

PAN PACIFIC BANK

FINANCIAL STATEMENTS

AS OF DECEMBER 31, 2009 AND 2008 AND

FOR THE YEARS THEN ENDED

AND

INDEPENDENT AUDITOR'S REPORT

TO SHAREHOLDERS, CUSTOMERS, AND FRIENDS:

Pan Pacific Bank has emerged from 2009 and the recent recession with a strong presence in its marketplace. The Bank's goal is to be recognized as a viable, safe and sound depository and lender that provides the business community with top quality, personal service.

Pan Pacific's foundation for future growth is based upon paying attention to its customers and market, at the same time managing the Bank with an eye on both safety and performance. It should be noted that to be identified as a "local bank" calls for *self-reliance*. Pan Pacific Bank has not looked to Washington or Wall Street for assistance. The Bank did not accept any "bail out" money from TARP (the federal Troubled Assets Relief Program) and funds its loans primarily with local deposits. Pan Pacific's customer deposits are invested back into the local economy for the benefit of all.

Total assets have reached \$82.6 million, with deposits of \$73.1 million and net loans totaling \$73.6 million. Good balance sheet growth continues and Pan Pacific anticipates improved earnings in 2010. The Bank had a net loss of \$2.4 million in 2009 which was a result of adding \$2.6 million to the loan loss reserve primarily in response to two struggling loan relationships. The good news is that one of those relationships has turned the corner and the other continues to make payments to the Bank under a restructured payment plan.

The Bank's executive management has been strengthened with the addition of Executive Vice President Rob Holden as Chief Credit Officer and Senior Vice President Mike Farstad to head up government lending programs. Both officers have many years of credit experience and bring a wealth of expertise to the Bank.

Although Pan Pacific's current capital ratios exceed regulatory definitions of "well capitalized," the Bank has entered into a consent agreement with FDIC/DFI that requires maintenance of a tier 1 leverage capital ratio of not less than 12%, at year end the ratio was at 11.4%. In addition, the Bank agrees to retain experienced management and directors and closely monitor the quality of its loan portfolio.

The Bank intends to seek additional capital during the Second Quarter 2010. This will give Pan Pacific the opportunity for proactive growth while further strengthening its financial condition and satisfying the requirements of the consent agreement.

Our most immediate growth plans include expansion into the South Bay region, initially as a Loan Production Office which will then be converted into a full service branch. Pan Pacific's spreading customer base calls for the new location and it will contribute to faster growth in deposits and loans. These plans require regulatory approvals and compliance with the consent agreement.

Pan Pacific continually seeks ways to improve all aspects of its banking services in order to attract more customers, all the while adding to shareholder value. Your comments and suggestions are welcomed. Please visit, call or e-mail with those thoughts and ideas, thus joining management and the board in their ongoing intention of building a solid, successful banking enterprise.

Sincere thanks to you all,


Wayne Doiguchi
Chairman & Chief Executive Officer


Joe Ching
President

INDEPENDENT AUDITOR'S REPORT

The Shareholders and
Board of Directors
Pan Pacific Bank

We have audited the accompanying balance sheet of Pan Pacific Bank as of December 31, 2009 and 2008, and the related statements of operations, changes in shareholders' equity and cash flows for the years then ended. These financial statements are the responsibility of the Bank's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Pan Pacific Bank as of December 31, 2009 and 2008, and the results of its operations and its cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

Perry-Smith LLP

April 13, 2010

PAN PACIFIC BANK

BALANCE SHEET

December 31, 2009 and 2008

	<u>2009</u>	<u>2008</u>
ASSETS		
Cash and due from banks	\$ 4,229,384	\$ 1,238,878
Available-for-sale investment securities (Note 2)	3,244,200	4,950,130
Loans less allowance for loan losses of \$1,625,000 in 2009 and \$1,048,000 in 2008 (Notes 3, 6 and 8)	73,550,559	75,285,708
Federal Home Loan Bank stock	735,800	735,800
Bank premises and equipment (Note 4)	337,688	434,004
Accrued interest receivable and other assets	<u>562,152</u>	<u>542,290</u>
Total assets	<u>\$ 82,659,783</u>	<u>\$ 83,186,810</u>
LIABILITIES AND SHAREHOLDERS' EQUITY		
Deposits:		
Non-interest bearing	\$ 10,352,929	\$ 9,999,688
Interest bearing (Note 5)	<u>62,708,716</u>	<u>45,305,292</u>
Total deposits	73,061,645	55,304,980
Short-term borrowings (Note 6)	-	15,952,000
Accrued interest payable and other liabilities	<u>297,973</u>	<u>305,112</u>
Total liabilities	<u>73,359,618</u>	<u>71,562,092</u>
Commitments and contingencies (Note 8)		
Shareholders' equity (Notes 9 and 10):		
Preferred stock – no par value; 10,000,000 shares authorized; none issued or outstanding	-	-
Common stock - no par value; 40,000,000 shares authorized; 1,584,500 shares issued and outstanding at December 31, 2009 and 2008	16,465,367	16,366,964
Accumulated deficit	(7,256,550)	(4,785,607)
Accumulated other comprehensive income	<u>91,348</u>	<u>43,361</u>
Total shareholders' equity	<u>9,300,165</u>	<u>11,624,718</u>
	<u>\$ 82,659,783</u>	<u>\$ 83,186,810</u>

