



PRESIDIO
BANK

FINANCIAL STATEMENTS

December 31, 2014 and 2013

PRESIDIO BANK
San Francisco, California

FINANCIAL STATEMENTS
December 31, 2014 and 2013

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INDEPENDENT AUDITOR'S REPORT

The Shareholders and
Board of Directors
Presidio Bank
San Francisco, California

Report on the Financial Statements

We have audited the accompanying financial statements of Presidio Bank, which comprise the balance sheets as of December 31, 2014 and 2013, and the related statements of income, comprehensive income, changes in shareholders' equity, and cash flows for the years then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

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

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

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

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Presidio Bank as of December 31, 2014 and 2013, and the results of its operations and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.



Crowe Horwath LLP

San Francisco, California
March 16, 2015

PRESIDIO BANK
BALANCE SHEETS
December 31, 2014 and 2013

	<u>2014</u>	<u>2013</u>
ASSETS		
Cash and due from banks	\$ 96,863,158	\$ 45,958,937
Other overnight deposits	<u>13,400,000</u>	<u>9,280,000</u>
Total cash and cash equivalents	110,263,158	55,238,937
Available-for-sale investment securities, at fair value	10,640,544	10,795,985
Held-to-maturity investment securities, at amortized cost	664,223	668,381
Federal Reserve Bank stock, at cost	1,378,400	1,399,150
Federal Home Loan Bank stock, at cost	1,708,900	1,366,200
Loans, less allowance for loan losses of \$5,172,046 in 2014 and \$4,867,106 in 2013	410,568,585	368,554,091
Premises and equipment, net	1,476,630	1,078,807
Deferred tax assets, net	3,414,000	3,140,000
Accrued interest receivable and other assets	<u>2,638,250</u>	<u>1,723,294</u>
Total assets	<u>\$ 542,752,690</u>	<u>\$ 443,964,845</u>
LIABILITIES AND SHAREHOLDERS' EQUITY		
Deposits:		
Non-interest bearing	\$ 164,353,390	\$ 132,546,444
Interest bearing	<u>317,338,335</u>	<u>264,612,028</u>
Total deposits	481,691,725	397,158,472
Subordinated debt	10,000,000	-
Accrued interest payable and other liabilities	<u>3,243,579</u>	<u>2,522,682</u>
Total liabilities	<u>494,935,304</u>	<u>399,681,154</u>
Commitments and contingencies (Note 10)		
Shareholders' equity:		
Preferred stock, no par value; 10,000,000 shares authorized:		
Series A, noncumulative, \$1,000 per share liquidation preference 6,544 shares issued and outstanding	6,544,000	6,486,222
Series B, noncumulative, \$1,000 per share liquidation preference; 325 shares issued and outstanding	325,000	325,000
Common stock, no par value; 30,000,000 shares authorized; 4,203,391 and 4,169,744 shares issued and outstanding in 2014 and 2013, respectively	44,207,446	43,540,149
Accumulated deficit	(3,166,933)	(5,898,579)
Accumulated other comprehensive loss, net of tax	<u>(92,127)</u>	<u>(169,101)</u>
Total shareholders' equity	<u>47,817,386</u>	<u>44,283,691</u>
Total liabilities and shareholders' equity	<u>\$ 542,752,690</u>	<u>\$ 443,964,845</u>

See accompanying notes to financial statements.

PRESIDIO BANK
STATEMENTS OF INCOME
Years Ended December 31, 2014 and 2013

	<u>2014</u>	<u>2013</u>
Interest and dividend income:		
Interest and fees on loans	\$ 19,200,614	\$ 16,299,176
Interest on due from banks and other overnight deposits	173,334	167,204
Interest on investment securities	156,013	151,048
Dividend income	<u>188,987</u>	<u>135,827</u>
Total interest and dividend income	19,718,948	16,753,255
Interest expense:		
Interest on deposits	796,526	806,763
Interest on subordinated debt	<u>213,144</u>	<u>-</u>
Total interest expense	<u>1,009,670</u>	<u>806,763</u>
Net interest income	18,709,278	15,946,492
Provision for loan losses	<u>301,074</u>	<u>-</u>
Net interest income after provision for loan losses	<u>18,408,205</u>	<u>15,946,492</u>
Non-interest income:		
Service charges and fees	619,073	510,657
Other non-interest income	<u>82,084</u>	<u>60,419</u>
Total non-interest income	<u>701,157</u>	<u>571,076</u>
Non-interest expenses:		
Salaries and employee benefits	8,550,036	7,348,831
Occupancy and equipment	1,586,202	1,535,304
Other	<u>3,592,971</u>	<u>3,502,910</u>
Total non-interest expenses	<u>13,729,209</u>	<u>12,387,045</u>
Income before income taxes	5,380,153	4,130,523
Provision for income taxes	<u>2,234,079</u>	<u>1,693,514</u>
Net income	<u>\$ 3,146,074</u>	<u>\$ 2,437,009</u>
Basic earnings per common share	<u>\$ 0.65</u>	<u>\$ 0.49</u>
Diluted earnings per common share	<u>\$ 0.63</u>	<u>\$ 0.48</u>

See accompanying notes to financial statements.

PRESIDIO BANK
STATEMENTS OF COMPREHENSIVE INCOME
Years Ended December 31, 2014 and 2013

	<u>2014</u>	<u>2013</u>
Net income	\$ 3,146,074	\$ 2,437,009
Other comprehensive income (loss):		
Unrealized gains (losses) on available-for-sale securities:		
Unrealized holding gain (loss) arising during the year	127,772	(255,749)
Tax effect	<u>(50,798)</u>	<u>104,809</u>
Other comprehensive income (loss)	<u>76,974</u>	<u>(150,940)</u>
Comprehensive income	<u>\$ 3,223,048</u>	<u>\$ 2,286,069</u>

See accompanying notes to financial statements.

PRESIDIO BANK
STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY
Years Ended December 31, 2014 and 2013

	<u>Preferred Stock – Series A</u>		<u>Preferred Stock – Series B</u>		<u>Common Stock</u>		<u>Accu- mulated Deficit</u>	<u>Accu- mulated Other Compre-- hensive Loss</u>	<u>Total Share- holders' Equity</u>
	<u>Shares</u>	<u>Amount</u>	<u>Shares</u>	<u>Amount</u>	<u>Shares</u>	<u>Amount</u>			
Balance, January 1, 2013	10,800	\$ 10,677,222	325	\$ 325,000	4,123,064	\$ 42,809,380	\$ (7,904,890)	\$ (18,161)	\$ 45,888,551
Settlement of Series A Preferred Stock	(4,256)	(4,226,827)	-	-	-	-	151,907	-	(4,074,920)
Accretion of discount on Series A Preferred stock	-	35,827	-	-	-	-	(35,827)	-	-
Preferred dividends	-	-	-	-	-	-	(546,778)	-	(546,778)
Restricted stock awards granted	-	-	-	-	46,680	-	-	-	-
Share-based compensation expense	-	-	-	-	-	730,769	-	-	730,769
Net Income	-	-	-	-	-	-	2,437,009	-	2,437,009
Other comprehensive loss	-	-	-	-	-	-	-	(150,940)	(150,940)
Balance, December 31, 2013	6,544	6,486,222	325	325,000	4,169,744	43,540,149	(5,898,579)	(169,101)	44,283,691
Accretion of discount on Series A Preferred stock	-	57,778	-	-	-	-	(57,778)	-	-
Preferred dividends	-	-	-	-	-	-	(356,650)	-	(356,650)
Restricted stock awards granted	-	-	-	-	29,247	-	-	-	-
Stock options exercises	-	-	-	-	4,400	42,748	-	-	42,748
Share-based compensation expense	-	-	-	-	-	624,549	-	-	624,549
Net Income	-	-	-	-	-	-	3,146,074	-	3,146,074
Other comprehensive income	-	-	-	-	-	-	-	76,974	76,974
Balance, December 31, 2014	6,544	\$ 6,544,000	325	\$ 325,000	4,203,391	\$ 44,207,446	\$ (3,166,933)	\$ (92,127)	\$ 47,817,386

See accompanying notes to financial statements.

