

PRESIDIO BANK

FINANCIAL STATEMENTS

AS OF DECEMBER 31, 2009 AND 2008

AND FOR THE YEARS THEN ENDED

AND

INDEPENDENT AUDITOR'S REPORT

INDEPENDENT AUDITOR'S REPORT

The Shareholders and
Board of Directors
Presidio Bank

We have audited the accompanying balance sheet of Presidio Bank as of December 31, 2009 and 2008 and the related statements of operations, changes in shareholders' equity and comprehensive loss 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 Presidio Bank as of December 31, 2009 and 2008 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 12, 2010

PRESIDIO BANK

BALANCE SHEET

December 31, 2009 and 2008

	2009	2008
ASSETS		
Cash and due from banks	\$ 21,141,507	\$ 2,875,639
Federal funds sold		40,470,460
Total cash and cash equivalents	21,141,507	43,346,099
Available-for-sale investment securities, at fair value (Note 3)	4,014,920	
Held-to-maturity investment securities, at amortized cost (Note 3)	684,583	
Federal Reserve Bank stock, at cost	872,850	958,750
Federal Home Loan Bank stock, at cost	1,151,500	1,151,500
Loans, less allowance for loan losses of \$4,926,017 in 2009 and \$2,983,000 in 2008 (Notes 4 and 9)	213,049,599	177,035,237
Premises and equipment, net (Note 5)	999,185	944,528
Accrued interest receivable and other assets	2,267,416	1,064,967
	\$ 244,181,560	\$ 224,501,081
LIABILITIES AND SHAREHOLDERS' EQUITY		
Deposits:		
Non-interest bearing	\$ 47,317,447	\$ 29,435,381
Interest bearing (Note 6)	147,075,858	139,022,940
Total deposits	194,393,305	168,458,321
Borrowings (Note 8)	10,000,000	24,500,000
Accrued interest payable and other liabilities	1,568,361	1,295,225
Total liabilities	205,961,666	194,253,546
Commitments and contingencies (Note 9)		
Shareholders' equity (Notes 10 and 11):		
Preferred stock, no par value; 10,000,000 shares authorized:		
Series A, noncumulative, \$1,000 per share liquidation preference; 10,800 shares issued and outstanding	10,482,222	
Series B, noncumulative, \$1,000 per share liquidation preference; 325 shares issued and outstanding	325,000	
Common stock, no par value; 30,000,000 shares authorized; 4,000,000 shares issued and outstanding in 2009 and 2008	41,647,773	41,359,278
Accumulated deficit	(14,250,021)	(11,111,743)
Accumulated other comprehensive income	14,920	
Total shareholders' equity	38,219,894	30,247,535
Total liabilities and shareholders' equity	\$ 244,181,560	\$ 224,501,081

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

PRESIDIO BANK

STATEMENT OF OPERATIONS

For the Years Ended December 31, 2009 and 2008

	2009	2008
Interest and dividend income:		
Interest and fees on loans	\$ 10,146,509	\$ 8,162,996
Interest on Federal Funds sold	32,975	450,468
Interest on due from banks and interest-bearing deposits in other financial institutions	26,737	238,761
Interest on investment securities	33,329	336,571
Dividend income	57,185	74,082
Total interest and dividend income	10,296,735	9,262,878
Interest expense:		
Interest on deposits	1,527,505	2,721,322
Interest on borrowings	331,970	158,799
Total interest expense	1,859,475	2,880,121
Net interest income	8,437,260	6,382,757
Provision for loan losses (Note 4)	1,950,894	1,915,000
Net interest income after provision for loan losses	6,486,366	4,467,757
Non-interest income:		
Service charges and fees	181,805	59,491
Other non-interest income	38,926	186,573
Total non-interest income	220,731	264,064
Non-interest expense:		
Salaries and employee benefits (Notes 4 and 13)	6,299,120	6,109,861
Occupancy and equipment (Notes 5 and 9)	946,706	974,078
Other	2,592,327	2,107,776
Total non-interest expense	9,838,153	9,191,715
Net loss	\$ (3,131,056)	\$ (4,477,894)
Basic loss per share	\$ (0.78)	\$ (1.12)
Weighted average number of shares outstanding	4,000,000	4,000,000

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

PRESIDIO BANK

STATEMENT OF CHANGES IN SHAREHOLDERS' EQUITY AND COMPREHENSIVE LOSS

For the Years Ended December 31, 2009 and 2008

	<u>Preferred Stock – Series A</u>		<u>Preferred Stock – Series B</u>		<u>Common Stock</u>		<u>Accumulated Deficit</u>	<u>Accumulated Other Comprehensive Income</u>	<u>Total Shareholders' Equity</u>	<u>Comprehensive Loss</u>
	<u>Shares</u>	<u>Amount</u>	<u>Shares</u>	<u>Amount</u>	<u>Shares</u>	<u>Amount</u>				
Balance, January 1, 2008					4,000,000	\$ 40,922,145	\$ (6,633,849)		\$ 34,288,296	
Share-based compensation expense						437,133			(437,133)	
Comprehensive loss and net loss							(4,477,894)		(4,477,894)	\$ (4,477,894)
Balance, December 31, 2008					4,000,000	41,359,278	(11,111,743)		30,247,535	
Issuance of Series A Preferred stock, net of discount	10,800	\$ 10,475,000							10,475,000	
Issuance of Series B Preferred stock			325	\$ 325,000					325,000	
Amortization of discount on Series A Preferred stock		7,222					(7,222)			
Share-based compensation expense						288,495			288,495	
Comprehensive loss:										
Net loss							(3,131,056)		(3,131,056)	\$ (3,131,056)
Net change in unrealized gains on available-for-sale investment securities								\$ 14,920	14,920	14,920
										\$ (3,116,136)
Balance, December 31, 2009	<u>10,800</u>	<u>\$ 10,482,222</u>	<u>325</u>	<u>\$ 325,000</u>	<u>4,000,000</u>	<u>\$ 41,647,773</u>	<u>\$ (14,250,021)</u>	<u>\$ 14,920</u>	<u>\$ 38,219,894</u>	

