 31, 2011 and 2010 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, 2010	660,703	\$ 9.79	7.81
Granted	24,993	\$ 6.86	
Forfeited or canceled	(7,906)	\$ 10.00	
Outstanding at December 31, 2010	<u>677,790</u>	<u>\$ 9.68</u>	<u>6.91</u>
Vested or expected to vest at December 31, 2010	<u>673,964</u>	<u>\$ 9.69</u>	<u>6.90</u>
Exercisable at December 31, 2010	<u>612,690</u>	<u>\$ 9.93</u>	<u>6.68</u>
Outstanding at December 31, 2010	677,790	\$ 9.68	6.91
Granted or exchanged	411,650	\$ 7.81	
Forfeited or canceled	(370,305)	\$ 9.90	
Outstanding at December 31, 2011	<u>719,135</u>	<u>\$ 8.49</u>	<u>6.73</u>
Vested or expected to vest at December 31, 2011	<u>703,878</u>	<u>\$ 8.51</u>	<u>6.72</u>
Exercisable at December 31, 2011	<u>453,842</u>	<u>\$ 8.99</u>	<u>6.25</u>

As of December 31, 2011, the unrecognized compensation cost related to non-vested stock option awards totaled \$400,440. That cost is expected to be amortized on a straight-line basis over a weighted average period of 0.91 years and will be adjusted for subsequent changes in estimated forfeitures.

At December 31, 2011, there was no intrinsic value associated with outstanding stock option awards.



NOTES TO FINANCIAL STATEMENTS

11. SHARE-BASED COMPENSATION (Continued)

Stock Option Awards (Continued)

The following information relates to stock option grants granted during the years ended December 31, 2011 and 2010:

	2011	2010
Weighted average grant date fair value per share of options granted	\$ 3.94	\$ 3.59
Significant fair value assumptions:		
Expected term in years	6 years	6 years
Expected annual volatility	66.98%	53.96%
Expected annual dividend yield	0%	0%
Risk-free interest rate	1.32%	2.12%

The weighted average grant date fair value and significant fair value assumptions above are for 64,400 shares of new options granted during 2011. There were also 347,250 shares of exchanged options 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

During 2011, no restricted stock awards were granted. Compensation cost related to the one outstanding restricted Stock award of \$3,892 was recognized for the year ended December 31, 2011. As of December 31, 2011, the unrecognized compensation cost related to the restricted stock award totaled \$5,837. That cost is expected to be amortized over 1.6 years and will be adjusted for subsequent changes in forfeitures. None of the restricted stock was vested as of December 31, 2011.

During 2010, the Bank granted one award of 3,243 shares of restricted stock under the Plan with a grant date fair value of \$7.00 per share. Compensation cost of \$1,948 was recognized for the year ended December 31, 2010. As of December 31, 2010, the unrecognized compensation cost related to non-vested restricted stock awards totaled \$9,729. None of the restricted stock was vested as of December 31, 2010.

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, 2011, 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.



NOTES TO FINANCIAL STATEMENTS

12. SHAREHOLDERS' EQUITY (Continued)

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.

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. 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, 2011 and 2010.

	2011		2010	
	Amount	Ratio	Amount	Ratio
<u>Leverage Ratio</u>				
California Bank of Commerce	\$ 33,119,000	11.43%	\$ 24,361,000	10.73%
Minimum requirement for "Well-Capitalized" institution under prompt corrective action provisions	\$ 14,490,000	5.00%	\$ 11,347,000	5.00%
Minimum regulatory requirement	\$ 11,592,000	5.00%	\$ 9,078,000	4.00%
<u>Tier 1 Risk-Based Capital Ratio</u>				
California Bank of Commerce	\$ 33,119,000	13.99%	\$ 24,361,000	10.8%
Minimum requirement for "Well-Capitalized" institution under prompt corrective action provisions	\$ 14,205,000	6.00%	\$ 13,538,000	6.00%
Minimum regulatory requirement	\$ 9,470,000	4.00%	\$ 9,025,000	4.00%
<u>Total Risk-Based Capital Ratio</u>				
California Bank of Commerce	\$ 36,094,000	15.25%	\$ 27,200,000	12.06%
Minimum requirement for "Well-Capitalized" institution under prompt corrective action provisions	\$ 23,674,000	10.00%	\$ 22,563,000	10.00%
Minimum regulatory requirement	\$ 18,940,000	8.00%	\$ 18,050,000	8.00%



NOTES TO FINANCIAL STATEMENTS

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 year ended December 31, 2011:

Balance, December 31, 2010	\$ 3,959,567
Disbursements	2,267,679
Amounts repaid	<u>(1,233,726)</u>
Balance, December 31, 2011	\$ 4,993,520
Undisbursed commitments to related parties, December 31, 2011	\$ 1,488,774

At December 31, 2011, the Bank's deposits from related parties totaled \$3,186,000.

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 \$434,357 for the year ended December 31, 2011 and \$431,368 for the year ended December 31, 2010.

14. EMPLOYEE BENEFIT PLANSProfit 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, 2011 or 2010.

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 6.5%. The expense recognized under this plan for the years ended December 31, 2011 and 2010 totaled \$63,864 and \$57,025, respectively. Accrued compensation payable under the salary continuation plan totaled \$256,663 and \$192,799 at December 31, 2011 and 2010, respectively, and is included in accrued interest payable and other liabilities on the Bank's balance sheet.



NOTES TO FINANCIAL STATEMENTS

15. OTHER EXPENSES

Other expenses for the years ended December 31, 2011 and 2010 consisted of the following:

	<u>2011</u>	<u>2010</u>
Outsourced data processing and electronic banking	\$ 287,320	\$ 262,671
Computer network and internet support	181,274	165,913
Director's stock-based and other compensation	112,885	102,574
Professional fees	246,333	214,214
Bank Insurance	53,220	49,994
Advertising, promotion and business development	233,650	183,012
Regulatory fees	285,413	376,625
Provision for unfunded loan commitments	85,000	-
Correspondent Bank service charges	93,177	81,224
Other operating expenses	353,112	281,520
	<u>\$ 1,931,384</u>	<u>\$ 1,717,747</u>

16. PREFERRED STOCKSmall 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, 2011 is 1%. The dividend rate can fluctuate between 1% and 5% during the next 18 quarters based on the growth in qualified small business loans.

Capital Purchase Program ("CPP")

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.

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.



NOTES TO FINANCIAL STATEMENTS

16. PREFERRED STOCK (Continued)

Capital Purchase Program ("CPP") (continued)

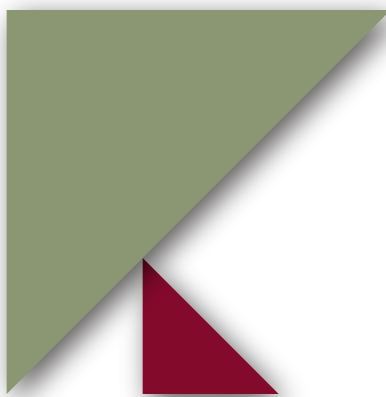
Costs incurred by the Bank for the issuance of the Series A and Series B Preferred Stock totaled \$54,230, and upon redemption are shown as an increase to accumulated deficit within shareholder's equity for the year ended December 31, 2011.

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, 2011 through March 19, 2012, the date the financial statements were available to be issued, and no subsequent events occurred requiring accrual or disclosure.





California Bank of Commerce
3595 Mt. Diablo Boulevard
Lafayette, CA 94549

www.californiabankofcommerce.com



Member FDIC