PRESIDIO BANK
STATEMENTS OF CASH FLOWS
Years Ended December 31, 2014 and 2013

	<u>2014</u>	<u>2013</u>
Cash flows from operating activities:		
Net income	\$ 3,146,074	\$ 2,437,009
Adjustments to reconcile net income to net cash provided by operating activities:		
Amortization of premiums on investment securities, net	12,688	19,519
Amortization of debt issuance costs	7,282	-
Depreciation and amortization	352,993	368,569
Provision for loan losses	301,074	-
Loss on disposal of equipment	5,475	-
Deferred loan origination fees (costs), net	92,003	(36,825)
Share-based compensation expense	624,549	730,769
(Benefit) provision for deferred income taxes	(326,000)	278,000
(Increase) decrease in accrued interest receivable and other assets	(484,340)	128,083
Increase in accrued interest payable and other liabilities	<u>720,898</u>	<u>313,459</u>
Net cash provided by operating activities	<u>4,452,696</u>	<u>4,238,583</u>
Cash flows for investing activities:		
Purchases of available-for-sale investment securities	-	(993,750)
Proceeds from principal payments on investment securities	274,682	155,296
Redemption (purchase) of FRB stock	20,750	(34,900)
Purchase of FHLB stock	(342,700)	(186,200)
Net increase in loans	(42,407,571)	(59,470,596)
Purchases of premises and equipment	(757,821)	(226,719)
Proceeds from sale of premises and equipment	<u>1,530</u>	<u>-</u>
Net cash used in investing activities	<u>(43,211,130)</u>	<u>(60,756,869)</u>
Cash flows from financing activities:		
Net increase in demand, interest-bearing and savings deposits	72,562,593	43,031,174
Net increase (decrease) in time deposits	11,970,660	(3,246,146)
Issuance of subordinated debentures, net of debt issuance costs of \$436,696	9,563,304	-
Redemption of Series A preferred stock, net of discount	-	(4,074,920)
Payment of dividends on preferred stock	(356,650)	(546,778)
Proceeds from the exercise of stock options	<u>42,748</u>	<u>-</u>
Net cash provided by financing activities	<u>93,782,655</u>	<u>35,163,330</u>
Increase (decrease) in cash and cash equivalents	55,024,221	(21,354,956)
Cash and cash equivalents at beginning of year	<u>55,238,937</u>	<u>76,593,893</u>
Cash and cash equivalents at end of year	<u>\$ 110,263,158</u>	<u>\$ 55,238,937</u>
Supplemental disclosure of cash flow information:		
Cash paid for interest expense	\$ 1,011,650	\$ 841,296
Cash paid for income taxes	\$ 2,535,000	\$ 1,491,000

See accompanying notes to financial statements.

PRESIDIO BANK
NOTES TO FINANCIAL STATEMENTS
December 31, 2014 and 2013

NOTE 1 – THE BUSINESS OF PRESIDIO BANK

Presidio Bank (the "Bank") is a state-chartered bank and a member of the Federal Reserve System (the "Fed"). The Bank is subject to regulation by the Fed, the California Department of Business Oversight (the "DBO"), 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 and also has branch offices in Walnut Creek, San Rafael, San Mateo and Palo Alto, California. 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.

NOTE 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, 2014 through March 16, 2015, the date the financial statements were available to be issued.

Use of Estimates: The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions. These estimates and assumptions affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from these estimates.

Operating Segments: While the Bank's executive officers monitor the revenue streams of the various products and services, operations are managed and financial performance is evaluated on a Bank-wide basis. Operating results are not reviewed by senior management to make resource allocation or performance decisions. Accordingly, all of the financial service operations are considered by management to be aggregated in one reportable operating segment.

Reclassifications: Certain reclassifications have been made to the prior year's balances in order to conform to the classifications used in the current year. None of the reclassifications had an impact on the prior year's net income or shareholder's equity.

Cash and Cash Equivalents: For the purpose of the statement of cash flows, cash and cash equivalents consist of cash and due from banks as well as other overnight deposits. Net cash flows are reported for customer loan and deposit transactions.

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. Both cash and stock dividends are reported as income.

(Continued)

PRESIDIO BANK
NOTES TO FINANCIAL STATEMENTS
December 31, 2014 and 2013

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

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, 2014 and 2013.

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.

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

Loans: Loans that management has the intent and ability to hold for the foreseeable future or until maturity or payoff are recorded at the principal balances outstanding, net of deferred loan origination fees and costs and the allowance for loan losses. Interest is accrued daily based upon outstanding loan balances. However, when in the opinion of management, loans are considered to be impaired and the future collectibility of interest and principal is in serious doubt, loans are placed on nonaccrual status and the accrual of interest income is suspended. Any interest accrued but unpaid is charged against income. Payments received are applied to reduce principal to the extent necessary to ensure collection. Subsequent payments on these loans, or payments received on nonaccrual loans for which the ultimate collectibility of principal is not in doubt, are applied first to earned but unpaid interest and then to principal. Generally, loans are placed on non-accrual status when they are 90 days past due. Past due status is based on the contractual terms of the loan. Loans are returned to accrual status when all the principal and interest amounts contractually due are brought current and future payments are reasonably assured. The Bank's policy for placing loans on nonaccrual status, recording payments received on nonaccrual loans resuming accrual of interest and determining past due or delinquency status does not differ by portfolio segment.

(Continued)

PRESIDIO BANK
NOTES TO FINANCIAL STATEMENTS
December 31, 2014 and 2013

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

All loans are evaluated and considered impaired when, based on current information and events, it is probable that the Bank will be unable to collect all amounts due (including both principal and interest) in accordance with the contractual terms of the loan agreement. The policy for recognizing interest on impaired loans is the same as the policy described above and does not differ by portfolio segment.

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 \$22,923,000 and \$27,620,000 at December 31, 2014 and 2013, respectively.

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

Loans determined to be impaired are individually evaluated for impairment. When a loan is impaired, the Bank measures impairment based on the present value of expected future cash flows discounted at the loan's effective interest rate, except that as a practical expedient, it may measure impairment based on a loan's observable market price, or the fair value of the collateral if the loan is collateral dependent. A loan is collateral dependent if the repayment of the loan is expected to be provided solely by the underlying collateral. The policy for measuring impaired loans does not differ by portfolio segment.

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

The determination of the general reserve for loans that are not considered impaired is based on estimates made by management, to include, but not limited to, consideration of historical losses by portfolio segment experienced by the Bank since inception and a peer group for the trailing ten years, internal asset classifications, and qualitative factors to include economic trends in the Bank's service areas, industry experience and trends, geographic concentrations, estimated collateral values, the Bank's underwriting policies, the character of the loan portfolio, and probable losses inherent in the portfolio taken as a whole.

The Bank maintains a separate allowance for each portfolio segment (loan type). These portfolio segments include commercial, construction and land development, commercial real estate and consumer loans. The allowance for loan losses attributable to each portfolio segment, which includes both impaired loans and loans that are not impaired, is combined to determine the Bank's overall allowance, which is included on the balance sheet.

(Continued)

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

The Bank assigns a risk rating to all loans and periodically performs detailed reviews of all such loans over a certain threshold to identify credit risks and to assess the overall collectability of the portfolio. These risk ratings are also subject to examination by independent specialists engaged by the Bank and the Bank's regulators. During these internal reviews, management monitors and analyzes the financial condition of borrowers and guarantors, trends in the industries in which borrowers operate and the fair values of collateral securing these loans. These credit quality indicators are used to assign a risk rating to each individual loan. The risk ratings can be grouped into five major categories, defined as follows:

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

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

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

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

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

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

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

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

(Continued)

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

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

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

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

Allowance for Credit Losses on Off-Balance-Sheet Credit Exposures: The Bank also maintains a separate allowance for off-balance-sheet commitments. Management estimates anticipated losses using historical data and utilization assumptions. The allowance for off-balance-sheet commitments is included in accrued interest payable and other liabilities on the balance sheet.

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.

(Continued)

PRESIDIO BANK
NOTES TO FINANCIAL STATEMENTS
December 31, 2014 and 2013

NOTE 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, 2014 and 2013, the Bank did not have a material 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, 2014 or December 31, 2013 because it does not have any significant unrecognized tax benefits.

Earnings Per Share: Basic earnings per share, which excludes dilution, is computed by dividing net income available to common shareholders by the weighted-average number of common shares outstanding for the period. Net income available to common shareholders differs from net income due to amounts for dividends paid on preferred stock, accretion of discounts on preferred stock and gain on settlement of preferred stock. 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.