The accompanying notes are an integral part of these financial statements

PRESIDIO BANK

STATEMENT OF CASH FLOWS

For the Years Ended December 31, 2009 and 2008

	2009	2008
Cash flows from operating activities:		
Net loss	\$ (3,131,056)	\$ (4,477,894)
Adjustments to reconcile net loss to net cash used in operating activities:		
Provision for loan losses	1,950,894	1,915,000
Accretion of discounts on investment securities		336,571
Depreciation and amortization	284,670	248,381
Deferred loan origination fees, net	65,217	76,608
Share-based compensation expense	288,495	437,133
Increase in accrued interest receivable and other assets	(1,202,449)	(355,930)
Increase in accrued interest payable and other liabilities	<u>273,136</u>	<u>574,379</u>
Net cash used in operating activities	<u>(1,471,093)</u>	<u>(1,245,752)</u>
Cash flows from investing activities:		
Purchase of available-for-sale investment securities	(4,000,000)	
(Purchases) maturities of held-to-maturity investment securities	(684,583)	29,561,521
Redemption of Federal Reserve Bank stock	85,900	90,450
Purchases of FHLB stock		(1,106,400)
Net increase in loans	(38,030,473)	(105,284,249)
Maturities of interest-bearing deposits in other financial institutions		5,000,000
Purchases of premises and equipment	<u>(339,327)</u>	<u>(423,825)</u>
Net cash used in investing activities	<u>(42,968,483)</u>	<u>(72,162,503)</u>
Cash flows from financing activities:		
Net increase in demand, interest-bearing and savings deposits	28,704,374	50,710,277
Net (decrease) increase in time deposits	(2,769,390)	21,842,344
Issuance of preferred stock	10,800,000	
(Repayments of) proceeds from FHLB advances	<u>(14,500,000)</u>	<u>24,500,000</u>
Net cash provided by financing activities	<u>22,234,984</u>	<u>97,052,621</u>
(Decrease) increase in cash and cash equivalents	(22,204,592)	23,644,366
Cash and cash equivalents at beginning of year	<u>43,346,099</u>	<u>19,701,733</u>
Cash and cash equivalents at end of year	<u>\$ 21,141,507</u>	<u>\$ 43,346,099</u>
Supplemental disclosure of cash flow information:		
Cash paid for interest expense	\$ 1,885,794	\$ 2,553,998

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

PRESIDIO BANK

NOTES TO FINANCIAL STATEMENTS

(Continued)

1. THE BUSINESS OF PRESIDIO BANK

Presidio Bank (the "Bank") was approved as state-chartered bank on July 24, 2006 and is a member of the Federal Reserve System (the "Fed"). The Bank is subject to regulation by the Fed, the California Department of Financial Institutions (the "DFI"), and the Federal Deposit Insurance Corporation (the "FDIC"). The Bank's deposits are insured by the FDIC up to applicable legal limits.

The Bank is participating in the FDIC's Transaction Account Guarantee Program. Under this program, through June 30, 2010, 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.

The Bank is headquartered in San Francisco, California and has branch offices in Walnut Creek, San Rafael and Santa Rosa, California. The Bank intends to open a branch in Palo Alto, California during the first quarter of 2010. The Bank provides traditional commercial banking services to its target market throughout Northern California, consisting of small to medium sized businesses, along with the owners and executives of those firms.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

General

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.

Subsequent Events

Management has reviewed all events occurring from December 31, 2009 through March 12, 2010, the date the financial statements were available to be issued and no events occurred during this period requiring accrual or disclosure.

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

For the purpose of the statement of cash flows, cash and cash equivalents consist of cash and due from banks and Federal funds sold. Generally, Federal funds are sold for one day periods.

PRESIDIO BANK

NOTES TO FINANCIAL STATEMENTS

(Continued)

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Federal Reserve Bank Stock and Federal Home Loan Bank Stock

As a member of both the Federal Reserve Bank (the "FRB") and the Federal Home Loan Bank (the "FHLB"), the Bank is required to maintain a minimum level of investment in the capital stocks of the FRB and FHLB. These investments are considered restricted equity securities and are carried at par value. The Bank may request redemption at par value in excess of the amount required to be held. Stock redemptions are made at the discretion of the FRB and FHLB.

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 and may only change the classification in certain limited circumstances. All transfers between categories are accounted for at fair value. There were no transfers between categories during the years ended December 31, 2009 or 2008.

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

Investment securities are periodically evaluated for impairment and more frequently when economic or market conditions warrant such an evaluation to determine whether a decline in their value is other than temporary. An investment security is impaired if its estimated fair value is less than its amortized cost. 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 the Bank does not intend to sell the security and 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 recovery of its amortized cost, the entire impairment loss is recognized as a charge to earnings. There was no such impairment for the years ended December 31, 2009 and 2008.

PRESIDIO BANK

NOTES TO FINANCIAL STATEMENTS

(Continued)

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Loans

Loans are stated at principal balances outstanding. Interest is accrued daily based upon outstanding loan balances. However, when in the opinion of management, loans are considered to be impaired and the future collectibility of interest and principal is in serious doubt, loans are placed on nonaccrual status and the accrual of interest income is suspended. Any interest accrued but unpaid is charged against income. Payments received are applied to reduce principal to the extent necessary to ensure collection. Subsequent payments on these loans, or payments received on nonaccrual loans for which the ultimate collectibility of principal is not in doubt, are applied first to earned but unpaid interest and then to principal.

