Pacific Valley Bank

Your Business. Our Priority.

ANNUAL REPORT 2014

PACIFIC VALLEY BANK
Your Business. Our Priority.

April 15, 2015

Dear Shareholders,

Enclosed please find our 2014 Audited Financial Statement for your review. As stated in the enclosed Proxy Statement, the Bank will have its 2015 Shareholders Meeting on Wednesday, May 27, 2015. Following are a few highlights of the Bank's financial statement.

<u>Assets:</u> Your bank finished 2014 with $252.9 million in assets. This is an increase over 2013 year end of $41.4 million, or 19.6%. The largest asset growth was seen in the Bank's liquidity, ending at $71.1 million, and loans ending 2014 at $169.9 million, an increase over 2013 year end of $14.4 million. Although the portfolio was consistently over $173 million for the fourth quarter, the Bank was successful in having over $5 million in classified loans removed from the portfolio. The excellent collection efforts by the Bank's Credit Department enabled the Bank to achieve classified asset ratios as mandated by our Consent Order six months earlier than requested in the Order.

<u>Deposits:</u> Similar to the Bank's earning assets growing at a substantial rate, deposits increased from $184.8 million at year-end 2013 to $225.5 million, an increase of $40.7 million, or 22%. Most impressive was the growth in the Bank's non-interest bearing accounts of $21.2 million, or 37.7%. Although interest bearing deposits also rose $19.5 million, the rate of growth was smaller at 15.2%. While interest bearing deposits grew, the growth was in lower rate CDs and Money Market accounts enabling the Bank to improve its cost-of-funds.

<u>Profitability:</u> Total interest income increased $257 thousand to end 2014 at just under $9 million. Net interest income ended the year at $8 million. Non interest expense also increased in 2014, due primarily to residual auditing and compliance expenses. We averaged 46 full time equivalent employees, and we do not anticipate increasing staff by more than one person in 2015. Pre-tax income was nearly $1 million higher than 2013 at $1.4 million, with the final net profit coming in at $779 thousand, resulting in earnings of $0.22 per share.

<u>Capital:</u> Shareholder's Capital increased proportionately from $25.9 million at year-end 2013 to $26.6 million at year-end 2015, resulting in a book value per share of $7.40.

The Board of Directors and Staff thank you for your continued support. The majority of our largest depositors are shareholders of the Bank, and your continue deposit growth enables the Bank to grow its loan portfolio and continue to work toward increased profitability.

Sincerely,

Michael T. Wilson
President / CEO

Joseph Robello
Chairman of the Board

This letter includes forward-looking information, which is subject to the "safe harbor" created by Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act and the Private Securities Litigation Reform Act of 1995. When the Bank uses or incorporates by reference in this letter the words "anticipate," "estimate," "expect," "project," "intend," "commit," "believe" and similar expressions, the Company intends to identify forward-looking statements. Our actual results may differ materially from those projected in any forward-looking statements, as they will depend on many factors about which we are unsure, including many factors which are beyond our control.

Pacific Valley Bank

FINANCIAL STATEMENTS

AS OF AND FOR THE YEARS ENDED DECEMBER 31, 2014 AND 2013

AND

INDEPENDENT AUDITOR'S REPORT

Crowe Horwath LLP
Independent Member Crowe Horwath International

INDEPENDENT AUDITOR'S REPORT

The Shareholders and Board of Directors
Pacific Valley Bank
Salinas, California

Report on the Financial Statements

We have audited the accompanying financial statements of Pacific Valley Bank (the "Bank"), which comprise the balance sheets as of December 31, 2014 and 2013, and the related statements of income, comprehensive income, changes in shareholders' equity and cash flows for the years then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

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

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

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

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Pacific Valley Bank as of December 31, 2014 and 2013, 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.

(Continued)

Emphasis of Matter

As discussed in Note 13 to the financial statements, the Bank has stipulated to the issuance of a Consent Order by the Federal Deposit Insurance Corporation and California Department of Business Oversight requiring, among other things, for the Bank to maintain a leverage capital ratio of 9.5% and a total risk-based capital ratio of 12%. At December 31, 2014, the Bank was in compliance with these required levels. Our opinion is not modified with respect to this matter.

Crowe Horwath LLP

Crowe Horwath LLP

San Francisco, California
March 27, 2015

PACIFIC VALLEY BANK
BALANCE SHEETS
December 31, 2014 and 2013

(amounts in thousands, except shares)

	2014	2013
ASSETS		
Cash and due from banks	$ 71,137	$ 45,580
Total cash and cash equivalents	71,137	45,580
Available-for-sale investment		
Securities at estimated fair value (Note 2)	1,639	2,138
Interest-bearing certificates of deposit	1,500	980
Loans, less allowance for loan losses of $3,714		
in 2014 and $4,611 in 2013 (Note 4, 5 and 11)	169,854	155,474
Bank premises and equipment, net (Note 6)	1,015	1,178
Other real estate owned (Note 7)	2,134	-
FHLB stock and other securities	1,002	980
Accrued interest receivable and other assets	4,653	5,153
Total Assets	$ 252,934	$ 211,483
LIABILITIES AND SHAREHOLDERS' EQUITY		
Deposits:		
Non-interest bearing	$ 77,402	$ 56,219
Interest bearing (Note 8)	148,096	128,584
Total deposits	225,498	184,803
Accrued interest payable and other liabilities	802	775
Total liabilities	226,300	185,578
Commitments and contingencies (Notes 10 and 11)		
Shareholders' equity (Notes 12 and 13)		
Preferred stock - no par value; 5,000,000 shares authorized; none issued	-	-
Common stock - no par value; 5,000,000 shares shares authorized; 3,596,996 shares outstanding at December 31, 2014 and December 31, 2013	32,480	32,524
Accumulated deficit	(5,920)	(6,699)
Accumulated other comprehensive income (Note 2)	74	80
Total shareholders' equity	26,634	25,905
	$ 252,934	$ 211,483

The accompanying notes are an integral part of these financial statements

PACIFIC VALLEY BANK
STATEMENTS OF INCOME
For the Years Ended December 31, 2014 and 2013

(amounts in thousands, except shares and per share amounts)

	2014	2013
Interest income:		
Interest and fees on loans	$ 8,757	$ 8,498
Interest on overnight investments	91	68
Interest on investment securities	79	118
Interest and dividends on deposits at other banks	69	55
Total interest income	8,996	8,739
Interest expense:		
Interest on deposits (Note 8)	967	960
Total interest expense	967	960
Net Interest Income	8,029	7,779
Provision for loan losses (Note 5)	-	1,400
Net interest income after provision for loan losses	8,029	6,379
Non-interest income:		
Service charges on deposit accounts	264	196
Gain on sale of OREO	49	93
Other income	158	144
Total non-interest income	471	433
Non-interest expense		
Salaries and employee benefits (Notes 4 and 15)	4,187	3,549
Occupancy and equipment (Notes 6 and 11)	687	650
Other (Note 14)	2,272	2,237
Total non-interest expense	7,146	6,436
Income before provision for income taxes	1,354	376
Income tax expense/(benefit) (Note 9)	575	(4,384)
Net Income	$ 779	$ 4,760
Basic earnings per share	$ 0.22	$ 1.32
Diluted earnings per share	$ 0.22	$ 1.32
Weighted average number of basic shares outstanding	3,596,996	3,596,996
Weighted average number of diluted shares outstanding	3,596,996	3,596,996

The accompanying notes are an integral part of these financial statements

PACIFIC VALLEY BANK
STATEMENTS OF COMPREHENSIVE INCOME
For the Years Ended December 31, 2014 and 2013

(amounts in thousands)

	2014	2013
Net Income	$ 779	$ 4,760
Other comprehensive loss:		
Unrealized losses on available-for-sale investment securities	(9)	(101)
Tax effect	3	41
Other comprehensive loss	(6)	(60)
Comprehensive income	$ 773	$ 4,700

The accompanying notes are an integral part of these financial statements

PACIFIC VALLEY BANK
STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY
For the Years Ended December 31, 2014 and 2013

(amounts in thousands, except shares)

