

**COMMUNITY BUSINESS BANK**

**FINANCIAL STATEMENTS**

**AS OF DECEMBER 31, 2008 AND 2007 AND**

**FOR THE YEARS THEN ENDED**

**AND**

**INDEPENDENT AUDITOR'S REPORT**

**INDEPENDENT AUDITOR'S REPORT**

The Shareholders and  
Board of Directors  
Community Business Bank

We have audited the accompanying balance sheet of Community Business Bank as of December 31, 2008 and 2007 and the related statements of operations, changes in shareholders' equity and comprehensive (loss) income and cash flows for the years then ended. These financial statements are the responsibility of the Bank's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Community Business Bank as of December 31, 2008 and 2007 and the results of its operations and its cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

*Perry-Smith LLP*

March 24, 2009

**COMMUNITY BUSINESS BANK****BALANCE SHEET****December 31, 2008 and 2007**

	<u>2008</u>	<u>2007</u>
<b>ASSETS</b>		
Cash and due from banks	\$ 1,109,755	\$ 1,956,348
Available-for-sale investment securities (Notes 2, 3 and 9)	3,168,832	4,496,106
Loans, less allowance for loan losses of \$1,945,000 in 2008 and \$1,225,000 in 2007 (Notes 2, 9, 10 and 13)	119,567,629	107,224,209
Federal Home Loan Bank stock (Note 5)	508,000	644,700
Premises and equipment, net (Note 6)	2,011,987	1,444,881
Bank owned life insurance	1,605,573	1,537,473
Other real estate (Note 2)	458,165	
Accrued interest receivable and other assets (Note 15)	<u>1,121,921</u>	<u>1,256,836</u>
	<u>\$ 129,551,862</u>	<u>\$ 118,560,553</u>
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
Deposits (Notes 7 and 13):		
Non-interest bearing	\$ 18,073,740	\$ 12,801,000
Interest bearing	<u>91,216,567</u>	<u>79,806,749</u>
Total deposits	109,290,307	92,607,749
Short-term borrowings (Note 9)	385,000	5,500,000
Accrued interest payable and other liabilities (Notes 6 and 15)	<u>1,775,817</u>	<u>1,497,734</u>
Total liabilities	<u>111,451,124</u>	<u>99,605,483</u>
Commitments and contingencies (Note 10)		
Shareholders' equity (Notes 11, 12 and 16):		
Preferred stock – no par value; 5,000,000 shares authorized, no shares issued or outstanding	-	-
Common stock – no par value; 50,000,000 shares authorized; 2,138,898 shares issued and outstanding in 2008 and 2007	21,454,074	21,367,201
Accumulated deficit	(3,380,481)	(2,424,298)
Accumulated other comprehensive income, net of taxes (Note 3)	<u>27,145</u>	<u>12,167</u>
Total shareholders' equity	<u>18,100,738</u>	<u>18,955,070</u>
	<u>\$ 129,551,862</u>	<u>\$ 118,560,553</u>

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

# COMMUNITY BUSINESS BANK

## STATEMENT OF OPERATIONS

For the Years Ended December 31, 2008 and 2007

	<u>2008</u>	<u>2007</u>
Interest income:		
Interest and fees on loans	\$ 8,254,074	\$ 7,684,220
Interest on Federal funds sold	27,653	23,091
Interest on available-for-sale investment securities	205,388	345,226
Interest on deposits in banks	<u>802</u>	<u>432</u>
Total interest income	<u>8,487,917</u>	<u>8,052,969</u>
Interest expense:		
Interest on deposits (Note 7)	2,945,000	3,147,508
Interest on borrowings (Note 9)	<u>123,344</u>	<u>534,723</u>
Total interest expense	<u>3,068,344</u>	<u>3,682,231</u>
Net interest income	5,419,573	4,370,738
Provision for loan losses (Note 4)	<u>1,600,912</u>	<u>296,867</u>
Net interest income after provision for loan losses	<u>3,818,661</u>	<u>4,073,871</u>
Non-interest income:		
Service charges and fees	68,071	52,554
Gain on sale of Bank assets (Note 6)	269,639	567,387
Rental income		71,876
Increase in cash surrender value of life insurance (Note 15)	68,101	37,473
Other non-interest income	<u>78,329</u>	<u>45,363</u>
Total non-interest income	<u>484,140</u>	<u>774,653</u>
Non-interest expense:		
Salaries and employee benefits (Notes 4 and 14)	2,993,009	2,600,289
Occupancy and equipment (Notes 6 and 10)	1,133,344	1,008,618
Other (Note 15)	<u>1,131,831</u>	<u>1,104,763</u>
Total non-interest expense	<u>5,258,184</u>	<u>4,713,670</u>
(Loss) income before provision for income taxes	(955,383)	134,854
Provision for income taxes (Note 8)	<u>800</u>	<u>800</u>
Net (loss) income	<u>\$ (956,183)</u>	<u>\$ 134,054</u>
Basic and diluted (loss) earnings per share (Note 12)	<u>\$ (0.45)</u>	<u>\$ 0.06</u>

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

**COMMUNITY BUSINESS BANK**

**STATEMENT OF CHANGES IN SHAREHOLDERS' EQUITY AND COMPREHENSIVE (LOSS) INCOME**

**For the Years Ended December 31, 2008 and 2007**

	<u>Common Stock</u>		<u>Accumulated</u>	<u>Other</u>	<u>Total</u>
	<u>Shares</u>	<u>Amount</u>	<u>Deficit</u>	<u>Income (Loss)</u>	<u>Shareholders'</u>
				<u>Net of Taxes</u>	<u>Equity</u>
Balance, January 1, 2007	2,128,210	\$ 21,279,637	\$ (2,558,352)	\$ (14,350)	\$ 18,706,935
Net income			134,054		134,054
Share-based expense		58,564			58,564
Stock option exercise	2,900	29,000			29,000
Restricted stock issuance	7,788				
Net change in unrealized loss on available-for-sale investment securities, net of tax				26,517	26,517
Balance, December 31, 2007	2,138,898	21,367,201	(2,424,298)	12,167	18,955,070
Net loss		(956,183)		(956,183)	
Share-based expense		86,873			86,873
Net change in unrealized gains on available-for-sale investment securities, net of tax (Note 3)				14,978	14,978
Balance, December 31, 2008	<u>2,138,898</u>	<u>\$ 21,454,074</u>	<u>\$ (3,380,481)</u>	<u>\$ 27,145</u>	<u>\$ 18,100,738</u>

	<u>2008</u>	<u>2007</u>
Comprehensive (loss) income:		
Net (loss) income	\$ (956,183)	\$ 134,054
Other comprehensive income:		
Unrealized holding gains arising during the period, net of tax	<u>14,978</u>	<u>26,517</u>
Total comprehensive (loss) income	<u>\$ (941,205)</u>	<u>\$ 160,571</u>