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 1,600,000 shares of the Bank's common stock, of which 201,263 shares were available for future grant at December 31, 2014. 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 four types of awards under the plan: Organizer options, which were granted to founders and organizers and were fully vested upon the granting of the awards; service-based options, that generally vest over four or five year periods; restricted stock and restricted stock units, certain of which vest only if the Bank meets or exceeds certain pre-determined financial goals and objectives.

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 awards and restricted stock units that are ultimately expected to vest as the requisite service is rendered.

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PRESIDIO BANK
NOTES TO FINANCIAL STATEMENTS
December 31, 2014 and 2013

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

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

Option awards granted to employees and members of the Bank's board of directors are accounted for as stock compensation, whereby compensation expense is generally based on the grant date fair value of the option awards. Option awards granted to board advisory members are accounted for as equity-based payments to non-employees, whereby the fair value of the option awards is re-measured each reporting period and the expense recorded is ultimately based on the fair value of the option awards on the vesting date.

The fair values of restricted stock awards and restricted stock units are determined using the fair value of the underlying shares on the date of the grant. In addition to the assumptions discussed above, management makes estimates regarding pre-vesting forfeitures that will impact total compensation expense recognized under the Plan.

Adoption of New Financial Accounting Standards: In February 2013, the FASB amended existing guidance related to reporting amounts reclassified out of accumulated other comprehensive income. These amendments do not change the current requirements for reporting net income or other comprehensive income in financial statements. These amendments require an entity to provide information about the amounts reclassified out of accumulated other comprehensive income (loss) by component. In addition, an entity is required to present, either on the face of the statement where net income is presented or in the notes, significant amounts reclassified out of accumulated other comprehensive income (loss) by the respective line items of net income, but only if the amount reclassified is required under U.S. GAAP to be reclassified to net income in its entirety in the same reporting period. For other amounts that are not required under U.S. GAAP to be reclassified in their entirety to net income, an entity is required to cross-reference to other disclosures required under U.S. GAAP that provide additional details about those amounts. These amendments were effective for the Bank for the year ended December 31, 2014. The effect of adopting this standard was not material to the Bank's operating results or financial condition.

Newly Issued Not Yet Effective Accounting Standards: In January 2014, the FASB amended existing guidance to clarify when a creditor should be considered to have received physical possession of residential real estate property collateralizing a consumer mortgage loan such that the loan should be derecognized and the real estate recognized. These amendments clarify that an in substance repossession or foreclosure occurs, and a creditor is considered to have received physical possession of residential real estate property collateralizing a consumer mortgage loan, upon either: (1) the creditor obtaining legal title to the residential real estate property upon completion of a foreclosure, or (2) the borrower conveying all interest in the residential real estate property to the creditor to satisfy that loan through completion of a deed in lieu of foreclosure or through a similar legal agreement. Amendments in this standard can be applied using a modified retrospective or prospective transition method. This amendment is effective for fiscal years, and interim periods within those years, beginning after December 15, 2014. Early adoption is permitted. The adoption of this standard is not expected to have a material effect on the Bank's operating results or financial condition.

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PRESIDIO BANK
NOTES TO FINANCIAL STATEMENTS
December 31, 2014 and 2013

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

In May 2014 the FASB amended existing guidance related to revenue from contracts with customers. This amendment supersedes and replaces nearly all existing revenue recognition guidance, including industry-specific guidance, establishes a new control-based revenue recognition model, changes the basis for deciding when revenue is recognized over time or at a point in time, provides new and more detailed guidance on specific topics and expands and improves disclosures about revenue. In addition, this amendment specifies the accounting for some costs to obtain or fulfill a contract with a customer. This amendment is effective for fiscal years, and interim periods within those years, beginning after December 15, 2016. Early adoption is not permitted. The amendments should be applied retrospectively to all periods presented or retrospectively with the cumulative effect recognized at the date of initial application. The Bank is currently evaluating the impact of this new accounting standard on the financial statements.

In June 2014, the FASB amended existing guidance related to the accounting for share- based payments when the terms of an award provide that a performance target could be achieved after the requisite service period. These amendments require that a performance target that affects vesting and that could be achieved after the requisite service period be treated as a performance condition. A reporting entity should apply existing guidance in Topic 718, Compensation – Stock Compensation, as it relates to awards with performance conditions that affect vesting to account for such awards. The total amount of compensation cost recognized during and after the requisite service period should reflect the number of awards that are expected to vest and should be adjusted to reflect those awards that ultimately vest. The requisite service period ends when the employee can cease rendering service and still be eligible to vest in the award if the performance target is achieved. These amendments are effective for annual periods and interim periods within those annual periods beginning after December 15, 2015. Early adoption is permitted. Entities may apply the amendments in this amendment either: (a) prospectively to all awards granted or modified after the effective date; or (b) retrospectively to all awards with performance targets that are outstanding as of the beginning of the earliest annual period presented in the financial statements and to all new or modified awards thereafter. The adoption of this standard is not expected to have a material effect on the Bank's operating results or financial condition.

In August 2014, the FASB amended existing guidance related to the classification of certain government-guaranteed mortgage loans, including those guaranteed by the FHA and the VA, upon foreclosure. It requires that a mortgage loan be derecognized and a separate other receivable be recognized upon foreclosure if the following conditions are met: 1) The loan has a government guarantee that is not separable from the loan before foreclosure; 2) At the time of foreclosure, the creditor has the intent to convey the real estate property to the guarantor and make a claim on the guarantee, and the creditor has the ability to recover under that claim; and 3) At the time of foreclosure, any amount of the claim that is determined on the basis of the fair value of the real estate is fixed. Upon foreclosure, the separate other receivable should be measured based on the amount of the loan balance (principal and interest) expected to be recovered from the guarantor. These amendments are effective for annual periods, and interim periods within those annual periods, beginning after December 15, 2014. Early adoption is permitted if the amendments under ASU 2014-04 *Receivables – Troubled Debt Restructurings by Creditors – Reclassification of Residential Real Estate Collateralized Consumer Mortgage Loans Upon Foreclosure* has been adopted. The amendments may be applied using a prospective transition method in which a reporting entity applies the guidance to foreclosures that occur after the date of adoption, or a modified retrospective transition using a cumulative-effect adjustment (through a reclassification to a separate other receivable) as of the beginning of the annual period of adoption. Prior periods should not be adjusted. A reporting entity must apply the same method of transition as elected under ASU 2014-04. The adoption of this standard is not expected to have a material effect on the Bank's operating results or financial condition.

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PRESIDIO BANK
NOTES TO FINANCIAL STATEMENTS
December 31, 2014 and 2013

NOTE 3 – INVESTMENT SECURITIES

Available-for-Sale Investment Securities: The following table summarizes the amortized cost and estimated fair value of available-for-sale investment securities at December 31, 2014 and 2013 and the corresponding amounts of gross unrealized gains and losses recognized in accumulated other comprehensive loss:

	2014			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Debt securities:				
Mortgage-backed securities- residential	\$ 5,818,348	\$ 5,753	\$ (114,312)	\$ 5,709,789
Asset-backed securities- student loan	4,981,036	-	(50,281)	4,930,755
	<u>\$ 10,799,384</u>	<u>\$ 5,753</u>	<u>\$ (164,593)</u>	<u>\$ 10,640,544</u>
	2013			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Debt securities:				
Mortgage-backed securities- residential	\$ 6,046,727	\$ -	\$ (263,417)	\$ 5,783,310
Asset-backed securities- student loan	5,035,870	-	(23,195)	5,012,675
	<u>\$ 11,082,597</u>	<u>\$ -</u>	<u>\$ (286,612)</u>	<u>\$ 10,795,985</u>

Net unrealized losses on available-for-sale investment securities totaling \$158,840 were recorded net of a related tax benefit of \$66,713 as accumulated other comprehensive loss at December 31, 2014. There were no sales or transfers of available-for-sale investment securities during the years ended December 31, 2014 and 2013. Available-for-sale residential mortgage-based securities with an amortized cost of \$4,959,193 and fair value of \$4,844,881 mature in 2019. Available-for-sale residential mortgage-based securities with an amortized cost of \$859,154 and fair value of \$864,908 mature in 2028. Available-for-sale student loan asset-backed securities mature in 2035. Expected maturities may differ from contractual maturities because the issuers of the securities may have the right to call or prepay obligations.

