Pacific Valley Bank

Your Business. Our Priority.

ANNUAL REPORT 2015

March 31, 2016

Dear Shareholders,

First and foremost, we thank you for your ongoing commitment and investment in Pacific Valley Bank. We truly appreciate your support all of these years. Our commitment to you, our customers, and our community drives us to look for ways to exceed your expectations for excellence. We are looking forward to some exciting developments for Pacific Valley Bank in the year ahead and we thank you for inspiring us to make Pacific Valley Bank even better.

The year of 2015 presented new opportunities and challenges for Pacific Valley Bank. The first two quarters brought about rapid loan growth. That growth slowed in the second half with the successful and prosperous local Agricultural season, which led to the early loan payoffs/paydowns and less dependence on lines of credit. Concurrently, the Bank saw an increase in the Agricultural deposit base. The good news is that Pacific Valley Bank is poised to substantially increase the loan portfolio in 2016, and to support the local business community with a good selection of loan products. This, in turn will generate greater profitability for the Bank. As of this writing, the loan pipeline is healthy and vibrant, and the Pacific Valley Bank employees are highly motivated to help local businesses begin and grow.

The Bank's Balance Sheet grew approximately 3% over 2014 year-end, ending at over $260.2 million in Total Assets as of December 31, 2015. Our gross loans declined by over $10 million in mid-2015, and the Bank ended 2015 at $163.5 million an overall 3.8% decrease from December 31, 2014. Deposits increased $6.3 million or 2.8% in 2015 and ended the year at $231.8 million. These events reduced the level of loan interest income due to fewer borrowed dollars which typically earn a yield in excess of 4.5%. At the same time, deposits increased above normal levels and increased the Bank's cost of funds. These events also increased excess liquidity and caused an increase in our overnight investments into Fed Funds sold, which earned a quarter percent most of the year and increased to nearly half of a percent with the Federal Reserve's rate increase of in mid-December 2015. The Bank's interest income of $9.1 million in 2015 was essentially unchanged from 2014. However, much of the earnings growth was realized in expense reduction.

In April of 2015, to defray personnel benefit related expenses, the Bank acquired $5 million in Bank Owned Life Insurance, earning better than a 5% pre tax yield. The Bank invested $20 million in other bank's CDs, which earned approximately three times our Fed Funds sold interest yield. Additionally, the Bank has been successful in reducing the number and amount of non-relationship, higher rate, Certificates of Deposits by $14.5 million, enabling the Bank to approximate Peer group cost-of-funds deposit costs. Finally, the Bank has been very successful in retiring many non-performing loans, which improved our non-performing ratios and increased our level of loan loss reserves.

In 2015, the Board of Directors challenged management to generate a minimum $1 million net profit. We are pleased to report that the Bank met and exceeded that challenge and earned $1.068 million in 2015, or nearly $0.30 per share. This equates to an after tax increase of

$289 thousand, or 37%. The primary reason for the increase was due to substantial loan growth early in the year and reduced salary expense while we searched for very capable officers. The Board of Directors has again challenged management to increase 2016 net profit above that of 2015, and management is steadfast about meeting that challenge. Pacific Valley Bank is committed to putting our excess liquidity to work by increasing loan levels in 2016.

In preparation for our substantial loan growth this year, we have hired, or will hire, three additional Relationship Managers. We have expanded our Primary Service Area to better approximate our anticipated growth. We are proud to announce that the Bank now has representatives working the San Jose and Paso Robles markets, as well as additional representation on the Monterey Peninsula and Salinas areas.

We are very pleased to announce new additions and modifications to our team of professional bankers. Carol Corsetti recently joined the Bank as our EVP / Chief Credit Officer. Our former EVP / CCO, Robert Navarrete, opened our San Jose market presence and is now our Relationship Manager for the area. Lee-Ann Cimino recently joined the Bank as our EVP / Chief Administrative Officer. In addition to the two new executive officers, the Bank has promoted several talented officers. As part of the strategy for the growth of the Bank, we have added new sales and support positions. We hope you can meet the new staff at this year's Shareholder meeting on May 25, 2016.

As discussed in detail on our letter dated November 12, 2014, the FDIC and California Department of Business Oversight ("DBO") issued a consent order, effective October 2, 2014, which requires the Bank to complete certain items by certain dates. The order contains provisions concerning management, corporate governance, asset quality, minimum capital ratios and compliance with the Bank Secrecy Act. Management believes the Bank is making progress in its efforts to comply with the order.

As always, we sincerely appreciate your support and patronage of the Bank and we ask you to introduce your friends to bank with us.

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
WITH
INDEPENDENT AUDITOR'S REPORT

DECEMBER 31, 2015 AND 2014

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INDEPENDENT AUDITOR'S REPORT

Board of Directors and Shareholders of
Pacific Valley Bank

Report on Financial Statements

We have audited the accompanying financial statements of Pacific Valley Bank, which are comprised of the statements of financial condition as of December 31, 2015, and the related statements of income, comprehensive income, changes in shareholders' equity and cash flows for the year 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 audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free 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.

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FRESNO • LAGUNA HILLS • PALO ALTO • PEASANTON • RANCHO CUCAMONGA • RIVERSIDE • SACRAMENTO

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, 2015 and 2014, 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.

Prior Period Financial Statements

The financial statements of Pacific Valley Bank as of and for the year ended December 31, 2014, were audited by other auditors whose report dated March 27, 2015, expressed an unmodified opinion on those statements.

Vavrinek, Trine, Day & Co., LLP

Laguna Hills, California
March 25, 2016

PACIFIC VALLEY BANK

STATEMENTS OF FINANCIAL CONDITION
DECEMBER 31, 2015 AND 2014

	2015	2014
ASSETS		
Cash and Due from Banks	$ 9,328,000	$ 7,485,000
Federal Funds Sold	60,606,000	63,652,000
Total Cash and Cash Equivalents	69,934,000	71,137,000
Time Deposits in Other Banks	19,105,000	1,500,000
Investment Securities Available for Sale	237,000	1,639,000
Loans, Net of Deferred Fees and Costs	163,472,000	173,568,000
Allowance for Loan Losses	(3,224,000)	(3,714,000)
Net Loans	160,248,000	169,854,000
Federal Home Loan and Other Bank Stocks, at Cost	1,065,000	1,002,000
Other Real Estate Owned	-	2,134,000
Premises and Equipment	943,000	1,015,000
Bank Owned Life Insurance	5,121,000	-
Accrued Interest and Other Assets	3,821,000	4,653,000
TOTAL ASSETS	$260,474,000	$252,934,000
LIABILITIES AND SHAREHOLDERS' EQUITY		
Deposits:		
Noninterest-Bearing	$ 90,922,000	$ 77,402,000
Interest-Bearing	140,906,000	148,096,000
Total Deposits	231,828,000	225,498,000
Accrued Interest and Other Liabilities	1,017,000	802,000
TOTAL LIABILITIES	232,845,000	226,300,000
Commitments and Contingencies (Notes D and K)		
Shareholders' Equity:		
Preferred Stock - 5,000,000 Shares Authorized, None Outstanding	-	-
Common Stock - No par value, 10,000,000 Shares Authorized, Shares Issued and Outstanding - 3,596,996 in 2015 and 2014	32,480,000	32,480,000
Accumulated Deficit	(4,852,000)	(5,920,000)
Accumulated Other Comprehensive Income - Net Unrealized Gain on Available-for-Sale Securities, Net of Taxes of $1,000 and $53,000 in 2015 and 2014, Respectively	1,000	74,000
TOTAL SHAREHOLDERS' EQUITY	27,629,000	26,634,000
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	$260,474,000	$252,934,000

