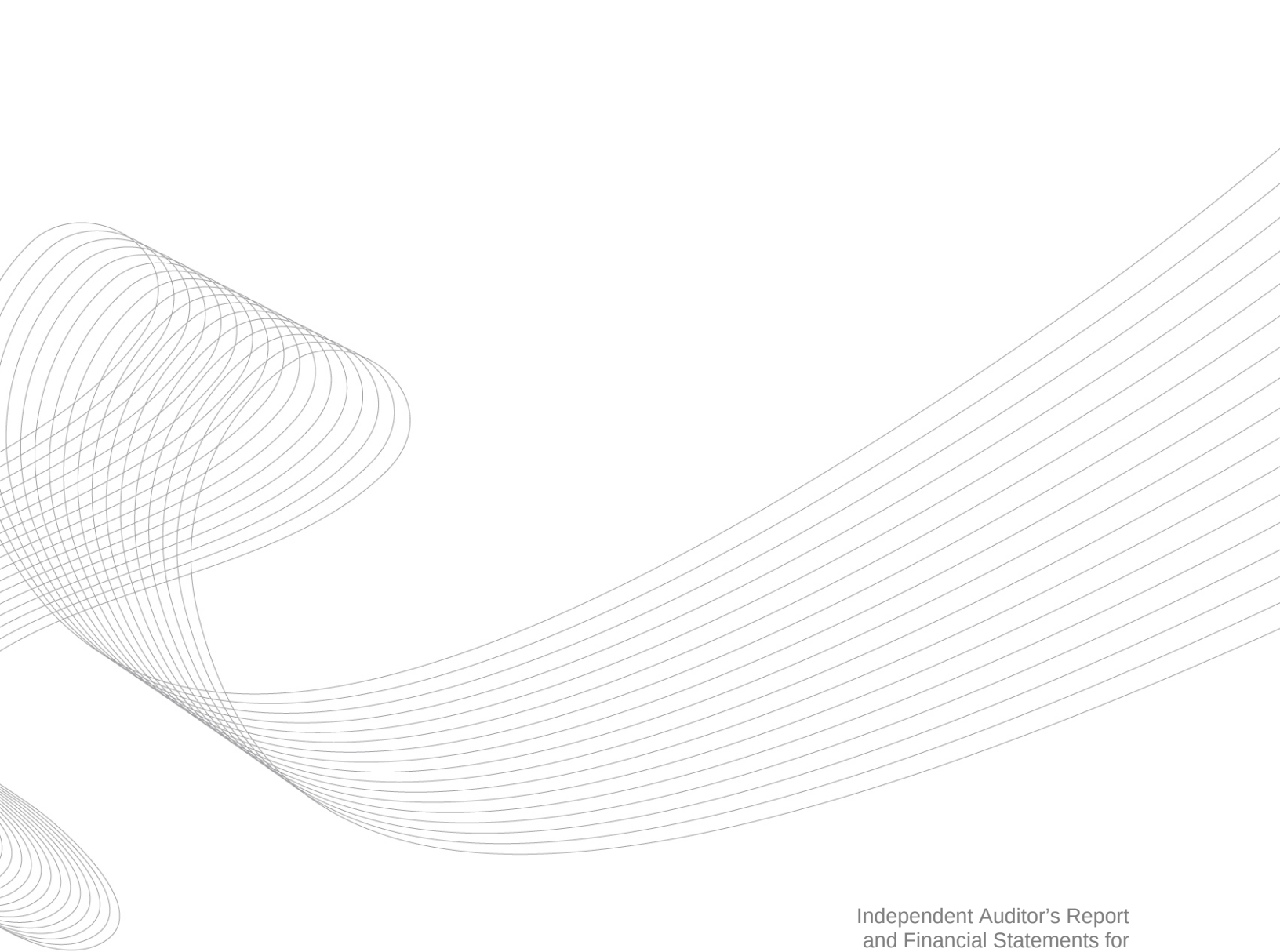




Independent Auditor's Report
and Financial Statements for

People's Bank of Commerce
(an Oregon Banking Corporation)

December 31, 2010 and 2009

MOSS-ADAMS LLP

Certified Public Accountants | Business Consultants

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

INDEPENDENT AUDITOR'S REPORT

To the Board of Directors and Stockholders
People's Bank of Commerce

We have audited the accompanying balance sheets of People's Bank of Commerce (an Oregon Banking Corporation) as of December 31, 2010 and 2009, and the related statements of operations, changes in stockholders' equity and comprehensive income (loss), and cash flows for the years then ended. These financial statements are the responsibility of the Bank's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of People's Bank of Commerce as of December 31, 2010 and 2009, and the results of its operations and its cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America.



Portland, Oregon
March 14, 2011

PEOPLE'S BANK OF COMMERCE
BALANCE SHEETS

	December 31,	
	2010	2009
ASSETS		
Cash and cash equivalents	\$ 6,054,016	\$ 3,688,930
Investment securities available-for-sale, at fair value	9,166,297	11,558,124
Restricted equity securities	163,200	136,600
Loans held-for-sale	607,600	1,750,609
Loans, net of allowance for loan losses and unearned income	79,471,348	75,187,449
Premises, equipment, and leasehold improvements, net of accumulated depreciation and amortization	3,248,226	3,441,203
Other real estate owned	2,426,735	987,935
Bank-owned life insurance	3,004,317	2,895,723
Accrued interest receivable and other assets	1,949,121	2,040,823
TOTAL ASSETS	\$ 106,090,860	\$ 101,687,396
LIABILITIES		
Noninterest-bearing demand deposits	\$ 20,576,464	\$ 16,435,485
Interest-bearing demand and money market accounts	36,111,516	31,460,485
Savings deposits	3,580,449	2,594,455
Time deposits	31,578,194	38,983,083
Total deposits	91,846,623	89,473,508
Borrowings	775,000	775,000
Accrued interest payable and other liabilities	1,041,918	567,807
Total liabilities	93,663,541	90,816,315
COMMITMENTS AND CONTINGENCIES (Notes 9 and 11)		
STOCKHOLDERS' EQUITY		
Common stock, \$5 par value, 2,000,000 shares authorized; 1,062,352 and 917,302 shares issued and outstanding at December 31, 2010 and 2009, respectively	5,244,260	4,586,510
Surplus	6,955,380	6,404,931
Retained earnings (deficit)	177,926	(187,506)
Accumulated other comprehensive income, net of taxes	49,753	67,146
Total stockholders' equity	12,427,319	10,871,081
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	\$ 106,090,860	\$ 101,687,396

PEOPLE'S BANK OF COMMERCE
STATEMENTS OF OPERATIONS

	Years Ended December 31,	
	2010	2009
INTEREST INCOME		
Interest and fees on loans	\$ 5,057,118	\$ 4,971,534
Interest on investment securities	276,647	208,876
Interest on federal funds sold	1,729	2,337
Total interest income	<u>5,335,494</u>	<u>5,182,747</u>
INTEREST EXPENSE		
Time deposit accounts	925,304	1,157,728
Interest-bearing deposit and savings accounts	228,240	299,210
Other borrowings	22,888	20,584
Total interest expense	<u>1,176,432</u>	<u>1,477,522</u>
NET INTEREST INCOME BEFORE PROVISION FOR LOAN LOSSES	4,159,062	3,705,225
PROVISION FOR LOAN LOSSES	<u>250,900</u>	<u>1,138,900</u>
NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES	<u>3,908,162</u>	<u>2,566,325</u>
NONINTEREST INCOME		
Service charges and other fees	610,952	577,950
Mortgage brokerage fees	280,094	640,512
Gain on sale of loans	389,262	342,987
Other noninterest income	145,711	146,943
Total noninterest income	<u>1,426,019</u>	<u>1,708,392</u>
NONINTEREST EXPENSE		
Salaries and employee benefits	2,643,733	2,805,942
Occupancy and equipment	701,232	711,670
Data processing	179,546	170,690
Advertising and promotional	162,639	148,818
Impairment loss on other real estate owned	141,620	51,037
(Gain) loss on sale of other real estate owned	(62,078)	14,121
Supplies	66,885	72,167
Other noninterest expense	1,044,782	1,053,764
Total noninterest expense	<u>4,878,359</u>	<u>5,028,209</u>
INCOME (LOSS) BEFORE PROVISION (BENEFIT) FOR INCOME TAXES	455,822	(753,492)
PROVISION (BENEFIT) FOR INCOME TAXES	<u>90,390</u>	<u>(365,150)</u>
NET INCOME (LOSS)	<u>\$ 365,432</u>	<u>\$ (388,342)</u>