A loan is considered impaired when, based on current information and events, it is probable that the Bank will be unable to collect all amounts due (including both principal and interest) in accordance with the contractual terms of the loan agreement. An impaired loan is measured based on the present value of expected future cash flows discounted at the loan's effective 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 and commitment fees, net of 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 to other financial institutions totaling approximately \$18,622,000 and \$21,665,000 at December 31, 2009 and 2008, respectively.

Allowance for Loan Losses

The allowance for loan losses 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 (net of recoveries) and loan growth.

The allowance is maintained to provide for losses related to impaired loans and other losses that are inherent in the Bank's loan portfolio. 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. In addition, regulatory agencies, as an integral part of their examination process, periodically review the Bank's allowance for loan losses, and may require the Bank to make additions to the allowance based on their judgment about information available to them at the time of their examinations. These estimates are particularly susceptible to changes in the economic environment and market conditions.

PRESIDIO BANK

NOTES TO FINANCIAL STATEMENTS

(Continued)

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Allowance for Loan Losses (Continued)

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 (3) where the Bank has not experienced losses, the loss experience of peer banks.

The Bank maintains a separate allowance for losses related to undisbursed loan commitments. Management estimates the amount of probable losses by applying a loss factor to the available portion of undisbursed lines of credit. This allowance of \$427,000 and \$87,000 at December 31, 2009 and 2008, respectively, is included in accrued interest payable and other liabilities on the balance sheet.

The allowance for loan losses at December 31, 2009 and 2008 reflects management's estimate of probable losses in the portfolio. The Bank's Directors' Loan Committee reviews the adequacy of the allowance for loan losses quarterly, including its reviews at December 31, 2009 and 2008. In the future, the Directors' Loan Committee will continue to review the adequacy of the allowance for loan losses at least quarterly. The allowance will be adjusted based on that review if, in the judgment of the Directors' Loan Committee and management, changes are warranted.

Bank Premises and Equipment

Bank premises and equipment are carried at cost. Depreciation is determined using the straight-line method over the estimated useful lives of the related assets. The useful lives of furniture, fixtures and equipment are estimated to be 3 to 7 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 10 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 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.

PRESIDIO BANK

NOTES TO FINANCIAL STATEMENTS

(Continued)

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

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.

At December 31, 2009 and 2008, the Bank did not have a reserve for uncertain tax positions. The Bank uses a comprehensive model for recognizing, measuring, presenting and disclosing in the financial statements tax positions taken or expected to be taken on a tax return. A tax position is recognized as a benefit only if it is "more likely than not" that the tax position would be sustained in a tax examination, with a tax examination being presumed to occur. The amount recognized is the largest amount of tax benefit that is greater than 50% likely of being realized on examination. For tax positions not meeting the "more likely than not" test, no tax benefit is recorded. Interest expense and penalties associated with unrecognized tax benefits, if any, are classified as income tax expense in the statement of operations. The Bank has not accrued for any interest or penalties as of December 31, 2009 or December 31, 2008 because it does not have any unrecognized tax benefits.

Earnings (Loss) Per Share

Basic earnings or loss per share, which excludes dilution, is computed by dividing net income or loss 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 in computing diluted earnings per share. However, diluted earnings per share is not presented when a net loss occurs because the conversion of potential common stock is anti-dilutive.

PRESIDIO BANK

NOTES TO FINANCIAL STATEMENTS

(Continued)

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Share-Based Compensation

The Bank has one share-based compensation plan, the Presidio Bank 2006 Stock Option Plan (the "Plan"), which has been approved by its shareholders and permits the grant of stock options and restricted stock for up to 1,200,000 shares of the Bank's common stock, of which 174,840 shares were available for future grant at December 31, 2009. 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 of stock options and vesting of restricted stock. 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. The Bank has issued three types of stock option awards under the plan: Organizer Options, which were granted to founders and organizers and were fully vested upon the granting of the award; Service-Based Options, which are granted to employees and Directors and that will generally vest over a five year period; and Performance-Based Options, which are granted to employees and Directors and will vest only if the Bank meets or exceeds certain pre-determined financial goals and objectives. The Bank has not granted any restricted stock awards.

The Bank accounts for share-based compensation using a fair-value based method that requires that share-based compensation expense be recorded for all stock options and restricted stock that are ultimately expected to vest as the requisite service is rendered.

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 the Bank's options due to the lack of sufficient historical data. 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 because 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. Management uses a simplified method to determine the expected term of our stock options due to the lack of sufficient historical data.

The fair value of restricted stock awards is determined using the fair value of the underlying shares on the date of the grant.

PRESIDIO BANK

NOTES TO FINANCIAL STATEMENTS

(Continued)

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Adoption of New Financial Accounting Standards

FASB Accounting Standards Codification™ (ASC or Codification)

In June 2009, the Financial Accounting Standards Board (FASB) issued new accounting standards ASC 105-10 (previously SFAS No. 168), *The FASB Accounting Standards Codification™ and the Hierarchy of Generally Accepted Accounting Principles*. With the issuance of ASC 105-10, the FASB Accounting Standards Codification ("the Codification" or "ASC") becomes the single source of authoritative U.S. accounting and reporting standards applicable for all nongovernmental entities. This change is effective for financial statements issued for interim or annual periods ended after September 15, 2009. Accordingly, all specific references to generally accepted accounting principles (GAAP) refer to the Codification and not to the pre-Codification literature.

FASB Clarifies Other-Than-Temporary Impairment

In April 2009, the FASB issued ASC No. 320-10-35 (previously FSP 115-2 and 124-2 and EITF 99-20-2), *Recognition and Presentation of Other-Than-Temporary-Impairment*. This standard (i) changes previously existing guidance for determining whether an impairment to debt securities is other than temporary and (ii) replaces the previously existing requirement that the entity's management assert it has both the intent and ability to hold an impaired security until recovery with a requirement that management assert: (a) it does not have the intent to sell the security; and (b) it is more likely than not it will not have to sell the security before recovery of its cost basis. Under this standard, declines in fair value below cost that are deemed to be other than temporary are reflected in earnings as realized losses to the extent the impairment is related to credit losses for both held-to-maturity and available-for-sale securities. The amount of impairment related to other factors is recognized in other comprehensive income. These changes were effective for interim and annual periods ended after June 15, 2009. The Bank adopted the provisions of this standard on April 1, 2009 and they did not have a material impact on its financial condition or results of operations.

