# PRESIDIO BANK

# FINANCIAL STATEMENTS

## AS OF DECEMBER 31, 2006

## AND FOR THE PERIOD FROM JULY 24, 2006

## (DATE OPERATIONS COMMENCED)

## TO DECEMBER 31, 2006

## AND

## INDEPENDENT AUDITOR'S REPORT

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ACCOUNTANTS

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# 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, 2006 and the related statements of operations, changes in shareholders' equity and cash flows for the period from July 24, 2006 (date operations commenced) to December 31, 2006. 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 audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free 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 audit provides 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, 2006 and the results of its operations and its cash flows for the period from July 24, 2006 (date operations commenced) to December 31, 2006, in conformity with accounting principles generally accepted in the United States of America.

Perry-Smith LLP

March 19, 2007

**PRESIDIO BANK**

**BALANCE SHEET**

**December 31, 2006**

**ASSETS**

| | |
|---|---|
| Cash and due from banks | $ 418,363 |
| Federal funds sold | 22,300,000 |
| Total cash and cash equivalents | 22,718,363 |
| Federal Reserve Bank stock | 1,200,000 |
| Loans, less allowance for loan losses of $302,000 (Note 3) | 24,869,537 |
| Bank premises and equipment, net (Note 4) | 851,174 |
| Accrued interest receivable and other assets | 282,666 |
| | $ 49,921,740 |

**LIABILITIES AND SHAREHOLDERS' EQUITY**

| | |
|---|---|
| Deposits (Note 5): | |
| Non-interest bearing | $ 1,925,360 |
| Interest bearing | 10,274,645 |
| Total deposits | 12,200,005 |
| Accrued interest payable and other liabilities | 342,294 |
| Total liabilities | 12,542,299 |
| Commitments and contingencies (Note 8) | |
| Shareholders' equity (Notes 9 and 10): | |
| Preferred stock – no par value; 10,000,000 shares authorized; no shares issued and outstanding | |
| Common stock – no par value; 30,000,000 shares authorized; 4,000,000 shares issued and outstanding | 40,316,463 |
| Accumulated deficit (including net pre-opening expenses of $1,503,366) | (2,937,022) |
| Total shareholders' equity | 37,379,441 |
| Total liabilities and shareholders' equity | $ 49,921,740 |

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

# PRESIDIO BANK

## STATEMENT OF OPERATIONS

### For the Period from July 24, 2006 (Date Operations Commenced) to December 31, 2006

| | |
|---|---|
| Interest income: | |
| Interest and fees on loans | $ 315,372 |
| Interest on Federal funds sold | 785,887 |
| Total interest income | 1,101,259 |
| Interest expense: | |
| Interest on deposits | 103,589 |
| Net interest income | 997,670 |
| Provision for loan losses (Note 3) | 302,000 |
| Net interest income after provision for loan losses | 695,670 |
| Non-interest income: | |
| Service charges and fees | 377 |
| Federal Reserve Bank stock dividends | 31,200 |
| Total non-interest income | 31,577 |
| Non-interest expense: | |
| Salaries and employee benefits (Notes 3 and 12) | 1,346,446 |
| Occupancy and equipment (Notes 4 and 8) | 294,016 |
| Other (Note 13) | 520,441 |
| Total non-interest expense | 2,160,903 |
| Net loss | $ (1,433,656) |
| Basic loss per share | $ 0.36 |
| Weighted average number of shares outstanding | 4,000,000 |