PEOPLE'S BANK OF COMMERCE
STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY
AND COMPREHENSIVE INCOME (LOSS)

	<u>Common Stock</u>		<u>Surplus</u>	<u>Retained Earnings (Deficit)</u>	<u>Accumulated Other Comprehensive Income</u>	<u>Total Stockholders' Equity</u>	<u>Comprehensive Income (Loss)</u>
	<u>Shares</u>	<u>Amount</u>					
BALANCE, December 31, 2008	867,071	\$ 4,335,355	\$ 6,293,057	\$ 682,210	\$ 1,849	\$ 11,312,471	
Net loss	-	-	-	(388,342)	-	(388,342)	\$ (388,342)
Change in net unrealized gain on investment securities available-for-sale, net of taxes	-	-	-	-	65,297	65,297	65,297
Exercise of stock options and related tax benefit	7,112	35,560	25,636	-	-	61,196	
Cash dividend	-	-	-	(177,969)	-	(177,969)	
Stock dividend	43,344	216,718	86,687	(303,405)	-	-	
Cash paid for fractional shares	(225)	(1,123)	(449)	-	-	(1,572)	
Total comprehensive loss							<u>\$ (323,045)</u>
BALANCE, December 31, 2009	917,302	4,586,510	6,404,931	(187,506)	67,146	10,871,081	
Net income	-	-	-	365,432	-	365,432	\$ 365,432
Change in net unrealized gain on investment securities available-for-sale, net of taxes	-	-	-	-	(3,846)	(3,846)	(3,846)
Reclassification adjustment for gains included in net income, net of taxes	-	-	-	-	(13,547)	(13,547)	(13,547)
Restricted stock grants issued	13,500	-	-	-	-	-	
Stock-based compensation expense	-	-	1,446	-	-	1,446	
Exercise of stock options and related tax benefit	7,113	35,565	24,838	-	-	60,403	
Common stock issued, net of expenses	124,437	622,185	524,165	-	-	1,146,350	
Total comprehensive income							<u>\$ 348,039</u>
BALANCE, December 31, 2010	<u>1,062,352</u>	<u>\$ 5,244,260</u>	<u>\$ 6,955,380</u>	<u>\$ 177,926</u>	<u>\$ 49,753</u>	<u>\$ 12,427,319</u>	

See accompanying notes.

PEOPLE'S BANK OF COMMERCE
STATEMENTS OF CASH FLOWS

	Years Ended December 31,	
	2010	2009
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income (loss)	\$ 365,432	\$ (388,342)
Adjustments to reconcile net income (loss) to net cash from operating activities:		
Deferred income taxes	(156,367)	(207,987)
Provision for loan losses	250,900	1,138,900
Depreciation and amortization	214,262	229,717
Stock-based compensation expense	1,446	-
Amortization of premiums/(accretion of discounts) on investment securities	84,564	(26,720)
Realized gain on sale of investment securities	(21,350)	-
Gain on sale of loans	(389,262)	(342,987)
Excess tax benefit on stock options exercised	(5,406)	(6,187)
Impairment loss on other real estate owned	141,620	51,037
(Gain) loss on sale of other real estate owned	(62,078)	14,121
Net appreciation of bank-owned life insurance	(108,594)	(111,120)
Proceeds from the sale of loans held-for-sale	32,720,626	51,909,270
Production of loans held-for-sale	(31,188,355)	(51,124,412)
Changes in cash due to changes in certain assets and liabilities:		
Accrued interest receivable and other assets	264,317	(765,451)
Accrued interest payable and other liabilities	474,111	(134,269)
Net cash from operating activities	<u>2,585,866</u>	<u>235,570</u>
CASH FLOWS FROM INVESTING ACTIVITIES		
Purchase of investment securities available-for-sale	(3,413,966)	(11,777,268)
Proceeds from payments, calls and sales of investment securities available-for-sale	5,714,344	5,427,909
Purchase of Federal Home Loan Bank stock	(26,600)	(65,600)
Net increase in loans	(6,409,798)	(9,513,536)
Proceeds from sale of other real estate owned	367,996	1,402,628
Improvements on other real estate owned	(11,339)	-
Payments made for purchase of premises, equipment, and leasehold improvements	(21,285)	(33,341)
Net cash from investing activities	<u>(3,800,648)</u>	<u>(14,559,208)</u>

PEOPLE'S BANK OF COMMERCE
STATEMENTS OF CASH FLOWS

	Years Ended December 31,	
	2010	2009
CASH FLOWS FROM FINANCING ACTIVITIES		
Net increase in deposit accounts	\$ 2,373,115	\$ 15,108,759
Paydowns of federal funds purchased	-	(895,000)
Proceeds from borrowings	-	775,000
Proceeds from stock options exercised	54,997	55,009
Proceeds from sales of common stock, net of expenses	1,146,350	-
Excess tax benefit on stock options exercised	5,406	6,187
Cash dividend paid	-	(177,969)
Payment for fractional shares in connection with stock dividend	-	(1,572)
Net cash from financing activities	3,579,868	14,870,414
NET INCREASE IN CASH AND CASH EQUIVALENTS	2,365,086	546,776
CASH AND CASH EQUIVALENTS, beginning of year	3,688,930	3,142,154
CASH AND CASH EQUIVALENTS, end of year	<u>\$ 6,054,016</u>	<u>\$ 3,688,930</u>
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION		
Cash paid for interest	<u>\$ 1,218,609</u>	<u>\$ 1,519,699</u>
Cash (paid) received for taxes	<u>\$ (41,962)</u>	<u>\$ 20,500</u>
SUPPLEMENTAL DISCLOSURE OF NONCASH INVESTING ACTIVITIES		
Change in fair value of investment securities available-for-sale, net of taxes	<u>\$ (3,846)</u>	<u>\$ 65,297</u>
Transfer of held-to-maturity investment securities to available-for-sale	<u>\$ -</u>	<u>\$ 2,569,512</u>
Transfers of loans to other real estate owned	<u>\$ 1,874,999</u>	<u>\$ 1,659,666</u>

PEOPLE'S BANK OF COMMERCE
NOTES TO FINANCIAL STATEMENTS

NOTE 1 – ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Organization – In March 1998, People's Bank of Commerce (the Bank) was incorporated and received regulatory approval to become a state-chartered institution authorized to provide banking services in the state of Oregon. The Bank is subject to the regulations of certain federal and state agencies and will undergo periodic examinations by those regulatory authorities.

The Bank, which is headquartered in Medford, Oregon, operates three full-service branches in Ashland, Central Point, and Medford, Oregon, and provides banking services to businesses and individuals located primarily in Southern Oregon.

Management's estimates and assumptions – In preparing the financial statements, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities as of the date of the balance sheets, and revenues and expenses for the reporting periods. Actual results could differ significantly from management's estimates. Material estimates that are particularly susceptible to significant change in the near-term relate to the determination of the allowance for loan losses, the valuation of investment securities available-for-sale, other real estate owned and deferred tax assets.

Cash and cash equivalents – Cash equivalents are generally short-term investments with a maturity of three months or less. Cash and cash equivalents include cash on hand, amounts due from banks, and federal funds sold. Generally, federal funds are purchased and sold for one-day periods.

The Bank maintains balances in correspondent bank accounts which, at times, may exceed federally insured limits. Management believes that its risk of loss associated with such balances is minimal due to the financial strength of correspondent banks. The Bank has not experienced any losses in such accounts.

Investment securities – The Bank is required to specifically identify its investment securities as "available-for-sale," "held-to-maturity," or "trading accounts." Management has designated investment securities held at December 31, 2010 and 2009, as "available-for-sale."

