Exchange Bank

March 1, 2013

Dear Shareholders:

We are pleased to present to you the 2012 Consolidated Financial Statements for the Exchange Bank. Our net income met our projections for the year, which was a modest increase over 2011. Additionally, we accomplished many important milestones in 2012:

- Continued improvement in credit quality
- Release of the Treasury Department's investment in Exchange Bank
- Substantial reduction in preferred shares outstanding issued under the Capital Repurchase Program that the U.S. Government put in place in 2008
- Reinstatement of a common shareholder cash dividend, which benefited our largest shareholder, the Doyle Trust, and their ability to reinstate the Doyle Scholarships at Santa Rosa Junior College
- The introduction of a full mobile banking suite of products for our customers

Net income in 2012 was $12.26 million, compared to $12.17 million in 2011. A major influencing factor in our performance was the continued low rate environment. Throughout the year, modest economic growth was reflected in continued weak consumer spending and business investment. In an effort to push for stronger activity, the Federal Reserve again drove interest even lower. With continued weak loan demand, this action continues to put revenue pressure on banks as we see a further reduction in net interest margin; consequently, our net interest income declined by $2.5 million. This decline was favorably offset, however, by improved loan quality, which enabled the Bank to reduce monthly expenditures for its provision for loan losses by an aggregate $2.6 million. Our loan loss provision is a strong 3.41% of loans, well above our peers.

As to a positive development in our capital and the reinstatement of our dividend, you will recall that in the fall of 2008, the U.S. government launched a variety of programs to address the financial crisis. This included the Capital Repurchase Program, under which investments were made in healthy banks to maintain lending in their communities. Exchange Bank received an investment under the CPP of $43 million in preferred stock and $2 million in associated warrants. Wanting to free themselves of the administrative burden of managing the residual parts of this program, in the summer of 2012 the Treasury Department successfully auctioned their investment in Exchange Bank and other banks to the private sector. Because of the aforementioned strong improvement in our earnings, capital levels and non-performing loans, we were able to successfully bid and retire $20 million of this preferred stock at a discount. The auction by Treasury also cleared the way for us to reinstate a common shareholder cash dividend in the third and fourth quarters of 2012. We plan to retire the remaining preferred stocks, subject to regulatory approval, as soon as practical and in a manner that considers the interests of all of our constituencies, including our shareholders. Our capital levels remain strong and above regulatory requirements and will exceed the proposed Basel III standards when they come into effect.

As we prepare our Bank for the future, we recognize that some individuals have speculated that technology is a threat to community banking and that a branch system is not relevant. We do not agree. True, technology is rapidly reinventing and changing our industry, but we continue to change as well.

We continue to make the important investments in technology that strive to accommodate each customer's unique financial needs and empowers them to transact their banking business with us virtually any time and in any way they wish without sacrificing the one-on-one personal banking profile that has been the defining part of our service culture since our inception in 1890.

True to these objectives, in the fourth quarter of 2012, we introduced mobile banking to our customer base that enables our customers to bank wherever they go. This new offering has been well received and is testament to how mobile devices have impacted the delivery of services in banking as well as other industries. The branch system we have will continue to be an important part of this new delivery system. The configuration of the branches may change and we will upgrade the knowledge of our employees to meet the needs of new and emerging technologies.

The Fed is determined to keep rates low until unemployment figures improve. This low rate environment is very difficult on all banks as we mentioned earlier with margins continuing to decline. We believe our strengths in traditional community based lending and deposit-taking activities, along with our strong customer service, position us very well to compete and succeed in the future. We believe that we will see an acceleration of bank consolidations as many smaller institutions decide that regulatory and compliance costs prevent them from achieving desired levels of returns. This consolidation will create opportunities for us to grow our customer base as we believe our local value proposition will be an attractive alternative to banking with one of the larger national banks.

We continued our commitment to the nonprofit community in Sonoma County through our charitable giving. Last year over 300 local nonprofits were the beneficiary of our financial support and countless volunteer hours by Bank employees. Like you, we live and work in this community and care about the welfare of both its resources and people.

The Bank's commitment to our community starts at the top with our dedicated Board members, who all reside in Sonoma County. The Board recently completed a project to modernize and update the Bank's Articles of Incorporation and Bylaws based on its belief that doing so is in the best interest of the Bank and assures the retention of our current directors and ability to attract qualified individuals to serve as directors in the future. With the written consent of more than a majority of the Bank's outstanding voting shares, the Bank's Articles were amended on January 30, 2013 to add a new provision, customary for almost all California corporations, that eliminates the personal liability of directors in certain circumstances and permits indemnification of the Bank's directors, officers and other agents to the fullest extent permissible under California law. Amended and Restated Bylaws were also adopted. We would like to invite you to our Annual Shareholders Meeting on Friday, March 22, 2013 at 2:00 p.m. If you are unable to attend, we would request that your proxy vote be given to management.

If you have any specific questions you would like answered, please direct them in writing to:

Marlene Soiland
Corporate Secretary
Exchange Bank
P.O. Box 403
Santa Rosa, CA 95402

You may also contact the Chairman directly via email at reinkingb@exchangebank.com.

On behalf of all of us, we thank you for the confidence you have placed in us.

Sincerely,

C. William Reinking
Chairman

William R. Schrader
President and Chief Executive Officer

NOTICE OF ANNUAL SHAREHOLDERS MEETING
TO BE HELD MARCH 22, 2013

March 1, 2013

Dear Shareholder:

The annual meeting of the shareholders of Exchange Bank will be held at the Andrew J. Shepard Administrative Services Building, second floor, 444 Aviation Boulevard, Santa Rosa, California on **Friday, March 22, 2013** at **2:00 p.m.** At the meeting, we will review our operating results for 2012 and attend to formal matters as follows:

1. To elect the following eight nominees to serve as directors for the ensuing year:

   - C. W. Reinking
   - M. K. Soiland
   - J. M. Ryan
   - D. B. Benedetti
   - C. G. Tamayo
   - D. G. Libarle
   - W. R. Schrader
   - R. W. Abbey

2. To transact such other business as may properly come before the meeting.

Shareholders of record at the close of business on February 20, 2013 are entitled to notice of and to vote at the meeting.