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

# COMMUNITY BUSINESS BANK

## STATEMENT OF CASH FLOWS

For the Years Ended December 31, 2008 and 2007

	<u>2008</u>	<u>2007</u>
Cash flows from operating activities:		
Net (loss) income	\$ (956,183)	\$ 134,054
Adjustments to reconcile net (loss) income to net cash provided by (used in) operating activities:		
Gain on sale of Bank assets		(1,322,333)
Gain on sale of real estate owned	(211,615)	
Provision for loan losses	1,600,912	296,867
Depreciation, amortization and accretion, net	409,065	380,884
Share-based expense	86,873	58,564
Deferred loan origination fees and costs, net	3,022	(195,743)
Decrease (increase) in accrued interest receivable, other assets and Bank owned life insurance	66,815	(426,640)
Increase in accrued interest payable and other liabilities	<u>267,675</u>	<u>1,069,469</u>
Net cash provided by (used in) operating activities	<u>1,266,564</u>	<u>(4,878)</u>
Cash flows from investing activities:		
Maturity of available-for-sale investment securities	1,000,000	4,375,534
Purchase of available-for-sale investment securities	(470,000)	(983,200)
Proceeds from principal repayments of available-for-sale investment securities	838,561	510,140
Redemption (purchase) of Federal Home Loan Bank stock, net	136,700	(308,900)
Loans funded, net	(15,024,338)	(33,715,357)
Purchase of premises and equipment	(1,020,110)	(404,101)
Proceeds from sale of Bank assets	28,038	3,480,509
Proceeds from sale of real estate owned	830,434	
Purchase of bank owned life insurance		<u>(1,500,000)</u>
Net cash used in investing activities	<u>(13,680,715)</u>	<u>(28,545,375)</u>
Cash flows from financing activities:		
Demand, interest bearing and savings deposits, net	10,254,225	4,771,946
Time deposits, net	6,428,333	23,270,438
Short-term borrowings, net	(5,115,000)	(1,679,300)
Stock option exercise		<u>29,000</u>
Net cash provided by financing activities	<u>11,567,558</u>	<u>26,392,084</u>
Decrease in cash and cash equivalents	(846,593)	(2,158,169)
Cash and cash equivalents at beginning of year	<u>1,956,348</u>	<u>4,114,517</u>
Cash and cash equivalents at end of year	<u>\$ 1,109,755</u>	<u>\$ 1,956,348</u>
Supplemental disclosure of cash flow information:		
Cash paid during the year for:		
Interest expense	\$ 3,324,527	\$ 3,632,161
Non-cash investing activities:		
Net change in unrealized holding gains on available-for-sale investment securities	\$ 25,385	\$ 44,944
Transfer of loans to other real estate	\$ 1,076,984	

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

**COMMUNITY BUSINESS BANK**  
**NOTES TO FINANCIAL STATEMENTS**

**1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

General

On June 10, 2005, the organizers of Community Business Bank (the "Bank") filed an application with the Federal Deposit Insurance Corporation (FDIC). The application was approved on August 8, 2005 and the Bank opened for business on November 14, 2005. The Bank provides products and services to customers who are predominantly small to middle-market businesses, professionals and not for profit organizations located in San Joaquin, Yolo, Solano, Sacramento and Placer Counties.

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.

The Bank is participating in the FDIC's Transaction Account Guarantee Program. Under this program, through December 31, 2009, all noninterest-bearing transaction accounts are fully guaranteed by the FDIC for the entire amount in the account and the Bank is assessed an annual fee of 10 basis points for all deposit amounts exceeding the existing deposit insurance limit of \$250,000. Coverage under the Transaction Account Guarantee Program is in addition to and separate from the coverage available under the FDIC's general deposit insurance rules.

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.

Reclassifications

Certain reclassifications have been made to prior year's balances to conform to classifications used in 2008.

Cash and Cash Equivalents

For the purpose of the statement of cash flows, the Bank considers all highly liquid investments with maturities of three months or less at date of acquisition to be cash equivalents. Cash equivalents include cash, due from banks, money market investments and Federal funds sold. Generally, Federal funds are sold for one-day periods.

## COMMUNITY BUSINESS BANK

### NOTES TO FINANCIAL STATEMENTS

(Continued)

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

##### Investment Securities

Investment securities are classified into the following categories:

- Available-for-sale investment 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 investment 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 and may only change the classification in certain limited circumstances. All transfers between categories are accounted for at fair value. At December 31, 2008 and 2007, all securities are classified as available-for-sale.

Gains and losses on the sale of 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. In addition, unrealized losses that are other than temporary are recognized in earnings for all investments.

Investment securities are evaluated for other than temporary impairment when economic or market conditions warrant such an evaluation to determine whether a decline in their value is other than temporary. Management utilizes criteria such as the magnitude and duration of the decline, the financial condition and near-term prospects of the debt issuer, 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, the value of the security is reduced and a corresponding charge to earnings is recognized.

##### Federal Home Loan Bank Stock

The investment in Federal Home Loan Bank (FHLB) stock is carried at cost and is redeemable at par with certain restrictions. Investment in FHLB stock is required to participate in FHLB programs.



## COMMUNITY BUSINESS BANK

### NOTES TO FINANCIAL STATEMENTS

(Continued)

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

##### Loans

Loans are reported at the principal amounts outstanding, adjusted for unamortized discounts and premiums and net of deferred loan origination fees and costs, write-downs and the allowance for loan losses. Interest is accrued daily based upon outstanding loan balances. However, when, in the opinion of management, loans are considered to be impaired and the future collectibility of interest and principal is in serious doubt, loans are placed on nonaccrual status and the accrual of interest income is suspended. Any interest accrued but unpaid is charged against income. Payments received are applied to reduce principal to the extent necessary to ensure collection. Subsequent payments on these loans, or payments received on nonaccrual loans for which the ultimate collectibility of principal is not in doubt, are applied first to earned but unpaid interest and then to principal.

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

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

The Bank services loans that have been participated with other financial institutions totaling approximately \$9.6 million as of December 31, 2008. The participated balances of these loans were sold without recourse and are not included on the Bank's balance sheet.

##### Allowance for Loan Losses

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

Loans determined to be impaired or classified are individually evaluated by management for specific risk of loss. In addition, reserve factors are assigned to currently performing loans based on management's assessment of the following for each identified loan type: (1) inherent credit risk, (2) historical losses and, where the Bank has not experienced losses, the loss experience of peer banks and (3) qualitative factors such as changes in the local economies, nature and volume of the loan portfolio, volume and severity of past due loans, and levels of concentrations. These estimates are particularly susceptible to changes in the economic environment and market conditions.

## COMMUNITY BUSINESS BANK

### NOTES TO FINANCIAL STATEMENTS

(Continued)

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

##### Allowance for Loan Losses (Continued)

The Directors' Loan Committee reviewed the adequacy of the allowance for loan losses at December 31, 2008, including consideration of the relative risks in the portfolio, current economic conditions and other factors. The Directors' Loan Committee reviews the adequacy of the allowance for loan losses at least quarterly. The allowance is adjusted based on that review if, in the judgment of the Directors' Loan Committee and management, changes are warranted.

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. The allowance for loan losses at December 31, 2008 and 2007 reflects management's estimate of probable losses in the portfolio. Although management believes the allowance for loan losses to be adequate, ultimate losses may vary from their estimates. In addition, the FDIC and California Department of Financial Institutions, as an integral part of their examination process, review the adequacy of the allowance for loan losses. These agencies may require additions to the allowance for loan losses based on their judgment about information available at the time of their examinations.