	Common Stock		Accumulated	Accumulated Other Comprehensive	Total Shareholders'
	Shares	Amount	Deficit	Income, Net of Taxes	Equity
Balance at January 1, 2013	3,269,955	$ 32,523	$ (11,459)	$ 140	$ 21,204
10% stock dividend	327,041				
Share-based compensation	-	1	-	-	1
Net Income	-	-	4,760	-	4,760
Other comprehensive loss	-	-	-	(60)	(60)
Balance at December 31, 2013	3,596,996	32,524	(6,699)	80	25,905
Share-based compensation	-	(44)	-	-	(44)
Net Income	-	-	779	-	779
Other comprehensive loss	-	-	-	(6)	(6)
Balance at December 31, 2014	3,596,996	$ 32,480	$ (5,920)	$ 74	$ 26,634

The accompanying notes are an integral part of these financial statements

PACIFIC VALLEY BANK
STATEMENTS OF CASH FLOWS
For the Years Ended December 31, 2014 and 2013

(amounts in thousands)

	2014	2013
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income	$ 779	$ 4,760
Adjustments to reconcile net income		
to net cash provided by operating activities:		
Provision for loan losses	-	1,400
Depreciation, amortization, and accretion	196	192
(Decrease) in deferred loan origination cost, net	(13)	21
Change in deferred taxes, net	633	(4,424)
Gain on disposition of other real estate owned	(49)	(93)
Other items, net	(155)	153
Net cash provided by operating activities	1,391	2,009
CASH FLOWS FROM INVESTING ACTIVITIES		
Proceeds from sale, call, and maturity of investments	-	10
Principal repayment of investments	498	1,316
Net purchase of interest-bearing deposits at banks	(520)	-
Proceeds from maturity of interest bearing deposits at banks	-	2,453
Net increase in loans	(16,581)	(8,747)
Proceeds from sale of other real estate owned	129	500
FHLB stock purchased and repurchased, net	(22)	(14)
Purchase of premises and equipment	(33)	(220)
Net cash used in investing activities	(16,529)	(4,702)
CASH FLOWS FROM FINANCING ACTIVITIES		
Net increase in non-time deposits	36,311	14,552
Net decrease in time deposits	4,384	(1,815)
Net cash provided by financing activities	40,695	12,737
NET INCREASE IN CASH AND CASH EQUIVALENTS	25,557	10,044
CASH AND CASH EQUIVALENTS, beginning of year	45,580	35,536
CASH AND CASH EQUIVALENTS, end of year	$ 71,137	$ 45,580
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION		
Cash paid during the period for interest expense	$ 969	$ 959
Cash paid during the period for income taxes	$ 27	$ 11
Noncash investing activities:		
Other real estate acquired in foreclosure	$ 2,214	$ -

The accompanying notes are an integral part of these financial statements

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

General

Pacific Valley Bank opened for business during September 2004. Our products and services are targeted to customers who operate small and middle-market businesses, professionals, high net worth individuals and families residing in Monterey County, California. We serve our business and individual customers from three branch locations: Salinas, Monterey and King City, California. Our mission is to "create prosperity in the community through excellence in Banking." It is our goal to compete on responsive service and not solely on the basis of price.

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

The Bank has evaluated subsequent events for recognition and disclosure through March 27, 2015, which is the date the financial statements were available to be issued.

Use of Estimates

The preparation of the financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect amounts reported in the financial statements. Changes in these estimates and assumptions are considered reasonably possible and may have a material impact on the financial statements and thus actual results could differ from the amounts reported and disclosed herein.

Certain reclassifications have been made to prior financial statements to conform to the current presentation. These reclassifications have no effect on operations, equity, or earnings per share.

Cash and Cash Equivalents

For the purpose of the statement of cash flows, cash and cash equivalents consist of cash and due from banks and excess balances on deposit at the Federal Reserve Bank. Net cash flows are reported for customer loan and deposit transactions, and interest bearing deposits in other financial institutions.

Interest-Bearing Certificates of Deposits

Interest-bearing certificates of deposits in other financial institutions mature within one year and are carried at cost.

Restrictions on Cash

Banking regulations require that banks maintain a percentage of their deposits as reserves in cash or on deposit with the Federal Reserve Bank. The Bank was in compliance with its reserve requirements at December 31, 2014.

Investment Securities

Investment securities are classified into the following categories:

- Available-for-sale securities, reported at fair value, with unrealized gains and losses excluded from earnings and reported, net of taxes, as accumulated other comprehensive income (loss) within shareholders' equity.

- Held-to-maturity securities, which management has the positive intent and ability to hold, reported at amortized cost, adjusted for the accretion of discounts and amortization of premiums.

Management determines the appropriate classification of our investments at the time of purchase and may only change the classification in certain limited circumstances. All transfers between categories are accounted for at fair value. Management has classified all investments as available-for-sale.

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

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

Investment in Bank Stocks

The Bank has restricted securities in the form of capital stock invested in the Federal Home Loan Bank of San Francisco, Pacific Coast Banker's Bank and The Independent Bankers Bank. Members are required to own a certain amount of stock based on the level of borrowings and other factors, and may invest in additional amounts. Investment in Bank stocks is carried at cost, classified as a restricted security, and periodically evaluated for impairment based on ultimate recovery of par value. Both cash and stock dividends are reported as income.

Loans

Loans that management has the intent and ability to hold for the foreseeable future or until maturity or payoff are stated at principal balance outstanding, net of deferred loan fees and costs, and an allowance for loan losses. Interest is accrued daily based upon outstanding loan balances. Interest income on real estate, agricultural and commercial loans is discontinued at the time the loan is 90 days delinquent unless the loan is well-secured and in process of collection. Consumer and other loans are typically charged off no later than 120 days past due. Past due status is based on the contractual terms of the loan. In all cases, loans are placed on nonaccrual or charged-off at an earlier date if collection of principal or interest is considered doubtful. Nonaccrual loans and loans past due 90 days still on accrual include both smaller balance homogeneous loans that are collectively evaluated for impairment and individually classified impaired loans. A loan is moved to non-accrual status in accordance with the Bank's policy, typically after 90 days of non-payment. Any interest accrued but unpaid is charged against income. Payments received are applied to reduce principal to the extent necessary to ensure collection. Subsequent payments on these loans, or payments received on nonaccrual loans for which the ultimate collectability of principal is not in doubt, are applied first to earned but unpaid interest and then to principal.

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

Allowance for Loan Losses

The allowance for loan losses is a valuation allowance for probable incurred credit losses in the Bank's loan portfolio. The allowance is established through a provision for loan losses which is charged to expense. Additions to the allowance are expected to maintain the adequacy of the total allowance after credit losses and loan growth. Credit exposures determined to be uncollectible are charged against the allowance. Cash received on previously charged off amounts is recorded as a recovery to the allowance. The overall allowance consists of two primary components, specific reserves related to impaired loans and general reserves for inherent losses related to loans that are not impaired.

All classes of loans are considered impaired when, based on current information and events, it is probable that the Bank will be unable to collect all amounts due, including principal and interest, according to the contractual terms of the original agreement. All loans determined to be impaired are individually evaluated for impairment. When a loan is impaired, the Bank measures impairment based on the present value of expected future cash flows discounted at the loan's effective interest rate, except that as a practical expedient, it may measure impairment based on a loan's observable market price, or the fair value of the collateral if the loan is collateral dependent. A loan is collateral dependent if the repayment of the loan is expected to be provided solely by the underlying collateral.

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

Factors considered by management in determining impairment include payment status, collateral value, and the probability of collecting scheduled principal and interest payments when due. Loans that experience insignificant payment delays and payment shortfalls generally are not classified as impaired. Management determines the significance of payment delays and payment shortfalls on case-by-case basis, taking into consideration all of the circumstances surrounding the loan and the borrower, including the length of the delay, the reasons for the delay, the borrower's prior payment record, and the amount of the shortfall in relation to the principal and interest owed.

Troubled debt restructurings are separately identified for impairment disclosures and are measured at the present value of estimated future cash flows using the loan's effective rate at inception. If a troubled debt restructuring is considered to be a collateral dependent loan, the loan is reported, net, at the fair value of the collateral. For troubled debt restructurings that subsequently default, the Company determines the amount of reserve in accordance with the accounting policy for the allowance for loan losses.

