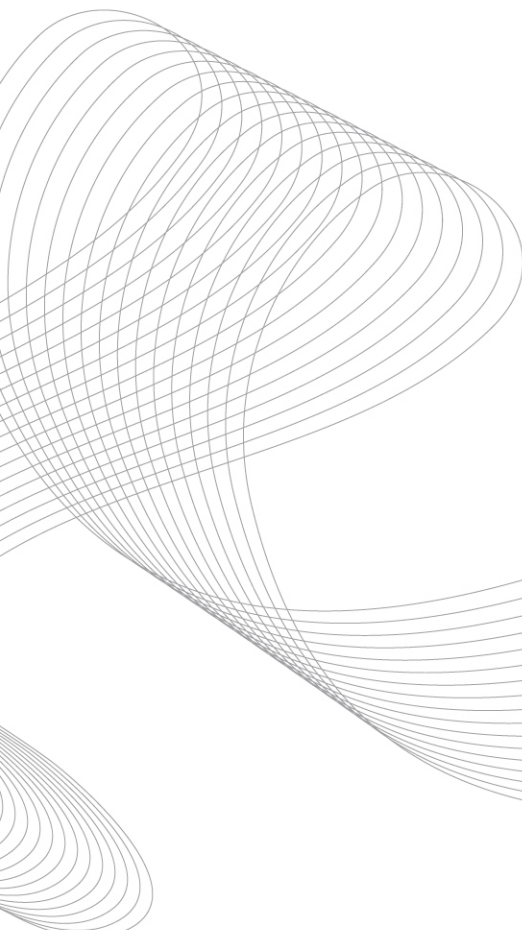




Report of Independent Auditors
and Financial Statements for

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

December 31, 2013 and 2012

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.

REPORT OF INDEPENDENT AUDITORS

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

Report on Financial Statements

We have audited the accompanying financial statements of People's Bank of Commerce (an Oregon Banking Corporation) (the Bank) which comprise the balance sheets as of December 31, 2013 and 2012, and the related statements of income, comprehensive income, changes in stockholders' equity, and cash flows for the years then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

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

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

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

REPORT OF INDEPENDENT AUDITORS (continued)

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, 2013 and 2012, and the results of its operations and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

A handwritten signature in black ink that reads "Moss Adams LLP". The signature is written in a cursive, flowing style.

Portland, Oregon

March 7, 2014

PEOPLE'S BANK OF COMMERCE
BALANCE SHEETS

	December 31,	
	2013	2012
ASSETS		
Cash and cash equivalents	\$ 21,058,237	\$ 5,046,574
Time deposits with other institutions	5,477,788	996,000
Investment securities		
Available-for-sale, at fair value	12,960,557	10,660,365
Held to maturity, at cost	3,557,118	-
Restricted equity securities	182,100	178,800
Loans held-for-sale	643,920	3,611,006
Loans, net of allowance for loan losses, and unearned income	123,721,846	110,314,350
Premises, equipment, and leasehold improvements, net of accumulated depreciation and amortization	3,489,300	3,497,963
Other real estate owned	1,687,711	1,707,098
Bank-owned life insurance	4,376,471	4,084,126
Investment in real estate joint venture	2,667,828	2,493,541
Accrued interest receivable and other assets	1,597,159	1,764,316
	<u>\$ 181,420,035</u>	<u>\$ 144,354,139</u>
LIABILITIES		
Noninterest-bearing demand deposits	\$ 55,381,817	\$ 36,640,891
Interest-bearing demand and money market accounts	69,886,820	52,363,005
Savings deposits	10,560,841	8,681,967
Time deposits	22,437,693	28,034,314
	<u>158,267,171</u>	<u>125,720,177</u>
Total deposits	158,267,171	125,720,177
Borrowings	775,000	3,275,000
Accrued interest payable and other liabilities	1,323,775	678,829
	<u>160,365,946</u>	<u>129,674,006</u>
Total liabilities	160,365,946	129,674,006
COMMITMENTS AND CONTINGENCIES (Notes 9 and 11)		
STOCKHOLDERS' EQUITY		
Common stock, \$5 par value, 2,500,000 shares authorized; 1,843,402 and 1,209,753 shares issued and outstanding at December 31, 2013 and 2012, respectively	9,217,010	6,048,765
Surplus	10,181,838	7,213,009
Retained earnings	1,551,103	1,183,023
Accumulated other comprehensive income	104,138	235,336
	<u>21,054,089</u>	<u>14,680,133</u>
Total stockholders' equity	21,054,089	14,680,133
Total liabilities and stockholders' equity	<u>\$ 181,420,035</u>	<u>\$ 144,354,139</u>

PEOPLE'S BANK OF COMMERCE

STATEMENTS OF INCOME

	Years Ended December 31,	
	2013	2012
INTEREST INCOME		
Interest and fees on loans	\$ 6,588,136	\$ 5,950,457
Interest on investment securities	243,694	212,830
Interest on federal funds sold	23,830	2,890
Total interest income	<u>6,855,660</u>	<u>6,166,177</u>
INTEREST EXPENSE		
Time deposit accounts	316,074	485,721
Interest-bearing deposit and savings accounts	139,383	121,310
Other borrowings	23,619	22,783
Total interest expense	<u>479,076</u>	<u>629,814</u>
NET INTEREST INCOME BEFORE PROVISION FOR LOAN LOSSES	6,376,584	5,536,363
PROVISION FOR LOAN LOSSES	<u>57,362</u>	<u>361,374</u>
NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES	<u>6,319,222</u>	<u>5,174,989</u>
NONINTEREST INCOME		
Service charges and other fees	794,446	754,745
Gain on sale of loans	649,982	1,090,316
Mortgage brokerage fees	147,941	134,859
Gain on sale of other real estate owned	252,203	7,959
Other noninterest income	196,276	162,846
Total noninterest income	<u>2,040,848</u>	<u>2,150,725</u>
NONINTEREST EXPENSE		
Salaries and employee benefits	4,068,439	3,422,332
Occupancy and equipment	993,814	835,186
Data processing	294,207	254,156
Advertising and promotional	225,630	202,630
Supplies	113,265	101,877
Impairment loss on other real estate owned	-	86,751
Other noninterest expense	1,152,668	1,134,857
Total noninterest expense	<u>6,848,023</u>	<u>6,037,789</u>
INCOME BEFORE PROVISION FOR INCOME TAXES	1,512,047	1,287,925
PROVISION FOR INCOME TAXES	<u>500,510</u>	<u>413,080</u>
NET INCOME	<u>\$ 1,011,537</u>	<u>\$ 874,845</u>
Basic and diluted earnings per share of common stock	<u>\$ 0.68</u>	<u>\$ 0.70</u>