It is important that your shares be represented at the meeting in person or by proxy. The giving of such proxy will not affect your right to revoke such proxy or to vote in person should you later decide to attend the meeting. For this reason, please complete, sign, date and return the proxy card as promptly as possible in the postage prepaid envelope whether or not you plan to attend the meeting in person.

The following information is included in accordance with the Bank's bylaws:

Any common stock shareholder may nominate a person for election to the Board of Directors at any meeting of shareholders called for the election of directors, provided that the nomination is received by the President not less than thirty-five (35) or more than sixty (60) days prior to any such meeting. To be eligible, all nominees submitted by shareholders must satisfy the age and residency requirements in Section 3.2 of the bylaws and include the name and address of the nominee(s) and all other information required by the bylaws.

Section 3.3 of the Bank's bylaws provides: "Nominations, other than those made by the Board of Directors shall be made in writing and shall be delivered or mailed to the President of the Corporation not less than thirty-five (35) days nor more than sixty (60) days prior to any meeting of shareholders called for the election of directors, provided, however, that if less than twenty-one (21) days' notice of the meeting is given to shareholders, such nomination shall be mailed or delivered to the President of the Corporation not later than the close of business on the seventh (7^{th}) day following the day on which the notice of meeting was mailed. Such notification shall contain the following information as to each proposed nominee and as to each person, acting alone or in conjunction with one or more other persons, in making such nomination or in organizing, directing or financing such nomination or solicitation of proxies to vote for the nominee: (a) the name, age, birthdate, residence address and business address of each proposed nominee and each such person and the date as of which such nominee commenced residency at such residence address; (b) the principal occupation or employment, the name, type of business and address of the organization or other entity in which such employment is carried on of each proposed nominee and of each such person; (c) if the proposed nominee is an attorney, a statement as to whether or not either he or she or any firm with whom he or she has a relationship as partner, associate, of counsel, employee, or otherwise, acts as legal counsel for any banking corporation, affiliate or subsidiary thereof, bank holding company, industrial loan company, savings bank or association or finance company, other than this Corporation or any affiliate or subsidiary of this Corporation; (d) a statement as to each proposed nominee and a statement as to each such person stating whether the nominee or person concerned has been a participant in any proxy contest within the past ten years, and, if so, the statement shall indicate the principals involved, the subject matter of the contest, the outcome thereof, and the relationship of the nominee or person to the principals; (e) the amount of stock of the Corporation owned beneficially, directly or indirectly, by each proposed nominee or by members of his or her family residing with him or her and the names of the registered owners thereof; (f) the amount of stock of the Corporation owned of record but not beneficially by each proposed nominee or by members of his or her family residing with him or her and by each such person or by members of his or her family residing with him or her and the names of the beneficial owners thereof; (g) if any shares specified in (e) or (f) above were acquired in the last two years, a statement of the dates of acquisition and amounts acquired on each date; (h) a statement showing the extent of any borrowings to purchase shares of the Corporation specified in (e) or (f) above acquired within the preceding two years, and if funds were borrowed otherwise than pursuant to a margin account or bank loan in the regular course of business of a bank, the material provisions of such borrowings and the names of the lenders; (i) the details of any contract, arrangement or understanding relating to the securities of the Corporation, to which each proposed nominee or to which each such person is a party, such as joint venture or option arrangements, puts or calls, guaranties against loss, or guaranties of profit or arrangements as to the division of losses or profits or with respect to the giving or withholding of proxies, and the name or names of the persons with whom such contracts, arrangements or understandings exist; (j) the details of any contract, arrangement, or understanding to which each proposed nominee or to which such person is a party with any banking corporation, affiliate or subsidiary thereof, bank holding company, industrial loan company, savings bank or association or finance company, other than this Corporation or any affiliate or subsidiary of this Corporation, or with any officer, director, employee, agent, nominee, attorney, or other representative of such covered entity; (k) a description of any arrangement or understanding of each proposed nominee and of each such person with any person regarding future employment or with respect to any future transaction to which the Corporation will or may be a party; 2) a statement as to each proposed nominee and a statement as to each such person as to whether or not the nominee or person concerned will bear any part of the expense incurred in any proxy solicitation, and, if so, the amount thereof; 3) a statement as to each proposed nominee and a statement as to each such person describing any conviction for a felony that occurred during the preceding ten years involving the unlawful possession, conversion or appropriation of money or other property, or the payment of taxes; 4) the total number of shares that will be voted for each proposed nominee; 5) the amount of stock, if any, owned, directly or indirectly, by each proposed nominee or by members of his or her family residing with him or her, in any banking corporation, affiliate or subsidiary thereof, bank holding company, industrial loan company, savings bank or association or finance company, other than this Corporation or any affiliate or subsidiary of this Corporation; and (a) the identity of any banking corporation, affiliate or subsidiary thereof, or bank holding company or industrial loan company, savings bank or association or finance company, other than this Corporation or any affiliate or subsidiary of this Corporation, as to which such nominee or any other such person serves as a director, officer, employee, agent, consultant, advisor, nominee or attorney, together with a description of such relationship."

The Chairman of the Board (or other person presiding at the meeting in accordance with the bylaws) may, in his or her discretion, determine and declare to the meeting that a nomination not made in accordance with Sections 3.2 and 3.3 of the bylaws shall be disregarded.

If you have questions about the operations of the Bank, you may submit them in writing before the meeting. Any questions that cannot be answered within a reasonable time during the meeting will be responded to in a post meeting report mailed by the Corporate Secretary to all shareholders within 30 days of the Annual Meeting.

As required by FDIC regulations, the Bank's annual disclosure statement will be sent to any shareholder upon request. The first copy of the annual disclosure statement will be provided to a shareholder without charge. If you wish a copy of this information, please send a written request to my attention at the address below or you may call (707) 524-3121.

By Order of the Board of Directors,

Marlene Soiland

Marlene K. Soiland
Corporate Secretary

MKS/ks

TRANSACTIONS WITH DIRECTORS AND OFFICERS

The Bank has had and expects in the future to have banking transactions in the ordinary course of its business with some of its Directors and Officers and their associates, including transactions with corporations or partnerships of which such persons are directors, officers, controlling shareholders, or partners on substantially the same terms (including interest rates and collateral) as those prevailing for comparable transactions with others. Management believes that in 2012 such transactions did not involve more than the normal risk of collectability or present other unfavorable features. Loans to Directors and Executive Officers of the Bank are subject to limitations prescribed by the Financial Code of the State of California as well as applicable federal law and regulations.