The determination of the general reserve for loans that are not impaired is based on estimates made by management, to include, but not limited to, consideration of historical losses by portfolio segment and internal asset classifications adjusted for current factors. The historical loss experience was determined by portfolio segment and was based on the actual loss history experienced by the Bank over the most recent three years. This actual loss experience is supplemented with other economic factors based on the risks present for each portfolio segment. These economic factors include consideration of the following qualitative factors to include economic trends in the Bank's service areas, industry experience and trends, geographic concentrations, estimated collateral values, levels of and trends in delinquencies, the Bank's underwriting policies, the character of the loan portfolio, and probable losses inherent in the portfolio taken as a whole.

The Bank maintains a separate allowance for each portfolio segment (loan type by class code). These portfolio segments include commercial and agricultural, real estate construction (including land and development loans), real estate commercial, real estate mortgage, consumer and other loans. The allowance for loan losses attributable to each portfolio segment; which includes both impaired loans and loans that are not impaired, is combined to determine the Bank's overall allowance, which is included on the balance sheet.

The Bank assigns a risk rating to all loans except pools of homogeneous loans and periodically performs detailed reviews of all such loans over a certain threshold to identify credit risks and to assess the overall collectability of the portfolio. Smaller balance homogeneous loans are risk rated at inception and then updated only when the loan become delinquent or when the borrower requests a modification. These risk ratings are also subject to examination by independent specialists engaged by the Bank and the Bank's regulators. During these internal reviews, management monitors and analyzes the financial condition of borrowers and guarantors, trends in the industries in which borrowers operate and the fair values of collateral securing these loans. These credit quality indicators are used to assign a risk rating to each individual loan. The risk ratings can be grouped into six major categories, defined as follows:

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

Pass/Watch – A pass/watch loan is a credit with characteristics that indicate above average risk and require an increased level of attention by management.

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

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

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

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

Individual loans and receivables in homogeneous loan portfolio segments are not evaluated for specific impairment. The general reserve component of the allowance for loan losses consists of reserve factors that are determined by collectively measuring impairment reserve factors based on management's assessment of the following for each portfolio segment: (1) inherent credit risk, (2) historical losses and (3) other qualitative factors. These reserve factors are inherently subjective and are driven by the repayment risk associated with each portfolio segment described below.

Commercial and Agricultural – Commercial and agricultural loans generally possess a lower inherent risk of loss than real estate portfolio segments because these loans are generally underwritten to existing cash flows of operating businesses. Debt service coverage is provided by business cash flows and economic trends influenced by unemployment rates and other key economic indicators that are closely correlated to the credit quality of these loans. In addition, agricultural loans, if secured by crop production, are also vulnerable to two risk factors that are largely outside the control of the Bank and borrowers: commodity prices and weather conditions.

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

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

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

Consumer and other Loans – Consumer and other loans are usually comprised of a large number of small loans scheduled to be amortized over a specific period. Most installment loans are made directly for consumer purchases. Economic trends determined by unemployment rates and other key economic indicators are closely correlated to the credit quality of these loans. Weak economic trends indicate that the borrowers' capacity to repay their obligations may be deteriorating.

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

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

The Bank also maintains a separate allowance for off-balance-sheet commitments. Management estimates anticipated losses using historical data and utilization assumptions. The allowance for off-balance-sheet commitments totaled $72,000 at December 31, 2014 and $57,000 at December 31, 2013, and is included in other liabilities on the balance sheet.

Other Real Estate Owned

Other real estate owned ("OREO") represents property acquired through foreclosure or deeds in lieu of foreclosure and is initially recorded at fair value less costs to sell when acquired, establishing a new cost basis. These assets are subsequently accounted for at the lower of cost or estimated net realizable value. Net realizable value is determined based on real estate appraisals less estimated selling costs. At the time the property is acquired, any excess of the loan balance over its estimated net realizable value is charged to the allowance for loan losses. Subsequent write-downs to the net realizable value, if any, or any disposition gains or losses are recognized in current earnings.

Bank Premises and Equipment

Bank premises and equipment are carried at cost less accumulated depreciation. Depreciation is determined using the straight-line method over the estimated useful lives of the related assets. The useful lives of furniture, fixtures and equipment are estimated to be three to seven years. Leasehold improvements are amortized over the lesser of the life of the asset or the expected term of the related lease. When assets are sold or otherwise disposed of, the cost and related accumulated depreciation or amortization are removed from the accounts, and any resulting gain or loss is recognized in income for the period. The cost of maintenance and repairs is charged to expense as incurred. The Bank evaluates premises and equipment for financial impairment as events or changes in circumstances indicate that the carrying amount of such assets may not be fully recoverable.

Income Taxes

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

The Bank uses a comprehensive model for recognizing, measuring, presenting and disclosing in the financial statements tax positions taken or expected to be taken on a tax return. A tax position is recognized as a benefit only if it is “more likely than not” that the tax position would be sustained in a tax examination, with a tax examination being presumed to occur. The amount recognized is the largest amount of tax benefit that is greater than 50% likely of being realized on examination. For tax positions not meeting the “more likely than not” test, no tax benefit is recorded. The Bank has elected to record interest accrued and penalties related to unrecognized tax benefits, if any, in the provision for income taxes.

Earnings Per Share

Basic earnings per share (EPS), which excludes dilution, is computed by dividing our net earnings by the weighted-average number of common shares outstanding for the period. Diluted EPS reflects the potential dilution that could occur if securities or other contracts to issue common stock, such as stock options, result in the issuance of common stock which share in our earnings. The treasury stock method is applied to determine the dilutive effect of stock options in computing diluted EPS. However, diluted EPS are not presented when a net loss occurs because the conversion of potential common stock is antidilutive. Earnings and dividends per share are restated for all stock splits and stock dividends through the date of issuance of the financial statements. The number of stock options outstanding excluded from the computation of diluted earnings per share because they were antidilutive totaled 45,566 and 105,516 for December 31, 2014 and 2013, respectively.

Comprehensive Income (Loss)

Comprehensive income (loss) is a more inclusive financial reporting methodology that includes disclosure of other comprehensive income or loss that historically has not been recognized in the calculation of net income or loss. Our only source of other comprehensive income/(loss) is derived from unrealized gains and losses on investment securities available-for-sale.

Share-Based Compensation

Stock Option Plan

The Bank had one share-based compensation plan, the Pacific Valley Bank 2004 Stock Option Plan which was amended in 2006 by our shareholders to add additional shares available for grant. The plan expired in September of 2014. The primary purpose of this plan is to attract and retain the staff required to meet the Bank's objectives. The shares available for grant may be granted to employees and directors eligible to participate in the plan. The plan requires that the option price may not be less than the fair market value of the stock at the date the option is granted and that the stock must be paid for in full at the time the option is exercised. The options under the plan expire on dates determined by the Board of Directors, but not later than ten years from the date of grant. The vesting period is generally three to five years; however the vesting period can be modified at the discretion of the Board of Directors; but cannot be less than three years. Outstanding options under the plan are exercisable until their expiration. The Bank issues new shares of common stock upon exercise of stock options.

Determining Fair Value

The following assumptions are used in estimating fair value at grant date for options granted under our plan.

Management estimates the fair value of each option award as of the date of grant using a Black-Scholes-Merton option pricing formula. Expected volatility is based on historical volatility of the Bank's stock commensurate with the expected term of the option. The expected term of options granted is based on historical data and represents the period of time that options granted are expected to be outstanding, which takes into account that the options are not transferable. The risk-free rate is based on the U.S. Treasury notes in effect at the time of grant with substantially the same remaining term as the term of the option. Expected dividend yield was not considered in the option pricing formula since the Bank has not paid cash dividends to holders of its common stock and has no current plans to do so in the future. In addition to these assumptions, management makes estimates regarding pre-vesting forfeitures based on historical data of option exercises and post-vesting termination behavior that will impact total share-based expense recognized under the Plan.

Loan Commitments and Related Financial Instruments: Financial instruments include off-balance sheet credit instruments, such as commitments to make loans and commercial letters of credit, issued to meet customer financing needs. The face amount for these items represents the exposure to loss, before considering customer collateral or ability to repay. Such financial instruments are recorded when they are funded.