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

PACIFIC VALLEY BANK

STATEMENTS OF INCOME
FOR THE YEARS ENDED DECEMBER 31, 2015 AND 2014

		2015		2014
INTEREST INCOME				
Interest and Fees on Loans	$	8,730,000	$	8,757,000
Interest on Investment Securities		10,000		79,000
Interest on Federal Funds Sold and Other		315,000		160,000
Total Interest Income		9,055,000		8,996,000
INTEREST EXPENSE				
Interest on Savings, NOW, and Money Market Accounts		188,000		287,000
Interest on Time Deposits		570,000		680,000
Total Interest Expense		758,000		967,000
Net Interest Income		8,297,000		8,029,000
Provision for Loan Losses		-		-
Net Interest Income After Provision For Loan Losses		8,297,000		8,029,000
NONINTEREST INCOME				
Service Charges and Fees on Deposit Accounts		284,000		264,000
Net Gain on Sales of Available-for-Sale Securities		75,000		-
Net Gain on Sale of Other Real Estate Owned		27,000		49,000
Earnings on Bank Owned Life Insurance		121,000		-
Other Noninterest Income		155,000		158,000
Total Noninterest Income		662,000		471,000
NONINTEREST EXPENSE				
Salaries and Employee Benefits		4,261,000		4,187,000
Occupancy and Equipment Expense		641,000		687,000
Other Expenses		2,214,000		2,272,000
Total Noninterest Expense		7,116,000		7,146,000
Income Before Income Taxes		1,843,000		1,354,000
Income Taxes		775,000		575,000
NET INCOME	$	1,068,000	$	779,000
NET INCOME PER SHARE - BASIC	$	0.30	$	0.22
NET INCOME PER SHARE - DILUTED	$	0.30	$	0.22

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

PACIFIC VALLEY BANK

STATEMENTS OF COMPREHENSIVE INCOME
FOR THE YEARS ENDED DECEMBER 31, 2015 AND 2014

	2015	2014
Net Income	$ 1,068,000	$ 779,000
OTHER COMPREHENSIVE LOSS:		
Unrealized Gain and Loss on Securities Available for Sale:		
Unrealized Loss on Investment Securities	(50,000)	(9,000)
Reclassification of Gain Recognized in Net Income	(75,000)	-
	(125,000)	(9,000)
Income Tax Expense (Benefit):		
Change in Net Unrealized Loss	(21,000)	(3,000)
Reclassification of Gain Recognized in Net Income	(31,000)	-
	(52,000)	(3,000)
TOTAL OTHER COMPREHENSIVE LOSS	(73,000)	(6,000)
TOTAL COMPREHENSIVE INCOME	$ 995,000	$ 773,000

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

PACIFIC VALLEY BANK

STATEMENT OF CHANGES IN SHAREHOLDERS' EQUITY
FOR THE YEARS ENDED DECEMBER 31, 2015 AND 2014

	Common Stock			Accumulated Other	
	Number of Shares	Amount	Accumulated Deficit	Comprehensive Income (Loss)	Total
Balance January 1, 2014	3,596,996	$ 32,524,000	$(6,699,000)	$ 80,000	$ 25,905,000
Net Income			779,000		779,000
Stock-based Compensation		(44,000)			(44,000)
Other Comprehensive Loss, Net of Taxes				(6,000)	(6,000)
Balance at December 31, 2014	3,596,996	32,480,000	(5,920,000)	74,000	26,634,000
Net Income			1,068,000		1,068,000
Other Comprehensive Loss, Net of Taxes				(73,000)	(73,000)
Balance at December 31, 2015	3,596,996	$ 32,480,000	$(4,852,000)	$ 1,000	$ 27,629,000

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

PACIFIC VALLEY BANK

STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED DECEMBER 31, 2015 AND 2014

	2015	2014
OPERATING ACTIVITIES		
Net Income	$ 1,068,000	$ 779,000
Adjustments to Reconcile Net Income to Net Cash		
From Operating Activities:		
Depreciation and Amortization	161,000	196,000
Provision for Loan Losses	-	-
Gain on Sale of Securities Available for Sale	(75,000)	-
Gain on Sale of Other Real Estate Owned	(27,000)	(49,000)
Net Increase in Bank Owned Life Insurance	(121,000)	-
Deferred Income Taxes	752,000	633,000
Other Items	30,000	(168,000)
Total Adjustments	720,000	612,000
Net Cash From Operating Activities	1,788,000	1,391,000
INVESTING ACTIVITIES		
Net Increase in Time Deposits in Other Banks	(17,605,000)	(520,000)
Principal Payments on Investment Securities Available for Sale	216,000	498,000
Proceeds from Sales of Investment Securities Available for Sale	1,129,000	-
Net Change in Loans to Customers	11,700,000	(16,581,000)
Purchase of Federal Home Loan Bank Stock	(61,000)	(22,000)
Proceeds from Sale of Other Real Estate Owned	382,000	129,000
Purchase of Bank Owned Life Insurance	(5,000,000)	-
Purchases of Premises and Equipment	(82,000)	(33,000)
Net Cash From Investing Activities	(9,321,000)	(16,529,000)
FINANCING ACTIVITIES		
Net Increase in Demand Deposits and Savings Accounts	20,864,000	36,311,000
Net Change in Time Deposits	(14,534,000)	4,384,000
Net Cash From Financing Activities	6,330,000	40,695,000
Net Increase (Decrease) in Cash and Cash Equivalents	(1,203,000)	25,557,000
Cash and Cash Equivalents at Beginning of Period	71,137,000	45,580,000
CASH AND CASH EQUIVALENTS AT END OF PERIOD	$ 69,934,000	$ 71,137,000
Supplemental Disclosures of Cash Flow Information:		
Interest Paid	$ 758,000	$ 969,000
Taxes Paid	$ 2,000	$ 27,000
Loans Transferred to Other Real Estate Owned	$ -	$ 2,214,000
Loans to Facilitate the Sale of Other Real Estate Owned	$ 2,094,000	$ -

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

NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Nature of Operations

The 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 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.

Subsequent Events

The Bank has evaluated subsequent events for recognition and disclosure through March 25, 2016, which is the date the financial statements were available to be issued.

Use of Estimates in the Preparation of Financial Statements

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Cash and Cash Equivalents

For purposes of reporting cash flows, cash and cash equivalents include cash, due from banks and federal funds sold. Generally, federal funds are sold for periods of less than ninety days.

Cash and Due from Banks

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 as of December 31, 2015 and 2014.

The Bank maintains amounts due from banks, which may exceed federally insured limits. The Bank has not experienced any losses in such accounts.

Time Deposits in Other Banks

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

Investment Securities

Bonds, notes, and debentures for which the Bank has the positive intent and ability to hold to maturity are reported at cost, adjusted for premiums and discounts that are recognized in interest income using the interest method over the period to maturity.

NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued

Investment Securities - Continued

Investments not classified as trading securities nor as held to maturity securities are classified as available-for-sale securities and recorded at fair value. Unrealized gains or losses on available-for-sale securities are excluded from net income and reported as an amount, net of taxes, as a separate component of other comprehensive income included in shareholders' equity. Premiums or discounts on held-to-maturity and available-for-sale securities are amortized or accreted into income using the interest method. Realized gains or losses on sales of held-to-maturity or available-for-sale securities are recorded using the specific identification method.

