



*... defined by the company we keep.<sup>sm</sup>*

## FINANCIAL STATEMENTS

AS OF DECEMBER 31, 2016 AND 2015

AND FOR THE YEARS THEN ENDED

AND

INDEPENDENT AUDITOR'S REPORT

## INDEPENDENT AUDITOR'S REPORT

The Shareholders and Board of Directors  
California Bank of Commerce  
Lafayette, California

**Report on the Financial Statements**

We have audited the accompanying financial statements of California Bank of Commerce, which comprise the balance sheets as of December 31, 2016 and 2015, and the related statements of income, comprehensive income, changes in shareholders' equity, and cash flows for the years then ended, and the related notes to the financial statements.

***Management's Responsibility for the Financial Statements***

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

***Auditor's Responsibility***

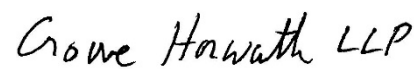
Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about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

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

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

***Opinion***

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of California Bank of Commerce as of December 31, 2016 and 2015, and the results of its operations and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.



Crowe Horwath LLP

San Francisco, California  
March 21, 2017

# California Bank of Commerce

## BALANCE SHEETS

December 31, 2016 and 2015

<b>ASSETS</b>	<u>2016</u>	<u>2015</u>
Cash and due from banks	\$ 10,489,633	\$ 12,921,429
Interest bearing deposits in banks	<u>76,928,001</u>	<u>55,942,946</u>
Total cash and cash equivalents	87,417,634	68,864,375
Investment securities (Note 4)		
Available-for-sale, at estimated fair value	15,561,837	31,786,518
Loans, less allowance for loan losses of \$7,525,000 in 2016 and \$5,875,000 in 2015 (Notes 5, 6, 11 and 12)	619,984,453	512,496,608
Premises and equipment, net (Note 7)	2,574,870	2,350,653
Bank owned life insurance (BOLI)	15,987,184	15,502,289
Deferred income taxes, net	6,152,143	6,272,699
Core Deposit Intangible (Note 8)	502,621	558,468
Goodwill (Note 8)	7,350,465	7,350,465
Accrued interest receivable and other assets	<u>9,311,371</u>	<u>7,753,271</u>
Total assets	<u>\$ 764,842,578</u>	<u>\$ 652,935,346</u>
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
Deposits:		
Non-interest bearing	\$ 284,674,085	\$ 225,139,528
Interest bearing (Note 9)	<u>365,372,728</u>	<u>317,044,351</u>
Total deposits	650,046,813	542,183,879
Other borrowings (Note 11)	29,000,000	29,000,000
Subordinated debentures, \$5,000,000 face amount (less unamortized debt issuance cost of \$74,316) (Note 11)	4,925,684	-
Accrued interest payable and other liabilities (Note 16)	<u>4,300,428</u>	<u>3,813,371</u>
Total liabilities	<u>688,272,925</u>	<u>574,997,250</u>
Commitments and contingencies (Note 12)		
Shareholders' equity (Notes 13 and 14):		
Preferred Stock – no par value: 10,000,000 shares authorized Series C, noncumulative, \$1,000 per share liquidation value, no shares and 11,000 shares issued and outstanding at December 31, 2016 and 2015 (Note 18)	-	10,949,443
Common stock - no par value; 40,000,000 shares authorized; 5,871,752 issued and outstanding in 2016 and 5,537,837 in 2015	68,750,160	64,123,095
Retained earnings	7,820,983	2,830,463
Accumulated other comprehensive (loss) income, net of taxes (Note 4)	<u>(1,490)</u>	<u>35,095</u>
Total shareholders' equity	<u>76,569,653</u>	<u>77,938,096</u>
Total liabilities and shareholders' equity	<u>\$ 764,842,578</u>	<u>\$ 652,935,346</u>

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

# California Bank of Commerce

## STATEMENTS OF INCOME For the Years Ended December 31, 2016 and 2015

	2016	2015
Interest income:		
Interest and fees on loans	\$ 28,588,884	\$ 18,071,786
Interest on investment securities	316,178	425,424
Interest on interest bearing deposits in banks	343,795	140,265
Total interest income	29,248,857	18,637,475
Interest expense:		
Interest on deposits (Note 9)	1,426,591	932,269
Interest on borrowings and subordinated debentures (Note 11)	672,422	452,545
Total interest expense	2,099,013	1,384,814
Net interest income before provision for loan losses	27,149,844	17,252,661
Provision for loan losses (Note 6)	1,403,151	280,408
Net interest income after provision for loan losses	25,746,693	16,972,253
Non-interest income:		
Service charges and other fees	1,737,488	1,609,245
Net gains on sales of loans	311,176	-
Net losses on sales of investment securities (Note 4)	(2,050)	(22,174)
Earnings on BOLI	452,736	300,888
Other	558,569	458,315
Total non-interest income	3,057,919	2,346,274
Non-interest expenses:		
Salaries and employee benefits (Notes 5 and 16)	12,164,221	9,354,241
Occupancy and equipment (Notes 7 and 12)	2,323,840	1,219,556
Merger related (Notes 2)	376,858	1,098,868
Other (Note 17)	5,524,284	3,791,232
Total non-interest expenses	20,389,203	15,463,897
Income before provision for income taxes	8,415,409	3,854,630
Provision for income taxes (Note 10)	3,222,472	1,586,173
Net Income	5,192,937	2,268,457
Preferred stock dividend	(151,861)	(110,000)
Income to common shareholders	\$ 5,041,076	\$ 2,158,457
Earnings per common share:		
Basic	\$ 0.88	\$ 0.49
Diluted	\$ 0.84	\$ 0.47
Weighted average number of common shares outstanding – basic	5,736,727	4,371,771
Weighted average number of common shares outstanding – diluted	5,995,129	4,627,360

The accompanying notes are an integral part of these financial statements

# California Bank of Commerce

## STATEMENTS OF COMPREHENSIVE INCOME For the Years Ended December 31, 2016 and 2015

	<u>2016</u>	<u>2015</u>
Net Income	\$ 5,192,937	\$ 2,268,457
Other comprehensive (loss) income:		
Unrealized (losses) gains on available-for-sale investment securities:		
Unrealized holding (losses) gains arising during year	(64,057)	(114,892)
Reclassification adjustment for losses included in net income	2,050	22,174
Tax effect	<u>25,422</u>	<u>38,015</u>
Total other comprehensive loss	<u>(36,585)</u>	<u>(54,703)</u>
Total comprehensive income	<u>\$ 5,156,352</u>	<u>\$ 2,213,754</u>

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

# California Bank of Commerce

## STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY For the Years Ended December 31, 2016 and 2015

	<u>Preferred Stock – Series C</u>		<u>Common Stock</u>		<u>Retained Earnings</u>	<u>Accumulated Other Comprehensive Income (Loss)</u>	<u>Total Shareholders' Equity</u>
	<u>Shares</u>	<u>Amount</u>	<u>Shares</u>	<u>Amount</u>			
Balance, December 31, 2014	11,000	\$10,949,443	4,328,488	\$46,866,592	\$ 672,006	\$ 89,798	\$58,577,839
Share-based compensation expense (Note 13)	-	-	-	212,210	-	-	212,210
Preferred stock dividends (Note 18)	-	-	-	-	(110,000)	-	(110,000)
Issuance of common stock – in business combination (Note 2)	-	-	1,135,430	16,406,964	-	-	16,406,964
Net income	-	-	-	-	2,268,457	-	2,268,457
Stock options exercised	-	-	62,919	484,979	-	-	484,979
Stock grants issued and related compensation expense	-	-	11,000	152,350	-	-	152,350
Other comprehensive loss	-	-	-	-	-	(54,703)	(54,703)
Balance, December 31, 2015	<u>11,000</u>	<u>\$10,949,443</u>	<u>5,537,837</u>	<u>\$64,123,095</u>	<u>\$ 2,830,463</u>	<u>\$ 35,095</u>	<u>\$77,938,096</u>
Share-based compensation expense (Note 13)	-	-	-	182,557	-	-	182,557
Preferred stock dividends (Note 18)	-	-	-	-	(151,860)	-	(151,860)
Preferred stock redemption (Note 18)	(11,000)	(10,949,443)	-	-	(50,557)	-	(11,000,000)
Issuance of common stock (Note 14)	-	-	296,297	3,981,762	-	-	3,981,762
Net income	-	-	-	-	5,192,937	-	5,192,937
Stock options exercised	-	-	25,000	291,141	-	-	291,141
Stock grants issued and related compensation expense	-	-	12,618	171,605	-	-	171,605
Other comprehensive loss	-	-	-	-	-	(36,585)	(36,585)
Balance, December 31, 2016	<u>-</u>	<u>\$ -</u>	<u>5,871,752</u>	<u>\$68,750,160</u>	<u>\$ 7,820,983</u>	<u>\$ (1,490)</u>	<u>\$76,569,653</u>

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

# California Bank of Commerce

## STATEMENTS OF CASH FLOWS For the Years Ended December 31, 2016 and 2015

	2016	2015
Cash flows from operating activities:		
Net Income	\$ 5,192,937	\$ 2,268,457
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for loan losses	1,403,151	280,408
Deferred tax provision (benefit)	145,793	(323,928)
Depreciation	210,577	206,159
Deferred loan origination costs, net	(1,565,255)	(50,246)
Amortization of premiums on investment securities, net	112,087	111,118
Share-based compensation expense, net	354,162	364,560
Increase in cash surrender value of life insurance	(454,812)	(308,125)
Accretion of discounts on retained portion of sold loans, net	252,935	(19,224)
Loss on sale of investment securities, net	2,050	22,174
Gain on sale of loans, net	(311,176)	-
Amortization of deposit intangible	55,847	-
Gain on sale of OREO	-	(17,531)
Increase in accrued interest receivable and other assets	(1,352,467)	(272,202)
Increase in accrued interest payable and other liabilities	487,057	631,013
	4,532,886	2,892,633
Net cash provided by operating activities		
Cash flows from investing activities:		
Purchase of available-for-sale investment securities	-	(8,527,745)
Proceeds from sales of available-for-sale investment securities	10,146,259	5,062,778
Proceeds from calls and maturities of available-for-sale investment securities	2,800,000	7,977,322
Proceeds from principal payments on available-for-sale investment securities	3,102,278	1,897,281
Net increase in loans	(111,914,087)	(68,473,650)
Proceeds from sale of loans	4,646,588	-
Proceeds from sale of OREO	-	2,588,621
Net cash paid in connection with business combination	-	(3,247,659)
Purchases of premises and equipment	(434,794)	(1,848,518)
Purchase of bank-owned life insurance policies	(30,082)	(1,000,000)
Purchase of Federal Home Loan Bank stock	(205,448)	(77,000)
	(91,889,286)	(65,648,570)
Net cash used in investing activities		
Cash flows from financing activities:		
Net increase in demand, interest bearing and savings deposits	98,056,485	76,013,417
Net increase (decrease) in time deposits	9,806,447	(2,764,618)
Redemption of preferred stock	(11,000,000)	-
Proceeds from issuance of subordinated debentures, net	4,925,684	-
Proceeds from exercised stock options	291,141	484,979
Payment of dividends on preferred stock	(151,860)	(110,000)
Issuance of common stock, net of offering costs	3,981,762	-
	3,981,762	-

(Continued)

# California Bank of Commerce

## STATEMENTS OF CASH FLOWS (Continued) For the Years Ended December 31, 2016 and 2015

	2016	2015
Net cash provided by financing activities	<u>105,909,659</u>	<u>73,623,778</u>
Increase in cash and cash equivalents	18,553,259	10,867,841
Cash and cash equivalents at beginning of year	<u>68,864,375</u>	<u>57,996,534</u>
Cash and cash equivalents at end of year	<u>\$ 87,417,634</u>	<u>\$ 68,864,375</u>
 Supplemental disclosure of cash flow information:		
Cash paid during the year for:		
Interest	\$ 2,021,694	\$ 1,379,090
Income taxes	1,752,000	1,385,000
 Supplemental noncash disclosures:		
Stock issued in connection with the PPB merger	\$ -	\$ 16,406,964
 Summary of the fair value of assets acquired and liabilities assumed in the PPB merger:		
Loans	\$ -	\$ 110,981,645
Securities	-	7,101,234
Goodwill	-	7,350,465
Core deposit intangible	-	558,468
Premises and equipment	-	446,449
Other assets	-	7,340,564
Deposits	-	(113,908,640)
Other liabilities	-	(235,561)

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



**California Bank of Commerce**  
**NOTES TO FINANCIAL STATEMENTS**  
**December 31, 2016 and 2015**

**1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

General

California Bank of Commerce (the "Bank") was approved as a state-chartered non-member bank on March 23, 2007, and commenced operations on July 17, 2007. The Bank is subject to regulation by the California Department of Business Oversight (the "CDBO") and the Federal Deposit Insurance Corporation (the "FDIC"). The Bank is headquartered in Lafayette, California and provides products and services to customers who are predominately small to middle-market businesses, professionals and not-for-profit organizations located in Contra Costa, Alameda, Santa Clara and surrounding counties.

