Communities First Financial Corporation

2014

ANNUAL REPORT

Communities First Financial Corporation

Communities First Financial Corporation strives to be the best company our employees ever work for, the best bank our customers ever do business with, and the best investment our shareholders ever make!

-CFFC Employee/Owner

COMMUNITIES FIRST FINANCIAL CORPORATION

Message from the Chairman

Your Board of Directors believes credibility, consistency, and honesty are the key to winning the trust of our clients in order to create value for you, our shareholders.

Community First Financial Corporation and Fresno First Bank continue to build earnings which will be a factor in long term shareholder value. We believe our mission, strategy, and culture serve to guide us in being the best bank for our clients and shareholders.

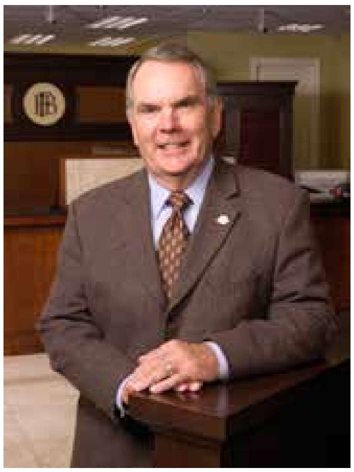
Our Corporate Governance Committee, under the leadership of Director Mark Saleh, drives board performance with the best and most cutting edge practices, keeping up to date in the ever changing corporate environment. Each director is required to complete continuing education in the form of conferences and webinars lead by organizations such as the National Association of Corporate Directors, Western Independent Bankers, and Independent Community Bankers of America, just to name a few.

We value the trust you have placed in your Board, and in me personally as the Chairman of the Board.

David N. Price
Chairman of the Board

COMMUNITIES FIRST FINANCIAL CORPORATION

Message from the President & CEO



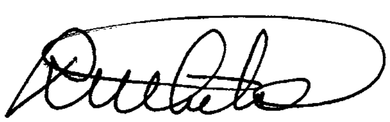
Communities First Financial Corporation, the bank holding company of Fresno First Bank reported net income of $2.12 million for the year ending December 31, 2014, compared to income of $26,000 for 2013. Income for the 4th quarter ending December 31, 2014, rose to $538,000, compared to net income of $509,000 during the comparable quarter in 2013. Fully diluted earnings per share for the year increased to $.79 in 2014 from $.01 in 2013.

We are very pleased with our performance in 2014, we accomplished a lot during the year. Breaking through $2 million in net income for the first time, once again posting double digit growth in loans, deposits and assets, and the formation of our holding company are all things we are proud of as we continue our work to enhance shareholder value.

So what's behind the numbers? We believe our continued success is a direct result of the belief that "when you appeal to the highest level of thinking, you get the highest level of performance".

We have accomplished this by practicing the Great Game of Business and "Open Book" management over the past six years. In practicing this model, we have been building a culture of ownership. An environment where all of our employees "think like owners, act like owners and feel like owners".

As a result of this transformation, we are looking forward to greater profits, improved efficiency, the highest level of services and a better return for our shareholders!



Richard "Rick" Whitsell
President & CEO

COMMUNITIES FIRST FINANCIAL CORPORATION

Mission Statement

The mission of Fresno First Bank is to become the Bank of choice for business owners, professionals, entrepreneurs and individuals that value a high touch approach, or "relationship" approach to their banking needs. We will accomplish this by:

- Developing an ownership culture that fosters a working environment which encourages professional and financial growth and entrepreneurial freedom.
- Committing to exceed customer service expectations for quality, responsiveness and professional excellence.
- Generating a superior return for our shareholders while investing in the communities we serve.

Values Statement

Fresno First Bank will be the Bank of choice for successful businesses and individuals who value superior service and a relationship approach to their banking and financing needs. Our group of experienced professional bankers will help clients navigate through complex financial choices which will ultimately assist in stimulating economic growth in our community. Our commitment to an ownership culture will foster an exceptional work environment that generates a fair return for our shareholders.

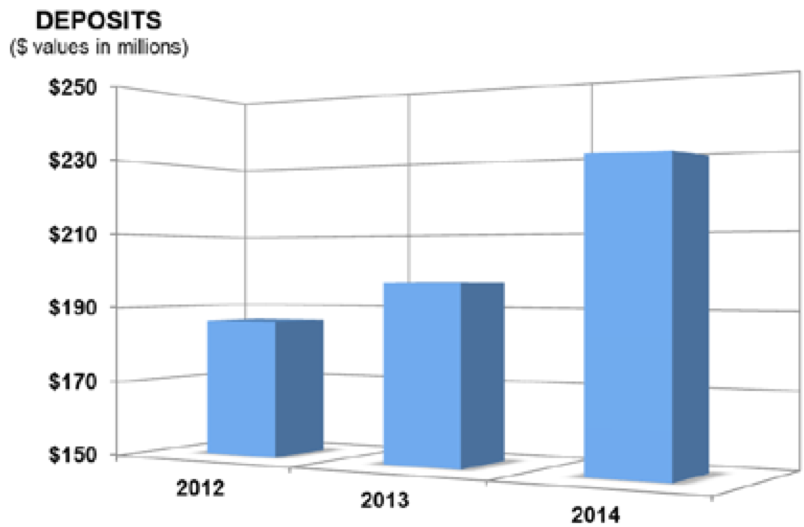
Core Values

We Value:

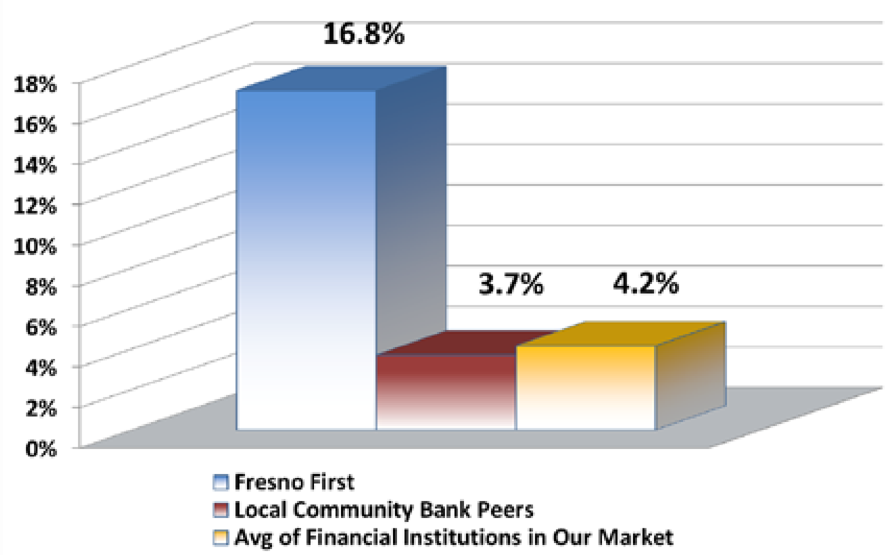
- The highest standard of ethical behavior and professional integrity.
- An owner-orientated working environment dedicated to teamwork that encourages respect and dignity, while recognizing and rewarding innovation and exceptional performance.
- Proactive, solutions-orientated recommendations that consistently exceed client expectations.
- The loyalty of our client relationships gained by knowing, understanding and placing their needs first.

Communities First Financial Corporation

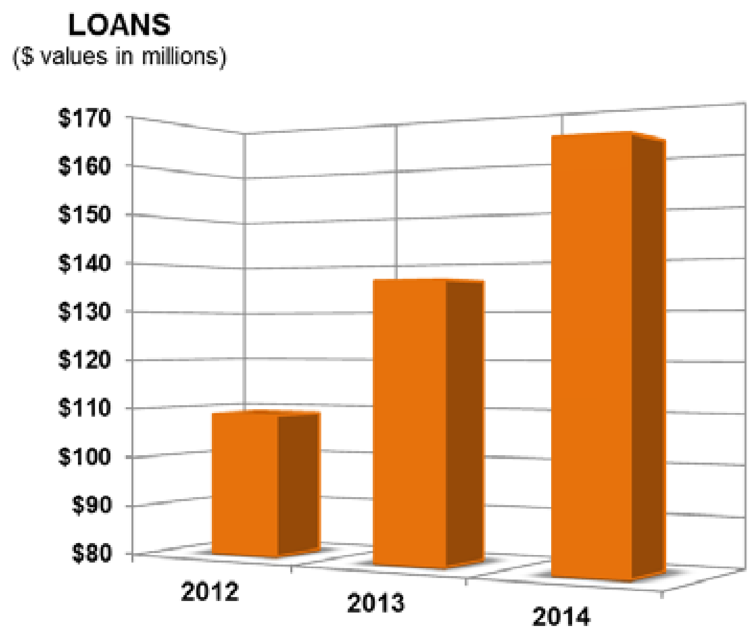
The business of banking is one of relationships. Deposit growth is the main catalyst for our growth in assets. Obtaining low cost local core deposits one relationship at a time is what we do every day. Deposits provide the foundation and raw materials we then deploy as loans and other "earning asset" investments to generate the bulk of our revenue.



Over the past two years we have grown deposits by more than $42 million. In 2014 growth was $31 million or 15.9%. Our zero interest deposit funding has provided the majority of this growth. Now with 40% of our deposits held in zero interest accounts, our overall cost of funds is an astonishing low .18%, ranking the bank above 93% of its FDIC peers.

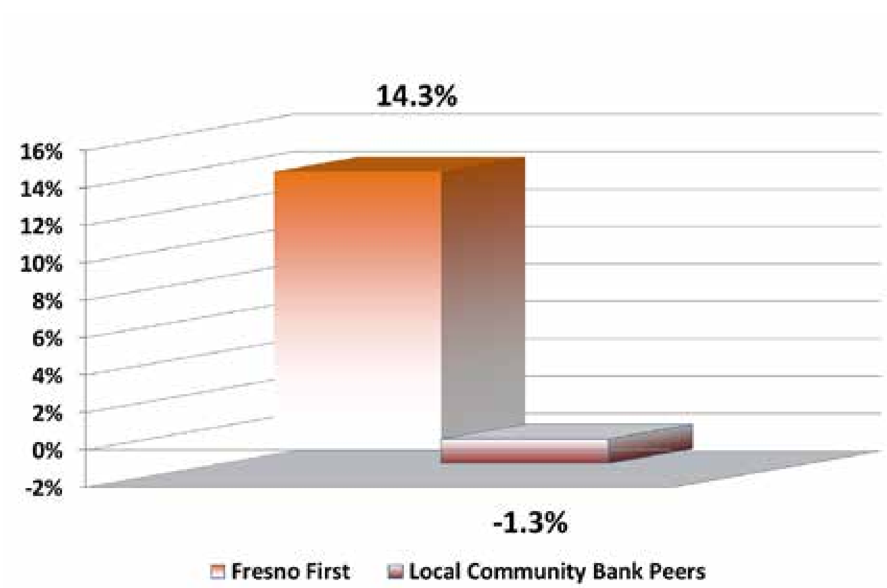


The graph at left reflects our compound annual growth rate ("CAGR") over the past five years compared to 5 local community bank peers (based in Fresno County) and compared to all financial institutions competing in our market. Over this period, our growth results are more than double our nearest competitors CAGR and are more than quadruple the average growth in our market.



We are the only local bank to increase our total loans outstanding each of the last 9 years. The growth continued in 2014 with loans outstanding up another $26 million or 19.5%. Our portfolio is well diversified and our credit quality ratios rank Fresno First Bank above peer banks. We pride ourselves on taking a consultative approach with our borrowing customers, tailoring lending solutions to meet client credit needs, which will allow their business to flourish.