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PRESIDIO BANK
NOTES TO FINANCIAL STATEMENTS
December 31, 2014 and 2013

NOTE 3 – INVESTMENT SECURITIES (Continued)

Held-to-Maturity Investment Securities: The following table summarizes the amortized cost and fair value of held-to-maturity investment securities at December 31, 2014 and 2013 and the corresponding amounts of gross unrecognized gains and losses:

	2014			
Amortized <u>Cost</u>	Gross Unrecognized <u>Gains</u>	Gross Unrecognized <u>Losses</u>	Estimated Fair <u>Value</u>	
Debt securities: Mortgage-backed securities- residential	\$ 664,223	\$ -	\$ (199)	\$ 664,024

	2013			
Amortized <u>Cost</u>	Gross Unrecognized <u>Gains</u>	Gross Unrecognized <u>Losses</u>	Estimated Fair <u>Value</u>	
Debt securities: Mortgage-backed securities- residential	\$ 668,381	\$ -	\$ (204)	\$ 668,177

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, 2014 and 2013. Held-to-maturity investment securities mature in 2019.

At December 31, 2014 and 2013, the residential mortgage-backed securities held by the Bank were issued by a U.S. government-sponsored entities, Fannie Mae and Freddie Mac, institutions which the government has affirmed its commitment to support. At December 31, 2014, the student loan asset-backed security held by the Bank was guaranteed by eligible guarantee agencies and reinsured by the U.S. Department of Education for at least 97% of defaulted principal and accrued interest. The structure of this security also incorporates other forms of credit enhancement. Because management believes the declines in the fair values of its residential mortgage-backed securities and student loan asset backed security are attributable to changes in interest rates and not credit quality, and because the Bank does not have the intent to sell these securities and it is likely that it will not be required to sell the securities before their anticipated recovery, the Bank does not consider these securities to be other-than-temporarily impaired at December 31, 2014 and 2013.

At December 31, 2014, the Bank held available-for-sale mortgage-backed securities and asset-backed securities with net unrealized losses of \$114,312 and \$50,281, respectively which had been in a continuous net unrealized loss position for more than 12 months. At December 31, 2014, the Bank held no securities with net unrealized losses which had been in a continuous net unrealized loss position for less than 12 months. At December 31, 2013, the Bank held available-for-sale mortgage-backed securities with net unrealized losses of \$229,524 which had been in a continuous net unrealized loss position for more than 12 months. At December 31, 2013, the Bank held available-for-sale mortgage-backed securities and asset-backed securities with net unrealized losses of \$33,893 and \$23,195, respectively, which had been in a continuous net unrealized loss position for less than 12 months.

(Continued)

PRESIDIO BANK
NOTES TO FINANCIAL STATEMENTS
December 31, 2014 and 2013

NOTE 4 – LOANS

Outstanding loans at December 31, 2014 and 2013 are summarized below:

	<u>2014</u>	<u>2013</u>
Commercial	\$ 133,857,147	\$ 118,863,103
Construction and land development	14,100,301	26,804,454
Commercial real estate	195,777,189	175,751,947
Consumer and other	<u>72,617,775</u>	<u>52,521,471</u>
	416,352,412	373,940,975
Deferred loan origination fees, net	(611,781)	(519,778)
Allowance for loan losses	<u>(5,172,046)</u>	<u>(4,867,106)</u>
	<u>\$ 410,568,585</u>	<u>\$ 368,554,091</u>

Salaries and employee benefits totaling \$592,800 and \$770,608 were deferred as loan origination costs for the years ended December 31, 2014 and 2013, respectively.

As of December 31, 2014, the Bank had a recorded investment in a troubled debt restructuring of \$1,190,905, had allocated \$112,455 of specific reserves for that loan and had not committed to lend additional amounts on that loan. The modification occurred during the year ended December 31, 2014 and included an extension of the maturity date and reduced payments in the near term, but did not change the Bank's recorded investment in the loan or impact the allowance or provision for loan losses because the loan was already considered impaired before it was modified and the specific allowance did not change as a result of the modification. The Bank had no troubled debt restructurings at December 31, 2013.

NOTE 5 – ALLOWANCE FOR LOAN LOSSES

The following table shows the allocation of the allowance for loan losses for the years ended December 31, 2014 and 2013 by portfolio segment and the allocation of the allowance for loan losses at December 31, 2014 and 2013 by portfolio segment and impairment methodology:

	<u>Commercial</u>	<u>Construction and Land Development</u>	<u>Commercial Real Estate</u>	<u>Consumer and Other</u>	<u>Unallocated</u>	<u>Total</u>
<u>Allowance for Loan Losses</u>						
<u>2014</u>						
Beginning balance allocated to portfolio segments	\$ 1,951,325	\$ 450,788	\$ 1,673,974	\$ 624,394	\$ 166,625	\$ 4,867,106
Provision for loan losses	80,232	(203,829)	148,116	243,180	33,375	301,074
Losses charged to allowance	-	-	-	-	-	-
Recoveries	3,172	-	-	694	-	3,866
	<u>\$ 2,034,729</u>	<u>\$ 246,959</u>	<u>\$ 1,822,090</u>	<u>\$ 868,268</u>	<u>\$ 200,000</u>	<u>\$ 5,172,046</u>
Ending balance allocated to portfolio segments						
Ending balance: individually evaluated for impairment	<u>\$ 112,455</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 112,455</u>
Ending balance: collectively evaluated for impairment	<u>\$ 1,922,274</u>	<u>\$ 246,959</u>	<u>\$ 1,822,090</u>	<u>\$ 868,268</u>	<u>\$ 200,000</u>	<u>\$ 5,059,591</u>

(Continued)

PRESIDIO BANK
NOTES TO FINANCIAL STATEMENTS
December 31, 2014 and 2013

NOTE 5 – ALLOWANCE FOR LOAN LOSSES (Continued)

<u>Allowance for Loan Losses</u>	<u>Commercial</u>	<u>Construction and Land Development</u>	<u>Commercial Real Estate</u>	<u>Consumer and Other</u>	<u>Unallocated</u>	<u>Total</u>
<u>2013</u>						
Beginning balance allocated to portfolio segments	\$ 2,375,800	\$ 817,601	\$ 1,185,749	\$ 543,689	\$ 22,477	\$ 4,945,316
Provision for loan losses	(316,635)	(366,813)	458,595	80,705	144,148	-
Losses charged to allowance	(110,000)	-	-	-	-	(110,000)
Recoveries	2,160	-	29,630	-	-	31,790
Ending balance allocated to portfolio segments	<u>\$ 1,951,325</u>	<u>\$ 450,788</u>	<u>\$ 1,673,974</u>	<u>\$ 624,394</u>	<u>\$ 166,625</u>	<u>\$ 4,867,106</u>
Ending balance: individually evaluated for impairment	<u>\$ 281,268</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 281,268</u>
Ending balance: collectively evaluated for impairment	<u>\$ 1,670,057</u>	<u>\$ 450,788</u>	<u>\$ 1,673,974</u>	<u>\$ 624,394</u>	<u>\$ 166,625</u>	<u>\$ 4,585,838</u>

The following table shows the loan portfolio at December 31, 2014 and 2013 by portfolio segment and impairment methodology:

<u>Loans</u>	<u>Commercial</u>	<u>Construction and Land Development</u>	<u>Commercial Real Estate</u>	<u>Consumer and Other</u>	<u>Total</u>
<u>2014</u>					
Ending balance	<u>\$ 133,857,147</u>	<u>\$ 14,100,301</u>	<u>\$ 195,777,189</u>	<u>\$ 72,617,775</u>	<u>\$ 416,352,412</u>
Ending balance: individually evaluated for impairment	<u>\$ 1,330,906</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 1,330,906</u>
Ending balance: collectively evaluated for impairment	<u>\$ 132,526,241</u>	<u>\$ 14,100,301</u>	<u>\$ 195,777,189</u>	<u>\$ 72,617,775</u>	<u>\$ 415,021,506</u>
<u>2013</u>					
Ending balance	<u>\$ 118,863,103</u>	<u>\$ 26,804,454</u>	<u>\$ 175,751,947</u>	<u>\$ 52,521,471</u>	<u>\$ 373,940,975</u>
Ending balance: individually evaluated for impairment	<u>\$ 1,968,381</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 1,968,381</u>
Ending balance: collectively evaluated for impairment	<u>\$ 116,894,722</u>	<u>\$ 26,804,454</u>	<u>\$ 175,751,947</u>	<u>\$ 52,521,471</u>	<u>\$ 371,972,594</u>

As of December 31, 2014 the Bank had impaired commercial loans totaling \$140,001 with no related allowance and impaired loans totaling \$1,190,905 with a related allowance of \$112,455. As of December 31, 2013 the Bank had impaired commercial loans totaling \$698,687 with no related allowance and impaired commercial loans totaling \$1,269,694 with a related allowance \$281,268. The average recorded investment in impaired loans totaled \$1,738,057 and \$1,126,412 for the years ended December 31, 2014 and 2013, respectively, and there was no interest income recognized on impaired loans for the years then ended.