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

PAN PACIFIC BANK
STATEMENT OF OPERATIONS

For the Years Ended December 31, 2009 and 2008

	<u>2009</u>	<u>2008</u>
Interest income:		
Interest and fees on loans	\$ 3,981,781	\$ 3,947,099
Interest on Federal funds sold	11	26,052
Interest on investment securities	<u>189,641</u>	<u>288,513</u>
Total interest income	<u>4,171,433</u>	<u>4,261,664</u>
Interest expense:		
Interest on deposits (Note 5)	922,477	1,004,761
Interest on borrowed funds (Note 6)	<u>24,769</u>	<u>63,067</u>
Total interest expense	<u>947,246</u>	<u>1,067,828</u>
Net interest income before provision for loan losses	3,224,187	3,193,836
Provision for loan losses (Note 3)	<u>2,579,280</u>	<u>440,300</u>
Net interest income after provision for loan losses	<u>644,907</u>	<u>2,753,536</u>
Non-interest income:		
Service charges and fees	<u>161,086</u>	<u>90,242</u>
Other expenses:		
Salaries and employee benefits (Notes 3 and 12)	2,044,331	1,794,270
Occupancy and equipment (Notes 4 and 8)	243,993	256,717
Other (Note 11)	<u>988,612</u>	<u>1,034,653</u>
Total other expenses	<u>3,276,936</u>	<u>3,085,640</u>
Net loss	<u>\$ (2,470,943)</u>	<u>\$ (241,862)</u>
Loss per share	<u>\$ (1.56)</u>	<u>\$ (0.15)</u>
Weighted average number of shares outstanding	<u>1,584,500</u>	<u>1,584,500</u>

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

PAN PACIFIC BANK

STATEMENT OF CHANGES IN SHAREHOLDERS' EQUITY

For the Years Ended December 31, 2009 and 2008

	<u>Common Stock</u>		<u>Accumulated Deficit</u>	<u>Accumulated Other Comprehensive (Loss) Income</u>	<u>Total Shareholders' Equity</u>
	<u>Shares</u>	<u>Amount</u>			
Balance, January 1, 2008	1,584,500	\$ 16,195,964	\$ (4,543,745)	\$ (18,177)	\$ 11,634,042
Net loss			(241,862)		(241,862)
Net change in unrealized loss on available-for-sale investment securities (Note 2)				61,538	61,538
Share-based compensation (Note 10)		171,000			171,000
Balance, December 31, 2008	1,584,500	16,366,964	(4,785,607)	43,361	11,624,718
Net loss			(2,470,943)		(2,470,943)
Net change in unrealized gain on available-for-sale investment securities (Note 2)				47,987	47,987
Share-based compensation (Note 10)		98,403			98,403
Balance, December 31, 2009	<u>1,584,500</u>	<u>\$ 16,465,367</u>	<u>\$ (7,256,550)</u>	<u>\$ 91,348</u>	<u>\$ 9,300,165</u>
				<u>2009</u>	<u>2008</u>
Comprehensive loss:					
Net loss				\$ (2,470,943)	\$ (241,862)
Other comprehensive income:					
Unrealized holding gains on available-for-sale investment securities arising during the period				47,987	61,538
Total comprehensive loss				<u>\$ (2,422,956)</u>	<u>\$ (180,324)</u>

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

PAN PACIFIC BANK
STATEMENT OF CASH FLOWS

For the Years Ended December 31, 2009 and 2008

	<u>2009</u>	<u>2008</u>
Cash flows from operating activities:		
Net loss	\$ (2,470,943)	\$ (241,862)
Adjustments to reconcile net loss to net cash provided by operating activities:		
Provision for loan losses	2,579,280	440,300
Depreciation	100,260	139,342
Share-based compensation	98,403	171,000
Increase (decrease) in deferred loan origination fees, net	(13,509)	20,552
Net amortization of investment security premiums and discounts	(6,577)	(11,666)
Decrease (increase) in interest receivable and other assets	(19,862)	37,687
Decrease in interest payable and other liabilities	(7,139)	(62,962)
	<u>259,913</u>	<u>492,391</u>
Net cash provided by operating activities		
Cash flows from investing activities:		
Maturity of available-for-sale investment securities	-	500,000
Principle repayments received from available-for-sale investment securities	1,760,495	1,268,853
Net decrease in loans	(830,623)	(18,339,643)
Purchase of leasehold improvements and equipment	(3,944)	(46,592)
Purchase of Federal Home Loan Bank stock	-	(492,300)
	<u>925,928</u>	<u>(17,109,682)</u>
Net cash provided by (used in) investing activities		
Cash flows from financing activities:		
Net increase (decrease) in demand, interest bearing and savings deposits	7,332,392	(11,502,274)
Net increase in time deposits	10,424,273	8,753,038
Net (decrease) increase in short-term borrowings	(15,952,000)	15,952,000
	<u>1,804,665</u>	<u>13,202,764</u>
Net cash provided by financing activities		
	2,990,506	(3,414,527)
Increase (decrease) in cash and cash equivalents		
Cash and cash equivalents at beginning of period	<u>1,238,878</u>	<u>4,653,405</u>
Cash and cash equivalents at end of year	<u>\$ 4,229,384</u>	<u>\$ 1,238,878</u>
Supplemental disclosure of cash flow information:		
Cash paid during the year for:		
Interest expense	\$ 925,176	\$ 1,204,193
Non-cash investing activities:		
Net change in unrealized gain on available-for-sale investment securities	\$ 47,987	\$ 61,538

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

PAN PACIFIC BANK

NOTES TO FINANCIAL STATEMENTS

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Pan Pacific Bank (the "Bank") is a state-chartered financial institution headquartered in Fremont, California. The Bank was organized March 10, 2005, and opened for business on July 18, 2005 following the successful offering of 1,584,500 shares of the Bank's common stock. The Bank engages in traditional banking activities offered through its financial center in Fremont, California. The Bank's deposits are insured up to applicable legal limits by the Federal Deposit Insurance Corporation (FDIC), which also regulates the Bank together with the California Department of Financial Institutions (DFI).