Management evaluates securities for other-than-temporary impairment ("OTTI") on at least a quarterly basis, and more frequently when economic or market conditions warrant such an evaluation. For securities in an unrealized loss position, management considers the extent and duration of the unrealized loss, and the financial condition and near-term prospects of the issuer. Management also assesses whether it intends to sell, or it is more likely than not that it will be required to sell, a security in an unrealized loss position before recovery of its amortized cost basis. If either of the criteria regarding intent or requirement to sell is met, the entire difference between amortized cost and fair value is recognized as impairment through earnings. For debt securities that do not meet the aforementioned criteria, the amount of impairment is split into two components as follows: OTTI related to credit loss, which must be recognized in the income statement, and OTTI related to other factors, which is recognized in other comprehensive income. The credit loss is defined as the difference between the present value of the cash flows expected to be collected and the amortized cost basis. For equity securities, the entire amount of impairment is recognized through earnings.

Loans

Loans receivable that management has the intent and ability to hold for the foreseeable future or until maturity or payoff are reported at their outstanding unpaid principal balances reduced by any charge-offs or specific valuation accounts and net of deferred fees or costs on originated loans, or unamortized premiums or discounts on purchased loans. Loan origination fees and certain direct origination costs are capitalized and recognized as an adjustment of the yield of the related loan. Amortization of deferred loan fees is discontinued when a loan is placed on nonaccrual status.

Loans on which the accrual of interest has been discontinued are designated as nonaccrual loans. The accrual of interest on loans is discontinued when principal or interest is past due 90 days based on the contractual terms of the loan or when, in the opinion of management, there is reasonable doubt as to collectability. When loans are placed on nonaccrual status, all interest previously accrued but not collected is reversed against current period interest income. Income on nonaccrual loans is subsequently recognized only to the extent that cash is received and the loan's principal balance is deemed collectible. Interest accruals are resumed on such loans only when they are brought current with respect to interest and principal and when, in the judgment of management, the loans are estimated to be fully collectible as to all principal and interest.

NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued

Allowance for Loan Losses

The allowance for loan losses is a valuation allowance for probable incurred credit losses. Loan losses are charged against the allowance when management believes the uncollectibility of a loan balance is confirmed. Subsequent recoveries, if any, are credited to the allowance. Management estimates the allowance balance required using past loan loss experience, the nature and volume of the portfolio, information about specific borrower situations and estimated collateral values, economic conditions, and other factors. Allocations of the allowance may be made for specific loans, but the entire allowance is available for any loan that, in management's judgment, should be charged off. Amounts are charged-off when available information confirms that specific loans or portions thereof, are uncollectible. This methodology for determining charge-offs is consistently applied to each segment.

The Bank determines a separate allowance for each portfolio segment. The allowance consists of specific and general reserves. Specific reserves relate to loans that are individually classified as impaired. A loan is impaired when, based on current information and events, it is probable that the Bank will be unable to collect all amounts due according to the contractual terms of the loan agreement. Factors considered in determining impairment include payment status, collateral value, and the probability of collecting all amounts when due. Measurement of impairment is based on the expected future cash flows of an impaired loan, which are to be discounted at the loan's effective interest rate, or measured by reference to an observable market value, if one exists, or the fair value of the collateral for a collateral-dependent loan. The Bank selects the measurement method on a loan-by-loan basis except that collateral-dependent loans for which foreclosure is probable are measured at the fair value of the collateral.

The Bank recognizes interest income on impaired loans based on its existing methods of recognizing interest income on nonaccrual loans. Loans, for which the terms have been modified resulting in a concession, and for which the borrower is experiencing financial difficulties, are considered troubled debt restructurings and classified as impaired with measurement of impairment as described above.

If a loan is impaired, a portion of the allowance is allocated so that the loan is reported, net, at the present value of estimated future cash flows using the loan's existing rate or at the fair value of collateral if repayment is expected solely from the collateral.

General reserves cover non-impaired loans and are based on historical loss rates for each portfolio segment, adjusted for the effects of qualitative or environmental factors that are likely to cause estimated credit losses as of the evaluation date to differ from the portfolio segment's historical loss experience. Qualitative factors include consideration of the following: changes in lending policies and procedures; changes in economic conditions, changes in the nature and volume of the portfolio; changes in the experience, ability and depth of lending management and other relevant staff; changes in the volume and severity of past due, nonaccrual and other adversely graded loans; changes in the loan review system; changes in the value of the underlying collateral for collateral-dependent loans; concentrations of credit and the effect of other external factors such as competition and legal and regulatory requirements.

NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued

Allowance for Loan Losses - Continued

Portfolio segments identified by the Bank include construction and land development, real estate, commercial and agriculture and consumer loans. Relevant risk characteristics for these portfolio segments generally include debt service coverage, loan-to-value ratios and financial performance on non-consumer loans and debt-to income, collateral type and loan-to-value ratios for consumer loans.

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 $32,000 at December 31, 2015 and $72,000 at December 31, 2014, and is included in other liabilities on the balance sheet.

Federal Home Loan Bank ("FHLB") and Other Bank Stock

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

Other Real Estate Owned

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

NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued

Premises and Equipment

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

Bank Owned Life Insurance

Bank owned life insurance is recorded at the amount that can be realized under insurance contracts at the date of the statement of financial condition, which is the cash surrender value adjusted for other charges or other amounts due that are probable at settlement.

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 reasonable estimated. Management does not believe there now are such matters that will have a material effect on the financial statements.

Stock-Based Compensation

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

Income Taxes

Deferred income taxes are computed using the asset and liability method, which recognizes a liability or asset representing the tax effects, based on current tax law, of future deductible or taxable amounts attributable to events that have been recognized in the financial statements. A valuation allowance is established to reduce the deferred tax asset to the level at which it is "more likely than not" that the tax asset or benefits will be realized. Realization of tax benefits of deductible temporary differences and operating loss carryforwards depends on having sufficient taxable income of an appropriate character within the carryforward periods.

The Bank has adopted guidance issued by the Financial Accounting Standards Board ("FASB") that clarifies the accounting for uncertainty in tax positions taken or expected to be taken on a tax return and provides that the tax effects from an uncertain tax position can be recognized in the financial statements only if, based on its merits, the position is more likely than not to be sustained on audit by the taxing authorities. Interest and penalties related to uncertain tax positions are recorded as part of income tax expense.

NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued

Earnings Per Share ("EPS")

Basic EPS excludes dilution and is computed by dividing income available to common stockholders by the weighted-average number of common shares outstanding for the period. Diluted EPS reflects the potential dilution that could occur if securities or other contracts to issue common stock were exercised or converted into common stock or resulted in the issuance of common stock that then shared in the earnings of the entity.

Comprehensive Income

Changes in unrealized gains and losses on investment securities is the only component of accumulated other comprehensive income for the Bank. The amount reclassified out of other accumulated comprehensive income relating to realized gains on securities available for sale was $75,000 for 2015, with the related tax effect of $31,000.

Reclassifications

Certain reclassifications have been made in the 2014 financial statements to conform to the presentation used in 2015. These reclassifications had no impact on the Bank's previously reported financial statements.

Financial Instruments

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

Fair Value Measurement

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

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

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

NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued

<u>Adopted Accounting Guidance</u>

In January 2014, the FASB issued Accounting Standards Update (ASU) No. 2014-04, *Receivables—Troubled Debt Restructurings by Creditors (Subtopic 310-40): Reclassification of Residential Real Estate Collateralized Consumer Mortgage Loans upon Foreclosure*, a consensus of the FASB Emerging Issues Task Force. This Update provides clarification as to when an in-substance repossession or foreclosure has occurred, i.e., the creditor is considered to have received physical possession of residential real estate property collateralizing a consumer mortgage loan and, therefore, the loan receivable should be derecognized and the real estate property should be recognized. Under ASU No. 2014-04, a creditor has received physical possession of residential real estate property collateralizing a consumer mortgage loan upon either (1) the creditor obtaining legal title to the property upon completion of a foreclosure or (2) the borrower conveying all interest in the property to the creditor to satisfy the loan through completion of a deed in lieu of foreclosure or a similar legal agreement. The Update also will require disclosure in annual and interim financial statements of both (1) the amount of foreclosed residential real estate property held by the creditor and (2) the recorded investment in consumer mortgage loans collateralized by residential real estate property that are in the process of foreclosure according to local requirements of the applicable jurisdiction. The amendments in this Update are effective for interim and annual periods beginning after December 15, 2014. Adoption of this Update did not have a material impact on the Bank's financial statements.