(Continued)

PRESIDIO BANK
NOTES TO FINANCIAL STATEMENTS
December 31, 2014 and 2013

NOTE 5 – ALLOWANCE FOR LOAN LOSSES (Continued)

The following table shows the loan portfolio allocated by management's internal risk ratings at December 31, 2014 and 2013:

	Credit Risk Profile by Internally Assigned Grade				Total
	Commercial	Construction and Land Development	Commercial Real Estate	Consumer and Other	
<u>2014</u>					
Grade:					
Pass	\$ 126,196,096	\$ 12,803,619	\$ 194,713,901	\$ 71,268,185	\$ 404,981,901
Special Mention	5,245,662	1,296,682	1,063,288	1,349,590	8,955,222
Substandard	<u>2,415,389</u>	-	-	-	<u>2,415,389</u>
Total	<u>\$ 133,857,147</u>	<u>\$ 14,100,301</u>	<u>\$ 195,777,189</u>	<u>\$ 72,617,775</u>	<u>\$ 416,352,412</u>
<u>2013</u>					
Grade:					
Pass	\$ 112,531,809	\$ 25,426,454	\$ 171,703,069	\$ 50,031,107	\$ 359,692,438
Special Mention	3,080,585	1,378,000	1,900,203	2,490,364	8,849,153
Substandard	<u>3,250,709</u>	-	<u>2,148,675</u>	-	<u>5,399,384</u>
Total	<u>\$ 118,863,103</u>	<u>\$ 26,804,454</u>	<u>\$ 175,751,947</u>	<u>\$ 52,521,471</u>	<u>\$ 373,940,975</u>

The following table shows an aging analysis of the loan portfolio by the time past due at December 31, 2014 and 2013:

	30-89 Days Past Due		Total Past Due and Nonaccrual		Current	Total
	Nonaccrual	Nonaccrual	Nonaccrual	Nonaccrual		
<u>2014</u>						
Commercial:						
Commercial	\$ -	\$ 1,330,906	\$ 1,330,906	-	\$132,526,241	\$133,857,147
Construction and land-development	-	-	-	-	14,100,301	14,100,301
Commercial real estate	-	-	-	-	195,777,189	195,777,189
Consumer and other	-	-	-	-	<u>72,617,775</u>	<u>72,617,775</u>
Total	<u>\$ -</u>	<u>\$ 1,330,906</u>	<u>\$ 1,330,906</u>	<u>\$ -</u>	<u>\$415,021,506</u>	<u>\$416,352,412</u>
<u>2013</u>						
Commercial:						
Commercial	\$ -	\$ 1,968,381	\$ 1,968,381	-	\$116,894,722	\$118,863,103
Construction and land-development	-	-	-	-	26,804,454	26,804,454
Commercial real estate	-	-	-	-	175,751,947	175,751,947
Consumer and other	-	-	-	-	<u>52,521,471</u>	<u>52,521,471</u>
Total	<u>\$ -</u>	<u>\$ 1,968,381</u>	<u>\$ 1,968,381</u>	<u>\$ -</u>	<u>\$371,972,594</u>	<u>\$373,940,975</u>

(Continued)

PRESIDIO BANK
NOTES TO FINANCIAL STATEMENTS
December 31, 2014 and 2013

NOTE 6 – PREMISES AND EQUIPMENT

Premises and equipment consisted of the following:

	December 31,	
	2014	2013
Furniture, fixtures and equipment	\$ 2,691,325	\$ 2,485,869
Leasehold improvements	1,372,606	1,125,078
	4,063,931	3,610,947
Less accumulated depreciation and amortization	(2,587,301)	(2,532,140)
	\$ 1,476,630	\$ 1,078,807

Depreciation and amortization included in occupancy and equipment expense totaled \$352,993 and \$368,569 for the years ended December 31, 2014 and 2013.

NOTE 7 – INTEREST BEARING DEPOSITS

Interest-bearing deposits consisted of the following:

	December 31,	
	2014	2013
Savings	\$ 2,620,220	\$ 2,507,953
Money market	193,429,810	150,672,137
Interest-bearing demand accounts	69,645,878	71,760,171
Time, \$100,000 or more	41,438,545	25,543,655
Other time	10,203,882	14,128,112
	\$ 317,338,335	\$ 264,612,028

Time deposits issued in denominations greater than or equal to \$250,000 totaled \$34,194,245 and \$16,847,800 at December 31, 2014 and 2013, respectively.

(Continued)

PRESIDIO BANK
NOTES TO FINANCIAL STATEMENTS
December 31, 2014 and 2013

NOTE 7 – INTEREST BEARING DEPOSITS (Continued)

Aggregate annual maturities of time deposits are as follows:

<u>Year Ending December 31,</u>	
2015	\$ 49,038,818
2016	1,797,512
2017	265,177
2018	416,274
2019	<u>124,646</u>
	<u>\$ 51,642,427</u>

Interest expense recognized on interest-bearing deposits for the years ended December 31, 2014 and 2013 consisted of the following:

	<u>December 31,</u>	
	<u>2014</u>	<u>2013</u>
Savings	\$ 2,311	\$ 3,642
Money market	358,483	322,910
Interest-bearing demand accounts	159,266	165,979
Time, \$100,000 or more	99,935	119,529
Other time	<u>176,531</u>	<u>194,703</u>
	<u>\$ 796,526</u>	<u>\$ 806,763</u>

NOTE 8 – INCOME TAXES

Income taxes for the years ended December 31, 2014 and 2013 consisted of the following:

	<u>Federal</u>	<u>State</u>	<u>Total</u>
<u>2014</u>			
Current	\$ 2,024,611	\$ 535,468	\$ 2,560,079
Deferred	<u>(341,000)</u>	<u>15,000</u>	<u>(326,000)</u>
Income tax expense	<u>\$ 1,683,611</u>	<u>\$ 550,468</u>	<u>\$ 2,234,079</u>
<u>2013</u>			
Current	\$ 1,398,009	\$ 17,505	\$ 1,415,514
Deferred	<u>(76,000)</u>	<u>354,000</u>	<u>278,000</u>
Income tax expense	<u>\$ 1,322,009</u>	<u>\$ 371,505</u>	<u>\$ 1,693,514</u>

(Continued)

PRESIDIO BANK
NOTES TO FINANCIAL STATEMENTS
December 31, 2014 and 2013

NOTE 8 – INCOME TAXES (Continued)

The provision for income taxes differs from amounts computed by applying the statutory Federal income tax rate to income before income taxes. The items comprising these differences consisted of the following for the years ended December 31, 2014 and 2013:

	<u>2014</u>		<u>2013</u>	
	<u>Amount</u>	<u>Rate</u>	<u>Amount</u>	<u>Rate</u>
Federal income tax expense at statutory rate	\$ 1,829,252	34.0%	\$ 1,404,378	34.0%
State franchise tax, net of Federal benefit	363,309	6.8%	309,583	7.5%
Compensation for incentive stock options	50,000	0.9%	32,344	0.8%
Other	<u>(8,482)</u>	<u>(0.2)%</u>	<u>(52,791)</u>	<u>(1.3)%</u>
Income tax expense	<u>\$ 2,234,079</u>	41.5%	<u>\$ 1,693,514</u>	41.0%

Deferred tax assets (liabilities) at December 31, 2014 and 2013 consisted of the following:

	<u>2014</u>	<u>2013</u>
Deferred tax assets:		
Net operating losses	\$ -	\$ 46,000
Organizational costs	246,000	284,000
Allowance for loan losses	2,177,000	2,053,000
Share-based compensation	311,000	287,000
Accrued expenses	664,000	579,000
Other	<u>455,000</u>	<u>438,000</u>
Total deferred tax assets	<u>3,853,000</u>	<u>3,687,000</u>
Deferred tax liabilities:		
FHLB stock dividends	(5,000)	(5,000)
Prepaid expenses	-	(45,000)
Change in accounting method	(71,000)	(143,000)
Deferred loan costs	<u>(363,000)</u>	<u>(354,000)</u>
Total deferred tax liabilities	<u>(439,000)</u>	<u>(547,000)</u>
Net deferred tax assets	<u>\$ 3,414,000</u>	<u>\$ 3,140,000</u>

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 its analysis of available evidence, including recent profitability and the ability to realize net operating losses in the near term, management has determined that it is "more likely than not" that the Bank's deferred income tax assets as of December 31, 2014 were be fully realized and therefore no valuation allowance was recorded.