FASB Clarifies Application of Fair Value Accounting

In April 2009, the FASB issued ASC 820-10 (previously FSP FAS 157-4), *Determining Fair Value When the Volume and Level of Activity for the Asset or Liability Have Significantly Decreased and Identifying Transactions That Are Not Orderly*. This standard affirms the objective of fair value when a market is not active, clarifies and includes additional factors for determining whether there has been a significant decrease in market activity, eliminates the presumption that all transactions are distressed unless proven otherwise, and requires an entity to disclose a change in valuation technique. This standard was effective for interim and annual periods ended after June 15, 2009. The Bank adopted the provisions of this standard on April 1, 2009 and they did not have a material impact on its financial condition or results of operations.

PRESIDIO BANK

NOTES TO FINANCIAL STATEMENTS

(Continued)

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Adoption of New Financial Accounting Standards (Continued)

Subsequent Events

In May 2009, the FASB issued ASC 855-10 (previously SFAS No. 165), *Subsequent Events*, which establishes general standards of accounting for and disclosure of events that occur after the balance sheet date but before financial statements are issued or are available to be issued. The adoption of this standard on July 1, 2009 required the Bank to disclose the date through which management evaluated subsequent events and had no effect on the Bank's financial position or results of operations.

Impact of New Financial Accounting Standards

Accounting for Transfers of Financial Assets

In June 2009, the FASB issued ASC Topic 860 (previously SFAS No. 166), *Accounting for Transfers of Financial Assets, an amendment of SFAS No. 140*. This standard amends the derecognition accounting and disclosure guidance included in previously issued standards. This standard eliminates the exemption from consolidation for qualifying special-purpose entities (SPEs) and also requires a transferor to evaluate all existing qualifying SPEs to determine whether they must be consolidated in accordance with ASC Topic 810. This standard also provides more stringent requirements for derecognition of a portion of a financial asset and establishes new conditions for reporting the transfer of a portion of a financial asset as a sale. This standard is effective as of the beginning of the first annual reporting period that begins after November 15, 2009. Management is assessing the impact this standard may have on the Bank's financial condition and results of operations.

Transfers and Servicing

In December 2009, the FASB issued Accounting Standards Update (ASU) No. 2009-16, *Transfers and Servicing (ASC Topic 860): Accounting for Transfers of Financial Assets*, which updates the derecognition guidance in ASC Topic 860 for previously issued SFAS No. 166. This update reflects the Board's response to issues entities have encountered when applying ASC 860, including: (1) requires that all arrangements made in connection with a transfer of financial assets be considered in the derecognition analysis, (2) clarifies when a transferred asset is considered legally isolated from the transferor, (3) modifies the requirements related to a transferee's ability to freely pledge or exchange transferred financial assets, and (4) provides guidance on when a portion of a financial asset can be derecognized. This update is effective for financial asset transfers occurring after the beginning of an entity's first fiscal year that begins after November 15, 2009. Early adoption is prohibited. Management is assessing the impact of this standard may have on the Bank's financial condition and results of operations.

PRESIDIO BANK

NOTES TO FINANCIAL STATEMENTS

(Continued)

3. INVESTMENT SECURITIES

Investment Securities Available-for-Sale

The amortized cost and estimated fair value of available-for-sale investment securities at December 31, 2009 consisted of the following:

	2009			
Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value	
Debt securities:				
Agency securities	\$ 4,000,000	\$ 14,920	\$ -	\$ 4,014,920

Net unrealized holding gains on available-for-sale investment securities totaling \$14,920 were recorded as other comprehensive income within shareholders' equity for the year ended December 31, 2009. There were no sales, calls or transfers of available for sale investment securities for the years ended December 31, 2009 and 2008. Available-for-sale investment securities mature in 2010.

Investment Securities Held-to-Maturity

The amortized cost and estimated fair value of held-to-maturity investment securities at December 31, 2009 consisted of the following:

	2009			
Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value	
Debt securities:				
Mortgage-backed securities	\$ 684,583	\$ -	\$ -	\$ 684,583

Held-to-maturity investment securities are recorded at amortized cost, adjusted for the amortization of premiums or accretion of discounts. There were no sales, calls or transfers of held-to-maturity investment securities for the years ended December 31, 2009 and 2008. Held-to-maturity investment securities mature in 2015.

The Bank held no investment securities at December 31, 2008.

PRESIDIO BANK

NOTES TO FINANCIAL STATEMENTS

(Continued)

4. LOANS

Outstanding loans are summarized below:

	<u>December 31,</u>	
	<u>2009</u>	<u>2008</u>
Commercial real estate	\$ 96,864,631	\$ 77,200,884
Construction and land development	18,969,184	15,552,199
Commercial	68,239,975	59,723,968
Consumer and other	<u>34,248,520</u>	<u>27,822,663</u>
	218,322,310	180,299,714
Deferred loan origination fees, net	(346,694)	(281,477)
Allowance for loan losses	<u>(4,926,017)</u>	<u>(2,983,000)</u>
	<u>\$ 213,049,599</u>	<u>\$ 177,035,237</u>

During the years ended December 31, 2009 and 2008, the Bank recognized a provision for loan losses of \$1,950,894 and \$1,915,000, respectively. During the year ended December 31, 2009 losses totaling \$7,877 were charged to the allowance for loan losses. There were no losses charged to the allowance for loan losses during the year ended December 31, 2008.