<u>Recent Accounting Guidance Not Yet Effective</u>

In May 2014, the FASB issued Accounting Standards Update (ASU) No. 2014-09, *Revenue from Contracts with Customers (Topic 606)*. This Update requires an entity to recognize revenue as performance obligations are met, in order to reflect the transfer of promised goods or services to customers in an amount that reflects the consideration the entity is entitled to receive for those goods or services. The following steps are applied in the updated guidance: (1) identify the contract(s) with a customer; (2) identify the performance obligations in the contract; (3) determine the transaction price; (4) allocate the transaction price to the performance obligations in the contract; and (5) recognize revenue when, or as, the entity satisfies a performance obligation. These amendments are effective for annual reporting periods beginning after December 15, 2017, including interim periods within that reporting period. Early adoption is permitted only as of annual reporting periods beginning after December 15, 2016, including interim reporting periods within that period. The Bank is currently evaluating the effects of ASU 2014-09 on its financial statements and disclosures, if any.

On January 5, 2016, the FASB issued Accounting Standards Update 2016-01, *Financial Instruments–Overall: Recognition and Measurement of Financial Assets and Financial Liabilities (Subtopic 825-10)*. Changes made to the current measurement model primarily affect the accounting for equity securities with readily determinable fair values, where changes in fair value will impact earnings instead of other comprehensive income. The accounting for other financial instruments, such as loans, investments in debt securities, and financial liabilities is largely unchanged. The Update also changes the presentation and disclosure requirements for financial instruments including a requirement that public business entities use exit price when measuring the fair value of financial instruments measured at amortized cost for disclosure purposes. This Update is generally effective for public business entities in fiscal years beginning after December 15, 2017, including interim periods within those fiscal years. All other entities will have an additional year, but may early adopt coincident with the public business entity effective date. The Bank is currently evaluating the effects of ASU 2016-01 on its financial statements and disclosures.

NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued

Recent Accounting Guidance Not Yet Effective - Continued

On February 25, 2016, the FASB issued Accounting Standards Update (ASU) 2016-02, *Leases (Topic 842)*. The most significant change for lessees is the requirement under the new guidance to recognize right-of-use assets and lease liabilities for all leases not considered short-term leases, which is generally defined as a lease term of less than 12 months. This change will result in lessees recognizing right-of-use assets and lease liabilities for most leases currently accounted for as operating leases under current lease accounting guidance. The amendments in this Update are effective for interim and annual periods beginning after December 15, 2018 for public business entities and one year later for all other entities. The Bank is currently evaluating the effects of ASU 2016-02 on its financial statements and disclosures.

NOTE B - INVESTMENT SECURITIES

Debt securities have been classified in the balance sheet according to management's intent. The amortized cost of securities and their approximate fair values at December 31 were as follows:

December 31, 2015	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Available-for-Sale Securities:				
Small Business Administration Pools	$ 235,000	$ 2,000	$ -	$ 237,000
December 31, 2014				
Available-for-Sale Securities:				
U.S. Government Sponsored				
Mortgage-Backed Securities	$ 1,154,000	$ 124,000	$ -	$ 1,278,000
Small Business Administration Pools	358,000	3,000	-	361,000
	$ 1,512,000	$ 127,000	$ -	$ 1,639,000

The amortized cost and estimated fair value of all investment securities as of December 31, 2015 by expected maturities are shown below. Expected maturities may differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

	Amortized Cost	Fair Value
Available-for-Sale Securities		
Due within One Year	$ -	$ -
Due from One to Five Years	235,000	237,000
Due from Five to Ten Years	-	-
Due after Ten Years	-	-
Total Available-for-Sale Securities	$ 235,000	$ 237,000

Gross realized gains and losses on sales of available-for-sale securities were $76,000 and $(1,000) in 2015, respectively. Proceeds from the sales of available-for-sale securities during 2015 were $1,129,000.

NOTE C - LOANS

The Bank's loan portfolio consists primarily of loans to borrowers within Monterey County, California and surrounding communities. Although the Bank seeks to avoid concentrations of loans to a single industry or based upon a single class of collateral, real estate and real estate associated businesses are among the principal industries in the Bank's market area and, as a result, the Bank's loan and collateral portfolios are, to some degree, concentrated in those industries. The Bank's loan portfolio concentration in real estate secured credit at December 31, 2015 and 2014 was approximately 69% and 65%, respectively.

The Bank has pledged loans to secure lines of credit with the Federal Home Loan Bank as discussed in Note F.

At December 31, the composition of the loan portfolio is as follows:

	2015	2014
Construction and Land Development	$ 7,702,000	$ 10,487,000
Real Estate - Other:		
1-4 Family Residential	17,045,000	21,348,000
Multifamily Residential	15,516,000	16,682,000
Commercial Real Estate	67,460,000	60,311,000
Commercial and Agriculture:		
Commercial and Industrial	36,852,000	38,971,000
Agriculture Production	10,725,000	16,786,000
Secured by Farmland	5,241,000	5,129,000
Consumer and Other	2,931,000	3,854,000
Total Loans	163,472,000	173,568,000
Allowance for Loan Losses	(3,224,000)	(3,714,000)
Net Loans	$ 160,248,000	$ 169,854,000

The balance of unamortized loan origination costs, net of unamortized fees, included in total loans was $132,000 and $131,000 as of December 31, 2015 and 2014, respectively.

A summary of the changes in the allowance for loan losses as of December 31 follows:

	2015	2014
Balance at Beginning of Year	$ 3,714,000	$ 4,611,000
Additions to the Allowance Charged to Expense	-	-
Recoveries on Loans Charged Off	224,000	247,000
	3,938,000	4,858,000
Less Loans Charged Off	(714,000)	(1,144,000)
	$ 3,224,000	$ 3,714,000

NOTE C - LOANS - Continued

The following table presents the activity in the allowance for loan losses for the year 2015 and 2014, and the recorded investment in loans and impairment method as of December 31, 2015 and 2014 by portfolio segment:

December 31, 2015	Construction and Land Development	Real Estate - Other	Commercial and Agriculture	Consumer	Total
Allowance for Loan Losses:					
Beginning of Year	$ 237,000	$ 2,464,000	$ 923,000	$ 90,000	$ 3,714,000
Provisions	(29,000)	(598,000)	682,000	(55,000)	-
Charge-offs	-	-	(714,000)	-	(714,000)
Recoveries	-	4,000	220,000	-	224,000
End of Year	$ 208,000	$ 1,870,000	$ 1,111,000	$ 35,000	$ 3,224,000
Reserves:					
Specific	$ -	$ 497,000	$ 126,000	$ -	$ 623,000
General	208,000	1,373,000	985,000	35,000	2,601,000
	$ 208,000	$ 1,870,000	$ 1,111,000	$ 35,000	$ 3,224,000
Loans Evaluated for Impairment:					
Individually	$ -	$ 4,960,000	$ 1,026,000	$ -	$ 5,986,000
Collectively	7,702,000	95,061,000	51,792,000	2,931,000	157,486,000
	$ 7,702,000	$ 100,021,000	$52,818,000	$ 2,931,000	$163,472,000
December 31, 2014					
Allowance for Loan Losses:					
Beginning of Year	$ 570,000	$ 2,871,000	$ 1,041,000	$ 129,000	$ 4,611,000
Provisions	(334,000)	(149,000)	522,000	(39,000)	-
Charge-offs	-	(441,000)	(703,000)	-	(1,144,000)
Recoveries	1,000	183,000	63,000	-	247,000
End of Year	$ 237,000	$ 2,464,000	$ 923,000	$ 90,000	$ 3,714,000
Reserves:					
Specific	$ -	$ 656,000	$ 108,000	$ -	$ 764,000
General	237,000	1,808,000	815,000	90,000	2,950,000
	$ 237,000	$ 2,464,000	$ 923,000	$ 90,000	$ 3,714,000
Loans Evaluated for Impairment:					
Individually	$ 1,865,000	$ 5,756,000	$ 1,937,000	$ -	$ 9,558,000
Collectively	8,622,000	92,585,000	58,949,000	3,854,000	164,010,000
	$ 10,487,000	$ 98,341,000	$60,886,000	$ 3,854,000	$173,568,000

NOTE C - LOANS - Continued

The Bank categorizes loans into risk categories based on relevant information about the ability of borrowers to service their debt such as current financial information, historical payment experience, collateral adequacy, credit documentation, and current economic trends, among other factors. The Bank analyzes loans individually by classifying the loans as to credit risk. This analysis typically includes larger, non-homogeneous loans such as commercial real estate and commercial and industrial loans. This analysis is performed on an ongoing basis as new information is obtained. The Bank uses the following definitions for risk ratings:

Pass - Loans classified as pass include loans not meeting the risk ratings defined below.

Special Mention - Loans classified as special mention have a potential weakness that deserves management's close attention. If left uncorrected, these potential weaknesses may result in deterioration of the repayment prospects for the loan or of the institution's credit position at some future date.

Substandard - Loans classified as substandard are inadequately protected by the current net worth and paying capacity of the obligor or of the collateral pledged, if any. Loans so classified have a well-defined weakness or weaknesses that jeopardize the liquidation of the debt. They are characterized by the distinct possibility that the institution will sustain some loss if the deficiencies are not corrected.

Doubtful - A loan 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.

The risk category of loans by class of loans was as follows as of December 31, 2015:

December 31, 2015	Pass	Special Mention	Substandard	Doubtful	Total
Construction and Land Development	$ 6,452,000	$ -	$ 1,250,000	$ -	$ 7,702,000
Real Estate - Other:					
1-4 Family Residential	15,762,000	-	1,283,000	-	17,045,000
Multifamily Residential	14,849,000	-	667,000	-	15,516,000
Commercial Real Estate	64,843,000	-	2,617,000	-	67,460,000
Commercial and Agriculture:					
Commercial and Industrial	36,757,000	-	95,000	-	36,852,000
Agriculture Production	10,503,000	-	222,000	-	10,725,000
Secured by Farmland	5,241,000	-	-	-	5,241,000
Consumer and Other	2,931,000	-	-	-	2,931,000
	$157,338,000	$ -	$ 6,134,000	$ -	$163,472,000

NOTE C - LOANS - Continued

The risk category of loans by class of loans was as follows as of December 31, 2014:

December 31, 2014	Pass	Special Mention	Substandard	Doubtful	Total
Construction and Land Development	$ 7,355,000	$ -	$ 3,132,000	$ -	$ 10,487,000
Real Estate - Other:					
1-4 Family Residential	18,742,000	-	2,606,000	-	21,348,000
Multifamily Residential	16,682,000	-		-	16,682,000
Commercial Real Estate	56,420,000	516,000	3,375,000	-	60,311,000
Commercial and Agriculture:					
Commercial and Industrial	35,070,000	1,578,000	2,323,000	-	38,971,000
Agriculture Production	16,551,000	-	235,000	-	16,786,000
Secured by Farmland	5,129,000	-		-	5,129,000
Consumer and Other	3,628,000	-	226,000	-	3,854,000
	$159,577,000	$ 2,094,000	$ 11,897,000	$ -	$173,568,000

An aging analysis of the loan portfolio by past due, nonaccrual and current loans presented by loan class is as follows as of December 31, 2015:

December 31, 2015	30-89 Days Past Due	Over 90 Days Past Due and Still Accruing	Nonaccrual	Current	Total Loans
Construction and Land Development	$ -	$ -	$ -	$ 7,702,000	$ 7,702,000
Real Estate - Other:					
1-4 Family Residential	-	-	748,000	16,297,000	17,045,000
Multifamily Residential	-	-	-	15,516,000	15,516,000
Commercial Real Estate	528,000	-	2,194,000	64,738,000	67,460,000
Commercial and Agriculture:					
Commercial and Industrial	120,000	-	72,000	36,660,000	36,852,000
Agriculture Production	-	-	222,000	10,503,000	10,725,000
Secured by Farmland	-	-	-	5,241,000	5,241,000
Consumer and Other	-	-	-	2,931,000	2,931,000
	$ 648,000	$ -	$ 3,236,000	$159,588,000	$163,472,000

NOTE C - LOANS - Continued

An aging analysis of the loan portfolio by past due, nonaccrual and current loans presented by loan class is as follows as of December 31, 2014:

December 31, 2014	30-89 Days Past Due	Over 90 Days Past Due and Still Accruing	Nonaccrual	Current	Total Loans
Construction and Land Development	$ -	$ -	$ 1,865,000	$ 8,622,000	$ 10,487,000
Real Estate - Other:					
1-4 Family Residential	1,252,000	-	799,000	19,297,000	21,348,000
Multifamily Residential	-	-	-	16,682,000	16,682,000
Commercial Real Estate	-	-	970,000	59,341,000	60,311,000
Commercial and Agriculture:					
Commercial and Industrial	99,000	-	1,262,000	37,610,000	38,971,000
Agriculture Production	-	-	234,000	16,552,000	16,786,000
Secured by Farmland	-	-	-	5,129,000	5,129,000
Consumer and Other	-	-	-	3,854,000	3,854,000
	$ 1,351,000	$ -	$ 5,130,000	$167,087,000	$173,568,000

Information relating to individually impaired loans presented by class of loans was as follows as of December 31:

			Impaired Loans				
December 31, 2015	Unpaid Principal Balance	Recorded Investment	Without Specific Allowance	With Specific Allowance	Related Allowance	Average Recorded Investment	Interest Income Recognized
Construction and Land Development	$ -	$ -	$ -	$ -	$ -	$ -	$ -
Real Estate - Other:							
1-4 Family Residential	1,533,000	1,283,000	-	1,283,000	74,000	1,525,000	33,000
Multifamily Residential	670,000	667,000	-	667,000	338,000	687,000	46,000
Commercial Real Estate	3,246,000	3,010,000	-	3,010,000	85,000	2,804,000	62,000
Commercial and Agriculture:							
Commercial and Industrial	579,000	580,000	109,000	471,000	101,000	524,000	35,000
Agriculture Production	480,000	446,000	-	446,000	25,000	373,000	11,000
	$ 6,508,000	$5,986,000	$ 109,000	$ 5,877,000	$ 623,000	$ 5,913,000	$187,000
December 31, 2014							
Construction and Land Development	$ 1,865,000	$1,865,000	$ 1,865,000	$ -	$ -	$ 1,890,000	$ 32,000
Real Estate - Other:							
1-4 Family Residential	1,354,000	1,354,000	1,354,000	-	-	1,556,000	83,000
Multifamily Residential	-	-	-	-	-	-	-
Commercial Real Estate	4,782,000	4,402,000	2,084,000	2,318,000	656,000	4,712,000	281,000
Commercial and Agriculture:							
Commercial and Industrial	2,437,000	1,937,000	839,000	1,098,000	108,000	2,754,000	139,000
	$10,438,000	$9,558,000	$ 6,142,000	$ 3,416,000	$ 764,000	$10,912,000	$535,000

Cash Basis income recognized on impaired loans for the years ended December 31, 2015 and 2014 was not material.