The Bank is participating in the FDIC's Transaction Account Guarantee Program. Under this program, through June 30, 2010, all noninterest-bearing transaction accounts are fully guaranteed by the FDIC for the entire amount in the account and the Bank is assessed an annual fee of 10 basis points for all deposit amounts exceeding the existing deposit insurance limit of \$250,000. Coverage under the Transaction Account Guarantee Program is in addition to and separate from the coverage available under the FDIC's general deposit insurance rules.

The financial statements of the Bank are prepared in conformity with accounting principles generally accepted in the United States of America and prevailing practices within the banking industry. The following is a summary of the significant accounting and reporting policies used in preparing the Bank's financial statements.

Management has evaluated subsequent events from December 31, 2009 through April 13, 2010, the date the financial statements were available to be issued.

Use of Estimates

In preparing the financial statements, management is required to make estimates and assumptions that affect reported amounts as of the date of the balance sheet and revenues and expenses for the period. These estimates are based on information available as of the date of the financial statements. Therefore, actual results could differ from those estimates.

Reclassifications

Certain reclassifications have been made to prior years' balances to conform to classifications used in 2009.

Cash and Cash Equivalents

For purposes of the statement of cash flows, the Bank has defined cash and cash equivalents as those amounts included in the balance sheet captions cash and due from banks, for which the carrying amount is a reasonable estimate of fair value.

PAN PACIFIC BANK

NOTES TO FINANCIAL STATEMENTS

(Continued)

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Investment Securities

Investment securities are classified into the following categories:

- Available-for-sale 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 both the positive intent and ability to hold to maturity, reported at amortized cost, adjusted for the accretion of discounts and amortization of premiums.

Management determines the appropriate classification of its investments at the time of purchase and may only change the classification in certain limited circumstances. All transfers between categories are accounted for at fair value. At December 31, 2009, all securities were classified as available-for-sale and there were no transfers between classifications during 2009 or 2008.

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

Investment securities are impaired when their carrying value is greater than their fair value.

Investment securities are evaluated for impairment on at least a quarterly basis and more frequently when economic or market conditions warrant such an evaluation to determine whether a decline in their value below amortized cost 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 issues 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. Management determined that none of the Bank's investment securities were impaired at December 31, 2009.

PAN PACIFIC BANK

NOTES TO FINANCIAL STATEMENTS

(Continued)

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Investment in Federal Home Loan Bank Stock

As a member of the Federal Home Loan Bank of San Francisco, the Bank is required to maintain an investment in the capital stock of the Federal Home Loan Bank (FHLB). The investment is carried at cost. At December 31, 2009 and 2008, FHLB stock totaled \$735,800.

Since January 2009, the FHLB has suspended its repurchase of excess capital stock and its dividends in 2009 were small. FHLB dividends totaled \$1,642 and \$13,716 for the years ended December 31, 2009 and 2008, respectively.

Loans

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

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

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

Allowance for Loan Losses

The allowance for loan losses is established through a provision for loan losses which is charged to expense. Additions to the allowance are expected to maintain the adequacy of the total allowance after credit losses (net of recoveries) and loan growth. The allowance for loan losses at December 31, 2009 and 2008 reflects management's estimate of probable losses in the portfolio.

PAN PACIFIC BANK

NOTES TO FINANCIAL STATEMENTS

(Continued)

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Allowance for Loan Losses (Continued)

The determination of the allowance is based on estimates made by management, to include consideration of the character of the loan portfolio, specifically identified problem loans, potential losses inherent in the portfolio taken as a whole and economic conditions in the Bank's service area.

Management individually evaluates loans determined to be impaired for specific risk of loss. Management also assigns reserve factors to classified loans that are not considered to be impaired and currently performing loans based on its assessment of the following for each identified loan type: (1) inherent credit risk; (2) historical losses; (3) qualitative factors such as changes in the local economies, nature and volume of the loan portfolio, volume and severity of past due loans, and levels of concentrations and; (4) where the Bank has not experienced losses, the loss experience of peer banks. These estimates are particularly susceptible to changes in the economic environment and market conditions.

The Bank's Board of Directors reviewed the adequacy of the allowance for loan losses at December 31, 2009 and 2008. The Board of Directors reviews the adequacy of the allowance for loan losses at least quarterly. The allowance is adjusted based on that review if, in the judgment of the Board of Directors and management, changes are warranted. In addition, the FDIC and DFI, as an integral part of their examination process, review the allowance for loan losses. These agencies may require additions to the allowance for loan losses based on their judgment about information at the time of their examinations.

Premises and Equipment

Premises, equipment and leasehold improvements are stated at cost, less accumulated depreciation and amortization. Depreciation is computed principally by the straight line method over the estimated useful lives of the assets. Estimated useful lives for furniture and equipment are from three to five years. Leasehold improvements are amortized over the lesser of the terms of the respective leases, or their useful lives, which are generally 5 to 10 years. Remodeling and capital improvements are capitalized while maintenance and repairs are charged directly to occupancy expense.

Income Taxes

Deferred tax assets and liabilities are recognized for the tax consequences of temporary differences between the financial statement and tax basis of existing assets and liabilities. 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.

PAN PACIFIC BANK

NOTES TO FINANCIAL STATEMENTS

(Continued)

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Income Taxes (Continued)

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 associated with unrecognized tax benefits is classified as income tax expense in the statement of income. Penalties associated with unrecognized tax benefits are classified as income tax expense in the statement of income.