Available-for-sale securities consist of bonds, notes, and debentures. Securities are generally classified as available-for-sale if the instrument may be sold in response to such factors as: (1) changes in market interest rates and related changes in prepayment risk, (2) needs for liquidity, (3) changes in the availability of and the yield on alternative instruments, and (4) changes in funding sources and terms. Unrealized holding gains and losses, net of taxes, on available-for-sale securities are reported as a net amount in a separate component of equity until realized. Fair values for these investment securities are based on quoted market prices. Gains and losses on the sale of available-for-sale securities are determined using the specific-identification method. Premiums and discounts are recognized in interest income using the effective interest method over the period to maturity.

NOTE 1 – ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – (continued)

Management reviews investment securities on an ongoing basis for the presence of other-than-temporary impairment (OTTI) or permanent impairment, taking into consideration current market conditions; fair value in relationship to cost; extent and nature of the change in fair value; issuer rating changes and trends; whether management intends to sell a security or if it is likely that the Bank will be required to sell the security before recovery of the amortized cost basis of the investment, which may be maturity; and other factors. For debt securities, if management intends to sell the security or it is likely that the Bank will be required to sell the security before recovering its cost basis, the entire impairment loss would be recognized in earnings as an OTTI. If management does not intend to sell the security and it is not likely that the Bank will be required to sell the security, but management does not expect to recover the entire amortized cost basis of the security, only the portion of the impairment loss representing credit losses would be recognized in earnings. The credit loss on a security is measured as the difference between the amortized cost basis and the present value of the cash flows expected to be collected. Projected cash flows are discounted by the original or current effective interest rate depending on the nature of the security being measured for potential OTTI. The remaining impairment related to all other factors, i.e., the difference between the present value of the cash flows expected to be collected and fair value, is recognized as a charge to other comprehensive income. Impairment losses related to all other factors are presented as separate categories within other comprehensive income.

Loans held-for-sale – Mortgage loans held-for-sale are carried at the lower of cost or estimated market value. Market value is determined on an aggregate loan basis.

Loans, net of allowance for loan losses and deferred loan costs – In the normal course of business, the Bank originates and services loans receivable from borrowers. Loans are stated at the amount of unpaid principal, net of an allowance for loan losses and net of deferred loan fees or costs. Interest on loans is calculated using the simple-interest method on daily balances of the principal amount outstanding. Loan origination fees and certain direct origination costs are capitalized and recognized as an adjustment to the yield of the related loan.

Loans are classified as impaired when, based on current information and events, it is probable that the Bank will be unable to collect the scheduled payments of principal and interest when due, in accordance with the terms of the original loan agreement. The carrying value of impaired loans is based on the present value of expected future cash flows (discounted at each loan's effective interest rate) or, for collateral dependent loans, at fair value of the collateral. If the measurement of each impaired loan's value is less than the recorded investment in the loan, an impairment allowance is created by either charging the provision for loan losses or allocating an existing component of the allowance for loan losses.

PEOPLE'S BANK OF COMMERCE
NOTES TO FINANCIAL STATEMENTS

NOTE 1 – ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – (continued)

Loans, including impaired loans, are classified as non-accrual if the collection of principal and interest is doubtful. Generally, this occurs when a loan is past due as to maturity or payment of principal or interest by 90 days or more, unless such loans are well-secured and in the process of collection. If a loan or portion thereof is partially charged-off, the loan is considered impaired and classified as non-accrual. Loans that are less than 90 days past due may also be classified as non-accrual if repayment in full of principal and/or interest is in doubt.

When a loan is classified as non-accrual, all uncollected accrued interest is reversed against interest income and the accrual of interest income is terminated. Generally, any cash payments are applied as a reduction of principal outstanding. In cases where the future collectibility of the principal balance in full is expected, interest income may be recognized on a cash basis. A loan may be restored to accrual status when the borrower's financial condition improves so that full collection of principal is considered likely.

A troubled debt restructuring is a formal restructure of a loan where the Bank, for economic or legal reasons related to the borrower's financial difficulties, grants a concession to the borrower. The concessions may be granted in various forms, including reduction in the stated interest rate, reduction in the loan balance or accrued interest, and extension of the maturity date. Troubled debt restructurings are evaluated at the time of restructure for impairment, and if impaired are subjected to the Bank's impaired loan accounting policy.

The allowance for loan losses is established through a provision for loan losses charged to expenses. Loans are charged against the allowance for loan losses when management believes that the collectibility of principal is unlikely. The allowance is an amount that management believes will be adequate to absorb possible losses on existing loans that may become uncollectible, based on evaluations of the collectibility of loans and prior loan loss experience. These evaluations take into consideration such factors as changes in the nature and volume of the loan portfolio, overall portfolio quality, review of specific problem loans, and current economic conditions that may affect the borrower's ability to pay. Management carefully monitors changing economic conditions, the concentrations of loan categories and collateral, the financial condition of borrowers, the history of the loan portfolio, and historical peer group loan loss data to determine the adequacy of the allowance for loan losses. The allowance is based on estimates, and actual losses may vary from the estimates. No assurance can be given that adverse future economic conditions will not lead to delinquent loans, increases in the provision for loan losses and/or charge-offs. In addition, regulatory agencies, as an integral part of their examination process, periodically review the estimated losses on loans. Such agencies may require the Bank to recognize additional losses based on their judgment about information available to them at the time of their examination.

Premises, equipment, and leasehold improvements – Premises, equipment, and leasehold improvements are stated at cost, less accumulated depreciation and amortization. Depreciation and amortization are computed principally by the straight-line method over the estimated useful lives of the assets, or lease term in the case of leasehold improvements, which range from two to forty years.

Other real estate owned – Property and assets acquired through foreclosure or deed in lieu of foreclosure are stated at the lower of the carrying value of the loan or the fair value of the assets received, less estimated costs to sell, at the date the asset is acquired. Costs relating to the development and improvement of property are capitalized and holding costs are charged to expense as incurred.

NOTE 1 – ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – (continued)

Federal Home Loan Bank (FHLB) stock – At December 31, 2010 and 2009, the Bank held FHLB stock with a par value of \$159,700 and \$133,100, respectively. As a member of the FHLB system, the Bank is required to maintain a minimum investment level in FHLB stock based on specific percentages of the Bank's outstanding mortgages, total assets, or FHLB advances. This security is reported at par value, which represents the Bank's cost. The Seattle FHLB recently announced that it would report a risk-based capital deficiency under the regulations of the Federal Housing Finance Agency (the FHFA), its primary regulator. As a result, the Seattle FHLB has stopped paying a dividend and stated that it would suspend the repurchase and redemption of outstanding common stock until its retained earnings deficiency was reclaimed.

The stock in the Seattle FHLB is classified as restricted stock and is evaluated for impairment based on ultimate recoverability. The determination of whether the investment is impaired is based on the Bank's assessment of the ultimate recoverability of par value rather than by recognizing temporary declines in value. The determination of whether a decline affects the ultimate recoverability is influenced by criteria such as (1) the significance of the decline in the net assets of the FHLB as compared to the capital stock amount for the FHLB and the length of time this situation has persisted, (2) commitments by the FHLB to make payments required by law or regulation and the level of such payments in relation to the operating performance of the FHLB, (3) the impact of the legislative and regulatory changes on institutions and, accordingly, on the customer base of the FHLB, and (4) the liquidity position of the FHLB. Management's review for impairment is based on ultimate recoverability of the Bank's cost basis in FHLB stock and concluded that the FHLB stock investment is not impaired as of December 31, 2010.

Income taxes – Income taxes are accounted for using an asset and liability approach that requires the recognition of deferred tax assets and liabilities for the expected future tax consequences of temporary differences between the financial statement and tax basis of assets and liabilities at the applicable enacted tax rates. A valuation allowance is provided when it is more likely than not that some portion or all of the deferred tax assets will not be realized. The Bank evaluates the realizability of its deferred tax assets by assessing its valuation allowance and by adjusting the amount of such allowance, if necessary.

