

# ANNUAL REPORT

## 2010







## ANNUAL REPORT 2010

2010 was a challenging year, with a continued decrease in real estate values, and real estate development due to defaults on mortgages. These defaults and reductions in values continue to put a damper on economic recovery.

As in 2008 and 2009, we continued our efforts to provide loan and deposit services to the communities we serve, and high quality service to our customers in our branch offices. We are beginning to see signs of economic stabilization, and we intend to provide the same high quality banking services to our clients and the communities we serve in 2011 and beyond.

Richard P. Loupe  
President and Chief Executive Officer

Phillip R. Boyce  
Chairman of the Board

VALLEY COMMUNITY BANK  
FINANCIAL STATEMENTS  
AS OF DECEMBER 31, 2010 AND 2009  
AND FOR THE YEARS ENDED  
DECEMBER 31, 2010, 2009 AND 2008  
AND  
INDEPENDENT AUDITOR'S REPORT

## INDEPENDENT AUDITOR'S REPORT

The Shareholders and  
Board of Directors  
Valley Community Bank

We have audited the balance sheets of Valley Community Bank as of December 31, 2010 and 2009, and the related statements of income, changes in shareholders' equity and cash flows for each of the years in the three year period ended December 31, 2010. These financial statements are the responsibility of the Bank's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Valley Community Bank as of December 31, 2010 and 2009, and the results of its operations and its cash flows for each of the years in the three year period ended December 31, 2010, in conformity with accounting principles generally accepted in the United States of America.

*Warriner Trine Day + Co. LLP*

Pleasanton, California  
March 21, 2011

# VALLEY COMMUNITY BANK

## BALANCE SHEETS DECEMBER 31, 2010 AND 2009

| ASSETS  | 2010                  | 2009                  |
|---|-----------------------|-----------------------|
| Cash and due from banks   | \$ 15,343,925         | \$ 22,735,294         |
| Time deposits with other financial institutions   | 580,698               | -                     |
| Securities available-for-sale   | 16,496,448            | 11,394,265            |
| Securities held-to-maturity   | 208,830               | 877,437               |
| Federal Home Loan Bank stock  | 933,900               | 965,900               |
| Loans, less allowance for loan losses of \$3,415,922 in 2010 and \$4,141,306 in 2009  | 163,590,594           | 175,784,712           |
| Bank premises and equipment, net  | 557,607               | 393,416               |
| Cash surrender value of life insurance policies   | 2,739,397             | 2,637,996             |
| Accrued interest receivable and other assets  | 6,450,698             | 6,311,704             |
| Total assets  | <u>\$ 206,902,097</u> | <u>\$ 221,100,724</u> |
| <b>LIABILITIES AND<br/>SHAREHOLDERS' EQUITY</b>   |                       |                       |
| Deposits:   |                       |                       |
| Non-interest bearing  | \$ 36,382,907         | \$ 36,538,708         |
| Interest bearing  | 139,232,434           | 151,856,038           |
| Total deposits  | <u>175,615,341</u>    | <u>188,394,746</u>    |
| Short-term borrowings   | 4,000,000             | 7,000,000             |
| Accrued interest payable and other liabilities  | <u>3,183,650</u>      | <u>1,487,254</u>      |
| Total liabilities   | 182,798,991           | 196,882,000           |
| Commitments and contingencies (Note 8)  |                       |                       |
| Shareholders' equity:   |                       |                       |
| Preferred stock - no par value; 10,000,000 shares authorized; issued and outstanding - 5,500 shares at December 31, 2010, and 2009  | 5,610,000             | 5,555,000             |
| Common stock - no par value; 20,000,000 shares authorized; issued and outstanding - 1,878,886 shares at December 31, 2010, and 2009 | 16,601,560            | 16,601,560            |
| Additional paid in capital  | 450,412               | 450,412               |
| Accumulated other comprehensive income (loss), net of tax   | 6,754                 | 26,179                |
| Retained earnings   | 1,434,380             | 1,585,573             |
| Total shareholders' equity  | <u>24,103,106</u>     | <u>24,218,724</u>     |
| Total liabilities and shareholders' equity  | <u>\$ 206,902,097</u> | <u>\$ 221,100,724</u> |

The notes are an integral part of these financial statements.

# VALLEY COMMUNITY BANK

## STATEMENTS OF INCOME FOR THE YEARS ENDED DECEMBER 31, 2010, 2009, AND 2008

|  | <u>2010</u>         | <u>2009</u>       | <u>2008</u>           |
|--|---------------------|-------------------|-----------------------|
| Interest income:                                       |                     |                   |                       |
| Interest and fees on loans                             | \$ 10,802,658       | \$ 11,659,441     | \$ 11,123,527         |
| Interest on Federal funds sold                         | -                   | 26,138            | 103,693               |
| Interest on investment securities                      | 286,145             | 234,425           | 248,942               |
| Interest on deposits with other financial institutions | 55,032              | 42,357            | 182,992               |
| Total interest income                                  | <u>11,143,835</u>   | <u>11,962,361</u> | <u>11,659,154</u>     |
| Interest expense:                                      |                     |                   |                       |
| Interest on deposits                                   | 1,821,355           | 2,287,904         | 2,959,627             |
| Interest on short-term borrowings                      | 82,371              | 382,024           | 451,161               |
| Total interest expense                                 | <u>1,903,726</u>    | <u>2,669,928</u>  | <u>3,410,788</u>      |
| Net interest income before provision for loan losses   | 9,240,109           | 9,292,433         | 8,248,366             |
| Provision for loan losses                              | <u>3,550,000</u>    | <u>3,700,000</u>  | <u>5,785,000</u>      |
| Net interest income after provision for loan losses    | 5,690,109           | 5,592,433         | 2,463,366             |
| Non-interest income:                                   |                     |                   |                       |
| Service charges  | 312,862             | 328,466           | 344,702               |
| Gain on sale of government guaranteed loans            | 596,192             | 1,582,782         | 707,836               |
| Loan servicing income                                  | 575,765             | 365,769           | 259,541               |
| Other income   | 473,221             | 463,322           | 300,033               |
| Total non-interest income                              | <u>1,958,040</u>    | <u>2,740,339</u>  | <u>1,612,112</u>      |
| Other expenses:  |                     |                   |                       |
| Salaries and employee benefits                         | 4,263,448           | 4,402,385         | 4,635,750             |
| Legal expense  | 165,515             | 183,720           | 358,000               |
| Occupancy and equipment                                | 941,023             | 907,454           | 993,839               |
| Other  | 1,980,513           | 1,810,148         | 1,485,903             |
| Total other expenses                                   | <u>7,350,499</u>    | <u>7,303,707</u>  | <u>7,473,492</u>      |
| Income (loss) before provision for income taxes        | 297,650             | 1,029,065         | (3,398,014)           |
| Provision (credit) for income taxes                    | 94,096              | 503,244           | (1,384,299)           |
| Net income (loss)                                      | 203,554             | 525,821           | (2,013,715)           |
| Preferred dividends and warrant accretion              | 354,747             | 352,469           | -                     |
| Net income (loss) available to common shareholders     | <u>\$ (151,193)</u> | <u>\$ 173,352</u> | <u>\$ (2,013,715)</u> |
| Basic earnings (loss) per share                        | <u>\$ (0.08)</u>    | <u>\$ 0.09</u>    | <u>\$ (1.11)</u>      |
| Diluted earnings (loss) per share                      | <u>\$ (0.08)</u>    | <u>\$ 0.09</u>    | <u>\$ (1.11)</u>      |

The notes are an integral part of these financial statements.

# VALLEY COMMUNITY BANK

## STATEMENT OF CHANGES IN SHAREHOLDERS' EQUITY FOR THE YEARS ENDED DECEMBER 31, 2010, 2009, AND 2008

|   | Common Stock     |                      | Preferred Stock |                     | Additional<br>Paid in<br>Capital | Comprehensive<br>Income<br>(Loss) | Retained<br>Earnings | Accumulated<br>Other Comprehensive<br>Income (Loss) | Shareholders'<br>Equity |
|---|------------------|----------------------|-----------------|---------------------|----------------------------------|-----------------------------------|----------------------|---|-------------------------|
|   | Shares           | Amount               | Shares          | Amount              |                                  |                                   |                      |   |                         |
| <b>Balance, January 1, 2008</b>                     | 1,793,255        | \$ 16,084,043        | -               | \$ -                | \$ 254,673                       |                                   | \$ 3,425,936         | \$ (718)  | \$ 19,763,934           |
| Stock option expense                                | -                | -                    | -               | -                   | 90,783                           |                                   | -                    | -   | 90,783                  |
| Stock options exercised and<br>related tax benefit  | 61,124           | 380,160              | -               | -                   | -                                |                                   | -                    | -   | 380,160                 |
| Unrealized gain (loss) on securities,<br>net of tax | -                | -                    | -               | -                   | -                                | \$ 31,099                         | -                    | 31,099  | 31,099                  |
| Net loss  | -                | -                    | -               | -                   | -                                | (2,013,715)                       | (2,013,715)          | -   | (2,013,715)             |
|   |                  |                      |                 |                     |                                  | <u>\$ (1,982,616)</u>             |                      |   |                         |
| <b>Balance, December 31, 2008</b>                   | 1,854,379        | 16,464,203           | -               | -                   | 345,456                          |                                   | 1,412,221            | 30,381  | 18,252,261              |
| Stock option expense                                | -                | -                    | -               | -                   | 104,956                          |                                   | -                    | -   | 104,956                 |
| Stock options exercised and<br>related tax benefit  | 24,507           | 137,357              | -               | -                   | -                                |                                   | -                    | -   | 137,357                 |
| Preferred stock issued                              | -                | -                    | 5,500           | 5,500,000           | -                                |                                   | -                    | -   | 5,500,000               |
| Annual accretion of the warrant                     | -                | -                    | -               | 55,000              | -                                |                                   | (55,000)             | -   | -                       |
| Preferred stock dividend                            | -                | -                    | -               | -                   | -                                |                                   | (297,469)            | -   | (297,469)               |
| Unrealized gain (loss) on securities,<br>net of tax | -                | -                    | -               | -                   | -                                | \$ (4,202)                        | -                    | (4,202)   | (4,202)                 |
| Net income  | -                | -                    | -               | -                   | -                                | 525,821                           | 525,821              | -   | 525,821                 |
|   |                  |                      |                 |                     |                                  | <u>\$ 521,619</u>                 |                      |   |                         |
| <b>Balance, December 31, 2009</b>                   | 1,878,886        | 16,601,560           | 5,500           | 5,555,000           | 450,412                          |                                   | 1,585,573            | 26,179  | 24,218,724              |
| Annual accretion of the warrant                     | -                | -                    | -               | 55,000              | -                                |                                   | (55,000)             | -   | -                       |
| Preferred stock dividend                            | -                | -                    | -               | -                   | -                                |                                   | (299,747)            | -   | (299,747)               |
| Unrealized gain (loss) on securities,<br>net of tax | -                | -                    | -               | -                   | -                                | \$ (19,425)                       | -                    | (19,425)  | (19,425)                |
| Net income  | -                | -                    | -               | -                   | -                                | 203,554                           | 203,554              | -   | 203,554                 |
|   |                  |                      |                 |                     |                                  | <u>\$ 184,129</u>                 |                      |   |                         |
| <b>Balance, December 31, 2010</b>                   | <u>1,878,886</u> | <u>\$ 16,601,560</u> | <u>5,500</u>    | <u>\$ 5,610,000</u> | <u>\$ 450,412</u>                |                                   | <u>\$ 1,434,380</u>  | <u>\$ 6,754</u>                                     | <u>\$ 24,103,106</u>    |

The notes are an integral part of these financial statements.