NOTE C - LOANS - Continued

At December 31, 2015 and 2014, the Bank had approximately $2,972,000 and $3,775,000 in recorded investment in loans identified as troubled debt restructurings, respectively, and had allocated approximately $438,000 and $108,000 as specific reserves for these loans, respectively. The Bank has committed to lend no additional amounts to customers with outstanding loans that are classified as troubled debt restructurings as of December 31, 2015.

Loans modified as troubled debt restructurings presented by class of loans were as follows as of December 31;

December 31, 2015	Number of Loans	Pre-Modification Recorded Investment	Post-Modification Recorded Investment
Commercial and Agriculture:			
Agriculture Production	1	$ 250,000	$ 250,000
December 31, 2014			
Commercial and Agriculture:			
Commercial and Industrial	1	$ 1,856,000	$ 1,098,000

The troubled debt restructurings described above had allocated reserves of $12,000 and $108,000 as of December 31, 2015 and 2014, respectively.

There were no loans modified as troubled debt restructuring for which there was a payment default within twelve months following the modification during the year ended December 31, 2015. Two loans previously modified as troubled debt restructuring subsequently defaulted in 2014 with a recorded investment amount of $1.5 million and resulted in charge offs of $150,000 in 2014. A loan is considered to be in payment default once it is 90 days contractually past due under the modified terms.

NOTE D - PREMISES AND EQUIPMENT

A summary of premises and equipment as of December 31 follows:

	2015	2014
Furniture, Fixtures, and Equipment	$ 1,393,000	$ 1,310,000
Leasehold Improvements	1,102,000	1,102,000
Bank Premises	284,000	284,000
Land	111,000	111,000
	2,890,000	2,807,000
Less Accumulated Depreciation and Amortization	(1,947,000)	(1,792,000)
	$ 943,000	$ 1,015,000

Depreciation and amortization included in occupancy and equipment expense total $154,000 and $196,000 during the years ended December 31, 2015 and 2014, respectively.

The Bank has entered into a lease for its main office, which will expire in March 2021. The lease also includes provisions for options to extend the lease. The Bank has leased for its Monterey branch location, which will expire in May 2017. The lease also includes a provision to extend the lease for an additional five years. 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. The leases include provision for periodic rent increases as well as payment by the lessee of certain operating expenses. Rental expense relating to these leases and other short term rentals was approximately $217,000 and $208,000 for the years ended December 31, 2015 and 2014, respectively.

At December 31, 2015, the future lease rental payable under noncancellable operating lease commitments for the Bank's main office and Monterey branch was as follows:

2016	$ 232,000
2017	236,000
2018	243,000
2019	248,000
2020	254,000
Thereafter	143,000
	$ 1,356,000

The minimum rental payments shown above are given for the existing lease obligations and are not a forecast of future rental expense.

NOTE E - DEPOSITS

Deposits consist of the following at December 31:

	2015	2014
Deposits:		
Noninterest-bearing Demand	$ 90,922,000	$ 77,402,000
Savings and NOW Accounts	24,337,000	21,447,000
Money Market Accounts	73,908,000	69,454,000
Time Deposits Under $250,000	33,856,000	45,463,000
Time Deposits $250,000 and Over	8,805,000	11,732,000
Total Deposits	$ 231,828,000	$ 225,498,000

At December 31, 2015, the scheduled maturities of time deposits are as follows:

2016	$ 32,119,000
2017	6,342,000
2018	1,661,000
2019	6,000
2020	1,703,000
2021	830,000
	$ 42,661,000

The Bank's ten largest deposit relationships represent approximately $76,290,000 or 32.91% of the total outstanding deposits of the Bank. 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.

NOTE F - OTHER BORROWINGS

The Bank may borrow up to $7,000,000 overnight on an unsecured basis from two correspondent banks. As of December 31, 2015 and 2014, no amounts were outstanding under these arrangements.

As of December 31, 2015, the Bank had an available line of credit with the Federal Home Loan Bank of San Francisco ("FHLB") secured by the assets of the Bank. Under this line, the Bank may borrow up to $51,000,000 subject to providing adequate collateral and continued compliance with the Advances and Security Agreement and other eligibility requirements established by the FHLB. The Bank has pledged loans in the amount of $91.9 million as collateral for this line. As of December 31, 2015 and 2014 no advances were outstanding under this arrangement.

NOTE G - INCOME TAXES

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

	2015	2014
Current:		
Federal	$ 19,000	$(98,000)
State	4,000	40,000
	23,000	(58,000)
Deferred	752,000	633,000
	$ 775,000	$ 575,000

Deferred taxes are a result of differences between income tax accounting and generally accepted accounting principles with respect to income and expense recognition. The following is a summary of the components of the net deferred tax asset accounts recognized in the accompanying statement of financial condition at December 31:

	2015	2014
Deferred Tax Assets:		
Depreciation Differences	$ 99,000	$ 89,000
Allowance for Loan Losses Due to Tax Limitations	704,000	704,000
Nonaccrual Loan Interest	323,000	267,000
Stock-Based Compensation	82,000	82,000
Net Operating Loss Carryforwards	1,724,000	2,700,000
Tax Credits	263,000	196,000
Other Assets and Liabilities	226,000	136,000
	3,421,000	4,174,000
Deferred Tax Liabilities:		
Deferred Loan Costs	(200,000)	(219,000)
Market Value Adjustment on Investment Securities	(1,000)	(53,000)
Other Assets and Liabilities	(182,000)	(164,000)
	(383,000)	(436,000)
Net Deferred Tax Assets (Liabilities)	$ 3,038,000	$ 3,738,000

The Bank is subject to federal income tax and franchise tax of the state of California. Income tax returns for the years ended after December 31, 2011 and 2010 are open to audit by the federal and state authorities, respectively. The Bank does not expect the total amount of unrecognized tax benefits to significantly increase or decrease within the next twelve months.

NOTE G - INCOME TAXES - Continued

At December 31, 2015, the Bank has net operating loss carryforwards of approximately $3,895,000 for Federal income and $5,588,000 for California franchise tax purposes. Federal and California net operating loss carryforwards, to the extent not used, will expire in 2030. At December 31, 2015 the Bank has California tax credits carryforwards of $251,000 which expire in 2024 and Federal alternative minimum tax credit carryforwards of $97,000 which do not expire.

A comparison of the federal statutory income tax rates to the Bank's effective income tax rates follows:

	2015		2014	
	Amount	Rate	Amount	Rate
Statutory Federal Tax	$ 627,000	34.0%	$ 460,000	34.0%
State Tax, Net of Federal Benefit	128,000	6.9%	127,000	9.4%
Tax Free Income	(41,000)	(2.2%)	-	-
Other Items, Net	61,000	3.3%	(12,000)	(0.9%)
	$ 775,000	42.0%	$ 575,000	42.5%

NOTE H - OTHER EXPENSES

Other expenses as of December 31 are comprised of the following:

	2015	2014
Professional Fees	$ 467,000	$ 649,000
Data Processing	554,000	521,000
Director Fees and Expenses	155,000	72,000
Office Expenses	72,000	99,000
Marketing and Business Promotion	77,000	153,000
Insurance	370,000	289,000
Other Expenses	519,000	489,000
	$ 2,214,000	$ 2,272,000

NOTE I - RELATED PARTY TRANSACTIONS

In the ordinary course of business, the Bank has extended credit to and received deposits from certain members of its Board of Directors and Executive Officers and companies in which they have an interest. These related parties had outstanding deposits at the Bank approximating $5.5 million and $10.1 million, and outstanding loans of $5.9 million plus $1.2 million in available credit and $10.6 million plus $1.0 million in available credit, at December 31, 2015 and 2014, respectively.