The Bank recognizes the tax benefit from uncertain tax positions only if it is more likely than not that the tax positions will be sustained on examination by the tax authorities, based on the technical merits of the position. The tax benefit is measured based on the largest benefit that has a greater than 50% likelihood of being realized upon ultimate settlement. The Bank recognizes interest and penalties related to income tax matters in income tax expense. The Bank does not anticipate that the amount of unrecognized tax benefits will significantly increase or decrease in the next 12 months. There were no interest and penalties accrued for the years ended December 31, 2010 and 2009.

Off-balance sheet financial instruments – The Bank holds no derivative financial instruments. However, in the ordinary course of business, the Bank enters into off-balance sheet financial instruments consisting of commitments to extend credit and standby letters of credit. These financial instruments are recorded in the financial statements when they are funded or related fees are incurred or received.

NOTE 1 – ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – (continued)

The allowance for off-balance sheet credit losses related to unfunded loan commitments is increased through charges to non-interest expense and is decreased by charge-offs or transfers to the allowance for loan losses at the time that the related loan is funded. Management periodically evaluates the adequacy of this allowance based on the Bank's off-balance sheet credit loss experience, known and inherent risks in the portfolio, adverse situations which may increase the likelihood of loss, and current economic conditions. This reserve for unfunded loan commitments is included in the balance sheets under the caption "accrued interest payable and other liabilities."

Advertising and promotional expenses – Advertising and promotional costs are charged to expense during the year in which they are incurred.

Earnings (loss) per share – Basic earnings (loss) per share is computed by dividing net income (loss) available to stockholders by the weighted average number of common shares outstanding during the period, after giving retroactive effect to stock dividends and splits. Diluted earnings (loss) per share is computed similar to basic earnings per share except that the denominator is increased to include dilutive common equivalent shares for stock options assumed to be outstanding during the period utilizing the treasury stock method.

Stock compensation plans – The Bank has stock-based compensation plans, which are described more fully in Note 13. The Bank utilizes the Black-Scholes valuation model for determining the fair value of options on the date of grant as well as compensation expense for stock options issued. Share-based awards that do not require future service (i.e., fully vested awards at grant date) are expensed immediately. Share-based employee awards that require future service are amortized over the relevant service period. The Bank recognizes share-based compensation expense on a straight-line basis.

Fair value measurements – Fair value is defined as the price that would be received to sell an asset, or paid to transfer a liability, in an orderly transaction between market participants at the measurement date. The Bank determines fair value based upon quoted prices when available or through the use of alternative approaches, such as matrix or model pricing, when market quotes are not readily accessible or available. The valuation techniques used are based on observable and unobservable inputs. Observable inputs reflect market data obtained from independent sources, while unobservable inputs reflect the Bank's market assumptions. These two types of inputs create the following fair value hierarchy:

- Level 1** Quoted prices in active markets for identical assets or liabilities.
- Level 2** Quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active and model-derived valuations whose inputs are observable or whose significant value drivers are observable.
- Level 3** Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the asset or liability. Unobservable inputs are used to measure fair value to the extent that observable inputs are not available. The Bank's own data used to develop unobservable inputs shall be adjusted for market consideration when reasonably available.

NOTE 1 – ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – (continued)

The Bank used the following methods and significant assumptions to estimate fair value for its assets measured and carried at fair value on a recurring or non-recurring basis in the accompanying financial statements:

Investment securities available-for-sale – Investment securities available for sale are measured and carried at fair value on a recurring basis. For these securities, the Bank obtains fair value measurements from an independent pricing service. The fair value measurements consider observable data that may include dealer quotes, market spreads, cash flows, the U.S. Treasury yield curve, live trading levels, trade execution data, market consensus prepayment speeds, credit information and the bond's terms and conditions, among other things (Level 1). When market quotes are not readily accessible or available, alternative approaches are utilized, such as matrix or model pricing (Level 2).

Impaired loans – Impaired loans are measured and adjusted to fair value on a non-recurring basis. Impaired loans are measured for impairment at the present value of expected future cash flows discounted at the loan's effective interest rate (Level 3), the loan's market price (Level 2), or the fair value of the collateral based on independent appraisals, less costs to sell, if the loan is collateral dependent (Level 3).

Other real estate owned – Other real estate owned is measured and adjusted to fair value on a non-recurring basis. On the date that other real estate owned is received in satisfaction of a loan receivable, it is measured at fair value, less costs to sell, based on recent independent appraisals (Level 3). Subsequent to the acquisition date, it is measured for impairment and written down to its fair value, less costs to sell, based on updated independent appraisals (Level 3).

The following methods and assumptions were used by the Bank in estimating fair values of assets and liabilities not carried at fair value on a recurring or non-recurring basis:

Cash and cash equivalents – The carrying amounts reported in the balance sheets for cash and cash equivalents approximate their fair value at the balance sheet date.

Restricted equity securities – The Bank's investment in restricted equity securities are carried at par value which is expected to approximate fair value.

Loans held-for-sale – The carrying value of loans held-for-sale approximates fair value.

Loans receivable, net – For variable rate loans that re-price frequently and have no significant change in credit risk, fair value is equivalent to carrying value. Fair values for all other loans are estimated using discounted cash flow analyses, using interest rates currently being offered for loans with similar terms to borrowers of similar credit quality.

Bank-owned life insurance – Fair values of insurance policies owned are based on the insurance contract's cash surrender value.

Borrowings – The fair value of borrowings is estimated by discounting future cash flows using rates currently offered for notes payable of similar remaining maturities.

PEOPLE'S BANK OF COMMERCE
NOTES TO FINANCIAL STATEMENTS

NOTE 1 – ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – (continued)

Deposit liabilities – Fair value disclosed for demand deposits equals their carrying amount, which represents the amount payable on demand. The carrying amounts for variable-rate interest bearing deposit accounts and certificates of deposit approximate their fair value at the balance sheet date. Fair value for fixed-rate certificates of deposit is estimated using a discounted cash flow calculation that applies interest rates currently being offered on certificates to a schedule of aggregate expected monthly maturities on time deposits.

Accrued interest receivable and payable – The fair value of accrued interest receivable and payable equals the carrying value at the balance sheet date.

Off-balance sheet instruments – The Bank's off-balance sheet instruments include unfunded commitments to extend credit and standby letters of credit. The fair value of these instruments is not considered practicable to estimate because of the lack of quoted market prices and the inability to estimate fair value without incurring excessive costs.

The Bank assumes interest rate risk (the risk that general interest rate levels will change) as a result of its normal operations. Consequently, the fair value of the Bank's financial instruments will change when interest rate levels change, and that change may be either favorable or unfavorable to the Bank. Management attempts to match maturities of assets and liabilities to the extent believed necessary to minimize interest rate risk. However, borrowers with fixed-rate obligations are less likely to prepay in a rising rate environment and more likely to prepay in a falling rate environment. Conversely, depositors who are receiving fixed rates are more likely to withdraw funds before maturity in a rising rate environment and less likely to do so in a falling rate environment. Management monitors rates and maturities of assets and liabilities, and attempts to minimize interest rate risk by adjusting terms of new loans and deposits and by investing in securities with terms that mitigate the Bank's overall interest rate risk.

Reclassifications – Certain reclassifications have been made to the prior year financial statements to conform to the current year presentation. These reclassifications have no effect on previously reported net loss.

Subsequent events – Subsequent events are events or transactions that occur after the balance sheet date but before financial statements are issued. The Bank recognizes in the financial statements the effects of all subsequent events that provide additional evidence about conditions that existed at the date of the balance sheet, including the estimates inherent in the process of preparing the financial statements. The Bank's financial statements do not recognize subsequent events that provide evidence about conditions that did not exist at the date of the balance sheet but arose after the balance sheet date and before financial statements are available to be issued. The Bank has evaluated subsequent events through March 14, 2011, which is the date the financial statements became available to be issued.