PEOPLE'S BANK OF COMMERCE

STATEMENTS OF COMPREHENSIVE INCOME

	Years Ended December 31,	
	2013	2012
Net income	\$ 1,011,537	\$ 874,845
Change in net unrealized gain on investment securities available-for-sale, net of taxes	(131,198)	110,141
Total comprehensive income	<u>\$ 880,339</u>	<u>\$ 984,986</u>

STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY

	Common Stock		Surplus	Retained Earnings	Accumulated Other Comprehensive Income	Total Stockholders' Equity
	Shares	Amount				
BALANCE, December 31, 2011	1,137,546	\$ 5,687,730	\$ 7,094,652	\$ 706,429	\$ 125,195	\$ 13,614,006
Net income	-	-	-	874,845	-	874,845
Change in net unrealized gain on investment securities available-for-sale, net of taxes	-	-	-	-	110,141	110,141
5% stock dividend	56,707	283,535	113,414	(396,949)	-	-
Cash in lieu of fractional shares	-	-	-	(1,302)	-	(1,302)
Restricted stock grants issued	15,500	77,500	(77,500)	-	-	-
Stock-based compensation expense	-	-	82,443	-	-	82,443
BALANCE, December 31, 2012	1,209,753	6,048,765	7,213,009	1,183,023	235,336	14,680,133
Net income	-	-	-	1,011,537	-	1,011,537
Change in net unrealized gain on investment securities available-for-sale, net of taxes	-	-	-	-	(131,198)	(131,198)
5% stock dividend	62,146	310,730	328,358	(639,088)	-	-
Cash in lieu of fractional shares	-	-	-	(4,369)	-	(4,369)
Options exercised	46,003	230,015	179,111	-	-	409,126
Restricted stock grants issued	25,500	127,500	(127,500)	-	-	-
Stock-based compensation expense	-	-	123,207	-	-	123,207
Common stock issued, net of expenses	500,000	2,500,000	2,465,653	-	-	4,965,653
BALANCE, December 31, 2013	<u>1,843,402</u>	<u>\$ 9,217,010</u>	<u>\$ 10,181,838</u>	<u>\$ 1,551,103</u>	<u>\$ 104,138</u>	<u>\$ 21,054,089</u>

PEOPLE'S BANK OF COMMERCE

STATEMENTS OF CASH FLOWS

	Years Ended December 31,	
	2013	2012
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income	\$ 1,011,537	\$ 874,845
Adjustments to reconcile net income to net cash from operating activities:		
Deferred income taxes	(147,845)	187,923
Provision for loan losses	57,362	361,374
Depreciation and amortization	344,387	235,713
Stock-based compensation expense	123,207	82,443
Amortization of premiums on investment securities	179,356	186,520
Impairment loss on other real estate owned	-	86,751
Gain on sale of other real estate owned	(252,203)	(7,959)
Net appreciation of bank-owned life insurance	(127,345)	(131,698)
Gain on sale of loans	(649,982)	(1,090,316)
Proceeds from the sale of loans held-for-sale	43,940,723	54,610,015
Production of loans held-for-sale	(40,323,655)	(53,603,815)
Changes in cash due to changes in certain assets and liabilities:		
Accrued interest receivable and other assets	396,789	103,005
Accrued interest payable and other liabilities	644,946	(457,175)
Net cash from operating activities	5,197,277	1,437,626
CASH FLOWS FROM INVESTING ACTIVITIES		
Purchase of time deposits with other institutions	(4,481,788)	(996,000)
Purchase of investment securities available-for-sale	(4,698,694)	(2,521,927)
Proceeds from payments, calls, and sales of investment securities available-for-sale	2,007,861	3,459,896
Purchase of investment securities held to maturity	(3,558,818)	-
Purchase of Federal Home Loan Bank stock	(3,300)	(15,600)
Net increase in loans	(13,778,929)	(18,474,147)
Proceeds from sale of other real estate owned	585,661	820,523
Purchase of bank-owned life insurance	(165,000)	(165,000)
Investment in real estate joint venture	(174,287)	(1,419,652)
Payments made for purchase of premises, equipment, and leasehold improvements	(335,724)	(683,894)
Net cash from investing activities	(24,603,018)	(19,995,801)

PEOPLE'S BANK OF COMMERCE
STATEMENTS OF CASH FLOWS

	Years Ended December 31,	
	2013	2012
CASH FLOWS FROM FINANCING ACTIVITIES		
Net increase in deposit accounts	\$ 32,546,994	\$ 15,172,978
(Payments on) proceeds from borrowings	(2,500,000)	2,500,000
Cash paid in lieu of fractional shares from stock dividend	(4,369)	(1,302)
Proceeds from stock options exercised	409,126	-
Proceeds from sales of common stock, net of expenses	4,965,653	-
Net cash from financing activities	35,417,404	17,671,676
NET CHANGE IN CASH AND CASH EQUIVALENTS	16,011,663	(886,499)
CASH AND CASH EQUIVALENTS, beginning of year	5,046,574	5,933,073
CASH AND CASH EQUIVALENTS, end of year	\$ 21,058,237	\$ 5,046,574
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION		
Cash paid for interest	\$ 508,488	\$ 684,914
Cash paid for taxes	\$ 469,000	\$ 729,000
SUPPLEMENTAL DISCLOSURE OF NONCASH INVESTING ACTIVITIES		
Change in fair value of investment securities available-for-sale, net of taxes	\$ (131,198)	\$ 110,141
Transfers of loans to other real estate owned	\$ 314,071	\$ -

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 five full-service branches in Ashland, Central Point, Grants Pass, and Medford, Oregon, and provides banking services to businesses and individuals located primarily in Southern Oregon.