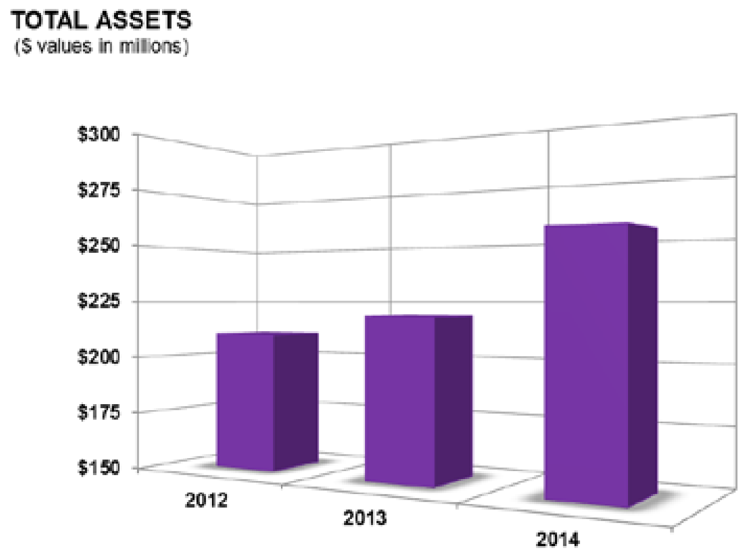
Over the past 5 years our local peers have had slightly negative growth on average (a decline in outstanding loan balances) in their loan portfolios. In comparison our CAGR of 14.3% stands out in our region. While we have growth in all areas of our loan portfolio, in the past two years our SBA department has received the distinction of being named the most active Small Business Administration ("SBA") Community Bank Lender in the Central California Region.



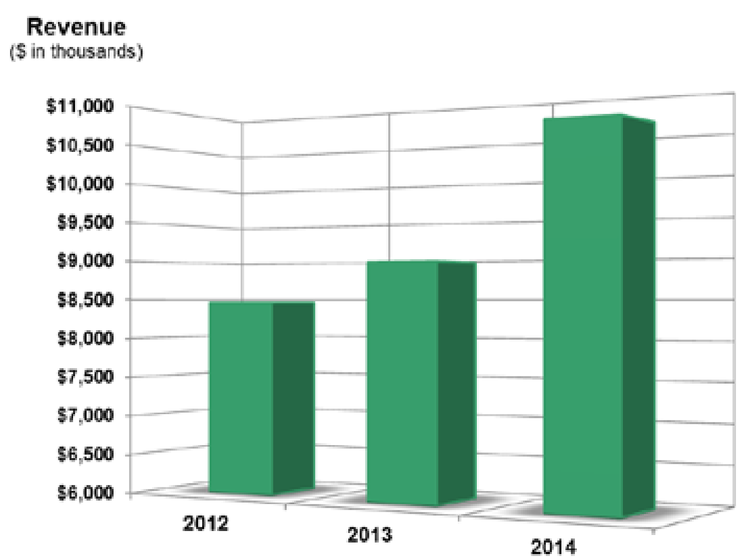
Our mix of total assets consists primarily of our loans, net of allowance for credit losses (63%), investment securities (28%), cash and short term equivalents for liquidity purposes (7%), and facilities, equipment and other of approximately (2%).

COMMUNITIES
FIRST FINANCIAL
CORPORATION

As mentioned above, asset growth is fueled by our ability to grow our deposit base and increase capital through retained earnings. By year end 2014 total assets had reached $253.7 million.

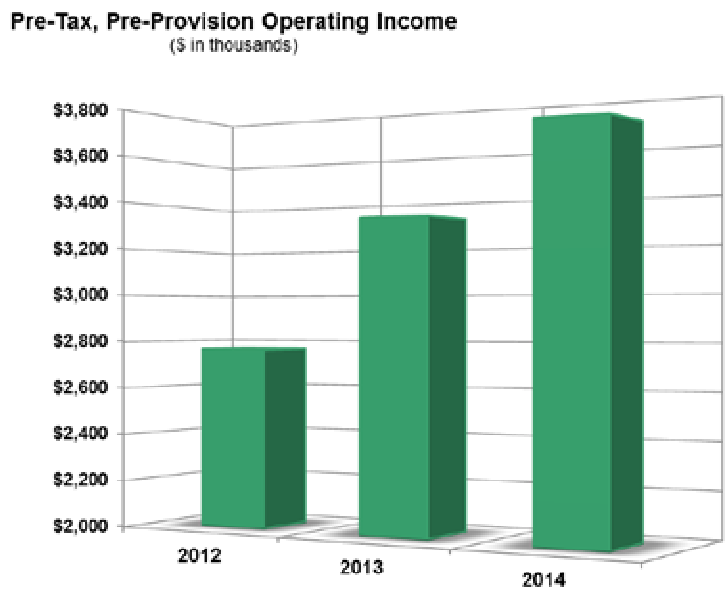


Revenue is comprised primarily of net interest income (interest income less interest expense) and non-interest income (revenue from fees, charges, services provided and gains from the sale of various financial assets). Our net interest income has grown as a result of adding new loans and investments while driving our funding costs down. For the year ended December 31, 2014, our overall cost of funds was far below peer at a mere .18%, while our earning assets yielded 4.36% , producing a net interest margin ("NIM") of 4.18%.

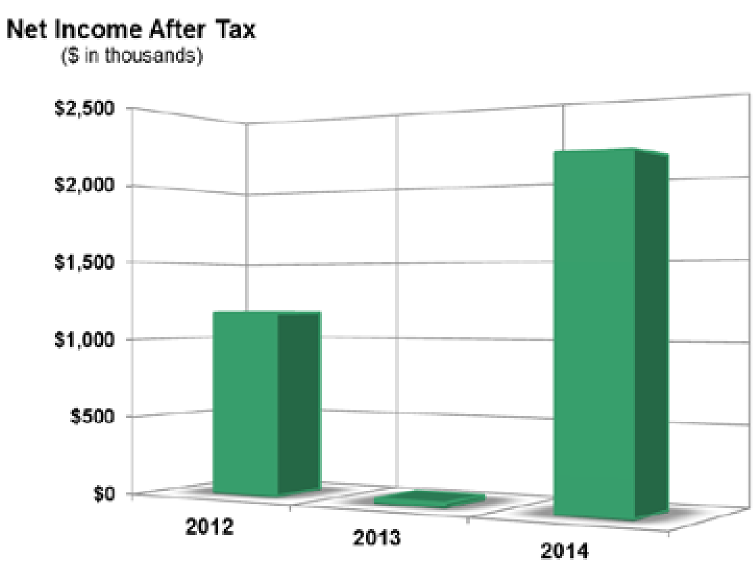


In addition to our superior net interest margin, we have focused on diversifying the Bank's non-interest income through new initiatives. Over the last five years we have started a government guaranteed lending department, a mortgage department and a merchant services department within the Bank. Although we chose to exit the mortgage business in early 2014, all three initiatives were/are profitable and added to the Bank's bottom line. In the years to come, our goal is to continue to expand these business lines while implementing new and innovative services to enhance the overall profitability of the Company.

Probably the best apple-to-apples measure in comparing one bank's core operations to another is looking at operating income before the provision for loan loss and taxes. As reflected in the chart, our pre-tax, pre-provision operating income has increased more than 33% over the past two years.



Net income after tax is the bottom line. After a tough year in 2013, we were very pleased to bounce back with a record year in 2014. With net income of $2.1 million, the Company produced a return on average assets of .88% and a return on average shareholders' equity of 9.2%.



Report of Independent Auditors and
Consolidated Financial Statements

Communities First Financial Corporation and Subsidiary

December 31, 2014 and 2013

MOSS-ADAMS LLP

Certified Public Accountants | Business Consultants

Acumen. Agility. Answers.

CONTENTS

MOSS ADAMS LLP
Certified Public Accountants | Business Consultants

REPORT OF INDEPENDENT AUDITORS

To the Board of Directors and Shareholders
Communities First Financial Corporation and Subsidiary

Report on the Financial Statements

We have audited the accompanying consolidated financial statements of Communities First Financial Corporation and Subsidiary, which comprise the consolidated balance sheets as of December 31, 2014 and 2013, and the related consolidated statements of operations, comprehensive income, changes in shareholders' equity, and cash flows for the years then ended, and the related notes to the consolidated financial statements.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

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

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

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

Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Communities First Financial Corporation and Subsidiary as of December 31, 2014 and 2013, and the results of their operations and their cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Change in Reporting Entity

As discussed in Note 1 to the consolidated financial statements, effective November 7, 2014, a bank holding company reorganization was completed whereby Communities First Financial Corporation became the parent holding company of Fresno First Bank (the Bank). Our opinion is not modified with respect to that matter.

Moss Adams LLP

Stockton, California
March 20, 2015

ASSETS

	DECEMBER 31, 2014	DECEMBER 31, 2013
Cash and due from banks	$ 6,800,028	$ 6,805,854
Federal funds sold	6,525,000	239,000
Interest-bearing deposits in banks	5,250,000	2,750,000
Total cash and cash equivalents	18,575,028	9,794,854
Certificates of deposit	5,200,457	1,494,000
Securities available-for-sale	65,753,890	66,338,524
Loans held for sale	-	1,059,887
Loans, net	159,380,441	132,491,048
Correspondent bank stock, at cost	1,595,610	1,127,720
Premises and equipment	327,453	515,784
Other real estate owned	-	2,023,493
Interest receivable and other assets	2,492,251	4,087,926
	$ 253,325,130	$ 218,933,236

LIABILITIES AND SHAREHOLDERS' EQUITY

	2014	2013
Deposits	$ 227,844,086	$ 197,026,864
Interest payable and other liabilities	754,412	446,429
Total liabilities	228,598,498	197,473,293
Commitments and contingencies (Notes 4 and 11)		
Shareholders' equity:		
Preferred stock – 5,000,000 shares authorized, $100 par value Series C shares, 60,593 and 61,000 issued and outstanding in 2014 and 2013, respectively	5,676,907	5,715,038
Common stock – 5,000,000 shares authorized, no par value; 1,967,502 and 1,963,015 shares issued and outstanding in 2014 and 2013, respectively	19,521,640	19,483,509
Additional paid-in capital	1,660,404	1,629,111
Accumulated deficit	(2,536,308)	(4,350,739)
Accumulated other comprehensive income (loss), net	403,989	(1,016,976)
Total shareholders' equity	24,726,632	21,459,943
Total liabilities and shareholders' equity	$ 253,325,130	$ 218,933,236

	YEARS ENDED DECEMBER 31, 2014	YEARS ENDED DECEMBER 31, 2013
INTEREST INCOME		
Interest and fees on loans	$ 8,367,242	$ 7,017,926
Interest on investment securities	1,482,304	1,398,932
Interest on federal funds sold and other	120,609	77,487
Total interest income	9,970,155	8,494,345
INTEREST EXPENSE		
Interest on savings deposits, NOW, and money market accounts	183,083	187,355
Interest on time deposits	239,240	279,799
Interest on other borrowings	317	26
Total interest expense	422,640	467,180
Net interest income	9,547,515	8,027,165
PROVISION FOR LOAN LOSSES	380,000	3,275,000
Net interest income after provision for loan losses	9,167,515	4,752,165
NON-INTEREST INCOME		
Service charges on deposits	607,843	469,675
Mortgage fee income	64,975	238,112
(Loss) gain on sale of investment securities	(105,380)	16,799
Gain on sale of loans held-for-sale	320,839	317,804
Gain on sale of other real estate owned	7,407	-
Other operating income	176,846	98,129
Total non-interest income	1,072,530	1,140,519
NON-INTEREST EXPENSES		
Salaries and employee benefits	3,981,870	3,117,771
Occupancy and equipment expenses	643,803	561,476
Regulatory assessments	206,000	146,877
Data processing fees	453,232	403,622
Professional fees	359,960	260,672
Marketing and business promotion	290,298	253,647
Director fees and stock-based compensation	213,422	201,199
Write-down of other real estate owned	-	200,000
Other expenses	781,046	703,329
Total non-interest expenses	6,929,631	5,848,593
Income before income taxes	3,310,414	44,091
PROVISION FOR INCOME TAXES	1,192,000	18,000
Net income	$ 2,118,414	$ 26,091
PREFERRED STOCK DIVIDENDS	$ 303,983	$ 305,000
Net income (loss) available to common shareholders	$ 1,814,431	$ (278,909)
NET INCOME (LOSS) PER SHARE – BASIC	$ 0.92	$ (0.15)
NET INCOME (LOSS) PER SHARE – DILUTED	$ 0.79	$ (0.15)