In addition, these transactions are disclosed as required by law.

During calendar year 2012 the Bank engaged in transactions with the law firm of Abbey, Weitzenberg, Warren & Emery, a Professional corporation, in which Richard W. Abbey, an Exchange Bank Director, has a material interest as a 12.5% shareholder. The amount of attorney's fees paid was in excess of $40,000.

EXCHANGE BANK
BOARD OF DIRECTORS

C. William Reinking

Mr. Reinking was elected to the Board in 1985 when he was appointed President and Chief Operating Officer. He has been with the Bank for 48 years. He retired in 2003 and at that time became Chairman of the Board. In 2008, he was again employed by the Bank as Chief Executive Officer and remained Chairman. On December 31, 2009, he retired again as Chief Executive Officer and remains as Chairman. In 2010, he was named a Doyle Trustee. Mr. Reinking is a graduate of the University of Oregon and the Pacific Coast Banking School. His community involvement, current and past, includes Becoming Independent, Canine Companions, Sonoma County Community Foundation, Chamber of Commerce, the Luther Burbank Center and the Active 20-30 Club.

Marlene K. Soiland

Ms. Soiland was elected to the Board in 1997 and is Corporate Secretary and Chair of the Board's Trust Committee. After graduation from Cal Poly in San Luis Obispo, she returned to Santa Rosa and her family business. She is currently President and owner of Soiland Management Co., Inc. Ms. Soiland is involved in several industry organizations such as the Sonoma County Alliance, Sonoma County Innovation Council, Institute for Family Business, and California Construction and Industrial Materials Association.

James M. Ryan

Mr. Ryan was elected to the Board in 1997 and named a Doyle Trustee in 2007. He now serves as Vice Chairman of the Board and Chairs the Board's Audit and Nominating Committees. He is a graduate of California State University Sacramento and is a licensed Real Estate Broker, Certified Public Accountant and a licensed General Contractor. Mr. Ryan is the owner and President of Ryan Mortgage Company, Inc. and Ryan Realty, Inc. in Santa Rosa. He has served as a Director of the American Red Cross, Sonoma County Chapter, and numerous trade associations.

Dante B. Benedetti

Mr. Benedetti was elected a Director in 2002 and named a Doyle Trustee in 2008. He is currently Chair of the Board's Compensation Committee. He attended Santa Rosa Junior College and graduated from Sonoma State University. Mr. Benedetti is the Past President of Clover Stornetta Farms, Inc. and is now Chairman of the Board of that company. Active in the community, he is on the President's Advisory Board at Santa Rosa Junior College and Sonoma State University, a former member of the Board at Sonoma County Community Foundation, Hanna Boys Center, California Dairy Institute, Culinary Institute of America, California Independent Grocers Association and the Sonoma County Probation Department Advisory Board.

Carlos G. Tamayo

Mr. Tamayo was elected a Director in 2004 and serves as Chair of the Board's Community Reinvestment Act Committee. He is a graduate of Arizona State University with a master's degree from American Graduate School of International Management. Mr. Tamayo is the President and Chairman of La Tortilla Factory, a family owned business founded in 1977. His community activities include the Salvation Army, Hispanic Chamber of Commerce, Lions Club, the Sonoma County Community Foundation and various trade groups.

Daniel G. Libarle

Mr. Libarle was elected to the Board in 2007 and serves as Chair of the Board's Loan and Corporate Governance Committees. A graduate of San Jose State University, he is President of their family owned business, Lace House Linen, Inc. The business has been in operation since 1915 in Petaluma. Mr. Libarle has previous banking experience as the founding Chairman of the Bank of Petaluma. That bank was bought by Greater Bay Bank and he served on their Board until it was bought by Wells Fargo Bank. He has been very active in his community. His involvement includes the Rotary Club, Boys & Girls Club, Chamber of Commerce, United Way and several trade groups.

William R. Schrader

Mr. Schrader was elected to the Board in 2008 when he was appointed President. Currently he is President and Chief Executive Officer. He joined the Bank in 1978 and has served as Senior Loan Officer and Chief Operating Officer. Mr. Schrader is a graduate of St. Mary's College and received his master's from Golden Gate University. He is also a graduate of the Pacific Coast School of Banking. His community involvement includes the YMCA, Diocesan School Board, the Santa Rosa Community Health Center, the Chamber of Commerce Education Leadership Committee and a Regent for Hanna Boys Center.

Richard W. Abbey

Mr. Abbey was appointed to the Board in 2010 and serves as Chair of the Board's Technology Committee. He received his degree from the University of California, Berkeley and his law degree from the University of California, Los Angeles. He has been a practicing attorney in Sonoma County since 1973 and presently has his own firm, Abbey, Weitzenberg, Warren and Emery. He has been the general counsel for the Exchange Bank since the mid 1980's. Mr. Abbey's community involvement activities include the Redwood Empire Food Bank, YMCA, Habitat for Humanity, the Santa Rosa Junior College Foundation and Schools Plus Enrichment Foundation.

EXCHANGE BANK AND SUBSIDIARIES
Santa Rosa, California

CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2012 and 2011

EXCHANGE BANK AND SUBSIDIARIES
Santa Rosa, California

FINANCIAL STATEMENTS
December 31, 2012 and 2011

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Crowe Horwath.

Crowe Horwath LLP
Independent Member Crowe Horwath International

INDEPENDENT AUDITOR'S REPORT

To the Stockholder's and
Board of Directors
Exchange Bank and Subsidiaries
Santa Rosa, California

Report on the Financial Statements

We have audited the accompanying consolidated financial statements of Exchange Bank and Subsidiaries, which comprise the consolidated balance sheets as of December 31, 2012 and 2011, and the related consolidated statements of income, comprehensive income, changes in stockholders' 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 consolidated 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 consolidated 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 consolidated 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 consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated 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 consolidated financial statements in order to design audit procedures that are appropriate in the circumstances. 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 consolidated 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 consolidated financial statements referred to above present fairly, in all material respects, the financial position of Exchange Bank and Subsidiaries as of December 31, 2012 and 2011, and the results of their operations and their cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Report on Other Legal and Regulatory Requirements

We have also audited in accordance with attestation standards established by the American Institute of Certified Public Accountants, Exchange Bank and Subsidiaries' internal control over financial reporting as of December 31, 2012 based on criteria established in *Internal Control – Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) and our report dated February 20, 2013 expressed an unqualified opinion.