The Company declared 5% stock dividends during 2013 and 2012. All per share amounts and calculations in the accompanying financial statements have been restated to reflect the effects of these stock dividends.

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, deferred tax assets, and the fair value of financial instruments.

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." The Bank holds no trading securities. However, debt securities that the Bank has the positive intent and ability to hold to maturity are classified as held-to-maturity and recorded at amortized cost. Securities not classified as held to maturity are classified as available-for-sale and recorded at fair value. Premiums and discounts are recognized in interest income using the effective interest method over the period to maturity.

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.

PEOPLE'S BANK OF COMMERCE

NOTES TO FINANCIAL STATEMENTS

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, which is 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. Market value adjustments

that reduce the carrying value of loans held for sale are recorded within a valuation allowance account and charged to non-interest income.

Loans, net of allowance for loan losses, and unearned income – 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 in which 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 measured at the time of restructure for impairment, and 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.

PEOPLE'S BANK OF COMMERCE

NOTES TO FINANCIAL STATEMENTS

Note 1 - Organization and Summary of Significant Accounting Policies (continued)

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 initially recorded at fair value and are subsequently 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. Adjustments that reduce loan balances to the lower carrying value at the time of foreclosure are recognized as charge-offs in the allowance for loan losses. Subsequent impairment write-downs to net realizable value, if any, or any disposal gains or losses are included in noninterest income or expense. Costs relating to the development and improvement of property are capitalized and holding costs are charged to expense as incurred.

Federal Home Loan Bank (FHLB) stock – At December 31, 2013 and 2012, the Bank held FHLB stock with a par value of \$178,600 and \$178,800, 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.

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 concluded that the Bank's FHLB stock investment was not impaired as of December 31, 2013.

Investment in real estate joint venture – During 2011, the Bank entered into a joint venture with another investor in a limited liability company formed to manage the construction and ownership of a new building that the Bank began to occupy at the end of 2012. The Bank accounted for its initial investment at 50% of total costs incurred to construct the new building. Following completion of construction and occupancy of the building, the Bank accounts for its investment in the limited liability company by following the equity method of accounting. Under this accounting treatment, the Bank recognizes its proportionate share of earnings and losses as a component of noninterest expense. During 2013 and 2012, the Bank recognized \$130,506 and \$22,721, respectively in net income from its investment in the limited liability company.

PEOPLE'S BANK OF COMMERCE

NOTES TO FINANCIAL STATEMENTS

Note 1 – Organization and Summary of Significant Accounting Policies (continued)

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 taxing 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 does not anticipate that any amount of unrecognized tax benefits will significantly increase or decrease in the next 12 months. Additionally, the Bank recognizes interest and penalties related to income tax matters in income tax expense, although there were no interest and penalties recognized for the years ended December 31, 2013 and 2012.

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.

The allowance for off-balance sheet credit losses related to unfunded loan commitments is increased through charges to noninterest 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 period in which they are incurred.

Earnings per share – Basic earnings per share is computed by dividing net income 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 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.

Note 1 – Organization and Summary of Significant Accounting Policies (continued)

Stock compensation plans – The Bank has adopted stock-based compensation plans, and recognizes compensation expense based on the fair value of options or restricted stock awards on the date of grant. 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.

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 nonrecurring 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).

PEOPLE'S BANK OF COMMERCE

NOTES TO FINANCIAL STATEMENTS

Note 1 – Organization and Summary of Significant Accounting Policies (continued)

Other real estate owned – Other real estate owned is measured and adjusted to fair value on a nonrecurring basis. On the date that other real estate owned is received in satisfaction of a loan receivable, it is measured at fair value, less cost 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 nonrecurring 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.

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.

Note 1 - Organization and Summary of Significant Accounting Policies (continued)

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 income or earnings per share.

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 7, 2014, 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
December 31, 2013					
Investment securities available-for-sale:					
U.S. government agency obligations	\$ 3,871,804	\$ 2,571	\$ (6,688)	\$ -	\$ 3,867,687
SBA backed securities	5,302,161	102,284	(9,577)	(753)	5,394,115
Municipal securities	3,617,538	110,778	(29,561)	-	3,698,755
	<u>\$ 12,791,503</u>	<u>\$ 215,633</u>	<u>\$ (45,826)</u>	<u>\$ (753)</u>	<u>\$ 12,960,557</u>
Investment securities held to maturity:					
Municipal securities	<u>\$ 3,557,118</u>	<u>\$ -</u>	<u>\$ (38,037)</u>	<u>\$ -</u>	<u>\$ 3,519,081</u>
Total investment securities:	<u><u>\$ 16,348,621</u></u>	<u><u>\$ 215,633</u></u>	<u><u>\$ (83,863)</u></u>	<u><u>\$ (753)</u></u>	<u><u>\$ 16,479,638</u></u>
December 31, 2012					
U.S. government agency obligations	\$ 1,000,095	\$ 14,082	\$ -	\$ -	\$ 1,014,177
SBA backed securities	5,635,611	101,598	(8,043)	-	5,729,166
Municipal securities	3,642,620	274,402	-	-	3,917,022
	<u>\$ 10,278,326</u>	<u>\$ 390,082</u>	<u>\$ (8,043)</u>	<u>\$ -</u>	<u>\$ 10,660,365</u>

At December 31, 2013, the Bank had five available-for sale investment securities with amortized cost of \$3,499,528 in a loss position for less than 12 months, and one available-for-sale investment security with amortized cost of \$286,538 in a loss position for greater than 12 months as shown in the table above. Nine of the Bank's held to maturity investment securities with amortized cost of \$3,557,118 were in a loss position for less than 12 months at December 31, 2013 as shown in the table above. At December 31, 2012, the Bank had two investment securities with amortized cost of \$746,116 in a loss position for less than 12 months, as shown in the table. The Bank evaluated the unrealized losses and determined that the declines in value at December 31, 2013 were temporary and related to the change in market interest rates since the date of purchase.