See accompanying notes

	YEARS ENDED DECEMBER 31,	
	2014	2013
Net income	$ 2,118,414	$ 26,091
Available-for-sale securities:		
Unrealized holding gains (losses) during the year	2,303,034	(2,782,095)
Reclassification adjustment for losses (gains) realized in net income	105,380	(16,799)
Net unrealized gains (losses)	2,408,414	(2,798,894)
Income tax (expense) benefit	(987,449)	1,147,559
Other comprehensive income (loss)	1,420,965	(1,651,335)
Total comprehensive income (loss)	$ 3,539,379	$ (1,625,244)

COMMUNITIES FIRST FINANCIAL CORPORATION
CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY

	Preferred Stock		Common Stock		Additional	Accumulated	Accumulated Other Comprehensive	
	Shares	Amount	Shares	Amount	Paid-in Capital	Deficit	Income (Loss)	Total
Balances, December 31, 2012	61,000	$ 5,715,038	1,857,893	$ 18,384,665	$ 1,626,381	$ (3,092,670)	$ 634,359	$ 23,267,773
Stock-based compensation	-	-	-	-	59,171	-	-	59,171
Exercise of stock options	-	-	12,058	121,672	(56,441)	-	-	65,231
Dividend paid on Series C preferred stocks	-	-	-	-	-	(305,000)	-	(305,000)
Five percent stock dividend	-	-	93,064	977,172	-	(977,172)	-	-
Cash paid in lieu of fractional shares	-	-	-	-	-	(1,988)	-	(1,988)
Net income	-	-	-	-	-	26,091	-	26,091
Other comprehensive loss	-	-	-	-	-	-	(1,651,335)	(1,651,335)
Balances, December 31, 2013	61,000	5,715,038	1,963,015	19,483,509	1,629,111	(4,350,739)	(1,016,976)	21,459,943
Stock-based compensation	-	-	-	-	31,293	-	-	31,293
Conversion of preferred stock	(407)	(38,131)	4,487	38,131	-	-	-	-
Dividend paid on Series C preferred stocks	-	-	-	-	-	(303,983)	-	(303,983)
Net income	-	-	-	-	-	2,118,414	-	2,118,414
Other comprehensive income	-	-	-	-	-	-	1,420,965	1,420,965
Balances, December 31, 2014	60,593	$ 5,676,907	1,967,502	$ 19,521,640	$ 1,660,404	$ (2,536,308)	$ 403,989	$ 24,726,632

See accompanying notes

	YEARS ENDED DECEMBER 31,	
	2014	2013
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income	$ 2,118,414	$ 26,091
Adjustments to reconcile net income to net cash from operating activities:		
Depreciation and amortization of premises and equipment	253,599	200,371
Amortization and accretion of premiums and discounts on securities available-for-sale, net	448,703	454,425
Provision for loan losses	380,000	3,275,000
Loss (gain) on sale of investment securities	105,380	(16,799)
Gain on sale of loans held-for-sale	(320,839)	(317,804)
Gain on sale of other real estate owned	(7,407)	-
Proceeds from sale of loans held-for-sale	6,587,725	12,594,198
Originations of loans held-for-sale	(5,206,999)	(13,336,281)
Stock-based compensation	31,293	59,171
Write-down of other real estate owned	-	200,000
Decrease (increase) in deferred taxes	362,000	(11,000)
Increase (decrease) in interest payable and other liabilities	307,983	(120,666)
Decrease (increase) in interest receivable and other assets	246,226	(275,433)
Net cash from operating activities	5,306,078	2,731,273
CASH FLOWS FROM INVESTING ACTIVITIES		
Purchase of certificates of deposit	(4,206,000)	(997,000)
Proceeds from maturities of certificates of deposit	499,543	250,000
Purchase of available-for-sale securities	(13,270,146)	(24,455,422)
Proceeds from maturities of available-for-sale securities	7,727,463	17,352,488
Proceeds from sale of available-for-sale securities	7,981,648	1,449,588
Net increase in loans	(27,269,393)	(29,301,547)
Purchase of correspondent bank stock	(467,890)	(186,120)
Proceeds from sale of other real estate owned	2,030,900	-
Purchases of premises and equipment	(65,268)	(244,349)
Net cash from investing activities	(27,039,143)	(36,132,362)

	YEARS ENDED DECEMBER 31,	
	2014	2013
CASH FLOWS FROM FINANCING ACTIVITIES		
Net increase in demand deposits and savings accounts	33,734,521	14,866,068
Net decrease in time deposits	(2,917,299)	(4,286,531)
Cash paid in lieu of fractional shares	-	(1,988)
Payment of dividends on Series C preferred stocks	(303,983)	(305,000)
Common stock issued	-	65,231
Net cash from financing activities	30,513,239	10,337,780
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	8,780,174	(23,063,309)
CASH AND CASH EQUIVALENTS, beginning of year	9,794,854	32,858,163
CASH AND CASH EQUIVALENTS, end of year	$ 18,575,028	$ 9,794,854
SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION:		
Interest paid	$ 425,035	$ 465,908
Taxes paid	$ 539,500	$ 210,000
NON-CASH FINANCING ACTIVITIES:		
Conversion of preferred stock	$ 38,131	$ -

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The accounting and reporting policies of Communities First Financial Corporation and Subsidiary (the Company) conform to accounting principles generally accepted in the United States of America and general practices within the banking industry. A summary of the significant accounting policies applied in the preparation of the accompanying consolidated financial statements is as follows:

Nature of operations – On November 7, 2014 (the Effective Date), a bank holding company reorganization was completed whereby Communities First Financial Corporation became the parent holding company of Fresno First Bank (the Bank). On the Effective Date, each of the Bank's outstanding shares of common stock converted into an equal number of shares of common stock of Communities First Financial Corporation, and the Bank became its wholly-owned subsidiary. The Company's administrative headquarters is based in Fresno, California.

The Bank is incorporated in the state of California and organized as a single operating segment that operates one full-service office in Fresno, California. The Bank's primary source of revenue is providing loans to customers, who are predominately small and middle-market businesses and individuals.

Consolidation – The 2014 consolidated financial statements include the accounts of Communities First Financial Corporation and its wholly owned subsidiary, Fresno First Bank. Intercompany accounts and transactions have been eliminated in consolidation. The 2013 financial statements included only the accounts of the Bank.

Estimates – In preparing consolidated financial statements in conformity with generally accepted accounting principles, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities, and the disclosure of contingent assets and liabilities at the date of the consolidated financial statements, and revenues and expenses during the reported year. Actual results could differ from those estimates.

The allowance for loan losses is the most significant accounting estimate reflected in the Company's consolidated financial statements. The allowance for loan losses includes charges to reduce the recorded balances of loans receivable to their estimated net realizable value, as appropriate. The allowance is based on estimates, and ultimate losses may vary from current estimates. These estimates for losses are based on individual assets and their related cash flow forecasts, sales values, independent appraisals, the volatility of certain real estate markets, and concern for disposing of real estate in distressed markets. Although management of the Company believes the estimates underlying the calculation of specific allowances are reasonable, there can be no assurances that the Company could ultimately realize these values. In addition to providing valuation allowances on specific assets where a decline in value has been estimated, the Company establishes general valuation allowances for losses based on the overall portfolio composition, general market conditions, concentrations, and prior loss experience of the Company and its peers.

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Estimates (continued) – Other significant management judgments and accounting estimates reflected in the Company's consolidated financial statements include:

- Decisions regarding the timing and placement of loans on non-accrual;
- Determination, recognition, and measurement of impaired loans;
- Recognition and measurement of asset servicing rights;
- Determination and evaluation of deferred tax assets and liabilities;
- Determination of the fair value of other real estate owned;
- Determination of the fair value of stock option awards; and
- Determination of the fair value of financial instruments.

Concentrations of credit risk – Assets and liabilities that subject the Company to concentrations of credit risk consist of cash balances at other banks, loans, and deposits. Most of the Company's customers are located within Fresno County and the surrounding areas. The Company's primary lending products are discussed in Note 3 to the consolidated financial statements. The Company did not have any significant concentrations in its business with any one customer or industry. The Company obtains what it believes to be sufficient collateral to secure potential losses on loans. The extent and value of collateral varies based on the details underlying each loan agreement.

As of December 31, 2014 and 2013, the Company has cash deposits at other financial institutions in excess of FDIC insured limits. However, as the Company places these deposits with major financial institutions and monitors the financial condition of these institutions, management believes the risk of loss to be minimal. Banking regulations require that banks maintain a percentage of their deposits as reserves in cash or on deposit with the Federal Reserve Bank. The Company complied with the reserve requirements as of December 31, 2014 and 2013.

Cash and cash equivalents – For purposes of reporting cash flows, cash equivalents include cash, due from banks, interest-bearing deposits in financial institutions with maturities of 90 days or less, and federal funds sold. Generally, federal funds are sold for one-day periods and interest-bearing deposits are for periods of 90 days or less.

Securities available-for-sale – Available-for-sale securities consist of U.S. Treasury securities, U.S. agency securities, obligations of states and political subdivisions, obligations of U.S. corporations, mortgage-backed securities, and other securities not classified as trading securities or held-to-maturity securities. These securities are carried at estimated fair value with unrealized holding gains and losses, net of tax, reported as a separate component of accumulated other comprehensive income, until realized. Gains and losses on the sale of available-for-sale securities are determined using the specific identification method. The amortization of premiums and accretion of discounts are recognized as adjustments to interest income using the interest method over the period to call or maturity.

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Securities available-for-sale (continued) – Investments with fair values that are less than amortized cost are considered impaired. Impairment may result from either a decline in the financial condition of the issuing entity or, in the case of fixed interest rate investments, from rising interest rates. At each financial statement date, management assesses each investment to determine if impaired investments are temporarily impaired or if the impairment is other than temporary. This assessment includes a determination of whether the Company intends to sell the security, or if it is more likely than not that the Company will be required to sell the security before recovery of its amortized cost basis less any current-period credit losses. For debt securities that are considered other than temporarily impaired and that the Company does not intend to sell and will not be required to sell prior to recovery of the amortized cost basis, the amount of impairment is separated into the amount that is credit related (credit loss component) and the amount due to all other factors.

The credit loss component is recognized in earnings and is calculated as the difference between the security's amortized cost basis and the present value of its expected future cash flows. The remaining difference between the security's fair value and the present value of the future expected cash flows is deemed to be due to factors that are not credit related and is recognized in other comprehensive income.

Loans – Loans are reported at the principal amount outstanding, net of deferred loan fees and costs and the allowance for loan losses. Unearned discounts on installment loans are recognized as income over the terms of the loans. Interest on other loans is calculated by using the simple interest method on the daily balance of the principal amount outstanding.

Loan fees, net of certain direct costs of origination, are deferred and amortized over the contractual term of the loan as an adjustment to the interest yield. During the years ended December 31, 2014 and 2013, salaries and employee benefits expense totaling $99,356 and $92,033, respectively, were deferred as loan origination costs.

Loans on which the accrual of interest has been discontinued are designated as non-accrual loans. Accrual of interest on loans is discontinued either when reasonable doubt exists as to the full and timely collection of interest or principal or when a loan becomes contractually past due by 90 days or more with respect to interest or principal. When a loan is placed on non-accrual status, all interest previously accrued, but not collected, is reversed against current period interest income. Income on such loans is then recognized only to the extent that cash is received and where the future collection of principal is probable. Interest accruals are resumed on such loans only when they are brought fully current with respect to interest and principal and when, in the judgment of management, the loans are estimated to be fully collectible as to both principal and interest.