# VALLEY COMMUNITY BANK

## STATEMENTS OF CASH FLOWS FOR THE YEARS ENDED DECEMBER 31, 2010, 2009, AND 2008

|  | 2010                | 2009                | 2008                   |
|--|---------------------|---------------------|------------------------|
| Cash flows from operating activities:  |                     |                     |                        |
| Net income (loss)  | \$ 203,554          | \$ 525,821          | \$ (2,013,715)         |
| Adjustments to reconcile net income (loss) to cash provided by operating activities: |                     |                     |                        |
| Provision for loan losses  | 3,550,000           | 3,700,000           | 5,785,000              |
| Depreciation and amortization  | 206,051             | 186,631             | 220,011                |
| Gain on sale of SBA and B&I loans  | (596,192)           | (1,582,782)         | (707,836)              |
| Gain on sale of equipment  | -                   | -                   | (1,200)                |
| Share based compensation expense   | -                   | 104,956             | 90,783                 |
| Excess tax benefits from share-based arrangements                                    | -                   | (274)               | (28,148)               |
| Provision for deferred taxes   | 385,000             | 54,000              | (197,000)              |
| Dividends from FHLB stock  | -                   | -                   | (41,600)               |
| Loss (gain) on other real estate owned   | -                   | 39,439              | -                      |
| (Increase) decrease in:  |                     |                     |                        |
| Loans held for sale, net   | 147,781             | -                   | -                      |
| Cash surrender value of life insurance policies                                      | (101,401)           | (102,119)           | (101,245)              |
| Accrued interest and other assets  | (254,874)           | (2,208,170)         | (540,257)              |
| Increase (decrease) in:  |                     |                     |                        |
| Deferred loan origination fees   | (36,710)            | (28,549)            | 16,757                 |
| Accrued interest payable and other liabilities                                       | 1,427,276           | 1,026,513           | (1,215,928)            |
| Net cash provided by operating activities  | <u>4,930,485</u>    | <u>1,715,466</u>    | <u>1,265,622</u>       |
| Cash flows from investing activities:  |                     |                     |                        |
| Net decrease (increase) in loans   | (7,087,954)         | (33,581,953)        | (72,111,240)           |
| Proceeds from sale of SBA and B&I loans  | 16,217,193          | 28,373,577          | 22,571,623             |
| Proceeds from called and matured held-to-maturity investment securities              | 160,587             | 153,348             | 2,500,000              |
| Proceeds from called and matured available-for-sale investments                      | 18,250,000          | 6,900,000           | 3,855,000              |
| Purchase of available-for-sale investments   | (23,385,000)        | (11,950,000)        | (7,404,000)            |
| Principal repayments received from held-to-maturity mortgage-backed securities       | 506,870             | 787,462             | 680,726                |
| Proceeds from sale of FHLB stock   | 32,000              | -                   | (188,600)              |
| Net increase in time deposits with other financial institutions                      | (580,698)           | 9,097,000           | (6,404,000)            |
| Proceeds from sale of equipment  | -                   | -                   | 1,200                  |
| Purchase of premises and equipment   | (355,700)           | (27,589)            | (126,616)              |
| Net cash provided (used) by investing activities                                     | <u>\$ 3,757,298</u> | <u>\$ (248,155)</u> | <u>\$ (56,625,907)</u> |

The notes are an integral part of these financial statements.

# VALLEY COMMUNITY BANK

## STATEMENTS OF CASH FLOWS FOR THE YEARS ENDED DECEMBER 31, 2010, 2009, AND 2008

|  | <u>2010</u>          | <u>2009</u>          | <u>2008</u>          |
|--|----------------------|----------------------|----------------------|
| Cash flows from financing activities:                                    |                      |                      |                      |
| Net increase (decrease) in demand, interest bearing and savings deposits | \$ 16,172,638        | \$ (5,728,171)       | \$ 10,601,984        |
| Net increase (decrease) in time deposits                                 | (28,952,043)         | 18,219,340           | 23,925,522           |
| Proceeds from short-term borrowings                                      | -                    | 7,000,000            | 14,000,000           |
| Repayments of short-term borrowings                                      | (3,000,000)          | (14,000,000)         | (6,000,000)          |
| Proceeds from the exercise of stock options                              | -                    | 137,083              | 352,013              |
| Excess tax benefit from share-based arrangements                         | -                    | 274                  | 28,148               |
| Cash dividends paid on preferred stock                                   | (299,747)            | (254,791)            | -                    |
| Proceeds from issuance of preferred stock                                | -                    | 5,500,000            | -                    |
| Net cash provided (used) by financing activities                         | <u>(16,079,152)</u>  | <u>10,873,735</u>    | <u>42,907,667</u>    |
| Increase (decrease) in cash and cash equivalents                         | (7,391,369)          | 12,341,046           | (12,452,618)         |
| Cash and cash equivalents at beginning of year                           | 22,735,294           | 10,394,248           | 22,846,866           |
| Cash and cash equivalents at end of year                                 | <u>\$ 15,343,925</u> | <u>\$ 22,735,294</u> | <u>\$ 10,394,248</u> |
| Supplemental disclosure of cash flow information:                        |                      |                      |                      |
| Cash paid during the year for the following:                             |                      |                      |                      |
| Interest expense   | <u>\$ 1,943,442</u>  | <u>\$ 2,692,314</u>  | <u>\$ 3,476,137</u>  |
| Income taxes   | <u>\$ 560,000</u>    | <u>\$ 1,595,000</u>  | <u>\$ 215,000</u>    |
| Non-cash investing activities:   |                      |                      |                      |
| Real estate acquired through foreclosure                                 | <u>\$ -</u>          | <u>\$ 378,000</u>    | <u>\$ 131,892</u>    |

The notes are an integral part of these financial statements.

# VALLEY COMMUNITY BANK

## NOTES TO FINANCIAL STATEMENTS DECEMBER 31, 2010

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### NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

#### General

Valley Community Bank (the "Bank") is a state-chartered financial institution organized under the laws of the State of California that opened for business on August 10, 1998.

The Bank engages in the general commercial banking business, to include the following: accepts checking and savings deposits; makes commercial, real estate, automobile and other installment and term loans; sells travelers' checks and provides other customary banking services, including note collection and safe deposit rental. The Bank attracts the majority of its loan and deposit business from the residents and numerous small to medium sized businesses and professional firms located in Pleasanton, Livermore, San Jose and nearby communities within Alameda and Santa Clara Counties. The deposits of the Bank are insured by the Federal Deposit Insurance Corporation (FDIC) up to the applicable limits. The Bank conducts its operations from four branches located in Pleasanton, Livermore, San Jose and Santa Cruz.

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

#### Reclassifications

Certain reclassifications have been made to prior years' balances to conform to classifications used in 2010.

#### Use of Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions. These estimates and assumptions affect the reported amounts of 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 these estimates.

#### Cash and Cash Equivalents

Cash and cash equivalents includes cash and due from banks and federal funds sold. Generally, federal funds sold mature the following business day.

#### Investment Securities

Investments are classified into one of 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 to maturity, reported at amortized cost, adjusted for the accretion of discounts and amortization of premiums.

# VALLEY COMMUNITY BANK

## NOTES TO FINANCIAL STATEMENTS DECEMBER 31, 2010

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### NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

#### **Investment Securities (Continued)**

Management determines the appropriate classification of its 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.

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.

Investment securities are evaluated for impairment at least quarterly and more frequently when economic or market conditions warrant such an evaluation to determine whether a decline in their 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 issues 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. 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.

#### **Investment in Federal Home Loan Bank Stock**

In order to borrow from the Federal Home Loan Bank (FHLB), the Bank is required to maintain an investment in FHLB capital stock. The investment is carried at cost and redeemable at par.

#### **Loans**

Loans are stated at principal balances outstanding. Interest is accrued daily based upon outstanding loan balances. However, when, in the opinion of management, loans are considered to be impaired and the future collectibility of interest and principal is in serious doubt, loans are placed on nonaccrual status and the accrual of interest income is suspended. 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 collectibility of principal is not in doubt, are applied first to earned but unpaid interest and then to principal.

A loan is considered impaired when, based on current information and events, it is probable that the Bank will be unable to collect all amounts due (including both principal and interest) in accordance with the contractual terms of the loan agreement. An impaired loan is measured based on the present value of expected future cash flows discounted at the loan's effective interest rate or, as a practical matter, at the loan's observable market

# VALLEY COMMUNITY BANK

## NOTES TO FINANCIAL STATEMENTS DECEMBER 31, 2010

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### NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

#### Loans (Continued)

price or the fair value of collateral if the loan is collateral dependent.

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.

In addition, the Bank services loans that have been participated with other financial institutions totaling approximately \$1,054,299 and \$2,162,923 as of December 31, 2010 and 2009, respectively. These loans were sold without recourse and, therefore, their sold balances are not included on the Bank's balance sheet.

The Bank may purchase loans or acquire loans through a business combination for which differences exist between the contractual cash flows and the cash flows expected to be collected due, at least in part, to credit quality. When the Bank acquires such loans, the yield that may be accreted (accretable yield) is limited to the excess of the Bank's estimate of undiscounted cash flows expected to be collected over the Bank's initial investment in the loan. The excess of contractual cash flows over cash flows expected to be collected may not be recognized as an adjustment to yield, loss, or a valuation allowance. Subsequent increases in cash flows expected to be collected generally should be recognized prospectively through adjustment of the loan's yield over its remaining life. Decreases in cash flows expected to be collected should be recognized as an impairment. The Bank may not "carry over" or create a valuation allowance in the initial accounting for loans acquired under these circumstances. At December 31, 2010, there were no loans being accounted for under this policy.

#### Allowance for Loan Losses

The allowance for loan losses is maintained to provide for losses related to impaired loans and other losses that can be expected to occur in the normal course of business. The determination of the allowance is based on estimates made by management, to include consideration of the character of the loan portfolio, specifically identified problem loans, potential losses inherent in the portfolio taken as a whole and economic conditions in the Bank's service area.

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.

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 Company will be unable to collect all amounts due according to the contractual terms of the loan agreement. Loans, for which the terms have been modified resulting in a concession, and for which the borrower is experiencing financial difficulties, are generally considered troubled debt restructurings and are also classified as impaired.

# VALLEY COMMUNITY BANK

## NOTES TO FINANCIAL STATEMENTS DECEMBER 31, 2010

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### NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

#### Allowance for Loan Losses (Continued)

Generally, large balance non-homogeneous loans are individually evaluated for impairment. If a loan is impaired, a portion of the allowance is allocated so that the loan is reported, net, at either the present value of estimated future cash flows using the loan's effective interest rate at inception or at the fair value of collateral if repayment is expected solely from the collateral. Large groups of smaller balance homogeneous loans, such as consumer and residential real estate loans, are collectively evaluated for impairment.

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.

In addition, reserve factors are assigned to currently performing loans based on management's assessment of the following for each identified loan type: (1) inherent credit risk, (2) historical losses and (3) where the Bank has not experienced losses, the loss experience of peer banks. General reserves for non-impaired loans 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.

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

The Bank's Loan Committee reviews the adequacy of the allowance for loan losses at least quarterly, to include consideration of the relative risks in the portfolio and current economic conditions. The allowance for loan losses is adjusted based on that review if, in the judgment of the Loan Committee and management, changes are warranted.