Crowe Horwath LLP

Crowe Horwath LLP

Sacramento, California
February 20, 2013

EXCHANGE BANK AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
December 31, 2012 and 2011
(In thousands, except share and par value amounts)

	2012	2011
ASSETS		
Cash and due from banks	$ 139,322	$ 94,122
Short-term investments	226	226
Total cash and cash equivalents	139,548	94,348
Interest-bearing deposits in other financial institutions	16,000	-
Available-for-sale investment securities	395,495	344,930
Loans and leases	1,044,869	1,052,754
Less allowance for loan and lease losses	(35,631)	(31,751)
Net loans and leases	1,009,238	1,021,003
Federal Home Loan Bank stock	6,401	7,068
Bank premises and equipment, net	16,485	17,772
Bank owned life insurance	35,041	33,907
Other real estate owned	12,154	8,781
Accrued interest receivable and other assets	68,495	72,594
Total assets	$ 1,698,857	$ 1,600,403
LIABILITIES AND STOCKHOLDERS' EQUITY		
Deposits:		
Non-interest bearing	$ 516,757	$ 466,937
Interest bearing	943,000	883,946
Total deposits	1,459,757	1,350,883
Federal Home Loan Bank advances and other long-term debt	38,000	41,000
Accrued interest payable and other liabilities	44,676	45,501
Total liabilities	1,542,433	1,437,384
Commitments and contingencies (Note 14)		
Stockholders' equity:		
Preferred stock, 1,000,000 shares authorized:		
Series A, noncumulative, $1,000 per share liquidation preference; 23,000 and 43,000 shares issued and outstanding as of December 31, 2012 and 2011	22,570	42,140
Series B, noncumulative, $1,000 per share liquidation preference; 2,150 shares issued and outstanding	2,150	2,150
Common stock, $2.50 par value; 3,000,000 shares authorized; 1,714,344 shares issued and outstanding	4,286	4,286
Additional paid-in capital	46,026	46,026
Retained earnings	84,937	73,561
Accumulated other comprehensive loss, net of taxes	(3,545)	(5,144)
Total stockholders' equity	156,424	163,019
Total liabilities and stockholders' equity	$ 1,698,857	$ 1,600,403

See accompanying notes to consolidated financial statements.

EXCHANGE BANK AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF INCOME
For the Years Ended December 31, 2012 and 2011
(In thousands, except per share amounts)

	2012	2011
Interest income:		
Interest and fees on loans and leases	$ 59,247	$ 61,896
Interest on investment securities:		
Taxable	5,043	5,294
Exempt from Federal income taxes	3,012	3,661
Total interest income	67,302	70,851
Interest expense:		
Interest on deposits	2,313	3,162
Interest on borrowings	1,518	1,684
Total interest expense	3,831	4,846
Net interest income before provision for loan and lease losses	63,471	66,005
Provision for loan and lease losses	9,150	12,550
Net interest income after provision for loan and lease losses	54,321	53,455
Non-interest income:		
Service charges and fees	8,060	7,453
Trust income	4,924	4,685
Merchant discount and interchange fees	4,044	3,719
Income from bank owned life insurance	1,402	1,418
Other income	3,359	3,547
Total non-interest income	21,789	20,822
Non-interest expense:		
Salaries and employee benefits	31,283	28,813
Occupancy and equipment	6,689	7,345
Professional fees	6,235	6,656
Loss on sale of other real estate owned	812	551
FDIC assessments	1,478	2,907
Other expenses	11,222	10,392
Total non-interest expense	57,719	56,664
Income before provision for income taxes	18,391	17,613
Provision for income taxes	6,129	5,435
Net income	$ 12,262	$ 12,178
Basic and diluted earnings per common share	$ 5.93	$ 5.74

See accompanying notes to consolidated financial statements.

EXCHANGE BANK AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
For the Years Ended December 31, 2012 and 2011
(In thousands)

	2012	2011
Net Income	$ 12,262	$ 12,178
Change in unrealized gain on available-for-sale investment securities	(539)	3,495
Tax effect	226	(1,513)
Changes in unrealized gain on available-for-sale investment securities, net of tax	(313)	1,982
Changes in defined benefit pension plan liabilities	2,993	(10,469)
Tax effect	(1,372)	4,716
Changes in defined benefit pension plans, net of tax	1,621	(5,753)
Change in deferred compensation trust liabilities	503	(461)
Tax effect	(212)	189
Changes in deferred compensation trust, net of tax	291	(272)
Other comprehensive income (loss)	1,599	(4,043)
Total Comprehensive Income	$ 13,861	$ 8,135

See accompanying notes to consolidated financial statements.

EXCHANGE BANK AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY
For the Years Ended December 31, 2012 and 2011
(In thousands)

	Preferred Stock						
	Series A	Series B	Common Stock	Additional Paid-In Capital	Retained Earnings	Accumulated Other Comprehensive (Loss) Income (Net of Taxes)	Total Stockholders' Equity
Balance, January 1, 2011	$ 41,710	$ 2,150	$ 4,286	$ 46,026	$ 64,155	$ (1,101)	$ 157,226
Net Income	-	-	-	-	12,178	-	12,178
Other comprehensive income:							
Net change in unrealized gain on available-for-sale investment securities (net of $1,513 in tax provision)	-	-	-	-	-	1,982	1,982
Defined benefit pension plans:							
Amortization of prior service costs included in net periodic pension costs (net of $191 in tax benefits)	-	-	-	-	-	(233)	(233)
Net loss arising during period (net of $4,525 in tax benefit)	-	-	-	-	-	(5,520)	(5,520)
Change in unrealized gain on deferred compensation trust (net of $189 in tax benefit)	-	-	-	-	-	(272)	(272)
Preferred stock dividends	-	-	-	-	(2,342)	-	(2,342)
Accretion of preferred stock discount	430	-	-	-	(430)	-	-
Balance, December 31, 2011	42,140	2,150	4,286	46,026	73,561	(5,144)	163,019
Net Income	-	-	-	-	12,262	-	12,262
Other comprehensive income:							
Net change in unrealized gain on available-for-sale investment securities (net of $226 in tax provision)	-	-	-	-	-	(313)	(313)
Defined benefit pension plans:							
Amortization of prior service costs included in net periodic pension costs (net of $6 in tax benefits)	-	-	-	-	-	8	8
Net gain arising during period (net of $1,365 in tax provision)	-	-	-	-	-	1,613	1,613
Change in unrealized gain on deferred compensation trust (net of $212 in tax benefit)	-	-	-	-	-	291	291
Preferred stock repurchase	(20,000)	-	-	-	2,495	-	(17,505)
Cash dividends	-	-	-	-	(2,951)	-	(2,951)
Accretion of preferred stock discount	430	-	-	-	(430)	-	-
Balance, December 31, 2012	$ 22,570	$ 2,150	$ 4,286	$ 46,026	$ 84,937	$ (3,545)	$ 156,424