Loss Per Share

Loss per share is computed by dividing net loss by the weighted average number of common shares outstanding for the period. Diluted loss 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 shares in the earnings of the Bank. The treasury stock method is applied to determine the dilutive effect of stock options in computing diluted loss per share. However, diluted per share amounts are not presented when a net loss occurs because the conversion of potential common stock is antidilutive.

Comprehensive Income (Loss)

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

Share-Based Compensation

The Bank has one share-based compensation plan, the Pan Pacific Bank Equity Incentive Plan, which was approved by the shareholders of the Bank. The Plan does not provide for the settlement of awards in cash and new shares are issued upon option exercise. The Plan is more fully described in Note 10.

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

PAN PACIFIC BANK

NOTES TO FINANCIAL STATEMENTS

(Continued)

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Share-Based Compensation (Continued)

The Bank measures the fair value of the options on the date of grant using a Black-Scholes option pricing model that uses assumptions based on expected option life, expected stock volatility and the risk-free interest rate. The Bank uses the "simplified" method to determine the expected term of the Bank's options due to the lack of sufficient historical data. Stock 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 risk-free rate is based on the U.S. Treasury yield curve and the expected term of the options.

The fair value of each option was estimated on the date of grant using the following weighted-average assumptions.

	<u>2009</u>	<u>2008</u>
Dividend yield	None	None
Expected volatility	37.05%	28.36%
Risk-free interest rate	2.30%	2.87%
Expected option life	6 years	6 years
Fair value of options	\$0.99	\$1.93

Adoption of New Financial Accounting Standards

FASB Accounting Standards Codification™ (ASC or Codification)

In June 2009, the Financial Accounting Standards Board (FASB) issued new accounting standards ASC 105-10 (previously SFAS No. 168), *The FASB Accounting Standards Codification™ and the Hierarchy of Generally Accepted Accounting Principles*. With the issuance of ASC 105-10, the FASB Accounting Standards Codification ("the Codification" or "ASC") becomes the single source of authoritative U.S. accounting and reporting standards applicable for all nongovernmental entities. This change is effective for financial statements issued for interim or annual periods ended after September 15, 2009. Accordingly, all specific references to generally accepted accounting principles (GAAP) refer to the Codification.

PAN PACIFIC BANK

NOTES TO FINANCIAL STATEMENTS

(Continued)

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Adoption of New Financial Accounting Standards (Continued)

FASB Clarifies Other-Than-Temporary Impairment

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

FASB Clarifies Application of Fair Value Accounting

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

Measuring Liabilities at Fair Value

In August 2009, the FASB issued ASU No. 2009-05, *Fair Value Measurements and Disclosures (ASC Topic 820) — Measuring Liabilities at Fair Value*. This update provides amendments for the fair value measurement of liabilities. It provides clarification that in circumstances in which a quoted price in an active market for the identical liability is not available, a reporting entity is required to measure fair value using one or more techniques. It also clarifies that when estimating the fair value of a liability, a reporting entity is not required to include a separate input or adjustment to other inputs relating to the existence of a restriction that prevents the transfer of the liability. This update was effective for the first reporting period (including interim periods) beginning after August 2009. Management adopted the provisions of this update on October 1, 2009 and they did not have a material impact on the Bank's financial condition or results of operations.

PAN PACIFIC BANK

NOTES TO FINANCIAL STATEMENTS

(Continued)

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Adoption of New Financial Accounting Standards (Continued)

Business Combinations

In December 2007, the FASB issued ASC Topic 805 (previously SFAS 141(R)), *Business Combinations*. This standard broadens the guidance for business combinations and extends its applicability to all transactions and other events in which one entity obtains control over one or more other businesses. It broadens the fair value measurement and recognition of assets acquired, liabilities assumed, and interests transferred as a result of business combinations. The acquirer is no longer permitted to recognize a separate valuation allowance as of the acquisition date for loans and other assets acquired in a business combination. It also requires acquisition-related costs and restructuring costs that the acquirer expected but was not obligated to incur to be expensed separately from the business combination. It also expands on required disclosures to improve the ability of the users of the financial statements to evaluate the nature and financial effects of business combinations. This standard was effective for the Bank in 2009 and will be applied to all future business combinations.

Subsequent Events

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

Recently Issued Financial Accounting Standards

Accounting for Transfers of Financial Assets

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

PAN PACIFIC BANK

NOTES TO FINANCIAL STATEMENTS

(Continued)

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Recently Issued Financial Accounting Standards (Continued)

Transfers and Servicing

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

2. AVAILABLE-FOR-SALE INVESTMENT SECURITIES

The amortized cost, unrealized losses and estimated fair value of available-for-sale investment securities at December 31, 2009 and 2008 consisted of the following:

	2009			
Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value	
Debt securities:				
Mortgage-backed securities	\$ 3,152,852	\$ 91,348	\$ -	\$ 3,244,200

Unrealized gains on available-for-sale investment securities totaling \$91,348 were recorded as accumulated other comprehensive income within shareholders' equity at December 31, 2009. There were no sales or transfers of available-for-sale investment securities for the year ended December 31, 2009.

	2008			
Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value	
Debt securities:				
Mortgage-backed securities	\$ 4,906,769	\$ 45,823	\$ (2,462)	\$ 4,950,130

Unrealized gains on available-for-sale investment securities totaling \$43,361 were recorded as accumulated other comprehensive income within shareholders' equity at December 31, 2008. There were no sales or transfers of available-for-sale investment securities for the year ended December 31, 2008.