NOTE J - EARNINGS PER SHARE ("EPS")

The following is a reconciliation of net income and shares outstanding to the income and number of shares used to compute EPS:

	2015		2014	
	Income	Shares	Income	Shares
Net Income as Reported	$ 1,068,000		$ 779,000	
Weighted Average Shares				
Outstanding During the Year		3,596,996		3,596,996
Used in Basic EPS	1,068,000	3,596,996	779,000	3,596,996
Dilutive Effect of Outstanding				
Stock Options and Stock Grants		-		-
Used in Dilutive EPS	$ 1,068,000	3,596,996	$ 779,000	3,596,996

At December 31, 2015 and 2014 there were 45,566 stock options, that could potentially dilute earnings per share in the future that were not included in the computation of diluted earnings per share because to do so would have been antidilutive.

NOTE K - COMMITMENTS

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

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

NOTE K - COMMITMENTS - Continued

As of December 31, 2015 and 2014, the Bank had the following outstanding financial commitments whose contractual amount represents credit risk:

	2015	2014
Commitments to Extend Credit	$ 39,211,000	$ 40,333,000
Standby Letters of Credit	3,644,000	4,536,000
	$ 42,855,000	$ 44,869,000

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

NOTE L - EMPLOYEE BENEFIT PLAN

The Bank adopted a 401(k) Plan for its employees. Under the plan, eligible employees may defer a portion of their salaries. The plan also provides for a matching contribution by the Bank. The Bank made contributions of $76,000 and $56,000 for 2015 and 2014, respectively.

NOTE M - STOCK-BASED COMPENSATION

The Bank's 2004 Stock Option Plan was approved by its shareholders in April 2005. Under the terms of the 2004 Stock Option Plan, officers and key employees may be granted both nonqualified and incentive stock options and directors and organizers, who are not also an officer or employee, may only be granted nonqualified stock options. The Plan provides for options to purchase 555,750 shares of common stock at a price not less than 100% of the fair market value of the stock on the date of the grant. Stock options expire no later than ten years from the date of the grant and generally vest over three to five years. The Plan provides for accelerated vesting if there is a change of control, as defined in the Plan. The Plan expired 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.

NOTE M - STOCK-BASED COMPENSATION - Continued

A summary of the status of the Bank's stock option plan as of December 31, 2015 and changes during the period ended thereon is presented below:

	Shares	Weighted-Average Exercise Price	Weighted-Average Remaining Contractual Term	Aggregate Intrinsic Value
Outstanding at Beginning of Year	45,566	$ 13.17		
Granted	-	$ -		
Exercised	-	$ -		
Forfeited	-	$ -		
Outstanding at End of Year	45,566	$ 13.17	0.42 Years	$ -
Options Exercisable	45,566	$ 13.17	0.42 Years	$ -

NOTE N - FAIR VALUE MEASUREMENT

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

Securities

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

Collateral-Dependent Impaired Loans

The Company does not record loans at fair value on a recurring basis. However, from time to time, fair value adjustments are recorded on these loans to reflect partial write-downs, through charge-offs or specific reserve allowances, that are based on the current appraised or market-quoted value of the underlying collateral. The fair value estimates for collateral-dependent impaired loans are generally based on recent real estate appraisals or broker opinions, obtained from independent third parties, which are frequently adjusted by management to reflect current conditions and estimated selling costs (Level 3).

Other Real Estate Owned

Nonrecurring adjustment to certain commercial and residential real estate properties classified as other real estate owned are measured at fair value, less costs to sell. The fair value of other real estate owned is generally based on recent real estate appraisals or broker opinions, obtained from independent third parties, which are frequently adjusted by management to reflect current conditions and estimated selling costs (Level 3).

NOTE N - FAIR VALUE MEASUREMENT - Continued

Appraisals for other real estate owned and collateral-dependent loans are performed by certified general appraisers whose qualifications and licenses have been reviewed and verified by the Company. 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. The Company also determines what additional adjustments, if any, should be made to the appraisal values on any remaining other real estate owned to arrive at fair value. No significant adjustments to appraised values have been made as a result of this comparison process as of December 31, 2015.

The following table provides a hierarchy and fair value for each major category of assets and liabilities measured at fair value at December 31:

	Fair Value Measurements Using				
December 31, 2015	Level 1	Level 2	Level 3	Total	Losses
Assets measured at fair value on a recurring basis					
Available-for-Sale Securities		$ 237,000	$ -	$ 237,000	
Assets measured at fair value on a non-recurring basis					
Impaired Loans:					
Commercial Real Estate	$ -	$ -	$2,124,000	$2,124,000	$ 70,000
December 31, 2014					
Assets measured at fair value on a recurring basis					
Available-for-Sale Securities	$ -	$1,639,000	$ -	$1,639,000	
Assets measured at fair value on a non-recurring basis					
Impaired Loans:					
Commercial and Industrial	$ -	$ -	$ 990,000	$ 990,000	
Commercial Real Estate	-	-	1,365,000	1,365,000	
	$ -	$ -	$2,355,000	$2,355,000	$1,100,000

NOTE N - FAIR VALUE MEASUREMENT - Continued

Qualitative information about the Bank's non-recurring Level 3 fair value measurements at December 31, follows:

December 31, 2015	Fair Value Amount	Valuation Technique	Unobservable Input	Range Weighted Average
Impaired Loans:				
Commercial Real Estate	$2,124,000	3rd Party Appraisals	Selling Costs	10%
December 31, 2014				
Impaired Loans:				
Commercial and Industrial	$ 990,000	Sales Comparison	Adjust for Differences Between the Comparable Sales and Loss of Tenants	-80% to +21% (-16%)
Commercial Real Estate	$1,365,000	3rd Party Appraisals	Adjust for Differences Between the Comparable Sales and Loss of Tenants	-35% to +80% (+24%)

NOTE O - FAIR VALUE OF FINANCIAL INSTRUMENTS

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

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

The following methods and assumptions were used to estimate the fair value of significant financial instruments not previously presented:

Cash and Cash Equivalents

The carrying amounts of cash and short term instruments approximate fair values.

NOTE O - FAIR VALUE OF FINANCIAL INSTRUMENTS - Continued

Time Deposits in Other Banks

Fair values for time deposits with other banks are estimated using discounted cash flow analyses, using interest rates currently being offered with similar terms.

Loans

For variable rate loans that re-price frequently and with no significant change in credit risk, fair values are based on carrying amounts. The 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 with similar credit quality. The methods utilized to estimate the fair value of loans do not necessarily represent an exit price.

Federal Home Loan and Other Bank Stock

The fair value of Federal Home Loan and other Bank Stock is not readily determinable due to the lack of its transferability.

Deposits

The fair values disclosed for demand deposits, including interest and non-interest demand accounts, savings, and certain types of money market accounts are, by definition based on carrying value. 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. Early withdrawal of fixed-rate certificates of deposit is not expected to be significant

Accrued Interest Receivable and Payable

The fair value of accrued interest receivable and payable approximate their carrying amounts.