See accompanying notes to consolidated financial statements.

EXCHANGE BANK AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
For the Years Ended December 31, 2012 and 2011
(In thousands)

	2012	2011
Cash flows from operating activities:		
Net Income	$ 12,262	$ 12,178
Adjustments to reconcile net income to net cash provided by operating activities:		
Valuation allowance on other real estate owned	645	1,680
Depreciation and amortization	2,357	2,487
Provision for loan losses	9,150	12,550
Provision for Deferred Income Taxes	1,233	4,237
Gain on sale of Bank premises and equipment		(636)
Gain on sale of loans	(1,231)	(1,075)
Loss (Gain) on sale of other real estate owned	167	(1,261)
Accretion of discounts and amortization of premiums on investment securities	3,018	2,602
Net change in deferred loan origination fees	35	(216)
Net loans originated with intent to sell	(579)	(4,784)
Increase in bank owned life insurance, net of expenses	(1,134)	(1,166)
Changes in operating assets and liabilities:		
Accrued interest receivable and other assets	3,020	(6,023)
Accrued interest payable and other liabilities	1,158	8,074
Net cash provided by operating activities	30,101	24,410
Cash flows from investing activities:		
Increase in Interest-bearing deposits in other financial institutions	(16,000)	-
Proceeds from sale of other real estate owned	5,675	10,464
Proceeds from sale of Bank premises and equipment	-	818
Proceeds from maturities of investment securities	240,225	198,405
Purchase of investment securities	(294,346)	(224,066)
Redemptions of Federal Home Loan Bank (FHLB) stock	667	1,370
Net increase in loans and leases	(5,470)	(11,383)
Purchase of bank premises and equipment	(1,070)	(2,835)
Net cash used in investing activities	(70,319)	(27,228)
Cash flows from financing activities:		
Net increase in demand, interest bearing and savings deposits	128,361	78,768
Net decrease in time deposits	(19,487)	(13,037)
Repayments of long-term FHLB advances	(3,000)	(6,000)
Repurchase of Preferred Stock	(17,505)	-
Cash paid for dividends	(2,951)	(2,342)
Net cash provided by financing activities	85,418	57,389
Increase in cash and cash equivalents	45, 200	54,571
Cash and cash equivalents, beginning of year	94,348	39,777
Cash and cash equivalents, end of year	$ 139,548	$ 94,348
Supplemental disclosure of cash flow information:		
Cash paid during the year for:		
Interest expense	$ 3,831	$ 4,896
Income taxes	$ 7,432	$ 2,615
Non-cash investing activity:		
Transfer of loans to other real estate owned	$ 9,860	$ 2,593

See accompanying notes to consolidated financial statements.

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Organization and Nature of Operations: Exchange Bank (the "Bank"), a California corporation, and its wholly-owned subsidiaries, A. J. Ventures, Inc. and AJV-Ripon LLC, conduct their business from their headquarters in Santa Rosa, California. The Bank is a full service bank providing a range of commercial and retail banking services to individuals and businesses. The Bank, through its loan portfolio, has geographically concentrated credit risk in Sonoma County. Additionally, the loan portfolio has a concentration in loans secured by real estate.

The accounting and reporting policies of the Bank and its subsidiaries conform with accounting principles generally accepted in the United States of America and prevailing practices within the financial services industry. A summary of the more significant accounting and reporting policies follows:

Principles of Consolidation: The consolidated financial statements include the accounts of the Bank and its wholly-owned subsidiaries, A. J. Ventures, Inc. and AJV-Ripon LLC. The subsidiaries are used to hold real estate properties acquired through, or in lieu of, loan foreclosure. All intercompany accounts and transactions have been eliminated upon consolidation.

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 and the disclosure of contingent 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 those estimates. The allowance for loan and lease losses, deferred tax assets and fair value of financial instruments are particularly subject to change.

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

The Bank maintains funds on deposit with the Federal Home Loan Bank (FHLB) and other federally insured financial institutions under correspondent banking agreements. Uninsured deposits with the FHLB and correspondent banks totaled $323 and $366 at December 31, 2012 and 2011, respectively.

Investment Securities: The Bank classifies its investment securities as either available-for-sale or held-to-maturity at the time of purchase. Available-for-sale investment securities are measured at fair value with a corresponding recognition of the net unrealized holding gain or loss, net of income taxes, within accumulated other comprehensive income (loss), which is a separate component of stockholders' equity, until realized. Held-to-maturity investment securities are measured at amortized cost, based on the Bank's positive intent and ability to hold such securities to maturity. At December 31, 2012 and 2011, the Bank did not hold any held-to-maturity investment securities.

Premiums and discounts are amortized or accreted over the life of the related investment security as an adjustment to interest income using a method that approximates the interest method. Interest income is recognized when earned. Realized gains and losses on the sale of investment securities are computed using the specific identification method for determining the cost of investment securities sold.