Loss Contingencies: Loss contingencies, including claims and legal actions arising in the ordinary course of business, are recorded as liabilities when the likelihood of loss is probable and an amount or range of loss can be reasonably estimated. Management does not believe there now are such matters that will have a material effect on the financial statements.

2. AVAILABLE-FOR-SALE INVESTMENT SECURITIES

The amortized cost and fair value of available-for-sale investment securities consisted of the following, (amounts in thousands):

	December 31, 2014			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Government sponsored mortgage - backed securities - Residential	$ 1,154	$ 124	$ -	$ 1,278
Small Business Administration Pools	358	3	-	361
	$ 1,512	$ 127	$ -	$ 1,639

	December 31, 2013			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Government sponsored mortgage - backed securities - Residential	$ 1,521	$ 131	$ -	$ 1,652
Small Business Administration Pools	481	5	$ -	486
	$ 2,002	$ 136	-	$ 2,138

Net unrealized gains on available-for-sale investment securities totaling $127,000 and $136,000 were recorded net of income taxes in the amount of $53,000 and $56,000 as accumulated other comprehensive income as a separate component of shareholders' equity at December 31, 2014 and 2013, respectively. There were no sales or transfers of available-for-sale investment securities during the years ended December 31, 2014 and 2013.

We had no individual securities in an unrealized loss position at December 31, 2014 and 2013.

The amortized cost and fair value of available-for-sale investment securities at December 31, 2014 by contractual maturity is shown below. Expected maturities will differ from contractual maturities because the issuers of certain securities may have the right to call or prepay obligations with or without call or prepayment penalties.

(amounts in thousands)	Amortized Cost		Fair Value	
Less than one year	$	350	$	375
After one year through 5 years		753		804
After five years through 10 years		180		201
After ten years or greater		229		259
	$	1,512	$	1,639

The following table shows securities that were pledged to secure borrowing lines, (amounts in thousands):

	Amortized Cost		Estimated Fair Value	
December 31, 2014	$	641	$	725

	Amortized Cost		Estimated Fair Value	
December 31, 2013	$	787	$	863

3. INVESTMENT IN BANK STOCKS

Our review of each issuer's most recent financial statements and capital position resulted in our conclusion that the investments are not impaired based on financial information dated December 31, 2014.

The following table reflects the carrying cost of the restricted capital investments, (amounts in thousands):

(amounts in thousands)	As of December 31,			
	2014		2013	
Federal Home Loan Bank of SF	$	751	$	730
Pacific Coast Banker's Bank		190		190
The Independent Banker's Bank		61		60
Total	$	1,002	$	980

4. LOANS

Outstanding loans are summarized below, (amounts in thousands):

	December 31,	
	2014	2013
Commercial	$ 38,869	$ 35,236
Real estate - mortgage	21,305	18,010
Real estate - commercial	77,044	74,041
Real estate - construction and land	10,490	10,456
Consumer and other	3,844	4,433
Agriculture	21,885	17,791
	$ 173,437	$ 159,967
Deferred loan origination cost, net	131	118
Allowance for loan losses	(3,714)	(4,611)
Total loans net of allowance	$ 169,854	$ 155,474

Salaries and employee benefits totaling $227,000 and $203,000 were deferred as loan origination costs for the years ended December 31, 2014 and 2013, respectively.

5. ALLOWANCE FOR LOAN LOSSES

The following table shows the allocation of the allowance for loan losses at and for the years ended December 31, 2014 and 2013 by portfolio segment and by impairment methodology, (amounts in thousands):

Allowance for Loan Losses and Recorded Investments in Loans
At and for the year December 31, 2014

	Commercial & Agriculture	Commercial Real Estate	Real Estate Construction and Land	Residential Mortgage	Consumer and Other	Un-allocated	Total
Allowance for loan losses:							
Beginning balance	$ 1,011	$ 2,367	$ 552	$ 420	$ 125	$ 136	$ 4,611
Charge offs	(703)	(441)	-	-	-	-	(1,144)
Recoveries	63	181	1	2	-	-	247
Provision	540	(45)	(320)	(47)	(36)	(92)	-
Ending Balance	$ 911	$ 2,062	$ 233	$ 375	$ 89	$ 44	$ 3,714
Ending balance: individually evaluated for impairment	$ 108	$ 656	$ -	$ -	$ -	$ -	$ 764
Ending balance: collectively evaluated for impairment	$ 803	$ 1,406	$ 233	$ 375	$ 89	$ 44	$ 2,950
Loans:							
Ending balance	$ 60,887	$ 76,992	$ 10,487	$ 21,348	$ 3,854		$ 173,568
Ending balance: individually evaluated for impairment	$ 1,937	$ 4,402	$ 1,865	$ 1,354	$ -		$ 9,558
Ending balance collectively evaluated for impairment	$ 58,950	$ 72,590	$ 8,622	$ 19,994	$ 3,854		$ 164,010

Allowance for Loan Losses and Recorded Investments in Loans
At and for the year December 31, 2013

	Commercial & Agriculture	Commercial Real Estate	Real Estate Construction and Land	Residential Mortgage	Consumer and Other	Un-allocated	Total
Allowance for loan losses:							
Beginning balance	$ 755	$ 1,696	$ 291	$ 246	$ 13	$ 396	$ 3,397
Charge offs	-	(251)	-	-	-	-	(251)
Recoveries	28	-	-	36	1	-	65
Provision	228	922	261	138	111	(260)	1,400
Ending Balance	$ 1,011	$ 2,367	$ 552	$ 420	$ 125	$ 136	$ 4,611
Ending balance: individually evaluated for impairment	$ 61	$ 143	$ -	$ -	$ -	$ -	$ 204
Ending balance: collectively evaluated for impairment	$ 950	$ 2,224	$ 552	$ 420	$ 125	$ 136	$ 4,407
Loans:							
Ending balance	$ 53,279	$ 73,863	$ 10,463	$ 18,046	$ 4,435		$ 160,086
Ending balance: individually evaluated for impairment	$ 880	$ 4,456	$ -	$ 1,479	$ -		$ 6,815
Ending balance collectively evaluated for impairment	$ 52,399	$ 69,407	$ 10,463	$ 16,567	$ 4,435		$ 153,271

The following table shows the loan portfolio allocated by management's internal risk ratings at December 31, 2014 and 2013, (amounts in thousands):

Credit Quality Indicators
At December 31, 2014

Commercial Credit Exposure
Credit Risk Profile by Internally Assigned Grade

	Commercial	Agricultural	Real Estate Commercial	Construction & Land
Grade:				
Pass	$ 35,070	$ 21,681	$ 73,101	$ 7,355
Special Mention	1,578	-	516	-
Substandard	2,323	235	3,375	3,132
Doubtful	-	-	-	-
Total	$ 38,971	$ 21,916	$ 76,992	$ 10,487

Residential and Consumer Credit Exposure
Credit Risk Profile by Internally Assigned Grade

	Real Estate Mortgage	Consumer & Other
Grade:		
Pass	$ 18,742	$ 3,628
Special Mention	-	-
Substandard	2,606	226
Doubtful	-	-
Total	$ 21,348	$ 3,854

Credit Quality Indicators
At December 31, 2013

Commercial Credit Exposure
Credit Risk Profile by Internally Assigned Grade

	Commercial	Agricultural	Real Estate Commercial	Construction & Land
Grade:				
Pass	$ 30,296	$ 17,563	$ 64,347	$ 7,273
Special Mention	2,509	-	1,392	-
Substandard	2,661	250	8,124	3,190
Doubtful	-	-	-	-
Total	$ 35,466	$ 17,813	$ 73,863	$ 10,463

Residential and Consumer Credit Exposure
Credit Risk Profile by Internally Assigned Grade

	Real Estate Mortgage	Consumer & Other
Grade:		
Pass	$ 15,250	$ 3,271
Special Mention	38	872
Substandard	2,758	292
Doubtful	-	-
Total	$ 18,046	$ 4,435

The following table shows an aging analysis of the loan portfolio by the time past due at December 31, 2014 and 2013, (amounts in thousands):