During the years ended December 31, 2013 and 2012, no available-for-sale securities were sold. At December 31, 2013 and 2012, securities in the amount of \$400,000 were pledged to secure public deposits.

PEOPLE'S BANK OF COMMERCE
NOTES TO FINANCIAL STATEMENTS

Note 2 – Investment Securities (continued)

The amortized cost and estimated fair value of investment securities by contractual maturity at December 31, 2013 are as follows:

	Available for Sale		Held to Maturity	
	Amortized Cost	Estimated Fair Value	Amortized Cost	Estimated Fair Value
Due from one year through five years	\$ 3,871,804	\$ 3,867,688	\$ -	\$ -
Due from five years through ten years	5,302,161	5,394,114	-	-
Due after ten years	3,617,538	3,698,755	3,557,118	3,519,081
	<u>\$ 12,791,503</u>	<u>\$ 12,960,557</u>	<u>\$ 3,557,118</u>	<u>\$ 3,519,081</u>

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:

	2013	2012
Real estate loans	\$ 87,803,262	\$ 76,153,389
Commercial loans	28,845,690	28,275,673
Construction loans	7,683,562	6,165,855
Consumer loans	<u>1,484,463</u>	<u>1,705,361</u>
Total loans	125,816,977	112,300,278
Allowance for loan losses	(1,960,602)	(1,832,760)
Unearned income	<u>(134,529)</u>	<u>(153,168)</u>
Loans, net of allowance for loan losses, and unearned income	<u>\$ 123,721,846</u>	<u>\$ 110,314,350</u>

PEOPLE'S BANK OF COMMERCE

NOTES TO FINANCIAL STATEMENTS

Note 4 – Allowance for Loan Losses

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

	2013				
	Real Estate	Commercial	Construction	Consumer	Total
Allowance for loan losses					
Beginning balance	\$ 1,433,084	\$ 270,585	\$ 128,959	\$ 132	\$ 1,832,760
Charge-offs	-	-	(25,000)	(4,096)	(29,096)
Recoveries	41,136	55,205	1,100	2,135	99,576
Provision for loan losses	96,341	(57,984)	(8,707)	27,712	57,362
Ending balance	<u>\$ 1,570,561</u>	<u>\$ 267,806</u>	<u>\$ 96,352</u>	<u>\$ 25,883</u>	<u>\$ 1,960,602</u>
Ending balance					
Loans individually evaluated for impairment	<u>\$ 37,368</u>	<u>\$ 27,299</u>	<u>\$ 19,930</u>	<u>\$ -</u>	<u>\$ 84,597</u>
Ending balance					
Loans collectively evaluated for impairment	<u>\$ 1,533,193</u>	<u>\$ 240,507</u>	<u>\$ 76,422</u>	<u>\$ 25,883</u>	<u>\$ 1,876,005</u>
	2012				
	Real Estate	Commercial	Construction	Consumer	Total
Allowance for loan losses					
Beginning balance	\$ 1,047,779	\$ 336,465	\$ 176,940	\$ 21,932	\$ 1,583,116
Charge-offs	(127,865)	(6,279)	-	(499)	(134,643)
Recoveries	11,201	5,548	3,904	2,260	22,913
Provision for loan losses	501,969	(65,149)	(51,885)	(23,561)	361,374
Ending balance	<u>\$ 1,433,084</u>	<u>\$ 270,585</u>	<u>\$ 128,959</u>	<u>\$ 132</u>	<u>\$ 1,832,760</u>
Ending balance					
Loans individually evaluated for impairment	<u>\$ 40,112</u>	<u>\$ 3,081</u>	<u>\$ 52,334</u>	<u>\$ -</u>	<u>\$ 95,527</u>
Ending balance					
Loans collectively evaluated for impairment	<u>\$ 1,392,972</u>	<u>\$ 267,504</u>	<u>\$ 76,625</u>	<u>\$ 132</u>	<u>\$ 1,737,233</u>

PEOPLE'S BANK OF COMMERCE
NOTES TO FINANCIAL STATEMENTS

Note 4 – Allowance for Loan Losses (continued)

The following table displays the activity and allocation of loans evaluated individually and collectively for impairment to significant segments of the loan portfolio at December 31:

	2013				
	Real Estate	Commercial	Construction	Consumer	Total
Loans					
Ending balance	<u>\$ 87,803,262</u>	<u>\$ 28,845,690</u>	<u>\$ 7,683,562</u>	<u>\$ 1,484,463</u>	<u>\$ 125,816,977</u>
Ending balance Loans individually evaluated for impairment	<u>\$ 1,461,220</u>	<u>\$ 381,390</u>	<u>\$ 2,865,684</u>	<u>\$ -</u>	<u>\$ 4,708,294</u>
Ending balance Loans collectively evaluated for impairment	<u>\$ 86,342,042</u>	<u>\$ 28,464,300</u>	<u>\$ 4,817,878</u>	<u>\$ 1,484,463</u>	<u>\$ 121,108,683</u>
	2012				
	Real Estate	Commercial	Construction	Consumer	Total
Loans					
Ending balance	<u>\$ 76,153,389</u>	<u>\$ 28,275,673</u>	<u>\$ 6,165,855</u>	<u>\$ 1,705,361</u>	<u>\$ 112,300,278</u>
Ending balance Loans individually evaluated for impairment	<u>\$ 1,777,158</u>	<u>\$ 289,943</u>	<u>\$ 2,884,724</u>	<u>\$ -</u>	<u>\$ 4,951,825</u>
Ending balance Loans collectively evaluated for impairment	<u>\$ 74,376,231</u>	<u>\$ 27,985,730</u>	<u>\$ 3,281,131</u>	<u>\$ 1,705,361</u>	<u>\$ 107,348,453</u>

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.