PAN PACIFIC BANK

NOTES TO FINANCIAL STATEMENTS

(Continued)

2. AVAILABLE-FOR-SALE INVESTMENT SECURITIES (Continued)

The amortized cost and estimated fair value of investment securities at December 31, 2009 by contractual maturity are shown below. Expected maturities may differ from contractual maturities because the issuers of the securities may have the right to call or prepay obligations.

	Amortized Cost	Estimated Fair Value
Less than twelve months	\$ 1,120,489	\$ 1,139,377
Twelve months or more	2,032,363	2,104,823
Total debt securities	\$ 3,152,852	\$ 3,244,200

The following table shows the gross unrealized losses and estimated fair values, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position, at December 31, 2008. There were no securities in a continuous loss position at December 31, 2009.

	December 31, 2008					
	Less than 12 Months		12 Months or More		Total	
	Estimated Fair Value	Unrealized Losses	Estimated Fair Value	Unrealized Losses	Estimated Fair Value	Unrealized Losses
Debt securities:						
Mortgage-backed securities	\$ -	\$ -	\$ 1,960,286	\$ (2,462)	\$ 1,960,286	\$ (2,462)

3. LOANS

Outstanding loans are summarized below:

	December 31,	
	2009	2008
Real estate	\$ 43,978,049	\$ 43,320,889
Commercial	31,297,630	33,065,270
Consumer	78,814	139,992
	75,354,493	76,526,151
Deferred loan origination fees, net	(178,934)	(192,443)
Allowance for loan losses	(1,625,000)	(1,048,000)
	\$ 73,550,559	\$ 75,285,708

PAN PACIFIC BANK

NOTES TO FINANCIAL STATEMENTS

(Continued)

3. LOANS (Continued)

Changes in the allowance for loan losses and undisbursed commitments were as follows:

Year Ended December 31, 2009

	2009	2008
Balance, beginning of year	\$ 1,048,000	\$ 607,700
Provision charged to operations	2,579,280	440,300
Losses charged to the allowance, net	(2,002,280)	-
Balance, end of year	\$ 1,625,000	\$ 1,048,000

There were \$2,182,587 in nonaccrual loans at December 31, 2009 and no nonaccrual loans at December 31, 2008. There were no accruing loans past due 90 days or more at December 31, 2009 or 2008.

At December 31, 2009 and 2008, the recorded investment in impaired loans was \$2,355,601 and \$1,732,215, respectively. The Bank had \$556,016 of specific allowance for loan losses on impaired loans at December 31, 2009. The average outstanding balance of impaired loans for the year ended December 31, 2009 was \$2,725,096, on which \$2,483 was recognized as interest income on a cash basis. Interest foregone on impaired loans was \$113,185 for the year ended December 31, 2009 and was not significant for the year ended December 31, 2008.

Salaries and employee benefits totaling \$95,050 and \$114,500 have been deferred as loan origination costs during the years ended December 31, 2009 and 2008, respectively.

4. BANK PREMISES AND EQUIPMENT

Bank premises and equipment consisted of the following:

	December 31,	
	2009	2008
Leasehold improvements	\$ 410,027	\$ 408,359
Furniture, fixtures and equipment	492,975	490,700
	903,002	899,059
Less accumulated depreciation and amortization	(565,314)	(465,055)
	\$ 337,688	\$ 434,004

Depreciation and amortization on premises and equipment included in occupancy and equipment expense totaled \$100,260 and \$139,342 for the years ended December 31, 2009 and 2008, respectively.

PAN PACIFIC BANK

NOTES TO FINANCIAL STATEMENTS

(Continued)

5. INTEREST-BEARING DEPOSITS

Interest-bearing deposits consisted of the following:

	December 31,	
	2009	2008
Savings	\$ 408,419	\$ 118,332
Money market	31,530,027	25,377,059
Interest-bearing transactions	2,130,684	1,594,589
Time, \$100,000 or more	25,686,656	16,740,792
Other time	2,952,930	1,474,520
	<u>\$ 62,708,716</u>	<u>\$ 45,305,292</u>

Aggregate annual maturities of time deposits are as follows:

Year Ending December 31,	
2010	\$ 25,148,241
2011	3,491,345
	<u>\$ 28,639,586</u>

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

	2009	2008
Savings	\$ 2,292	\$ 352
Money market	492,718	590,995
Interest-bearing transactions	11,920	7,629
Time, \$100,000 or more	359,951	337,617
Other time	55,596	68,168
Total interest expense	<u>\$ 922,477</u>	<u>\$ 1,004,761</u>

6. SHORT-TERM BORROWING ARRANGEMENTS

The Bank has an unsecured Federal funds line of credit with The Independent Bankers Bank under which it can borrow up to \$2,300,000. There were no borrowings outstanding under this arrangement at December 31, 2009.

In addition, the Bank has an unsecured Federal funds line of credit with the Pacific Coast Bankers Bank under which it may borrow amounts not to exceed \$2,000,000. There were no borrowings outstanding under this arrangement at December 31, 2009. There were \$300,000 of borrowings outstanding under this arrangement at December 31, 2008.

PAN PACIFIC BANK

NOTES TO FINANCIAL STATEMENTS

(Continued)

6. SHORT-TERM BORROWING ARRANGEMENTS (Continued)

The Bank has an arrangement with the Federal Home Loan Bank of San Francisco (FHLB) under which it may borrow amounts not to exceed 20% of the Bank's total assets. At December 31, 2009, the Bank's total borrowing capacity under this arrangement was \$10,895,300. There were no borrowings outstanding under this arrangement at December 31, 2009. There were \$15,652,000 of borrowings outstanding under this arrangement at December 31, 2008, which matured on January 2, 2009. The Bank is required to pledge loans and to secure any advances from this arrangement. There were \$21,790,624 in loans pledged at December 31, 2009.