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

**PRESIDIO BANK**

**STATEMENT OF CHANGES IN SHAREHOLDERS' EQUITY**

**For the Period from July 24, 2006 (Date Operations Commenced) to December 31, 2006**

| | Common Stock | | | |
|---|---|---|---|---|
| | Shares | Amount | Accumulated Deficit | Total Shareholders' Equity |
| Sale of common stock, net of offering costs of $69,949 | 4,000,000 | $ 39,930,051 | | $ 39,930,051 |
| Pre-opening expenses (Note 2) | | 200,000 | $ (1,503,366) | (1,303,366) |
| Balance, July 24, 2006 (date operations commenced) (Note 2) | 4,000,000 | 40,130,051 | (1,503,366) | 38,626,685 |
| Share-based compensation expense (Notes 1 and 9) | | 186,412 | | 186,412 |
| Net loss | | | (1,433,656) | (1,433,656) |
| Balance, December 31, 2006 | 4,000,000 | $ 40,316,463 | $ (2,937,022) | $ 37,379,441 |

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

# PRESIDIO BANK

## STATEMENT OF CASH FLOWS

### For the Period From July 24, 2006 (Date Operations Commenced) to December 31, 2006

| | |
|---|---|
| Cash flows from operating activities: | |
| Net loss | $ (1,433,656) |
| Adjustments to reconcile net loss to net cash used in operating activities: | |
| Provision for loan losses | 302,000 |
| Depreciation and amortization | 71,171 |
| Deferred loan origination fees, net | 53,372 |
| Share-based compensation expense | 186,412 |
| Decrease in accrued interest receivable and other assets | 185,080 |
| Decrease in accrued interest payable and other liabilities | (87,510) |
| Net cash used in operating activities | (723,131) |
| Cash flows from investing activities: | |
| Net increase in loans | (25,224,909) |
| Purchase of premises and equipment | (38,300) |
| Net cash used in investing activities | (25,263,209) |
| Cash flows from financing activities: | |
| Net increase in demand, interest-bearing and savings deposits | 10,571,121 |
| Net increase in time deposits | 1,628,884 |
| Repayment of organizational advances from Directors and organizers | (2,000,000) |
| Net cash provided by financing activities | 10,200,005 |
| Decrease in cash and cash equivalents | (15,786,335) |
| Cash and cash equivalents at date operations commenced | 38,504,698 |
| Cash and cash equivalents at end of year | $ 22,718,363 |
| Supplemental disclosure of cash flow information: | |
| Cash paid for interest expense | $ 98,485 |

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

## 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

General

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 headquartered in San Francisco, California, has a branch office in Walnut Creek, California and expects to open a branch office in Santa Rosa, California during 2007. 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.

Prior to commencement of operations, the Bank was considered a development stage company and was engaged in activities designed to prepare it for opening. These pre-opening activities included, among other things, the retention of management and staff, acquisition and preparation of facilities for operation, regulatory filings related to approval of the Bank's charter, obtaining FDIC insurance and the sale of common stock.

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.

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.

Investment in Federal Reserve Bank Stock

As a member of the Federal Reserve System, the Bank is required to maintain an investment in the capital stock of the Federal Reserve Bank (Fed). The investment is carried at cost.

## 1. 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 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.

### 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 for loan losses at December 31, 2006 reflects management's estimate of probable losses in the portfolio.

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. These estimates are particularly susceptible to changes in the economic environment and market conditions.

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.

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

Allowance for Loan Losses (Continued)

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 $13,000 is included in accrued interest payable and other liabilities on the balance sheet.

The Bank's Directors' Loan Committee reviewed the adequacy of the allowance for loan losses at December 31, 2006. In the future, the Directors' Loan Committee will 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.

Equipment and Leasehold Improvements

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. 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 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.

## 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) 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.

Share-Based Payments

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 for up to 1,200,000 shares of the Bank's common stock. 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. 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. Options generally vest over a five year period and expire after ten years from the grant date, except in the case of performance-based awards which vest subject to achievement of certain pre-determined goals and objectives.

The Bank accounts for share-based compensation under Statement of Financial Accounting Standards ("SFAS") No. 123(R), *Share-Based Payment*. SFAS No. 123(R) generally requires that such transactions be accounted for using a fair-value based method and requires that share-based compensation expense be recorded for all stock options 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 SEC Staff Accounting Bulletin No. 107 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 since the Bank has not paid dividends and have 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.