The allowance for loan losses is established through a provision for loan losses which is charged to expense. Additions to the allowance for loan losses are expected to maintain the adequacy of the allowance for loan losses after credit losses and loan growth. The allowance for loan losses at December 31, 2010 and 2009 reflects management's estimate of possible losses in the portfolio.

Management also computed expected loss reserves for loan commitments that totaled \$45,000 and \$45,000 as of December 31, 2010 and 2009, respectively. These reserves are included in accrued interest payable and other liabilities on the balance sheet. These estimates are particularly susceptible to changes in the economic environment and market conditions.

# VALLEY COMMUNITY BANK

## NOTES TO FINANCIAL STATEMENTS DECEMBER 31, 2010

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### NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

#### Other Real Estate Owned

Other real estate owned includes real estate acquired in full or partial settlement of loan obligations. When property is acquired, any excess of the Bank's recorded investment in the loan balance and accrued interest income over the estimated fair market value of the property, net of estimated selling costs, is charged against the allowance for loan losses. A valuation allowance for losses on other real estate is maintained to provide for temporary declines in value. The allowance is established through a provision for losses on other real estate which is included in other expenses. Subsequent gains or losses on sales or write-downs resulting from permanent impairments are recorded in other income or expense as incurred. Property is evaluated regularly to ensure the recorded amount is supported by its current fair value and valuation allowances to reduce the carrying amounts to fair value less estimated costs to dispose are recorded as necessary. On the balance sheet, other real estate owned is included in accrued interest receivable and other assets. Operating expenses of such properties, net of related income, are included in other expenses. The Bank held other real estate owned in the amount of \$360,000 and \$378,000 at December 31, 2010 and 2009, respectively.

#### Sales and Servicing of Government Guaranteed Loans

Included in the portfolio are loans which, in general, are 75 percent to 90 percent guaranteed by the Small Business Administration and loans which, in general, are 80 percent to 90 percent guaranteed under the Business and Industry (B&I) Guaranteed Loan Program. Loans held for sale are carried at the lower of cost or market value. Market value is determined by the specific identification method as of the balance sheet date or the date on which a third party has committed to purchase the loans. The guaranteed portion of these loans may be sold to a third party, with the Bank retaining the unguaranteed portion. The Bank generally receives a premium in excess of the adjusted carrying value of the loan at the time of sale. Certain recourse provisions in SBA sales agreements cause a delay in the recognition of the sale transaction under current accounting standards. The Bank may be required to refund a portion of the sales premium if the borrower defaults or the loan prepays within ninety days of the settlement date. The Bank had received premiums of approximately \$459,000, \$1,015,000 and \$36,000 at December 31, 2010, 2009 and 2008, which were subject to these recourse provisions. Upon expiration of the recourse provisions, the Bank recognizes a gain on the sale. Gains deferred on SBA loan sales amounted to \$525,599 as of December 31, 2010. The guaranteed portion of SBA and B&I loans, totaling approximately \$71,958,000, and \$61,309,000 was being serviced for others at December 31, 2010 and 2009, respectively.

Sales of loans are recognized when the transferred loans are put beyond the reach of the Bank and its creditors, even in receivership. Servicing rights acquired through 1) a purchase or 2) the origination of loans which are sold with servicing rights retained are recognized as separate assets or liabilities. Servicing assets or liabilities are recorded at the difference between the contractual servicing fees and adequate compensation for performing the servicing, and are subsequently amortized in proportion to and over the period of the related net servicing income or expense. Servicing assets are periodically evaluated for impairment. Fair values are estimated using discounted cash flows based on current market interest rates. For purposes of measuring impairment, servicing assets are stratified based on note rate and term. The amount of impairment recognized is the amount by which the servicing assets for a stratum exceed their fair value. When management deems there to be impairment of the servicing asset, a write-down is charged to a valuation allowance. On the balance sheet, servicing assets are included in accrued interest receivable and other assets.

In addition, assets (accounted for as interest-only (IO) strips) are recorded at the fair value of the difference between note rates and rates paid to purchasers (the interest spread) and contractual servicing fees, if applicable.

# VALLEY COMMUNITY BANK

## NOTES TO FINANCIAL STATEMENTS DECEMBER 31, 2010

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### NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

#### **Sales and Servicing of Government Guaranteed Loans (Continued)**

IO strips are carried at fair value with gains or losses recorded as a component of shareholders' equity, similar to available-for-sale investment securities. IO strips were not material at December 31, 2010 and 2009 and have been included in servicing assets.

The Bank's investment in the loan is allocated between the retained portion of the loan, the servicing asset, the IO strip, and the sold portion of the loan based on their relative fair values on the date the loan is sold. The gain on the sold portion of the loan is recognized as income at the time of sale. The carrying value of the retained portion of the loan is discounted based on the estimated yield of a comparable non-guaranteed loan. Significant future prepayments of these loans will result in the recognition of additional amortization of related servicing assets and an adjustment to the carrying value of related IO strips.

#### **Bank Premises and Equipment**

Bank premises and equipment are carried at cost. 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 life of the asset or the term of the related lease, whichever is shorter. The leasehold interest is amortized over the underlying lease term, including option renewal periods. When assets are sold or otherwise disposed of, the cost and related accumulated depreciation 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.

#### **Cash Surrender Value of Life Insurance**

The Bank accounts for its investment in life insurance policies at the amount that could be realized under the insurance contract.

#### **Income Taxes**

Deferred tax assets and liabilities are recognized for the tax consequences of temporary differences between the financial statement and tax bases of existing assets and liabilities. 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. Realization of tax benefits of deductible temporary differences and operating loss carryforwards depend on having sufficient taxable income of an appropriate character within the carryforward period. On the balance sheet, net deferred tax assets are included in accrued interest receivable and other assets.

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. Management believes that all tax positions taken to date are highly certain and, accordingly, no accounting adjustment has been made to the financial statements. Interest and penalties related to uncertain tax positions are recorded as part of operating expense/income tax expense.

# VALLEY COMMUNITY BANK

## NOTES TO FINANCIAL STATEMENTS DECEMBER 31, 2010

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### NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

#### **Earnings (Loss) Per Share**

Basic earnings (loss) per share (EPS), which excludes dilution, is computed by dividing income available to common shareholders 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 shares in the earnings of the Bank. The treasury stock method is applied to determine the dilutive effect of stock options in computing diluted EPS. Earnings per share are retroactively adjusted for stock dividends and stock splits for all periods presented.

#### **Fair Value Measurement**

Fair values 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 15 for more information and disclosures relating to the Bank's fair value measurements.

#### **Subsequent Events**

The Bank has evaluated subsequent events for recognition and disclosure through March 21, 2011, which is the date the financial statements were available to be issued.

#### **Adoption of New Accounting Standards**

In June 2009, accounting standards were amended to clarify when a transferor has surrendered control over transferred financial assets and thus is entitled to account for the transfer as a sale. The amendments establish specific conditions for accounting for the transfer of a financial asset, or a portion of a financial asset, as a sale. This guidance was effective for transfers occurring on or after January 1, 2010 and impacted when a loan participation or SBA loan sale could be accounted for as a sale and the related transferred asset derecognized by the Bank. Adoption of the standard by the Bank in 2010 did not have a material impact on its balance sheet or statement of operations other than a three month delay in the recognition of the sale and related gain on SBA loan sales due to the existence of recourse provisions commonly found in SBA loan sale agreements.

# VALLEY COMMUNITY BANK

## NOTES TO FINANCIAL STATEMENTS DECEMBER 31, 2010

### NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

#### Adoption of New Accounting Standards (Continued)

In July 2010, accounting standards were amended to require significantly more information about the credit quality of the Bank's loan portfolio. Although this statement addresses only disclosure and does not seek to change recognition or measurement, the disclosure represents a meaningful change in practice. New period-end related disclosures are reflected in these financial statements while new activity related disclosures will be effective in 2011.

### NOTE 2 - INVESTMENT SECURITIES

The amortized cost and estimated fair value of investment securities at December 31, 2010 and 2009, consisted of the following:

|                                     | 2010              |                           |                            |                         |
|-------------------------------------|-------------------|---------------------------|----------------------------|-------------------------|
|                                     | Amortized<br>Cost | Gross<br>Unrealized Gains | Gross<br>Unrealized Losses | Estimated<br>Fair Value |
| Held-to-Maturity Debt Securities:   |                   |                           |                            |                         |
| Mortgage-backed securities          | \$ 208,830        | \$ 4,229                  | \$ -                       | \$ 213,059              |
| Available-for-Sale Debt Securities: |                   |                           |                            |                         |
| U.S. Government agencies            | \$ 16,485,000     | \$ 34,141                 | \$ (22,693)                | \$ 16,496,448           |
|                                     |                   |                           |                            |                         |
|                                     | 2009              |                           |                            |                         |
|                                     | Amortized<br>Cost | Gross<br>Unrealized Gains | Gross<br>Unrealized Losses | Estimated<br>Fair Value |
| Held-to-Maturity Debt Securities:   |                   |                           |                            |                         |
| Mortgage-backed securities          | \$ 877,437        | \$ 8,023                  | \$ (271)                   | \$ 885,189              |
| Available-for-Sale Debt Securities: |                   |                           |                            |                         |
| U.S. Government agencies            | \$ 11,349,893     | \$ 48,300                 | \$ (3,928)                 | \$ 11,394,265           |

There were no sales or transfers of held-to-maturity investment securities for the years ended December 31, 2010 and 2009.

# VALLEY COMMUNITY BANK

## NOTES TO FINANCIAL STATEMENTS DECEMBER 31, 2010

### NOTE 2 - INVESTMENT SECURITIES (CONTINUED)

Investment securities with unrealized losses at December 31, 2010, are summarized and classified according to the duration of the loss period as follows:

|                          | Less than 12 months  |                    | 12 Months or More   |                   | Total                |                    |
|--------------------------|----------------------|--------------------|---------------------|-------------------|----------------------|--------------------|
|                          | Estimated Fair Value | Unrealized Losses  | Estimate Fair Value | Unrealized Losses | Estimated Fair Value | Unrealized Losses  |
| Available-for-sale:      |                      |                    |                     |                   |                      |                    |
| U.S. Government agencies | \$ 4,478,307         | \$ (22,693)        | \$ -                | \$ -              | \$ 4,478,307         | \$ (22,693)        |
|                          | <u>\$ 4,478,307</u>  | <u>\$ (22,693)</u> | <u>\$ -</u>         | <u>\$ -</u>       | <u>\$ 4,478,307</u>  | <u>\$ (22,693)</u> |

At December 31, 2010, the Bank held 72 investment securities of which 18 were in a loss position for less than twelve months.

Investment securities with unrealized losses at December 31, 2009, are summarized and classified according to the duration of the loss period as follows:

|                            | Less than 12 months  |                   | 12 Months or More   |                   | Total                |                   |
|----------------------------|----------------------|-------------------|---------------------|-------------------|----------------------|-------------------|
|                            | Estimated Fair Value | Unrealized Losses | Estimate Fair Value | Unrealized Losses | Estimated Fair Value | Unrealized Losses |
| Held-to-maturity:          |                      |                   |                     |                   |                      |                   |
| Mortgage-backed securities | \$ 47,406            | \$ (150)          | \$ 127,660          | \$ (121)          | \$ 175,066           | \$ (271)          |
| Available-for-sale:        |                      |                   |                     |                   |                      |                   |
| U.S. Government agencies   | 496,072              | (3,928)           | -                   | -                 | 496,072              | (3,928)           |
|                            | <u>\$ 543,478</u>    | <u>\$ (4,078)</u> | <u>\$ 127,660</u>   | <u>\$ (121)</u>   | <u>\$ 671,138</u>    | <u>\$ (4,199)</u> |

At December 31, 2009, the Bank held 62 investment securities of which 3 were in a loss position for less than twelve months and 3 were in a loss position and had been in a loss position for twelve months or more.