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.

PEOPLE'S BANK OF COMMERCE

NOTES TO FINANCIAL STATEMENTS

Note 4 – Allowance for Loan Losses (continued)

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.

The following table represents loan portfolio information by loan type and credit grade as of December 31:

		2013				
		Real Estate	Commercial	Construction	Consumer	Total
Grade						
Pass		\$ 78,328,592	\$ 26,003,935	\$ 5,401,264	\$ 1,484,226	\$ 111,218,017
Special mention		6,463,451	1,092,924	-	237	7,556,612
Substandard		3,011,219	1,748,831	2,282,298	-	7,042,348
Doubtful		-	-	-	-	-
Loss		-	-	-	-	-
Total		<u>\$ 87,803,262</u>	<u>\$ 28,845,690</u>	<u>\$ 7,683,562</u>	<u>\$ 1,484,463</u>	<u>\$ 125,816,977</u>
		2012				
		Real Estate	Commercial	Construction	Consumer	Total
Grade						
Pass		\$ 68,797,406	\$ 26,526,324	\$ 3,067,486	\$ 1,703,977	\$ 100,095,193
Special mention		6,990,526	859,249	813,802	1,384	8,664,961
Substandard		365,457	890,100	2,284,567	-	3,540,124
Doubtful		-	-	-	-	-
Loss		-	-	-	-	-
Total		<u>\$ 76,153,389</u>	<u>\$ 28,275,673</u>	<u>\$ 6,165,855</u>	<u>\$ 1,705,361</u>	<u>\$ 112,300,278</u>

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 terms. The following table represents loans past due by loan category as of December 31:

2013					
	30 – 59 Days Past Due	60 – 89 Days Past Due	Greater than 90 Days Past Due	Total Past Due	Total Loans
Real estate	\$ -	\$ -	\$ -	\$ -	\$ 87,803,262
Commercial	-	-	-	-	28,845,690
Construction	-	-	-	-	7,683,562
Consumer	-	4,311	-	4,311	1,480,152
	<u>\$ -</u>	<u>\$ 4,311</u>	<u>\$ -</u>	<u>\$ 4,311</u>	<u>\$ 125,812,666</u>
	<u>\$ -</u>	<u>\$ 4,311</u>	<u>\$ -</u>	<u>\$ 4,311</u>	<u>\$ 125,816,977</u>
2012					
	30 – 59 Days Past Due	60 – 89 Days Past Due	Greater than 90 Days Past Due	Total Past Due	Total Loans
Real estate	\$ -	\$ -	\$ 49,896	\$ 49,896	\$ 76,103,493
Commercial	-	-	-	-	28,275,673
Construction	-	-	-	-	6,165,855
Consumer	132	-	-	132	1,705,229
	<u>\$ 132</u>	<u>\$ -</u>	<u>\$ 49,896</u>	<u>\$ 50,028</u>	<u>\$ 112,250,250</u>
	<u>\$ 132</u>	<u>\$ -</u>	<u>\$ 49,896</u>	<u>\$ 50,028</u>	<u>\$ 112,300,278</u>

As of December 31, 2013, no loans were carried on nonaccrual status. As of December 31, 2012, real estate loans totaling \$49,896 and that were greater than 90 days past due were carried on nonaccrual status.

PEOPLE'S BANK OF COMMERCE

NOTES TO FINANCIAL STATEMENTS

Note 4 – Allowance for Loan Losses (continued)

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

	2013				
	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized
With no related allowance recorded					
Real estate	\$ 103,142	\$ 179,755		\$ 181,982	\$ 11,316
Commercial	-	-		60,433	-
Construction	-	-		415,223	-
Consumer	-	-		-	-
	<u>\$ 103,142</u>	<u>\$ 179,755</u>		<u>\$ 657,638</u>	<u>\$ 11,316</u>
With allowance recorded					
Real estate	\$ 1,358,078	\$ 1,358,078	\$ 37,368	\$ 2,036,486	\$ 70,433
Commercial	381,390	381,390	27,299	461,813	6,464
Construction	2,865,684	2,865,684	19,930	2,445,148	79,642
Consumer	-	-	-	-	-
	<u>\$ 4,605,152</u>	<u>\$ 4,605,152</u>	<u>\$ 84,597</u>	<u>\$ 4,943,447</u>	<u>\$ 156,539</u>
Total					
Real estate	\$ 1,461,220	\$ 1,537,833	\$ 37,368	\$ 2,218,468	\$ 81,749
Commercial	381,390	381,390	27,299	522,246	6,464
Construction	2,865,684	2,865,684	19,930	2,860,371	79,642
Consumer	-	-	-	-	-
	<u>\$ 4,708,294</u>	<u>\$ 4,784,907</u>	<u>\$ 84,597</u>	<u>\$ 5,601,085</u>	<u>\$ 167,855</u>

PEOPLE'S BANK OF COMMERCE
NOTES TO FINANCIAL STATEMENTS

Note 4 – Allowance for Loan Losses (continued)