PEOPLE'S BANK OF COMMERCE
NOTES TO FINANCIAL STATEMENTS

NOTE 2 - INVESTMENT SECURITIES

The amortized cost and estimated fair value of the Bank's investment securities available-for-sale, with gross unrealized gains and losses, are summarized as follows:

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses Less than 12 Months	Gross Unrealized Losses Greater than 12 Months	Estimated Fair Value
<u>December 31, 2010</u>					
U.S. government agency obligations	\$ 5,863,554	\$ 94,413	\$ (1,317)	\$ -	\$ 5,956,650
Municipal securities	3,221,974	7,084	(13,802)	(5,609)	3,209,647
	<u>\$ 9,085,528</u>	<u>\$ 101,497</u>	<u>\$ (15,119)</u>	<u>\$ (5,609)</u>	<u>\$ 9,166,297</u>
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses Less than 12 Months	Gross Unrealized Losses Greater than 12 Months	Estimated Fair Value
<u>December 31, 2009</u>					
U.S. government agency obligations	\$ 7,834,770	\$ 70,539	\$ (18,230)	\$ -	\$ 7,887,079
Municipal securities	3,614,351	68,047	(11,353)	-	3,671,045
	<u>\$ 11,449,121</u>	<u>\$ 138,586</u>	<u>\$ (29,583)</u>	<u>\$ -</u>	<u>\$ 11,558,124</u>

At December 31, 2010, the Bank had seven investment securities with amortized cost of \$3,071,504 in a loss position for less than 12 months, and one security with amortized cost of \$330,371, in an unrealized loss position for more than 12 months, as shown in the above table. The Bank evaluated the unrealized losses and determined that the declines in value at December 31, 2010 were temporary and related to the change in market interest rates since the date of purchase.

At December 31, 2010 and 2009, securities in the amount of \$400,000 were pledged to secure public deposits.

The amortized cost and estimated fair value of available-for-sale investment securities by contractual maturity at December 31, 2010, are as follows:

	Amortized Cost	Estimated Fair Value
Due from one year through five years	\$ 3,500,703	\$ 3,593,397
Due from five years through ten years	1,523,448	1,519,021
Due after ten years	4,061,377	4,053,879
	<u>\$ 9,085,528</u>	<u>\$ 9,166,297</u>

PEOPLE'S BANK OF COMMERCE
NOTES TO FINANCIAL STATEMENTS

NOTE 3 - LOANS, NET OF ALLOWANCE FOR LOAN LOSSES AND UNEARNED INCOME

The composition of loan balances is summarized as follows as of December 31:

	<u>2010</u>	<u>2009</u>
Real estate loans	\$ 50,202,582	\$ 49,884,361
Commercial loans	21,750,673	17,239,019
Construction loans	7,557,041	7,953,357
Consumer loans	<u>1,538,368</u>	<u>1,502,470</u>
 Total loans	 81,048,664	 76,579,207
 Allowance for loan losses	 (1,429,814)	 (1,221,693)
Unearned income	<u>(147,502)</u>	<u>(170,065)</u>
 Loans, net of allowance for loan losses and unearned income	 <u>\$ 79,471,348</u>	 <u>\$ 75,187,449</u>

PEOPLE'S BANK OF COMMERCE
NOTES TO FINANCIAL STATEMENTS

NOTE 4 – ALLOWANCE FOR LOAN LOSSES

The following table displays the allocation of the allowance for loan losses to significant segments of the loan portfolio at December 31, 2010:

	Real Estate	Commercial	Construction	Consumer	Unallocated	Total
Allowance for loan losses						
Beginning balance	\$ 634,877	\$ 350,359	\$ 122,145	\$ 6,396	\$ 107,916	\$ 1,221,693
Charge-offs	(70,829)	(1,749)	(24,000)	(689)	-	(97,267)
Recoveries	7,360	47,003	-	125	-	54,488
Provision for loan losses	271,328	(80,039)	163,347	4,180	(107,916)	250,900
Ending balance	<u>\$ 842,736</u>	<u>\$ 315,574</u>	<u>\$ 261,492</u>	<u>\$ 10,012</u>	<u>\$ -</u>	<u>\$ 1,429,814</u>
Ending balance						
Loans individually evaluated for impairment	<u>\$ 133,113</u>	<u>\$ 28,296</u>	<u>\$ 125,774</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 287,183</u>
Ending balance						
Loans collectively evaluated for impairment	<u>\$ 709,623</u>	<u>\$ 287,278</u>	<u>\$ 135,718</u>	<u>\$ 10,012</u>	<u>\$ -</u>	<u>\$ 1,142,631</u>
Loans						
Ending balance	<u>\$ 50,202,582</u>	<u>\$ 21,750,673</u>	<u>\$ 7,557,041</u>	<u>\$ 1,538,368</u>		<u>\$ 81,048,664</u>
Ending balance						
Loans individually evaluated for impairment	<u>\$ 1,185,928</u>	<u>\$ 930,803</u>	<u>\$ 2,248,085</u>	<u>\$ -</u>		<u>\$ 4,364,816</u>
Ending balance						
Loans collectively evaluated for impairment	<u>\$ 49,016,654</u>	<u>\$ 20,819,870</u>	<u>\$ 5,308,956</u>	<u>\$ 1,538,368</u>		<u>\$ 76,683,848</u>

The following table represents loan portfolio information by loan type and credit grade for the period ended December 31, 2010:

	Real Estate	Commercial	Construction	Consumer	Total
Grade					
Pass	\$ 45,679,159	\$ 17,859,111	\$ 4,745,898	\$ 1,532,033	\$ 69,816,201
Special Mention	3,073,779	2,525,239	2,641,143	6,335	8,246,496
Substandard	1,449,644	1,366,323	170,000	-	2,985,967
Doubtful	-	-	-	-	-
Loss	-	-	-	-	-
Total	<u>\$ 50,202,582</u>	<u>\$ 21,750,673</u>	<u>\$ 7,557,041</u>	<u>\$ 1,538,368</u>	<u>\$ 81,048,664</u>

Credit quality indicators – The Bank's risk rating methodology assigns risk ratings ranging from 1 to 10, where a higher rating represents higher risk. Assignment of a risk rating is done on the individual loan rather than at the borrower level. Loans are graded from inception and on a continuing basis until the debt is repaid.

NOTE 4 – ALLOWANCE FOR LOAN LOSSES – (continued)

The risk rating categories can be generally described by the following groupings:

Pass – An acceptable asset carrying a normal degree of credit risk exhibiting the capacity to perform according to the repayment terms.

Special Mention – A Special Mention asset has potential weaknesses that deserve management's close attention. If left uncorrected, these potential weaknesses may result in a 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 an institution to sufficient risk to warrant adverse classification.

Substandard – A Substandard asset is inadequately protected by the current sound worth and paying capacity of the obligor or of the collateral pledged. Assets so classified must have a well-defined weakness or weaknesses that jeopardize the liquidation of the debt.

Doubtful – Any asset classified doubtful has all the weaknesses inherent in one classified Substandard with the added characteristic that the weaknesses make collection or liquidation in full, on the basis of currently existing facts, conditions, and value, highly questionable and improbable.

Loss – Assets classified loss are considered uncollectible and of such minimal value that the continuance as bankable assets are not warranted. This classification does not mean that the asset has absolutely no recovery or salvage value but that it is not practical or desirable to defer writing off this basically worthless asset even though a partial recovery may occur in the future.