On December 31, 2015, the bank completed its merger with Pan Pacific Bank ("PPB") with Branch offices in Fremont and San Jose, California. The acquisition complements the Bank's expansion strategy and enhances the Bank's market presence in the San Francisco South Bay region.

Basis of Presentation

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

Certain Reclassification

Certain items in the consolidated financial statements for the years ended December 31, 2015 were reclassified to conform to the 2016 presentation. These reclassifications did not affect previously reported net income.

Subsequent Events

Management has reviewed all events occurring from December 31, 2016 through March 21, 2017 the date the financial statements were available to be issued.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions. 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

**California Bank of Commerce**  
**NOTES TO FINANCIAL STATEMENTS**  
**December 31, 2016 and 2015**

**1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)**

For the purpose of the statement of cash flows, cash and cash equivalents consist of cash and due from banks, interest bearing deposits in banks with original maturities of 90 days or less and Federal funds sold. Generally, Federal funds are sold for one day periods. Cash flows from loans, deposits and other borrowings are presented on a net basis.

Investment Securities

Investment securities are classified into the following categories:

- Available-for-sale securities, reported at fair value, with unrealized gains and losses excluded from earnings and reported, net of taxes, as accumulated other comprehensive income (loss) within shareholders' equity.
- Held-to-maturity securities, which management has the positive intent and ability to hold, reported at amortized cost, adjusted for the accretion of discounts and amortization of premiums.

Management determines the appropriate classification of its investments at the time of purchase. Subsequent transfers between categories are accounted for at fair value.

Gains and 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 using the level yield method adjusted for changes in principal prepayment speeds.

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

**California Bank of Commerce**  
**NOTES TO FINANCIAL STATEMENTS**  
**December 31, 2016 and 2015**

**1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)**

Investment in Federal Home Loan Bank Stock

As a member of the Federal Home Loan Bank of San Francisco, the Bank is required to maintain an investment in the capital stock of the Federal Home Loan Bank (the "FHLB"). The investment is carried at cost, classified as a restricted security, and periodically evaluated for impairment based on the ultimate recovery of par value.

At December 31, 2016 and 2015, the Bank's investment in FHLB stock totaled \$2,370,700 and \$2,140,000, respectively, and is included on the balance sheet in accrued interest receivable and other assets. Cash dividends are reported as non-interest income.

Investment in Other Bank Stocks

*Independent Bankers Financial Corporation*

The Independent Bankers Financial Corporation (the "IBFC"), the holding company for The Independent Banker's Bank, provides services exclusively to banks. At December 31, 2016 and 2015, the Bank's investment in IBFC stock totaled \$88,242 and \$112,795, respectively. The investment is carried at cost and is included on the balance sheet in accrued interest receivable and other assets.

*Pacific Coast Bankers' Bancshares*

The Pacific Coast Bankers' Bancshares ("PCBB"), the holding company for The Pacific Coast Banker's Bank, provides services exclusively to banks. At December 31, 2016 and 2015, the Bank's investment in PCBB stock totaled \$380,000 and \$380,000 respectively. The investment is carried at cost and is included on the balance sheet in accrued interest receivable and other assets. Cash dividends are reported as non-interest income.

Bank Owned Life Insurance

The Bank has purchased life insurance policies on certain current and former executives. Bank owned life insurance is recorded at the amount that can be realized under the insurance contract at the balance sheet date, which is the cash surrender value adjusted for other charges or other amounts due that are probable at settlement.

**California Bank of Commerce**  
**NOTES TO FINANCIAL STATEMENTS**  
**December 31, 2016 and 2015**

**1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)**

Loans

Loans that management has the intent and ability to hold for the foreseeable future, or until maturity or payoff, are reported at the principal balances outstanding, net of deferred fees and costs, purchase premiums and discounts and the allowance for loan losses. Loans transferred from loans held for sale are carried at the lower of principal balance or market value at the date of transfer adjusted for accretion of discounts. 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 collectability 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 collectability of principal is not in doubt, are applied first to earned but unpaid interest and then to principal.

Generally, loans are restored to accrual status when the obligation is brought current and has performed in accordance with the contractual terms for a reasonable period of time and the ultimate collectability of the total contractual principal and interest is no longer in doubt. The policy for placing loans on nonaccrual status, recording payments received on nonaccrual loans, resuming the accrual of interest and determining past due or delinquency status, does not differ by portfolio segment or class of financing receivable.

An impaired loan is measured based on the present value of expected future cash flows discounted at the loan's effective rate or, as a practical matter, at the loan's observable market price or the fair value of collateral less estimated costs to sell if the loan is collateral dependent. A loan is collateral dependent if the repayment of the loan is expected to be provided solely by the underlying collateral. All loans are evaluated and 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. The policy for accounting for impaired loans, recognizing interest on impaired loans and recording payments on impaired loans is generally the same as that described above for nonaccrual loans, and does not differ by portfolio segment or class of financing receivable.

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

The Bank services loans that have been participated with other financial institutions totaling approximately \$42,671,000 and \$40,517,000, respectively, as of December 31, 2016 and 2015. The participated balances of these loans were sold without recourse and are not included on the Bank's balance sheet.

**California Bank of Commerce**  
**NOTES TO FINANCIAL STATEMENTS**  
**December 31, 2016 and 2015**

**1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)**

Allowance for Loan Losses

The allowance for loan losses is an estimate of probable credit losses in the Bank's loan portfolio that have been incurred as of the balance-sheet date. The allowance is established through a provision for loan losses which is charged to expense. Additions to the allowance are expected to maintain the adequacy of the total allowance after credit losses and loan growth. Credit exposures determined to be uncollectible are charged against the allowance. Cash received on previously charged off amounts is recorded as a recovery to the allowance. The policy for charging off loans and recording recoveries does not differ by portfolio segment or class of financing receivable. The overall allowance consists of two primary components, specific reserves related to individually identify impaired loans and general reserves for losses related to loans that are collectively evaluated for impairment.

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

The determination of the general reserve for loans that are collectively evaluated for impairment is based on estimates made by management, to include, but not limited to, consideration of historical losses by portfolio segment for the trailing four quarters, the loan risk rating, internal asset classifications, and qualitative factors to include economic trends in the Bank's service areas, industry experience and trends, geographic concentrations, estimated collateral values, the Bank's underwriting policies, the character of the loan portfolio, and probable losses inherent in the portfolio taken as a whole.

The Bank maintains a separate allowance for each portfolio segment (loan type). These portfolio segments include commercial & industrial, real estate - construction & land, real estate - other, real estate - home equity lines of credit ("HELOC") and installment & other. The allowance for loan losses attributable to each portfolio segment, which includes both impaired loans and loans that are not impaired, is combined to determine the Bank's overall allowance, which is included on the balance sheet.

The Bank assigns a risk rating to all loans and periodically, but not less than annually, performs reviews of all such loans to identify credit risks and to assess the overall collectability of the portfolio. These risk ratings are also subject to examination by independent specialists engaged by the Bank and the Bank's regulators. During these internal reviews, management monitors and analyzes the financial condition of borrowers and guarantors, trends in the industries in which borrowers operate and the fair values of collateral securing these loans. These credit quality indicators are used to assign a risk rating to each individual loan. The risk ratings can be grouped into five major categories, defined as follows:

# California Bank of Commerce

## NOTES TO FINANCIAL STATEMENTS

December 31, 2016 and 2015

### 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

#### Allowance for Loan Losses (Continued)

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

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

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

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

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

The general reserve component of the allowance for loan losses also consists of reserve factors that are based on management's assessment of the following for each portfolio segment: (1) risk ratings, (2) historical losses of the Bank or its peers for the trailing four quarters and (3) other qualitative factors. These reserve factors are inherently subjective and are driven by the repayment risk associated with each portfolio segment described below.

**California Bank of Commerce**  
**NOTES TO FINANCIAL STATEMENTS**  
**December 31, 2016 and 2015**

1. **SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES** (Continued)

Allowance for Loan Losses (Continued)

**Commercial & Industrial** – Commercial loans generally possess a lower inherent risk of loss than real estate portfolio segments because these loans are generally underwritten to existing cash flows of operating businesses. Debt coverage is provided by business cash flows and economic trends influenced by unemployment rates and other key economic indicators are closely correlated to the credit quality of these loans.

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

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

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

**California Bank of Commerce**  
**NOTES TO FINANCIAL STATEMENTS**  
**December 31, 2016 and 2015**

**1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)**

Allowance for Loan Losses (Continued)

***Installment & Other*** – An installment loan portfolio is usually comprised of a number of small loans scheduled to be amortized over a specific period. Most installment loans are made directly for consumer purchases, but business loans granted for the purchase of heavy equipment or industrial vehicles may also be included. Economic trends determined by unemployment rates and other key economic indicators are closely correlated to the credit quality of these loans. Weak economic trends indicate that the borrowers' capacity to repay their obligations may be deteriorating. Loans in the "Other" category are typically inconsequential and typically include overdrafts on deposit accounts.

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

Acquired Loans

The Bank acquired loans through a business acquisition. Acquired loans are recorded at their estimated fair values at acquisition date, factoring in credit losses expected to be incurred over the life of the loan. Accordingly, an allowance for loan losses is not carried over or recorded for acquired loans as of the acquisition date.

The entire fair value discount accreted to interest income using an effective interest rate method for term loans, and on a straight line basis to interest income for revolving lines, as the timing and amount of cash flows under revolving lines are not predictable. Subsequent to acquisition, if the probable and estimable credit losses for non-purchased credit impaired loans exceed the amount of the remaining unaccreted discount, the excess is established as an allowance for loan losses.



**California Bank of Commerce**  
**NOTES TO FINANCIAL STATEMENTS**  
**December 31, 2016 and 2015**

**1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)**

Purchased Credit Impaired Loans

The Bank acquired one loan in its merger with PPB that had evidence of credit quality deterioration subsequent to its origination and for which it was probable, at acquisition, that the Bank would be unable to collect all contractually required payments (PCI loan). These loans are evaluated on an individual basis. Management has applied significant subjective judgment in determining which loans are PCI loans. Evidence of credit quality deterioration as of the purchase date may include data such as past due and nonaccrual status, risk grades and recent loan-to-value percentages. Revolving credit agreements (e.g., home equity lines of credit and revolving commercial loans) where the borrower had revolving privileges at acquisition date are not considered PCI loans because the timing and amount of cash flows cannot be reasonably estimated. This loan was paid off in full during the third quarter of 2016 with a gain of \$15,991.

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

The Bank also maintains a separate allowance for off-balance-sheet commitments. Management estimates anticipated losses using historical data and utilization assumptions. The allowance for off-balance-sheet commitments is included in accrued interest payable and other liabilities on the balance sheet, and totaled \$120,000 and \$135,000 at December 31, 2016 and 2015, respectively.

Other Real Estate Owned

Other real estate owned ("OREO") consist of properties acquired through foreclosure. The Bank values these properties at fair value less estimated costs to sell at the time it acquires them, which establishes the new cost basis. After it acquires them, the Bank carries such properties at the lower of cost or fair value less estimated selling costs. If the Bank records any income from the property after acquiring them, it includes this amount in other non-interest income. If the Bank records any write-downs or there are any operating expense of such properties after acquiring them, it includes this amount in other non-interest expense.

At December 31, 2016 and 2015, the Bank did not have any OREO.

Transfer of Financial Assets

Transfers of financial assets are accounted for as sales, when control over the assets has been surrendered. Control over transferred assets is deemed surrendered when (1) the assets have been isolated from the Bank, (2) the transferee obtains the right (free of conditions that constrain it from taking advantage of that right) to pledge or exchange the transferred assets, and (3) the Bank does not maintain effective control over the transferred assets through an agreement to repurchase them before their maturity.