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

Impact of Recently Issued Accounting Standards

*Fair Value Measurements*

In September 2006, the FASB issued Statement No. 157 (SFAS 157), *Fair Value Measurements*. SFAS 157 defines fair value, establishes a framework for measuring fair value and expands disclosures about fair value measurements. SFAS 157 applies whenever other standards require (or permit) assets or liabilities to be measured at fair value but does not expand the use of fair value in any new circumstances. In this standard, the FASB clarifies the principle that fair value should be based on the assumptions market participants would use when pricing the asset or liability. In support of this principle, SFAS 157 establishes a fair value hierarchy that prioritizes the information used to develop those assumptions. The provisions of SFAS 157 are effective for financial statements issued for fiscal years beginning after November 15, 2007 and interim periods within those fiscal years. The provisions should be applied prospectively, except for certain specifically identified financial instruments. Management does not expect the adoption of SFAS 157 to have a material impact on the Bank's financial position or result of operations.

*Accounting for Uncertainty in Income Taxes*

In July 2006, the FASB issued Financial Accounting Standards Interpretation No. 48 (FIN 48), *Accounting for Uncertainty in Income Taxes*. FIN 48 clarifies the accounting for uncertainty in income taxes recognized in an enterprise's financial statements in accordance with FASB Statement No. 109, *Accounting for Income Taxes*. FIN 48 prescribes a recognition threshold and measurement attributable for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. FIN 48 also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosures and transitions. FIN 48 is effective for fiscal years beginning after December 15, 2006. Management does not expect the adoption of FIN 48 to have a material impact on the Bank's financial position or results of operations.

## 2. PRE-OPENING ACTIVIES

Prior to commencement of operations, the Bank was considered a development stage company and was engaged in activities designed to prepare it for opening as an FDIC-insured financial institution. The Bank received its initial funding during this period from directors and organizers in the form of interest-free loans. The initial funds were used during the development stage of the Bank to pay for salaries, legal and consulting expenses, rent, and the purchase of premises and equipment. These funds were repaid to the directors and organizers following approval by the banking regulators. In consideration for the funding during the organizational period each director and organizer received one option for each $10 loaned to the Bank. The fair value of these options, estimated based upon imputed interest associated with the interest-free loans, was $200,000, and is included in pre-opening expenses.

## 2. PRE-OPENING ACTIVIES (Continued)

During the development stage, the Bank incurred the following pre-opening expenses, net of interest earned, which were charged to accumulated deficit at the date the Bank commenced operations:

| | |
|---|---|
| Salaries and benefits | $ 551,528 |
| Consulting and professional fees | 498,732 |
| Share-based compensation expense | 200,000 |
| Rent | 127,306 |
| Other | 423,032 |
| Interest income | (297,232) |
| Net pre-opening expenses | $ 1,503,366 |

Cash flows from organizational and pre-opening activities were as follows:

| | |
|---|---|
| Proceeds from organizational advances from Directors and organizers | $ 2,000,000 |
| Proceeds from sale of common stock, net of offering costs of $69,949 | 39,930,051 |
| Pre-opening expenses, net of interest income of $297,232 | (1,503,366) |
| Share-based compensation expense included in pre-opening expenses | 200,000 |
| Purchase of premises and equipment | (884,045) |
| Purchase of Federal Reserve Bank Stock | (1,200,000) |
| Increase in prepaid expenses and other assets | (467,746) |
| Increase in accrued liabilities | 429,804 |
| Cash and cash equivalents at date operations commenced | $ 38,504,698 |

## 3. LOANS

Outstanding loans at December 31, 2006 are summarized below:

| | |
|---|---|
| Commercial real estate | $ 5,919,959 |
| Construction and land development | 11,017,956 |
| Commercial | 3,604,829 |
| Consumer and other | 4,682,165 |
| | 25,224,909 |
| Deferred loan origination fees, net | (53,372) |
| Allowance for loan losses | (302,000) |
| | $ 24,869,537 |

## 3. LOANS (Continued)

For the period from July 24, 2006 (date operations commenced) to December 31, 2006, the Bank had no impaired loans or loans placed on nonaccrual status. During the same period, the Bank recognized a provision for loan losses of $302,000 and no losses were charged to the allowance.