Nonaccrual loans totaled \$480,726 at December 31, 2009. There were no nonaccrual loans at December 31, 2008. There were no accruing loans past due 90 days or more at December 31, 2009 or 2008. Interest forgone on nonaccrual loans totaled \$9,729 for the year ended December 31, 2009. There was no interest forgone on nonaccrual loans for the year ended December 31, 2008.

At December 31, 2009 the recorded investment impaired loans and specific allowance for loan losses on impaired loans were \$480,726 and \$270,000, respectively. The average recorded investment in impaired loans for the year ended December 31, 2009 was \$128,999, and there was no interest income recognized on a cash basis. There were no impaired loans for the year ended December 31, 2008.

Salaries and employee benefits totaling \$70,940 and \$209,894 were deferred as loan origination costs for the years ended December 31, 2009 and 2008, respectively.

PRESIDIO BANK

NOTES TO FINANCIAL STATEMENTS

(Continued)

5. PREMISES AND EQUIPMENT

Premises and equipment consisted of the following:

	December 31,	
	2009	2008
Furniture, fixtures and equipment	\$ 1,387,203	\$ 1,071,444
Leasehold improvements	414,461	390,893
	1,801,664	1,462,337
Less accumulated depreciation and amortization	(802,479)	(517,809)
	\$ 999,185	\$ 944,528

Depreciation and amortization included in occupancy and equipment expense totaled \$284,670 and \$248,381 for the years ended December 31, 2009 and 2008.

6. INTEREST-BEARING DEPOSITS

Interest-bearing deposits consisted of the following:

	December 31,	
	2009	2008
Savings	\$ 217,075	\$ 245,034
Money market	91,834,474	88,890,845
Interest-bearing demand accounts	27,333,416	19,426,778
Time, \$100,000 or more	26,309,486	24,561,937
Other time	1,381,407	5,898,346
	\$ 147,075,858	\$ 139,022,940

Aggregate annual maturities of time deposits are as follows:

Year Ending <u>December 31,</u>	
2010	\$ 26,215,241
2011	799,892
2012	122,802
2013	442,958
2014	110,000
	\$ 27,690,893

PRESIDIO BANK

NOTES TO FINANCIAL STATEMENTS

(Continued)

6. INTEREST-BEARING DEPOSITS (Continued)

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

	December 31,	
	2009	2008
Savings	\$ 783	\$ 5,763
Money market	702,458	1,876,122
Interest-bearing demand accounts	284,747	289,503
Time, \$100,000 or more	500,640	298,911
Other time	38,877	251,023
	\$ 1,527,505	\$ 2,721,322

Deposits totaling approximately \$56,893,855, or 29% of total deposits, were from five major depositors at December 31, 2009. The loss of these deposit relationships could have a material impact on the bank's operations and liquidity. Management attempts to mitigate this risk by working directly with these depositors and by maintaining sufficient liquidity to manage fluctuations in account balances within these larger relationships.

7. INCOME TAXES

Income taxes for the years ended December 31, 2009 and 2008 consisted of the following:

	Federal	State	Total
<u>2009</u>			
Deferred	\$ (815,000)	\$ (291,000)	\$ (1,106,000)
Valuation allowance	815,000	291,000	1,106,000
Income tax expense	\$ -	\$ -	\$ -
<u>2008</u>			
Deferred	\$ (1,245,000)	\$ (445,000)	\$ (1,690,000)
Valuation allowance	1,245,000	445,000	1,690,000
Income tax expense	\$ -	\$ -	\$ -

The Bank's income tax expense differed from the amount computed by applying the Federal statutory rate of 34% for 2009 and 2008 to the loss before income taxes primarily as a result of the imposition of the valuation allowance against the Bank's deferred tax assets.

PRESIDIO BANK

NOTES TO FINANCIAL STATEMENTS

(Continued)

7. INCOME TAXES (Continued)

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

	2009	2008
Deferred tax assets:		
Net operating losses	\$ 2,673,000	\$ 2,366,000
Organization costs	448,000	487,000
Allowance for loan losses	2,134,000	1,191,000
Share-based compensation	101,000	168,000
Accrued expenses	77,000	
Other	33,000	20,000
Deferred tax assets before valuation allowance	5,466,000	4,232,000
Valuation allowance	(5,189,000)	(4,089,000)
Total deferred tax assets	277,000	143,000
Deferred tax liabilities:		
Depreciation and amortization	(59,000)	(60,000)
FHLB stock dividends	(6,000)	(62,000)
Prepaid expenses	(20,000)	
Unrealized gain on available-for-sale securities	(6,000)	
Deferred loan costs	(186,000)	
Accrual to cash adjustment		(21,000)
Total deferred tax liabilities	(277,000)	(143,000)
Net deferred tax assets	\$ -	\$ -

The determination of the amount of deferred income tax assets which are more likely than not to be realized is primarily dependent on projections of future earnings, which are subject to uncertainty and estimates that may change given economic conditions and other factors. The realization of deferred income tax assets is assessed and a valuation allowance is recorded if it is "more likely than not" that all or a portion of the deferred tax asset will not be realized. "More likely than not" is defined as greater than a 50% chance. All available evidence, both positive and negative is considered to determine whether, based on the weight of that evidence, a valuation allowance is needed. Based upon management's analysis of available evidence, it is "more likely than not" that none of the Bank's deferred income tax assets as of December 31, 2009 and 2008 will be fully realized and therefore a full valuation allowance was recorded.

At December 31, 2009, the Bank had Federal net operating loss carryforwards (NOLs) of approximately \$6,527,000 and State NOLs of approximately \$6,348,000. The Federal NOLs begin to expire in 2026 and the State NOLs begin to expire in 2016. The Bank's tax returns filed since inception continue to be open to examination by both federal and California tax authorities.

PRESIDIO BANK

NOTES TO FINANCIAL STATEMENTS

(Continued)

8. BORROWING ARRANGEMENTS

Lines of Credit

The Bank has unsecured Federal funds lines of credit with two of its correspondent banks under which it can borrow up to an aggregate of \$10,000,000. There were no borrowings outstanding under these arrangements at December 31, 2009 or 2008.