# California Bank of Commerce

## NOTES TO FINANCIAL STATEMENTS

December 31, 2016 and 2015

### 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

#### Sales and Servicing of Government Guaranteed Loans

Included in the portfolio are loans which, in general, are 70 to 90 percent guaranteed by either the U.S. Department of Agriculture (the "USDA") or the Small Business Administration (the "SBA"). 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. 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. However, none of the premiums the Bank had received were subject to these recourse provisions as of December 31, 2016 and 2015. There were no USDA and SBA loans held for sale at December 31, 2016 and 2015. The guaranteed portion of USDA and SBA loans sold, totaling approximately \$17,587,000 and \$9,297,000 were being serviced for others at December 31, 2016 and 2015, respectively.

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 initially recorded at fair value 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. Servicing assets totaling \$119,000 and \$147,000 associated with loans previously sold which were included in accrued interest receivable and other assets at December 31, 2016 and 2015, respectively.

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. 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. At December 31, 2016 and 2015 no IO strips were recorded.

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.

**California Bank of Commerce**  
**NOTES TO FINANCIAL STATEMENTS**  
**December 31, 2016 and 2015**

**1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)**

Bank Premises and Equipment

Bank premises and equipment are carried at cost, less accumulated depreciation. Depreciation is determined using the straight-line method over the estimated useful lives of the related assets. The useful lives of furniture, fixtures and equipment are estimated to be 3 to 5 years. Leasehold improvements are amortized over the lesser of the respective lease term (including renewal periods that are reasonably assured) or their useful lives, which are generally 7 to 14 years.

Certain operating leases contain scheduled and specified rent increases or incentives in the form of tenant improvement allowances or credits. The scheduled rent increases are recognized on a straight-line basis over the lease term as an increase in the amount of rental expense recognized each period. Lease incentives are capitalized at the inception of the lease and amortized on a straight-line basis over the lease term as a reduction of rental expense. Amounts accrued in excess of amounts paid related to the scheduled rent increases and the unamortized deferred credits are included in accrued interest payable and other liabilities on the balance sheet.

When assets are sold or otherwise disposed of, the cost and related accumulated depreciation or amortization are removed from the accounts, and any resulting gain or loss is recognized in income for the period. The cost of maintenance and repairs is charged to expense as incurred. The Bank evaluates premises and equipment for financial impairment as events or changes in circumstances indicate that the carrying amount of such assets may not be fully recoverable.

Business Combinations

The Bank accounts for acquisitions of businesses using the acquisition method of accounting. Under the acquisition method, assets acquired and liabilities assumed are recorded at their estimated fair values at the date of acquisition. The Bank utilizes various valuation techniques including discounted cash flow analyses to determine these fair values. Any excess of the purchase price over amounts allocated to the acquired assets, including identifiable intangible assets, and liabilities assumed is recorded as goodwill.

Goodwill and Other Intangible Assets

Goodwill resulted from the acquisition of PPB on December 31, 2015, and represents the excess of the purchase price over the fair value of acquired tangible asset and liabilities and identifiable intangible assets. Goodwill acquired in a purchase business combination and determined to have an indefinite useful life is not amortized, but tested for impairment at least annually or more frequently if events and circumstance exist that indicate a goodwill impairment test should be performed. The Bank has selected December 31 as the date to perform the annual impairment test. The Bank has one reporting unit to which all the goodwill is assigned. Goodwill is the only intangible asset with an indefinite life on the Bank's balance sheet.

# California Bank of Commerce

## NOTES TO FINANCIAL STATEMENTS

December 31, 2016 and 2015

### 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Intangible assets with definite useful lives are amortized over their estimated lives to their estimated residual values. Intangible assets with definite useful lives consisted of core deposit intangible assets from the PPB acquisition. The core deposit intangible assets is being amortized on a straight line method over ten years.

#### Borrowings

The Bank issued subordinated debentures during the second quarter of 2016. The Bank adopted the amended guidance within ASU 2015-03, Simplifying the Presentation of Debt Issuance Costs. The amendments in ASU 2015-03 to Subtopic 835-30, Interest - Imputation of Interest, require that debt issuance costs related to a recognized debt liability be presented in the balance sheet as a direct deduction from the carrying amount of that debt liability, consistent with debt discounts. As a result of the adoption of this amended guidance, the subordinated debentures were recorded net of related issuance costs of \$86,578. The discount is being accreted on a straight-line basis using 5 years life.

#### Income Taxes

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

#### Accounting for Uncertainty in Income Taxes

The Bank considers all tax positions recognized in its financial statements for the likelihood of realization. When tax returns are filed, it is highly certain that some positions taken would be sustained upon examination by the taxing authorities, while others are subject to uncertainty about the merits of the position taken or the amount of the position that would be ultimately sustained. The benefit of a tax position is recognized in the financial statements in the period during which, based on all available evidence, management believes it is more likely than not that the position will be sustained upon examination, including the resolution of appeals or litigation processes, if any. Tax positions taken are not offset or aggregated with other positions. Tax positions that meet the more-likely-than-not recognition threshold are measured as the largest amount of the tax benefit that is more than 50 percent likely of being realized upon settlement with the applicable taxing authority.

**California Bank of Commerce**  
**NOTES TO FINANCIAL STATEMENTS**  
**December 31, 2016 and 2015**

**1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)**

The portion of the benefits associated with tax positions taken that exceeds the amount measured as described above is reflected as a liability for unrecognized tax benefits in the accompanying balance sheet along with any associated interest and penalties that would be payable to the taxing authorities upon examination. Interest expense and penalties associated with unrecognized tax benefits, if any, are classified as income tax expense in the statement of income.

Earnings Per Share

Basic earnings per share (EPS), which excludes dilution, is computed by dividing net income by the weighted-average number of common shares outstanding for the period. Diluted earnings per share reflects the potential dilution that could occur if securities or other contracts to issue common stock, such as stock options, result in the issuance of common stock which share in the earnings of the Bank. The treasury stock method is applied to determine the dilutive effect of stock options and restricted stock in computing diluted earnings per share. There were 854,587 and 800,587 stock options outstanding at December 31, 2016 and 2015, respectively. There were 198,000 and 120,060 anti-dilutive stock options outstanding at December 31, 2016 and 2015, respectively that were excluded from the calculation of EPS.

Share-Based Compensation

The Bank has one share-based compensation plan, the California Bank of Commerce 2007 Equity Incentive Plan (the "Plan"), which has been approved by its shareholders and permits the grant of stock options and restricted stock for up to 825,000 shares of the Bank's common stock which none were available for grant at December 31, 2016.

The Bank has issued the California Bank of Commerce 2014 Equity Incentive Plan (the "Plan"), which has been approved by its shareholders and permits the grant of stock options and restricted stock for up to 384,986 shares of the Bank's common stock, of which 205,317 shares were available for grant at December 31, 2016. The Plan is designed to attract and retain employees and directors. The amount, frequency, and terms of share-based awards may vary based on competitive practices, the Bank's operating results and government regulations. New shares are issued upon option exercise or restricted share grants. The Plan does not provide for the settlement of awards in cash.

For options, the Plan requires that the option price may not be less than the fair market value of the stock at the date the option is granted, and that the stock must be paid in full at the time the option is exercised.

Restricted stock awards are grants of shares of common stock that are subject to forfeiture until specific conditions or goals are met. Conditions may be based on continuing employment or achieving specified performance goals. During the period of restriction, participants holding restricted stock may have full voting and dividend rights. The restrictions lapse in accordance with a schedule or with other conditions determined by the Board of Directors.

**California Bank of Commerce**  
**NOTES TO FINANCIAL STATEMENTS**  
**December 31, 2016 and 2015**

**1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)**

The Bank recognizes share-based compensation expense for the fair value of all stock options and restricted stock that are ultimately expected to vest as the requisite service is rendered and considering the probability of any performance criteria being achieved.

Management estimates the fair value of each option award as of the date of grant using a Black-Scholes-Merton option pricing formula. Expected volatility is based on historical volatility of similar entities over a preceding period commensurate with the expected term of the option because the Bank's common stock has been publicly traded for a shorter period than the expected term for the options. The "simplified" method described in the Securities and Exchange Commission's Staff Accounting Bulletin No. 110 is used to determine the expected term of option awards. The risk-free rate for the expected term of the option is based on the U.S. Treasury yield curve in effect at the time of grant. Expected dividend yield was not considered in the option pricing formula since the Bank has not paid common stock dividends and has no current plans to do so in the future. The fair value of restricted stock awards is based on the value of the underlying shares at the date of the grant. Management makes estimates regarding pre-vesting forfeitures that will impact total compensation expense recognized under the Plan.

Comprehensive Income

Comprehensive income is a more inclusive financial reporting methodology that includes disclosure of other comprehensive income or loss that historically has not been recognized in the calculation of net income. Sources of other comprehensive income or loss include unrealized gains and losses on available-for-sale investment securities. Total comprehensive income and components of other comprehensive income, or loss, are presented in the statement of comprehensive income.

Fair Value of Financial Instruments

Fair values of financial instruments are estimated using relevant market information and other assumptions, as more fully disclosed in a separate note. Fair value estimates involve uncertainties and matters of significant judgment regarding interest rates, credit risk, prepayments, and other factors, especially in the absence of broad markets for particular items. Changes in assumptions or in market conditions could significantly affect these estimates.

New Accounting Standards

In January 2016, the FASB issued guidance on Recognition and Measurement of Financial Assets and Financial Liabilities. The guidance intend to improve the recognition and measurement of financial instrument. The update intends to enhance the reporting model for financial instruments to provide users of financial instruments with more decision-useful information and addresses certain aspects of the recognition, measurement, presentation, and disclosure of financial instruments. This guidance is effective for all entities that hold financial assets and liabilities for fiscal year beginning after December 15, 2017. The Bank is currently evaluating the impact of this new accounting standard on the financial statements.

**California Bank of Commerce**  
**NOTES TO FINANCIAL STATEMENTS**  
**December 31, 2016 and 2015**

**1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)**

In February 2016, the FASB issued guidance on Accounting for Leases. The guidance clarifies the recognition of a right-to-use asset and lease liability on the statement of financial position for those leases previously classified as operating leases under the old guidance. The update maintains two classification of leases: Finance Leases (which replaces capital leases) and Operating Leases. The update provided certain criteria at lease commencement are met, the lease would be classify as a finance lease. This guidance is effective for public entities for fiscal year beginning after December 15, 2018, and including interim period within fiscal year beginning on January 1, 2019. The Bank is currently evaluating the impact of this new accounting standard on the financial statements.

In March 2016, the FASB issued guidance on Compensation – Stock Compensation: Improvements to Employee Share-Based Payment Accounting. The guidance include (a) income tax consequences; (b) classification of awards as either equity or liabilities; (c) classification on the statement of cash flow; and (d) policy election to estimate the number of awards that are expected to vest or account for forfeitures when they occur. This guidance is effective for public entities for fiscal year beginning after December 15, 2016. The Bank expects this new accounting standard will create some volatility that could either increase or decrease the effective tax rate reported as existing vested stock options are exercised. The amount of the impact on the effective tax rate will be determined by the number of stock options exercised and the stock price of the Bank when the stock options are exercised.

In June 2016, the FASB issued guidance on Financial Instrument – Credit Losses. The guidance is to replace the incurred loss model with an expected loss model, which is referred to as the current expected credit loss (CECL) model. The CECL model is applicable to the measurement of credit losses on financial assets measured at amortized cost, including loan receivables, held-to maturity debt securities, and reinsurance receivables. It also applies to off-balance sheet credit exposures not accounted for as insurance (loan commitments, standby letters of credit, financial guarantees, and other similar instruments) and net investments in leases recognized by a lessor. This guidance is effective for the Bank for the fiscal year beginning after December 15, 2020. The Bank is currently evaluating the impact of this new accounting standard on the financial statements.

**California Bank of Commerce**  
**NOTES TO FINANCIAL STATEMENTS**  
**December 31, 2016 and 2015**

**2. BUSINESS COMBINATION**

On December 31, 2015, the Bank completed its merger with PPB, acquiring 100% of the outstanding common stock of PPB in exchange for stock and cash. Under the terms of the merger agreement, the Bank issued 1,135,430 shares of its common stock and paid \$8,103,605 in cash in exchange for 5,016,710 shares of PPB common stock outstanding on December 31, 2015, which represent 100% of the voting equity interest of PPB. Also, pursuant to the merger agreement, the Bank paid cash totaling \$554,296 to settle certain stock option and restricted stock awards that had been granted by PPB to its employees and directors in connection with share-based compensation plans. This payment was accounted for by the Bank as part of the merger consideration.