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Allowance for loan losses – The allowance for loan losses is established through a provision for loan losses charged to operations. Loan losses are charged against the allowance for loan losses when management believes that the collectability of the principal is unlikely. Subsequent recoveries of previously charged off amounts, if any, are credited to the allowance.

Management employs a systematic methodology for determining the allowance for loan losses. On a regular basis, management reviews the credit quality of the loan portfolio and considers problem and delinquent loans, existing general economic conditions affecting the key lending areas of the Company, credit quality trends, collateral values, loan volumes and concentrations, seasoning of the loan portfolio, specific industry conditions, recent loss experience, duration of the current business cycle, bank regulatory examination results, and findings of the Company's internal credit examiners. The allowance for loan losses at December 31, 2014 and 2013 reflects management's estimate of probable losses in the portfolio. This evaluation is inherently subjective as it requires estimates that are susceptible to significant revision as more information becomes available.

The allowance consists of specific, general, and unallocated components. The specific component relates to loans that are classified as impaired. Impaired loans, as defined, are measured based on the present value of expected future cash flows discounted at the loan's effective interest rate or the fair value of the collateral if the loan is collateral dependent. The general component relates to non-impaired loans and is based on historical loss experience and loss history experienced by the Company's peers when the Company did not have losses in a particular loan class, adjusted for qualitative factors impacting the loan portfolio. An unallocated component is maintained to cover uncertainties that could affect management's estimate of probable losses. The unallocated component of the allowance reflects the margin of imprecision inherent in the underlying assumptions used in the methodologies for estimating specific and general losses in the portfolio.

The Company considers a loan impaired when it is probable that all amounts of principal and interest due will not be collected according to the contractual terms of the loan agreement. Factors considered by management in determining impairment include payment status, borrower's ability to repay, credit worthiness, collateral value, and the probability of collecting scheduled principal and interest payments when due. Loans that experience insignificant payment delays and payment shortfalls generally are not classified as impaired. Management determines the significance of payment delays and payment shortfalls on a case-by-case basis, taking into consideration all of the circumstances surrounding the loan and the borrower, including the length of the delay, the reasons for the delay, the borrower's prior payment record, current credit worthiness, and the amount of the shortfall in relation to the principal and interest owed.

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Troubled debt restructuring – In situations where, for economic or legal reasons related to a borrower's financial difficulties, the Company grants a concession to the borrower that it would not otherwise consider, the related loan is classified as a troubled debt restructuring. The Company measures any loss on the troubled debt restructuring in accordance with the guidance concerning impaired loans set forth above. Additionally, loans modified in troubled debt restructurings are generally placed on non-accrual status at the time of restructuring. These loans are returned to accrual status after the borrower demonstrates performance with the modified terms for a sustained period of time (generally six months) and has the capacity to continue to perform in accordance with the modified terms of the restructured debt.

Correspondent bank stock – The Company is a member of the Federal Home Loan Bank (FHLB) system. Members are required to own a certain amount of stock based on the level of borrowings and other factors, and may invest in additional amounts. The Bank held stock in the FHLB totaling $977,000 and $912,100 at December 31, 2014 and 2013, respectively. FHLB stock is carried at cost, classified as a restricted security, and periodically evaluated for impairment based on the ultimate recovery of par value. Both cash and stock dividends are reported as income. FHLB stock was not considered impaired as of December 31, 2014 and 2013. The remaining balance in the correspondent bank stock account on the consolidated balance sheet includes The Independent Bankers Bank (TIB) stock of $218,610 and $215,620 and Pacific Coast Bankers' Bank (PCBB) stock of $400,000 and $0 at December 31, 2014 and 2013, respectively. TIB and PCBB stock are carried at cost and were not considered impaired as of December 31, 2014 and 2013.

Premises and equipment – Premises and equipment are carried at cost less accumulated depreciation and amortization. Depreciation is computed using the straight-line method over the estimated useful lives, which range from three to seven years for computer equipment, equipment, furniture, and fixtures. Leasehold improvements are amortized using the straight-line method over the estimated useful lives of the improvements or the remaining lease term, whichever is shorter. Expenditures for betterments or major repairs are capitalized and those for ordinary repairs and maintenance are charged to operations as incurred.

Advertising costs – The Company expenses the costs of advertising in the year incurred. Advertising expense was $192,118 and $162,323 for the years ended December 31, 2014 and 2013, respectively.

Other real estate owned – Real estate acquired by foreclosure or deed in lieu of foreclosure is recorded at fair value at the date of foreclosure, establishing a new cost basis by a charge to the allowance for loan losses, if necessary. Fair value is based on current appraisals less estimated selling costs. Any subsequent write-downs are charged against operating expenses and recognized as a valuation allowance. Operating expenses of such properties, net of related income, and gains and losses on their disposition are included in other operating expenses.

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Loans held for sale – Loans held for sale include mortgage loans and are reported at the lower of cost or market value. Cost generally approximates market value, given the short duration of these assets. Gains or losses on the sale of loans that are held for sale are recognized at the time of the sale, subject to the expiration of any warranty or recourse provisions, and determined by the difference between net sale proceeds and the net book value of the loans, plus the estimated fair value of any retained mortgage servicing rights, less the estimated discount associated with the unguaranteed portion of the sold loan that is retained.

Income taxes – The Company uses the asset and liability method to account for income taxes. Under such method, deferred tax assets and liabilities are recognized for the future tax consequences of differences between the consolidated financial statement carrying amounts of existing assets and liabilities and their respective tax basis (temporary differences). Deferred tax assets and liabilities are reflected at currently enacted income tax rates applicable to the period in which the deferred tax assets or liabilities are expected to be realized or settled. As changes in tax laws or rates are enacted, deferred tax assets and liabilities are adjusted through the provision for income taxes in the period of enactment.

A valuation allowance against net deferred tax assets is established to the extent that it is more likely than not that the benefits associated with the deferred tax assets will not be fully realized.

In accordance with accounting standards, the Company has assessed its tax positions and has concluded there are no unrecognized tax benefits at December 31, 2014 and 2013.

The Company recognizes interest accrued and penalties related to unrecognized tax benefits in tax expense. During the years ended December 31, 2014 and 2013, the Company recognized no interest and penalties.

The Company files a consolidated tax return in the U.S. federal jurisdiction and with the state of California and has a tax sharing agreement with the Bank. The Company is subject to U.S. federal and state income tax examinations by tax authorities for years beginning 2010.

Comprehensive income – Changes in unrealized gains and losses on available-for-sale securities are the only component of accumulated other comprehensive income for the Company.

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

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

See Note 14 for more information and disclosures relating to the Company's fair value measurements.

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Financial instruments – In the ordinary course of business, the Company has entered into off-balance sheet financial instruments consisting of commitments to extend credit, commercial letters of credit, and standby letters of credit as described in Note 11. Such financial instruments are recorded in the consolidated financial statements when they are funded or related fees are incurred or received.

Earnings (loss) per share (EPS) – Basic EPS excludes dilution and is computed by dividing income available to common stockholders by the weighted-average number of common shares outstanding for the period. Diluted EPS reflects the potential dilution that could occur if securities or other contracts to issue common stock, such as stock options, were exercised or converted into common stock or resulted in the issuance of common stock that then shared in the earnings of the entity. The treasury stock method is applied to determine the dilutive effect of stock options when computing diluted earnings per share.

Stock-based compensation – The Company recognizes the cost of employee services received in exchange for awards of stock options, or other equity instruments, based on the grant-date fair value of those awards. This cost is recognized over the period that an employee is required to provide services in exchange for the award, generally the vesting period. See Note 12 for additional information on the Company's stock option plan.

Transfers 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 to be surrendered when: (1) the assets have been isolated from the Company, (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 Company does not maintain effective control over the transferred assets through an agreement to repurchase them before their maturity.

Servicing rights – The Company sells or transfers loans, including the guaranteed portion of various government agencies' loans (with servicing retained) for cash proceeds equal to the principal amount of loans, as adjusted to yield interest to the investor based upon the current market rates. The Company records an asset representing the right to service a loan for others when it sells a loan and retains the servicing rights. The carrying value of the loan is allocated between the loan and the servicing rights, based on their relative fair values. The fair value of servicing rights is estimated by discounting estimated future cash flows from servicing using discount rates that approximate current market rates and estimated prepayment rates.

The servicing rights are initially measured at fair value and amortized in proportion to and over the period of the estimated net servicing income assuming prepayments. Additionally, management assesses the servicing rights for impairment as of each financial reporting date. For purposes of evaluating and measuring impairment, servicing rights are based on a discounted cash flow methodology, current prepayment speeds, and market discount rates. Any impairment is measured as the amount by which the carrying value of servicing rights for a stratum exceeds its fair value. The carrying value of servicing rights at December 31, 2014 and 2013 were $95,472 and $37,863, respectively. No impairment charges were recorded for the years ended December 31, 2014 or 2013 related to servicing assets.

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Reclassifications – Certain reclassifications have been made to the 2013 consolidated financial statements to conform to the classifications used in 2014.

Adoption of new accounting standards – In January 2014, the FASB issued Accounting Standards Update (ASU) 2014-04 - *Receivables—Troubled Debt Restructurings by Creditors (Subtopic 310-40) - Reclassification of Residential Real Estate Collateralized Consumer Mortgage Loans upon Foreclosure.* This update clarifies when an in-substance repossession or foreclosure occurs, that is, when a creditor should be considered to have received physical possession of residential real estate property collateralizing a consumer mortgage loan such that the loan receivable should be derecognized and the real estate property recognized. The objective of the amendments in this update is to reduce diversity in practice. An in-substance repossession or foreclosure occurs, and a creditor is considered to have received physical possession of residential real estate property collateralizing a consumer mortgage loan, upon either (1) the creditor obtaining legal title to the residential real estate property upon completion of foreclosure or (2) the borrower conveying all interest in the residential real estate property to the creditor to satisfy the loan through completion of a deed in lieu of foreclosure or through a similar legal agreement. The amendments in this update are effective for public business entities for annual periods, and interim periods within those annual periods, beginning after December 15, 2014. Early adoption is permitted. The Company does not anticipate that the adoption of this ASU will have a material impact on the Company's financial position, results of operation, cash flows, or disclosure.

In May 2014, the FASB issued ASU No. 2014-09, *Revenue from Contracts with Customers: Topic 606*. This update affects any entity using U.S. GAAP that either enters into contracts with customers to transfer goods or services or enters into contracts for the transfer of nonfinancial assets unless those contracts are within the scope of other standards (e.g., insurance contracts or lease contracts). This ASU will supersede the revenue recognition requirements in Topic 605, *Revenue Recognition*, and most industry-specific guidance. This ASU also supersedes some cost guidance included in Subtopic 605-35, *Revenue Recognition—Construction-Type and Production-Type Contracts*. In addition, the existing requirements for the recognition of a gain or loss on the transfer of nonfinancial assets that are not in a contract with a customer (e.g., assets within the scope of Topic 360, Property, Plant, and Equipment, and intangible assets within the scope of Topic 350, *Intangibles—Goodwill and Other*) are amended to be consistent with the guidance on recognition and measurement (including the constraint on revenue) in this ASU. The core principle of the guidance is that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. For a public entity, the amendments in this ASU are effective for annual reporting periods beginning after December 15, 2016, including interim periods within that reporting period. Early application is not permitted. The Company does not anticipate that the adoption of this ASU will have a material impact on the Company's financial position, results of operation, cash flows, or disclosure.