##### Other Real Estate

Real estate properties acquired through, or in lieu of, loan foreclosure are expected to be sold and are initially recorded at the fair value of the property, less estimated costs to sell. The excess, if any, of the loan amount over the fair value less costs to sell is charged to the allowance for loan losses. Subsequent declines in the fair value of other real estate, along with related revenue and expenses from operations, are charged to noninterest expense as incurred. Other real estate held by the Bank totaled \$458,165 at December 31, 2008. The Bank also recorded liens against other real estate in the amount of \$191,250, which is recorded in accrued interest payable and other liabilities on the balance sheet. The Bank did not hold other real estate at December 31, 2007.

##### Bank Premises and Equipment

Bank premises and equipment are carried at cost, less accumulated depreciation. Depreciation is determined using the straight-line method over the estimated useful lives of the related assets. The useful lives of furniture, fixtures and equipment are estimated to be three to five years. Leasehold improvements are amortized over the life of the asset or the term of the related lease, including expected renewal periods, whichever is shorter. 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.

## COMMUNITY BUSINESS BANK

### NOTES TO FINANCIAL STATEMENTS

(Continued)

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

##### Bank Premises and Equipment (Continued)

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, including tenant improvement credits, 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 tenant improvement 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.

##### Income Taxes

Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases and tax credit carryforwards. Deferred tax assets and liabilities are measured using enacted tax rates which are expected to be applied to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date. 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.

Since January 1, 2007, the Bank has accounted for uncertainty in income taxes under Financial Accounting Standards Board (FASB) Interpretation No. 48, *Accounting for Uncertainty in Income Taxes* (FIN 48). Under the provisions of FIN 48, only tax positions that met the more-likely-than-not recognition threshold on January 1, 2007 were recognized or continue to be recognized. The Bank previously recognized income tax positions based on management's estimate of whether it was reasonably possible that a liability had been incurred for unrecognized income tax benefits by applying FASB Statement No. 5, *Accounting for Contingencies*. The adoption of FIN 48 did not have a material impact on the Bank's financial position, results of operations or cash flows.

## COMMUNITY BUSINESS BANK

### NOTES TO FINANCIAL STATEMENTS

(Continued)

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

##### Earnings (Loss) Per Share

Basic earnings (loss) per share (EPS), which excludes dilution, is computed by dividing net income (loss), less preferred stock dividends, by the weighted-average number of common shares outstanding for the period. Diluted EPS reflects the potential dilution that could occur if securities or other contracts to issue common stock, such as stock options, result in the issuance of common stock which shares in the earnings of the Bank. The treasury stock method is applied to determine the dilutive effect of stock options in computing diluted EPS. However, conversion is not assumed when a net loss occurs because the conversion would be antidilutive.

##### Salary Continuation Agreements

The Bank has established salary continuation agreements providing nonqualified defined benefit retirement income for certain executive officers of the Bank. In connection with establishing these agreements, the Bank purchased single premium life insurance policies on each participant. The salary continuation agreements are accounted for by accruing a liability based upon the present value of each individual's benefit at retirement age and recognizing the related cost of these benefits over the term of employment. The single payment premium for the life insurance policies is recorded based on the cash surrender value adjusted for income earned on the investment and expense related to mortality costs.

##### Share-Based Payments

The Bank has one share-based payment plan, the Community Business Bank Equity Incentive Plan (the "Plan"), which has been approved by its shareholders. Under the Plan, 558,656 shares of common stock are reserved for issuance to employees, directors and consultants under incentive and nonstatutory stock option agreements and 79,807 shares are reserved for issuance as stock bonus awards. The Plan is designed to retain employees, directors and founders who are advisory group members. 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 stock bonus awards. The Plan does not provide for the settlement of awards in cash. 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. All options expire on a date determined by the Board of Directors but not later than ten years from the date of grant. The vesting period is determined by the Board of Directors and is generally over a three to five year period.

## COMMUNITY BUSINESS BANK

### NOTES TO FINANCIAL STATEMENTS

(Continued)

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

##### Share-Based Payments (Continued)

Management estimates the fair value of each option award as of the date of grant using a Black-Scholes-Merton option pricing formula and the following assumptions. 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 SEC Staff Accounting Bulletin No. 110 is used to determine the expected term of the options due to the lack of sufficient historical data. The risk-free rate is based on the U.S. Treasury yield curve in effect at the time of grant with substantially the same remaining term as the term of the option. Expected dividend yield was not considered in the option pricing formula since the Bank has not paid dividends and has no current plans to do so in the future. In addition to these assumptions, management makes estimates regarding pre-vesting forfeitures that will impact total compensation expense recognized under the Plan.

##### Comprehensive Income (Loss)

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

##### Impact of New Financial Accounting Standards

###### *Determining the Fair Value of a Financial Asset When the Market for That Asset Is Not Active*

In October 2008, the FASB issued FASB Staff Position (FSP) Financial Accounting Standard No. 157-3, *Determining the Fair Value of a Financial Asset When the Market for That Asset Is Not Active*. The FSP clarifies the application of FASB Statement No. 157, *Fair Value Measurements* and provides an example to illustrate key considerations in determining the fair value of a financial asset when the market for that financial asset is not active. The FSP was effective immediately, and includes prior period financial statements that have not yet been issued. The Bank is subject to the provisions of the FSP effective immediately; however, the impact of adoption was not material to the Bank's financial condition or results of operations.

## COMMUNITY BUSINESS BANK

### NOTES TO FINANCIAL STATEMENTS

(Continued)

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

##### Impact of New Financial Accounting Standards (Continued)

###### *The Fair Value Option for Financial Assets and Financial Liabilities*

In February 2007, the FASB issued Statement of Financial Accounting Standards No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities* (SFAS No. 159), including an amendment of FASB Statement No. 115. SFAS No. 159 permits fair value accounting to be irrevocably elected for certain financial assets and liabilities on an individual contract basis at the time of acquisition or at a remeasurement event date. Upon adoption of SFAS No. 159, fair value accounting may also be elected for existing financial assets and liabilities. For those instruments for which fair value accounting is elected, changes in fair value will be recognized in earnings and fees and costs associated with origination or acquisition will be recognized as incurred rather than deferred. The Bank adopted SFAS No. 159 on January 1, 2008, but did not elect the fair value option for any assets or liabilities for the year ended December 31, 2008.

###### *Business Combinations*

In December 2007, the FASB issued Statement of Financial Accounting Standards No. 141 (revised 2007), *Business Combinations* (SFAS No. 141(R)). SFAS No. 141(R), among other things, establishes principles and requirements for how the acquirer in a business combination (i) recognizes and measures in its financial statements the identifiable assets acquired, the liabilities assumed, and any noncontrolling interest in the acquired business, (ii) recognizes and measures the goodwill acquired in the business combination or a gain from a bargain purchase, and (iii) determines what information to disclose to enable users of the financial statements to evaluate the nature and financial effects of the business combination. The Bank is required to adopt SFAS No. 141(R) for all business combinations for which the acquisition date is on or after January 1, 2009. This Standard will change the Bank's accounting treatment for business combinations on a prospective basis.