FHLB Advances

The Bank has a borrowing arrangement with FHLB under which short-term and long term advances are secured by the Bank's loan portfolio. The Bank's credit limit varies according to the amount and composition of loans pledged as collateral. At December 31, 2009, the amounts pledged and borrowing capacity under such limits were approximately \$76,698,000 and \$36,583,000, respectively. At December 31, 2008, the amounts pledged and borrowing capacity under such limits were approximately \$68,000,000 and \$28,000,000, respectively.

At December 31, 2009, borrowings outstanding under these arrangements were as follows:

<u>Interest Rate</u>	<u>Maturity Date</u>	<u>Advance Amount</u>
3.15%	September 10, 2010	\$ 4,000,000
3.62%	October 31, 2011	3,000,000
0.06%	January 4, 2010	<u>3,000,000</u>
		<u>\$ 10,000,000</u>

At December 31, 2008, borrowings outstanding under these arrangements were as follows:

<u>Interest Rate</u>	<u>Maturity Date</u>	<u>Advance Amount</u>
0.05%	January 2, 2009	\$ 7,500,000
0.68%	January 6, 2009	5,000,000
3.02%	August 21, 2009	5,000,000
3.15%	September 10, 2010	4,000,000
3.62%	October 31, 2011	<u>3,000,000</u>
		<u>\$ 24,500,000</u>

PRESIDIO BANK

NOTES TO FINANCIAL STATEMENTS

(Continued)

8. BORROWING ARRANGEMENTS (Continued)

FDIC Temporary Liquidity Guarantee Programs

The Bank is eligible to issue certain debt that is backed by the full faith and credit of the United States government, up to a limit of \$3,433,000, under the Federal Deposit Insurance Corporation's Temporary Liquidity Guarantee Program, expiring on June 30, 2010. Any senior unsecured debt with a stated maturity of more than thirty days issued by the Bank up to its debt guarantee limit falls under this program. The Bank will be charged an annualized assessment from the FDIC, ranging from 50 to 100 basis points, based on the term and amount of the debt outstanding under the program. At December 31, 2009 and 2008, the Bank had no borrowings under this debt guarantee program.

9. COMMITMENTS AND CONTINGENCIES

Operating Leases

The Bank leases its San Francisco headquarters and Walnut Creek, San Rafael and Santa Rosa branch offices under non-cancelable operating leases. The leases expire on June 1, 2016, May 1, 2011, March 1, 2013 and February 28, 2010, respectively. On March 1, 2010, the Bank entered into an agreement to extend the Santa Rosa lease for six months. The leases include annual rent adjustments of approximately 2.6%, 1.6%, 3% and 3%, respectively, each year during the initial lease terms. The San Francisco lease has two five year renewal options, the Walnut Creek, San Rafael and Santa Rosa leases each have one five year renewal option. On October 5, 2009 the Bank signed a lease for a Palo Alto office. The lease commenced on February 1, 2010 and expires on January 31, 2020. The lease includes annual rent adjustments of 3% each year during the lease term. The lease has one five year renewal option.

Approximate future minimum lease payments are as follows:

<u>Year Ending December 31,</u>	<u>Operating Leases</u>
2010	\$ 731,546
2011	781,996
2012	761,844
2013	673,224
2014	668,821
Thereafter	<u>2,262,454</u>
	<u>\$ 5,879,885</u>

Rental expense included in occupancy and equipment expense totaled \$612,997 and \$629,228 for years ended December 31, 2009 and 2008, respectively.

PRESIDIO BANK

NOTES TO FINANCIAL STATEMENTS

(Continued)

9. COMMITMENTS AND CONTINGENCIES (Continued)

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 the following:

	<u>December 31,</u>	
	<u>2009</u>	<u>2008</u>
Commitments to extend credit	\$ 72,560,000	\$ 61,438,000
Standby letters of credit	\$ 2,334,000	\$ 1,294,000

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.

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, 2009. The Bank recognizes these fees as revenue over the term of the commitment or when the commitment is used.

PRESIDIO BANK

NOTES TO FINANCIAL STATEMENTS

(Continued)

9. COMMITMENTS AND CONTINGENCIES (Continued)

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

Commercial loan commitments represent approximately 64.65% of total commitments and are generally unsecured or secured by collateral other than real estate and have variable interest rates. Consumer loan commitments represent approximately 11.33% of total commitments and are generally unsecured or secured by collateral other than real estate and have variable interest rates. Real estate loan commitments represent approximately 6.83% of total commitments and are generally secured by property with a loan-to-value ratio not to exceed 75%. The majority of real estate commitments also have variable interest rates. Letters of credit represent 3.12% of total commitments. Home equity lines of credit represent the remaining 14.08% of total commitments and are generally secured by residential real estate and have both variable and fixed interest rates.

Concentrations of Credit Risk

The Bank grants real estate mortgage, real estate construction and commercial loans to customers in San Francisco and surrounding counties. A substantial portion of its portfolio is secured by commercial and residential real estate at December 31, 2009 and 2008.

In management's judgment, a concentration of loans exists in real estate related loans with approximately 64% of the Bank's loans being real estate related. Although management believes the loans within this concentration have no more than the normal risk of collectibility, a substantial decline in the performance of the economy in general or a decline in real estate values in the Bank's primary market area, in particular, could have an adverse impact on the collectibility of these loans. Personal and business income represent the primary source of repayment for a majority of these loans.

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.