Off-Balance Sheet Financial Instruments

The fair value of commitments to extend credit and standby letters of credit is estimated using the fees currently charged to enter into similar agreements. The fair value of these financial instruments is not material.

NOTE O - FAIR VALUE OF FINANCIAL INSTRUMENTS - Continued

The fair value hierarchy level and estimated fair value of financial instruments at December 31, 2015 and 2014 are summarized as follows:

		2015		2014	
	Fair Value Hierarchy	Carrying Value	Fair Value	Carrying Value	Fair Value
Financial Assets:					
Cash and Cash Equivalents	Level 1	$69,934,000	$69,934,000	$71,137,000	$71,137,000
Time Deposits in Other Banks	Level 1	19,105,000	19,105,000	1,500,000	1,500,000
Investment Securities	Level 2	237,000	237,000	1,639,000	1,639,000
Loans, net	Level 3	160,248,000	161,532,000	169,854,000	170,218,000
Federal Home Loan and Other Bank Stock	N/A	1,065,000	N/A	1,002,000	N/A
Accrued Interest Receivable	Level 2	597,000	597,000	637,000	637,000
Financial Liabilities:					
Deposits	Level 2	231,828,000	232,120,000	225,498,000	226,333,000
Accrued Interest Payable	Level 2	2,000	2,000	2,000	2,000

NOTE P - REGULATORY MATTERS

The Bank is subject to various regulatory capital requirements administered by the 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 their assets, liabilities, and certain off-balance-sheet items as calculated under regulatory accounting practices. The capital amounts and classification are also subject to qualitative judgments by the regulators about components, risk weightings, and other factors.

In July, 2013, the federal bank regulatory agencies approved the final rules implementing the Basel Committee on Banking Supervision's capital guidelines for U.S. banks. The new rules became effective on January 1, 2015, with certain of the requirements phased-in over a multi-year schedule, and fully phased in by January 1, 2019. The rules include a new common equity Tier 1 ("CET1") capital to risk-weighted assets ratio with minimums for capital adequacy and prompt corrective action purposes of 4.5% and 6.5%, respectively. The net unrealized gain or loss on available for sale securities is not included in computing regulatory capital. Capital amounts and ratios for December 31, 2014 are calculated using Basel I rules.

Quantitative measures established by regulation to ensure capital adequacy require the Bank to maintain minimum amounts and ratios (set forth in the table below) of total, Tier 1 and CET1 capital (as defined in the regulations) to risk-weighted assets (as defined), and of Tier 1 capital (as defined) to average assets (as defined). Management believes, as of December 31, 2015 and 2014, that the Bank meets all capital adequacy requirements.

NOTE P - REGULATORY MATTERS – Continued

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 a Tier 1 capital to average assets that equals or exceeds 9.5% and to maintain Total capital to risk-weighted assets that equals or exceeds 12.0%. As of December 31, 2015, the Bank's Tier 1 capital to average assets ratio and total capital to risk-weighted assets ratio were above the agreed-upon minimum.

As of December 31, 2015 and 2014, the most recent notification from the FDIC categorized the Bank as adequately capitalized under the regulatory framework for prompt corrective action (there are no conditions or events since that notification that management believes have changed the Bank's category). To be categorized as well-capitalized, the Bank must be released from the Consent Order and maintain minimum ratios as set forth in the table below.

The following table also sets forth the Bank's actual capital amounts and ratios:

			Amount of Capital Required			
	Actual		For Capital Adequacy Purposes		To Be Well-Capitalized Under Prompt Corrective Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
As of December 31, 2015:						
Total Capital (to Risk-Weighted Assets)	$27,460,000	15.57%	$14,111,000	8.00%	$17,639,000	10.00%
Tier 1 Capital (to Risk-Weighted Assets)	$25,225,000	14.30%	$10,583,000	6.00%	$14,111,000	8.00%
CET1 Capital (to Risk-Weighted Assets)	$25,225,000	14.30%	$7,937,000	4.50%	$11,465,000	6.50%
Tier 1 Capital (to Average Assets)	$25,225,000	10.15%	$9,944,000	4.00%	$12,430,000	5.00%
As of December 31, 2014:						
Total Capital (to Risk-Weighted Assets)	$25,630,000	14.36%	$14,279,000	8.00%	$17,848,000	10.00%
Tier 1 Capital (to Risk-Weighted Assets)	$23,379,000	13.10%	$7,139,000	4.00%	$10,708,000	6.00%
Tier 1 Capital (to Average Assets)	$23,379,000	9.95%	$9,399,000	4.00%	$11,748,000	5.00%

The California Financial Code provides that a bank may not make a cash distribution to its shareholders in excess of the lesser of the bank's undivided profits or the bank's net income for its last three fiscal years less the amount of any distribution made to the bank's shareholders during the same period.

Pacific Valley Bank Corporate Information

Annual Meeting of Shareholders

The annual meeting of shareholders of Pacific Valley Bank will be held Wednesday, May 25, 2016 at 6:00 P.M. in the Downtown Main Branch Office located at 422 Main Street, Salinas, CA 93901. All shareholders are cordially invited.

Stock Transfer Agent and Registrar

Pacific Valley Bank's stock transfer agent, Computershare, maintains all shareholder records and can assist with stock transfer and registration, address changes, and changes or corrections in Social Security or Tax Identification numbers.

Computershare Trust Company, NA
PO Box 43078
Providence, RI 02940-3070
Overnight/ Express Delivery
211 Quality Circle, Suite 210
College Station, TX 77845
Phone and Fax: Phone: (800) 962-4284 Fax: (781) 575-3120 www.computershare.com

Stock Listing

Pacific Valley Bank is listed on the Over the Counter Bulletin Board (www.otcbb.com) under the symbol PVBK.

Independent Auditors

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25231 Paseo De Alicia, Suite 100
Laguna Hills, CA 92653

Legal Counsel

Loren P. Hansen, ESQ
1301 Dove Street, Suite 900
Newport Beach, CA 92660

Corporate Office

Pacific Valley Bank
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Salinas, CA 93901

Market Makers

Wedbush Securities
One SW Columbia Street, Suite 1000
Portland, OR 97258
Contact: Joey Warmenhoven
(503)922-4888 or (866)662-0351

Western Financial Corporation
600 B Street, Suite 2204
San Diego, CA 92101
Contact: Rick Levenson
(800) 488-5990

Raymond James & Associates
One Embarcadero Center, Suite 650
San Francisco, CA 94111
Contact: John Thomas Cavendar
(415) 616-8935

Pacific Valley Bank Locations

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498 Alvarado Street
Monterey, CA 93940
(831) 645-6560

King City
302 Broadway
King City, CA 93930
(831) 385-2200

Board of Directors

Andrew P. Ausonio
President and CEO, Ausonio, Incorporated

Michael D. Cling
Attorney

Anthony M. Cosentino
Real Estate Broker
Vice President, Cosentino Realty Company Inc./
Columbus Property Management

Lucio P. Cosentino
President and CEO
Cosentino Realty Co., Inc./
Columbus Property Management

Robert LaBrier
Retired Senior Vice President, American Ag Credit

Guillermo Nieto, Sr.
General Partner, The Nieto Limited Partnership

Joseph L. Robello
Chairman of the Board
Retired Telecommunications Company Owner

Gordon Rubbo
Certified Public Accountant

Michael T. Wilson
President & CEO, Pacific Valley Bank

Senior Management

Michael T. Wilson
President & Chief Executive Officer

Ralph Wiita
Executive Vice President & Chief Financial Officer

Carol Corsetti
Executive Vice President & Chief Credit Officer

Lee-Ann Cimino
Executive Vice President & Chief Administrative Officer

Norman J. Shikuzawa
Senior Vice President & Risk Management Officer

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