###### *Employers' Disclosures about Postretirement Benefit Plan Assets*

In December 2008, the FASB issued FSP Financial Accounting Standard No. 132R-1, *Employers' Disclosures about Postretirement Benefit Plan Assets* (FSP 132(R)-1). This standard provides guidance on an employer's disclosures about plan assets of a defined benefit pension or other postretirement plan. It also includes a technical amendment to FASB Statement No. 132(R) that requires a nonpublic entity to disclose net periodic benefit cost for each annual period for which a statement of income is presented. The objectives of the disclosures about plan assets in an employer's defined benefit pension or other postretirement plan are to provide users of financial statements with an understanding of how investment allocation decisions are made, including the factors that are pertinent to an understanding of investment policies and strategies, the major categories of plan assets, the inputs and valuation techniques used to measure the fair value of plan assets, the effect of fair value measurements using significant unobservable inputs (Level 3) on changes in plan assets for the period and significant concentrations of risk within plan assets. The disclosures about plan assets required by this FSP are effective for fiscal years ending after December 15, 2009. Early adoption is permitted. The Bank is currently assessing the potential effect of FSP 132(R)-1.

# COMMUNITY BUSINESS BANK

## NOTES TO FINANCIAL STATEMENTS

(Continued)

### 2. FAIR VALUE MEASUREMENTS

#### Fair Value of Financial Instruments

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

	December 31, 2008		December 31, 2007	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
Financial assets:				
Cash and due from banks	\$ 1,109,755	\$ 1,109,755	\$ 1,956,348	\$ 1,956,438
Available-for-sale investment securities	3,168,832	3,168,832	4,496,106	4,496,106
Loans, net	119,567,629	121,460,527	107,224,209	107,259,492
FHLB stock	508,000	508,000	644,700	644,700
Bank owned life insurance	1,605,573	1,605,573	1,537,473	1,537,473
Accrued interest receivable	577,180	577,180	695,659	695,659
Financial liabilities:				
Deposits	109,290,307	107,067,613	92,607,749	90,544,187
Short-term borrowings	385,000	385,000	5,500,000	5,500,000
Accrued interest payable	153,506	153,506	409,689	409,689

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.

The following methods and assumptions were used to estimate the fair value of financial instruments. For cash and due from banks, variable-rate loans, accrued interest receivable and payable, FHLB stock, cash surrender value of bank owned life insurance, demand deposits and short-term borrowings, the carrying amount is estimated to be fair value. For available-for-sale investment securities, fair values are based on quoted market prices, quoted market prices for similar securities and indications of value provided by brokers. The fair values for fixed-rate loans are estimated using discounted cash flow analyses, using interest rates currently being offered at each reporting date for loans with similar terms to borrowers of comparable creditworthiness. Fair values for fixed-rate certificates of deposit are estimated using discounted cash flow analyses using interest rates offered at each reporting date by the Bank for certificates with similar remaining maturities. The fair values of commitments are estimated using the fees currently charged to enter into similar agreements and are not significant and, therefore, not included in the above table.

## COMMUNITY BUSINESS BANK

### NOTES TO FINANCIAL STATEMENTS

(Continued)

#### 2. FAIR VALUE MEASUREMENTS (Continued)

##### Fair Value Measurements Under SFAS 157

On January 1, 2008, the Bank adopted Financial Accounting Standards Board (FASB) Statement No. 157 (SFAS No. 157), *Fair Value Measurements*. SFAS No. 157 defines fair value, establishes a framework for measuring fair value under generally accepted accounting principles, and expands disclosures about fair value measurement. Upon adoption of SFAS No. 157, there was no cumulative effect adjustment to beginning retained earnings and no impact on the consolidated financial statements.

##### *Fair Value Hierarchy*

In accordance with SFAS No. 157, the Bank groups its assets and liabilities measured at fair value within 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.

##### *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 as of December 31, 2008:

##### Recurring Basis

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

<u>Description</u>	<u>Fair Value</u>	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>
Available-for-sale investment securities	<u>\$ 3,168,832</u>	<u>\$ -</u>	<u>\$ 3,168,832</u>	<u>\$ -</u>

Fair values for available-for-sale investment securities, which include debt securities of U.S. Governmental agencies and government-guaranteed mortgage-backed securities are based on quoted market prices for similar securities.



# COMMUNITY BUSINESS BANK

## NOTES TO FINANCIAL STATEMENTS

(Continued)

### 2. FAIR VALUE MEASUREMENTS (Continued)

#### Fair Value Measurements Under SFAS 157 (Continued)

#### *Assets Recorded at Fair Value* (Continued)

#### 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.

Description	Fair Value	Level 1	Level 2	Level 3
Impaired loans	\$ 5,736,338		\$ 5,736,338	
Other real estate	<u>458,165</u>		<u>458,165</u>	
Total assets measured at fair value on a non-recurring basis	<u>\$ 6,194,503</u>	<u>\$ -</u>	<u>\$ 6,194,503</u>	<u>\$ -</u>

The following methods were used to estimate the fair value of each class of assets above:

Impaired Loans – The fair value of impaired loans is based on the fair value of the collateral, obtained through property appraisals, for all collateral dependent loans and for other impaired loans is estimated using a discounted cash flow model.

Other Real Estate – The fair value of other real estate is based on the values obtained through property appraisals.

### 3. AVAILABLE-FOR-SALE INVESTMENT SECURITIES

The amortized cost and estimated fair value of available-for-sale investment securities at December 31, 2008 and 2007 consisted of the following:

	2008		
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses
Debt securities:			Estimated Fair Value
U.S. Government agencies	\$ 991,619	\$ 20,841	\$ 1,012,460
U.S. Government guaranteed mortgage-backed securities	1,791,206	25,166	1,816,372
Other	<u>340,000</u>		<u>340,000</u>
	<u>\$ 3,122,825</u>	<u>\$ 46,007</u>	<u>\$ -</u>
			<u>\$ 3,168,832</u>

# COMMUNITY BUSINESS BANK

## NOTES TO FINANCIAL STATEMENTS

(Continued)

### 3. AVAILABLE-FOR-SALE INVESTMENT SECURITIES (Continued)

Net unrealized gains on available-for-sale investment securities totaling \$46,007 were recorded net of \$18,862 in tax benefits as accumulated other comprehensive loss within shareholders' equity at December 31, 2008.

	2007		
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses
Debt securities:			
U.S. Government agencies	\$ 1,973,804	\$ 13,596	
U.S. Government guaranteed mortgage-backed securities	2,311,678	7,026	
Other	190,002		
	<u>\$ 4,475,484</u>	<u>\$ 20,622</u>	<u>\$ -</u>
			<u>\$ 4,496,106</u>

Net unrealized gains on available-for-sale investment securities totaling \$20,622 were recorded net of \$8,455 in tax benefits as accumulated other comprehensive loss within shareholders' equity at December 31, 2007.

There were no sales or transfers of available-for-sale investment securities during 2008 and 2007.

Certain investment securities were pledged to secure a borrowing arrangement (see Note 9).