The Bank has an arrangement with the Federal Reserve Bank of San Francisco (FRB). At December 31, 2009, the Bank's total borrowing capacity under this arrangement was \$10,070,545. There were no borrowings outstanding under this arrangement at December 31, 2009. The Bank is required to pledge loans to secure any advances from this arrangement. There were \$22,887,602 in loans pledged at December 31, 2009. This arrangement did not exist as of December 31, 2008.

7. INCOME TAXES

The provision for Federal and State income taxes is as follows for the years ended December 31, 2009 and 2008:

	Federal	State	Total
<u>2009</u>			
Current			
Deferred	\$ (760,000)	\$ (271,000)	\$ (1,031,000)
Change in valuation allowance	760,000	271,000	1,031,000
Income tax provision	\$ -	\$ -	\$ -
<u>2008</u>			
Current			
Deferred	\$ (45,000)	\$ (16,000)	\$ (61,000)
Change in valuation allowance	45,000	16,000	61,000
Income tax provision	\$ -	\$ -	\$ -

The primary difference between the federal statutory tax rate and the tax expense recorded in the financial statements includes the establishment of a valuation allowance against the net deferred tax assets.

PAN PACIFIC BANK

NOTES TO FINANCIAL STATEMENTS

(Continued)

7. INCOME TAXES (Continued)

Deferred income taxes reflect temporary differences between the tax basis of assets and liabilities and the reported amounts of assets and liabilities for financial statement reporting purposes. The Bank's total net deferred tax assets and corresponding valuation allowance at December 31, 2009 and 2008 consist of the following:

	2009	2008
Deferred tax assets:		
Net operating losses and other credits	\$ 1,573,000	\$ 802,000
Organization costs	217,000	238,000
Allowance for loan losses	435,000	333,000
Share-based compensation	118,000	64,000
Securities accretion		56,000
Other	13,000	12,000
State deferred tax assets	488,000	308,000
Deferred tax assets before valuation allowance	2,844,000	1,813,000
Valuation allowance	(2,805,000)	(1,774,000)
Total deferred tax assets	39,000	39,000
Deferred tax liabilities:		
Deferred loan costs	(34,000)	(34,000)
FHLB stock	(5,000)	(5,000)
Total deferred tax liabilities	(39,000)	(39,000)
Net deferred tax assets	\$ -	\$ -

The amounts above include a valuation allowance which is provided to reduce deferred tax assets to a level which, more likely than not, will be realized. Due to the losses recognized during the organizational period and since operations commenced, management has determined that a full valuation allowance is required for the Bank's net deferred tax asset. The need for this valuation allowance will be periodically reviewed and benefits will be recognized when they are determined to be realizable.

At December 31, 2009, the Bank had Federal and State net operating loss carryforwards (NOLs) of approximately \$4,626,696 and \$4,580,870, respectively. The Federal NOLs begin to expire in 2025 and the State NOLs begin to expire in 2017.

The Bank is subject to U.S. Federal income tax and California state franchise tax. Federal and California tax returns for 2006 to 2008 and 2005 to 2008 respectively, are currently open for examination.

PAN PACIFIC BANK

NOTES TO FINANCIAL STATEMENTS

(Continued)

7. INCOME TAXES (Continued)

The total amount of unrecognized tax benefits, including interest and penalties, at December 31, 2009 is 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.

8. COMMITMENTS AND CONTINGENCIES

Commitments to Extend Credit

The Bank is a party to financial instruments with off-balance-sheet risk in the normal course of business in order to meet the financing needs of its customers and to reduce its own exposure to fluctuations in interest rates. These financial instruments consist of commitments to extend credit and standby letters of credit. These instruments involve, to varying degrees, elements of credit and interest rate risk in excess of the amount recognized on the balance sheet.

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

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

	<u>December 31,</u>	
	<u>2009</u>	<u>2008</u>
Commitments to extend credit	\$ 10,589,035	\$ 9,859,518

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.

At December 31, 2009, real estate loan commitments represent approximately 30% of total commitments and are generally secured by property with a loan-to-value ratio not to exceed 75%. Commercial lines of credit and other commitments represent the remaining 70% of total commitments. In addition, the majority of the Bank's loan commitments have variable interest rates.

PAN PACIFIC BANK

NOTES TO FINANCIAL STATEMENTS

(Continued)

8. COMMITMENTS AND CONTINGENCIES (Continued)

Concentrations of Credit Risk

The Bank grants real estate, commercial and consumer loans to customers in Fremont, Alameda and Santa Clara Counties. In management's judgment, a concentration exists in real estate related loans which represented approximately 58% and 56% of the Bank's loan portfolio at December 31, 2009 and 2008, respectively. Although management believes such concentrations to have no more than the normal risk of collectibility, a substantial decline in the economy in general, or additional declines in real estate values in the Bank's primary market area in particular, could have an adverse impact on collectibility of these loans. Personal and business income represent the primary source of repayment for a majority of these loans.

Operating Lease

The Bank leases its branch and headquarters under a non-cancelable operating lease.

Future minimum lease payments are as follows:

<u>Year Ending</u> <u>December 31,</u>	
2010	\$ 113,500
2011	119,640
2012	126,820
2013	132,910
2014	137,610
Thereafter	<u>70,080</u>
	<u>\$ 700,560</u>

Rental expense included in occupancy and equipment expense totaled \$128,695 and \$136,233 for the years ended December 31, 2009 and 2008, respectively.