Management periodically evaluates each investment security for other than temporary impairment, relying primarily on industry analyst reports and observation of market conditions and interest rate fluctuations. Management believes it will be able to collect all amounts due according to the contractual terms of the underlying investment securities and that the noted decline in fair value is considered temporary and due only to interest rate fluctuations.

The amortized cost and estimated fair value of held-to-maturity investment securities at December 31, 2010, by contractual maturity are shown below. Mortgage-backed securities are excluded from the table below because they are not due at a single maturity date but are generally repaid monthly over the life of the underlying mortgage loans. Expected maturities may differ from contractual maturities because borrowers may have the right to call or repay obligations with or without call or prepayment penalties.

# VALLEY COMMUNITY BANK

## NOTES TO FINANCIAL STATEMENTS DECEMBER 31, 2010

### NOTE 2 - INVESTMENT SECURITIES (CONTINUED)

|                                       | Held-to-maturity  |                         | Available-for-sale   |                         |
|---------------------------------------|-------------------|-------------------------|----------------------|-------------------------|
|                                       | Amortized<br>Cost | Estimated<br>Fair Value | Amortized<br>Cost    | Estimated<br>Fair Value |
| Due within one year                   | \$ -              | \$ -                    | \$ 300,000           | \$ 302,758              |
| Due after one year through five years | 208,830           | 213,059                 | 16,185,000           | 16,193,690              |
|                                       | <u>\$ 208,830</u> | <u>\$ 213,059</u>       | <u>\$ 16,485,000</u> | <u>\$ 16,496,448</u>    |

At December 31, 2010 and 2009, held-to-maturity and available-for-sale investment securities in the approximate amount of \$4,550,000 and \$3,000,000, respectively, were pledged to secure borrowing arrangements with the Federal Reserve Bank and Federal Home Loan Bank (see Note 6).

### NOTE 3 - LOANS

Outstanding loans are summarized below:

|                                     | December 31,          |                       |
|-------------------------------------|-----------------------|-----------------------|
|                                     | 2010                  | 2009                  |
| Commercial                          | \$ 60,353,238         | \$ 67,576,118         |
| Real estate - mortgage              | 81,477,481            | 85,305,763            |
| Real estate - land and construction | 24,958,051            | 26,875,933            |
| Consumer                            | 184,766               | 171,934               |
|                                     | <u>166,973,536</u>    | <u>179,929,748</u>    |
| Deferred loan origination fees, net | 32,980                | (3,730)               |
| Allowance for loan losses           | <u>(3,415,922)</u>    | <u>(4,141,306)</u>    |
|                                     | <u>\$ 163,590,594</u> | <u>\$ 175,784,712</u> |

Changes in the allowance for loan losses for the years ended December 31, 2010, 2009, and 2008 were as follows:

|                                  | 2010                | 2009                | 2008                |
|----------------------------------|---------------------|---------------------|---------------------|
| Balance, beginning of year       | \$ 4,141,306        | \$ 3,132,073        | \$ 1,786,053        |
| Provisions charged to operations | 3,550,000           | 3,700,000           | 5,785,000           |
| Loans charged off                | (5,041,896)         | (3,111,560)         | (4,442,631)         |
| Recoveries                       | 766,512             | 420,793             | 3,651               |
| Balance, end of year             | <u>\$ 3,415,922</u> | <u>\$ 4,141,306</u> | <u>\$ 3,132,073</u> |

For the 2008 fiscal year, both 1) the total loan loss provision charged to operations of \$5,785,000 and 2) total loans charged off of \$4,442,631, were impacted by the write-off of one non-real estate related loan in the amount of \$4.2 million.

# VALLEY COMMUNITY BANK

## NOTES TO FINANCIAL STATEMENTS DECEMBER 31, 2010

### NOTE 3 – LOANS (CONTINUED)

The following table presents the approximate balance in the allowance for loan losses and the recorded investment in loans by impairment method as of December 31, 2010:

|                                  | Evaluated for Impairment |                      | Total                 |
|----------------------------------|--------------------------|----------------------|-----------------------|
|                                  | Collectively             | Individually         |                       |
| <b>Allowance for Loan Losses</b> |                          |                      |                       |
| Land & Construction              | \$ 553,288               | \$ -                 | \$ 553,288            |
| Commercial Real Estate           | 677,881                  | 16,076               | 693,957               |
| Residential Real Estate          | 263,410                  | 117,441              | 380,851               |
| Com'l & Industrial               | 1,073,323                | 78,487               | 1,151,810             |
| SBA                              | 364,752                  | 85,682               | 450,434               |
| Consumer                         | 2,402                    | -                    | 2,402                 |
| Unallocated                      | 183,180                  | -                    | 183,180               |
|                                  | <u>\$ 3,118,236</u>      | <u>\$ 297,686</u>    | <u>\$ 3,415,922</u>   |
| <b>Loans</b>                     |                          |                      |                       |
| Land & Construction              | \$ 21,883,251            | \$ 3,074,800         | \$ 24,958,051         |
| Commercial Real Estate           | 55,019,667               | 1,092,347            | 56,112,014            |
| Residential Real Estate          | 20,194,437               | 4,961,030            | 25,155,467            |
| Com'l & Industrial               | 36,897,889               | 4,623,965            | 41,521,854            |
| SBA                              | 18,439,727               | 601,657              | 19,041,384            |
| Consumer                         | 184,766                  | -                    | 184,766               |
|                                  | <u>\$ 152,619,737</u>    | <u>\$ 14,353,799</u> | <u>\$ 166,973,536</u> |

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:

**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.

**Impaired** - A loan is considered 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. Additionally, all loans classified as troubled debt restructurings are considered impaired.

# VALLEY COMMUNITY BANK

## NOTES TO FINANCIAL STATEMENTS DECEMBER 31, 2010

### NOTE 3 – LOANS (CONTINUED)

Loans listed as pass include larger non-homogeneous loans not meeting the risk rating definitions above and smaller, homogeneous loans not assessed on an individual basis.

Based on the most recent analysis performed, the approximate amount of loans by risk category and class of loans is as follows as of December 31, 2010:

|                          | Pass                  | Special<br>Mention   | Substandard         | Impaired             | Total                 |
|--------------------------|-----------------------|----------------------|---------------------|----------------------|-----------------------|
| <b>December 31, 2010</b> |                       |                      |                     |                      |                       |
| Land & Construction      | \$ 10,810,139         | \$ 10,388,401        | \$ 684,711          | \$ 3,074,800         | \$ 24,958,051         |
| Commercial Real Estate   | 49,895,204            | 1,788,234            | 3,336,229           | 1,092,347            | 56,112,014            |
| Residential Real Estate  | 19,814,444            | 99,993               | 280,000             | 4,961,030            | 25,155,467            |
| Com'l & Industrial       | 27,865,336            | 6,181,271            | 2,851,282           | 4,623,965            | 41,521,854            |
| SBA                      | 16,991,577            | 780,650              | 667,500             | 601,657              | 19,041,384            |
| Consumer                 | 184,766               | -                    | -                   | -                    | 184,766               |
|                          | <u>\$ 125,561,466</u> | <u>\$ 19,238,549</u> | <u>\$ 7,819,722</u> | <u>\$ 14,353,799</u> | <u>\$ 166,973,536</u> |

Approximate amounts of past due and nonaccrual loans were as follows as of December 31, 2010:

|                          | Still Accruing         |                          | Nonaccrual           |
|--------------------------|------------------------|--------------------------|----------------------|
|                          | 30-89 Days<br>Past Due | Over 90 Days<br>Past Due |                      |
| <b>December 31, 2010</b> |                        |                          |                      |
| Land & Construction      | \$ 332,991             | \$ -                     | \$ 3,074,800         |
| Commercial Real Estate   | 2,297,133              | -                        | 824,412              |
| Residential Real Estate  | -                      | -                        | 2,025,000            |
| Com'l & Industrial       | 299,422                | 39,507                   | 4,060,363            |
| SBA                      | 1,215,860              | -                        | 284,317              |
| Consumer                 | -                      | -                        | -                    |
|                          | <u>\$ 4,145,406</u>    | <u>\$ 39,507</u>         | <u>\$ 10,268,892</u> |

# VALLEY COMMUNITY BANK

## NOTES TO FINANCIAL STATEMENTS DECEMBER 31, 2010

### NOTE 3 – LOANS (CONTINUED)

Amounts relating to individually impaired loans were as follows as of December 31, 2010:

|   | Unpaid<br>Principal<br>Balance | Recorded<br>Investment | Related<br>Allowance | Average<br>Recorded<br>Investment |
|---|--------------------------------|------------------------|----------------------|-----------------------------------|
| <b>December 31, 2010</b>                      |                                |                        |                      |                                   |
| <b>With An Allowance Recorded</b>             |                                |                        |                      |                                   |
| Land & Construction                           | \$ -                           | \$ -                   | \$ -                 | \$ -                              |
| Commercial Real Estate                        | 267,935                        | 267,935                | 16,076               | 156,571                           |
| Residential Real Estate                       | 2,936,030                      | 2,936,030              | 117,441              | 2,950,603                         |
| Com'l & Industrial                            | 564,462                        | 564,462                | 78,487               | 98,601                            |
| SBA   | 317,340                        | 317,340                | 85,682               | 79,335                            |
| Consumer                                      | -                              | -                      | -                    | -                                 |
| <b>With No Related Allowance<br/>Recorded</b> |                                |                        |                      |                                   |
| Land & Construction                           | 5,236,146                      | 3,074,800              | -                    | 2,999,245                         |
| Commercial Real Estate                        | 1,034,412                      | 824,412                | -                    | 383,603                           |
| Residential Real Estate                       | 3,540,313                      | 2,025,000              | -                    | 3,188,424                         |
| Com'l & Industrial                            | 5,559,433                      | 4,059,503              | -                    | 3,601,509                         |
| SBA   | 547,816                        | 284,317                | -                    | 320,068                           |
| Consumer                                      | -                              | -                      | -                    | -                                 |
|   | <u>\$ 20,003,887</u>           | <u>\$ 14,353,799</u>   | <u>\$ 297,686</u>    | <u>\$ 13,777,959</u>              |

The Bank recognized interest income on impaired loans of \$360,000, \$668,000 and \$0 during the years ended December 31, 2010, 2009 and 2008, respectively. The Bank has allocated \$225,000 of specific reserves on loans with a recorded investment of \$9,124,000 whose terms have been modified in troubled debt restructurings as of December 31, 2010.

The following is a summary of the investment in impaired loans, the related allowance for loan losses, and income recognized thereon and information pertaining to nonaccrual and past due loans as of December 31, 2010 and 2009:

|   | <b>2010</b>   | <b>2009</b>  |
|---|---------------|--------------|
| Impaired Loans with No Allocated Allowance              | \$ 10,268,032 | \$ 2,956,000 |
| Impaired Loans with Allocated Allowance                 | 4,085,767     | 10,136,000   |
|   | 14,353,799    | 13,092,000   |
| Related Allowance for Loan Losses                       | 297,686       | 346,000      |
| Average Recorded Investment in Impaired Loans           | 13,777,959    | 6,483,000    |
| Total Nonaccrual Loans                                  | 10,268,892    | 1,883,000    |
| Total Loans Past-Due 90 Days or More and Still Accruing | 39,507        | 734,000      |

# VALLEY COMMUNITY BANK

## NOTES TO FINANCIAL STATEMENTS DECEMBER 31, 2010

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### NOTE 3 – LOANS (CONTINUED)

Interest foregone on nonaccrual loans was \$544,000, \$58,000 and \$32,000 for the years ended December 31, 2010, 2009 and 2008, respectively. Salaries and employee benefits totaling \$259,000, \$333,000, and \$358,000 were deferred as loan origination costs for the years ended December 31, 2010, 2009 and 2008, respectively.