Salaries and employee benefits totaling $62,832 were deferred as loan origination costs for the period from July 24, 2006 (date operations commenced) to December 31, 2006.

## 4. BANK PREMISES AND EQUIPMENT

Bank premises and equipment consisted of the following at December 31, 2006:

| | |
|---|---|
| Furniture, fixtures and equipment | $ 740,071 |
| Leasehold improvements | 182,274 |
| | 922,345 |
| Less accumulated depreciation and amortization | (71,171) |
| | $ 851,174 |

Depreciation and amortization included in occupancy and equipment expense totaled $71,171 for the period from July 24, 2006 (date operations commenced) to December 31, 2006.

## 5. INTEREST-BEARING DEPOSITS

Interest-bearing deposits consisted of the following at December 31, 2006:

| | |
|---|---|
| Savings | $ 122,898 |
| Money market | 5,991,516 |
| Interest-bearing demand accounts | 2,531,347 |
| Time, $100,000 or more | 1,602,384 |
| Other time | 26,500 |
| | $ 10,274,645 |

Aggregate annual maturities of time deposits are as follows:

| Year Ending December 31, | |
|---|---|
| 2007 | $ 526,500 |
| 2009 | 1,102,384 |
| | $ 1,628,884 |

## 5. INTEREST-BEARING DEPOSITS (Continued)

Interest expense recognized on interest-bearing deposits for the period from July 24, 2006 (date operations commenced) to December 31, 2006 consisted of the following:

| | |
|---|---|
| Savings | $ 1,397 |
| Money market | 82,711 |
| Interest-bearing demand accounts | 11,430 |
| Time, $100,000 or more | 7,752 |
| Other time | 299 |
| | $ 103,589 |

Deposits totaling $3,338,473, or 27% of total deposits, were from five major depositors at December 31, 2006.

## 6. INCOME TAXES

Income taxes for the period from July 24, 2006 (date operations commenced) to December 31, 2006 consisted of the following:

| | |
|---|---|
| Deferred | $ 1,107,000 |
| Establishment of a valuation allowance | (1,107,000) |
| Income tax expense | $ - |

Deferred tax assets (liabilities) at December 31, 2006 consisted of the following:

| | |
|---|---|
| Deferred tax assets: | |
| Net operating losses | $ 405,000 |
| Organization costs | 608,000 |
| Allowance for loan losses | 135,000 |
| Stock-based compensation | 18,000 |
| Other | 60,000 |
| Deferred tax assets before valuation allowance | 1,226,000 |
| Valuation allowance | (1,107,000) |
| Total deferred tax assets | 119,000 |
| Deferred tax liabilities: | |
| Prepaid expenses | (20,000) |
| Future liability of state deferred tax asset | (99,000) |
| Total deferred tax liabilities | (119,000) |
| Net deferred tax assets | $ - |

## 6. INCOME TAXES (Continued)

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, 2006, the Bank had Federal and State net operating loss carryforwards (NOLs) of $902,000. The Federal NOLs expire in 2027 and the State NOLs expire in 2017, respectively.

## 7. SHORT-TERM BORROWING ARRANGEMENTS

The Bank has unsecured Federal funds lines of credit with two of its correspondent banks under which it can borrow up to $10,000,000. There were no borrowings outstanding under these arrangements at December 31, 2006.