(Continued)

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Management evaluates securities for other-than-temporary impairment ("OTTI") on at least a quarterly basis, and more frequently when economic or market conditions warrant such an evaluation. For securities in an unrealized loss position, management considers the extent and duration of the unrealized loss, and the financial condition and near-term prospects of the issuer. Management also assesses whether it intends to sell, or it is more likely than not that it will be required to sell, a security in an unrealized loss position before recovery of its amortized cost basis. If either of the criteria regarding intent or requirement to sell is met, the entire difference between amortized cost and fair value is recognized as impairment through earnings. For debt securities that do not meet the aforementioned criteria, the amount of impairment is split into two components as follows: 1) OTTI related to credit loss, which must be recognized in the income statement and 2) other-than-temporary impairment (OTTI) related to other factors, which is recognized in other comprehensive income. The credit loss is defined as the difference between the present value of the cash flows expected to be collected and the amortized cost basis. For equity securities, the entire amount of impairment is recognized through earnings.

Federal Home Loan Bank (FHLB) Stock: The Bank is a member of the FHLB system. Members are required to own a certain amount of stock based on the level of borrowings and other factors, and may invest in additional amounts. FHLB stock is carried at cost, classified as a restricted security, and periodically evaluated for impairment based on ultimate recovery of par value. Both cash and stock dividends are reported as income.

Loans and Leases: Loans that management has the ability and intent to hold for the foreseeable future or maturity or payoff are reported at the principal amounts outstanding, adjusted for unamortized discounts and premiums and net of deferred loan origination fees and costs, write-downs and the allowance for loan losses. Direct financing leases are carried net of unearned income. Income from leases is recognized by a method that approximates a level yield on the outstanding net investment in the lease.

The Bank charges fees for originating loans and leases. These origination and commitment fees, net of certain related direct loan and lease origination costs, are deferred. The net deferred fees or costs are recognized as an adjustment of yield over the contractual life of the loan or lease using the interest method. The unamortized balance of deferred fees and costs is reported as a component of net loans and leases.

For all classes of loans, interest is accrued daily based upon outstanding loan and lease balances. However, when, in the opinion of management, loans or leases become 90 days past due or are considered impaired and the future collectibility of interest and principal is in serious doubt, a loan or lease is 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 leases, or payments received on nonaccrual loans or leases 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 and leases are restored to accrual status when the obligation is brought current and has performed in accordance with the contractual terms for a reasonable period of time and the ultimate collectibility of the total contractual principal and interest is no longer in doubt.

(Continued)

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Loan Sales and Servicing: Included in the portfolio are loans guaranteed by the Small Business Administration (SBA) that may be sold in the secondary market. Loans held for sale are carried at the lower of cost or market value. Fair value is determined by the specific identification method as of the balance sheet date or the date that the purchasers have committed to purchase the loans. At the time the loan is sold, the related right to service the loan is recorded at fair value with the Bank earning future servicing income. Gains and losses are recognized based on the difference between the selling price and the fair value of servicing assets or liabilities and the allocated carrying value of the loans sold. At December 31, 2012 and 2011 the balance of loans originated and unsold under the SBA program totaled $579 and $4,793, respectively. Management has determined that the unsold loans originated through the SBA program were not material for disclosure as held for sale at December 31, 2012 and 2011.

Loans held for sale subsequently transferred to the loan portfolio are transferred at the lower of cost or market value at the date of transfer. Any difference between the carrying amount of the loan and its outstanding principal balance is recognized as an adjustment to yield by the interest method.

Servicing rights acquired through 1) a purchase or 2) the origination of loans which are sold or securitized with servicing rights retained are recognized as separate assets or liabilities. Servicing assets or liabilities are recorded at fair value, and are subsequently amortized in proportion to and over the period of the related net servicing income or expense. SBA loans with unpaid balances of approximately $30,408 and $16,434 were being serviced for others at December 31, 2012 and 2011, respectively. Servicing assets at December 31, 2012 and 2011 were not significant.

Allowance for Loan and Lease Losses: The allowance for loan and lease losses is an estimate of probable credit losses in the Bank's loan portfolio that have been incurred as of the balance-sheet date. For all loan classes the allowance is established through a provision for loan and lease 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 overall allowance consists of two primary components, specific reserves related to impaired loans and general reserves for inherent losses related to loans that are not impaired.

For all classes of the portfolio, a loan or lease 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 principal and interest, according to the contractual terms of the original agreement. Loans and leases determined to be impaired are individually evaluated for impairment. When a loan or lease 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.

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.

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

The determination of the general reserve for loans and leases that are not impaired is based on estimates made by management, to include, but not limited to, consideration of historical losses by portfolio segment, internal asset classifications, and qualitative factors to include economic trends in the Bank's service areas, industry experience and trends, 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 real estate – commercial, real estate – construction, commercial, lease financing and consumer loans. The allowance for loan and lease 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 consolidated balance sheet.

The Bank assigns a risk rating to all loans except pools of homogeneous 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 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 and lease 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.

(Continued)

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Real Estate–Commercial – This segment is comprised of loans used to finance the acquisition of commercial real property. These loans are secured by first liens against the underlying real property. The inherent risk is driven by the borrower's capacity to service the debt combined with the value of the property collateral relative to the loan balance. Economic trends including consumer spending, consumer confidence, market interest rates, and general economic growth are closely correlated to the credit quality of these loans. A sustained decline in the economy can impair a borrower's capacity to service the underlying debt.

Real Estate–Construction – This segment is comprised of loans used to acquire, develop, and/or construct residential housing or commercial property types, including office, industrial and retail. Inherent risk is high as this segment evidences construction risk and absorption risk. Economic trends including consumer spending, consumer confidence, business confidence, market interest rates, and general economic growth are closely correlated to the credit quality of these loans. A sustained decline in the economy can impair absorption and compromise the borrower's capacity to service the underlying debt.

Commercial – These loans are primarily for business purposes and are typically secured by personal property and in some cases by junior liens against real property. Credit risk is mitigated by financial covenants and financial reporting requirements. Economic trends including consumer spending, consumer confidence, market interest rates, and general economic growth are closely correlated to the credit quality of these loans. A sustained decline in the economy can impair a borrower's capacity to service the underlying debt.

Individual loans and receivables in homogeneous loan portfolio segments are not evaluated for specific impairment. Rather, the sole component of the allowance for these loan types is determined by collectively measuring impairment reserve factors based on management's assessment of the following for each homogeneous loan portfolio segment: (1) inherent credit risk, (2) historical losses and (3) other qualitative factors. These reserve factors are described in further detail below for each homogeneous loan portfolio segment.