PEOPLE'S BANK OF COMMERCE
NOTES TO FINANCIAL STATEMENTS

NOTE 4 - ALLOWANCE FOR LOAN LOSSES - (continued)

Past due loans are loans for which principal and interest were not paid timely according to the contractual payment date. The following table represents loans past due by loan category for the period ended December 31, 2010:

	30 – 59 Days Past Due	60 – 89 Days Past Due	Greater than 90 Days Past Due	Total Past Due	Current	Total Loans
Real estate	\$ 255,750	\$ 588,205	\$ 234,829	\$ 1,078,784	\$ 49,123,798	\$ 50,202,582
Commercial	-	25,155	-	25,155	21,725,518	21,750,673
Construction	-	170,000	-	170,000	7,387,041	7,557,041
Consumer	-	-	-	-	1,538,368	1,538,368
	<u>\$ 255,750</u>	<u>\$ 783,360</u>	<u>\$ 234,829</u>	<u>\$ 1,273,939</u>	<u>\$ 79,774,725</u>	<u>\$ 81,048,664</u>

The following shows loan on nonaccrual status as of December 31, 2010:

	Loans on Nonaccrual Status	Recorded Investment > 90 Days and Accruing
Real estate	\$ 1,078,784	\$ -
Commercial	-	-
Construction	170,000	-
Consumer	-	-
	<u>\$ 1,248,784</u>	<u>\$ -</u>

PEOPLE'S BANK OF COMMERCE
NOTES TO FINANCIAL STATEMENTS

NOTE 4 - ALLOWANCE FOR LOAN LOSSES – (continued)

The following table represents comparison of impaired loans with and without specific allowance recorded for the period ended December 31, 2010:

	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized
With no related allowance recorded					
Real estate	\$ 651,886	\$ 772,486	\$ -	\$ 655,260	\$ 45,386
Commercial	-	-	-	-	-
Construction	-	-	-	-	-
Consumer	-	-	-	-	-
	<u>\$ 651,886</u>	<u>\$ 772,486</u>	<u>\$ -</u>	<u>\$ 655,260</u>	<u>\$ 45,386</u>
With allowance recorded					
Real estate	\$ 534,042	\$ 544,396	\$ 133,113	\$ 537,330	\$ 28,317
Commercial	930,803	930,803	28,296	885,297	58,472
Construction	2,248,085	2,248,085	125,774	2,263,230	98,397
Consumer	-	-	-	-	-
	<u>\$ 3,712,930</u>	<u>\$ 3,723,284</u>	<u>\$ 287,183</u>	<u>\$ 3,685,857</u>	<u>\$ 185,186</u>
Total					
Real estate	\$ 1,185,928	\$ 1,316,882	\$ 133,113	\$ 1,192,590	\$ 73,703
Commercial	930,803	930,803	28,296	885,297	58,472
Construction	2,248,085	2,248,085	125,774	2,263,230	98,397
Consumer	-	-	-	-	-
	<u>\$ 4,364,816</u>	<u>\$ 4,495,770</u>	<u>\$ 287,183</u>	<u>\$ 4,341,117</u>	<u>\$ 230,572</u>

As of December 31, 2010, total troubled debt restructurings were \$2,186,004.

The change in allowance for loan losses for the year ended December 31, 2009 is summarized as follows:

Balance, beginning of year	\$ 836,864
Provision for loan losses	1,138,900
Loans charged-off	(777,856)
Recoveries of loans previously charged-off	<u>23,785</u>
Balance, end of year	<u>\$ 1,221,693</u>

PEOPLE'S BANK OF COMMERCE
NOTES TO FINANCIAL STATEMENTS

NOTE 4 – ALLOWANCE FOR LOAN LOSSES – (continued)

The following table discloses impaired loans for the year ended December 31, 2009:

Impaired loans with no related allowance	\$ -
Impaired loans with specific allowance	3,643,054
Specific allowance related to impaired loans	<u>(402,545)</u>
	<u>\$ 3,240,509</u>
 Average balance of impaired loans for the year	 \$ 1,963,067
Interest income recognized on impaired loans	\$ 195,349
Interest income recognized using cash-basis method	\$ 14,951
Loans on nonaccrual status	\$ 890,491
Loans over 90-days past due and still accruing interest	\$ -
Troubled debt restructurings	\$ 435,517

NOTE 5 – PREMISES, EQUIPMENT, AND LEASEHOLD IMPROVEMENTS

The composition of premises, equipment, and leasehold improvements is summarized as follows as of December 31:

	<u>2010</u>	<u>2009</u>
Land	\$ 583,248	\$ 583,248
Bank premises	2,783,839	2,783,839
Furniture and equipment	1,101,669	1,096,466
Leasehold improvements	<u>117,199</u>	<u>117,199</u>
	4,585,955	4,580,752
 Less accumulated depreciation and amortization	 <u>(1,337,729)</u>	 <u>(1,139,549)</u>
 Premises, equipment, and leasehold improvements, net of accumulated depreciation and amortization	 <u>\$ 3,248,226</u>	 <u>\$ 3,441,203</u>

Depreciation expense for the years ended December 31, 2010 and 2009 was \$214,262 and \$229,717, respectively.

PEOPLE'S BANK OF COMMERCE
NOTES TO FINANCIAL STATEMENTS

NOTE 6 - TIME DEPOSITS

Time certificates of deposit of \$100,000 and over totaled \$12,420,973 and \$15,175,405 at December 31, 2010 and 2009, respectively.

As of December 31, 2010, the scheduled maturities for all time deposits are as follows:

Years ending December 31, 2011	\$ 20,067,445
2012	2,479,276
2013	3,314,295
2014	1,824,863
2015	221,154
Thereafter	<u>3,671,161</u>
	<u>\$ 31,578,194</u>

NOTE 7 - BORROWINGS

Federal Home Loan Bank advances – As a member of the Federal Home Loan Bank of Seattle (FHLB), the Bank has entered into an “Advances, Security and Deposit Agreement” with the FHLB. Borrowings under the credit arrangement are collateralized by the Bank’s FHLB stock as well as deposits or other instruments, which may be pledged. As of December 31, 2010 and 2009, the Bank had \$775,000 in outstanding borrowings with the FHLB carrying an interest rate of 2.91% and maturing in 2014. As of December 31, 2010, the Bank had approximately \$15,827,000 available for borrowing with the FHLB.

Federal funds line of credit – The Bank has obtained federal funds lines totaling \$7,500,000 with three correspondent banks. One federal fund line for \$3,000,000 will expire at the discretion of the correspondent bank. A second federal fund line for \$500,000 will expire upon the consent of both parties. The third line for \$4,000,000 was established with a term extending from June 1, 2010 through June 30, 2011. There were no balances outstanding on these federal funds lines as of December 31, 2010 and 2009.

PEOPLE'S BANK OF COMMERCE
NOTES TO FINANCIAL STATEMENTS

NOTE 8 - INCOME TAXES

The benefit for income taxes consists of the following as of December 31:

	<u>2010</u>	<u>2009</u>
Current income taxes		
Federal	\$ 222,284	\$ (161,163)
State	<u>24,473</u>	<u>4,000</u>
Total current income taxes	<u>246,757</u>	<u>(157,163)</u>
Deferred income taxes		
Federal	(124,863)	(166,071)
State	<u>(31,504)</u>	<u>(41,916)</u>
Total deferred income taxes	<u>(156,367)</u>	<u>(207,987)</u>
Provision (benefit) for income taxes	<u>\$ 90,390</u>	<u>\$ (365,150)</u>

Deferred income taxes, recorded as other assets, represent the tax effect of differences in timing between financial income and taxable income. Net deferred tax assets, in the accompanying balance sheets, include the following components as of December 31:

	<u>2010</u>	<u>2009</u>
Allowance for loan losses	\$ 452,152	\$ 400,446
Unrealized gains on investment securities available-for-sale	(31,015)	(41,857)
Prepays	(39,463)	(31,753)
Supplemental executive retirement plan	212,640	177,399
Split-dollar liability	51,214	42,297
Intangible assets – permits and licenses	(20,914)	(16,993)
Reserve for off-balance sheet instruments	6,224	4,781
Depreciation and organization costs	(20,474)	(48,518)
Oregon net operating loss	-	58,348
Non-accrual interest	86,746	23,244
Other	<u>74,505</u>	<u>37,012</u>
Net deferred tax assets	<u>\$ 771,615</u>	<u>\$ 604,406</u>

A valuation allowance has not been recognized as an offset to the net deferred tax assets since management believes it is more likely than not that all deferred tax assets will be utilized in future periods.

PEOPLE'S BANK OF COMMERCE
NOTES TO FINANCIAL STATEMENTS

NOTE 9 – FINANCIAL INSTRUMENTS WITH OFF-BALANCE SHEET RISK

In the normal course of business to meet the financing needs of its customers, the Bank is a party to financial instruments with off-balance sheet risk. These financial instruments include commitments to extend credit and the issuance of letters of credit. These instruments involve, to varying degrees, elements of credit and interest-rate risk in excess of the amount recognized in the balance sheets. The contract amounts of those instruments reflect the extent of involvement the Bank has in particular classes of financial instruments.