## 8. COMMITMENTS AND CONTINGENCIES

Operating Leases

The Bank leases its San Francisco headquarters and Walnut Creek branch offices under non-cancelable operating leases. The leases expire on June 1, 2016 and May 1, 2011, respectively. The San Francisco lease has two five year renewal options and the Walnut Creek lease has one five year renewal option. The leases include annual rent adjustments of approximately 2.6% and 1.6%, respectively, each year during the initial lease terms.

Future minimum lease payments are estimated as follows:

| Year Ending December 31, | Operating Leases |
|---|---|
| 2007 | $ 411,000 |
| 2008 | 421,000 |
| 2009 | 432,000 |
| 2010 | 442,000 |
| 2011 | 381,000 |
| Thereafter | 1,561,000 |
| | $ 3,648,000 |

Rental expense included in occupancy and equipment expense totaled $194,521 for the period from July 24, 2006 (date operations commenced) to December 31, 2006.

## 8. 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:

| | December 31, 2006 |
|---|---|
| Commitments to extend credit | $ 12,584,000 |
| Standby letters of credit | $ 1,000,000 |

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, 2006. The Bank recognizes these fees as revenue over the term of the commitment or when the commitment is used.

Commercial loan commitments represent approximately 22% 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 24% 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 51% 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. Home equity lines of credit represent the remaining 3% of total commitments and are generally secured by residential real estate and have both variable and fixed interest rates.

## 8. COMMITMENTS AND CONTINGENCIES (Continued)

### Concentrations of Credit Risk

The Bank grants real estate mortgage, real estate construction and commercial loans to customers in San Francisco and surrounding counties. Although the Bank intends to have a diversified loan portfolio, a substantial portion of its portfolio is secured by commercial and residential real estate at December 31, 2006.

In management's judgment, a concentration of loans exists in real estate related loans with approximately 67% 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.

### Legal Proceedings

From time to time, the Bank may become a party to claims and legal proceedings arising in the ordinary course of business. Management evaluates the Bank's exposure to cases individually and in the aggregate and provides for potential losses on such litigation if it is probable that a loss has been incurred and it can be reasonably estimated. Other than as described below, the Bank believes that there are no material litigation matters at the current time. However, litigation is inherently uncertain and no assurance can be given that any current or future litigation will not result in loss which might be material to the Bank.

A potential claim against the Bank, one of its officers and one of its Directors has been asserted by another financial institution. The potential claim alleges breach of fiduciary duty, theft of company property and information and unfair competition. Management is assessing both the merits of the claim and the Bank's exposure to loss. At the present time, management is unable to predict either the ultimate outcome of the potential claim or the range of potential loss to which the Bank may be exposed.

### Correspondent Banking Agreements

The Bank maintains funds on deposit with other federally insured financial institutions under correspondent banking agreements. There were no uninsured deposits at December 31, 2006.

## 9. SHARE-BASED PAYMENTS

Stock Option Awards

During the pre-opening period and the period from July 24, 2006 (date operations commenced) to December 31, 2006, the Board of Directors granted stock options to organizers, officers and directors with various terms and conditions designed to attract and retain qualified officers and directors and to provide founders with an incentive to advance the initial funding of the Bank's organizational efforts. These actions were ratified by the Bank's shareholders on September 12, 2006.

At December 31, 2006, 873,250 shares are subject to outstanding stock option awards and 326,750 shares are available for future grant. Included in the outstanding stock option awards are 200,000 stock options granted to founders and organizers (Organizer Options) which are fully vested, 538,600 stock options granted to employees and Directors solely with service conditions (Service-Based Options) that will generally vest over five years, and 134,650 stock options granted to executive officers and Directors that will vest only if the Bank meets or exceeds certain performance measures after five years of operations (Performance-Based Options). None of the aforementioned awards have been forfeited or exercised and only the Organizer Options were exercisable at December 31, 2006.