PRESIDIO BANK

NOTES TO FINANCIAL STATEMENTS

(Continued)

10. SHARE-BASED PAYMENTS

Stock Option Awards

Stock option activity for the year ended December 31, 2009 is summarized as follows:

	<u>Number of Stock Options Outstanding</u>	<u>Weighted Average Exercise Prices</u>	<u>Weighted Average Remaining Contractual Life</u>
Granted and outstanding at January 1, 2008	1,019,250	\$ 9.99	
Granted	142,250	\$ 9.54	
Cancelled or expired	<u>(192,040)</u>	\$ 9.90	
Outstanding at December 31, 2008	969,460	\$ 9.94	7.9 years
Granted	61,000	\$ 10.00	
Cancelled or expired	<u>(5,300)</u>	\$ 9.46	
Outstanding at December 31, 2009	<u>1,025,160</u>	\$ 9.95	<u>7.2 years</u>
Exercisable at December 31, 2009	<u>521,080</u>	\$ 9.99	<u>6.7 years</u>
Additional Options expected to vest	<u>325,608</u>	\$ 9.89	<u>7.5 years</u>

There was no intrinsic value of stock options outstanding, exercisable or expected to vest at December 31, 2009.

The weighted average exercise price and weighted average remaining contractual term of these awards was as follows at December 31, 2009:

	<u>Shares</u>	<u>Weighted Average Exercise Price</u>	<u>Weighted Average Remaining Contractual Term</u>
Organizer Options	200,000	\$ 10.00	6.5 years
Service-Based Options	667,160	\$ 9.94	7.3 years
Performance-Based Options	158,000	\$ 9.93	7.3 years

PRESIDIO BANK

NOTES TO FINANCIAL STATEMENTS

(Continued)

10. SHARE-BASED PAYMENTS (Continued)

Stock Option Awards (Continued)

The unrecognized compensation cost related to non-vested Service-Based Options totaled \$264,929 as of December 31, 2009. That cost is expected to be amortized on an accelerated basis over a weighted average period of 3.1 years and will be adjusted for subsequent changes in estimated forfeitures. The unrecognized compensation cost related to non-vested Performance-Based Options totaled approximately \$400,000 as of December 31, 2009. That cost will be amortized for awards that are expected to vest when and if it becomes probable that the performance measures will be achieved. These performance measures are principally related to asset and deposit size and return on average assets for the twelve months ended June 30, 2011. In management's opinion, it is not probable at the present time that the Bank will achieve these targets by June 30, 2011 and, therefore, no compensation expense has been recorded for the Performance-Based Options for the years ended December 31, 2009 and 2008.

The following stock option information for service-based options is for the years ended December 31, 2009 and 2008:

	<u>2009</u>	<u>2008</u>
Weighted average grant date fair value per share of options granted	\$0.76	\$1.19
Significant fair value assumptions:		
Expected term in years	6.5 years	6.5 years
Expected annual volatility	23.99%	19.60%
Expected annual dividend yield	0%	0%
Risk-free interest rate	3.1%	3.7%
Total compensation cost (included in operating expenses)	\$288,495	\$437,133

11. SHAREHOLDERS' EQUITY

Preferred Stock

On November 20, 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) 10,800 shares of Fixed Rate Non-cumulative Perpetual Preferred Stock, Series A (the "Series A Preferred Stock") for a purchase price of \$10,800,000 and (ii) a warrant to purchase 325 shares of Fixed Rate Non-cumulative Perpetual Preferred Stock, Series B stock, (the "Warrant Preferred") for \$.01 per share for an aggregate exercise price of \$3.25. The Treasury exercised the warrant immediately upon issuance.

PRESIDIO BANK

NOTES TO FINANCIAL STATEMENTS

(Continued)

11. SHAREHOLDERS' EQUITY (Continued)

Preferred Stock (Continued)

The Series A Preferred Stock qualifies as Tier 1 capital and pays non-cumulative dividends quarterly at a rate of 5% per annum for the first five years, and 9% per annum thereafter. The Warrant Preferred pays non-cumulative dividends at a rate of 9% per annum until redemption. Either series may be redeemed by the Bank after three years; however, the Warrant Preferred may not be redeemed until after all the Series A Preferred Stock has been redeemed. Prior to the end of three years, the Series A Preferred Stock and the Warrant Preferred may be redeemed by the Bank only with proceeds from the sale of qualifying equity securities (a "Qualified Equity Offering").

The Series A Preferred Stock and the Warrant Preferred were issued in a private placement exempt from registration pursuant to Section 4(2) of the Securities Act of 1933, as amended. Neither the Series A Preferred Stock nor the Warrant Preferred 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 Preferred and Warrant Preferred shall be non-voting, other than class voting rights on (i) any authorization or issuance of shares ranking senior to the Series A Preferred and Warrant Preferred, (ii) any amendment to the rights of the Series A Preferred and Warrant Preferred, or (iii) any merger, exchange or similar transaction which would adversely affect the rights of the Series A Preferred and Warrant Preferred.

If dividends on the Series A Preferred and Warrant Preferred are not paid in full for six dividend periods, whether or not consecutive, the holders of the Series A Preferred and Warrant Preferred will have the right to elect 2 directors. The right to elect directors will end when full dividends have been paid for all prior dividend periods.

In the Purchase Agreement, the Bank agreed that, until such time as the Treasury ceases to own any of its debt or equity securities 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 Preferred Stock and the Warrant Preferred, and the Bank 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.

PRESIDIO BANK

NOTES TO FINANCIAL STATEMENTS

(Continued)

11. SHAREHOLDERS' EQUITY (Continued)

Preferred Stock (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 Preferred Stock and the Warrant Preferred are redeemed in whole or the Treasury has transferred all of the Series A Preferred Stock and Warrant Preferred 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 is 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 Preferred Stock or Warrant Preferred is outstanding, no dividends may be declared or paid on junior preferred shares, preferred shares ranking pari passu with the Series A Preferred Stock or Warrant Preferred, or common shares (other than in the case of pari passu preferred shares or dividends on a pro rata basis with the Series A Preferred Stock or Warrant Preferred), nor may the Bank repurchase or redeem any junior preferred shares, preferred shares ranking pari passu with the Series A Preferred Stock or Warrant Preferred, unless 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 Warrant Preferred. The discount recorded on the Series A Preferred Stock will be amortized on the level-yield method over five years.