(Continued)

PRESIDIO BANK
NOTES TO FINANCIAL STATEMENTS
December 31, 2014 and 2013

NOTE 8 – INCOME TAXES (Continued)

At December 31, 2014, the Bank had no Federal or State net operating loss carryforwards. The Bank files income tax returns in the United States and California jurisdictions. Federal and California tax returns are currently open for examination for tax years since 2011 and 2010, respectively. The total amount of unrecognized tax benefits, including interest and penalties, at December 31, 2014 was not material. The amount of tax benefits that would impact the effective rate, if recognized, is not expected to be material. The Bank does not anticipate any significant changes with respect to unrecognized tax benefits within the next 12 months.

NOTE 9 – 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, 2014 or 2013.

FRB: The Bank has a borrowing arrangement with the Federal Reserve Bank of San Francisco secured by certain of the Bank's loans. At December 31, 2014, the amounts pledged and borrowing capacity under this arrangement totaled \$114,831,088 and \$97,477,166, respectively. At December 31, 2013, the amounts pledged and borrowing capacity under this arrangement totaled \$32,386,703 and \$28,597,696, respectively. There were no borrowings outstanding under this arrangement at December 31, 2014 or 2013.

FHLB: 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, 2014, the loans pledged and borrowing capacity under such limits were approximately \$104,356,631 and \$81,031,686, respectively. At December 31, 2013, the loans pledged and borrowing capacity under such limits were approximately \$94,796,349 and \$41,728,035, respectively. There were no borrowings outstanding under this arrangement at December 31, 2014 and 2013. Of the borrowing capacity at December 31, 2014, \$22,000,000 was pledged as collateral in the form of a letter of credit to secure public deposits. There were no such pledges at December 31, 2013.

Subordinated Debentures: During 2014 the Bank issued \$10,000,000 of subordinated debentures in a private placement to accredited investors.

The subordinated debentures mature on September 30, 2024. The subordinated debentures are redeemable in whole or in part, from time to time, upon the occurrence of specific events defined within the notes. The subordinated debentures are also redeemable in whole or in part, on or after the fifth anniversary of the effective date of issuance, at prices ranging from 101% to 103% of the principal amount outstanding. Debt issuance costs totaling \$436,696 were capitalized as prepaid expenses and are being amortized over the term of the debt as additional interest expense.

The subordinated debentures may be included in Tier 2 capital (with certain limitations applicable) under current regulatory guidelines and interpretations. The subordinated debentures have a fixed rate of interest equal to 8%.

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PRESIDIO BANK
NOTES TO FINANCIAL STATEMENTS
December 31, 2014 and 2013

NOTE 10 – COMMITMENTS AND CONTINGENCIES

Operating Leases: The Bank leases its San Francisco headquarters, branch offices in Walnut Creek, San Rafael, San Mateo and Palo Alto, and an office in Santa Rosa under non-cancelable operating leases. The leases expire on May 31, 2016, March 31, 2016, August 21, 2017, January 31, 2020, August 31, 2024 and May 30, 2016 respectively. The leases include annual rent adjustments of approximately 2.6%, 2.0%, 3%, 3%, 3% and 3%, respectively, each year during the lease terms. The San Francisco lease has two five year renewal options, the Walnut Creek, San Rafael, San Mateo and Palo Alto leases each have one five year renewal option and the Santa Rosa lease has one three year renewal option.

Approximate future minimum lease payments are as follows:

<u>Year Ending December 31,</u>	<u>Operating Leases</u>
2015	\$ 1,197,926
2016	915,892
2017	743,544
2018	765,850
2019	788,826
Thereafter	<u>1,759,669</u>
	<u>\$ 6,171,707</u>

Rental expense included in occupancy and equipment expense totaled \$1,098,374 and \$1,000,115 for years ended December 31, 2014 and 2013, respectively.

Financial Instruments With Off-Balance-Sheet Risk: The Bank is a party to financial instruments with off-balance-sheet risk in the normal course of business in order to meet the financing needs of its customers and to reduce its own exposure to fluctuations in interest rates. These financial instruments consist of the following at December 31, 2014 and 2013:

	<u>2014</u>	<u>2013</u>
Commitments to extend credit	\$ 194,723,000	\$ 163,263,000
Standby letters of credit	\$ 8,084,000	\$ 4,183,000

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.

(Continued)

PRESIDIO BANK
NOTES TO FINANCIAL STATEMENTS
December 31, 2014 and 2013

NOTE 10 – COMMITMENTS AND CONTINGENCIES (Continued)

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, 2013. The Bank recognizes these fees as revenue over the term of the commitment or when the commitment is used.

Commercial loan commitments represent approximately 66% 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 7% 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 14% 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 4% of total commitments. Home equity lines of credit represent the remaining 9% 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, 2014 and 2013.

In management's judgment, a concentration of loans exists in real estate related loans with approximately 65% 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: Bank maintains funds on deposit with other federally insured financial institutions under correspondent banking agreements. Bank balances totaling approximately \$4,048 exceeded FDIC insurance limits as of December 31, 2014.

(Continued)

PRESIDIO BANK
NOTES TO FINANCIAL STATEMENTS
December 31, 2014 and 2013

NOTE 11 – SHARE-BASED COMPENSATION

Stock Option Awards: Stock option activity for the years ended December 31, 2014 and 2013 is summarized as follows:

	Number of Stock Options Outstanding	Weighted Average Exercise Prices	Weighted Average Remaining Contractual Life
Outstanding at January 1, 2013	1,017,700	\$ 9.29	
Granted	45,000	\$ 8.43	
Cancelled or expired	<u>(52,275)</u>	\$ 9.57	
Outstanding at December 31, 2013	<u>1,010,425</u>	\$ 9.24	4.5 years
Granted	173,500	\$ 10.52	
Exercised	(4,400)	\$ 9.72	
Cancelled or expired	<u>(3,225)</u>	\$ 9.02	
Outstanding at December 31, 2014	<u>1,176,300</u>	\$ 9.35	4.3 years
Exercisable at December 31, 2014	<u>864,940</u>	\$ 9.54	2.9 years
Additional options expected to vest	<u>263,851</u>	\$ 8.76	8.2 years

At December 31, 2014, the aggregate intrinsic value of stock options outstanding was \$3,605,051, the aggregate intrinsic value of options exercisable was \$2,560,748 and the aggregate intrinsic value of additional options expected to vest was \$910,563.

The weighted average exercise price and weighted average remaining contractual term by type of option award were as follows at December 31, 2014:

	Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term
Organizer options	180,000	\$ 10.00	1.6 years
Service-based options	996,300	\$ 9.24	4.8 years

The unrecognized compensation cost related to non-vested service-based options totaled \$608,554 as of December 31, 2014. That cost is expected to be amortized on an accelerated basis over a weighted average period of 2.7 years and will be adjusted for subsequent changes in estimated forfeitures.

(Continued)

PRESIDIO BANK
NOTES TO FINANCIAL STATEMENTS
December 31, 2014 and 2013

NOTE 11 – SHARE-BASED COMPENSATION (Continued)

The following stock option information for service-based options is for the years ended December 31, 2014 and 2013:

	<u>2014</u>	<u>2013</u>
Weighted average grant date fair value per share of options granted	\$ 3.65	\$ 2.92
Significant fair value assumptions:		
Expected term in years	7.2 years	6.3 years
Expected annual volatility	29.6%	32.6%
Expected annual dividend yield	0%	0%
Risk-free interest rate	2.02%	2.0%
Total compensation cost (included in operating expenses)	\$ 236,752	\$ 137,128

Restricted Stock Awards: The following restricted stock information is for the years ended December 31, 2014 and 2013.