The assets acquired and liabilities assumed have been accounted for under the acquisition method of accounting (formerly the purchase method). The assets and liabilities, both tangible and intangible, were recorded at their estimated fair values as of the December 31, 2015 acquisition date. The application of the acquisition method of accounting resulted in the recognition of goodwill of \$7,350,465. The goodwill represents the excess of the purchase price over the estimated fair value of the net assets acquired. The goodwill is not deductible for income tax purposes.

For the year ended December 31, 2015, the Bank recorded merger related expenses of \$1,098,868, of which \$580,451 were deductible for income purposes. Below is the detail of the total consideration.

Cash consideration	\$ 8,103,605
Cash paid to settle PPB stock options and restricted stock	554,296
Stock consideration	<u>16,406,964</u>
Total	<u>\$ 25,064,865</u>



**California Bank of Commerce**  
**NOTES TO FINANCIAL STATEMENTS**  
**December 31, 2016 and 2015**

**2. BUSINESS COMBINATION** (Continued)

The table below summarizes the amounts recognized at their estimated fair values as of the acquisition date for each major class of assets acquired and liabilities assumed:

	<u>December 31, 2015</u>
Estimated fair value of assets acquired and liabilities assumed:	
Cash and cash equivalents	\$ 5,410,243
Securities	7,101,234
FHLB and other correspondent bank stocks	748,976
Loans	110,981,645
Premises and equipment	466,449
BOLI	2,339,689
Deferred tax asset, net	3,592,037
Core deposit intangible	558,468
Other assets	<u>659,860</u>
Total assets acquired	<u>131,858,601</u>
Deposits	113,908,640
Other liabilities	<u>235,561</u>
Total liabilities assumed	<u>114,144,201</u>
Cash and stock consideration	<u>25,064,865</u>
Goodwill recognized	<u>\$ 7,350,465</u>

The table below summarizes the adjustments made to the cost basis of in order to reflect them at their estimated fair values as of the acquisition date:

	<u>December 31, 2015</u>
Consideration	\$ 25,064,865
Less cost basis of net assets on merger date	16,968,397
Fair value adjustments:	
Loans	(419,647)
Core deposit intangible	558,468
Deferred tax assets, net	625,838
Other assets	98,640
Interest bearing deposits	(335,854)
Other liabilities	<u>218,558</u>
Less total fair value adjustments	<u>746,003</u>
Goodwill recognized	<u>\$ 7,350,465</u>

**California Bank of Commerce**  
**NOTES TO FINANCIAL STATEMENTS**  
**December 31, 2016 and 2015**

**2. BUSINESS COMBINATION** (Continued)

The following table presents unaudited pro forma information as if the acquisition had occurred on January 1, 2015. The unaudited pro forma information includes adjustments for interest income on loans and securities acquired, amortization of intangibles arising from the transaction, depreciation expense on property acquired, interest expense on deposits acquired, and the related income tax effects. The proforma net income presented for the year ended December 31, 2015 also excludes certain other expenses directly attributable to the business combination totaling \$2,509,568, which primarily related to severance payments and professional services. The unaudited pro forma financial information is not necessarily indicative of the results of operations that would have occurred had the transaction been effected on January 1, 2015:

	<u>Pro Forma</u> <u>(Unaudited)</u> <u>2015</u>
Net interest income	\$ <u>23,755,725</u>
Net income	\$ <u>3,429,057</u>
Basic earnings per common share	\$ <u>0.62</u>
Diluted earnings per common share	\$ <u>0.60</u>

**California Bank of Commerce**  
**NOTES TO FINANCIAL STATEMENTS**  
**December 31, 2016 and 2015**

**3. FAIR VALUE MEASUREMENTS**

Fair Value Hierarchy

The Bank groups its assets and liabilities measured at fair value in three levels, based on the markets in which the assets and liabilities are traded and the reliability of the assumptions used to determine fair value. Valuations within these levels are based upon:

Level 1 – Quoted market prices for identical instruments traded in active exchange markets.

Level 2 – Quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active, and model-based valuation techniques for which all significant assumptions are observable or can be corroborated by observable market data.

Level 3 – Model-based techniques that use at least one significant assumption not observable in the market. These unobservable assumptions reflect the Bank's estimates of assumptions that market participants would use on pricing the asset or liability. Valuation techniques include management judgment and estimation which may be significant.

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

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

**California Bank of Commerce**  
**NOTES TO FINANCIAL STATEMENTS**  
**December 31, 2016 and 2015**

**3. FAIR VALUE MEASUREMENTS (Continued)**

Fair Value of Financial Instruments

The carrying amounts and estimated fair values of financial instruments, at December 31, 2016 and December 31, 2015 are as follows:

	Carrying Amount	Fair Value Measurements at December 31, 2016 Using:			Total
		Level 1	Level 2	Level 3	
<b>Financial assets</b>					
Cash and cash equivalents	\$ 87,417,634	\$ 87,417,634	\$ -	\$ -	\$ 87,417,634
Securities available-for-sale	15,561,837	-	15,561,837	-	15,561,837
Loans, net	619,984,453	-	-	621,325,000	621,325,000
FHLB stock	2,370,700	N/A	N/A	N/A	N/A
IBFC stock	88,242	N/A	N/A	N/A	N/A
PCBB stock	380,000	N/A	N/A	N/A	N/A
Accrued interest receivable	2,138,182	-	46,816	2,091,366	2,138,182
<b>Financial liabilities</b>					
Deposits	\$ 650,046,813	\$ 560,673,000	\$ 88,969,000	\$ -	\$ 649,642,000
Other borrowings	29,000,000	-	29,026,000	-	29,026,000
Subordinated debentures	4,925,684	-	4,942,000	-	4,942,000
Accrued interest payable	101,193	-	101,193	-	101,193

	Carrying Amount	Fair Value Measurements at December 31, 2015 Using:			Total
		Level 1	Level 2	Level 3	
<b>Financial assets</b>					
Cash and cash equivalents	\$ 68,864,375	\$ 68,864,375	\$ -	\$ -	\$ 68,864,375
Securities available-for-sale	31,786,518	-	31,786,518	-	31,786,518
Loans, net	512,496,608	-	-	518,131,000	518,131,000
FHLB stock	2,140,700	N/A	N/A	N/A	N/A
IBFC stock	112,795	N/A	N/A	N/A	N/A
PCBB stock	380,000	N/A	N/A	N/A	N/A
Accrued interest receivable	1,680,280	-	65,919	1,614,361	1,680,280
<b>Financial liabilities</b>					
Deposits	\$ 542,183,879	\$ 462,618,000	\$ 79,458,000	\$ -	\$ 542,076,000
Other borrowings	29,000,000	-	28,967,000	-	28,967,000
Accrued interest payable	23,874	-	23,874	-	23,874

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.

**California Bank of Commerce**  
**NOTES TO FINANCIAL STATEMENTS**  
**December 31, 2016 and 2015**

**3. FAIR VALUE MEASUREMENTS (Continued)**

Fair Value of Financial Instruments (Continued)

The methods and assumptions used to estimate fair values are described as follows:

*Cash and Cash Equivalents* – The carrying amounts of cash and short-term instruments approximate fair values and are classified as Level 1.

*Investment Securities* – Since quoted prices are generally not available for identical securities, fair values are calculated based on market prices of similar securities on similar dates, resulting in Level 2 classification.

*FHLB, IBFC, PCBB Stocks* – It is not practical to determine the fair value of these correspondent bank stocks due to restrictions placed on their transferability.

*Loans* – Fair values of loans are estimated as follows: For variable rate loans that reprice frequently and with no significant change in credit risk, fair values are based on carrying values resulting in Level 3 classification. Fair values for other loans are estimated using discounted cash flow analyses, using interest rates currently being offered for loans with similar terms to borrowers of similar credit quality resulting in Level 3 classification. The fair value of impaired loans with specific allocations of the allowance for loan losses is generally based on recent real estate appraisals. These appraisals may utilize a single valuation approach or a combination of approaches including comparable sales and the income approach. Adjustments are routinely made in the appraisal process by the independent appraisers to adjust for differences between the comparable sales and income data available. Such adjustments are usually significant and typically result in a Level 3 classification of the inputs for determining fair value. Non-real estate collateral may be valued using an appraisal, net book value per the borrower's financial statements, or aging reports, adjusted or discounted based on management's historical knowledge, changes in market conditions from the time of the valuation, and management's expertise and knowledge of the client and client's business, resulting in a Level 3 fair value classification. Impaired loans are evaluated on a quarterly basis for additional impairment and adjusted accordingly. The methods utilized to estimate the fair value of loans do not necessarily represent an exit price.

*Deposits* – The fair values disclosed for demand deposits (e.g., interest and non-interest checking, passbook savings, and certain types of money market accounts) are, by definition, equal to the amount payable on demand at the reporting date (i.e., their carrying amount) resulting in Level 1 classification. The carrying amounts of variable rate and fixed-term money market accounts approximate their fair values at the reporting date resulting in Level 1 classification. Fair values for fixed rate certificates of deposit are estimated using a discounted cash flows calculation that applies interest rates currently being offered on certificates to a schedule of aggregated expected monthly maturities on time deposits resulting in Level 2 classification.

**California Bank of Commerce**  
**NOTES TO FINANCIAL STATEMENTS**  
**December 31, 2016 and 2015**

**3. FAIR VALUE MEASUREMENTS** (Continued)

Fair Value of Financial Instruments (Continued)

*Other Borrowings* – Fair values for other borrowings are estimated using discounted cash flow analyses using interest rates offered at each reporting date by correspondent banks for advances with similar maturities resulting in Level 2 classification.

*Subordinated Debentures* – Fair values for subordinated debentures are estimated using discounted cash flow calculation that applies the interest rate and remaining maturities with similar credit and terms at December 31, 2016, to the cash flow from the debentures, based on fixed interest rate for the term. The inputs utilized in determining the fair value of subordinated debentures are observable and accordingly which classified within in Level 2 classification.

*Accrued Interest Receivable* – The carrying amounts of accrued interest receivable approximate fair value resulting in a Level 2 classification for accrued interest receivable on investment securities and a Level 3 classification for accrued interest receivable on loans since investment securities are generally classified using Level 2 inputs and loans are generally classified using Level 3 inputs.

*Accrued Interest Payable* – The carrying amounts of accrued interest payable approximate fair value resulting in a Level 2 classification, since accrued interest payable is from deposits that are generally classified using Level 2 inputs.

*Off Balance Sheet Instruments* – Fair values for off-balance sheet, credit-related financial instruments are based on fees currently charged to enter into similar agreements, taking into account the remaining terms of the agreements and the counterparties' credit standing. The fair value of commitments is not material.

Assets Recorded at Fair Value

The following tables present information about the Bank's assets and liabilities measured at fair value on a recurring and nonrecurring basis:

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**3. FAIR VALUE MEASUREMENTS (Continued)**

*Recurring Basis*

The Bank is required or permitted to record the following assets at fair value on a recurring basis.

<u>Description</u>	<u>Fair Value</u>	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>
<u>December 31, 2016</u>				
Available-for-sale investment securities				
Debt securities:				
Mortgage-backed securities - residential	\$ 13,058,717	\$ -	\$ 13,058,717	\$ -
Corporate bonds	<u>2,503,120</u>	<u>-</u>	<u>2,503,120</u>	<u>-</u>
Total assets measured at fair value on a recurring basis	<u>\$ 15,561,837</u>	<u>\$ -</u>	<u>\$ 15,561,837</u>	<u>\$ -</u>
<u>Description</u>	<u>Fair Value</u>	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>
<u>December 31, 2015</u>				
Available-for-sale investment securities				
Debt securities:				
Mortgage-backed securities - residential	\$ 17,171,608	\$ -	\$ 17,171,608	\$ -
Corporate bonds	<u>14,614,910</u>	<u>-</u>	<u>14,614,910</u>	<u>-</u>
Total assets measured at fair value on a recurring basis	<u>\$ 31,786,518</u>	<u>\$ -</u>	<u>\$ 31,786,518</u>	<u>\$ -</u>

Fair values for available-for-sale investment securities are based on quoted market prices for exact or similar securities. During the years ended December 31, 2016 and 2015, there were no significant transfers in or out of Levels 1 and 2 and there were no changes in the valuation techniques used.