Age Analysis of Past Due Loans
At December 31, 2014

	30-89 Days Past Due	Greater Than 90 Days and still Accruing	Non Accrual	Current	Total Loans
Commercial					
Commercial	$ 99	$ -	$ 1,262	$ 37,610	$ 38,971
Agricultural	-	-	234	21,682	21,916
Real Estate Commercial	-	-	970	76,022	76,992
Construction and Land	-	-	1,865	8,622	10,487
Residential					-
Real Estate Mortgage	1,252	-	-	15,682	16,934
Construction and Land	-	-	-	-	-
Equity LOC	-	-	799	3,615	4,414
Consumer					-
Installment	-	-	-	-	-
Auto	-	-	-	-	-
Other	-	-	-	3,854	3,854
Total	$ 1,351	$ -	$ 5,130	$ 167,087	$ 173,568

Age Analysis of Past Due Loans
At December 31, 2013

	30-89 Days Past Due	Greater Than 90 Days and still Accruing	Non Accrual	Current	Total Loans
Commercial					
Commercial	$ -	$ -	$ 150	$ 35,316	$ 35,466
Agricultural	-	-	250	17,563	17,813
Real Estate Commercial	-	-	2,840	71,023	73,863
Construction and Land	-	-	-	10,463	10,463
Residential					
Real Estate Mortgage	-	-	74	14,384	14,458
Construction and Land	-	-	-	-	-
Equity LOC	-	-	849	2,739	3,588
Consumer					
Installment	-	-	-	-	-
Auto	-	-	-	-	-
Other	9	-	-	4,426	4,435
Total	$ 9	$ -	$ 4,163	$ 155,914	$ 160,086

Interest foregone on nonaccrual loans totaled $208,000 and $109,000 for the years ended December 31, 2014 and 2013, respectively.

The following table shows information related to impaired loans at and for the year ended December 31, 2014 and 2013 (amounts in thousands):

Impaired Loans
For the Year December 31, 2014

	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized
With no related allowance recorded:					
Commercial					
Commercial and Agriculture	$ 839	$ 839	$ -	$ 911	$ 57
Real Estate Commercial	2,084	2,440	-	2,329	155
Real Estate Construction and Land	1,865	1,865	-	1,890	32
Residential			-		
Real Estate Mortgage	1,354	1,354	-	1,556	83
Subtotal	6,142	6,498	-	6,686	327
With an allowance recorded:					
Commercial					
Commercial and Agriculture	1,098	1,598	108	1,843	82
Real Estate Commercial	2,318	2,342	656	2,383	126
Real Estate Construction and Land	-	-	-	-	-
Subtotal	3,416	3,940	764	4,226	208
Total:					
Commercial	8,204	9,084	764	9,356	452
Residential	1,354	1,354	-	1,556	83
Consumer	-	-	-	-	-
Total	$ 9,558	$ 10,438	$ 764	$ 10,912	$ 535

Impaired Loans
For the Year December 31, 2013

	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized
With no related allowance recorded:					
Commercial					
Commercial and Agriculture	$ 819	$ 819	$ -	$ 846	$ 50
Real Estate Commercial	2,942	3,677	-	3,437	180
Real Estate Construction and Land	-	-	-	-	-
Residential					
Real Estate Mortgage	1,479	1,554	-	1,704	89
Subtotal	5,240	6,050	-	5,987	319
With an allowance recorded:					
Commercial					
Commercial and Agriculture	61	61	61	66	4
Real Estate Commercial	1,514	1,765	143	1,789	93
Real Estate Construction and Land	-	-	-	-	-
Subtotal	1,575	1,826	204	1,855	97
Total:					
Commercial	5,336	6,322	204	6,138	327
Residential	1,479	1,554	-	1,704	89
Consumer	-	-	-	-	-
Total	$ 6,815	$ 7,876	$ 204	$ 7,842	$ 416

Cash basis income recognized on impaired loans for the years ended December 31, 2014 and 2013 was not material.

Troubled Debt Restructurings

The Company has allocated $108,000 and $0 of specific reserves to customers whose loan terms have been modified in troubled debt restructurings as of December 31, 2014 and 2013. Troubled debt restructured loans totaled $3.8 million as of December 31, 2014 and $4.5 million as of December 31, 2013. The Company has not committed to lend additional amounts as of December 31, 2014 or 2013 to customers with outstanding loans that are classified as troubled debt restructurings.

The following table presents loans by class modified as troubled debt restructurings for the years ending December 31, 2014 and 2013, (amounts in thousands, except number of contracts):

Troubled Debt Restructuring Modifications
For the year ended December 31, 2014

	Number of Contracts	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment
Troubled Debt Restructurings			
Commercial			
Commercial and Agriculture	1	$ 1,856	$ 1,098
Real Estate	-	$ -	$ -

Troubled Debt Restructuring Modifications
For the year ended December 31, 2013

	Number of Contracts	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment
Troubled Debt Restructurings			
Commercial			
Commercial and Agriculture	3	$ 841	$ 819
Real Estate	2	$ 2,241	$ 1,824
Residential			
Real Estate Mortgage	1	$ 150	$ 74

The troubled debt restructurings described above increased the allowance for loan losses by $108,000 and $0 during the periods ending December 31, 2014 and 2013.

In order to determine whether a borrower is experiencing financial difficulty, an evaluation is performed of the probability that the borrower will be in payment default on any of its debt in the foreseeable future without the modification. This evaluation is performed under the company's internal underwriting policy.

Two loans previously classified as troubled debt restructures subsequently defaulted in 2014 with a recorded investment amount of $1.5 million and resulted in charge offs of $150,000 in 2014. In 2013 one loan classified as a troubled debt restructure defaulted with a recorded investment amount of $75,000 and resulted in $75,000 in charge offs.

6. BANK PREMISES AND EQUIPMENT

Bank premises and equipment consisted of the following, (amounts in thousands):

	December 31,	
	2014	2013
Furniture, fixtures, and equipment	$ 1,310	$ 1,302
Leasehold improvements	1,102	1,077
Bank premises	284	284
Land	111	111
	2,807	2,774
Less accumulated depreciation and amortization	(1,792)	(1,596)
	$ 1,015	$ 1,178

Depreciation and amortization included in occupancy and equipment expense totaled $196,000 and $192,000 for the years ended December 31, 2014 and 2013, respectively.

7. OTHER REAL ESTATE OWNED

The table below provides a summary of the change in other real estate owned (OREO) balances for the years ended December 31, 2014 and 2013 (in thousands).

	December 31,	
	2014	2013
Balance, beginning of year	$ -	$ 407
Additions	$ 2,214	$ -
Dispositions	(80)	(407)
Write-downs	-	-
Net Gain on dispositions	-	-
Balance, end of year	$ 2,134	$ -

8. DEPOSITS

Interest-bearing deposits consisted of the following, (amounts in thousands):

	As of December 31, 2014	As of December 31, 2013
Savings	$ 6,939	$ 6,576
Money Market	69,454	59,475
NOW Accounts	14,508	9,722
Time, $250,000 or more	11,732	9,667
Other Time	45,463	43,144
	$ 148,096	$ 128,584

Aggregate annual amounts maturing of time deposits are as follows, (amounts in thousands):

CD Maturities Year Ending December 31, 2014	
2015	$ 39,754
2016	16,077
2017	756
2018	602
2019	6
	$ 57,195

Interest expense recognized on interest-bearing deposits for the years ended December 31, 2014 and 2013 consisted of the following, (amounts in thousands):

	2014	2013
Savings	$ 7	$ 12
Now Accounts	14	9
Money Market	267	232
Time, $250,000 or more	162	135
Other Time	517	572
	$ 967	$ 960

At December 31, 2014, the five largest depositors (based upon total relationship of the depositors) accounted for $56.29 million in deposits, or 24.98% of total deposits. The loss of any one of these large depositors could have a material impact on our operations. However, some of these large depositors have other business relationships with us, such as commercial loans and lines of credit, and/or are related parties, which we believe mitigates the risk of a material decline in these deposits.