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

Commitments to extend credit are agreements to lend to customers as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Since many of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. The amount of collateral obtained, if deemed necessary by the Bank upon extension of credit, is based on management's credit evaluation of the counter party. Collateral held varies but may include accounts receivable, inventory, property and equipment, and income-producing properties.

Letters of credit written are conditional commitments issued by the Bank to guarantee the performance of a customer to a third party. Those guarantees are primarily issued to support bonding requirements for real estate developers and contractors. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loan facilities to customers. The Bank holds cash, marketable securities, or real estate as collateral supporting those commitments for which collateral is deemed necessary.

A summary of the notional amounts of the Bank's financial instruments with off-balance sheet risk as of December 31 is as follows:

	2010	2009
Commitments to extend credit	\$ 8,632,610	\$ 9,631,944
Commercial and standby letters of credit	\$ 237,802	\$ 75,506

NOTE 10 – CONCENTRATIONS OF CREDIT RISK

All of the Bank's loans, commitments, and commercial and standby letters of credit have been granted to customers in the Bank's market area. The majority of such customers are also depositors of the Bank. Concentrations of credit by type of loan are set forth in Note 3. During 2010, the Bank's loan policy did not allow the extension of credit to any single borrower or group of related borrowers in excess of \$750,000 on an unsecured basis and \$1,500,000 on a secured basis, without approval from the Board of Directors' Loan Committee.

NOTE 11 – COMMITMENTS AND CONTINGENCIES

Lease commitments – As of December 31, 2010, the Bank leased branch and administrative office space under two operating lease agreements. The branch and administrative office space lease will expire in 2013 while the other branch lease expires in 2036.

Future minimum lease payments associated with the office space lease and other agreements are as follows:

Years ending December 31, 2011	\$ 284,918
2012	286,918
2013	78,951
2014	61,960
2015	64,129
Thereafter	<u>1,954,052</u>
	<u><u>\$ 2,730,928</u></u>

For the years ended December 31, 2010 and 2009, rent expense was \$281,367 and \$274,781, respectively.

Legal contingencies – The Bank may become a defendant in certain claims and legal actions arising in the ordinary course of business. As of December 31, 2010, the Bank was not involved in any current matters expected to have a material adverse effect on its financial condition or results of operations.

NOTE 12 – TRANSACTIONS WITH RELATED PARTIES

Certain directors, executive officers, and principal stockholders are customers of and have had banking transactions with the Bank in the ordinary course of business, and the Bank expects to have such transactions in the future. All loans and commitments to lend included in such transactions are made in compliance with applicable laws on substantially the same terms (including interest rates and collateral) as those prevailing at the time for comparable transactions with other persons and, in the opinion of the management of the Bank, do not involve more than the normal risk of collection or present any other unfavorable features.

PEOPLE'S BANK OF COMMERCE
NOTES TO FINANCIAL STATEMENTS

NOTE 12 – TRANSACTIONS WITH RELATED PARTIES – (continued)

The amount of loans and loan commitments outstanding to directors, executive officers, principal stockholders, and companies that they are associated with was as follows as of December 31:

	2010	2009
Balance, beginning of year	\$ 1,338,589	\$ 549,387
Loans made	2,533,547	1,692,130
Loans repaid	<u>(1,899,783)</u>	<u>(902,928)</u>
Balance, end of year	<u>\$ 1,972,353</u>	<u>\$ 1,338,589</u>
Outstanding loan commitments	<u>\$ 713,642</u>	<u>\$ 913,496</u>

NOTE 13 – STOCK-BASED COMPENSATION PLANS

Under its stock-based compensation plans, the Bank may grant options and restricted stock awards to its directors, officers, and employees for up to 282,966 shares of common stock. Both incentive stock options and nonqualified stock options may be granted under the plans. The exercise price of each option must be at least equal to 100% of the market price of the Bank's stock on the date of grant. An option's maximum term is 10 years.

The following summarizes stock option activity under the Plans:

	Number of Shares	Weighted Average Exercise Price	Aggregate Intrinsic Value	Weighted Average Contractual Term
Options under grant as of December 31, 2009	95,664			
Options granted	26,500			
Options exercised	<u>(7,113)</u>	\$ 7.73	\$ 12,558	
Options under grant as of December 31, 2010	<u>115,051</u>	\$ 9.92	\$ 158,505	4.26
Options exercisable as of December 31, 2010	<u>86,696</u>	\$ 10.07	\$ 129,410	2.45

NOTE 13 – STOCK-BASED COMPENSATION PLAN – (continued)

The Bank determines fair value of stock options at grant date using the Black-Scholes pricing model that takes into account the stock price at the grant date, the exercise price, the expected life of the option, the volatility of the underlying stock, the expected dividend yield and the risk-free interest rate over the expected life of the option. The assumptions used in the pricing model are noted in the table below. The expected term of options granted is derived from historical data on employee exercise and post-vesting employment termination behavior. The risk-free rate for periods within the contractual life of the option is based on the U.S. Treasury yield curve in effect at the time of the grant. Expected volatility is based on the historical volatility of an index of comparable bank stocks.

The fair values of options granted during 2010 and 2009 were computed utilizing the following weighted-average assumptions.

	<u>2010</u>	<u>2009</u>
Dividend yield	0.00%	0.00%
Weighted average expected life	7.5 years	7.5 years
Expected volatility	24.56%	38.56%
Risk-free rate	2.70%	2.20%

The Black-Scholes option valuation model requires the input of highly subjective assumptions, including the expected life of the stock-based award and stock price volatility. These assumptions represent management's best estimates, but involve inherent uncertainties and the application of management judgment. As a result, if other assumptions had been used, the Bank's recorded stock-based compensation expense could have been materially different. Additionally, the effects of applying this accounting model are not indicative of future amounts that may be realized by the option holders upon exercise. The weighted average grant-date fair value of options granted during the years 2010 and 2009 was \$3.24 and \$3.61, respectively. The total intrinsic value of options exercised during the years ended December 31, 2010 and 2009, was \$12,558 and \$16,111, respectively.

The Bank expenses stock options on a straight-line basis over the options' related vesting term. As of December 31, 2010, there was \$91,543 of unrecognized compensation expense related to the granting of stock options. That cost is expected to be recognized over a period of five years.

PEOPLE'S BANK OF COMMERCE
NOTES TO FINANCIAL STATEMENTS

NOTE 13 – STOCK-BASED COMPENSATION PLAN – (continued)

The following table summarizes restricted stock award activity under the Plan as of December 31, 2010:

	Number of Shares	Aggregate Intrinsic Value	Weighted Average Fair Value
Restricted stock awards unvested at beginning of period	-		
Awards granted	13,500	\$ 128,250	\$ 9.50
Awards vested	-		
Restricted stock awards unvested at end of period	<u>13,500</u>	\$ 128,250	\$ 9.50

As of December 31, 2010, there was \$128,250 of unrecognized stock-based compensation expense related to nonvested restricted stock awards. The cost is expected to be recognized over the vesting period upon certain performance conditions being reached.

NOTE 14 – EMPLOYEE BENEFIT PLANS AND AGREEMENTS

During 1999, the Bank adopted a 401(k) plan in which substantially all employees participate. Employees may contribute the maximum permissible under federal tax laws. The Bank matches employee contributions on the first 3% of their compensation. Matching contributions vest to the employee equally over a five-year period. For the years ended December 31, 2010 and 2009, the Bank's expense attributable to the plan was \$54,673 and \$81,872, respectively.

In December 2005, the Bank entered into supplemental retirement plans with key executive officers. In 2006, to support its obligations under these plans and to provide death benefits to selected employees, the Bank acquired bank-owned life insurance. The Bank's liability pursuant to these supplemental retirement plans was \$672,860 and \$560,249, as of December 31, 2010 and 2009, respectively. These amounts are included on the balance sheet among "accrued interest payable and other liabilities." For 2010 and 2009, compensation expense related to these plans was \$149,310 and \$109,427, respectively.