*Non-recurring Basis*

The Bank may be required, from time to time, to measure certain assets at fair value on a non-recurring basis. These include assets that are measured at the lower of cost or market value that were recognized at fair value which was below cost at the reporting date. There were no assets or liabilities measured at fair value on a non-recurring basis as of December 31, 2016 and 2015. The Bank sold an OREO property in 2015, resulting in a gain on sale of \$17,531.

# California Bank of Commerce

## NOTES TO FINANCIAL STATEMENTS

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### 4. INVESTMENT SECURITIES

The following table summarizes the amortized cost and fair value of securities available-for-sale at December 31, 2016 and 2015 and the corresponding amounts of gross unrealized gains and losses:

<i>Available-for-Sale</i>	December 31, 2016			Estimated Fair Value
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	
Mortgage-backed securities - residential	\$ 13,058,982	\$ 32,214	\$ (32,479)	\$ 13,058,717
Corporate bonds	<u>2,505,382</u>	<u>2,118</u>	<u>(4,380)</u>	<u>2,503,120</u>
Total available-for-sale	<u>\$ 15,564,364</u>	<u>\$ 34,332</u>	<u>\$ (36,859)</u>	<u>\$ 15,561,837</u>

<i>Available-for-Sale</i>	December 31, 2015			Estimated Fair Value
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	
Mortgage-backed securities - residential	\$ 17,083,627	\$ 87,981	\$ -	\$ 17,171,608
Corporate bonds	<u>14,643,409</u>	<u>15,693</u>	<u>(44,192)</u>	<u>14,614,910</u>
Total available-for-sale	<u>\$ 31,727,036</u>	<u>\$ 103,674</u>	<u>\$ (44,192)</u>	<u>\$ 31,786,518</u>

Net unrealized loss on available-for-sale investment securities totaling \$2,526 were recorded, net of \$1,035 in deferred tax assets, as accumulated other comprehensive loss within shareholders' equity at December 31, 2016. Net unrealized holding gains arising during the year ended December 31, 2016 totaled \$64,057.

Net unrealized gains on available-for-sale investment securities totaling \$59,482 were recorded, net of \$24,388 in deferred tax assets, as accumulated other comprehensive income within shareholders' equity at December 31, 2015. Net unrealized holding losses arising during the year ended December 31, 2015 totaled \$114,892.

There were two available-for-sale investment securities which matured during the year ended December 31, 2016 totaling \$2,800,000. Proceeds and gross realized loss from the sale of available-for-sale investment securities for the year ended December 31, 2016 totaled \$10,146,259 and \$2,050, respectively.

There was one available-for-sale investment security which matured during the year ended December 31, 2015 totaling \$1,500,000. Available-for-sale investment securities that were called during the year December 31, 2015 totaled 6,477,322. Proceeds and gross realized losses from the sale of available-for-sale investment securities for the year ended December 31, 2015 totaled \$5,062,778 and \$22,174, respectively.



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**December 31, 2016 and 2015**

**4. INVESTMENT SECURITIES (Continued)**

The amortized cost and fair value of debt securities as of December 31, 2016 are shown by contractual maturity. Expected maturities may differ from contractual maturities if borrowers have the right to call or prepay obligations with or without call or prepayment penalties. Securities not due at a single maturity date are shown separately.

	<u>Amortized Cost</u>	<u>Fair Value</u>
Available-for-sale		
Within one year	\$ -	\$ -
One to five years	2,505,382	2,503,120
Five to ten years	-	-
Mortgage-backed securities not due at a single maturity date	<u>13,058,982</u>	<u>13,058,717</u>
Total	<u>\$ 15,564,364</u>	<u>\$ 15,561,837</u>

At December 31, 2016, investment securities with amortized costs totaling \$9,082,463 and estimated fair values totaling \$9,067,002 were pledged to secure borrowing arrangements in place with the Wells Fargo Bank. (See Note 11)

At December 31, 2015, investment securities with amortized costs totaling \$9,176,144 and estimated fair values totaling \$9,245,549 were pledged to secure borrowing arrangements in place with the Wells Fargo Bank. (See Note 11)

At year-end 2016, there were no holdings of securities of any one issuer, other than the U.S. Government Agencies, in an amount greater than 2.0% of shareholder's equity.

At December 31, 2016, the Bank's investment security portfolio consisted of 15 securities, 8 of which were in an unrealized loss position at year end. Two of the securities in a loss position at year-end, were corporate bonds and six of the securities in a loss position were MBS. Management believes that changes in the market value of its MBS and corporate securities since purchase are primarily attributable to changes in interest rates and relative illiquidity and not credit quality. Because the Bank has the ability and intent to hold those investments until a recovery of fair value, which may be at maturity, the Bank does not consider those investments to be other-than-temporarily impaired at December 31, 2016.

**California Bank of Commerce**  
**NOTES TO FINANCIAL STATEMENTS**  
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**4. INVESTMENT SECURITIES (Continued)**

The following table summarizes securities with unrealized losses at December 31, 2016 and December 31, 2015, aggregated by major security type and length of time in a continuous unrealized loss position:

	<u>Less Than 12 Months</u>		<u>12 Months or Longer</u>		<u>Total</u>	
	<u>Fair Value</u>	<u>Unrealized Losses</u>	<u>Fair Value</u>	<u>Unrealized Losses</u>	<u>Fair Value</u>	<u>Unrealized Losses</u>
December 31, 2016						
Available-for-sale						
Mortgage-backed securities - residential	\$ 5,854,224	\$ 32,478	\$ -	\$ -	\$ 5,854,224	\$ 32,478
Corporate bonds	-	-	1,499,020	4,380	1,499,020	4,380
Total available-for-sale	<u>\$ 5,854,224</u>	<u>\$ 32,478</u>	<u>\$ 1,499,020</u>	<u>\$ 4,380</u>	<u>\$ 7,353,244</u>	<u>\$ 36,858</u>
December 31, 2015						
Available-for-sale						
Corporate bonds	\$ 6,278,207	\$ 31,943	\$ 1,492,473	\$ 12,249	\$ 7,770,680	\$ 44,192
Total available-for-sale	<u>\$ 6,278,207</u>	<u>\$ 31,943</u>	<u>\$ 1,492,473</u>	<u>\$ 12,249</u>	<u>\$ 7,770,680</u>	<u>\$ 44,192</u>

**5. LOANS**

Outstanding loans are summarized below:

	<u>December 31,</u>	
	<u>2016</u>	<u>2015</u>
Commercial & Industrial	\$ 253,619,468	\$ 221,865,420
Real estate - Construction & Land	31,908,291	36,461,026
Real Estate - Other	324,894,759	247,156,474
Real Estate - HELOC	4,218,442	3,753,292
Installment and Other	10,741,635	7,893,104
	<u>625,382,595</u>	<u>517,129,316</u>
Deferred loan origination costs, net	2,126,858	1,242,292
Allowance for loan losses	<u>(7,525,000)</u>	<u>(5,875,000)</u>
	<u>\$ 619,984,453</u>	<u>\$ 512,496,608</u>

Salaries and employee benefits totaling \$4,055,022 and \$2,132,600 were deferred as loan origination costs for the years ended December 31, 2016 and 2015, respectively.

Loans with carrying values totaling approximately \$399,550,000 were pledged to secure borrowing arrangements at December 31, 2016 (see Note 11).

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**6. ALLOWANCE FOR LOAN LOSSES**

The following table shows the changes in and allocation of the allowance for loan losses for the years ended December 31, 2016 and 2015 by portfolio segment, as well as the balances of the allowance for loan losses and loans by portfolio segment and impairment methodology:

	Commercial & Industrial	Real Estate Construction & Land	Real Estate - Other	Real Estate HELOC	Installment & Other	Total
<u>Allowance for Loan Losses</u>						
<u>December 31, 2016</u>						
Balance at beginning of year	\$ 3,736,622	\$ 139,433	\$ 1,949,471	\$ 42,388	\$ 7,086	\$ 5,875,000
Provision for loan losses	62,423	451,447	876,587	2,099	10,595	1,403,151
Loans charged-off	-	-	-	-	-	-
Recoveries of loans previously charged-off	<u>246,849</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>246,849</u>
Ending balance allocated to portfolio segments	<u>\$ 4,045,894</u>	<u>\$ 590,880</u>	<u>\$ 2,826,058</u>	<u>\$ 44,487</u>	<u>\$ 17,681</u>	<u>\$ 7,525,000</u>
Ending balance: individually evaluated for impairment	<u>\$ 2,000</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 2,000</u>
Ending balance: collectively evaluated for impairment	<u>\$ 4,043,894</u>	<u>\$ 590,880</u>	<u>\$ 2,826,058</u>	<u>\$ 44,487</u>	<u>\$ 17,681</u>	<u>\$ 7,523,000</u>
	Commercial & Industrial	Real Estate Construction & Land	Real Estate - Other	Real Estate HELOC	Installment & Other	Total
<u>Loans – December 31, 2016</u>						
Ending balance	<u>\$253,619,468</u>	<u>\$ 31,908,291</u>	<u>\$324,894,759</u>	<u>\$ 4,218,442</u>	<u>\$ 10,741,635</u>	<u>\$625,382,595</u>
Ending balance: individually evaluated for impairment	<u>\$ 1,939,507</u>	<u>\$ -</u>	<u>\$ 1,504,243</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 3,443,750</u>
Ending balance: collectively evaluated for impairment	<u>\$ 252,329,897</u>	<u>\$ 31,908,291</u>	<u>\$323,390,516</u>	<u>\$ 4,218,442</u>	<u>\$ 10,741,635</u>	<u>\$622,588,781</u>

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**6. ALLOWANCE FOR LOAN LOSSES (Continued)**

	Commercial & Industrial	Real Estate Construction & Land	Real Estate - Other	Real Estate HELOC	Installment & Other	Total
<u>Allowance for Loan Losses</u>						
<u>December 31, 2015</u>						
Balance at beginning of year	\$ 3,780,490	\$ 143,678	\$ 1,587,260	\$ 42,446	\$ 6,126	\$ 5,560,000
Provision for loan losses	(78,460)	(4,245)	362,211	(58)	960	280,408
Loans charged-off	-	-	-	-	-	-
Recoveries of loans previously charged-off	34,592	-	-	-	-	34,592
Ending balance allocated to portfolio segments	<u>\$ 3,736,622</u>	<u>\$ 139,433</u>	<u>\$ 1,949,471</u>	<u>\$ 42,388</u>	<u>\$ 7,086</u>	<u>\$ 5,875,000</u>
Ending balance: individually evaluated for impairment	<u>\$ 225,000</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 225,000</u>
Ending balance: collectively evaluated for impairment	<u>\$ 3,511,622</u>	<u>\$ 139,433</u>	<u>\$ 1,949,471</u>	<u>\$ 42,388</u>	<u>\$ 7,086</u>	<u>\$ 5,650,000</u>
Ending balance: purchased credit impaired	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>

	Commercial & Industrial	Real Estate Construction & Land	Real Estate - Other	Real Estate HELOC	Installment & Other	Total
<u>Loans – December 31, 2015</u>						
Ending balance	<u>\$221,865,420</u>	<u>\$ 36,461,026</u>	<u>\$247,156,474</u>	<u>\$ 3,753,292</u>	<u>\$ 7,893,104</u>	<u>\$517,129,316</u>
Ending balance: individually evaluated for impairment	<u>\$ 1,619,543</u>	<u>\$ -</u>	<u>\$ 1,253,556</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 2,873,099</u>
Ending balance: collectively evaluated for impairment	<u>\$220,245,877</u>	<u>\$ 36,461,026</u>	<u>\$245,330,438</u>	<u>\$ 3,753,292</u>	<u>\$ 7,893,104</u>	<u>\$513,683,737</u>
Ending balance: purchased credit impaired	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 572,480</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 572,480</u>

# California Bank of Commerce

## NOTES TO FINANCIAL STATEMENTS

December 31, 2016 and 2015

### 6. ALLOWANCE FOR LOAN LOSSES (Continued)

The following table shows the loan portfolio allocated by management's internal risk ratings at December 31, 2016:

	Credit Exposure					Total
	Credit Risk Profile by Internally Assigned Grade					
	Commercial & Industrial	Real Estate Construction & Land	Real Estate - Other	Real Estate HELOC	Installment & Other	
Grade:						
Pass	\$ 250,025,459	\$ 30,405,969	\$ 322,758,447	\$ 4,218,442	\$ 10,741,635	\$ 618,149,952
Special Mention	2,579,074	-	632,069	-	-	3,211,143
Substandard	1,014,935	1,502,322	1,504,243	-	-	4,021,500
Total	<u>\$ 253,619,468</u>	<u>\$ 31,908,291</u>	<u>\$ 324,894,759</u>	<u>\$ 4,218,442</u>	<u>\$ 10,741,635</u>	<u>\$ 625,382,595</u>

The following table shows the loan portfolio allocated by management's internal risk ratings at December 31, 2015:

	Credit Exposure					Total
	Credit Risk Profile by Internally Assigned Grade					
	Commercial & Industrial	Real Estate Construction & Land	Real Estate - Other	Real Estate HELOC	Installment & Other	
Grade:						
Pass	\$ 219,793,473	\$ 36,461,026	\$ 243,608,621	\$ 3,753,292	\$ 7,893,104	\$ 511,509,516
Special Mention	237,530	-	645,807	-	-	883,337
Substandard	1,834,417	-	2,902,046	-	-	4,736,463
Total	<u>\$ 221,865,420</u>	<u>\$ 36,461,026</u>	<u>\$ 247,156,474</u>	<u>\$ 3,753,292</u>	<u>\$ 7,893,104</u>	<u>\$ 517,129,316</u>

The following table shows an aging analysis of the loan portfolio by the time past due at December 31, 2016:

	30-89 Days Past Due	90 Days and Still Accruing	Nonaccrual	Total Past Due	Current	Total
Commercial & Industrial	\$ -	\$ -	\$ -	\$ -	\$253,619,468	\$253,619,468
Real Estate - Construction & Land	-	-	-	-	31,908,291	31,908,291
Real Estate - Other	-	-	739,878	739,878	324,154,881	324,894,759
Real Estate - HELOC	-	-	-	-	4,218,442	4,218,442
Installment & Other	-	-	-	-	10,741,635	10,741,635
Total	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 739,878</u>	<u>\$ 739,878</u>	<u>\$624,642,717</u>	<u>\$625,382,595</u>

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**6. ALLOWANCE FOR LOAN LOSSES (Continued)**

The following table shows an aging analysis of the loan portfolio by the time past due at December 31, 2015:

	30-89 Days Past Due	90 Days and Still Accruing	Nonaccrual	Total Past Due	Current	Total
Commercial & Industrial	\$ -	\$ 269,923	\$ -	\$ 269,923	\$221,595,497	\$221,865,420
Real Estate - Construction & Land	-	-	-	-	36,461,026	36,461,026
Real Estate - Other	-	-	1,826,036	1,826,036	245,330,438	247,156,474
Real Estate - HELOC	-	-	-	-	3,753,292	3,753,292
Installment & Other	-	-	-	-	7,893,104	7,893,104
<b>Total</b>	<b>\$ -</b>	<b>\$ 269,923</b>	<b>\$ 1,826,036</b>	<b>\$ 2,095,959</b>	<b>\$515,033,357</b>	<b>\$517,129,316</b>

**Impaired Loans**

The following table shows information related to impaired loans at and for the year ended December 31, 2016:

	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized
With no related allowance recorded:					
Commercial & Industrial	\$ 1,289,571	\$ 1,289,571	\$ -	\$ 1,450,178	\$ 82,085
Real Estate - Other	1,504,243	1,746,777	-	1,534,921	39,724
With an allowance recorded:					
Commercial & Industrial	\$ 649,935	\$ 649,935	\$ 2,000	\$ 656,239	\$ 35,027
<b>Total:</b>					
Commercial & Industrial	\$ 1,939,507	\$ 1,939,507	\$ 2,000	\$ 2,106,417	\$ 117,112
Real Estate - Other	1,504,243	1,746,777	-	1,534,921	39,724

The following table shows information related to impaired loans at and for the year ended December 31, 2015:

	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized
With no related allowance recorded:					
Commercial & Industrial	\$ -	\$ -	\$ -	\$ -	\$ -
Real Estate - Other	1,253,556	1,491,587	-	1,253,556	-
With an allowance recorded:					
Commercial & Industrial	\$ 1,619,543	\$ 1,619,543	\$ 225,000	\$ 2,067,600	\$ 107,221
<b>Total:</b>					
Commercial & Industrial	\$ 1,619,543	\$ 1,619,543	\$ 225,000	\$ 2,067,600	\$ 107,221
Real Estate - Other	1,253,556	1,491,587	-	1,253,556	-

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**NOTES TO FINANCIAL STATEMENTS**  
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**6. ALLOWANCE FOR LOAN LOSSES (Continued)**

Interest forgone on nonaccrual loans totaled \$92,533 and \$88,031 for the years ended December 31, 2016 and 2015, respectively. There was no interest recognized on a cash-basis on impaired loans for the years ended December 31, 2016 and 2015.

The recorded investment in impaired loans in the tables above excludes accrued interest receivable and net deferred loan origination costs due to their immateriality.

Troubled Debt Restructurings

At December 31, 2016, the Bank had a recorded investment of \$2,158,561 and had allocated specific reserves totaling \$2,000 related to loans with terms that had been modified in troubled debt restructurings. At December 31, 2015, the Bank had a recorded investment of \$2,739,115 and had allocated specific reserves totaling \$225,000 related to loans with terms that had been modified in troubled debt restructurings. The Bank has no commitment as of December 31, 2016 to customers with outstanding loans that are classified as troubled debt restructurings.

During the year ending December 31, 2016 and 2015, the terms of certain loans were modified as troubled debt restructurings. The modification of the terms of such loans included either a reduction of the stated interest rate of the loan, an extension of the maturity date at a stated rate of interest lower than the current market rate for new debt with similar risk, or a combination thereof.

During the year ending December 31, 2016 each of the three modifications involved a 14 month extension of the maturity date. During the year ending December 31, 2015 three modifications involved one loan a 3 month extension of the maturity date and two loans a 12 month extension of the maturity date.

The following table presents loans by class modified as troubled debt restructurings that occurred during the years ending December 31, 2016 and 2015:

	<u>Number of Loans</u>	<u>Pre-Modification Outstanding Recorded Investment</u>	<u>Post-Modification Outstanding Recorded Investment</u>
<u>2016</u>			
Troubled Debt Restructurings:			
Commercial & industrial	<u>3</u>	<u>\$ 1,022,469</u>	<u>\$ 1,022,469</u>
<u>2015</u>			
Troubled Debt Restructurings:			
Commercial & industrial	<u>3</u>	<u>\$ 1,370,528</u>	<u>\$ 1,370,528</u>

**California Bank of Commerce**  
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**6. ALLOWANCE FOR LOAN LOSSES (Continued)**

Troubled Debt Restructurings (Continued)

The 2016 troubled debt restructurings described above increased the allowance for loan losses by \$2,000. The 2015 troubled debt restructurings described above increased the allowance for loan losses by \$69,000.

There were no loans modified as troubled debt restructurings for which there was a payment default within twelve months following the modification during the year ending December 31, 2016 and 2015.

A loan is considered to be in payment default once it is 90 days contractually past due under the modified terms.

Purchased Credit Impaired Loans

The Bank evaluated loans acquired in its merger with PPB in accordance with accounting guidance related to loans acquired with deteriorated credit quality (PCI loans). Acquired loans are considered PCI loans if there is evidence of deterioration of credit quality since origination and it is probable, at the acquisition date, that the Bank will be unable to collect all contractually required payments receivable. At December 31, 2015, the Bank determined one loan to be a PCI loan with an estimated fair value of \$572,480. The contractual cash flows of this loan totaled \$721,092 and the expected cash flows totaled \$598,383, resulting in an accretable difference of \$25,903 and a nonaccretable difference of \$122,709. There was no allowance for loan losses on this loan, as it was recorded at its estimated fair value as of December 31, 2015. During the third quarter of 2016, this PCI loan was paid off with a gain of \$15,991.



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**7. PREMISES AND EQUIPMENT**

Premises and equipment consisted of the following:

	December 31,	
	2016	2015
Furniture, fixtures and equipment	\$ 2,898,861	\$ 2,269,424
Leasehold improvements	2,337,997	1,292,518
	5,236,858	3,561,942
Less accumulated depreciation and amortization	(2,661,988)	(1,211,289)
	\$ 2,574,870	\$ 2,350,653

Depreciation and amortization included in occupancy and equipment expense totaled \$210,577 and \$206,159, respectively, for 2016 and 2015.

**8. GOODWILL AND OTHER INTANGIBLE ASSETS**

Goodwill

At December 31, 2016 and 2015, the Bank's goodwill totaled \$7,350,465 for both years.

The Bank analyzes its goodwill for impairment on an annual basis and between annual tests in certain circumstances such as upon material adverse changes in legal, business, regulatory and economic factors. Impairment exists when a reporting unit's carrying value of goodwill exceeds its fair value, which is determined through a qualitative assessment.

If the qualitative assessment indicates it is more likely than not that the fair value of equity of a reporting unit is less than book value, than a quantitative two-step impairment test is required. Step 1 includes the determination of the carrying value of the Bank's single reporting unit, including the existing goodwill and intangible assets, and estimating the fair value of the reporting unit. If the carrying amount of a reporting unit exceeds its fair value, the Bank is required to perform a second step to the impairment test. Step 2 requires that the implied fair value of the reporting unit goodwill be compared to the carrying amount of that goodwill. If the carrying amount of the reporting unit goodwill exceeds the implied fair value of that goodwill, an impairment loss shall be recognized in an amount equal to that excess.

At December 31, 2016, the Bank's reporting unit had positive equity and management determined there was no need for an impairment analysis because based on the qualitative analysis performed, the Bank determined that it is more likely than not that the fair value of the reporting unit exceeded its reported book value of equity at December 31, 2016. As such, no impairment was indicated and no further testing was required.

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**8. GOODWILL AND OTHER INTANGIBLE ASSETS (Continued)**

Other Intangible Assets

The core deposit intangible ("CDI") is evaluated for impairment if events and circumstances indicate a possible impairment. The CDI is amortized on a straight line over an estimated life of 10 years.

CDI amortization expensed total \$55,847 in 2016. The following table provides the estimated future amortization expense of core deposit intangibles:

Year Ending December 31,	
2017	\$ 55,847
2018	55,847
2019	55,847
2020	55,847
2021	55,847
2022 and after	223,386
Total	\$ 502,621

Impairment testing of the intangible assets is performed at the individual asset level. The Bank's intangibles are tested for recoverability whenever events or changes in circumstances indicate that their carrying amounts may not be recoverable. If such events or changes in circumstances are identified, an impairment loss is recognized only if the carrying amount of the intangible asset is not recoverable and exceeds its fair value. If an impairment loss exists, the carrying amount of the intangible asset is adjusted to a new cost basis. The new cost basis is then amortized over the remaining useful life of the asset.

Based on its assessment, the Bank did not identify any events or changes in circumstances indicating that such intangible assets may not be recoverable at December 31, 2016 or 2015.

**California Bank of Commerce**  
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**9. INTEREST-BEARING DEPOSITS**

Interest-bearing deposits consisted of the following:

	<u>December 31,</u>	
	<u>2016</u>	<u>2015</u>
Savings	\$ 47,834,583	\$ 44,573,564
Money market	200,757,716	172,756,432
Interest-bearing demand accounts	27,406,298	20,146,673
Time, \$250,000 or more	45,322,133	31,031,936
Other time	<u>44,051,998</u>	<u>48,535,746</u>
	<u>\$ 365,372,728</u>	<u>\$ 317,044,351</u>

Aggregate annual maturities of time deposits are as follows:

<u>Year Ending</u> <u>December 31,</u>	
2017	\$ 68,651,163
2018	15,097,505
2019	5,252,498
2020	85,405
2021	<u>287,560</u>
	<u>\$ 89,374,131</u>

Interest expense recognized on interest-bearing deposits for the years ended December 31, 2016 and 2015 consisted of the following:

	<u>Year Ended December 31,</u>	
	<u>2016</u>	<u>2015</u>
Savings	\$ 179,743	\$ 182,987
Money market	852,127	461,143
Interest-bearing demand accounts	15,105	16,365
Time, \$250,000 or more	327,084	260,296
Other time	<u>52,532</u>	<u>11,478</u>
	<u>\$ 1,426,591</u>	<u>\$ 932,269</u>

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**10. INCOME TAXES**

The provision for income taxes for the years ended December 31, 2016 and 2015 consisted of the following:

	<u>Federal</u>	<u>State</u>	<u>Total</u>
<u>2016</u>			
Current	\$ 2,083,312	\$ 993,367	\$ 3,076,679
Deferred	<u>241,313</u>	<u>(95,520)</u>	<u>145,793</u>
Provision for income taxes	<u>\$ 2,324,625</u>	<u>\$ 897,847</u>	<u>\$ 3,222,472</u>
	<u>Federal</u>	<u>State</u>	<u>Total</u>
<u>2015</u>			
Current	\$ 1,356,636	\$ 553,465	\$ 1,910,101
Deferred	<u>(225,419)</u>	<u>(98,509)</u>	<u>(323,928)</u>
Provision for income taxes	<u>\$ 1,131,217</u>	<u>\$ 454,956</u>	<u>\$ 1,586,173</u>

The Bank's reported amount of income tax expense differs from federal statutory rates in 2016 and 2015 due principally to California franchise taxes and merger expenses. The effective tax rate differs from the Federal statutory rate for the years ended December 31, 2016 and 2015 are as follow.