The weighted average exercise price, weighted average remaining contractual term and aggregate intrinsic value of these awards was as follows at December 31, 2006:

| Options | Shares | Weighted Average Exercise Price | Weighted Average Remaining Contractual Term | Aggregate Intrinsic Value |
|---|---|---|---|---|
| Organizer options | 200,000 | $ 10.00 | 9.6 years | $ 460,000 |
| Service-based options | 538,600 | $ 10.01 | 9.6 years | $ 1,231,580 |
| Performance-based options | 134,650 | $ 10.01 | 9.6 years | $ 307,895 |

The unrecognized compensation cost related to non-vested Service-Based options totaled $1,147,000 as of December 31, 2006. That cost is expected to be amortized on an accelerated basis over a weighted average period of 4.6 years and will be adjusted for subsequent changes in estimated forfeitures. The unrecognized compensation cost related to non-vested Performance-Based options totaled $473,000 as of December 31, 2006. 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 period July 24, 2006 (date operations commenced) to December 31, 2006.

## 9. SHARE-BASED PAYMENT (Continued)

Stock Option Awards (Continued)

The following stock option information is for the period July 24, 2006 (date operations commenced) to December 31, 2006:

| | | |
|---|---|---|
| Weighted average grant date fair value per share of options granted | $ | 3.20 |
| Significant fair value assumptions: | | |
| Expected term in years | | 6.5 years |
| Expected annual volatility | | 17.75% |
| Expected annual dividend yield | | 0% |
| Risk-free interest rate | | 4.8% |
| Total compensation cost (included in operating expenses) | $ | 186,412 |

## 10. SHAREHOLDERS' EQUITY

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, 2006, no amounts were free of such restrictions.

Regulatory Capital

The Bank is subject to certain regulatory capital requirements administered by the Fed and FDIC. Failure to meet these minimum capital requirements can initiate certain mandatory, and possibly additional discretionary, actions by regulators that, if undertaken, could have a direct material effect on the Bank's financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Bank must meet specific capital guidelines that involve quantitative measures of the Bank's assets, liabilities and certain off-balance-sheet items as calculated under regulatory accounting practices. The Bank's capital amounts and classification are also subject to qualitative judgments by the regulators about components, risk weightings and other factors.

Quantitative measures established by regulation to ensure capital adequacy require the Bank to maintain minimum amounts and ratios of total and Tier 1 capital to risk-weighted assets and of Tier 1 capital to average assets. Each of these components is defined in the regulations. Management believes that the Bank meets all its capital adequacy requirements as of December 31, 2006.

## 10. SHAREHOLDERS' EQUITY (Continued)

Regulatory Capital (Continued)

Under terms of its charter approval, the Bank is required to maintain a minimum leverage ratio of 9% during its first three years of operation. In addition, to be categorized as well capitalized, the Bank must maintain minimum total risk-based, Tier 1 risk-based and Tier 1 leverage ratios as set forth below.

| | Amount | Ratio |
|---|---|---|
| Leverage Ratio | | |
| Presidio Bank | $ 37,379,000 | 78.2% |
| Minimum requirement for "Well-Capitalized" institution | $ 2,391,000 | 5.0% |
| Minimum regulatory requirement | $ 1,912,000 | 4.0% |
| Minimum leverage ratio for de novo institution | $ 4,303,000 | 9.0% |
| Tier 1 Risk-Based Capital Ratio | | |
| Presidio Bank | $ 37,379,000 | 109.9% |
| Minimum requirement for "Well-Capitalized" institution | $ 2,042,000 | 6.0% |
| Minimum regulatory requirement | $ 1,361,000 | 4.0% |
| Total Risk-Based Capital Ratio | | |
| Presidio Bank | $ 37,682,000 | 110.7% |
| Minimum requirement for "Well-Capitalized" institution | $ 3,403,000 | 10.0% |
| Minimum regulatory requirement | $ 2,722,000 | 8.0% |

## 11. RELATED PARTY TRANSACTIONS

During the normal course of business, the Bank may enter into transactions with related parties, including Directors, executive officers and affiliates. These transactions could include borrowings from the Bank with substantially the same terms, including rates and collateral, as loans to unrelated parties. The Bank had no activity involving related party borrowers during the period from July 24, 2006 (date operations commenced) to December 31, 2006.