#### Contractual Maturities

The amortized cost and estimated fair value of available-for-sale investment securities at December 31, 2008 by contractual maturity are shown below. Expected maturities will differ from contractual maturities because the issuers of the securities may have the right to call or prepay obligations with or without call or prepayment penalties.

	2008	
	Amortized Cost	Estimated Fair Value
Within one year	\$ 991,619	\$ 1,012,460
Investment securities not due at a single maturity date:		
U.S. Government guaranteed mortgage-backed securities	1,791,206	1,816,372
Other	340,000	340,000
	<u>\$ 3,122,825</u>	<u>\$ 3,168,832</u>

# COMMUNITY BUSINESS BANK

## NOTES TO FINANCIAL STATEMENTS

(Continued)

### 4. LOANS

Outstanding loans are summarized below:

	December 31,	
	2008	2007
Real estate mortgage	\$ 41,178,521	\$ 31,250,899
Construction and land development	27,220,064	33,470,551
Agriculture	7,021,375	7,313,543
Other real estate	<u>10,349,614</u>	<u>9,587,464</u>
Total real estate	85,769,574	81,622,457
Commercial	34,794,271	26,381,490
Other	<u>977,462</u>	<u>470,918</u>
	121,541,307	108,474,865
Deferred loan origination fees, net	(28,678)	(25,656)
Allowance for loan losses	<u>(1,945,000)</u>	<u>(1,225,000)</u>
	<u>\$ 119,567,629</u>	<u>\$ 107,224,209</u>

Activity in the allowance for loan losses for the years ended December 31, 2008 and 2007 was as follows:

	2008	2007
Balance, beginning of year	\$ 1,225,000	\$ 1,000,000
Losses charged to the allowance	(880,912)	(71,867)
Provision for loan losses	<u>1,600,912</u>	<u>296,867</u>
Balance, end of year	<u>\$ 1,945,000</u>	<u>\$ 1,225,000</u>

Nonaccrual loans totaled \$5,736,338 and \$536,919 at December 31, 2008 and 2007, respectively. Accruing loans past due 90 days or more were \$1,272,980 at December 31, 2008. There were no accruing loans past due 90 days or more at December 31, 2007. Forgone interest on non-accrual loans was approximately \$348,000 for the year ended December 31, 2008, compared with \$14,000 for the year ended December 31, 2007. There was no interest income recognized on nonaccrual loans on a cash basis for the years ended December 31, 2008 and 2007.

At December 31, 2008 and 2007, the recorded investment in impaired loans was \$5,736,338 and \$2,318,455, respectively. The Bank had \$651,398 of specific allowance for loan losses on impaired loans of \$4,182,712 at December 31, 2008 as compared to \$146,378 of specific allowance for loan losses on impaired loans of \$1,608,128 at December 31, 2007. At December 31, 2008 and 2007, the average recorded investment in impaired loans was \$2,832,953 and \$104,776, respectively.

# COMMUNITY BUSINESS BANK

## NOTES TO FINANCIAL STATEMENTS

(Continued)

### 4. LOANS (Continued)

Salaries and employee benefits totaling \$720,896 and \$874,690 were deferred as loan origination costs for the years ended December 31, 2008 and 2007.

Certain loans have been pledged to secure borrowing arrangements (see Note 9).

### 5. FEDERAL HOME LOAN BANK STOCK

As a member of the Federal Home Loan Bank of San Francisco, the Bank is required to own capital stock in an amount specified by regulation. At December 31, 2008 and 2007, the Bank owned 5,080 and 6,447 shares, respectively, of \$100 par value FHLB stock. The stock is carried at cost and is redeemable at par with certain restrictions. The amount of stock required to be held is adjusted periodically based on a determination made by the FHLB.

### 6. PREMISES AND EQUIPMENT

Premises and equipment consisted of the following:

	<u>December 31,</u>	
	<u>2008</u>	<u>2007</u>
Leasehold improvements	\$ 1,345,979	\$ 576,304
Furniture, fixtures and equipment	1,688,946	1,394,616
Work in progress		<u>78,751</u>
	3,034,925	2,049,671
Less accumulated depreciation and amortization	<u>(1,022,938)</u>	<u>(604,790)</u>
	<u>\$ 2,011,987</u>	<u>\$ 1,444,881</u>

During October 2007, the Bank sold a building in a sale-leaseback transaction. The sale price was \$3,480,509 and resulted in a total gain on sale of \$1,322,333, of which \$299,856 was recognized immediately and \$1,022,477 was recorded as deferred revenue and is being accreted into income over the 10 year life of the lease. Amounts totaling \$90,596 and \$8,951 were recognized as an offset to rental expense for the years ended December 31, 2008 and 2007, respectively. The remaining deferred revenue totaled \$922,930 and \$1,013,526 as of December 31, 2008 and 2007, respectively,

Depreciation and amortization included in occupancy and equipment expense totaled \$424,966 and \$407,180 for the years ended December 31, 2008 and 2007, respectively.

# COMMUNITY BUSINESS BANK

## NOTES TO FINANCIAL STATEMENTS

(Continued)

### 7. INTEREST-BEARING DEPOSITS

Interest-bearing deposits consisted of the following:

	December 31,	
	2008	2007
Savings	\$ 550,721	\$ 237,577
Money market	27,155,624	23,032,505
NOW accounts	2,373,390	1,828,168
Time deposits:		
\$100,000 or more	2,463,191	9,870,691
Retail – under \$100,000	15,762,186	11,046,808
Wholesale brokered – under \$100,000	42,911,455	33,791,000
	<u>\$ 91,216,567</u>	<u>\$ 79,806,749</u>

At December 31, 2008, the Bank's retail – under \$100,000 deposits included \$12,691,756 under the Certificate of Deposit Account Registry Service (CDARS) program. The Bank did not participate in the CDARS program during 2007.

During 2008, the Bank began participating in the CDARS program. The CDARS program allows bank deposit customers to have the entire balance of their certificate of deposit account insured by the FDIC.

Aggregate annual maturities of time deposits are as follows:

Year Ending December 31,	
2009	\$ 60,684,277
2011	399,368
2012	<u>53,187</u>
	<u>\$ 61,136,832</u>

Interest expense recognized on interest-bearing deposits for the years ended December 31, 2008 and 2007 consisted of the following:

	2008	2007
Savings	\$ 6,886	\$ 6,505
Money market	670,362	1,180,396
NOW accounts	9,206	25,395
Time deposits:		
\$100,000 or more	195,777	588,264
Retail – under \$100,000	163,352	398,698
Wholesale brokered – under \$100,000	1,899,417	948,250
	<u>\$ 2,945,000</u>	<u>\$ 3,147,508</u>

# COMMUNITY BUSINESS BANK

## NOTES TO FINANCIAL STATEMENTS

(Continued)

### 7. INTEREST-BEARING DEPOSITS (Continued)

At December 31, 2008, the two largest depositors accounted for approximately \$11,400,000 in deposits, or 10% of total deposits. The loss of one of these depositors could have a material impact on the Bank's operations. However, both of these large depositors have other business relationships with the Bank and one is a related party, which management believes mitigates the risk of losing their deposits.