Loans with fair values of approximately \$60,450,000 and \$26,647,000 were pledged to secure borrowing arrangements and public deposits at December 31, 2010 and 2009, respectively (see Note 6).

### **Sales and Servicing of Government Guaranteed Loans**

The Bank adopted guidance issued by the FASB relating to the sale and servicing of government guaranteed loans effective January 1, 2007. The Bank identified servicing assets relating to all existing SBA loans as a class of servicing rights and elected to apply the amortization method of accounting to these servicing assets. In accordance with the guidance issued, servicing assets are initially recorded at fair value. The Bank generally estimates fair value based on the present value of future expected cash flows estimated using management's best estimates of the key assumptions that include prepayment speeds and discount rates commensurate with the risks involved.

The servicing asset represents the value of the contractual servicing fee less adequate servicing compensation. Adequate servicing compensation in the SBA industry has been considered 40 basis points. Therefore, the servicing asset value is based upon the contractual servicing fee of generally 1% less adequate servicing compensation of 40 basis points. When the interest rate retained exceeds the contractual servicing fee, the excess is considered the interest-only strip receivable. The balance of interest-only strip receivable is not material and has been included in the servicing asset. No impairment gains or losses were recognized. Servicing assets are included in accrued interest receivable and other assets on the balance sheet.

At December 31, 2010 and 2009, the unpaid principal balance of SBA and B&I loans serviced for others totaled \$71,958,000 and \$61,309,000, respectively. The gain on sale of SBA and B&I loans was \$596,192, \$1,582,782, and \$707,836 for the years ended December 31, 2010, 2009, and 2008, respectively.

Servicing income is a component of non interest income in the statement of income. The Bank recognized \$576,000, \$366,000 and \$260,000 in servicing fees for the years ended December 31, 2010, 2009 and 2008, respectively.

# VALLEY COMMUNITY BANK

## NOTES TO FINANCIAL STATEMENTS DECEMBER 31, 2010

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### NOTE 3 – LOANS (CONTINUED)

Following is an analysis of activity in servicing assets:

|   | <b>December 31,</b> |                     |
|---|---------------------|---------------------|
|   | <b>2010</b>         | <b>2009</b>         |
| Carrying amount, beginning of year          | \$ 1,567,698        | \$ 626,680          |
| Additions:                                  |                     |                     |
| Assumption of servicing obligations         | 306,192             | 1,021,340           |
| Subtractions:                               |                     |                     |
| Amortization                                | (134,252)           | (80,322)            |
| Carrying amount, before valuation allowance | 1,739,638           | 1,567,698           |
| Valuation allowance                         | -                   | -                   |
| Carrying amount, end of year                | <u>\$ 1,739,638</u> | <u>\$ 1,567,698</u> |

### NOTE 4 - BANK PREMISES AND EQUIPMENT

Bank premises and equipment consisted of the following:

|   | <b>December 31,</b> |                   |
|---|---------------------|-------------------|
|   | <b>2010</b>         | <b>2009</b>       |
| Leasehold improvements                            | \$ 1,275,237        | \$ 1,028,668      |
| Leasehold interest                                | 193,000             | 193,000           |
| Furniture and equipment                           | 1,345,977           | 1,225,854         |
| Construction in progress                          | -                   | 10,992            |
|   | <u>2,814,214</u>    | <u>2,458,514</u>  |
| Less accumulated depreciation<br>and amortization | (2,256,607)         | (2,065,098)       |
|   | <u>\$ 557,607</u>   | <u>\$ 393,416</u> |

Depreciation and amortization included in occupancy and equipment expense totaled \$192,000, \$180,000 and \$236,000 for the years ended December 31, 2010, 2009 and 2008, respectively.

# VALLEY COMMUNITY BANK

## NOTES TO FINANCIAL STATEMENTS DECEMBER 31, 2010

### NOTE 5 - INTEREST-BEARING DEPOSITS

Interest-bearing deposits consisted of the following:

|                         | <b>December 31,</b>   |                       |
|-------------------------|-----------------------|-----------------------|
|                         | <b>2010</b>           | <b>2009</b>           |
| Savings                 | \$ 4,013,169          | \$ 2,370,472          |
| Money market            | 64,207,383            | 49,010,519            |
| NOW accounts            | 8,279,973             | 8,791,095             |
| Time, \$100,000 or more | 32,452,038            | 33,213,096            |
| Other time              | 30,279,871            | 58,470,856            |
| Total                   | <u>\$ 139,232,434</u> | <u>\$ 151,856,038</u> |

Aggregate annual maturities of time deposits are as follows:

| Year Ending<br>December 31 | <b>2010</b>          |
|----------------------------|----------------------|
| 2011                       | \$ 53,118,457        |
| 2012                       | 9,613,452            |
|                            | <u>\$ 62,731,909</u> |

Interest expense recognized on interest-bearing deposits for the years ended December 31, 2010, 2009 and 2008 consisted of the following:

|                         | <b>2010</b>         | <b>2009</b>         | <b>2008</b>         |
|-------------------------|---------------------|---------------------|---------------------|
| Savings                 | \$ 14,471           | \$ 11,097           | \$ 19,555           |
| CDARS                   | 44,622              | -                   | -                   |
| Money market            | 667,237             | 509,548             | 918,498             |
| NOW accounts            | 12,698              | 7,633               | 19,522              |
| Time, \$100,000 or more | 480,090             | 668,703             | 1,053,166           |
| Other time              | 602,237             | 1,090,923           | 948,886             |
| Total                   | <u>\$ 1,821,355</u> | <u>\$ 2,287,904</u> | <u>\$ 2,959,627</u> |

# VALLEY COMMUNITY BANK

## NOTES TO FINANCIAL STATEMENTS DECEMBER 31, 2010

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### NOTE 6 - BORROWING ARRANGEMENTS

The Bank may borrow up to \$5,000,000 overnight on an unsecured basis from one of its correspondent banks. The Bank can also borrow up to \$4,550,000 on an overnight basis from the Federal Reserve Bank, secured by investments with amortized costs and estimated market values totaling \$4,550,000 and \$4,545,454 (see Note 2). There were no amounts outstanding under either of these borrowing arrangements at December 31, 2010 and 2009.

At December 31, 2010, the Bank could borrow up to \$18,553,000 from the FHLB on either a short-term or long-term basis, secured by loans with fair values, as calculated by FHLB, totaling approximately \$46,191,000 (see Note 3).

An advance totaling \$4,000,000 was outstanding from the FHLB at December 31, 2010, bearing interest rate of 1.74% with maturity date of March 31, 2011. Two advances totaling \$7,000,000 were outstanding from the FHLB at December 31, 2009, bearing interest rates of 0.75% and 1.74% with maturity dates of July 23, 2010 and March 31, 2011, respectively.

# VALLEY COMMUNITY BANK

## NOTES TO FINANCIAL STATEMENTS DECEMBER 31, 2010

### NOTE 7 - INCOME TAXES

The provision (credit) for income taxes for the years ended December 31, 2010, 2009 and 2008 consisted of the following:

|                                     | <u>2010</u>      | <u>2009</u>       | <u>2008</u>           |
|-------------------------------------|------------------|-------------------|-----------------------|
| Current:                            |                  |                   |                       |
| Federal                             | \$ (291,000)     | \$ 342,000        | \$ (1,187,300)        |
| State                               | -                | 107,000           | -                     |
| Total current                       | <u>(291,000)</u> | <u>449,000</u>    | <u>(1,187,300)</u>    |
| Deferred:                           |                  |                   |                       |
| Federal                             | 361,000          | 52,000            | 168,000               |
| State                               | 24,000           | 2,000             | (365,000)             |
| Total deferred                      | <u>385,000</u>   | <u>54,000</u>     | <u>(197,000)</u>      |
| Provision (credit) for income taxes | <u>\$ 94,000</u> | <u>\$ 503,000</u> | <u>\$ (1,384,300)</u> |

Deferred tax assets (liabilities) at December 31, 2010, 2009 and 2008, consisted of the following:

|   | <u>2010</u>       | <u>December 31,<br/>2009</u> | <u>2008</u>         |
|---|-------------------|------------------------------|---------------------|
| Deferred tax assets:                                |                   |                              |                     |
| Allowance for loan losses                           | \$ 539,000        | \$ 1,066,000                 | \$ 828,000          |
| Bank premises and equipment                         | 166,000           | 230,000                      | 207,000             |
| Deferred compensation                               | 443,000           | 337,000                      | 255,000             |
| State taxes and net operating<br>loss carryforwards | 267,000           | 269,000                      | 232,000             |
| Other   | 320,000           | 164,000                      | 209,000             |
| Total deferred tax assets                           | <u>1,735,000</u>  | <u>2,066,000</u>             | <u>1,731,000</u>    |
| Deferred tax liabilities:                           |                   |                              |                     |
| Servicing asset                                     | (716,000)         | (645,000)                    | (258,000)           |
| Deferred loan costs                                 | (176,000)         | (191,000)                    | (189,000)           |
| FHLB stock dividends                                | (64,000)          | (66,000)                     | (66,000)            |
| Other   | (5,000)           | (18,000)                     | (21,000)            |
| Total deferred tax liabilities                      | <u>(961,000)</u>  | <u>(920,000)</u>             | <u>(534,000)</u>    |
| Net deferred tax assets                             | <u>\$ 774,000</u> | <u>\$ 1,146,000</u>          | <u>\$ 1,197,000</u> |

# VALLEY COMMUNITY BANK

## NOTES TO FINANCIAL STATEMENTS DECEMBER 31, 2010

### NOTE 7 - INCOME TAXES (CONTINUED)

The provision for income taxes differs from amounts computed by applying the statutory Federal and State income tax rates to operating income before income taxes. The significant items comprising these differences for the years ended December 31, 2010, 2009 and 2008 consisted of the following:

|  | 2010             |              | 2009              |              | 2008                  |                |
|--|------------------|--------------|-------------------|--------------|-----------------------|----------------|
|  | Amount           | Rate %       | Amount            | Rate %       | Amount                | Rate %         |
| Federal income tax expense (credit), at statutory rate | \$ 101,000       | 34.00        | \$ 350,000        | 34.00        | \$ (1,155,000)        | (34.00)        |
| State franchise tax expense, net of Federal tax effect | 21,000           | 7.20         | 74,000            | 7.20         | (243,000)             | (7.20)         |
| Net increase in cash surrender value of life insurance | (20,000)         | (6.90)       | (46,000)          | (4.40)       | (48,600)              | (1.40)         |
| Other  | (8,000)          | (2.70)       | 125,000           | 12.10        | 62,300                | 1.60           |
| Total income tax expense                               | <u>\$ 94,000</u> | <u>31.60</u> | <u>\$ 503,000</u> | <u>48.90</u> | <u>\$ (1,384,300)</u> | <u>(41.00)</u> |

The net operating loss carryforward of \$3,735,877 for state tax purposes was suspended for 2010 and will expire in December 2030.

The Bank is subject to federal income tax and income tax of the state of California. Our federal income tax returns for the years ended December 31, 2009, 2008 and 2007 are open to audit by the federal authorities and our California state tax returns for the years ended December 31, 2009, 2008, 2007 and 2006, are open to audit by state authorities.