9. INCOME TAXES

The provision for income taxes for the year ended December 31, 2014 and 2013 consisted of the following, (amounts in thousands):

December 31, 2014	Total	Federal	State
Current	$ (58)	$ (98)	$ 40
Deferred	633	523	110
Income tax expense	$ 575	$ 425	$ 150

December 31, 2013	Total	Federal	State
Current	$ 40	$ 39	$ 1
Deferred	$ 242	$ 324	$ (82)
Decrease in valuation allowance	(4,666)	(3,186)	(1,480)
Income tax expense	$ (4,384)	$ (2,823)	$ (1,561)

Deferred tax assets (liabilities) at December 31, 2014 and 2013 consisted of the following, (amounts in Thousands):

	December 31,	
	2014	2013
Net operating losses	$ 2,700	$ 2,798
Nonaccrual loan interest	267	317
Share-based compensation	82	125
Allowance for loan losses	704	1,202
Reserve for unfunded commitments	30	23
Accrued rent	44	-
Premises and equipment	89	57
Tax credits	196	159
Accrued vacation	62	61
Accrued bonus	-	10
Total deferred tax assets	4,174	4,752
Deferred loan costs	(219)	(214)
Prepaid expenses	(25)	(36)
FHLB dividends	(13)	(13)
Unrealized gain on available-for-sales securities	(53)	(56)
Other	(126)	(65)
Total deferred (liabilities)	(436)	(384)
Net amount	$ 3,738	$ 4,368

The determination of the amount of deferred income tax assets which are more likely than not to be realized is primarily dependent on projections of future taxable earnings, which are subject to uncertainty and estimates that may change given economic conditions and other factors. The realization of deferred income tax assets is assessed and a valuation allowance is recorded if it is “more likely than not” that all or a portion of the deferred tax asset will not be realized. “More likely than not” is defined as greater than a 50% chance. All available evidence, both positive and negative is considered to determine whether, based on the weight of that evidence, a valuation allowance is needed. As of December 31, 2014 and 2013, the Bank has no valuation allowance. The bank's income taxes differ from amounts computed by applying the statutory federal income tax rate to income before taxes. The items comprising these differences consisted of the following, (amounts in thousands, except percentages):

	Year Ended December 31,			
	2014		2013	
	Amount	Rate %	Amount	Rate %
Federal tax expense at statutory rate	$ 460	34.0%	$ 128	34.0%
State franchise tax, net of federal tax effect	127	9.4	(54)	(14.4)
Change in valuation allowance	-	-	(4,666)	(1,241.0)
Other	(12)	(0.9)	208	55.4
	$ 575	42.5%	$ (4,384)	-1166.0%

At December 31, 2014, the Bank had Federal and State net operating loss carryforwards (NOLs) of $6.0 million and $9.2 million, respectively. The Federal NOLs begin to expire in 2028 and the State NOLs begin to expire in 2015. At December 31, 2014, the Bank had State tax credit carryforwards of $207,000 which expire in 2024 and minimum Federal tax credit carryforward of $58,000 which do not expire.

The Bank files income tax returns in the U.S. Federal and California jurisdictions. The Bank has been notified that it's California income tax returns for the years 2011 and 2012 are under examination. The examination has not yet concluded. The Bank's tax returns are no longer open for examination for years beginning before 2011 and 2010, for Federal and California, respectively.

The Bank evaluated all the tax positions taken in its tax returns filed for 2010 through 2013 and expected to be taken in its returns to be filed for 2014. The Bank has concluded that all tax positions are more-likely-than-not to be sustained upon possible examination by the taxing authorities. Accordingly, there are no material unrecognized tax benefits and no amounts have been recognized for potential interest and penalties.

10. OTHER BORROWING ARRANGEMENTS

In addition to the deposits which provide the normal funding source for the Bank's interest-earning assets, the Bank has an available line of credit at the Federal Home Loan Bank ("FHLB") of $42.69 million, pledged by assets totaling $93.22 million, the Pacific Coast Banker's Bank ("PCBB") in the amount of $3.00 million, and The Independent Bankers Bank ("TIB") in the amount of $4.00 million as of December 31, 2014. At December 31, 2014 and 2013 there were no borrowings outstanding at the FHLB, however at December 31, 2013, the line of credit was restricted by $1.50 million to reflect the FHLB's confirmation of a standby letter of credit issued by the Bank. There were no borrowings at PCBB or TIB as of December 31, 2014 or 2013.

11. COMMITMENTS

Operating Leases

We lease our branch office at 422 Main Street in Salinas under a non-cancelable operating lease. The lease expires on March 31, 2016, and has two five-year renewal options. The first renewal option includes an annual rent adjustment of three percent commencing the first year of the option. The rate for the second option period will be negotiated at that time. It is Management's intention to exercise both renewal options because we believe that by not exercising these options it would result in an economic penalty to the Bank.

We lease our branch office at 498 Alvarado Street in Monterey under a non-cancelable operating lease. The lease expires on May 31, 2017 with one five-year renewal option. It is Management's intention to exercise the renewal option because we believe that by not exercising this option it would result in an economic penalty to the Bank.

Future minimum lease payments are as follows, (amounts in thousands):

Year Ending December 31,	
2015	217
2016	224
2017	229
2018	236
2019	243
Thereafter	393
	$ 1,542

Rental expense included in occupancy and equipment expense totaled $208,000 and $187,000 for the years ended December 31, 2014 and 2013, respectively.

Financial Instruments with Off-Balance-Sheet Risk

We are a party to financial instruments with off-balance sheet risk in the normal course of business in order to meet the financing needs of our customers and to reduce our own exposure to fluctuations in interest rates. These financial instruments consist of commitments to extend credit and involve, to varying degrees, elements of credit and interest rate risk in excess of the amount recognized on the balance sheet. Off balance sheet risk to credit loss exists up to the face amount of these instruments, although material losses are not anticipated.

The contractual amounts of financial instruments with off-balance-sheet risk at year end were as follows, (amounts in thousands):

	2014		2013	
	Fixed Rate	Variable Rate	Fixed Rate	Variable Rate
Unused lines of credit	$ 4,811	$ 35,522	$ 4,394	$ 27,214
Standby letters of credit	-	4,536	-	4,955

Because some of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements.

We evaluate each customer's creditworthiness on a case-by-case basis. The amount of collateral obtained, if deemed necessary by the Bank upon extension of credit, is based on management's credit evaluation of the borrower. Collateral held varies, but includes accounts receivable, inventory, and deeds of trust on real estate.

At December 31, 2014, commercial and industrial commitments represented approximately 50%, agriculture commitments represented approximately 31% and real estate commitments represent approximately 7% of the total commitments and are generally secured by property with a loan-to-value ratio not to exceed 75%. Of the 7% of real estate commitments, 3% are real estate mortgage and 4% are commercial. Consumer and other commitments represent approximately 2%. Standby letters of credit are principally performance letters of credit related to real estate projects and represented approximately 10% of total commitments. In addition, loan commitments have both variable and fixed interest rates.

Significant Concentrations of Credit Risk

We grant real estate mortgage, real estate construction, commercial and consumer loans to customers in Monterey County, California and the surrounding communities. A substantial portion of our portfolio is secured by real estate. However, business income represents the primary repayment for a majority of these loans.

In management's judgment, a concentration exists in real estate-related loans which represented approximately 65% of the loan portfolio at December 31, 2014 and approximately 64% at December 31, 2013. Although management believes such concentration to have no more than the normal risk of collectability, a substantial decline in the economy in general, or a decline in real estate values in our primary market areas in particular, could have an adverse impact on collectability of these loans. Personal and business income represents the primary source of repayment for a majority of these loans.

12. SHAREHOLDERS' EQUITY

Stock Options

On May 6, 2004, the Board of Directors adopted the Pacific Valley Bank 2004 Stock Option Plan (the "Plan") and the Plan was approved by shareholders' in April 2005. Under the original Plan, 371,250 shares of common stock are reserved for issuance to employees and directors under incentive and non-statutory agreements. On May 22, 2006, an additional 184,500 shares of common stock were approved by the shareholders, in conjunction with our secondary stock offering. The Plan requires that the option price not be less than the fair market value of the stock at the date the option is granted, and that the stock must be paid for in full at the time the option is exercised. All options expire on a date determined by the Board of Directors, but not later than ten years from the date of grant. The vesting period is determined by the Board of Directors; but cannot be less than three years. Typically, portions of the options are vested annually with all options vested in three to five years, but not to exceed ten years. The Pacific Valley Bank 2004 Stock Option Plan terminated in September 2014 and has not been replaced. All options outstanding may be exercised until their expiration date, however no new options can be issued.