### 8. INCOME TAXES

Income taxes for the years ended December 31, 2008 and 2007 consisted of the following:

#### 2008

Current	\$	800
Deferred		519,000
Increase in valuation allowance		<u>(519,000)</u>
Income tax expense	\$	<u>800</u>

#### 2007

Current	\$	800
Deferred		10,000
Increase in valuation allowance		<u>(10,000)</u>
Income tax expense	\$	<u>800</u>

Deferred tax assets (liabilities) at December 31, 2008 and 2007 consisted of the following:

	<u>2008</u>	<u>2007</u>
Deferred tax assets:		
Net operating losses	\$ 1,083,000	\$ 918,000
Organization costs	68,000	74,000
Allowance for loan losses	778,000	503,000
Stock-based expense	44,000	19,000
Hiring and sales tax credits	242,000	128,000
Sale leaseback	154,000	243,000
Other	<u>17,000</u>	<u>9,000</u>
Deferred tax assets before valuation allowance	2,386,000	1,894,000
Valuation allowance	<u>(1,575,000)</u>	<u>(1,056,000)</u>
Total deferred tax assets	<u>811,000</u>	<u>838,000</u>

## COMMUNITY BUSINESS BANK

### NOTES TO FINANCIAL STATEMENTS

(Continued)

#### 8. INCOME TAXES (Continued)

	<u>2008</u>	<u>2007</u>
Deferred tax liabilities:		
Accrual to cash conversion	\$ (470,000)	\$ (704,000)
Future liability of state deferred tax asset	(235,000)	(129,000)
Bank premises and equipment	(83,000)	(5,000)
FHLB stock dividends	(23,000)	
Unrealized gain on available-for-sale investment securities	<u>(11,000)</u>	<u>(5,000)</u>
Total deferred tax liabilities	<u>(822,000)</u>	<u>(843,000)</u>
Net deferred tax assets (liabilities)	<u>\$ (11,000)</u>	<u>\$ (5,000)</u>

A valuation allowance is provided to reduce deferred tax assets to a level which, more likely than not, will be realized. Due to the losses recognized during the organizational period and since operations commenced, a valuation allowance has been recorded for substantially all of the Bank's net deferred tax assets. The need for this valuation allowance will be periodically reviewed and benefits will be recognized when they are determined to be realizable.

At December 31, 2008, the Bank had Federal and state net operating loss carryforwards (NOLs) of approximately \$2,233,000 and \$2,824,000, respectively. The Federal and state NOLs expire beginning in 2025 and 2015, respectively.

#### 9. SHORT-TERM BORROWING ARRANGEMENTS

##### Federal Reserve Bank

The Bank can borrow up to approximately \$9,961,000 at the Federal Reserve Bank (FRB) discount window. Various loans were pledged to secure FRB borrowings totaling approximately \$13,283,000 as of December 31, 2008. There were no borrowings or loans pledged to the FRB at December 31, 2007. There were \$365,000 in short-term borrowings outstanding under this arrangement at December 31, 2008.

The Bank can also borrow up to \$6,000,000 under an unsecured Federal funds line of credit with one of its correspondent banks. There were \$20,000 in Federal funds purchased under this arrangement at December 31, 2008. There were no such borrowings outstanding at December 31, 2007.

## COMMUNITY BUSINESS BANK

### NOTES TO FINANCIAL STATEMENTS

(Continued)

#### 9. SHORT-TERM BORROWING ARRANGEMENTS (Continued)

##### Federal Home Loan Bank Advances

The Bank has an arrangement with the FHLB under which it may borrow an amount not to exceed 15% of total assets. Various loans totaling approximately \$20,425,000 and the FHLB stock held by the Bank are pledged to secure FHLB borrowings as of December 31, 2008. Various loans totaling approximately \$15,112,000 were pledged to secure FHLB borrowings as of December 31, 2007. In addition, investment securities with amortized costs of \$2,782,825 and \$4,285,482 and estimated fair values of \$2,828,832 and \$4,306,104 were pledged to secure the borrowing arrangement as of December 31, 2008 and 2007, respectively. There were no borrowings outstanding at December 31, 2008 and \$5,500,000 outstanding at December 31, 2007.

#### 10. COMMITMENTS AND CONTINGENCIES

##### Operating Leases

The Bank leases its branch offices, administration office and various equipment under noncancelable operating leases. These leases expire on various dates through 2018 and have renewal options ranging from three to five years.

Future minimum lease payments are as follows:

<u>Year Ending</u> <u>December 31,</u>	
2009	\$ 523,708
2010	489,054
2011	490,398
2012	411,342
2013	332,394
Thereafter	<u>1,516,347</u>
	<u>\$ 3,763,243</u>

Rents included in occupancy and equipment expense totaled \$275,074 and \$230,129 for the years ended December 31, 2008 and 2007, 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. These financial instruments consist of commitments to extend credit and standby letters of credit. These instruments involve, to varying degrees, elements of credit and interest rate risk in excess of the amount recognized on the balance sheet. The Bank's exposure to credit loss in the event of nonperformance by the other party for commitments to extend credit and standby letters of credit is represented by the contractual amount of those instruments. The Bank uses the same credit policies in making commitments and standby letters of credit as it does for loans included on the balance sheet.



# COMMUNITY BUSINESS BANK

## NOTES TO FINANCIAL STATEMENTS

(Continued)

### 10. COMMITMENTS AND CONTINGENCIES (Continued)

#### Financial Instruments With Off-Balance-Sheet Risk (Continued)

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

	December 31,	
	2008	2007
Commitments to extend credit	\$ 28,183,223	\$ 35,568,917
Standby letters of credit	\$ 975,000	\$ 1,422,000

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. 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 and agricultural properties.

Standby letters of credit are conditional commitments issued by the Bank to guarantee the performance or financial obligation of a customer to a third party. The credit risk involved in issuing standby letters of credit is essentially the same as that involved in extending loans to customers.

The fair value of the liability related to these commitments, which represents the fees received for issuing the guarantees, was not significant at December 31, 2008 and 2007. The Bank recognizes these fees as revenue over the term of the commitment or when the commitment is used.

At December 31, 2008, commercial loan commitments represent approximately 56% of total commitments and are generally secured by accounts receivable and inventory. Real estate loan commitments represent approximately 44% of total commitments and are generally secured by property with a loan-to-value ratio not to exceed 80%. In addition, the majority of the Bank's loan commitments have variable interest rates.

#### Concentrations of Credit Risk

The Bank grants real estate mortgage, real estate construction, commercial and consumer loans to customers in San Joaquin, Yolo, Solano, Sacramento and Placer Counties. Although management continues to diversify the Bank's loan portfolio, a substantial portion of the portfolio is secured by commercial and residential real estate.

## COMMUNITY BUSINESS BANK

### NOTES TO FINANCIAL STATEMENTS

(Continued)

#### 10. COMMITMENTS AND CONTINGENCIES (Continued)

##### Concentrations of Credit Risk (Continued)

In management's judgment, a concentration of loans exists in real estate related loans with approximately 71% and 75% of the Bank's loans being real estate related at December 31, 2008 and 2007. A substantial decline in the performance of the economy in general or a continuing decline in real estate values in the Bank's primary market area, in particular, could have an adverse impact on the collectibility of these loans. Personal and business income represent the primary source of repayment for a majority of these loans.