We record interest and penalties related to uncertain tax positions as part of operating expense. There was no penalty or interest expense recorded as of December 31, 2010. We do not expect the total amount of unrecognized tax benefits to significantly increase or decrease within the next twelve months.

### NOTE 8 - COMMITMENTS AND CONTINGENCIES

#### Operating Leases

The Bank leases its branch offices and various equipment under noncancelable operating leases expiring on various dates through the year 2015. The Bank has subleased a portion of its Pleasanton office space under a non-cancelable agreement that expires in 2012. Future minimum lease payments and sublease rental income are as follows:

# VALLEY COMMUNITY BANK

## NOTES TO FINANCIAL STATEMENTS DECEMBER 31, 2010

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### NOTE 8 - COMMITMENTS AND CONTINGENCIES (CONTINUED)

| Year Ending<br>December 31, | Minimum<br>Lease<br>Payments | Minimum<br>Sublease<br>Rental<br>Income |
|-----------------------------|------------------------------|---|
| 2011                        | \$ 533,859                   | \$ 66,336                               |
| 2012                        | 523,775                      | 68,328                                  |
| 2013                        | 142,569                      | -                                       |
| 2014                        | 92,106                       | -                                       |
| 2015                        | 2,550                        | -                                       |
|                             | <u>\$ 1,294,859</u>          | <u>\$ 134,664</u>                       |

Rental expense included in occupancy and equipment expense, net of related rental income, totaled \$466,000, \$483,000 and \$464,000 for the years ended December 31, 2010, 2009 and 2008, respectively.

#### **Federal Reserve Requirements**

Banks are required to maintain reserves with the Federal Reserve Bank equal to a percentage of their reservable deposits. At December 31, 2010 and 2009, the Bank's cash balances were sufficient to comply with this reserve requirement and, therefore, no such reserve balances were held with the Federal Reserve Bank.

#### **Correspondent Banking Agreements**

The Bank maintains funds on deposit with the Federal Home Loan Bank and other federally insured institutions under correspondent banking agreements. Uninsured deposits totaled approximately \$2,041,000 at December 31, 2010.

#### **Financial Instruments with Off-Balance-Sheet Risk**

The Bank is a party to financial instruments with off-balance-sheet risk in the normal course of business in order to meet the financing needs of its customers and to reduce its own exposure to fluctuations in interest rates. These financial instruments consist of commitments to extend credit and letters of credit and involve, to varying degrees, elements of credit and interest rate risk in excess of the amount recognized on the balance sheet.

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

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. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Since some of the commitments are expected to expire without

# VALLEY COMMUNITY BANK

## NOTES TO FINANCIAL STATEMENTS DECEMBER 31, 2010

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### NOTE 8 - COMMITMENTS AND CONTINGENCIES (CONTINUED)

being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. Management evaluates each customer's creditworthiness on a case-by-case basis. The amount of collateral obtained, if deemed necessary upon extension of credit, is based on management's credit evaluation of the borrower. Collateral held varies, but may include accounts receivable, inventory, and deeds of trust on residential real estate and income producing commercial properties.

Standby letters of credit are conditional commitments to guarantee the performance or financial obligation of a customer to a third party. The credit risk involved in issuing standby letters of credit is essentially the same as that involved in extending loans to customers. The fair value of the liability related to these standby letters of credit, which represents the fees received for issuing the guarantees, was not significant at December 31, 2010 and 2009. The Bank recognizes these fees as revenue over the term of the commitment or when the commitment is used.

The following financial instruments represent off-balance-sheet credit risk:

|  | <b>December 31,</b>              |                                  |
|--|----------------------------------|----------------------------------|
|  | <b>2010</b>                      | <b>2009</b>                      |
|  | <hr/>                            | <hr/>                            |
| Commitments to extend credit:  |                                  |                                  |
| Revolving lines of credit secured by 1-4 family residence  | \$ 4,837,000                     | \$ 7,092,000                     |
| Commercial real estate, construction and land development commitments secured by real estate   | 16,792,000                       | 8,150,000                        |
| Other unused commitments, comprised primarily of commercial and consumer loans secured by collateral other than real estate or unsecured | 14,785,000                       | 22,184,000                       |
|  | <hr/> <b>\$ 36,414,000</b> <hr/> | <hr/> <b>\$ 37,426,000</b> <hr/> |
| Standby letters of credit  | <hr/> <b>\$ 76,000</b> <hr/>     | <hr/> <b>\$ 822,000</b> <hr/>    |

### Concentrations of Credit Risk

The Bank grants real estate mortgage, real estate construction, commercial, and consumer loans to customers in Alameda, Contra Costa and Santa Clara counties. Although the Bank has a diversified loan portfolio, a substantial portion of its portfolio is secured by commercial and residential real estate. However, personal and business income represents the primary source of repayment for a majority of these loans. As of December 31, 2010 and 2009, approximately 65% and 63%, respectively, of total loans were real estate related.

Although management believes the loans within these concentrations have no more than the normal risk of collectibility, a substantial decline in the performance of the economy in general or a decline in real estate values in the Bank's primary market area, in particular, could have an adverse impact on collectibility.

### Contingencies

The Bank is subject to legal proceedings and claims which arise in the ordinary course of business. In the opinion of management, the amount of liability with respect to such actions will not materially affect the

# VALLEY COMMUNITY BANK

## NOTES TO FINANCIAL STATEMENTS DECEMBER 31, 2010

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### NOTE 8 - COMMITMENTS AND CONTINGENCIES (CONTINUED)

financial position or results of operations of the Bank.

### NOTE 9 - SHAREHOLDERS' EQUITY

#### Preferred Stock

On January 9, 2009 the Bank issued 5,500 shares of the Bank's Fixed Rate Non-Cumulative Perpetual Preferred Stock, Series A ("Series A Preferred Stock") and a related warrant for 275 shares of Fixed Rate Non-Cumulative Perpetual Preferred Stock, Series B ("Series B Preferred Stock") to the U.S. Treasury in connection with Bank's participation in Troubled Asset Relief Program (TARP).

#### Troubled Asset Relief Program (TARP)

The TARP Capital Purchase Program, created by the U.S. Treasury, is a voluntary program which selected healthy financial institutions were encouraged to participate.

On January 9, 2009 the Bank received \$5.5 million as an approved participant in the U.S. Treasury Department's TARP Capital Purchase Program. The Bank issued 5,500 shares of Series A Preferred Stock and a related warrant for 275 shares of Series B Preferred Stock, which represents 5% of the Series A Preferred Stock amount or \$275,000, to the U.S. Treasury.

The Series A Preferred Stock issued by the Bank will pay non-cumulative cash dividends at an initial rate per annum equal to 5% on \$1,000 per share for the first 5 years, after which the rate will increase to 9% if the Bank does not redeem the preferred shares. The Series B Preferred Stock issued by the Bank will pay non-cumulative cash dividends at a rate per annum equal to 9% on \$1,000 per share. Dividends are payable quarterly in arrears on February 15, May 15, August 15 and November 15 of each year. In 2010 and 2009 the Bank reflected \$299,747 and \$297,469 in dividends on the Series A Preferred Shares, respectively.

The dividends will be paid only as declared by the Board of Directors of the Bank. However, in the event such dividends have not been paid for an aggregate of six or more quarterly dividend periods, whether or not consecutive, the holders of the Series A Preferred Stock and Series B Preferred Stock have the right to elect two directors at the Bank's next annual meeting of stockholders and at each subsequent annual meeting of stockholders until the full dividends have been paid for at least four consecutive dividend periods.

These preferred shares do not carry voting rights, except in certain limited circumstances.

For as long as Series A and Series B Preferred Stock is outstanding, no dividends may be declared or paid on common shares unless the full dividend for the latest completed dividend period of Series A and Series B Preferred Stock has been declared and paid in full.

Series A Preferred Stock may not be redeemed for a period of three years from the date of this investment, except with the proceeds from a Qualified Equity Offering, which results in aggregate gross proceeds to the Bank of not less than 25% of the issue price of the Series A Preferred Stock. Qualified Equity Offering is the sale by the Bank after the date of this investment of Tier 1 qualifying perpetual preferred stock or common stock for cash. After the third anniversary of the date of this investment, the Series A Preferred Stock may be redeemed, in whole or in part, at any time and from time to time, at the option of the Bank. All redemptions of the Series A Preferred Stock shall be at 100% of its issue price and accrued and unpaid dividends for the then

# VALLEY COMMUNITY BANK

## NOTES TO FINANCIAL STATEMENTS DECEMBER 31, 2010

### NOTE 9 - SHAREHOLDERS' EQUITY (CONTINUED)

current dividend period. Series B Preferred Stock may not be redeemed until all the Series A Preferred Stock has been redeemed.

#### Dividends on Common Shares

The California Financial Code restricts the total dividend payment of any bank 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. At December 31, 2010, the Bank had \$0 in retained earnings available for dividends to shareholders.

No dividends were declared in 2010, 2009 and 2008.

#### Earnings (Loss) Per Share

The reconciliation of the numerators and denominators of the basic and diluted earnings (loss) per share computations are as follows:

|                                  | Net Income<br>(Loss) Available<br>To Common<br>Shareholders | Weighted Average<br>Number of Shares<br>Outstanding | Per Share<br>Amount |
|----------------------------------|---|---|---------------------|
| <hr/>                            |   |   |                     |
| December 31, 2010                |   |   |                     |
| Basic (loss) per share           | \$ (151,193)  | 1,878,886   | \$ (0.08)           |
| Effect of dilutive stock options | -   | -   | -                   |
| Diluted (loss) per share         | \$ (151,193)  | 1,878,886   | \$ (0.08)           |
| <hr/>                            |   |   |                     |
| December 31, 2009                |   |   |                     |
| Basic earnings per share         | \$ 173,352  | 1,867,824   | \$ 0.09             |
| Effect of dilutive stock options | -   | -   | -                   |
| Diluted earnings per share       | \$ 173,352  | 1,867,824   | \$ 0.09             |
| <hr/>                            |   |   |                     |
| December 31, 2008                |   |   |                     |
| Basic (loss) per share           | \$ (2,013,715)  | 1,808,016   | \$ (1.11)           |
| Effect of dilutive stock options | -   | -   | -                   |
| Diluted (loss) per share         | \$ (2,013,715)  | 1,808,016   | \$ (1.11)           |

### NOTE 10 - STOCK OPTIONS

On January 1, 2006, the Bank adopted the guidance issued by the Financial Accounting Standards Board (FASB) which has been subsequently codified into ASC Topic 718, "Compensation – Stock Compensation", which requires the measurement and recognition of all share-based compensation under the fair value method.

# VALLEY COMMUNITY BANK

## NOTES TO FINANCIAL STATEMENTS DECEMBER 31, 2010

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### NOTE 10 – STOCK OPTIONS (CONTINUED)

Under the modified prospective transition method adopted by the Bank, share-based compensation expense is recorded for all awards granted after the adoption date and for the unvested portion of previously granted awards outstanding on the adoption date. Compensation cost related to the unvested portion of previously granted awards is based on the grant-date fair value estimated. Total compensation costs recorded during the year ended December 31, 2010, 2009 and 2008, amounted to \$0, \$105,000 and \$91,000, respectively, and the related tax benefit was \$0, \$21,000 and \$17,000, respectively.