A summary of the activity within the Plan for the years ended December 31, 2014 and 2013 follows:

	Options	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term	Aggregate Intrinsic Value
Outstanding at January 1, 2013	133,993	$ 13.06		
Forfeited	(28,477)	$ 11.94		
Outstanding at December 31, 2013	105,516	$ 13.37		
Expired	(59,400)	$ 13.56		
Forfeited	(550)	$ 9.09		
Outstanding at December 31, 2014	45,566	$ 13.17	1.00	$ -
Exercisable at December 31, 2014	45,566	$ 13.17	1.00	$ -

All options outstanding at December 31, 2014, were fully vested.

The aggregate intrinsic value is calculated as the difference between the exercise price of the underlying awards and the quoted price of the Bank's common stock for options that were in-the-money at December 31, 2014.

The compensation cost that has been charged against income for stock options was $0 and $1,000 for the years ended December 31, 2014 and 2013, respectively. We recognize compensation costs only for those equity awards expected to vest. The total fair value of the shares that vested during the years ended December 31, 2014 and 2013 totaled $0 and $1,000, respectively.

At December 31, 2014, there were no non-vested stock option awards and no unrecognized compensation cost.

13. REGULATORY MATTERS

Regulatory Capital

We are subject to certain regulatory capital requirements administered by the FDIC. Failure to meet these minimum capital requirements can initiate certain mandatory, and possibly additional discretionary, actions by regulators that, if undertaken, could have a direct material effect on our financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, we must meet specific capital guidelines that involve quantitative measures of our assets, liabilities and certain off-balance-sheet items as calculated under regulatory accounting practices. Our capital amounts and classification are also subject to qualitative judgments by the regulators about components, risk weightings and other factors. On September 26, 2014, the Bank executed a Stipulation to the Issuance of a Consent Order by the FDIC and California Department of Business Oversight requiring the Bank to maintain Tier 1 capital in such an amount to ensure the Bank's leverage ratio equals or exceeds 9.5% and to ensure the Bank's total risk-based capital ratio equals or exceeds 12.0%. As of December 31, 2014, the Bank's Tier 1 leverage ratio and total risk-based capital ratio were above this agreed upon minimum.

Management believes as of December 31, 2014, the Bank met all capital adequacy requirements to which they are subject.

Prompt corrective action regulations provide five classifications: well capitalized, adequately capitalized, undercapitalized, significantly undercapitalized, and critically undercapitalized, although these terms are not used to represent overall financial condition. If adequately capitalized, regulatory approval is required to accept brokered deposits. If undercapitalized, capital distributions are limited, as is asset growth and expansion, and capital restoration plans are required. Although at year end 2014 and 2013, the Bank would be considered "well capitalized" under the regulatory framework for prompt corrective action, the Bank cannot be considered "well capitalized" until the Consent Order is lifted. There are no conditions or events since that notification that management believes have changed the institution's category.

Quantitative measures established by regulation to ensure capital adequacy require us to maintain minimum amounts and ratios of total and Tier 1 capital to risk-weighted assets and of Tier 1 capital to average assets. Each of these components is defined in the regulations.

Our calculated ratios as of December 31, 2014 and 2013 are presented in the following table, (amounts in thousands, except percentages):

	Year Ended December 31,			
	2014		2013	
	Amount	Ratio %	Amount	Ratio %
Tier 1 Leverage Ratio				
Pacific Valley Bank	$ 23,379	9.95%	$ 21,824	10.94%
Minimum required under Consent Order	$ 22,320	9.50%	n/a	n/a
Minimum requirement for "Well-Capitalized" institution	$ 11,748	5.00%	$ 9,976	5.00%
Minimum regulatory requirement	$ 9,399	4.00%	$ 7,981	4.00%
Tier 1 Risk Based Capital Ratio				
Pacific Valley Bank	$ 23,379	13.10%	$ 21,824	13.70%
Minimum requirement for "Well-Capitalized" institution	$ 10,708	6.00%	$ 9,556	6.00%
Minimum regulatory requirement	$ 7,139	4.00%	$ 6,371	4.00%
Total Risk Based Capital Ratio				
Pacific Valley Bank	$ 25,630	14.36%	$ 23,848	14.97%
Minimum required under Consent Order	$ 21,420	12.00%	n/a	n/a
Minimum requirement for "Well-Capitalized" institution	$ 17,848	10.00%	$ 15,926	10.00%
Minimum regulatory requirement	$ 14,279	8.00%	$ 12,741	8.00%

Dividends

The California Financial Code restricts the total cash dividend payment of any state banking association in any calendar year to the lesser of (1) the bank's retained earnings or (2) the bank's net income for its last three fiscal years, less distributions made to shareholders during the same three-year period. The Bank will continue a practice of obtaining prior written consent of the Regional Director and the Commissioner prior to payment of cash dividends. As of December 31, 2014, none of the Bank's retained earnings were free of these restrictions.

14. OTHER EXPENSES

Other expenses for the periods ending December 31st consisted of the following, (amounts in thousands):

	Year Ended December 31, 2014	Year Ended December 31, 2013
Data processing	$ 521	$ 477
Director fees	72	300
Professional fees	649	399
FDIC insurance	246	151
Advertising and marketing	153	191
Other real estate related expenses	(24)	88
Stationary and supplies	99	86
Loan related expenses	58	40
Insurance	43	37
Correpondent bank service charges	26	28
Other	429	440
	$ 2,272	$ 2,237

15. EMPLOYEE BENEFIT PLAN

Our 401(k) plan is available to employees meeting certain service requirements. Under the plan, employees may defer a selected percentage of their annual compensation. The Board of Directors may approve matching contributions. Matching contributions were $56,000 and $43,000 for the years ended December 31, 2014 and 2013, respectively.

16. RELATED PARTY TRANSACTIONS

Loans to principal officers, directors, and their affiliates at year-end 2014 and 2013 were $10.57 million plus $1.0 million in commitments and $9.54 million, respectively.

Deposits from principal officers, directors, and their affiliates at year-end 2014 and 2013 were $10.06 million and $10.08 million, respectively.

17. DISCLOSURES ABOUT FAIR VALUE OF FINANCIAL INSTRUMENTS

Fair value is the exchange price that would be received for an asset or paid to transfer a liability (exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. There are three levels of inputs that may be used to measure fair values:

Level 1 – Quoted prices (unadjusted) for identical assets or liabilities in active markets that the entity has the ability to access as of the measurement date.

Level 2 – Significant other observable inputs other than Level 1 prices such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data.

Level 3 – Significant unobservable inputs that reflect a company's own assumptions about the assumptions that market participants would use in pricing an asset or liability.

We determined the estimated fair value amounts using available market information and appropriate valuation methodologies. However, considerable judgment is necessary to interpret market data in the development of the estimates of fair value. The use of different market assumptions and/or estimation methodologies may have a material effect on the estimated fair value amounts.

The following methods and assumptions were used to estimate the fair value of the following classes of financial instruments (under Financial Accounting Standards Board Accounting Standards Codification, "FASB ASC" section 820, Fair Value Measurements and Disclosures):

Cash and Due From Bank – Due to the relatively short period of time between the origination of these instruments and their expected realization, the carrying amount is estimated to approximate fair value and are classified as Level 1.

Interest-Bearing Certificates of Deposit – The carrying amount represents a reasonable estimate of fair value due to the short-term nature of the deposit and are classified as Level 2.

Investments – Securities fair values are determined by obtaining quoted prices on nationally recognized securities exchanges (Level 1) or for securities where quoted prices are not available, fair values are calculated based on market prices of similar securities (Level 2). Available for sale securities are carried at fair value.