	<u>December 31,</u>	
	<u>2016</u>	<u>2015</u>
Statutory Federal income tax rate	34.0%	34.0%
State income taxes, net of Federal tax benefit	7.0	7.8
Low income housing credits, net of investment losses	-2.0	-3.6
Earnings from bank owned life insurance	-1.8	-2.7
Merger expenses	0.3	4.6
Other, net	<u>0.8</u>	<u>1.0</u>
Effective tax rate	<u>38.3%</u>	<u>41.1%</u>

**California Bank of Commerce**  
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**10. INCOME TAXES (Continued)**

Deferred tax assets (liabilities) consisted of the following:

	December 31,	
	2016	2015
Deferred tax assets:		
Allowance for loan losses	\$ 1,930,539	\$ 1,299,766
State deferred tax asset	1,483,014	1,254,018
Accrued expenses	768,598	829,601
Organization costs	241,911	293,190
Share-based compensation	303,352	303,356
Deferred compensation	191,567	151,898
Net operating loss carryforward	2,308,108	2,526,226
Loan discounts	644,305	726,530
Unrealized loss on available-for-sale investment securities	860	-
Other	212,166	301,127
Total deferred tax assets	8,084,420	7,685,712
	December 31,	
	2016	2015
Deferred tax liabilities:		
Deferred loan origination costs	(1,428,987)	(1,008,613)
Unrealized gain on available-for-sale investment securities	-	(60,758)
Core Deposit Intangible	(170,891)	(189,879)
Other	(332,399)	(153,763)
Total deferred tax liabilities	(1,932,277)	(1,413,013)
Net deferred tax assets	\$ 6,152,143	\$ 6,272,699

As a result of the merger with PPB, at December 31, 2015, the Bank has approximately \$7,430,071 of net operating loss carryforwards for Federal and California income tax purposes which begin to expire in 2026 and 2018, respectively. At December 31, 2016, net operating loss carryforwards for Federal and California income tax purposes totaled \$6,788,554, which begin to expire in 2027 and 2019, respectively. Pursuant to Sections 382 of the Internal Revenue Code, annual use of net operating loss carryforwards may be limited in the event of a change in ownership. Net operating losses acquired from PPB are subject to Section 382 annual limitations in the amount of approximately \$640,000 per year.

# California Bank of Commerce

## NOTES TO FINANCIAL STATEMENTS

December 31, 2016 and 2015

### 10. INCOME TAXES (Continued)

The Bank files income tax returns in the U.S. Federal, California, and Virginia jurisdictions. There are currently no pending U.S. Federal or state income tax or non-U.S. income tax examinations by tax authorities. The Bank is subject to tax examinations by U.S. Federal and state taxing authorities for all tax returns filed since 2012 for Federal purposes and 2011 for California purposes.

The Bank is required to determine a valuation allowance if it is more likely than not that some portion, or all, of the deferred tax asset will not be realized. The Bank will continue to evaluate both positive and negative evidence, including forecasts of future income, cumulative losses, applicable tax planning strategies, and assessments of current and future economic and business conditions.

As of December 31, 2016 and 2015, there were no unrecognized tax benefits or interest and penalties accrued by the Bank.

### 11. BORROWING ARRANGEMENTS

Under agreements with several correspondent banks, the Bank can borrow up to \$58,000,000. In a separate agreement, the Bank can borrow up to \$10,000,000 or the total market value of securities pledged to a correspondent bank under a repurchase agreement. At December 31, 2016 and 2015, there were no investment securities pledged to the correspondent bank under this agreement. There were no borrowings outstanding under these arrangements at December 31, 2016 and 2015.

The Bank has a borrowing arrangement with the Federal Reserve Bank of San Francisco (FRB) under which advances are secured by portions of the Bank's loan and investment securities portfolios. The Bank's credit limit varies according to the amount and composition of the assets pledged as collateral. At December 31, 2016, amounts pledged and available borrowing capacity under such limits were approximately \$180,461,000 and \$121,761,000, respectively. There were no borrowings outstanding under this arrangement as of December 31, 2016 and 2015.

The Bank has a borrowing arrangement with the Federal Home Loan Bank (FHLB) under which advances are secured by portions of the Bank's loan portfolio. The Bank's credit limit varies according to its total assets and the amount and composition of the loan portfolio pledged as collateral. At December 31, 2016, amounts pledged and available borrowing capacity under such limits were approximately \$219,089,000 and \$64,128,000, respectively. At December 31, 2016 and 2015, there were \$29,000,000 in borrowings outstanding under this arrangement at fixed interest rates ranging from 1.11% to 1.16%, respectively, which were paid off at maturity on February 7, 2017. The weighted average interest rate on these borrowings was 1.13% at December 31, 2016 and 2015.

**California Bank of Commerce**  
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**11. BORROWING ARRANGEMENTS** (Continued)

The Bank issued \$5,000,000 in subordinated debentures on April 15, 2016. The subordinated debentures have a fixed interest rate of 5.875% for first 5 years. After the fifth year, the interest rate is changed to variable at Prime plus 2.00%. The subordinated debentures were recorded net of related issuance costs of \$86,578. On December 31, 2016, the balance was \$4,925,684, net of issuance cost. There were no subordinated debentures in 2015.

**12. COMMITMENTS AND CONTINGENCIES**

Operating Leases

The Bank currently operates five offices (its headquarters in Lafayette, California, two loan production offices - one in Oakland, California and the other in San Jose, California and two branch offices – one in Fremont, California and the other in San Jose, California).

The main office lease, dated June, 2007, as amended, had a 90 month initial term from the date of occupancy in November 2007. The Bank has executed several renewal amendments with a current leased premises of approximately 7,000 square feet. The current lease term is five years from October 2015 to September 2020 with one 60 month renewal option. The headquarters office is leased from an affiliated party. (See Note 15)

The Bank leases premises with approximately 11,000 square feet in Oakland, California for a loan production and administrative office. The lease for the Oakland loan production and administrative office is for an initial term of seven years, with a 60 month renewal option. The current term of the lease expires on January 31, 2023.

The Bank leases premises with approximately 4,000 square feet in San Jose, California for a loan production office. The lease for the San Jose loan production office is for an initial term of seven years, with a 60 month renewal option. The current term of the lease expires on February 1, 2023.

The Bank leases premises with approximately 8,500 square feet in Fremont, California as a branch office. The lease for the Fremont branch office was assumed in the Bank's merger with PPB and had an initial term of ten years, with a 84 month renewal option. The current term of the lease expires on June 30, 2022.

The Bank leases premises with approximately 3,500 square feet in San Jose, California as a branch office. The lease for the San Jose branch office was assumed in the Bank's merger with PPB and had an initial term of 88 months. The current term of the lease expires on September 30, 2021.

**California Bank of Commerce**  
**NOTES TO FINANCIAL STATEMENTS**  
**December 31, 2016 and 2015**

**12. COMMITMENTS AND CONTINGENCIES (Continued)**

Future minimum lease payments are as follows:

	<u>Year Ending December 31,</u>
2017	\$ 1,135,855
2018	1,171,153
2019	1,208,489
2020	1,152,477
2021	903,357
Thereafter	<u>818,266</u>
	<u>\$ 6,389,597</u>

Rental expense included in occupancy and equipment expense totaled \$1,254,550 and \$735,268 for the years ended December 31, 2016 and 2015, respectively.

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.

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

	<u>December 31,</u>	
	<u>2016</u>	<u>2015</u>
Commitments to extend credit	\$ 283,053,000	\$ 190,800,000
Standby letters of credit	\$ 4,679,000	\$ 7,567,000

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



# California Bank of Commerce

## NOTES TO FINANCIAL STATEMENTS

December 31, 2016 and 2015

### 12. COMMITMENTS AND CONTINGENCIES (Continued)

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 being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. The Bank evaluates each customer's creditworthiness on a case-by-case basis. The amount of collateral obtained, if deemed necessary by the Bank upon extension of credit, is based on management's credit evaluation of the borrower. Collateral held varies, but 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 issued to guarantee the performance of a client 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 clients. 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, 2016 and 2015. The Bank recognizes these fees as revenue over the term of the commitment or when the commitment is used.

Commercial loan commitments represent approximately 83% of total commitments and are generally unsecured or secured by collateral other than real estate and have variable interest rates. Real estate related loan commitments represent approximately 16% of total commitments and are generally secured by property with a loan-to-value ratio not to exceed 75%. The majority of real estate related loan commitments also have variable interest rates.

#### Significant Concentrations of Credit Risk

The Bank grants real estate mortgage, real estate construction, commercial and installment loans to customers in the Bank's geographic service area. Commercial & industrial loans and real estate loans represented 41% and 52% of total loans, respectively, at December 31, 2016. Although management believes such concentrations to have no more than the normal risk of collectability, a substantial decline in the economy in general, or a decline in real estate values in the Bank's primary market area in particular, could have an adverse impact on collectability of these loans. Personal and business income represents the primary source of repayment for a majority of these loans.

**California Bank of Commerce**  
**NOTES TO FINANCIAL STATEMENTS**  
**December 31, 2016 and 2015**

**12. COMMITMENTS AND CONTINGENCIES (Continued)**

Deposit Concentrations

At December 31, 2016 and 2015, there were no deposit relationships exceeded 5% of total deposits.

Contingencies

The Bank may be subject to legal proceedings and claims which arise in the ordinary course of business. In the opinion of management, the amount of ultimate liability with respect to such actions will not materially affect the financial position or results of operations of the Bank.

Correspondent Banking Agreements

The Bank maintains funds on deposit with other federally insured financial institutions under correspondent banking agreements. Insured financial institution deposits up to \$250,000 are fully insured by the FDIC under the FDIC's general deposit insurance rules. At December 31, 2016, uninsured deposits at financial institutions were not significant. Uninsured deposits at financial institutions were not significant at December 31, 2015, with the exception of one interest-bearing deposit in the amounts of \$5,250,000 as of December 31, 2015.

**California Bank of Commerce**  
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**13. SHARE-BASED COMPENSATION**

Share-Based Compensation Plans

The California Bank of Commerce 2007 Equity Incentive Plan (the "2007 Plan") permits the granting of stock options and restricted stock to directors, organizers and employees of the Bank. Grants of options to the organizers during the start-up phase of the Bank and to the Directors are considered non-qualified stock option awards. All other option grants are considered incentive stock option awards. The 2007 Plan does not have any shares available for future grant as of December 31, 2016.

The Bank has issued the California Bank of Commerce 2014 Equity Incentive Plan (the "2014 Plan"), which was approved by its shareholders and permits the grant of stock options and restricted stock for up to 384,986 shares of the Bank's common stock, of which 205,317 shares were available for future grant at December 31, 2016. The Plan is designed to attract and retain employees and directors. The amount, frequency, and terms of share-based awards may vary based on competitive practices, the Bank's operating results and government regulations. New shares are issued upon option exercise or restricted share grants. Shares may also be granted under the 2014 Plan that vest immediately without restriction. The Plan does not provide for the settlement of awards in cash.

Stock Option Awards

For the years ended December 31, 2016 and 2015, the compensation cost recognized for stock option awards was \$182,557 and \$212,210, respectively.