On October 22, 1998 and January 21, 1999, respectively, the Board of Directors adopted the Valley Community Bank 1998 Employee Stock Option Plan (the "Employee Plan") and the Valley Community Bank 1998 Directors' Stock Option Plan (the "Directors' Plan"). Both plans were approved at the 1999 shareholders meeting. In 2004, the Board of Directors approved an amendment to the 1998 Employee Stock Option Plan, which was approved by the shareholders, to reserve 138,443 additional shares. In 2005, the Board of Directors approved the transfer of 48,000 shares from shares reserved under the Employee Plan to shares reserved under the Director's Plan. In 2009, the Board of Directors approved the 2009 Omnibus Equity Incentive Compensation Plan (the "Plan"), that reserved 556,300 shares for issuance to participants under the Plan. The Plan was approved at the 2010 shareholders meeting. Under the 1998 Employee Plan at December 31, 2010, 44,993 shares of common stock are reserved for issuance to employees under incentive agreements. Under the 1998 Directors' Plan at December 31, 2010, 17,794 shares of common stock are reserved for issuance to non-employee directors. Under the 2010 Employee Plan at December 31, 2010, 246,244 shares of common stock are reserved for issuance to employees under incentive agreements. Under the 2010 Directors' Plan at December 31, 2010, 204,617 shares of common stock are reserved for issuance to non-employee directors. The plans require 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. All options expire on a date determined by the Board of Directors, but not later than ten years from the date of grant. The options vest ratably over a three year period, beginning one year from the date of grant.

The fair value of each option award is estimated on the date of grant using the Black Scholes option pricing model. Expected volatility is based on historical volatility of the common stock. The Bank uses historical data to estimate option exercise and forfeiture rates within the valuation model. The expected life of the options granted is derived from the award's vesting period and the award recipient's exercise history, if applicable, and represents the period of time that the options are expected to be outstanding. The risk-free rate for periods within the expected life of the option is based on the U.S. Treasury note rate at the time of the grant corresponding to the expected life. The assumptions used for determining the fair value of the options granted during the year ended December 31, 2010, 2009, and 2008 are as follows:

|                     | 2010    | 2009     | 2008    |
|---------------------|---------|----------|---------|
| Expected volatility | 51.19%  | 35.87%   | 35.87%  |
| Expected dividends  | None    | None     | None    |
| Expected term       | 5 years | 3 months | 5 years |
| Risk-free rate      | 1.99%   | 0.17%    | 2.86%   |

# VALLEY COMMUNITY BANK

## NOTES TO FINANCIAL STATEMENTS DECEMBER 31, 2010

### NOTE 10 - STOCK OPTIONS (CONTINUED)

A summary of option activity of the Bank's fixed stock option plan is presented below.

|                                | Shares    | Weighted<br>average exercise<br>price | Weighted<br>average<br>remaining<br>contractual term<br>in years | Aggregate<br>intrinsic value<br>using end of<br>period market<br>price |
|--------------------------------|-----------|---------------------------------------|--|--|
| Outstanding, January 1, 2010   | 354,749   | \$ 9.65                               | 3.18   | \$ 2,792   |
| Exercised                      | -         | -                                     |  |  |
| Expired                        | (117,645) | 6.76                                  |  |  |
| Granted                        | 85,639    | 3.44                                  |  |  |
| Outstanding, December 31, 2010 | 322,743   | 9.05                                  | 5.16   | -  |
| Exercisable, December 31, 2010 | 236,087   | 11.09                                 | 3.40   | -  |

The weighted-average grant-date fair value of options granted during the year ended December 31, 2010 and 2009 was \$1.61 and \$0.32, respectively. The total intrinsic value of options exercised during the year ended December 31, 2010 and 2009, was \$0 and \$0, respectively.

Cash received from options exercised under the Plan for the years ended December 31, 2010 and 2009, was \$0 and \$137,357, respectively. The actual tax benefit realized for the tax deductions from options exercised was \$0 and \$274 for the years ended December 31, 2010 and 2009, respectively.

As of December 31, 2010, there was \$137,000 of total unrecognized compensation cost related to nonvested share-based compensation arrangements granted under the Plan. That cost is expected to be recognized over a weighted-average period of 3.89 years.

### NOTE 11 – REGULATORY CAPITAL

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

Quantitative measures established by regulation to ensure capital adequacy require the Bank to maintain minimum amounts and ratios 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. Management believes that the Bank met all its capital adequacy requirements as of December 31, 2010 and 2009.

# VALLEY COMMUNITY BANK

## NOTES TO FINANCIAL STATEMENTS DECEMBER 31, 2010

### NOTE 11 – REGULATORY CAPITAL (CONTINUED)

In addition, the most recent notification from the FDIC categorized the Bank as well capitalized under the regulatory framework for prompt corrective action. To be categorized as well capitalized, the Bank must maintain minimum total risk-based, Tier 1 risk-based, and Tier 1 leverage ratios as set forth below. There are no conditions or events since that notification that management believes have changed the Bank's category.

Regulatory capital ratios and requirements are detailed as follows:

|  | <b>December 31,</b> |       |               |       |
|--|---------------------|-------|---------------|-------|
|  | <b>2010</b>         |       | <b>2009</b>   |       |
|  | Amount              | Ratio | Amount        | Ratio |
| <b>Leverage Ratio</b>                                  |                     |       |               |       |
| Tier 1 Capital to Average Assets                       | \$ 23,358,000       | 11.0% | \$ 23,675,000 | 10.5% |
| Minimum requirement for "Well-Capitalized" institution | 10,686,000          | 5.0%  | 11,276,000    | 5.0%  |
| Minimum regulatory requirement                         | 8,549,000           | 4.0%  | 9,021,000     | 4.0%  |
| <b>Tier Risk-Based Capital Ratio</b>                   |                     |       |               |       |
| Tier 1 Capital to Risk Weighted Assets                 | 23,358,000          | 13.1% | 23,675,000    | 12.3% |
| Minimum requirement for "Well-Capitalized" institution | 10,709,000          | 6.0%  | 11,561,000    | 6.0%  |
| Minimum regulatory requirement                         | 7,139,000           | 4.0%  | 7,707,000     | 4.0%  |
| <b>Total Risk-Based Capital Ratio</b>                  |                     |       |               |       |
| Total Capital to Risk Weighted Assets                  | 25,604,000          | 14.4% | 26,105,000    | 13.6% |
| Minimum requirement for "Well-Capitalized" institution | 17,849,000          | 10.0% | 19,268,000    | 10.0% |
| Minimum regulatory requirement                         | 14,279,000          | 8.0%  | 15,414,000    | 8.0%  |

### NOTE 12 – RELATED PARTY TRANSACTIONS

During the normal course of business, the Bank enters into transactions with related parties, including Directors and executive officers. These transactions include borrowings from the Bank with substantially the same terms, including rates and collateral, as loans to unrelated parties. The following is a summary of the aggregate activity involving related party borrowers during 2010:

# VALLEY COMMUNITY BANK

## NOTES TO FINANCIAL STATEMENTS DECEMBER 31, 2010

### NOTE 12 – RELATED PARTY TRANSACTIONS (CONTINUED)

|  |                     |
|--|---------------------|
| Balance, January 1, 2010   | \$ 4,169,399        |
| Disbursement   | 3,812,900           |
| Amounts paid   | (2,084,778)         |
| Balance, December 31, 2010                                       | <u>\$ 5,897,521</u> |
| Undisbursed commitments to related parties,<br>December 31, 2010 | <u>\$ 250,164</u>   |

Deposits with related parties totaled \$4,328,000 and \$2,855,000 at December 31, 2010 and 2009, respectively.

During 2007, the Bank entered into a lease agreement with a member of the Board of Directors. Rental payments under this agreement totaled approximately \$103,000, \$97,000, and \$92,000 for the years ended December 31, 2010, 2009, and 2008, respectively.

### NOTE 13 – OTHER EXPENSES

Other expenses for the years ended December 31, 2010, 2009, and 2008 consisted of the following:

|                                 | <u>2010</u>         | <u>2009</u>         | <u>2008</u>         |
|---------------------------------|---------------------|---------------------|---------------------|
| Data processing                 | \$ 471,837          | \$ 473,390          | \$ 411,759          |
| Professional fees               | 118,802             | 143,652             | 156,384             |
| Advertising promotion           | 13,700              | 25,250              | 31,009              |
| Office supplies                 | 97,430              | 88,490              | 110,694             |
| Insurance                       | 24,493              | 18,255              | 20,557              |
| Amortization of servicing asset | 134,252             | 80,322              | 42,079              |
| Other                           | 1,119,999           | 980,789             | 713,421             |
|                                 | <u>\$ 1,980,513</u> | <u>\$ 1,810,148</u> | <u>\$ 1,485,903</u> |

### NOTE 14 – EMPLOYEE BENEFIT PLANS

#### 401 (k) Savings Plan

In August 1998, the Bank adopted a 401(k) savings plan covering substantially all employees of the Bank. Under the provisions of the plan, participants may contribute up to 15% of their pretax income. The Bank matches fifty percent of the employee's contribution up to 3% of their pretax income. Employees vest in the matching contribution over three years beginning in the second year of service. The Bank contributed \$66,400, \$67,200 and \$63,500 to the 401(k) plan on behalf of employees for the years ended December 31, 2010, 2009 and 2008, respectively.

#### Salary Continuation Agreements

In 2003, the Bank implemented salary continuation agreements for three key executives. Under these agreements, the Bank is obligated to provide the executives, or their designated beneficiaries, with annual

# VALLEY COMMUNITY BANK

## NOTES TO FINANCIAL STATEMENTS DECEMBER 31, 2010

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### NOTE 14 – EMPLOYEE BENEFIT PLANS (CONTINUED)

benefits for fifteen years after retirement or death. These benefits are substantially equivalent to those available under insurance policies purchased by the Bank on the lives of the executives. The estimated present value of these future benefits are accrued over the period from the effective date of the agreement until the executive's expected retirement date.

The expense recognized under these agreements totaled \$256,000, \$199,000 and \$176,000 for the years ended December 31, 2010, 2009 and 2008, respectively, and is included in salaries and employee benefits expense in the statement of income.

In connection with these agreements, the Bank invested in single premium life insurance policies with cash surrender values totaling \$2,739,000 and \$2,638,000 at December 31, 2010 and 2009, respectively. Income from these policies, net of expense, totaled \$101,000, \$104,000 and \$101,000 for the years ended December 31, 2010, 2009 and 2008, respectively, and is included as other non-interest income in the statement of income.

### NOTE 15 - DISCLOSURES ABOUT FAIR VALUE OF FINANCIAL INSTRUMENTS

The Bank adopted guidance issued by the Financial Accounting Standards Board (FASB) relating to fair value measurements on January 1, 2008. The guidance defines fair value, establishes a framework for measuring fair value under U.S. GAAP and expands disclosures about fair value measurements. The guidance applies whenever other accounting pronouncements require or permit assets or liabilities to be measured at fair value.

Fair value is a market-based measurement and is defined as the price that would be received for selling an asset or paid for transferring a liability in an orderly transaction between market participants at the measurement date. The transaction to sell the asset or transfer the liability is a hypothetical transaction at the measurement date, considered from the perspective of a market participant that holds the asset or owes the liability. In general, the transaction price will equal the exit price and, therefore, represent the fair value of the asset or liability at initial recognition. In determining whether a transaction price represents the fair value of the asset or liability at initial recognition, each reporting entity is required to consider factors specific to the asset or liability, the principal or most advantageous market for the asset or liability, and market participants with whom the entity would transact in the market.