##### 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. Those insured financial institutions have elected to participate in the FDIC sponsored Transaction Account Guarantee Program. Under that program, through December 31, 2009, all noninterest-bearing transaction accounts are fully guaranteed by the FDIC for the entire amount in the account. Coverage under the Transaction Account Guarantee Program is in addition to and separate from the coverage available under the FDIC's general deposit insurance rules. This program was not in effect in 2007 and uninsured deposits totaled \$144,709 at December 31, 2007.

# COMMUNITY BUSINESS BANK

## NOTES TO FINANCIAL STATEMENTS

(Continued)

### 11. SHARE-BASED EXPENSE

#### Stock Option Awards

A summary of option activity under the Plan for the years ended December 31, 2007 and 2008 is presented below:

<u>Options</u>	<u>Shares</u>	<u>Weighted Average Exercise Price</u>	<u>Weighted Average Remaining Contractual Term</u>
Granted and exercisable at December 31, 2006	<u>104,700</u>	<u>\$ 10.00</u>	
Granted	30,862	\$ 14.70	
Cancelled	(16,820)	\$ 10.00	
Exercised	<u>(2,900)</u>	<u>\$ 10.00</u>	
Outstanding at December 31, 2007	358,762	\$ 10.50	8.1 years
Granted	25,500	\$ 9.08	
Cancelled	<u>(28,880)</u>	<u>\$ 11.78</u>	
Outstanding at December 31, 2008	<u>355,382</u>	<u>\$ 10.29</u>	7.2 years
Exercisable at December 31, 2008	<u>302,263</u>	<u>\$ 10.14</u>	6.9 years

As of December 31, 2008, the unrecognized cost related to non-vested stock option awards totaled \$144,701. That cost is expected to be amortized on a straight-line basis over a weighted average period of 3.3 years and will be adjusted for subsequent changes in estimated forfeitures.

At December 31, 2008, there was no intrinsic value associated with outstanding stock option awards.

The following information relates to stock options granted during the years ended December 31, 2008 and 2007:

	<u>2008</u>	<u>2007</u>
Weighted average grant date fair value of options	\$ 3.42	\$ 5.46
Significant fair value assumptions:		
Expected term	7.5 years	7.5 years
Expected annual volatility	27%	20%
Risk-free interest rate	2.54% - 3.60%	4.81%
Total share-based expense (included in salaries and employee benefits and other non-interest expense)	\$ 70,769	\$ 58,564
Intrinsic value of options exercised	N/A	\$ 9,475

# COMMUNITY BUSINESS BANK

## NOTES TO FINANCIAL STATEMENTS

(Continued)

### 11. SHARE-BASED EXPENSE (Continued)

#### Restricted Common Stock Awards

In December 2007, the Bank granted 7,788 shares of restricted common stock to selected officers, which had a fair market value of \$10.00 per share on the date of grant. These restricted common stock awards vest at the end of five years of service. No restricted shares were granted or forfeited during the year ended December 31, 2008.

As of December 31, 2008, 7,788 shares of restricted stock are outstanding, nonvested and expected to vest. Compensation cost charged against income for restricted stock awards was \$16,104 for the year ended December 31, 2008 and was immaterial for the year ended December 31, 2007. The tax benefit recognized in the consolidated statement of income for restricted stock awards for the year ended December 31, 2008 was not significant. At December 31, 2008, the total compensation cost related to nonvested restricted common stock but not yet recognized was \$61,776. Restricted stock compensation expense is recognized on a straight line basis over the vesting period. This cost is expected to be recognized over a weighted average remaining period of approximately 3.9 years and will be adjusted for subsequent changes in estimated forfeitures. Restricted common stock outstanding as of December 31, 2008 had no intrinsic value.

### 12. SHAREHOLDERS' EQUITY AND REGULATORY MATTERS

#### Earnings (Loss) Per Share

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

<u>For the Year Ended</u>	<u>Net (Loss) Income</u>	<u>Weighted Average Number of Shares Outstanding</u>	<u>Per Share Amount</u>
<u>December 31, 2008</u>			
Basic and diluted loss per share	<u>\$ (956,183)</u>	<u>2,138,898</u>	<u>\$ (0.45)</u>
<u>December 31, 2007</u>			
Basic earnings per share	\$ 134,054	2,129,729	<u>\$ 0.06</u>
Effect of potentially dilutive shares		<u>73,142</u>	
Diluted earnings per share	<u>\$ 134,054</u>	<u>2,202,871</u>	<u>\$ 0.06</u>

# COMMUNITY BUSINESS BANK

## NOTES TO FINANCIAL STATEMENTS

(Continued)

### 12. SHAREHOLDERS' EQUITY AND REGULATORY MATTERS (Continued)

#### 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. At December 31, 2008, no amounts were free of such restrictions.

#### Regulatory Capital

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

Under capital adequacy guidelines, 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 and Tier 1 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 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 and Tier 1 leverage ratios as set forth in the table below. 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 their capital adequacy requirements as of December 31, 2008 and 2007.

	2008		2007	
	Amount	Ratio	Amount	Ratio
<u>Leverage Ratio</u>				
Community Business Bank	\$ 18,074,000	13.1%	\$ 18,943,000	16.0%
Minimum requirement for "Well-Capitalized" institution under the prompt corrective action provisions	\$ 6,892,000	5.0%	\$ 5,928,000	5.0%
Minimum regulatory requirement	\$ 5,514,000	4.0%	\$ 4,743,000	4.0%
Minimum leverage ratio for de novo institution	\$ 11,028,000	8.0%	\$ 9,485,000	8.0%

# COMMUNITY BUSINESS BANK

## NOTES TO FINANCIAL STATEMENTS

(Continued)

### 12. SHAREHOLDERS' EQUITY AND REGULATORY MATTERS (Continued)

#### Regulatory Capital (Continued)

	2008		2007	
	Amount	Ratio	Amount	Ratio
<u>Tier 1 Risk-Based Capital Ratio</u>				
Community Business Bank	\$ 18,074,000	13.6%	\$ 18,943,000	15.7%
Minimum requirement for "Well-Capitalized" institution under the prompt corrective action provisions	\$ 7,954,000	6.0%	\$ 7,222,000	6.0%
Minimum regulatory requirement	\$ 5,302,000	4.0%	\$ 4,815,000	4.0%
<u>Total Risk-Based Capital Ratio</u>				
Community Business Bank	\$ 19,735,000	14.9%	\$ 20,168,000	16.8%
Minimum requirement for "Well-Capitalized" institution under the prompt corrective action provisions	\$ 13,256,000	10.0%	\$ 12,037,000	10.0%
Minimum regulatory requirement	\$ 10,605,000	8.0%	\$ 9,629,000	8.0%

### 13. RELATED PARTY TRANSACTIONS

#### Loans

During the normal course of business, the Bank enters into transactions with related parties, including Directors, executive officers and affiliates. These transactions include borrowings from the Bank with substantially the same terms, including rates and collateral, as loans to unrelated parties. The following is a summary of aggregate related party borrowing arrangements at December 31, 2008:

Beginning balance	\$ 6,705,132
Disbursements	4,272,732
Amounts repaid	<u>(3,986,823)</u>
Ending balance	<u>\$ 6,991,041</u>
Undisbursed commitments	<u>\$ 1,058,987</u>

#### Deposits

At December 31, 2008, the Bank's deposits from related parties totaled approximately \$2,798,000.