	<u>2014</u>		<u>2013</u>	
	<u>Number of Shares</u>	<u>Weighted Average Grant Date Fair Value Per Share</u>	<u>Number of Shares</u>	<u>Weighted Average Grant Date Fair Value Per Share</u>
Nonvested, beginning of year	29,252	\$ 7.49	37,307	\$ 6.91
Granted	4,500	\$ 10.50	46,680	\$ 8.10
Vested	(31,502)	\$ 7.70	(54,735)	\$ 7.62
Forfeited	-	-	-	\$ -
Nonvested, end of year	<u>2,250</u>	\$ 10.50	<u>29,252</u>	\$ 7.49

Restricted Stock Units: The following restricted stock unit information is for the year ended December 31, 2014 and 2013.

	<u>2014</u>		<u>2013</u>	
	<u>Number of Shares</u>	<u>Weighted Average Grant Date Fair Value Per Share</u>	<u>Number of Shares</u>	<u>Weighted Average Grant Date Fair Value Per Share</u>
Nonvested, beginning of year	24,747	\$ -	-	-
Granted	19,046	\$ 10.50	24,747	\$ 8.25
Vested	(24,747)	\$ 8.25	-	\$ -
Forfeited	-	-	-	-
Nonvested, end of year	<u>19,046</u>	\$ 10.50	<u>24,747</u>	\$ 8.25

(Continued)

NOTE 11 – SHARE-BASED COMPENSATION (Continued)

Restricted stock units granted during 2013 and 2014 were earned as of December 31, 2013 and December 31, 2014, respectively, but are payable in shares to the holders as of May 15, 2014 and May 15, 2015, respectively. Units granted with these terms are, therefore, fully expensed as of the year-end but not reflected in shares outstanding until the payout date.

Compensation cost associated with the restricted stock and restricted stock units totaled \$387,797 and \$593,641 for the years ended December 31, 2014 and 2013, respectively. As of December 31, 2014 the unrecognized compensation cost related to the nonvested restricted stock and restricted stock units totaled approximately \$23,593. The unrecognized compensation cost at December 31, 2014 is expected to be amortized on a straight-line basis over a weighted average period of one year and will be adjusted for subsequent changes in estimated forfeitures.

NOTE 12 – 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 \$0.01 per share for an aggregate exercise price of \$3.25. The Treasury exercised the warrant immediately upon issuance. On December 11, 2012, the Treasury sold at auction all 10,800 shares of the Series A Preferred and all 325 shares of the Series B Preferred to private investors.

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.

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.

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PRESIDIO BANK
NOTES TO FINANCIAL STATEMENTS
December 31, 2014 and 2013

NOTE 12 – SHAREHOLDERS' EQUITY (Continued)

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 Series B Preferred. The discount recorded on the Series A Preferred Stock was amortized on the level-yield method over five years.

On November 22, 2013, the Bank repurchased 4,256 shares of the Series A Preferred Stock for \$4,074,920 from a private investor.

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, 2014, no amounts were free of such restrictions. The Bank received regulatory approval to pay the quarterly dividends on the Series A Preferred and the Series B Preferred during 2014 and 2013.

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.

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. As of December 31, 2014 and 2013, the most recent notification from the FDIC categorized the Bank as well capitalized under these guidelines. Management believes as of December 31, 2014 the Bank meets all capital adequacy requirements to which it is subject. There are no conditions or events since that notification that management believes have changed the Bank's category.

(Continued)

PRESIDIO BANK
NOTES TO FINANCIAL STATEMENTS
December 31, 2014 and 2013

NOTE 12 – SHAREHOLDERS' EQUITY (Continued)

Management believes that the Bank met all of its capital adequacy requirements as of December 31, 2014 and 2013.

	<u>2014</u>		<u>2013</u>	
	<u>Amount</u>	<u>Ratio</u>	<u>Amount</u>	<u>Ratio</u>
<u>Leverage Ratio</u>				
Presidio Bank	\$ 47,910,000	8.8%	\$ 44,453,000	10.0%
Minimum requirement for "Well-Capitalized" institution	\$ 27,194,000	5.0%	\$ 22,208,000	5.0%
Minimum regulatory requirement	\$ 21,755,000	4.0%	\$ 17,767,000	4.0%
<u>Tier 1 Risk-Based Capital Ratio</u>				
Presidio Bank	\$ 47,910,000	10.00%	\$ 44,453,000	10.5%
Minimum requirement for "Well-Capitalized" institution	\$ 28,751,000	6.0%	\$ 25,516,000	6.0%
Minimum regulatory requirement	\$ 19,167,000	4.0%	\$ 17,011,000	4.0%
<u>Total Risk-Based Capital Ratio</u>				
Presidio Bank	\$ 63,618,000	13.3%	\$ 49,770,000	11.7%
Minimum requirement for "Well-Capitalized" institution	\$ 47,918,000	10.0%	\$ 42,527,000	10.0%
Minimum regulatory requirement	\$ 38,334,000	8.0%	\$ 34,022,000	8.0%

Earnings Per Share: The factors used in the earnings per share computation for the years ended December 31, 2014 and 2013 are as follows:

	<u>2014</u>	<u>2013</u>
<u>Basic:</u>		
Net income	\$ 3,146,074	\$ 2,437,009
Dividends on preferred stock	(356,650)	(546,778)
Gain on settlement of Series A Preferred Stock	-	151,907
Accretion of discount on Series A Preferred Stock	<u>(57,778)</u>	<u>(35,827)</u>
Net income available to common shareholders	<u>\$ 2,731,646</u>	<u>\$ 2,006,311</u>
Weighted average common shares outstanding	<u>4,177,784</u>	<u>4,119,020</u>
Basic earnings per common share	<u>\$ 0.65</u>	<u>\$ 0.49</u>

(Continued)

PRESIDIO BANK
NOTES TO FINANCIAL STATEMENTS
December 31, 2014 and 2013

NOTE 12 – SHAREHOLDERS' EQUITY (Continued)

	<u>2014</u>	<u>2013</u>
Diluted:		
Net income available to common shareholders	\$ <u>2,731,646</u>	\$ <u>2,006,311</u>
Weighted average common shares outstanding for basic earnings per common share	4,177,784	4,119,020
Add: Dilutive effects of assumed exercises of stock options	<u>187,054</u>	<u>36,701</u>
Average shares and dilutive potential common shares	<u>4,364,838</u>	<u>4,155,721</u>
Diluted earnings per common share	\$ <u>0.63</u>	\$ <u>0.48</u>

Stock options to purchase shares totaling 731,800 for the years ended December 31, 2013 were excluded from the calculation of diluted earnings per share because they were considered ant-dilutive in that the assumed proceeds from exercise price, tax benefits and average future compensation were greater than the average price of the Bank's common stock, but such stock options could become dilutive in the future. There were no such stock options excluded from the calculation of diluted earnings per share for the year ended December 31, 2014.

NOTE 13 – RELATED PARTY TRANSACTIONS

The Bank has entered into transactions with related parties, including Directors, executive officers and affiliates. The following is a summary of the aggregate activity involving related party borrowers during the years ended December 31, 2014 and 2013:

	<u>2014</u>	<u>2013</u>
Beginning balance	\$ 893,000	\$ 388,000
Disbursements	4,062,000	2,971,000
Amounts repaid	<u>(4,032,000)</u>	<u>(2,466,000)</u>
Ending balance	\$ <u>923,000</u>	\$ <u>893,000</u>
Undisbursed commitments to related parties	\$ <u>714,000</u>	\$ <u>679,000</u>

NOTE 14 – 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 \$242,000 and \$227,000 for the years ended December 31, 2014 and 2013, respectively.