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Adoption of new accounting standards (continued) – In August 2014, the FASB issued ASU No. 2014-14, *Receivables -Troubled Debt Restructuring by Creditors*. Under certain government-sponsored loan guarantee programs, such as those offered by the Federal Housing Administration (FHA) and the Department of Veterans Affairs (VA), qualifying creditors can extend mortgage loans to borrowers with a guarantee that entitles the creditor to recover all or a portion of the unpaid principal balance from the government if the borrower defaults. The objective of this update is to reduce diversity in practice by addressing the classification of foreclosed mortgage loans that are fully or partially guaranteed under government programs. Currently, some creditors reclassify those loans to real estate as with other foreclosed loans that do not have guarantees; others reclassify the loans to other receivables. The amendments affect creditors that hold government-guaranteed mortgage loans, including those guaranteed by the FHA and the VA. This ASU is effective for annual periods and interim periods within those annual periods beginning after December 15, 2014 with early adoption permitted. The Company does not anticipate that the adoption of this ASU will have a material impact on the Company's financial position, results of operation, cash flows, or disclosure.

NOTE 2 – INVESTMENT SECURITIES

The amortized cost and estimated fair values of securities available-for-sale are as follows:

	2014			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Available-for-sale:				
U.S. government and agency securities	$ 28,033,151	$ 458,999	$ (55,895)	$ 28,436,255
Mortgage-backed securities	22,736,848	176,953	(119,008)	22,794,793
State and municipal agencies	14,299,165	253,746	(30,069)	14,522,842
	$ 65,069,164	$ 889,698	$ (204,972)	$ 65,753,890

	2013			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Available-for-sale:				
U.S. government and agency securities	$ 32,327,985	$ 477,873	$ (1,114,197)	$ 31,691,661
Mortgage-backed securities	16,483,121	94,569	(401,740)	16,175,950
State and municipal agencies	15,225,605	13,463	(885,890)	14,353,178
Corporate debt securities	4,025,501	92,234	-	4,117,735
	$ 68,062,212	$ 678,139	$ (2,401,827)	$ 66,338,524

The amortized cost and estimated fair value of all investment securities as of December 31, 2014 by expected maturities are shown below. Expected maturities may differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

	Amortized Cost	Estimated Fair Value
Due in one year or less	$ 557,268	$ 564,639
Due after one year to five years	8,504,194	8,566,053
Due from five years to ten years	18,588,036	18,662,986
Due after ten years	37,419,666	37,960,212
	$ 65,069,164	$ 65,753,890

NOTE 2 – INVESTMENT SECURITIES (CONTINUED)

The gross unrealized loss and related estimated fair value of investment securities that have been in a continuous loss position for less than twelve months and over twelve months are as follows:

	2014					
	Less than 12 months		12 months or more		Total	
	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
U.S. government and agency securities	$ 2,868,285	$ (3,098)	$ 6,205,346	$ (52,797)	$ 9,073,631	$ (55,895)
Mortgage-backed securities	5,504,306	(21,221)	6,481,077	(97,787)	11,985,383	(119,008)
State and municipal agencies	860,678	(2,044)	2,734,463	(28,025)	3,595,141	(30,069)
	$ 9,233,269	$ (26,363)	$ 15,420,886	$ (178,609)	$ 24,654,155	$ (204,972)

	2013					
	Less than 12 months		12 months or more		Total	
	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
U.S. government and agency securities	$ 17,865,678	$ (1,102,158)	$ 1,757,076	$ (12,039)	$ 19,622,754	$ (1,114,197)
Mortgage-backed securities	10,205,515	(264,012)	2,229,838	(137,728)	12,435,353	(401,740)
State and municipal agencies	9,828,975	(647,619)	3,431,212	(238,271)	13,260,187	(885,890)
	$ 37,900,168	$ (2,013,789)	$ 7,418,126	$ (388,038)	$ 45,318,294	$ (2,401,827)

Certain investment securities shown in the previous table currently have fair values less than amortized cost and therefore contain unrealized losses. The Bank considers a number of factors including, but not limited to: (a) the length of time and the extent to which the fair value has been less than the amortized cost, (b) the financial condition and near-term prospects of the issuer, (c) the intent and ability of the Bank to retain its investment for a period of time sufficient to allow for an anticipated recovery in value, (d) whether the debtor is current on interest and principal payments, and (e) general market conditions and the industry-or sector-specific outlook. Management has evaluated all securities at December 31, 2014 and 2013 and has determined that no securities are other than temporarily impaired.

NOTE 2 – INVESTMENT SECURITIES (CONTINUED)

The Bank does not have the intent to sell the investments that are impaired, and it is more likely than not that the Bank will not be required to sell those investments before recovery of the amortized cost basis. The Bank has evaluated these securities and has determined that the decline in value is temporary and is related to the change in market interest rates since purchase. The decline in value is not related to any issuer or industry-specific event. These temporary unrealized losses relate principally to current interest rates for similar types of securities. In analyzing an issuer's financial condition, management considers whether the securities are issued by the federal government or its agencies, whether downgrades by bond rating agencies have occurred, and the results of reviews of the issuer's financial condition. At December 31, 2014, there were 37 investment securities with unrealized losses. The Bank anticipates full recovery of amortized cost with respect to these securities at maturity or sooner in the event of a more favorable market interest rate environment.

Proceeds from the sales of investment securities totaled $7,981,648 and $1,449,588 during the years ended December 31, 2014 and 2013, respectively. Gross realized gains totaled $103,562 and $25,052 during 2014 and 2013, respectively. Gross realized losses totaled $208,942 and $8,253 during 2014 and 2013, respectively.

Investment securities carried at approximately $2,516,000 and $5,588,000 at December 31, 2014 and 2013, respectively, were pledged to secure public deposits or other purposes as permitted or required by law.

NOTE 3 – LOANS

Major classifications of loans are as follows:

	DECEMBER 31, 2014	DECEMBER 31, 2013
Commercial and industrial	$ 60,931,287	$ 47,763,877
Commercial real estate	56,378,310	43,579,467
Land and construction	7,717,903	7,390,927
Residential real estate	14,628,999	16,735,830
Agriculture	22,704,848	19,202,344
Consumer	44,796	209,808
	162,406,143	134,882,253
Allowance for loan losses	(3,042,862)	(2,523,337)
Deferred loan fees and costs, net	17,160	132,132
	$ 159,380,441	$ 132,491,048

NOTE 3 – LOANS (CONTINUED)

The Bank's loan portfolio consists primarily of loans to borrowers within Fresno County, California. Although the Bank seeks to avoid concentrations of loans to a single industry or based upon a single class of collateral, real estate and real estate associated businesses are among the principal industries in the Bank's market area.

All of the Bank's loans are underwritten by evaluating the borrower's character, cash flow, collateral, and credit worthiness and, for commercial and business loans, managerial and operational experience. Underwriting standards are designed to promote relationship banking rather than transactional banking.

Commercial and industrial loans are primarily made to commercial and business entities for working capital, equipment purchases, growth and expansion, and any other permissible purposes. The Bank's management examines current and projected cash flows to determine the ability of the borrower to repay its obligations as agreed. Commercial loans are primarily made based on the identified cash flows of the borrower and secondarily on the underlying collateral provided by the borrower. The cash flows of borrowers, however, may not be as expected and the collateral securing these loans may fluctuate in value. Most commercial loans are secured by the assets being financed or other business assets such as equipment, accounts receivable, or inventory and may incorporate personal guarantees or personal assets as collateral; however, some loans may be made on an unsecured basis.

Commercial real estate loans are primarily made to owner-users of the property or investors with current tenants in the property. Commercial real estate loans are subject to underwriting standards and processes similar to commercial loans. These loans are viewed primarily as cash flow loans and secondarily as loans secured by real estate. Commercial real estate lending typically involves higher loan principal amounts and the repayment of these loans is generally largely dependent on the successful operation of the property securing the loan or the business conducted on the property securing the loan. Commercial real estate loans may be more adversely affected by conditions in the real estate markets or in the general economy. The properties securing the Bank's commercial real estate portfolio are diverse in terms of type and industries operating within the properties. This diversity helps reduce the Bank's exposure to adverse economic events that affect any single market or industry. Management monitors and evaluates commercial real estate loans based on collateral type, geography, industry, and risk grade criteria.

Land and construction loans are primarily made to borrowers who are using the property for their own purposes. The Bank does not make speculative land loans where repayment will be from the eventual sale of the property to unknown parties. Land loans are made with amortizing repayment terms to borrowers with proven, historic cash flow sufficient to repay the loan. Collateral values are based on the current "as is" market value of the property. Construction loans are made based on the borrower's historic and projected cash flow. The Bank does not engage in speculative construction loans where repayment will come from the sale or lease of the property to unknown parties.

NOTE 3 – LOANS (CONTINUED)

Residential real estate loans are made to individuals for the purchase or refinance of residential 1-to-4 family properties or for other consumer purposes. Residential real estate loans are underwritten based upon income, credit history, and collateral. To monitor and manage residential loan risk, policies and procedures are developed and modified, as needed. Underwriting standards for home loans are heavily influenced by statutory requirements, which include, but are not limited to, a determination and verification of the borrower’s ability to repay the loan, maximum loan-to-value percentage, collection remedies, and documentation requirements.

Agricultural loans are primarily made to producers of agricultural products. Agricultural loans are subject to underwriting standards and processes similar to commercial loans. These loans are viewed primarily as cash flow loans and secondarily as loans secured by real estate and/or agricultural commodities. Agricultural real estate lending typically involves higher loan principal amounts and the repayment of these loans is generally largely dependent on the successful operation of the property securing the loan or the business conducted on the property securing the loan. Agricultural crop loans may be more adversely affected by conditions in the weather or in the general economy. The properties securing the Bank’s agricultural portfolio are diverse in terms of type of crop. This diversity helps reduce the Bank’s exposure to adverse economic events that affect any single commodity. Management monitors and evaluates agricultural real estate loans based on collateral, crop type, geography, and risk grade criteria.

Consumer loans are made to individuals for personal, household, and family expenditures and consist of term loans and lines of credit. The Bank does not offer credit card plans. Consumer loans are subject to underwriting standards and processes similar to residential real estate loans and are based primarily on income, credit history, and collateral; however, some consumer loans are unsecured. To monitor and manage consumer loan risk, policies and procedures are developed and modified, as needed. This activity coupled with relatively small loan amounts that are spread across many individual borrowers minimizes risk.

The Bank utilizes an independent third party loan review consultant to review and validate the credit risk program on a periodic basis. Results of these reviews are presented to management and the Bank’s Board of Directors. The loan review process complements and reinforces the risk identification and assessment decisions made by lenders and credit personnel, as well as the Bank’s policies and procedures.