## COMMUNITY BUSINESS BANK

### NOTES TO FINANCIAL STATEMENTS

(Continued)

#### 14. EMPLOYEE BENEFIT PLANS

In 2005, the Bank adopted the Community Business Bank 401(k) Profit Sharing Plan and Trust. All employees 21 years of age or older with one year of service are eligible to participate in the plan. Eligible employees may elect to make tax deferred contributions of their salary 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 vest at a rate of 20% annually for all employees. The Bank did not make contributions to the Plan during the years ended December 31, 2008 and 2007.

In 2007, the Bank entered into salary continuation agreements with certain executive officers which provide for certain benefits if the executive works until normal retirement age. In the event of early retirement, involuntary termination or full disability, the agreement provides for benefits of a lesser amount which equals the vested amount as of the month end preceding the separation from service. The liability accrued under these agreements is included in accrued interest payable and other liabilities on the balance sheet and is equal to the estimated present value of benefits to be paid under the agreements of \$160,701 and \$38,446 at December 31, 2008 and 2007, respectively.

In connection with the salary continuation agreements, the Bank invested in single premium life insurance policies with cash surrender values totaling \$1,605,573 and \$1,537,473 at December 31, 2008 and 2007, respectively. On the balance sheet, the cash surrender value of the policies is included in accrued interest receivable and other assets. Income on these policies, net of related expenses, totaled \$68,100 and \$37,473 for the years ended December 31, 2008 and 2007, respectively, and is included in other-noninterest income in the statement of operations.

#### 15. OTHER EXPENSE

Other expense for the years ended December 31, 2008 and 2007 consisted of the following:

	<u>2008</u>	<u>2007</u>
Professional fees	\$ 262,940	\$ 254,730
Advertising and marketing	53,455	113,373
Business development	143,243	146,181
Stationery and supplies	76,972	84,902
Communication and postage	117,557	124,542
Data processing	187,034	161,782
Loan related expenses	104,867	35,671
Other	<u>185,763</u>	<u>183,582</u>
	<u>\$ 1,131,831</u>	<u>\$ 1,104,763</u>

## COMMUNITY BUSINESS BANK

### NOTES TO FINANCIAL STATEMENTS

(Continued)

#### 16. SUBSEQUENT EVENT

##### Troubled Asset Relief Program (TARP)

On February 27, 2009, the Bank entered into a Letter Agreement (the "Purchase Agreement") with the United States Department of the Treasury (the "Treasury"), pursuant to which the Bank issued and sold (i) 3,976 shares of the Bank's Fixed Rate Non-cumulative Perpetual Preferred Stock, Series A (the "Series A Preferred Stock") for a purchase price of \$3,976,000 and (ii) warrants to purchase 199 shares of the Bank's Fixed Rate Non-cumulative Perpetual Preferred Stock, Series B, (the "Series B Preferred Stock") for \$.01 per share. The Treasury exercised the warrants on February 27, 2009.

The Series A Preferred Stock will qualify as Tier 1 capital and will pay non-cumulative dividends quarterly at a rate of 5% per annum for the first five years, and 9% per annum thereafter. The Series B Preferred Stock will pay non-cumulative dividends at a rate of 9% per annum until redemption. Either series may be redeemed by the Bank; however, the Series B Preferred Stock may not be redeemed until after all the Series A Preferred Stock has been redeemed.

The Series A Preferred Stock and the Series B Preferred Stock were issued in a private placement exempt from registration under the Securities Act of 1933, as amended. Neither the Series A nor the Series B Preferred Stock will be subject to any contractual restrictions on transfer, except that the Treasury and its transferees shall not effect any transfer of the Series A or Series B Preferred Stock which would require the Bank to become subject to the periodic reporting requirements of Section 13 or 15(d) of the Exchange Act.

The Series A and Series B Preferred Stock shall be non-voting, other than class voting rights on (i) any authorization or issuance of shares ranking senior to the Series A and Series B Preferred Stock, (ii) any amendment to the rights of the Series A and Series B Preferred Stock, or (iii) any merger, exchange or similar transaction which would adversely affect the rights of the Series A and Series B Preferred Stock.

If dividends on the Series A and Series B Preferred Stock are not paid in full for six dividend periods, whether or not consecutive, the holders of the Series A and Series B Preferred Stock will have the right to elect two directors. The right to elect directors will end when full dividends have been paid for four consecutive dividend periods.

In the Purchase Agreement, the Bank agreed that, until such time as the Treasury ceases to own any debt or equity securities of the Bank acquired pursuant to the Purchase Agreement, the Bank will take all necessary action to ensure that its benefit plans with respect to its senior executive officers comply with Section 111(b) of the Emergency Economic Stabilization Act of 2008 (the "EESA") as implemented by any guidance or regulation under the EESA that has been issued and is in effect as of the date of issuance of the Series A and the Series B Preferred Stock, and has agreed to not adopt any benefit plans with respect to, or which cover, its senior executive officers that do not comply with the EESA, and the applicable executives have consented to the foregoing. Furthermore, the Purchase Agreement allows the Treasury to unilaterally amend the terms of the agreement.



## COMMUNITY BUSINESS BANK

### NOTES TO FINANCIAL STATEMENTS

(Continued)

#### 16. SUBSEQUENT EVENT (Continued)

##### Troubled Asset Relief Program (TARP) (Continued)

With respect to dividends on the Bank's common stock, the Treasury's consent shall be required for any increase in common dividends per share until the third anniversary of the date of its investment, unless prior to such third anniversary the Series A and the Series B Preferred Stock are redeemed in whole or the Treasury has transferred all of the Series A and Series B Preferred Stock to third parties. After the third anniversary and prior to the tenth anniversary, the Treasury's consent shall be required for any increase in aggregate common dividends per share greater than 3% per annum; provided that no increase in common dividends may be made as a result of any dividend paid in common shares, any stock split or similar transaction. After the tenth anniversary, the Bank shall be prohibited from paying common dividends or repurchasing any equity securities or trust preferred securities until all equity securities held by the Treasury are redeemed in whole or the Treasury has transferred all of such equity securities to third parties.

Furthermore, for as long as any Series A or Series B Preferred Stock is outstanding, no dividends may be declared or paid on junior preferred shares, preferred shares ranking pari passu with the Series A or Series B Preferred Stock, or common shares (other than in the case of pari passu preferred shares, dividends on a pro rata basis with the Series A or Series B Preferred Stock), nor may the Bank repurchase or redeem any junior preferred shares, preferred shares ranking pari passu with the Series A Preferred Stock or Series B Preferred Stock, unless (i) in the case of non-cumulative Series A and the Series B Preferred Stock the full dividend for the latest completed dividend period has been declared and paid in full.

The Bank recorded a discount on the Series A Preferred Stock at approximately the liquidation preference of the Series B Preferred Stock. The discount recorded on the Series A Preferred Stock will be amortized on the level-yield method over five years.