At December 31, 2006, the Bank's deposits from related parties totaled $ 361,000.

## 12. 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 did not make a contribution to the Plan during the period from July 24, 2006 (date operations commenced) to December 31, 2006.

## 13. OTHER EXPENSES

Other expenses for the period from July 24, 2006 (date operations commenced) to December 31, 2006 consisted of the following:

| | |
|---|---|
| Data processing | $ 103,336 |
| Professional fees | 89,589 |
| Advertising and marketing | 81,784 |
| Stationery and supplies | 66,747 |
| Business development | 65,307 |
| Stock-based compensation | 39,198 |
| Telephone | 21,202 |
| Insurance | 17,476 |
| Provision for losses on unfunded commitments | 13,000 |
| Other | 22,802 |
| | $ 520,441 |

## 14. DISCLOSURES ABOUT FAIR VALUE OF FINANCIAL INSTRUMENTS

Estimated fair values are disclosed for financial instruments for which it is practicable to estimate fair value. These estimates are made at a specific point in time based on relevant market data and information about the financial instruments. These estimates do not reflect any premium or discount that could result from offering the Bank's entire holdings of a particular financial instrument for sale at one time, nor do they attempt to estimate the value of anticipated future business related to the instruments. In addition, the tax ramifications related to the realization of unrealized gains and losses can have a significant effect on fair value estimates and have not been considered in any of these estimates.

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

The following methods and assumptions were used by the Bank to estimate the fair value of its financial instruments at December 31, 2006:

Cash and due from banks and Federal funds sold: For cash and due from banks and Federal funds sold, the carrying amount is estimated to be fair value.

Federal Reserve Bank stock: The stock may be redeemed at par by the issuer. Accordingly, the carrying amount is a reasonable estimate of fair value.

## 14. DISCLOSURES ABOUT FAIR VALUE OF FINANCIAL INSTRUMENTS (Continued)

Loans: For variable-rate loans that reprice frequently with no significant change in credit risk, fair values are based on carrying values. The fair values for other loans are estimated using discounted cash flow analyses, using interest rates offered at December 31, 2006 for loans with similar terms to borrowers of comparable creditworthiness. The fair value of loans is adjusted for the allowance for loan losses. The carrying amount of accrued interest receivable approximates its fair value.

Deposits: The fair values for demand deposits are, by definition, equal to the amount payable on demand at December 31, 2006 represented by their carrying amount. Fair values for fixed-rate certificates of deposit are estimated using a discounted cash flow analysis using interest rates offered at December 31, 2006 by the Bank for certificates with similar remaining maturities. The carrying amount of accrued interest payable approximates its fair value.

Commitments to fund loans/standby letters of credit: Off-balance-sheet commitments to extend credit are primarily for adjustable rate loans and letters of credit. The fair values of commitments are estimated using the fees currently charged to enter into similar agreements, taking into account the remaining terms of the agreements and the present creditworthiness of the counterparties. The differences between the carrying value of commitments to fund loans or standby letters of credit and their fair value are not significant and, therefore, are not included in the following table.

The estimated fair values of the Bank's financial instruments at December 31, 2006 are as follows:

| | Carrying Amount | Estimated Fair Value |
|---|---|---|
| Financial assets: | | |
| Cash and due from banks | $ 418,363 | $ 418,363 |
| Federal funds sold | 22,300,000 | 22,300,000 |
| Federal Reserve Bank stock | 1,200,000 | 1,200,000 |
| Loans, net | 24,869,537 | 24,840,000 |
| Accrued interest receivable | 101,044 | 101,044 |
| Financial liabilities: | | |
| Deposits | $ 12,200,005 | $ 11,856,000 |
| Accrued interest payable | 5,104 | 5,104 |