Contingencies

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

PAN PACIFIC BANK

NOTES TO FINANCIAL STATEMENTS

(Continued)

8. COMMITMENTS AND CONTINGENCIES (Continued)

Correspondent Banking Agreements

The Bank maintains funds on deposit with other federally insured financial institutions under correspondent banking agreements. Those insured financial institutions have elected to participate in the FDIC sponsored Transaction Account Guarantee Program. Under that program, through June 30, 2010, all noninterest-bearing transaction accounts are fully guaranteed by the FDIC for the entire amount in the account. Coverage under the Transaction Account Guarantee Program is in addition to and separate from the coverage available under the FDIC's general deposit insurance rules. Deposits at the FHLB are not insured by the FDIC and totaled \$7,004 and \$15,280 at December 31, 2008, respectively.

9. REGULATORY MATTERS

Dividend Restrictions

Upon declaration by the Board of Directors, all shareholders of record will be entitled to receive dividends. The California Financial Code restricts the total dividend payment of any state banking association in any calendar year to the lesser of (1) the bank's retained earnings or (2) the bank's net income for its last three fiscal years, less distributions made to shareholders during the same three-year period. At December 31, 2009, no amounts were free of such restrictions.

Regulatory Agreement

On April 13, 2010, as a result of a recent regulatory examination of the Bank, management and the Board of Directors entered into a Consent Order (Order) with the FDIC and DFI. The Order will require the Bank, among other things, to have and retain qualified management, to reduce the Bank's risk exposure to adversely classified assets, and to improve liquidity and funds management practices. It also requires the Bank to obtain the permission of the FDIC and DFI to enter into any new lines of business, to establish any new branches or other offices, or to pay cash dividends or otherwise reduce the Bank's capital. Finally, within 120 days of the effective date of the Order, the Bank shall increase and thereafter maintain its Tier 1 capital in such an amount to ensure the Bank's leverage ratio equals or exceeds 12%.

While management believes that a significant portion of these matters were in various stages of completion at the time of the examination, it also believes that full compliance with the Order has not yet been achieved. Failure to comply with the articles of the Order could subject the Bank to additional enforcement action and could have a materially adverse effect on the Bank's business, financial condition and results of operations.

PAN PACIFIC BANK

NOTES TO FINANCIAL STATEMENTS

(Continued)

9. REGULATORY MATTERS (Continued)

Regulatory Capital

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

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

The Bank is also subject to additional capital guidelines under the regulatory framework for prompt corrective action. To be categorized as well capitalized, the Bank must maintain minimum total risk-based, Tier 1 risk-based and Tier 1 leverage ratios as set forth in the table below and may not be subject to any written agreement to meet and maintain a specific capital level for any capital measure. The Bank will be considered "adequately capitalized" under these guidelines as a result of the Order. There are no conditions or events since that notification that management believes have changed the Bank's category.

	2009		2008	
	Amount	Ratio	Amount	Ratio
<u>Leverage Ratio</u>				
Pan Pacific Bank	\$ 9,208,000	11.4%	\$ 11,581,000	14.5%
Minimum requirement for "Well-Capitalized" institution	\$ 4,049,000	5.0%	\$ 3,992,000	5.0%
Minimum regulatory requirement	\$ 3,239,000	4.0%	\$ 3,193,000	4.0%
<u>Tier 1 Risk-Based Capital Ratio</u>				
Pan Pacific Bank	\$ 9,209,000	11.5%	\$ 11,581,000	13.9%
Minimum requirement for "Well-Capitalized" institution	\$ 4,813,000	6.0%	\$ 4,989,000	6.0%
Minimum regulatory requirement	\$ 3,209,000	4.0%	\$ 3,326,000	4.0%
<u>Total Risk-Based Capital Ratio</u>				
Pan Pacific Bank	\$ 10,217,000	12.8%	\$ 12,629,000	15.2%
Minimum requirement for "Well-Capitalized" institution	\$ 8,022,000	10.0%	\$ 8,315,000	10.0%
Minimum regulatory requirement	\$ 6,417,000	8.0%	\$ 6,652,000	8.0%

PAN PACIFIC BANK

NOTES TO FINANCIAL STATEMENTS

(Continued)

10. SHARE-BASED COMPENSATION

During 2005, the shareholders approved the Bank's Amended and Restated 2005 Equity Incentive Plan (the "Plan"). The Plan is intended to attract and retain the best available personnel for positions of substantial responsibility, encourage ownership of stock by employees and directors of the Bank and any of its affiliates, to provide additional incentive for them to promote the success of the Bank's business, and to reward organizers of the Bank for placing personal funds at risk by contributing to the pre-opening funds utilized to organize the Bank. The Plan issues incentive stock option awards within the meaning of Section 422 of the Code, but not all awards are required to be incentive options. At December 31, 2009, 475,300 options to purchase shares of the Bank's common stock are authorized under this Plan. 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 options expire on a date determined by the Board of Directors, but not later than ten years from the date of grant. The vesting period is determined by the Board of Directors and is generally over three years.

A summary of the activity of the Plan for the years ended December 31, 2009 and 2008 follows:

	<u>Number of Stock Options Outstanding</u>	<u>Weighted Average Exercise Price</u>	<u>Weighted Average Remaining Contractual Term (Years)</u>
Options outstanding at December 31, 2008	330,500	\$ 8.50	
Options granted	15,000	\$ 2.50	
Options forfeited	<u>(47,500)</u>	<u>\$ 10.00</u>	
Options outstanding at December 31, 2009	<u>298,000</u>	<u>\$ 7.95</u>	<u>6.75 years</u>
Options vested or expected to vest at December 31, 2009	<u>298,000</u>	<u>\$ 7.95</u>	<u>6.75 years</u>
Options exercisable at December 31, 2009	<u>246,248</u>	<u>\$ 8.58</u>	<u>6.38 years</u>

There were no options exercised in 2009 or 2008.