A summary of option activity under the 2007 Plan and 2014 Plan for the years ended December 31, 2016 and 2015 is presented below:

<u>Options</u>	<u>Shares</u>	<u>Weighted Average Exercise Price</u>	<u>Weighted Average Remaining Contractual Term (Years)</u>	<u>Aggregate Intrinsic Value</u>
Outstanding at January 1, 2015	782,337	\$ 8.49		
Granted	82,000	\$ 13.87		
Exercised	(62,919)	\$ 7.71		
Forfeited or canceled	<u>(831)</u>	\$ 8.00		
Outstanding December 31, 2015	<u>800,587</u>	<u>\$ 9.11</u>		
Granted	82,000	\$ 11.67		
Exercised	(25,000)	\$ 7.73		
Forfeited or canceled	<u>(3,000)</u>	\$ 13.85		
Outstanding December 31, 2016	<u>854,587</u>	<u>\$ 9.58</u>	<u>4.01</u>	<u>\$ 4,932,808</u>
Vested or expected to vest at December 31, 2016	<u>833,431</u>	<u>\$ 9.49</u>	<u>3.05</u>	<u>\$ 4,887,531</u>
Exercisable at December 31, 2016	<u>692,345</u>	<u>\$ 8.66</u>	<u>2.85</u>	<u>\$ 4,635,457</u>

**California Bank of Commerce**  
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**13. SHARE-BASED COMPENSATION (Continued)**

Stock Option Awards (Continued)

As of December 31, 2016, the unrecognized compensation cost related to non-vested stock option awards totaled \$705,979. That cost is expected to be amortized on a straight-line basis over a weighted average period of 1.95 years and will be adjusted for subsequent changes in estimated forfeitures. The intrinsic value of options exercised during the years ended December 31, 2016 and 2015 totaled \$150,450 and \$328,179, respectively.

The following information relates to stock option grants granted during the years ended December 31, 2016 and 2015:

	<u>2016</u>	<u>2015</u>
Weighted average grant date fair value per share of options granted	\$ 5.98	\$ 6.57
Significant fair value assumptions:		
Expected term in years	6 years	6 years
Expected annual volatility	33.93%	40.17%
Expected annual dividend yield	0%	0%
Risk-free interest rate	1.23%	1.44%

Stock Awards

Eleven stock awards totaling 12,618 shares were granted and issued during the year ended December 31, 2016. These stock awards were fully vested upon grant. The grant date fair value of these awards was \$13.60 per share, or \$171,605 which was recorded as compensation expense for the year ended December 31, 2016.

Ten stock awards totaling 11,000 shares were granted and issued during the year ended December 31, 2015. These stock awards were fully vested upon grant. The grant date fair value of these awards was \$13.85 per share, or \$152,350 which was recorded as compensation expense for the year ended December 31, 2015.

**California Bank of Commerce**  
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**14. SHAREHOLDERS' EQUITY**

Issuance of Common Stock in Business Combination

On December 31, 2015, the Bank issued 1,135,430 shares of its common stock with a fair value totaling \$16,406,964 in connection with its merger with PPB.

Common Stock Offering

On May 17, 2016, the Bank issued 296,297 shares of its common stock totaling \$3,981,762, net of issuance costs of \$18,238, for general corporate purposes.

Dividends

Upon declaration by the Board of Directors, all shareholders of record will be entitled to receive dividends. The California Financial Code restricts the total dividend payment of any state banking association in any calendar year to the lesser of (1) the bank's retained earnings or (2) the bank's net income for its last three fiscal years, less distributions made to shareholders during the same three-year period.

Regulatory Capital

The Bank is subject to certain regulatory capital requirements administered by the FDIC. Failure to meet these minimum capital requirements can initiate certain mandatory and possibly additional discretionary, actions by regulators that, if undertaken, could have a direct material effect on the Bank's financial statements.

Under capital adequacy guidelines, the Bank must meet specific capital guidelines that involve quantitative measures of their assets, liabilities and certain off-balance-sheet items as calculated under regulatory accounting practices. These quantitative measures are established by regulation and require that minimum amounts and ratios of total capital, Tier 1 capital and Common Equity Tier 1 ("CET1") capital to risk-weighted assets and of Tier 1 capital to average assets be maintained. Capital amounts and classification are also subject to qualitative judgments by the regulators about components, risk weightings and other factors.

The final rules implementing Basel Committee on Banking Supervision's capital guidelines for U.S. banks (Basel III rules) became effective for the bank on January 1, 2015 with full compliance with all of the requirements being phased in over a multi-year schedule, and fully phased in by January 1, 2019. Under the Basel III rules, the Bank must hold a capital conservation buffer above the adequately capitalized risk-based ratios. The implementation of the capital conservation buffer began on January 1, 2016 at 0.625% and will be phased in over a four-year period (increasing by that amount on each subsequent January 1, until it reaches 2.5% on January 1, 2019). Thus, when fully phased-in on January 1, 2019, the Bank will be required to maintain this additional capital conservation buffer of 2.5% of CET1.

# California Bank of Commerce

## NOTES TO FINANCIAL STATEMENTS

December 31, 2016 and 2015

### 14. SHAREHOLDERS' EQUITY (Continued)

The Bank is also subject to additional capital guidelines 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, Tier 1 leverage and CET1 risk-based ratios as set forth in the table on the following page. As of December 31, 2016 and 2015, the most recent notification from the FDIC categorized the Bank as well capitalized under these guidelines. There are no conditions or events since that notification that management believes have changed the Bank's category. Management believes that the Bank met all capital adequacy requirements as of December 31, 2016 and 2015.

	2016		2015	
	Amount	Ratio	Amount	Ratio
<u>Common Equity Tier 1 Risk Based Capital Ratio</u>				
California Bank of Commerce	\$ 67,410,000	8.96%	\$ 57,961,000	9.15%
To be "Well-Capitalized" under prompt corrective action regulation	\$ 48,920,000	6.50%	\$ 41,154,000	6.50%
Required for capital adequacy purposes (including capital conservation buffer)	\$ 38,572,000	5.125%	\$ 28,492,000	4.50%
<u>Leverage Ratio</u>				
California Bank of Commerce	\$ 67,410,000	8.78%	\$ 68,909,000	13.25%
To be "Well-Capitalized" under prompt corrective action regulation	\$ 38,383,000	5.00%	\$ 26,012,000	5.00%
Required for capital adequacy purposes	\$ 30,706,000	4.00%	\$ 20,810,120	4.00%
<u>Tier 1 Risk-Based Capital Ratio</u>				
California Bank of Commerce	\$ 67,410,000	8.96%	\$ 68,909,000	10.88%
To be "Well-Capitalized" under prompt corrective action regulation	\$ 60,210,000	8.00%	\$ 50,652,000	8.00%
Required for capital adequacy purposes (including capital conservation buffer)	\$ 49,861,000	6.625%	\$ 37,989,000	6.00%
<u>Total Risk-Based Capital Ratio</u>				
California Bank of Commerce	\$ 79,981,000	10.63%	\$ 74,919,000	11.83%
To be "Well-Capitalized" under prompt corrective action regulation	\$ 75,262,000	10.00%	\$ 63,315,000	10.00%
Required for capital adequacy purposes (including capital conservation buffer)	\$ 64,913,000	8.625%	\$ 50,652,000	8.00%

**California Bank of Commerce**  
**NOTES TO FINANCIAL STATEMENTS**  
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**15. RELATED PARTY TRANSACTIONS**

The Bank enters into transactions with related parties, including Directors, executive officers and affiliates.

The following is a summary of the aggregate activity involving related party borrowers during the years ended December 31, 2016 and 2015:

Balance, January 1, 2015	\$ 9,324,365
Disbursements	7,730,771
Amounts repaid	<u>(7,482,773)</u>
Balance, December 31, 2015	<u>9,572,363</u>
Disbursements	7,075,549
Amounts repaid	<u>(8,762,311)</u>
Balance, December 31, 2016	<u>\$ 7,885,601</u>
Undisbursed commitments to related parties, December 31, 2016	<u>\$ 10,355,950</u>

At December 31, 2016 and 2015, the Bank's deposits from related parties totaled approximately \$25,431,000 and \$18,316,000, respectively.

The Bank also leases its head office from a company owned by a member of the Board of Directors. Rental payments under this agreement totaled \$370,150 for the year ended December 31, 2016 and \$556,928 for the year ended December 31, 2015.

**16. EMPLOYEE BENEFIT PLANS**

Profit Sharing Plan

In 2007, the Bank adopted the California Bank of Commerce Profit Sharing 401(k) Plan. All full-time employees 21 years of age or older with 3 months of service are eligible to participate in the 401(k) Plan. Eligible employees may elect to make tax deferred contributions up to the maximum amount allowed by law. The Bank may make additional contributions to the plan at the discretion of the Board of Directors. Bank contributions may vest at a rate of 20% annually for all employees. The Bank made a fully vested contribution to the 401(k) Plan for the year ended December 31, 2016 in the amount of \$373,000. The Bank made a fully vested contribution to the 401(k) Plan for the year ended December 31, 2015 in the amount of \$249,000.

**California Bank of Commerce**  
**NOTES TO FINANCIAL STATEMENTS**  
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**16. EMPLOYEE BENEFIT PLANS (Continued)**

Salary Continuation and Retirement Plan

The Board of Directors approved a salary continuation plan for certain executives during 2007 and 2014. Under the Plan, once executives reach age 65, the Bank is obligated to provide executives with annual benefits after retirement. The estimated present value of these future benefits is accrued from the effective date of the plan based on a discount rate of 4.0%.

The expense recognized under this plan for the years ended December 31, 2016 and 2015 totaled \$141,672 and \$62,360, respectively. Accrued compensation payable under the salary continuation plan totaled \$563,432 and \$446,760 at December 31, 2016 and 2015, respectively, and is included in accrued interest payable and other liabilities on the Bank's balance sheet.

**17. OTHER EXPENSES**

Other expenses for the years ended December 31, 2016 and 2015 consisted of the following:

	<u>2016</u>	<u>2015</u>
Computer network and internet support	\$ 860,553	\$ 402,788
Outsourced data processing and electronic banking	737,884	563,578
Director's stock-based and other compensation	689,615	595,348
Advertising, promotion and business development	619,046	411,621
Professional fees	525,242	518,828
Regulatory fees	451,808	346,895
Loan processing	399,954	174,711
Telecommunications	209,439	101,570
Correspondent bank service charges	197,643	164,072
Bank insurance	103,530	84,709
Provision for unfunded loan commitments	-	30,000
Other operating expenses	<u>729,570</u>	<u>397,112</u>
Total other expenses	<u>\$ 5,524,284</u>	<u>\$ 3,791,232</u>



**California Bank of Commerce**  
**NOTES TO FINANCIAL STATEMENTS**  
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**18. PREFERRED STOCK**

Small Business Lending Fund ("SBLF")

On September 15, 2011, as part of the Small Business Lending Fund ("SBLF"), the Bank entered into a Small Business Lending Fund Securities Purchase Agreement ("SBLF Purchase Agreement") with the United States Department of the Treasury ("Treasury"). Under the SBLF Purchase Agreement, the Bank issued 11,000 shares of Senior Non-Cumulative Perpetual Preferred Stock, Series C (the "Series C Preferred") to the Treasury. The preferred stock series C shares qualify as Tier 1 capital and will pay quarterly dividends. The initial and current dividend as of December 31, 2015 was 1%. The dividend rate was fixed at 1% until March 15, 2016. After this date, the dividend rate increased to 9%.

The Bank repurchased 5,500 shares of Series C Preferred stock on April 15, 2016 and 5,500 shares of Series C Preferred stock on May 19, 2016. There was no Series C Preferred stock at December 31, 2016.

**19. QUALIFIED AFFORDABLE HOUSING PROJECT INVESTMENT**

The Bank invests in low income housing investments with commitments of \$8,000,000 and \$6,000,000 at December 31, 2016 and 2015, respectively. The outstanding balances were \$3,366,164 and \$1,888,358 at December 31, 2016 and 2015, respectively. These balances are reflected in the accrued interest receivable and other assets line on the balance sheets. The Bank expects \$952,000 in capital calls during the year ending 2017.

For the years ended December 31, 2016 and 2015, the Bank recognized amortization expense of \$179,100 and \$139,497, respectively, which was included within income tax expense on the statement of income.

For tax purposes, the Bank recorded tax credit and other benefits of \$770,638 and \$605,714 for the years ended December 31, 2016 and 2015, respectively. Amortization of the low income housing investment totaled \$591,538 and \$466,217 for the years ended December 31, 2016 and 2015.