	2012				
	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized
With no related allowance recorded					
Real estate	\$ 392,247	\$ 508,739		\$ 180,083	\$ 31,243
Commercial	83,461	90,339		33,658	4,452
Construction	-	-		-	-
Consumer	-	-		-	-
	<u>\$ 475,708</u>	<u>\$ 599,078</u>		<u>\$ 213,741</u>	<u>\$ 35,695</u>
With allowance recorded					
Real estate	\$ 1,384,911	\$ 1,384,911	\$ 40,112	\$ 1,370,308	\$ 83,464
Commercial	206,482	206,482	3,081	464,042	5,171
Construction	2,884,724	2,884,724	52,334	2,352,477	101,682
Consumer	-	-	-	2,926	-
	<u>\$ 4,476,117</u>	<u>\$ 4,476,117</u>	<u>\$ 95,527</u>	<u>\$ 4,189,753</u>	<u>\$ 190,317</u>
Total					
Real estate	\$ 1,777,158	\$ 1,893,650	\$ 40,112	\$ 1,550,391	\$ 114,707
Commercial	289,943	296,821	3,081	497,700	9,623
Construction	2,884,724	2,884,724	52,334	2,352,477	101,682
Consumer	-	-	-	2,926	-
	<u>\$ 4,951,825</u>	<u>\$ 5,075,195</u>	<u>\$ 95,527</u>	<u>\$ 4,403,494</u>	<u>\$ 226,012</u>

Troubled debt restructurings – At December 31, 2013 and 2012, impaired loans of \$4,708,295 and \$3,977,561, respectively, were classified as troubled debt restructured loans. The restructurings were granted in response to borrower financial difficulty, and generally provide for a temporary modification of loan repayment terms.

The types of modifications offered can generally be described in the following categories:

Rate modification – A modification in which the interest rate is modified.

Term modification – A modification in which the maturity date, timing of payments, or frequency of payments is changed.

Payment modification – A modification in which the payment amount is changed.

Combination modification – Any other type of modification, including the use of multiple types of modifications.

PEOPLE'S BANK OF COMMERCE
NOTES TO FINANCIAL STATEMENTS

Note 4 – Allowance for Loan Losses (continued)

The following table presents newly restructured loans that occurred during the years ended December 31:

2013			
	Number of Contracts	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment
Commercial loan	1	\$ 175,113	\$ 175,113
2012			
	Number of Contracts	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment
Real estate loans	3	\$ 1,140,924	\$ 1,140,924

All modifications offered during the years ended December 31, 2013 and 2012 were rate modifications and have an insignificant impact to the financial statements.

There were no loans restructured for which there was a payment default within a period of 12 months following the restructure during the years ended December 31, 2013 and 2012.

PEOPLE'S BANK OF COMMERCE

NOTES TO FINANCIAL STATEMENTS

Note 5 – Premises, Equipment, and Leasehold Improvements

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

	2013	2012
Land	\$ 583,248	\$ 583,248
Bank premises	2,783,839	2,783,839
Furniture and equipment	1,831,896	1,712,754
Leasehold improvements	169,814	127,036
	5,368,797	5,206,877
Less accumulated depreciation and amortization	(1,879,497)	(1,708,914)
Premises, equipment, and leasehold improvements, net of accumulated depreciation and amortization	<u>\$ 3,489,300</u>	<u>\$ 3,497,963</u>

Depreciation and amortization expense for the years ended December 31, 2013 and 2012 was \$344,387 and \$235,713, respectively.

Note 6 – Time Deposits

Time certificates of deposit of \$100,000 and over totaled \$12,756,234 and \$12,787,470 at December 31, 2013 and 2012, respectively.

As of December 31, 2013, the scheduled maturities for all time deposits are as follows:

Years ending December 31,	2014	\$ 11,146,460
	2015	2,314,164
	2016	5,221,526
	2017	3,472,639
	2018	282,904
		<u>\$ 22,437,693</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, 2013 and 2012, the Bank had \$775,000 and \$3,275,000, respectively, in outstanding borrowings with the FHLB. Borrowings at December 31, 2013 were carrying an interest rate of 2.91% and mature in 2014. As of December 31, 2013, the Bank had approximately \$26,300,000 available for additional borrowings with the FHLB.

Federal funds line of credit – The Bank has obtained lines of credit totaling \$7,250,000 with two correspondent banks. One federal fund line for \$3,000,000 will expire or renew at the discretion of the correspondent bank. A second line for \$4,000,000 was established with a term extending from April 17, 2012 through June 30, 2014. A third international cash letter guidance line in the amount of \$250,000 was granted to the Bank in November, 2012 and will expire or renew at the discretion of the correspondent bank. There were no balances outstanding on these lines of credit as of December 31, 2013 and 2012.

Note 8 – Income Taxes

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

	2013	2012
Current income taxes		
Federal	\$ 520,383	\$ 183,245
State	127,972	41,912
Total current income taxes	648,355	225,157
Deferred income taxes		
Federal	(119,049)	151,321
State	(28,796)	36,602
Total deferred income taxes	(147,845)	187,923
Provision for income taxes	<u>\$ 500,510</u>	<u>\$ 413,080</u>

PEOPLE'S BANK OF COMMERCE

NOTES TO FINANCIAL STATEMENTS

Note 8 – Income Taxes (continued)

Net 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:

	2013	2012
Deferred tax assets		
Allowance for loan losses	\$ 613,437	\$ 591,057
Unrealized gains on investment securities available-for-sale	(64,917)	(146,703)
Prepays	(57,747)	(168,755)
Supplemental executive retirement plan	358,418	308,669
Split-dollar liability	50,542	45,950
Intangible assets - permits and licenses	(32,513)	(28,612)
Reserve for off-balance sheet instrument	13,953	10,375
Depreciation and organization costs	(216,003)	(180,210)
Non-accrual interest	-	1,236
Stock-based compensation	20,887	26,315
Accrued bonuses	58,203	-
Other	34,783	90,090
Net deferred tax assets	<u>\$ 779,043</u>	<u>\$ 549,412</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.

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 contractual 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.