Lease Financing – This segment is primarily comprised of smaller business purpose commitments used to finance an array of business equipment. Leases are amortized over a specific period of time. Economic trends including consumer spending, consumer confidence, market interest rates, and general economic growth are closely correlated to the credit quality of these loans. A sustained decline in the economy can impair a borrower's capacity to service the underlying debt.

Consumer – This segment is comprised of installment and home equity loans and lines used to finance direct consumer purchases and/or establish lines of credit for consumer purposes. Economic trends including consumer spending, consumer confidence, market interest rates, trends in housing values, and general economic growth are closely correlated to the credit quality of these loans. A sustained decline in the economy can impair a borrower's capacity to service the underlying debt.

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 FDIC and the California Department of Financial Institutions, 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.

(Continued)

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Allowance for Off-Balance-Sheet Commitments: The Bank also maintains a separate allowance for off-balance-sheet commitments. Management estimates anticipated losses using historical loss data and utilization assumptions. The allowance for off-balance-sheet commitments is included in accrued interest payable and other liabilities on the consolidated balance sheet and is not significant.

Other Real Estate Owned: Real estate properties acquired through, or in lieu of, loan foreclosure are expected to be sold and are initially recorded at the fair value of the property, less estimated costs to sell. The excess, if any, of the loan amount over the fair value is charged to the allowance for loan and lease losses. Subsequent declines in the fair value of real estate owned, along with related revenue and expenses from operations, are charged to noninterest expense as incurred. Other real estate held by the Bank and its subsidiaries totaled $12,154 and $8,781 at December 31, 2012 and 2011, respectively.

Bank Premises and Equipment: Bank premises and equipment are carried at cost, less accumulated depreciation and amortization. Depreciation and amortization are computed on the straight-line basis over the lesser of the life of the lease or the estimated useful lives of the assets, ranging from 3 to 10 years for furniture and equipment, 5 to 10 years for leasehold improvements and 10 to 40 years for premises. When assets are sold or otherwise disposed of, the cost and related accumulated depreciation or amortization are removed from the accounts, and any resulting gain or loss is recognized in income for the period. The cost of maintenance and repairs is charged to expense as incurred. The Bank evaluates premises and equipment for financial impairment as events or changes in circumstances indicate that the carrying amount of such assets may not be fully recoverable.

Bank Owned Life Insurance: The Bank has purchased life insurance policies on certain key executives. Bank owned life insurance is recorded at the amount that can be realized under the insurance contract at the balance sheet date, which is the cash surrender value adjusted for other charges or other amounts due that are probable at settlement.

Retirement Plan and Postretirement Healthcare Plan: The Bank has a defined benefit pension plan covering all qualified personnel employed for the minimum required term of one year. Benefits are based on years of service and compensation projected to the separation date. Contributions are intended to provide not only for benefits attributed to service to date but also for those expected to be earned in the future. It is the Bank's policy to contribute annually an amount at least equal to the minimum required by law. During 2007, the Plan was amended to freeze future benefit accruals for participants who have less than 15 years of service and age plus years of service less than 60. The plan was also amended to limit cost-of-living adjustments for continuing active participants. The amendments are expected to significantly reduce Plan liability and future net period pension costs.

(Continued)

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

<u>Retirement Plan and Postretirement Healthcare Plan</u> (Continued)

In addition, the Bank sponsors a defined benefit postretirement healthcare plan that covers both salaried and nonsalaried employees. The Plan provides medical benefits through health maintenance organizations. The Plan is funded by a voluntary employee beneficiary association (VEBA) trust maintained by the Bank. The contribution level for a retiree is based on a percentage of premium that varies according to the retiree's years of service with the Bank. The Bank's contribution for dependents is 50% of the Bank's share of the retiree's annual premium. The portion paid by the Bank is limited to 200% of the 1991 premium. Future cost-sharing plans are not expected to change from the current stated policy in the written plan. In addition, for the group of retirees that retired prior to January 1, 1991, the retiree medical benefit will be paid fully by the Bank for the life of the retiree and dependent. For employees retiring prior to January 1, 1992, or active employees with more than 25 years of service as of December 31, 1991, the 200% limit on lifetime benefits will not apply and the Bank will pay 100% of the retiree's premium and 50% of the dependent's premium. Effective December 31, 2007, the Plan was amended to cover only active employees who have at least 15 years of service and age plus years of service more than 60. The Plan was also amended to limit the maximum reimbursement amount to grandfathered retirees. The amendments are expected to significantly reduce Plan liability and future net period pension costs.

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

The Bank also has endorsement split-dollar life insurance agreements with certain employees whereby the Bank has effectively agreed to maintain a life insurance policy during the employees' postretirement period. The Bank is accruing, over the employees' service period, a liability for the actuarial present value of future costs to maintain life insurance during the employees' postretirement period.

<u>Income Taxes</u>: Income tax expense is the total of current year income tax due or refundable and the change in deferred tax assets and liabilities. Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases and tax credit carryforwards. Deferred tax assets and liabilities are measured using enacted tax rates which are expected to be applied to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date. On the consolidated balance sheet, net deferred tax assets are included in accrued interest receivable and other assets.

(Continued)

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Income Taxes (Continued)

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 their analysis of available evidence, management determined that it is "more likely than not" that all of the deferred income tax assets as of December 31, 2012 and 2011 will be fully realized and therefore no valuation allowance was recorded.

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. The Bank recognizes interest and/or penalties related to income tax matters in income tax expense.

Earnings Per Share: Earnings per share is computed by dividing net income, less preferred stock dividends and accretion, by the weighted average number of shares outstanding during the year, which was 1,714,344 for 2012 and 2011. There were $2,094 and $2,343 in preferred stock dividends and accretion paid in 2012 and 2011, respectively. In addition, there were no dilutive securities; therefore, basic and diluted earnings per share are equivalent.

Advertising: Advertising costs are charged to expense in the period incurred and totaled $799 and $643 for the years ended December 31, 2012 and 2011, respectively.

Reclassifications: Some items in the prior year financial statements were reclassified to conform to the current presentation. Reclassifications had no affect on prior year net income or shareholders' equity.