NOTE 3 – LOANS (CONTINUED)

Information related to impaired loans as of December 31, 2014 and for the year ended consisted of the following:

	Commercial and Industrial	Commercial Real Estate	Land and Construction	Residential Real Estate	Agriculture	Consumer	Total
Recorded investment in impaired loans:							
With no specific allowance recorded	$ -	$ -	$ -	$ 49,054	$ -	$ -	$ 49,054
With a specific allowance recorded	-	820,653	-	-	-	-	820,653
Total recorded investment in impaired loans	$ -	$ 820,653	$ -	$ 49,054	$ -	$ -	$ 869,707
Unpaid principal balance of impaired loans:							
With no specific allowance recorded	$ -	$ -	$ -	$ 49,054	$ -	$ -	$ 49,054
With a specific allowance recorded	-	820,653	-	-	-	-	820,653
Total unpaid principal balance of impaired loans	$ -	$ 820,653	$ -	$ 49,054	$ -	$ -	$ 869,707
Specific allowance	$ -	$ 38,449	$ -	$ -	$ -	$ -	$ 38,449
Average recorded investment in impaired loans during the year	$ -	$ 829,861	$ -	$ 101,427	$ -	$ -	$ 931,288
Interest income recognized on impaired loans during the year	$ -	$ 19,027	$ -	$ 4,993	$ -	$ -	$ 24,020

Information related to impaired loans as of December 31, 2013 and for the year ended consisted of the following:

	Commercial and Industrial	Commercial Real Estate	Land and Construction	Residential Real Estate	Agriculture	Consumer	Total
Recorded investment in impaired loans:							
With no specific allowance recorded	$ -	$ -	$ -	$ 124,723	$ -	$ -	$ 124,723
With a specific allowance recorded	-	845,109	-	-	-	-	845,109
Total recorded investment in impaired loans	$ -	$ 845,109	$ -	$ 124,723	$ -	$ -	$ 969,832
Unpaid principal balance of impaired loans:							
With no specific allowance recorded	$ -	$ -	$ -	$ 124,723	$ -	$ -	$ 124,723
With a specific allowance recorded	-	845,109	-	-	-	-	845,109
Total unpaid principal balance of impaired loans	$ -	$ 845,109	$ -	$ 124,723	$ -	$ -	$ 969,832
Specific allowance	$ -	$ 25,658	$ -	$ -	$ -	$ -	$ 25,658
Average recorded investment in impaired loans during the year	$ 330,006	$ 958,722	$ -	$ 113,634	$ -	$ -	$ 1,402,362
Interest income recognized on impaired loans during the year	$ -	$ 23,322	$ -	$ 10,308	$ -	$ -	$ 33,630

NOTE 3 – LOANS (CONTINUED)

The Bank has established a loan risk rating system to measure and monitor the quality of the loan portfolio. All loans are assigned a risk rating from the inception of the loan until the loan is paid off. The primary loan grades are as follows:

Loans rated Pass – These are loans to borrowers with satisfactory financial support, repayment capacity, and credit strength. Borrowers in this category demonstrate fundamentally sound financial positions, repayment capacity, credit history, and management expertise. Loans in this category must have an identifiable and stable source of repayment and meet the Bank's policy regarding debt service coverage ratios. These borrowers are capable of sustaining normal economic, market, or operational setbacks without significant financial impacts. Financial ratios and trends are acceptable. Negative external industry factors are generally not present. The loan may be secured, unsecured, or supported by non-real estate collateral for which the value is more difficult to determine and/or marketability is more uncertain. These loans carry a normal degree of risk. The borrowers have the capacity to perform according to terms; any deviation from historic performance is limited and temporary.

Loans rated Special Mention – These are loans that have potential weaknesses that deserve management's close attention. If left uncorrected, these potential weaknesses may result in deterioration of the repayment prospects for the asset or in the Bank's credit position at some future date. Special Mention assets are not adversely classified and do not expose the Bank to sufficient risk to warrant adverse classification. These loans exhibit a more weakened condition than Pass loans, but not to the degree where they would be considered substandard. These loans show definite signs of deterioration or weakness, and the likelihood of correction is somewhat questionable. Weaknesses might include significant earnings decline, collection of accounts receivable is slowing, delayed accounts payable, greater dependency on line usage, and covenants not being met and/or waived for short periods.

Loans rated Substandard – These are loans that are inadequately protected by the current sound worth and paying capacity of the borrower or by the collateral pledged, if any. These loans have a well-defined weakness or weaknesses that jeopardize the liquidation of the loan. They are characterized by the distinct possibility that the Bank will sustain some loss if the deficiencies are not corrected.

Loans rated Doubtful – These are loans that have all the weaknesses inherent in a loan classified as Substandard with the added characteristic that the weaknesses make the collection or liquidation in full, on the basis of currently known facts, conditions and values, highly questionable, and improbable. These loans have a high probability of loss due to significant deterioration in financial condition of the borrower and collateral value pledged, if any. The borrower is unable to demonstrate the ability to strengthen their financial condition within a reasonable time; therefore, close supervision is required and the loan is placed on non-accrual. The risk of loss is measured by an impairment analysis; any loss exposure determined through this analysis is to be charged off.

NOTE 3 – LOANS (CONTINUED)

The following table summarizes the loan portfolio by credit quality and product and/or collateral type as of December 31, 2014:

	Pass	Special Mention	Substandard	Doubtful	Total
Grade:					
Commercial and industrial	$ 56,871,911	$ 825,529	$ 3,233,847	$ -	$ 60,931,287
Commercial real estate	52,601,572	-	3,776,738	-	56,378,310
Land and construction	7,717,903	-	-	-	7,717,903
Residential real estate	14,286,001	-	342,998	-	14,628,999
Agriculture	22,704,848	-	-	-	22,704,848
Consumer	44,796	-	-	-	44,796
Total	$ 154,227,031	$ 825,529	$ 7,353,583	$ -	$ 162,406,143

The following table summarizes the loan portfolio by credit quality and product and/or collateral type as of December 31, 2013:

	Pass	Special Mention	Substandard	Doubtful	Total
Grade:					
Commercial and industrial	$ 47,541,839	$ -	$ 222,038	$ -	$ 47,763,877
Commercial real estate	39,760,308	-	3,819,159	-	43,579,467
Land and construction	7,390,927	-	-	-	7,390,927
Residential real estate	16,392,527	-	343,303	-	16,735,830
Agriculture	19,202,344	-	-	-	19,202,344
Consumer	209,808	-	-	-	209,808
Total	$ 130,497,753	$ -	$ 4,384,500	$ -	$ 134,882,253

NOTE 3 – LOANS (CONTINUED)

The following table is an aging analysis of loans, segregated by class of loans, as of December 31, 2014:

	30-59 Days Past Due	60-89 Days Past Due	Greater Than 90 Days	Total Past Due	Current	Total Loans	Recorded Investment > 90 Days and Accruing
Commercial and industrial	$ -	$ -	$ -	$ -	$ 60,931,287	$ 60,931,287	$ -
Commercial real estate	-	3,269,247	-	3,269,247	53,109,063	56,378,310	-
Land and construction	-	-	-	-	7,717,903	7,717,903	-
Residential real estate	-	-	-	-	14,628,999	14,628,999	-
Agriculture	-	-	-	-	22,704,848	22,704,848	-
Consumer	-	-	-	-	44,796	44,796	-
Total	$ -	$ 3,269,247	$ -	$ 3,269,247	$ 159,136,896	$ 162,406,143	$ -

The following table is an aging analysis of loans, segregated by class of loans, as of December 31, 2013:

	30-59 Days Past Due	60-89 Days Past Due	Greater Than 90 Days	Total Past Due	Current	Total Loans	Recorded Investment > 90 Days and Accruing
Commercial and industrial	$ -	$ -	$ -	$ -	$ 47,763,877	$ 47,763,877	$ -
Commercial real estate	-	-	-	-	43,579,467	43,579,467	-
Land and construction	-	-	-	-	7,390,927	7,390,927	-
Residential real estate	126,174	-	48,750	174,924	16,560,906	16,735,830	-
Agriculture	-	-	-	-	19,202,344	19,202,344	-
Consumer	-	-	-	-	209,808	209,808	-
Total	$ 126,174	$ -	$ 48,750	$ 174,924	$ 134,707,329	$ 134,882,253	$ -

NOTE 3 – LOANS (CONTINUED)

During 2014 and 2013, there were no loans that were modified and considered troubled debt restructurings. The Bank has not committed to lend any additional amounts to customers with outstanding loans that are classified as troubled debt restructurings.

Year end non-accrual loans, segregated by class, are as follows:

	DECEMBER 31,	
	2014	2013
Commercial and industrial	$ -	$ -
Commercial real estate	-	-
Land and construction	-	-
Residential real estate	48,750	48,750
Agriculture	-	-
Consumer	-	-
	$ 48,750	$ 48,750

NOTE 3 – LOANS (CONTINUED)

The following table summarizes the Bank's allowance for loan losses for the year ended December 31, 2014 by loan product and collateral type:

	Commercial and Industrial	Commercial Real Estate	Land and Construction	Residential Real Estate	Agriculture	Consumer	Unallocated	Total
Allowance for loan losses:								
Beginning balance	$ 621,055	$ 1,010,534	$ 141,395	$ 218,796	$ 206,558	$ 519	$ 324,480	$ 2,523,337
Charge-offs	-	-	-	-	-	-	-	-
Recoveries	139,509	-	-	-	-	16	-	139,525
Provision	773,773	(226,177)	(47,665)	(85,556)	(37,688)	(291)	3,604	380,000
Ending balance	$ 1,534,337	$ 784,357	$ 93,730	$ 133,240	$ 168,870	$ 244	$ 328,084	$ 3,042,862
Period-end amount allocated to:								
Loans individually evaluated for impairment	$ -	$ 38,449	$ -	$ -	$ -	$ -	$ -	$ 38,449
Loans collectively evaluated for impairment	1,534,337	745,908	93,730	133,240	168,870	244	328,084	3,004,413
Ending balance	$ 1,534,337	$ 784,357	$ 93,730	$ 133,240	$ 168,870	$ 244	$ 328,084	$ 3,042,862
Loans:								
Individually evaluated for impairment	$ -	$ 820,653	$ -	$ 49,054	$ -	$ -		$ 869,707
Collectively evaluated for impairment	60,931,287	55,557,657	7,717,903	14,579,945	22,704,848	44,796		161,536,436
Ending balance	$ 60,931,287	$ 56,378,310	$ 7,717,903	$ 14,628,999	$ 22,704,848	$ 44,796		$ 162,406,143

NOTE 3 – LOANS (CONTINUED)

The following table summarizes the Bank's allowance for loan losses for the year ended December 31, 2013 by loan product and collateral type:

	Commercial and Industrial	Commercial Real Estate	Land and Construction	Residential Real Estate	Agriculture	Consumer	Unallocated	Total
Allowance for loan losses:								
Beginning balance	$ 1,425,653	$ 440,053	$ 84,861	$ 169,922	$ 58,587	$ 798	$ 318,265	$ 2,498,139
Charge-offs	(3,015,053)	-	-	(259,045)	-	(1,502)	-	(3,275,600)
Recoveries	25,698	-	-	-	-	100	-	25,798
Provision	2,184,757	570,481	56,534	307,919	147,971	1,123	6,215	3,275,000
Ending balance	$ 621,055	$ 1,010,534	$ 141,395	$ 218,796	$ 206,558	$ 519	$ 324,480	$ 2,523,337
Period-end amount allocated to:								
Loans individually evaluated for impairment	$ -	$ 25,658	$ -	$ -	$ -	$ -	$ -	$ 25,658
Loans collectively evaluated for impairment	621,055	984,876	141,395	218,796	206,558	519	324,480	2,497,679
Ending balance	$ 621,055	$ 1,010,534	$ 141,395	$ 218,796	$ 206,558	$ 519	$ 324,480	$ 2,523,337
Loans:								
Individually evaluated for impairment	$ -	$ 845,109	$ -	$ 124,723	$ -	$ -		$ 969,832
Collectively evaluated for impairment	47,763,877	42,734,358	7,390,927	16,611,107	19,202,344	209,808		133,912,421
Ending balance	$ 47,763,877	$ 43,579,467	$ 7,390,927	$ 16,735,830	$ 19,202,344	$ 209,808		$ 134,882,253

NOTE 4 – PREMISES AND EQUIPMENT

A summary of premises and equipment is as follows:

	DECEMBER 31, 2014	DECEMBER 31, 2013
Leasehold improvements	$ 1,217,831	$ 1,216,391
Furniture, fixtures, and equipment	563,740	553,383
Computer equipment	752,135	697,464
	2,533,706	2,467,238
Less accumulated depreciation and amortization	(2,206,253)	(1,951,454)
	$ 327,453	$ 515,784

The Bank has entered into a ten-year lease for its main banking and administrative offices. The Bank is responsible for common area maintenance, taxes, and insurance to the extent they exceed the base year amounts. The lease expires on January 31, 2016.