(Continued)

PRESIDIO BANK
NOTES TO FINANCIAL STATEMENTS
December 31, 2014 and 2013

NOTE 15 – OTHER EXPENSES

Other expenses for the years ended December 31, 2014 and 2013 consisted of the following:

	<u>2014</u>	<u>2013</u>
Data processing	\$ 1,063,871	\$ 1,005,920
Regulatory and insurance	393,944	371,212
Professional fees	429,258	555,846
Provision for unfunded loan commitments	-	(100,000)
Advertising and promotions	210,922	156,898
Stationery and supplies	161,543	153,060
Travel and entertainment	230,444	215,833
Correspondent bank charges	199,508	168,502
Directors fees and share-based compensation	424,047	554,249
Telephone	144,459	126,791
Other	<u>334,975</u>	<u>294,599</u>
	<u>\$ 3,592,971</u>	<u>\$ 3,502,910</u>

NOTE 16 – FAIR VALUE MEASUREMENTS

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

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

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

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

Management monitors the availability of observable market data to assess the appropriate classification of financial instruments within the fair value hierarchy. Changes in economic conditions or model-based valuation techniques may require the transfer of financial instruments from one fair value level to another. In such instances, the transfer is reported at the beginning of the reporting period. Management evaluates the significance of transfers between levels based upon the nature of the financial instrument and size of the transfer relative to total assets, total liabilities or total earnings.

(Continued)

PRESIDIO BANK
NOTES TO FINANCIAL STATEMENTS
December 31, 2014 and 2013

NOTE 16 – FAIR VALUE MEASUREMENTS (Continued)

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

	Carrying Amount	Fair Value Measurements at December 31, 2014 using:				Total
		Level 1	Level 2	Level 3		
Financial assets						
Cash and cash equivalents	\$ 110,263,158	\$ 110,263,158	\$ -	\$ -	\$ 110,263,158	
Securities available-for-sale	10,640,544	-	10,640,544	-	10,640,544	
Securities held-to-maturity	664,223	-	-	664,223	664,223	
FRB and FHLB stock	3,087,300	N/A	N/A	N/A	N/A	
Loans, net	410,568,585	-	-	413,876,721	413,876,721	
Accrued interest receivable	1,089,133	-	18,309	1,070,824	1,089,133	
Financial liabilities						
Deposits	\$ 481,691,725	\$ 421,947,557	\$ 51,756,504	\$ -	\$ 473,704,061	
Subordinated debt	10,000,000	-	-	10,000,000	10,000,000	
Accrued interest payable	21,529	400	21,129	-	21,529	

	Carrying Amount	Fair Value Measurements at December 31, 2013 using:				Total
		Level 1	Level 2	Level 3		
Financial assets						
Cash and cash equivalents	\$ 55,238,937	\$ 55,238,937	\$ -	\$ -	\$ 55,238,937	
Securities available-for-sale	10,795,985	-	10,795,985	-	10,795,985	
Securities held-to-maturity	668,381	-	-	668,177	668,177	
FRB and FHLB stock	2,765,350	N/A	N/A	N/A	N/A	
Loans, net	368,554,091	-	-	369,728,828	369,728,828	
Accrued interest receivable	1,032,172	-	18,756	1,013,416	1,032,172	
Financial liabilities						
Deposits	\$ 397,158,472	\$ 357,486,705	\$ 39,926,882	\$ -	\$ 397,413,587	
Accrued interest payable	23,509	256	23,253	-	23,509	

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 methods and assumptions used to estimate the fair values of financial instruments are described as follows:

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

(b) *FRB and FHLB Stock* – It is not practical to determine the fair value of FRB and FHLB stock due to restrictions placed on its transferability.

(c) *Investment Securities* – The fair value of investment securities available-for-sale is based on quoted market prices for similar securities in active markets resulting in a Level 2 classification. The fair value for investment securities held-to-maturity is based on a discounted cash flow model resulting in a Level 3 classification.

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PRESIDIO BANK
 NOTES TO FINANCIAL STATEMENTS
 December 31, 2014 and 2013

NOTE 16 – FAIR VALUE MEASUREMENTS (Continued)

(d) *Loans* – Fair values of loans are estimated as follows: For variable rate loans that reprice frequently and with no significant change in credit risk, fair values are based on carrying values resulting in a Level 3 classification. Fair values for other loans are estimated using discounted cash flow analyses, using interest rates currently being offered for loans with similar terms to borrowers of similar credit quality resulting in a Level 3 classification. Certain impaired loans are valued at the lower of cost or fair value of collateral. The methods utilized to estimate the fair value of loans do not necessarily represent an exit price.

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

(f) *Subordinated Debt* – The fair values for subordinated debt are estimated using a discounted cash flows calculation using a discount rate approximating the rate applicable at the balance sheet date for debt issued to institutions of similar credit worthiness resulting in a Level 3 classification.

(g) *Accrued Interest Receivable/Payable* – The carrying amounts of accrued interest approximate fair value resulting in Level 2 for accrued interest receivable on investment securities, Level 3 for accrued interest receivable on loans Level 1 for accrued interest payable on money market deposits and level 2 for accrued interest payable on certificates of deposit.

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

Assets Recorded at Fair Value: The following tables present information about the Bank's assets measured at fair value on a recurring and nonrecurring basis. There were no liabilities measured at fair value on a recurring or nonrecurring basis.

Recurring Basis

The Bank is required or permitted to record the following assets at fair value on a recurring basis at December 31, 2014 and 2013:

<u>Description</u>	<u>Fair Value</u>	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>
<u>December 31, 2014</u>				
Available-for-sale investment securities:				
Debt securities:				
Mortgage backed securities				
residential	\$ 5,709,789	\$ -	\$ 5,709,789	\$ -
Asset backed securities				
Student loans	4,930,755	-	4,930,755	-
Total assets measured at fair value on a recurring basis	<u>\$ 10,640,544</u>	<u>\$ -</u>	<u>\$ 10,640,544</u>	<u>\$ -</u>

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PRESIDIO BANK
NOTES TO FINANCIAL STATEMENTS
December 31, 2014 and 2013

NOTE 16 – FAIR VALUE MEASUREMENTS (Continued)

<u>Description</u>	<u>Fair Value</u>	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>
<u>December 31, 2013</u>				
Available-for-sale investment securities:				
Debt securities:				
Mortgage backed securities				
residential	\$ 5,783,310	\$ -	\$ 5,783,310	\$ -
Asset backed securities				
Student loans	<u>5,012,675</u>	<u>-</u>	<u>5,012,675</u>	<u>-</u>
Total assets measured at fair value on a recurring basis	<u>\$ 10,795,985</u>	<u>\$ -</u>	<u>\$ 10,795,985</u>	<u>\$ -</u>

During the year ended December 31, 2014, there were no transfers in or out of Level 1 or Level 2 categories.

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>
<u>December 31, 2014</u>				
Impaired loans:				
Commercial	<u>\$ 1,078,450</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 1,078,450</u>
Total assets measured at fair value on a non-recurring basis	<u>\$ 1,078,450</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 1,078,450</u>
<u>December 31, 2013</u>				
Impaired loans:				
Commercial	<u>\$ 988,426</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 988,426</u>
Total assets measured at fair value on a non-recurring basis	<u>\$ 988,426</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 988,426</u>

The fair value of impaired loans included above is based on the fair value of the collateral less costs to sell. Impaired loans were categorized as Level 3 with unobservable inputs and assumptions in fair value measurements. Gains of \$168,813 were recognized as decreases in the specific reserves on the above impaired commercial loans for during the year ended December 31, 2014. Losses of \$281,268 were recognized as increases in specific reserves on the above impaired commercial loans during the year ended December 31, 2013.

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PRESIDIO BANK
 NOTES TO FINANCIAL STATEMENTS
 December 31, 2014 and 2013

NOTE 16 – FAIR VALUE MEASUREMENTS (Continued)

The following table presents quantitative information about level 3 fair value measurements for assets measured at fair value on a non-recurring basis at December 31, 2014 and 2013:

<u>December 31, 2014</u>	<u>Fair value</u>	<u>Valuation Technique(s)</u>	<u>Unobservable Input(s)</u>	<u>Input</u>
Impaired loan – commercial	\$ 1,190,905	Sales comparison approach	Adjustment for differences between the comparable sales	13.4%

<u>December 31, 2013</u>	<u>Fair value</u>	<u>Valuation Technique(s)</u>	<u>Unobservable Input(s)</u>	<u>Input</u>
Impaired loan – commercial	\$ 988,426	Sales comparison approach	Adjustment for differences between the comparable sales	9.3%