PEOPLE'S BANK OF COMMERCE

NOTES TO FINANCIAL STATEMENTS

Note 9 – Financial Instruments with Off-Balance Sheet Risk (continued)

A summary of the notional amounts of the Bank's financial instruments with off-balance sheet risk as of December 31, 2013 is as follows:

	2013
Commitments to extend credit	
Commercial	\$ 11,167,567
Construction	3,580,319
Residential	5,367,140
Consumer	1,293,749
	<u>\$ 21,408,775</u>
Commercial and standby letters of credit	<u>\$ 379,335</u>

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 2013, the Bank's loan policy did not allow the extension of credit to any single borrower or group of related borrowers in excess of \$875,000 on an unsecured basis and \$1,750,000 on a secured basis, without approval from the Board of Directors' Loan Committee. Additionally, no individual new loans in excess of \$1,000,000 can be originated without Board approval.

Note 11 – Commitments and Contingencies

Lease commitments – As of December 31, 2013, the Bank leased branch office space under two operating lease agreements. One of the branch leases expires in 2018 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,	2014	\$ 390,679
	2015	316,930
	2016	324,231
	2017	331,711
	2018	339,376
	Thereafter	<u>2,875,720</u>
		<u>\$ 4,578,647</u>

For the years ended December 31, 2013 and 2012, rent expense was \$396,477 and \$293,099, 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, 2013, the Bank was not involved in any current matters expected to have a material adverse effect on its financial condition or results of operations.

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NOTES TO FINANCIAL STATEMENTS

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.

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

	2013	2012
Balance, beginning of year	\$ 2,662,853	\$ 2,814,422
Loans made	3,585,831	1,844,941
Loans repaid	(3,530,086)	(1,996,510)
Balance, end of year	<u>\$ 2,718,598</u>	<u>\$ 2,662,853</u>
Outstanding loan commitments	<u>\$ 1,294,352</u>	<u>\$ 769,597</u>

The Bank has a loan to its other 50% member in the limited liability company that owns its headquarters building. The loan carries an interest rate of 6.25%, matures in December of 2037, and is collateralized by member's interest in the land on which the building is located. The loan was originated for the purpose of funding the partner's portion of construction costs of the new administrative office and had a balance of \$2,051,000 as of December 31, 2013.

Related party deposits held by the Bank at December 31, 2013 and 2012 were \$9,776,956 and \$6,749,983, respectively.

Note 13 – Stock-Based Compensation Plans

Under its stock-based compensation plans, the Bank may grant nonqualified stock options and restricted stock awards to its directors, officers, and employees for up to 282,966 shares of common stock. 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, adjusted for the 2013 and 2012 5% stock dividends:

	Number of Shares	Weighted Average Exercise Price	Aggregate Intrinsic Value	Weighted Average Contractual Term
Options under grant as of December 31, 2011	130,815			
Options granted - 2012	<u>18,900</u>	\$ 7.95		10.00
Options under grant as of December 31, 2012	<u>149,715</u>	\$ 8.83		5.14
Options exercised - 2013	<u>(46,003)</u>	\$ 8.89	\$ 61,960	
Options under grant as of December 31, 2013	<u>103,712</u>	\$ 8.98		6.12
Options exercisable as of December 31, 2013	<u>42,217</u>	\$ 10.88	\$ 30,708	3.52

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 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.

PEOPLE'S BANK OF COMMERCE

NOTES TO FINANCIAL STATEMENTS

Note 13 – Stock-Based Compensation Plans (continued)

The fair values of options granted during 2012 were computed utilizing the following weighted-average assumptions.

	<u>2012</u>
Dividend yield	0.00%
Weighted average expected life	7.5 years
Expected volatility	46.01%
Risk-free rate	1.20%

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 Bank expenses stock options on a straight-line basis over the options' related vesting term. As of December 31, 2013, there was \$153,007 of unrecognized compensation expense related to the granting of stock options. That cost is expected to be recognized over a period of five years.

The following table summarizes restricted stock award activity under the plan as of December 31, 2013:

	Number of Shares	Weighted Average Fair Value
Restricted stock awards unvested at December 31, 2011	26,791	
Awards granted	16,275	\$ 7.95
Awards vested	<u>(5,954)</u>	\$ 7.86
Restricted stock awards unvested at December 31, 2012	<u>37,112</u>	\$ 7.65
Awards granted	25,500	\$ 9.62
Awards vested	<u>(9,209)</u>	\$ 7.75
Restricted stock awards unvested at December 31, 2013	<u>53,403</u>	\$ 8.35

As of December 31, 2013, there was \$456,106 of unrecognized stock-based compensation expense related to nonvested restricted stock awards. The cost is expected to be recognized over the vesting period.

Total compensation expense recognized for stock-based compensation plans was \$123,207 and \$82,443 for the years ended December 31, 2013 and 2012, respectively.

Note 14 – Employee Benefit Plans and Agreements

The Bank adopted a 401(k) plan in which substantially all employees participate. Employees may contribute the maximum amount 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, 2013 and 2012, the Bank's expense attributable to the plan was \$86,653 and \$76,357, respectively.

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NOTES TO FINANCIAL STATEMENTS

Note 14 - Employee Benefit Plans and Agreements (continued)

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 \$1,048,188 and \$908,905 as of December 31, 2013 and 2012, respectively. These amounts are included on the balance sheet among "accrued interest payable and other liabilities." For 2013 and 2012, compensation expense related to these plans was \$173,159 and \$116,042, respectively.

Note 15 - Earnings Per Share

The following table illustrates the computations of basic and diluted earnings per share for the years ended December 31 (adjusted for the 2013 and 2012 stock dividends):

	<u>Net Income</u>	<u>Weighted Average Shares</u>	<u>Per Share Amount</u>
For the year ended December 31, 2013			
Basic income per share	\$ 1,011,537	1,493,587	<u>\$ 0.68</u>
Stock options		<u>3,809</u>	
Diluted income per share	\$ 1,011,537	<u>1,497,396</u>	<u>\$ 0.68</u>
For the year ended December 31, 2012			
Basic income per share	\$ 874,845	1,245,399	<u>\$ 0.70</u>
Stock options		<u>129</u>	
Diluted income per share	\$ 874,845	<u>1,245,528</u>	<u>\$ 0.70</u>

Options for 67,767 and 146,756 shares of common stock were excluded from the diluted earnings per share calculation in 2013 and 2012, respectively, due to their anti-dilutive effect.