At December 31, 2014, the future lease rental payable under non-cancellable operating lease commitments for the Bank's main and administrative offices were as follows:

2015	$ 321,388
2016	26,848
Thereafter	-
	$ 348,236

The minimum rental payments shown above are given for the existing lease obligations and are not a forecast of future rental expense. Total rental expense was approximately $277,000 for both years ended December 31, 2014 and 2013.

NOTE 5 – DEPOSITS

Customer deposits were as follows:

	DECEMBER 31, 2014	DECEMBER 31, 2013
Non-interest-bearing demand	$ 90,228,529	$ 74,386,391
Savings, NOW, and money market accounts	102,226,179	84,333,796
Time deposits under $250,000	23,559,219	24,996,724
Time deposits $250,000 and over	11,830,159	13,309,953
	$ 227,844,086	$ 197,026,864

At December 31, 2014, the scheduled maturities of time deposits are as follows:

2015	$ 29,432,910
2016	3,225,517
2017	1,192,554
2018	1,056,314
2019	482,083
Thereafter	-
	$ 35,389,378

NOTE 6 – BORROWING ARRANGEMENTS

The Bank may borrow up to $19,000,000 overnight on an unsecured basis from three correspondent banks. The Bank may also borrow up to approximately $37,999,000 from the Federal Home Loan Bank of San Francisco, subject to providing collateral and fulfilling other conditions of the credit facility. The Bank has pledged investment securities of approximately $2,516,000 for the credit facility at Federal Home Loan Bank of San Francisco. The Bank may also borrow from the Federal Reserve Bank of San Francisco, subject to fulfilling other conditions of the credit facility and providing collateral. As of December 2014 and 2013, no amounts were outstanding under these arrangements.

NOTE 7 – EMPLOYEE BENEFITS

The Company sponsors an employee stock ownership plan (ESOP) for eligible employees. Eligibility begins after an employee has attained the age of 21 and completed one year of service, as defined in the ESOP documents. Under the ESOP, the Company contributes a discretionary amount to the ESOP for the purchase of the Company's stock, to be held in trust for each participant to be distributed later in accordance with the ESOP. For the years ended December 31, 2014 and 2013, contributions to the ESOP were $181,782 and $164,714, respectively.

The Company sponsors a 401(k) plan for the benefit of its employees. The Company can match employee contributions and make additional contributions annually as determined by the Board of Directors. The Company made no contributions for the years ended December 31, 2014 and 2013.

NOTE 8 – INCOME TAXES

The provision for income taxes for the years ended December 31 consists of the following:

	2014	2013
Current		
Federal	$ 775,000	$ (29,000)
State	55,000	58,000
	830,000	29,000
Deferred		
Federal	68,000	(45,000)
State	294,000	34,000
	362,000	(11,000)
	$ 1,192,000	$ 18,000

Deferred taxes are a result of differences between income tax accounting and generally accepted accounting principles with respect to income and expense recognition.

NOTE 8 – INCOME TAXES (CONTINUED)

The following is a summary of the components of the net deferred tax asset accounts recognized in the accompanying consolidated balance sheets at December 31:

	2014	2013
Deferred tax assets:		
Pre-operating expenses	$ 103,000	$ 120,000
Depreciation differences	225,000	230,000
Allowance for loan losses due to tax limitations	659,000	546,000
Stock-based compensation	274,000	274,000
Operating loss carryforwards	98,000	591,000
Unrealized losses on available-for-sale securities	-	707,000
Other	110,000	28,000
	1,469,000	2,496,000
Deferred tax liabilities:		
Unrealized gains on available-for-sale securities	(280,000)	-
Other	(118,000)	(76,000)
	(398,000)	(76,000)
Valuation allowance	(66,000)	(66,000)
Net deferred income tax asset	$ 1,005,000	$ 2,354,000

As of December 31, 2014 and 2013, a valuation allowance of $66,000 was recorded for both years equal to the amount of deferred tax assets for certain non-qualified stock options the Company determined are more likely than not unable to be realized before those options expire. The Bank has net operating loss carryforwards of approximately $1,363,000 for California franchise tax purposes that begin to expire in 2028.

The Company is subject to federal income tax and franchise tax of the state of California. Income tax returns for the years ended December 31, 2014, 2013, and 2012 are open to audit by the federal authorities and income tax returns for the years ended December 31, 2014, 2013, 2012, 2011, and 2010 are open to audit by state authorities. Unrecognized tax benefits are not expected to significantly increase or decrease within the next 12 months.

NOTE 9 – RELATED PARTY TRANSACTIONS

In the ordinary course of business, the Bank has granted loans to certain directors and their related interests with which they are associated. The balance of these loans outstanding was approximately $488,000 and $835,000 at December 31, 2014 and 2013, respectively.

Deposits from certain directors, officers, and their related interests with which they are associated, held by the Bank at December 31, 2014 and 2013, amounted to approximately $3,511,000 and $3,524,000, respectively.

NOTE 10 – EARNINGS PER SHARE (EPS)

Earnings per share for the years ended December 31 were computed as follows:

	2014	2013
Basic earnings per share:		
Net income	$ 2,118,414	$ 26,091
Dividends paid on Series C preferred stock	(303,983)	(305,000)
Net income (loss) available to common shareholders	$ 1,814,431	$ (278,909)
Weighted average common shares outstanding	1,966,715	1,873,683
Basic earnings (loss) per share	$ 0.92	$ (0.15)
Diluted earnings per share:		
Net income (loss) available to common shareholders	$ 1,814,431	$ (278,909)
Preferred stock dividends on convertible Series C preferred stock	303,983	-
Net income (loss) available to common shareholders - diluted	$ 2,118,414	$ (278,909)
Weighted average common shares outstanding	1,966,715	1,873,683
Effect of dilutive stock options	33,893	-
Dilutive effect of Series C convertible preferred stock	668,038	-
Adjusted weighted average common shares outstanding - diluted	2,668,646	1,873,683
Diluted earnings (loss) per share	$ 0.79	$ (0.15)

At December 31, 2014 and 2013, there were 495,306 and 542,800 stock options, respectively, that could potentially dilute earnings per share in the future that were not included in the computation of diluted earnings per share because to do so would have been antidilutive. All income per share amounts have been retroactively adjusted for the effect of stock dividends.

NOTE 11– COMMITMENTS

In the ordinary course of business, the Bank enters into financial commitments to meet the financing needs of its customers. These financial commitments include commitments to extend credit and standby letters of credit. Those instruments involve, to varying degrees, elements of credit and interest rate risk not recognized in the Company's consolidated financial statements.

The Bank's exposure to loan loss in the event of non-performance on commitments to extend credit and standby letters of credit is represented by the contractual amount of those instruments. The Bank uses the same credit policies in making commitments as it does for loans reflected in the consolidated financial statements.

As of December 31, 2014 and 2013, the Bank had the following outstanding financial commitments whose contractual amount represents credit risk:

	2014	2013
Commitments to extend credit	$ 46,107,000	$ 42,508,000
Letters of credit	-	-
	$ 46,107,000	$ 42,508,000

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Since many of the commitments are expected to expire without being drawn upon, the total amounts do not necessarily represent future cash requirements. The Bank evaluates each client's credit worthiness on a case-by-case basis. The amount of collateral obtained, if deemed necessary by the Bank, is based on management's credit evaluation of the customer. The majority of the Bank's commitments to extend credit and standby letters of credit are secured by real estate.

NOTE 12 – STOCK OPTION PLAN

The Company's 2005 Equity Based Compensation Plan (the Plan) was approved by its shareholders in February 2006. Under the terms of the Plan, officers and key employees may be granted both non-qualified, incentive stock options and restricted stock awards, and directors, who are not also an officer or employee, may only be granted non-qualified stock options and restricted stock awards. The Plan provides for a maximum number of shares that may be awarded to eligible employees and directors not to exceed 495,000 shares. In July 2012, the shareholders approved an additional 183,000 shares to be added to the Plan increasing the total to 678,000 shares. There are 774,782 shares authorized under the Plan. The total number of shares authorized has been retroactively adjusted for the effect of stock dividends. Stock options are granted at a price not less than 100% of the fair market value of the stock on the date of grant. Stock options expire no later than ten years from the date of the grant and all equity-based awards generally vest over three years. The Plan provides for accelerated vesting if there is a change of control, as defined in the Plan. The Company recognized stock based compensation cost of $31,293 and $59,171 in 2014 and 2013, respectively. The Company did not recognize tax expense related to stock-based compensation for either year ended December 31, 2014 or 2013.

The following table shows weighted average assumptions used in valuing stock options granted for the years ended December 31:

	2014	2013
Expected volatility	18.99%	25.30%
Expected term	6.5 years	6.5 years
Expected dividends	None	None
Risk free rate	1.83%	1.07%
Grant date fair value	$ 2.23	$ 2.56

Since the Company has a limited amount of historical stock activity, the expected volatility is based on the historical volatility of similar banks that have a longer trading history. The expected term represents the estimated average period of time that the options remain outstanding. Since the Company does not have sufficient historical data on the exercise of stock options, the expected term is based on the "simplified" method that measures the expected term as the average of the vesting period and the contractual term. The risk free rate of return reflects the grant date interest rate offered for U.S. Treasury bonds over the expected term of the options.

NOTE 12 – STOCK OPTION PLAN (CONTINUED)

A summary of the status of stock options that have been granted by the Company as of December 31, 2014, and changes during the year ending thereon, is presented below:

	Shares	Weighted-Average Exercise Price	Weighted-Average Remaining Contractual Term	Aggregate Intrinsic Value
Outstanding at beginning of year	542,800	$ 9.27		
Granted	9,000	$ 9.25		
Exercised	-	$ -		
Forfeited or expired	(22,601)	$ 8.95		
Outstanding at end of year	529,199	$ 9.27	2.8 years	$ 208,763
Options exercisable	488,025	$ 9.25	2.3 years	$ 199,253

As of December 31, 2014, there was approximately $46,000 of total unrecognized compensation cost related to the outstanding stock options that will be recognized over a weighted average period of 1.7 years.

NOTE 13 – REGULATORY MATTERS

The Bank is subject to various regulatory capital requirements administered by the federal banking agencies. 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 Company's consolidated financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Bank must meet specific capital guidelines that involve quantitative measures of the Bank's assets, liabilities, and certain off-balance-sheet items as calculated under regulatory accounting practices. The Bank's capital amounts and classifications are also subject to qualitative judgments by the regulators about components, risk-weightings, and other factors.

Quantitative measures established by regulation to ensure capital adequacy require the Bank to maintain minimum amounts and ratios (set forth in the table below) of total and Tier I capital (as defined in the regulations) to risk-weighted assets (as defined), and of Tier I capital (as defined) to average assets (as defined). Management believes, as of December 31, 2014, that the Bank meets all capital adequacy requirements to which it is subject.

NOTE 13 – REGULATORY MATTERS (CONTINUED)

As of December 31, 2014, the most recent notification from the FDIC categorized the Bank as well capitalized under the regulatory framework for prompt corrective action. There are no conditions or events since that notification that management believes have changed the Bank's category. To be categorized as well capitalized, the Bank must maintain minimum ratios as set forth in the table below. The following table also sets forth the Bank's actual capital amounts and ratios (dollar amounts in thousands):

	Actual		For capital adequacy purposes		To be well-capitalized under prompt corrective action provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
December 31, 2014:						
Total Capital (to Risk-Weighted Assets)	$ 25,529	18.3%	$ 11,170	≥ 8.0%	$ 13,962	≥ 10.0%
Tier I Capital (to Risk-Weighted Assets)	$ 23,768	17.0%	$ 5,585	≥ 4.0%	$ 8,377	≥ 6.0%
Tier I Capital (to Average Assets)	$ 23,768	9.1%	$ 10,493	≥ 4.0%	$ 13,116	≥ 5.0%
December 31, 2013:						
Total Capital (to Risk-Weighted Assets)	$ 24,012	18.9%	$ 10,166	≥ 8.0%	$ 12,708	≥ 10.0%
Tier I Capital (to Risk-Weighted Assets)	$ 22,412	17.6%	$ 5,083	≥ 4.0%	$ 7,625	≥ 6.0%
Tier I Capital (to Average Assets)	$ 22,412	9.8%	$ 9,124	≥ 4.0%	$ 11,405	≥ 5.0%

The California Financial Code provides that a bank may not make a cash distribution to its shareholders in excess of the lessor of the bank's undivided profits or the bank's net income for its last three fiscal years less any distributions made to shareholders during the same period without the approval in advance of the Commissioner of the California Department of Business Oversight.