#### **Fair Value Hierarchy**

The guidance established a fair value hierarchy to prioritize the inputs of the valuation techniques used to measure fair value. The inputs are evaluated and an overall level for the measurement is determined. This overall level is an indication of how market observable the fair value measurement is and defines the level of disclosure. The guidance clarifies fair value in terms of the price in an orderly transaction between market participants to sell an asset or transfer a liability in the principal (or most advantageous) market for the asset or liability. The objective of a fair value measurement is to determine the price that would be received to sell the asset or paid to transfer the liability at the measurement date (an exit price). In order to determine the fair value, entities must determine the unit of account, highest and best use, principal market, and market participants. These determinations allow the reporting entity to define the inputs for fair value and level of hierarchy.

# VALLEY COMMUNITY BANK

## NOTES TO FINANCIAL STATEMENTS DECEMBER 31, 2010

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### NOTE 15 - DISCLOSURES ABOUT FAIR VALUE OF FINANCIAL INSTRUMENTS (CONTINUED)

To increase consistency and comparability in fair value measures, the fair value measures, the fair value hierarchy prioritizes the inputs used in valuation techniques to measure fair value into three broad levels:

- Level 1 – quoted prices in active markets for identical assets or liabilities
- Level 2 – directly or indirectly observable inputs other than quoted prices, and
- Level 3 – unobservable inputs.

A financial instrument's categorization within the fair value hierarchy is based upon the lowest level of input that is significant to the fair value measurement. The Bank categories available for sale securities as level 2 because the inputs to the valuation methodology used to measure the fair value of these securities include quoted prices for similar assets in active markets, and inputs that are observable for the asset, either directly or indirectly, for substantially the full term of the financial instrument.

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

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

Collateral-Dependent Impaired Loans: The Bank does not record loans at fair value on a recurring basis. However, from time to time, fair value adjustments are recorded on these loans to reflect (1) partial write-downs, through charge-offs or specific reserve allowances, that are based on the current appraised or market-quoted value of the underlying collateral or (2) the full charge-off of the loan carrying value. In some cases, the properties for which market quotes or appraised values have been obtained are located in areas where comparable sales data is limited, outdated, or unavailable. Fair value estimates for collateral-dependent impaired loans are obtained from real estate brokers or other third-party consultants. Adjustments are routinely made in the appraisal process by the appraisers to adjust for differences between the comparable sales and income data available and such adjustments are typically significant (Level 3).

Other Real Estate Owned: Nonrecurring adjustments to certain commercial and residential real estate properties classified as other real estate owned (OREO) are measured at the lower of carrying amount or fair value, less costs to sell. Fair values are generally based on third party appraisals of the property, resulting in a Level 3 classification. In cases where the carrying amount exceeds the fair value, less costs to sell, an impairment loss is recognized.

#### **Fair Value on a Recurring Basis**

The following table presents for each hierarchy level the financial assets and liabilities that are measured at fair value on a recurring basis in the Balance Sheet as of December 31, 2010 and 2009.

**VALLEY COMMUNITY BANK**

**NOTES TO FINANCIAL STATEMENTS  
DECEMBER 31, 2010**

**NOTE 15 - DISCLOSURES ABOUT FAIR VALUE OF FINANCIAL INSTRUMENTS (CONTINUED)**

| Fair Value Hierarchy          | As of December 31, 2010 |         |               |         |
|-------------------------------|-------------------------|---------|---------------|---------|
|                               | Total                   | Level 1 | Level 2       | Level 3 |
| Available For Sale Securities | \$ 16,496,448           | \$ -    | \$ 16,496,448 | \$ -    |
| Total assets at fair value    | \$ 16,496,448           | \$ -    | \$ 16,496,448 | \$ -    |

| Fair Value Hierarchy          | As of December 31, 2009 |         |               |         |
|-------------------------------|-------------------------|---------|---------------|---------|
|                               | Total                   | Level 1 | Level 2       | Level 3 |
| Available For Sale Securities | \$ 11,394,265           | \$ -    | \$ 11,394,265 | \$ -    |
| Total assets at fair value    | \$ 11,394,265           | \$ -    | \$ 11,394,265 | \$ -    |

Changes in the observability of the valuation attributes may result in a reclassification of certain financial assets or liabilities. Such reclassifications are reported as transfers in or out at fair value in the year in which the changes occurs.

**Fair Value on a Nonrecurring Basis**

The Bank measures certain loans at fair value on a nonrecurring basis. These loans are subject to fair value adjustments only in certain circumstances (i.e., when there is evidence of other-than-temporary impairment). The following table presents for each hierarchy level the financial assets and liabilities that are measured at fair value on a non-recurring basis on the Balance Sheet as of December 31, 2010 and 2009.

| Fair Value Hierarchy                                  | As of December 31, 2010 |         |         |               |
|---|-------------------------|---------|---------|---------------|
|   | Total                   | Level 1 | Level 2 | Level 3       |
| Impaired loans net of related allowance for loan loss | \$ 10,266,809           | \$ -    | \$ -    | \$ 10,266,809 |
| Other real estate owned                               | 360,000                 | -       | -       | 360,000       |
| Total assets at fair value                            | \$ 10,626,809           | \$ -    | \$ -    | \$ 10,626,809 |

| Fair Value Hierarchy                                  | As of December 31, 2009 |         |         |              |
|---|-------------------------|---------|---------|--------------|
|   | Total                   | Level 1 | Level 2 | Level 3      |
| Impaired loans net of related allowance for loan loss | \$ 9,229,909            | \$ -    | \$ -    | \$ 9,229,909 |
| Other real estate owned                               | 378,000                 | -       | -       | 378,000      |
| Total assets at fair value                            | \$ 9,607,909            | \$ -    | \$ -    | \$ 9,607,909 |

As of December 31, 2010 and 2009, other real estate owned, which is carried at the lower of the carrying amount or the fair value less costs to sell, were written down to fair value of \$360,000 and \$378,000, respectively. A charge of \$18,000 and \$33,624 was included in earnings for the period as of December 31, 2010 and 2009, respectively.

# VALLEY COMMUNITY BANK

## NOTES TO FINANCIAL STATEMENTS DECEMBER 31, 2010

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### NOTE 15 - DISCLOSURES ABOUT FAIR VALUE OF FINANCIAL INSTRUMENTS (CONTINUED)

Estimated fair values are disclosed for financial instruments for which it is practicable to estimate fair value. These estimates are made as of a specific point in time based on relevant market data and information about the financial instruments. 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.

Because no market exists for a significant portion of the Bank's financial instruments, fair value estimates are based on judgments regarding current economic conditions, risk characteristics of various financial instruments and other factors. These estimates are subjective in nature and involve uncertainties and matters of significant judgment and, therefore, cannot be determined with precision. Changes in assumptions could significantly affect the fair value presented.

The following methods and assumptions were used by the Bank to estimate the fair value of its financial instruments at December 31, 2010 and 2009:

**Cash and cash equivalents and short-term borrowings:** For cash and cash equivalents and short-term borrowings, the carrying amount is estimated to be fair value.

**Held-to-maturity investment securities:** The fair values of held-to-maturity investment securities are based on quoted market prices, where available. If quoted market prices are not available, fair values are estimated using quoted market prices for similar securities and indications of value provided by brokers.

**Federal Home Loan Bank stock:** For Federal Home Loan Bank stock, cost approximates fair value.

**Loans:** For variable-rate loans that reprice frequently with no significant change in credit risk, fair values are based on carrying values. Fair values of loans held for sale are estimated using quoted market prices for similar loans. The fair values for other loans are estimated using discounted cash flow analyses, using interest rates offered at each reporting date for loans with similar terms to borrowers of comparable creditworthiness. The carrying amount of accrued interest receivable approximates its fair value.

**Cash surrender value of life insurance policies:** The fair value of the cash surrender value of life insurance policies is based on the current cash surrender value provided by the insurers.

**Deposits:** The fair values for demand deposits are, by definition, equal to the amount payable on demand at the reporting date represented by their carrying amount. Fair values for fixed-rate certificates of deposit are estimated using discounted cash flow analyses using interest rates offered at each reporting date by the Bank for certificates with similar remaining maturities. The carrying amount of accrued interest payable approximates its fair value.

**Commitments to extend credit and standby letters of credit:** 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.

# VALLEY COMMUNITY BANK

## NOTES TO FINANCIAL STATEMENTS DECEMBER 31, 2010

### NOTE 15 - DISCLOSURES ABOUT FAIR VALUE OF FINANCIAL INSTRUMENTS (CONTINUED)

The estimated fair values of the Bank's financial instruments are as follows:

|   | December 31, 2010 |               | December 31, 2009 |               |
|---|-------------------|---------------|-------------------|---------------|
|   | Carrying Amount   | Fair Value    | Carrying Amount   | Fair Value    |
| Financial assets:                               |                   |               |                   |               |
| Cash and due from banks                         | \$ 15,343,925     | \$ 15,343,925 | \$ 22,735,294     | \$ 22,735,294 |
| Time deposits with other institutions           | 580,698           | 626,277       | -                 | -             |
| Available-for-sale investment securities        | 16,496,448        | 16,496,448    | 11,394,265        | 11,394,265    |
| Held-to-maturity investment securities          | 208,830           | 213,059       | 877,437           | 885,189       |
| Federal home loan bank stock                    | 933,900           | 933,900       | 965,900           | 965,900       |
| Loans, net                                      | 163,590,594       | 163,885,449   | 175,784,712       | 174,762,200   |
| Cash surrender value of life insurance policies | 2,739,397         | 2,739,397     | 2,637,996         | 2,637,996     |
| Servicing asset                                 | 1,739,638         | 1,739,638     | 1,567,698         | 1,567,698     |
| Accrued interest receivable                     | 703,538           | 703,538       | 791,193           | 791,193       |
| Financial liabilities:                          |                   |               |                   |               |
| Deposits  | 175,615,341       | 175,717,395   | 188,394,746       | 188,552,643   |
| Short-term borrowings                           | 4,000,000         | 4,000,000     | 7,000,000         | 7,000,000     |
| Accrued interest payable                        | 134,898           | 134,898       | 174,614           | 174,614       |

## **Bank Officers**

Richard P. Loupe, *President & Chief Executive Officer*  
Greg J. Hickel, *Executive Vice President & Chief Credit Officer*  
Rebecca I. Holowich, *Executive Vice President & Chief Financial Officer*  
John Angelesco, *Senior Vice President & San Jose Office Manager*  
Jenny Boister, *Senior Vice President & Manager of Credit Services*  
W. Brent Chaney, *Senior Vice President & Pleasanton Office Manager*  
Cindy Chase, *Senior Vice President & Construction Loan Officer*  
Howard Hoover, *Senior Vice President & SBA Lending Officer*  
Robert Johnson, *Senior Vice President & Special Assets Officer*  
Sati Kanwar, *Senior Vice President & SBA Lending Officer*  
Rick J. Peterson, *Senior Vice President & Livermore Office Manager*  
Randy Ruddach, *Senior Vice President & Senior Business Relationship Manager*  
John Herzog, *First Vice President*  
Bernie Billen, *Vice President & Business Development Officer*  
Beverly Brinker, *Vice President & Compliance Officer*  
Michael Cook, *Vice President & Controller / Risk Officer*  
Geri Fernandez, *Vice President & Credit Underwriter*  
Donna Moehring, *Vice President & Operations / Business Development*  
Susan Siau, *Vice President & Credit Administrator*  
Genelle Wrzesinski, *Vice President / Administrative / BSA*

## **Board of Directors**

Phillip R. Boyce, *Chairman*  
Jerome W. Carlson  
William M. Eames  
Richard A. Lewis  
Richard P. Loupe, *President, CEO & Secretary of the Board*  
Peter MacDonald  
Dean L. Schenone  
Anelli P. Stamm

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