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, 2009, no amounts were free of such restrictions.

Regulatory Capital

The Bank is subject to certain regulatory capital requirements administered by the FRB and 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.

PRESIDIO BANK

NOTES TO FINANCIAL STATEMENTS

(Continued)

11. SHAREHOLDERS' EQUITY (Continued)

Regulatory Capital (Continued)

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 on the following page. 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, 2009 and 2008.

	2009		2008	
	Amount	Ratio	Amount	Ratio
<u>Leverage Ratio</u>				
Presidio Bank	\$ 38,205,000	16.1%	\$ 30,248,000	13.5%
Minimum requirement for "Well-Capitalized" institution	\$ 11,865,000	5.0%	\$ 11,203,000	5.0%
Minimum regulatory requirement	\$ 9,492,000	4.0%	\$ 8,962,000	4.0%
<u>Tier 1 Risk-Based Capital Ratio</u>				
Presidio Bank	\$ 38,205,000	16.0%	\$ 30,248,000	14.2%
Minimum requirement for "Well-Capitalized" institution	\$ 14,327,000	6.0%	\$ 12,781,000	6.0%
Minimum regulatory requirement	\$ 9,551,000	4.0%	\$ 8,521,000	4.0%
<u>Total Risk-Based Capital Ratio</u>				
Presidio Bank	\$ 41,225,000	17.2%	\$ 33,231,000	15.6%
Minimum requirement for "Well-Capitalized" institution	\$ 23,968,000	10.0%	\$ 21,302,000	10.0%
Minimum regulatory requirement	\$ 19,174,000	8.0%	\$ 17,042,000	8.0%

PRESIDIO BANK

NOTES TO FINANCIAL STATEMENTS

(Continued)

12. RELATED PARTY TRANSACTIONS

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 the aggregate activity involving related party borrowers during the years ended December 31, 2009 and 2008:

	<u>2009</u>	<u>2008</u>
Beginning balance	\$ 1,184,000	\$ 159,000
Disbursements	4,553,000	2,361,000
Amounts repaid	<u>(3,823,000)</u>	<u>(1,336,000)</u>
Ending balance	<u>\$ 1,914,000</u>	<u>\$ 1,184,000</u>
Undisbursed commitments to related parties	<u>\$ 1,125,000</u>	<u>\$ 2,374,000</u>

13. EMPLOYEE BENEFIT PLANS

Profit Sharing Plan

In 2006, the Bank adopted the Presidio Bank 401(k) Profit Sharing Plan and Trust. All employees 21 years of age or older are eligible to participate in the 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 vest at a rate of 20% annually for all employees. The Bank made contributions to the Plan totaling approximately \$163,000 and \$160,000 for the years ended December 31, 2009 and 2008, respectively.

Deferred Compensation Plan

During 2008 the Bank adopted the Presidio Bank Deferred Compensation Plan. The plan was terminated on June 10, 2009 and the bank expects final distributions from the plan in July 2010. The Bank made no contributions to the plan.

PRESIDIO BANK

NOTES TO FINANCIAL STATEMENTS

(Continued)

14. FAIR VALUE MEASUREMENTS

Fair Value of Financial Instruments

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

	December 31, 2009		December 31, 2008	
	Carrying Amount	Estimated Fair Value	Carrying Amount	Estimated Fair Value
Financial assets:				
Cash and due from banks	\$ 21,141,507	\$ 21,141,507	\$ 2,875,639	\$ 2,875,639
Federal funds sold			40,470,460	40,470,460
Available-for-sale investment Securities	4,014,920	4,014,920		
Held-to-maturity investment Securities	684,583	684,583		
Federal Reserve Bank and Federal Home Loan Bank stock	2,024,350	2,024,350	2,110,250	2,110,250
Loans, net	213,049,599	218,602,000	177,035,237	182,530,000
Accrued interest receivable	701,019	701,019	600,810	600,810
Financial liabilities:				
Deposits	\$ 194,393,305	\$ 191,184,000	\$ 168,469,321	\$ 166,898,000
Borrowings	10,000,000	10,210,000	24,500,000	24,838,000
Accrued interest payable	162,381	162,381	188,700	188,700

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 cash equivalents, variable-rate loans and leases, accrued interest receivable and payable, Federal Reserve Bank and Federal Home Loan Bank stock, demand deposits and short-term borrowings, the carrying amount is estimated to be fair value. For 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 and leases 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 value of long term borrowings are estimated using discounted cash flow analyses using interest rates offered at each reporting date by FHLB for advances 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.

PRESIDIO BANK

NOTES TO FINANCIAL STATEMENTS

(Continued)

14. FAIR VALUE MEASUREMENTS (Continued)

Fair Value of Financial Instruments (Continued)

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.

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 non-recurring basis as of December 31, 2009:

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>\$ 4,014,920</u>	<u>\$ -</u>	<u>\$ 4,014,920</u>	<u>\$ -</u>

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

PRESIDIO BANK

NOTES TO FINANCIAL STATEMENTS

(Continued)

14. FAIR VALUE MEASUREMENTS (Continued)

Fair Value of Financial Instruments (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.

<u>Description</u>	<u>Fair Value</u>	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>
Impaired loans	\$ 210,726	\$ -	\$ -	\$ 210,726

The fair value of impaired loans is based on the fair value of the collateral for all collateral dependent loans and for other impaired loans is estimated using a discounted cash flow model. Impaired loans were categorized as Level 3 with unobservable inputs and assumptions in fair value measurements. Losses on impaired loans totaled \$270,000 for the year ended December 31, 2009.

There were no assets or liabilities measured at fair value on a recurring or non-recurring basis at December 31, 2008.