The Federal Reserve and the FDIC approved final capital rules in July 2013 that substantially amend the existing capital rules for banks. These new rules reflect, in part, certain standards initially adopted by the Basel Committee on Banking Supervision in December 2010 (which standards are commonly referred to as "Basel III") as well as requirements contemplated by the Dodd-Frank Act. Under the new capital rules, the Bank will be required to meet certain minimum capital requirements that differ from current capital requirements. The rules implement a new capital ratio of common equity Tier 1 capital to risk-weighted assets.

The prompt corrective action rules are modified to include the common equity Tier 1 capital ratio noted above and to increase the Tier 1 capital ratio requirements for the various existing thresholds. The rules also modify the manner in which certain capital elements are determined and make changes to the methods of calculating the risk-weighting of certain assets, which in turn affects the calculation of the risk-weighted capital ratios. Higher risk weights are assigned to various categories of assets. The Bank is required to comply with the new capital rules on January 1, 2015, with a measurement date of March 31, 2015. Certain calculations under the rules will also have phase-in periods.

NOTE 14 – FAIR VALUE MEASUREMENT

The following is a description of valuation methodologies used for assets and liabilities recorded at fair value:

Securities – The fair values of securities available-for-sale are determined by obtaining quoted prices on nationally recognized securities exchanges (Level 1) or matrix pricing, which is a mathematical technique used widely in the industry to value debt securities without relying exclusively on quoted prices for specific securities, but rather by relying on the securities' relationship to other benchmark securities (Level 2).

Loans held for sale – The Bank does not record loans held for sale at fair value on a recurring basis. Loans held for sale are carried at the lower of cost or fair value. The fair value of loans held for sale is based on what secondary markets are currently offering for portfolios with similar characteristics (Level 2).

Collateral-dependent impaired loans – The Bank does not record loans at fair value on a recurring basis. However, from time to time, fair value adjustments are recorded on these loans to reflect: (1) partial write-downs, through charge offs or specific reserve allowances, that are based on the current appraised or market-quoted value of the underlying collateral, or (2) the full charge off of the loan carrying value. In some cases, the properties for which market quotes or appraisal values have been obtained are located in areas where comparable sales data is limited, outdated, or unavailable. Fair value estimates for collateral-dependent impaired loans are obtained from real estate brokers or other third-party consultants. Adjustments are routinely made in the appraisal process by the appraisers to adjust for differences between the comparable sales and income data available. Management also considers unobservable inputs regarding market trends or other relevant factors and selling and commission costs of about 15% at December 31, 2013 (Level 3). There were no collateral-dependent impaired loans measured at fair value at December 31, 2014.

NOTE 14 – FAIR VALUE MEASUREMENT (CONTINUED)

The following table summarizes the Company's assets that were measured at fair value on a recurring and non-recurring basis at December 31, 2014:

Description of Assets	December 31, 2014	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Securities available-for-sale (recurring)				
U.S. government and agency securities	$ 28,436,255	$ -	$ 28,436,255	$ -
Mortgage-backed securities	22,794,793	-	22,794,793	-
State and municipal agencies	14,522,842	-	14,522,842	-
Total	$ 65,753,890	$ -	$ 65,753,890	$ -

The following table summarizes the Company's assets that were measured at fair value on a recurring and non-recurring basis at December 31, 2013:

Description of Assets	December 31, 2013	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Securities available-for-sale (recurring)				
U.S. government and agency securities	$ 31,691,661	$ -	$ 31,691,661	$ -
Mortgage-backed securities	16,175,950	-	16,175,950	-
State and municipal agencies	14,353,178	-	14,353,178	-
Corporate debt securities	4,117,735	-	4,117,735	-
Impaired loans (non-recurring)	48,750	-	-	48,750
Other real estate owned (non-recurring)	2,023,493	-	-	2,023,493
Total	$ 68,410,767	$ -	$ 66,338,524	$ 2,072,243

NOTE 15 – FAIR VALUE OF FINANCIAL INSTRUMENTS

The fair value of a financial instrument is the amount at which the asset or obligation could be exchanged in a current transaction between willing parties, other than in a forced or liquidation sale. Fair value estimates are made at a specific point in time based on relevant market information and information about the financial instrument. These estimates do not reflect any premium or discount that could result from offering for sale at one time the entire holdings of a particular financial instrument. Because no market value exists for a significant portion of the financial instruments, fair value estimates are based on judgments regarding future expected loss experience, current economic conditions, risk characteristics of various financial instruments, and other factors. These estimates are subjective in nature, involve uncertainties and matters of judgment and, therefore, cannot be determined with precision. Changes in assumptions could significantly affect the estimates.

Fair value estimates are based on financial instruments both on and off the balance sheet without attempting to estimate the value of anticipated future business and the value of assets and liabilities that are not considered financial instruments. Additionally, tax consequences related to the realization of the unrealized gains and losses can have a potential effect on fair value estimates and have not been considered in many of the estimates.

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

Financial assets – The carrying amounts of cash, short-term investments due from customers on acceptances, and bank acceptances outstanding are considered to approximate fair value. Short-term investments include federal funds sold, securities purchased under agreements to resell, and interest bearing deposits with banks. The fair values of investment securities, including available for sale and held to maturity, are generally based on quoted market prices. The fair value of variable loans that reprice frequently and that have experienced no significant change in credit risk is based on carrying values. The fair values for all other loans are estimated using discounted cash flow analyses and interest rates currently being offered for loans with similar terms to borrowers with similar credit quality. Loans are generally expected to be held to maturity and any unrealized gains or losses are not expected to be realized. Fair value for Federal Home Loan Bank stock and interest receivable approximates its carrying value.

Financial liabilities – The carrying amounts of deposit liabilities payable on demand, commercial paper, and other borrowed funds are considered to approximate fair value. For fixed maturity deposits, fair value is estimated by discounting estimated future cash flows using currently offered rates for deposits of similar remaining maturities. The fair value of interest payable approximates its carrying amount.

NOTE 15 – FAIR VALUE OF FINANCIAL INSTRUMENTS (CONTINUED)

Off-balance sheet financial instruments – The fair value of commitments to extend credit and standby letters of credit is estimated using the fees currently charged to enter into similar agreements, taking into account the remaining terms of the agreements and the credit standing of the counterparties.

The estimated fair value of financial instruments at December 31 is summarized as follows (in thousands):

	2014			2013		
	Carrying Amount	Estimated Fair Value	Fair Value Hierarchy	Carrying Amount	Estimated Fair Value	Fair Value Hierarchy
Financial assets:						
Cash and cash equivalents	$ 18,575	$ 18,575	Level 1	$ 9,795	$ 9,795	Level 1
Certificates of deposit	5,200	5,200	Level 1	1,494	1,494	Level 1
Securities available-for-sale	65,754	65,754	Level 2	66,339	66,339	Level 2
Loans, net	159,380	161,503	Level 3	132,491	135,105	Level 3
Loans held for sale	-	-		1,060	1,088	Level 2
Correspondent bank stock	1,596	1,596	Level 2	1,128	1,128	Level 2
Interest receivable	1,137	1,137	Level 2	1,049	1,049	Level 2
Financial liabilities:						
Deposits	227,844	228,148	Level 2	197,027	197,245	Level 2
Interest payable	30	30	Level 2	33	33	Level 2
Off-balance-sheet liabilities:						
Commitments to extend credit and letters of credit	-	461	Level 3	-	425	Level 3

NOTE 16 – SUBSEQUENT EVENTS

The Company has evaluated the effects of subsequent events that have occurred after the period ending December 31, 2014 and through March 20, 2015, which is the date the consolidated financial statements were issued.

COMMUNITIES FIRST FINANCIAL CORPORATION

Board of Directors

Sheila Frowsing, Director • President/CEO Sheila Kamps Insurance Agency

Jack Holt, Director • President of Holt Lumber Company, Inc.

Dr. Robert Kubo, Director • Orthodontist, Kubo Orthodontic Group

Lorrie Lorenz, Director • Principal of Lorenz & Associates

Jared Martin, Director • Realtor, Keller Williams Realty

David Price, Chairman • President/CEO David N. Price & Associates

Mark Saleh, Director • President of Wm. B. Saleh & Company

Joel Slonski, Director • Joel Slonski, CPA

Al Smith, Director • President/CEO Greater Fresno Area Chamber of Commerce

Dr. Daniel Suchy, Director • Retired Physician

Richard Whitsell, Director • President & CEO of Fresno First Bank

Employee Owners

Jarod Ashton, AVP/Commercial Loan Officer
Lisa Bassill, AVP/ Personal Banker
Tobi Burnes, Loan Documentation Clerk
Debbie Cameron, VP/Executive Secretary
Seven Campos, Merchant Sales/Services Officer
Steve Canfield, EVP/Chief Financial Officer
Lanny Chan, VP/Personal Banker
Ana Coria, Customer Service Representative
Craig DeShields, SVP/Senior Loan Officer
Ken Dodderer, SVP/Agri-Business Manager
Laura Drake, Customer Service Representative
Mary Edsberg, Loan Assistant
Michael Fanucchi, SVP/SBA Dept. Manager
Catherine Fitzgerald, VP/Merchant Sales/Services
Melissa Gamez, Accounting Assistant
Evangelina Gonzalez, SVP/Operations
Julie Henvit, AVP/Operations Officer
Candy Jones, Senior Vault Teller
David Kraechan, SVP/Commercial Loan Officer
Teresa Palsgaard, VP/Relationship Manager
Elizabeth Parsons, SBA Processor
Jennifer Peterson, VP, Customer Service Manager
Lee Reed, EVP/Chief Credit Officer
Margaret Rodriguez, Loan Assistant
Ruth Setencich, Business Banking Officer
Alice Shevenell, VP/Loan Services Manager
Noel Terriquez, Commercial Loan Analyst
Nick Ward, Senior Loan Underwriter
Melanie Welch, SBA Loan Processor
Rick Whitsell, President & CEO
Maurice Williams, SBA Loan Officer

COMMUNITIES FIRST FINANCIAL CORPORATION

Annual Meeting of Shareholders
Tuesday, July 21, 2015 at 5:30 pm
Fort Washington Country Club
10272 N. Millbrook
Fresno, CA 93730

Corporate Office:
Communities First Financial Corp.
7690 N. Palm Avenue, Suite 101
Fresno, CA 93711
559.439.0200

Transfer Agent:
Continental Stock Transfer & Trust Co.
17 Battery Place
New York, NY
212.509.4000

Independent Auditors:
Moss Adams, LLP
3121 West March Lane, Suite 100
Stockton, CA 95219
209.955.6100

Legal Counsel:
Stuart & Moore
641 Higuera Street, Suite 302
San Luis Obispo, CA 93401
805.545.8590

Stock Facilitators:
Michael Natzic • Crowell, Weedon & Co
800.288.2811

Joey Warmerhoven • Wedbush Securities
866.662.0351

Tom Weil • Stifel
877.816.9089

Robert Cook • Fig Partners, LLC
866.344.2657

Communities First Financial Corporation

COMMUNITIES
FIRST FINANCIAL
CORPORATION

7690 N. Palm Avenue, Fresno, California 93711
559.439.0200
WWW.FRESNOFIRSTBANK.COM