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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.

		Fair Value Measurements Using		
		Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Carrying Value				
<u>Recurring items as of December 31, 2013</u>				
Investment securities available-for-sale				
U.S. government agency obligations	\$ 3,867,687	\$ -	\$ 3,867,687	\$ -
SBA backed securities	5,394,115	-	5,394,115	-
Municipal securities	3,698,755	-	3,698,755	-
Total investment securities available-for-sale	<u>\$ 12,960,557</u>	<u>\$ -</u>	<u>\$ 12,960,557</u>	<u>\$ -</u>
<u>Nonrecurring items as of December 31, 2013</u>				
Loans measured for impairment	\$ 4,520,555	\$ -	\$ -	\$ 4,520,555
Other real estate owned	\$ 1,687,711	\$ -	\$ -	\$ 1,687,711
		Fair Value Measurements Using		
		Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Carrying Value				
<u>Recurring items as of December 31, 2012</u>				
Investment securities available-for-sale:				
U.S. government agency obligations	\$ 1,014,177	\$ -	\$ 1,014,177	\$ -
SBA backed securities	5,729,166	-	5,729,166	-
Municipal securities	3,917,022	-	3,917,022	-
Total investment securities available-for-sale	<u>\$ 10,660,365</u>	<u>\$ -</u>	<u>\$ 10,660,365</u>	<u>\$ -</u>
<u>Nonrecurring items as of December 31, 2012</u>				
Loans measured for impairment	\$ 4,380,590	\$ -	\$ -	\$ 4,380,590
Other real estate owned	\$ 1,707,098	\$ -	\$ -	\$ 1,707,098

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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 at December 31, 2013			
		Quoted Prices			
		in Active Markets for Identical Assets			
		Significant Other Observable Inputs			
		Significant Unobservable Inputs			
	Carrying Amount	Total	(Level 1)	(Level 2)	(Level 3)
Financial assets					
Cash and cash equivalents	\$ 21,058,237	\$ 21,058,237	\$ 21,058,237	\$ -	\$ -
Time deposits with other institutions	5,477,788	5,477,788	5,477,788	-	-
Investment securities available-for-sale	12,960,557	12,960,557	-	12,960,557	-
Investment securities held to maturity	3,557,118	3,519,081	-	3,519,081	-
Restricted equity securities	182,100	182,100	182,100	-	-
Loans held-for-sale	643,920	643,920	-	643,920	-
Loans receivable, gross	125,816,977	106,215,832	-	-	106,215,832
Bank-owned life insurance	4,376,471	4,376,471	4,376,471	-	-
Financial liabilities					
Noninterest-bearing demand deposits	\$ 55,381,817	\$ 55,381,817	\$ 55,381,817	\$ -	\$ -
Interest-bearing demand, money market accounts, and savings deposits	80,447,661	80,447,661	-	80,447,661	-
Time certificates of deposit	22,437,693	21,357,267	-	21,357,267	-
Borrowings	775,000	770,045	-	770,045	-

		Fair Value at December 31, 2012			
		Quoted Prices			
		in Active Markets for Identical Assets			
		Significant Other Observable Inputs			
		Significant Unobservable Inputs			
	Carrying Amount	Total	(Level 1)	(Level 2)	(Level 3)
Financial assets					
Cash and cash equivalents	\$ 5,046,574	\$ 5,046,574	\$ 5,046,574	\$ -	\$ -
Time deposits with other institutions	996,000	996,000	996,000	-	-
Investment securities available-for-sale	10,660,365	10,660,365	-	10,660,365	-
Restricted equity securities	178,800	178,800	178,800	-	-
Loans held-for-sale	3,611,006	3,611,006	-	3,611,006	-
Loans receivable, gross	112,300,278	82,610,413	-	-	82,610,413
Bank-owned life insurance	4,084,126	4,084,126	4,084,126	-	-
Financial liabilities					
Noninterest-bearing demand deposits	\$ 36,640,891	\$ 36,640,891	\$ 36,640,891	\$ -	\$ -
Interest-bearing demand, money market accounts, and savings deposits	61,044,972	61,044,972	-	61,044,972	-
Time certificates of deposit	28,034,314	27,577,796	-	27,577,796	-
Borrowings	3,275,000	3,290,463	-	3,290,463	-

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he 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, 2013 and 2012.

PEOPLE'S BANK OF COMMERCE

NOTES TO FINANCIAL STATEMENTS

Note 17 – Common Stock Issuance

The Bank completed a Private Placement Offering (the Offering), selling 500,000 shares of common stock to directors, executives, and other investors at a price of \$10.00 per share during the year ended December 31, 2013. Total proceeds to the Bank, net of direct offering costs, were \$4,965,653 for the year ended December 31, 2013, and are being 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.

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, 2013

and 2012, 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.

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NOTES TO FINANCIAL STATEMENTS

Note 18 – Regulatory Matters (continued)

(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, 2013</u>						
Total capital to risk-weighted assets	\$ 22,457	17.0%	\$ 10,580	≥8.0%	\$ 13,224	≥10.0%
Tier 1 capital to risk-weighted assets	20,800	15.7%	5,290	≥4.0%	7,935	≥6.0%
Tier 1 capital to average assets	20,800	11.7%	7,125	≥4.0%	8,907	≥5.0%
<u>December 31, 2012</u>						
Total capital to risk-weighted assets	\$ 15,759	13.6%	\$ 9,275	≥8.0%	\$ 11,593	≥10.0%
Tier 1 capital to risk-weighted assets	14,295	12.3%	4,637	≥4.0%	6,956	≥6.0%
Tier 1 capital to average assets	14,295	10.1%	5,653	≥4.0%	7,066	≥5.0%