PEOPLE'S BANK OF COMMERCE
NOTES TO FINANCIAL STATEMENTS

NOTE 15 - EARNINGS (LOSS) PER SHARE

The following table illustrates the computations of basic and diluted earnings (loss) per share for the years ended December 31:

	Net Income (Loss)	Weighted Average Shares	Per Share Amount
For the year ended December 31, 2010			
Basic income per share	\$ 365,432	930,584	\$ 0.39
Stock options		<u>15,756</u>	
Diluted income per share	\$ 365,432	<u>946,340</u>	<u>\$ 0.39</u>
For the year ended December 31, 2009			
Basic loss per share	\$ (388,342)	<u>910,774</u>	<u>\$ (0.43)</u>
Diluted loss per share	\$ (388,342)	<u>910,774</u>	<u>\$ (0.43)</u>

Options for 24,249 and 95,666 shares of common stock were excluded from the diluted earnings per share calculation in 2010 and 2009, respectively, due to their anti-dilutive effect.

PEOPLE'S BANK OF COMMERCE
NOTES TO FINANCIAL STATEMENTS

NOTE 16 – FAIR VALUE OF FINANCIAL INSTRUMENTS

Assets are displayed at fair value in the table below based upon recurring or nonrecurring measurement status. Recurring assets are initially measured at fair value and are required to be re-measured at fair value in the financial statements at each reporting date. Assets measured on a nonrecurring basis are assets that, due to an event or circumstance, were required to be re-measured at fair value after initial recognition in the financial statements at some time during the reporting period. Total losses included in earnings represent impairments on loans recognized as a charge to the allowance for loan losses, or impairments of other real estate owned for fair value adjustments based on the fair value of the real estate.

		Fair Value Measurements Using			
	Carrying Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total Losses Included in Earnings
<u>Recurring items as of December 31, 2010</u>					
Investment securities available-for-sale:					
U.S. government agency obligations	\$ 5,956,650	\$ -	\$ 5,956,650	\$ -	
Municipal securities	3,209,647	-	3,209,647	-	
Total investment securities available-for-sale	<u>\$ 9,166,297</u>	<u>\$ -</u>	<u>\$ 9,166,297</u>	<u>\$ -</u>	
<u>Nonrecurring items as of December 31, 2010</u>					
Loans measured for impairment	\$ 3,425,747	\$ -	\$ -	\$ 3,425,747	\$ 287,183
Other real estate owned	\$ 2,426,735	\$ -	\$ -	\$ 2,426,735	\$ 132,635
<u>Recurring items as of December 31, 2009</u>					
Investment securities available-for-sale:					
U.S. government agency obligations	\$ 7,887,079	\$ -	\$ 7,887,079	\$ -	
Municipal securities	3,671,045	-	3,671,045	-	
Total investment securities available-for-sale	<u>\$ 11,558,124</u>	<u>\$ -</u>	<u>\$ 11,558,124</u>	<u>\$ -</u>	
<u>Nonrecurring items as of December 31, 2009</u>					
Loans measured for impairment	\$ 2,378,118	\$ -	\$ -	\$ 2,378,118	\$ 446,141
Other real estate owned	\$ 987,935	\$ -	\$ -	\$ 987,935	\$ 65,158

PEOPLE'S BANK OF COMMERCE
NOTES TO FINANCIAL STATEMENTS

NOTE 16 – FAIR VALUE OF FINANCIAL INSTRUMENTS – (continued)

The following table discloses fair value information about all financial instruments, whether carried or not carried at fair value on the balance sheet, where it is practicable to estimate that value.

	Fair Value Measurements Using			
	2010		2009	
	Carrying Amount	Estimated Fair Value	Carrying Amount	Estimated Fair Value
Financial assets				
Cash and cash equivalents	\$ 6,054,016	\$ 6,054,016	\$ 3,688,930	\$ 3,688,930
Investment securities available-for-sale	\$ 9,166,297	\$ 9,166,297	\$ 11,558,124	\$ 11,558,124
Restricted equity securities	\$ 163,200	\$ 163,200	\$ 136,600	\$ 136,600
Loans held-for-sale	\$ 607,600	\$ 607,600	\$ 1,750,609	\$ 1,750,609
Loans receivable, gross	\$ 81,048,664	\$ 81,072,238	\$ 76,579,207	\$ 75,511,106
Other real estate owned	\$ 2,426,735	\$ 2,426,735	\$ 987,935	\$ 987,935
Bank-owned life insurance	\$ 3,004,317	\$ 3,004,317	\$ 2,895,723	\$ 2,895,723
Financial liabilities				
Noninterest-bearing demand deposits	\$ 20,576,464	\$ 20,576,464	\$ 16,435,485	\$ 16,435,485
Interest-bearing demand, money market accounts, and savings deposits	\$ 39,691,965	\$ 39,691,965	\$ 34,054,940	\$ 34,054,940
Time certificates of deposit	\$ 31,578,194	\$ 31,897,104	\$ 38,983,083	\$ 40,763,592
Borrowings	\$ 775,000	\$ 780,783	\$ 775,000	\$ 775,000

The Bank normally intends to hold the majority of its financial instruments until maturity; it does not expect to realize many of the estimated amounts disclosed. The disclosures also do not include estimated fair value amounts for items which are not defined as financial instruments but which have significant value. These include such off-balance sheet items as core deposit intangibles on non-acquired deposits. The Bank does not believe that it would be practicable to estimate a representational fair value for these types of items as of December 31, 2010 and 2009.

NOTE 17 – COMMON STOCK ISSUANCE

The Bank completed a Private Placement Offering (Offering), selling 124,437 shares of common stock to directors, executives, and other investors at a price of \$9.50 per share during the year ended December 31, 2010. Total proceeds to the Bank, net of direct offering costs of \$35,802, were \$1,146,350 and will be used to fund continuing operations and anticipated growth.

NOTE 18 – REGULATORY MATTERS

The Bank is subject to various regulatory capital requirements administered by federal banking agencies. Failure to meet minimum capital requirements can initiate certain mandatory – and possibly additional discretionary – actions by regulators that, if undertaken, could have a direct material effect on the Bank's financial statements. Under capital adequacy guidelines 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 classification are also subject to qualitative judgments by the regulators about components, risk weightings, and other factors.

PEOPLE'S BANK OF COMMERCE
NOTES TO FINANCIAL STATEMENTS

NOTE 18 - REGULATORY MATTERS - (continued)

Quantitative measures established by regulation to ensure capital adequacy require the Bank to maintain minimum amounts and ratios (set forth in the following table) of total and Tier 1 capital (as defined in the regulations) to risk-weighted assets (as defined), and of Tier 1 capital to average assets (as defined). Management believes, as of December 31, 2010 and 2009, that the Bank met all capital adequacy requirements to which it is subject.

As of the most recent notifications from its regulatory agencies, the Bank was categorized as well-capitalized under the regulatory framework for prompt corrective action. To be categorized as adequately capitalized, the Bank must maintain minimum total risk-based capital, Tier 1 risk-based capital, and Tier 1 leverage capital ratios as set forth in the following table. There are no conditions or events since that notification that management believes may have changed the Bank's category.

(in thousands)	Actual		For Capital Adequacy Purposes		To Be Well-Capitalized under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
<u>December 31, 2010</u>						
Total capital to risk-weighted assets	\$ 13,295	15.6%	\$ 6,808	≥8.0%	\$ 8,510	≥10.0%
Tier 1 capital to risk-weighted assets	\$ 12,227	14.4%	\$ 3,404	≥4.0%	\$ 5,106	≥6.0%
Tier 1 capital to average assets	\$ 12,227	11.7%	\$ 4,189	≥4.0%	\$ 5,236	≥5.0%
<u>December 31, 2009</u>						
Total capital to risk-weighted assets	\$ 11,666	14.5%	\$ 6,444	≥8.0%	\$ 8,055	≥10.0%
Tier 1 capital to risk-weighted assets	\$ 10,657	13.2%	\$ 3,222	≥4.0%	\$ 4,833	≥6.0%
Tier 1 capital to average assets	\$ 10,657	10.4%	\$ 4,115	≥4.0%	\$ 5,144	≥5.0%