As of December 31, 2009, there was \$87,483 of total unrecognized compensation cost related to non-vested share-based compensation arrangements. The cost is expected to be recognized over a weighted average period of 2.5 years. Total compensation expense for share-based awards was \$98,403 and \$171,000 in 2009 and 2008, respectively.

PAN PACIFIC BANK

NOTES TO FINANCIAL STATEMENTS

(Continued)

11. OTHER OPERATING EXPENSES

Other expenses for the years ended December 31, 2009 and 2008 consisted of the following:

	<u>2009</u>	<u>2008</u>
Technology	\$ 287,989	\$ 328,641
Legal and professional fees	175,954	248,303
FDIC assessments	156,431	61,957
Stationery and supplies	28,253	24,453
Communication	22,252	24,900
Loan expenses	14,994	12,902
Marketing	5,331	14,240
Other	<u>297,408</u>	<u>319,257</u>
	<u>\$ 988,612</u>	<u>\$ 1,034,653</u>

12. BENEFIT PLAN

401(k) Plan

The Bank sponsors a "safe harbor 401(k) plan" for substantially all full-time employees of the Bank with three or more months of service. Bank employees are permitted, within limitations imposed by tax law, to make pretax contributions to the plan. The Bank makes a matching contribution equal to 100% of each employee's salary deferrals that do not exceed 3% of compensation plus 50% of salary deferrals between 3% and 5% of compensation. For these purposes, compensation is measured annually. This matching contribution is fully vested and is referred to as a Basic Matching Contribution. The Bank contributed \$51,547 and \$41,309 to the plan during the years ended December 31, 2009 and 2008, respectively.

PAN PACIFIC BANK

NOTES TO FINANCIAL STATEMENTS

(Continued)

13. FAIR VALUE MEASUREMENTS

Fair Value of Financial Instruments

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

	December 31, 2009		December 31, 2008	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
Financial assets:				
Cash and cash equivalents	\$ 4,229,384	\$ 4,229,384	\$ 1,238,878	\$ 1,238,878
Available-for-sale investment securities	3,244,200	3,244,200	4,950,130	4,950,130
Loans, net	73,550,559	73,509,000	75,285,708	75,046,000
FHLB stock	735,800	735,800	735,800	735,800
Pacific Coast Bankers' Bancshares stock	190,000	190,000	190,000	190,000
Accrued interest receivable	221,283	221,283	226,460	226,460
Financial liabilities:				
Deposits	\$ 73,061,645	\$ 73,822,000	\$ 55,304,980	\$ 55,495,000
Short-term borrowings	-	-	15,952,000	15,963,000
Accrued interest payable	73,610	73,610	51,540	51,540

These estimates do not reflect any premium or discount that could result from offering the Bank's entire holdings of a particular financial instrument for sale at one time, nor do they attempt to estimate the value of anticipated future business related to the instruments. In addition, the tax ramifications related to the realization of unrealized gains and losses can have a significant effect on fair value estimates and have not been considered in any of these estimates.

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

PAN PACIFIC BANK

NOTES TO FINANCIAL STATEMENTS

(Continued)

13. FAIR VALUE MEASUREMENTS (Continued)

Fair Value Measurements Under SFAS 157

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

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

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

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

Assets Recorded at Fair Value

The following tables present information about the Bank's assets and liabilities measured at fair value on a recurring and nonrecurring basis as of December 31, 2009 and 2008, and the total losses resulting from the recurring fair value adjustments:

Recurring Basis

The Bank is required or permitted to record the following assets at fair value on a recurring basis under other accounting pronouncements at December 31, 2009 and 2008.

<u>Description</u>	<u>Fair Value</u>	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>
Available-for-sale investment securities - 2009	<u>\$ 3,244,200</u>	<u>\$ -</u>	<u>\$ 3,244,200</u>	<u>\$ -</u>
Available-for-sale investment securities - 2008	<u>\$ 4,950,130</u>	<u>\$ -</u>	<u>\$ 4,950,130</u>	<u>\$ -</u>

PAN PACIFIC BANK

NOTES TO FINANCIAL STATEMENTS

(Continued)

13. FAIR VALUE MEASUREMENTS (Continued)

Fair Value Measurements Under SFAS 157 (Continued)

Assets Recorded at Fair Value (Continued)

Recurring Basis (Continued)

Fair values for available-for-sale investment securities, which include government-guaranteed mortgage-backed securities, are based on quoted market prices for similar securities.

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 dates of December 31, 2009 and 2008.

<u>Description</u>	<u>Fair Value</u>	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Total Losses</u>
Impaired loans - 2009	<u>\$1,799,582</u>	<u>\$ 688,290</u>	<u>\$ -</u>	<u>\$1,111,292</u>	<u>\$ 556,016</u>
Impaired loans - 2008	<u>\$1,518,890</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$1,518,890</u>	<u>\$ 213,325</u>

The fair value of impaired loans is based on the fair value of the collateral, less estimated selling costs, for all collateral dependent loans and for other impaired loans is estimated using a discounted cash flow model.

If management determines that the fair value of an impaired loan is less than the recorded investment in the loan, the carrying value is adjusted through a charge-off or additional specific loan loss provisions recorded through the allowance for loan losses. Total losses represent impairment charges recognized during the years ended December 31, 2009 and 2008 related to these impaired loans.