Loans – Fair values of loans are estimated as follows: For variable rate loans that reprice frequently and with no significant change in credit risk, fair values are based on carrying values resulting in a Level 3 classification. Fair values for other loans are estimated using discounted cash flow analyses, using interest rates currently being offered for loans with similar terms to borrowers of similar credit quality resulting in a Level 3 classification. Impaired loans are valued at the lower of cost or fair value as described below. The methods utilized to estimate the fair value of loans do not necessarily represent an exit price.

Federal Home Loan Bank of San Francisco Stock and Other Securities – The FHLB Stock and other securities are carried at $100 par value. These investments are considered restricted, at a minimum, the investment must be maintained in order to obtain borrowing commitments and other arrangements. It was not practicable to determine the fair value of FHLB or other stock due to restrictions placed on its transferability.

Impaired Loans – A loan is considered impaired when, based upon currently known information, it is deemed probable that scheduled amounts due (principal and interest) will not be collected in accordance with the original terms of the agreement. Impaired loans are measured in accordance with FASB ASC 310-10-35, Subsequent Measurement of Receivables based on the present value of expected future cash flows discounted at the loan's effective interest rate or on the loan's observable market price or fair value. The fair value of impaired loans with specific allocations of the allowance for loan losses is generally based on recent real estate appraisals. These appraisals may utilize a single valuation approach or a combination of approaches including comparable sales and the income approach. Adjustments are routinely made in the appraisal process by the independent appraisers to adjust for differences between the comparable sales and income data available. Such adjustments are usually significant and typically result in a Level 3 classification of the inputs for determining fair value. Non-real estate collateral may be valued using an appraisal, net book value per the borrower's financial statements, or aging reports, adjusted or discounted based on management's historical knowledge, changes in market conditions from the time of the valuation, and management's expertise and knowledge of the client and client's business, resulting in a Level 3 fair value classification. Impaired loans are evaluated on a quarterly basis for additional impairment and adjusted accordingly.

Real Estate Owned-Assets acquired through or instead of loan foreclosure are initially recorded at fair value less costs to sell when acquired, establishing a new cost basis. These assets are subsequently accounted for at lower of cost or fair value less estimated costs to sell. Fair value is commonly based on recent real estate appraisals which are updated no less frequently than annually. These appraisals may utilize a single valuation approach or a combination of approaches including comparable sales and the income approach. Adjustments are routinely made in the appraisal process by the independent appraisers to adjust for differences between the comparable sales and income data available. Such adjustments are usually significant and typically result in a Level 3 classification of the inputs for determining fair value. Real estate owned properties are evaluated on a quarterly basis for additional impairment and adjusted accordingly.

Appraisals for both collateral-dependent impaired loans and real estate owned are performed by certified general appraisers (for commercial properties) or certified residential appraisers (for residential properties) whose qualifications and licenses have been reviewed and verified by the Bank. Once received, a member of the Loan Department reviews the assumptions and approaches utilized in the appraisal as well as the overall resulting fair value in comparison with independent data sources such as recent market data or industry-wide statistics.

Accrued Interest Receivable/Payable – Due to the short-term nature of these amounts, recorded book value is believed to approximate fair value resulting in a Level 1, Level 2 and Level 3 classification based on the host asset or liabilities classification.

Deposits – The fair values disclosed for deposits are estimated based on the expected timing of their future cash flows and using a discounted cash flows calculation to approximate the intrinsic value of the financial instruments resulting in a Level 3 classification.

Off-Balance-Sheet Instruments – The off-balance-sheet instruments include unfunded commitments to extend credit and borrowing facilities available to the Bank. The fair values of commitments are estimated using the fees currently charged to enter into similar agreements and are not significant and, therefore, not included in the table below.

The estimated fair values of financial instruments are as follows, (amounts in thousands):

	December 31, 2014				
	Carrying Amount	Level 1	Level 2	Level 3	Estimated Fair Value
Financial assets:					
Cash and due from banks	$ 71,137	$ 71,137	$ -	$ -	$ 71,137
Available-for-sale investment securities	1,639	-	1,639	-	1,639
Interest-bearing certificate of deposit	1,500	-	1,500	-	1,500
Loans	169,854	-	-	170,218	170,218
FHLB stock and other securities	1,002	N/A	N/A	N/A	N/A
Accrued interest receivable	637	-	8	629	637
Financial liabilities:					
Deposits	$ 225,498	$ -	$ -	$ 226,333	$ 226,333
Accrued interest payable	2	-	-	2	2

	December 31, 2013				
	Carrying Amount	Level 1	Level 2	Level 3	Estimated Fair Value
Financial assets:					
Cash and due from banks	$ 45,580	$ 45,580	$ -	$ -	$ 45,580
Available-for-sale investment securities	2,138	-	2,138	-	2,138
Interest-bearing certificate of deposit	980	-	980	-	980
Loans	155,474	-	-	160,114	160,114
FHLB stock and other securities	980	N/A	N/A	N/A	N/A
Accrued interest receivable	571	1	10	560	571
Financial liabilities:					
Deposits	$ 184,803	$ -	$ -	$ 185,611	$ 185,611
Accrued interest payable	4	-	-	4	4

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

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

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

The following table presents the financial assets and liabilities measured at fair value on a recurring basis at December 31, 2014 and 2013, (amounts in thousands):

		December 31, 2014		
Description	**Fair Value**	**Level 1**	**Level 2**	**Level 3**
Government guaranteed mortgage-backed securities	$ 1,278	$ -	$ 1,278	$ -
Small Business Administration Pools	361	-	361	-
Total available-for-sale investment securities	$ 1,639	$ -	$ 1,639	$ -

		December 31, 2013		
Description	**Fair Value**	**Level 1**	**Level 2**	**Level 3**
Government guaranteed mortgage-backed securities	$ 1,652	$ -	$ 1,652	$ -
Small Business Administration Pools	486	-	486	-
Total available-for-sale investment securities	$ 2,138	$ -	$ 2,138	$ -

There were no transfers between Level 1 and Level 2 during 2014 or 2013.

There were no liabilities recorded at fair value on a recurring basis at December 31, 2014 and 2013.

There were no assets or liabilities measured at fair value on a recurring basis using significant unobservable inputs (Level 3) for the year ended December 31, 2014 and 2013.

The following table's present assets measured at fair value on a nonrecurring basis as of December 31, 2014 and 2013, (amounts in thousands):

Description	December 31, 2014			
	Fair Value	Level 1	Level 2	Level 3
Impaired loans:				
Commercial	$ 990	$ -	$ -	$ 990
Real estate				
Commercial	$ 1,365	$ -	$ -	$ 1,365
	$ 2,355	$ -	$ -	$ 2,355

Description	December 31, 2013			
	Fair Value	Level 1	Level 2	Level 3
Impaired loans:				
Real estate				
Commercial	$ 2,697	$ -	$ -	$ 2,697

The following table presents quantitative information about Level 3 fair value measurements for financial instruments measured at fair value on a non-recurring basis at December 31, 2014 and 2013, (amounts in thousands, except percentages):

2014

	Fair value	Valuation Technique(s)	Unobservable Input(s)	Range (Weighted Average)
Impaired Loans – Commercial	$ 990	Sales Comparison	Adjust for differences between the comparable sales and loss of tenants	-80% to +21% (-16%)
Impaired Loans – Commercial Real Estate	$ 1,365	Sales Comparison	Adjust for differences between the comparable sales and loss of tenants	-35% to +80% (+24%)

2013

	Fair value	Valuation Technique(s)	Unobservable Input(s)	Range (Weighted Average)
Impaired Loans – Commercial Real Estate	$ 2,697	Sales Comparison and Income Approach	Adjust for differences between the comparable sales, loss of tenants, and/or capitalization rates	-25% to +244% (+78%)

There were no changes in the valuation techniques in the above tables from prior periods.

The following methods and assumptions were used by the Bank to estimate the fair value of the following classes of financial instruments:

Impaired Loans –Impaired loans that are measured for impairment using the fair value of the collateral for collateral dependent loans, had a recorded principal balance of $3.4 million, with a valuation allowance of $1.1 million at December 31, 2014, resulting in an additional provision for loan losses of $1.4 million. At December 31, 2013, impaired loans had a principal balance of $2.8 million, with a valuation allowance of $143,000, resulting in an additional provision for loan losses of $394,000.

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