Subsequent Events: The Bank considered all events occurring from December 31, 2012 through February 20, 2013, the date the consolidated financial statements were available to be issued for disclosure and accrual in these consolidated financial statements.

Adoption of New Accounting Standards

In June 2011, the FASB amended existing guidance and eliminated the option to present the components of other comprehensive income as part of the statement of changes in shareholder's equity. The amendment requires that comprehensive income be presented in either a single continuous statement or in two separate consecutive statements. The amendments in this guidance are effective for annual reporting periods ending after December 15, 2012, and interim and annual periods thereafter. The adoption of this amendment changed the presentation of the components of comprehensive income for the Bank as part of the consolidated statement of shareholder's equity.

(Continued)

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Adoption of New Accounting Standards (Continued)

In May 2011, the FASB issued an amendment to achieve common fair value measurement and disclosure requirements between U.S. and International accounting principles. Overall, the guidance is consistent with existing U.S. accounting principles; however, there are some amendments that change a particular principle or requirement for measuring fair value or for disclosing information about fair value measurements. The amendments in this guidance are effective for annual reporting periods beginning after December 15, 2011. The effect of adopting this standard resulted in expanded disclosures in Note 2.

In April 2011, the FASB amended existing guidance for assisting a creditor in determining whether a restructuring is a troubled debt restructuring. The amendments clarify the guidance for a creditor's evaluation of whether it has granted a concession and whether a debtor is experiencing financial difficulties. With regard to determining whether a concession has been granted, the ASU clarifies that creditors are precluded from using the effective interest method to determine whether a concession has been granted. In the absence of using the effective interest method, a creditor must now focus on other considerations such as the value of the underlying collateral, evaluation of other collateral or guarantees, the debtor's ability to access other funds at market rates, interest rate increases and whether the restructuring results in a delay in payment that is insignificant. This guidance was effective for interim and annual reporting periods beginning after June 15, 2011, and was applied retrospectively to the beginning of the annual period of adoption. For purposes of measuring impairment on newly identified troubled debt restructurings, the amendments were applied prospectively for the first interim or annual period beginning on or after June 15, 2011. The effect of adopting this standard did not have a material effect on the Bank's operating results or financial condition.

NOTE 2 – FAIR VALUE MEASUREMENTS

Fair Value Measurements

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

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

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

Level 3 – Model-based techniques that use at least one significant assumption not observable in the market. These unobservable assumptions reflect the Bank's estimates of assumptions that market participants would use in 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.

(In thousands, except per share amounts)

NOTE 2 – FAIR VALUE MEASUREMENTS (Continued)

Fair Value Measurements (Continued)

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, 2012 and 2011:

Recurring Basis

	2012			
Description	Fair Value	Level 1	Level 2	Level 3
Debt securities:				
U.S. Government agencies	$ 216,241	$ -	$ 216,241	$ -
Obligations of states and political subdivisions	117,775	-	117,775	-
Government sponsored entities residential mortgage-backed securities	57,379	-	57,379	-
U.S. Treasuries	1,013	-	1,013	-
Other securities	3,087	-	3,087	-
Total assets measured at fair value	$ 395,495	$	$ 395,495	$

	2011			
Description	Fair Value	Level 1	Level 2	Level 3
Debt securities:				
U.S. Government agencies	$ 153,165	$ -	$ 153,165	$ -
Obligations of states and political subdivisions	127,936	-	127,936	-
Government sponsored entities residential mortgage-backed securities	55,743	-	55,743	-
U.S. Treasuries	2,549	-	2,549	-
Other securities	5,537	-	5,537	-
Total assets measured at fair value	$ 344,930	$ -	$ 344,930	$ -

Fair values for available-for-sale investment securities are based on quoted market prices for similar securities. During the years ended December 31, 2012 and 2011, there were no significant transfers between Level 1 and Level 2.

(Continued)

(In thousands, except per share amounts)

NOTE 2 – FAIR VALUE MEASUREMENTS (Continued)

Fair Value Measurements (Continued)

Non-recurring Basis

The Bank may be required, from time to time, to measure certain assets at fair value on a non-recurring basis. These include assets that are measured at the lower of cost or market value that were recognized at fair value which was below cost at the reporting date.

	2012				
	Fair Value	Level 1	Level 2	Level 3	Total Losses
Impaired loans:					
Real estate – commercial	$ 15,684	$ -	$ -	$ 15,684	$ 852
Real estate – construction	4,698	-	-	4,698	2,545
Commercial	7,549	-	-	7,549	704
Lease financing	99	-	-	99	0
Consumer	4,435	-	-	4,435	143
Other real estate owned:					
Raw Land	4,213	-	-	4,213	1,794
Commercial Real Estate	7,941	-	-	7,941	227
Total assets measured at fair value on a non-recurring basis	$ 44,619	$ -	$ -	$ 44,619	$ 6,265

	2011				
	Fair Value	Level 1	Level 2	Level 3	Total Losses
Impaired loans:					
Real estate – commercial	$ 24,435	$ -	$ -	$ 24,435	$ 2,031
Real estate – construction	19,014	-	-	19,014	7,092
Commercial	7,380	-	-	7,380	135
Lease financing	33	-	-	33	4
Consumer	5,914	-	-	5,914	211
Other real estate owned:					
Raw Land	6,314	-	-	6,314	3,358
Commercial Real Estate	2,467	-	-	2,467	48
Total assets measured at fair value on a non-recurring basis	$ 65,557	$ -	$ -	$ 65,557	$ 12,879

Impaired loans are collateral dependent and have been adjusted to fair value based on the estimated fair value of the underlying collateral, less estimated selling costs. If the Bank determines that the value of an impaired loan is less than the recorded investment in the loan, the carrying value is adjusted through a charge-off recorded through the allowance for loan and lease losses. Total losses of $4,244 and $9,473 represent impairment charges recognized during the years ended December 31, 2012 and 2011, respectively related to the above impaired loans.

(Continued)

NOTE 2 – FAIR VALUE MEASUREMENTS (Continued)

Fair Value Measurements (Continued)

Other real estate owned has been adjusted to estimated fair value, less estimated selling costs. At the time of foreclosure, assets are recorded at the estimated fair value less estimated selling costs. Any write-downs based on the asset's fair value at the date of acquisition are charged to the allowance for loan and lease losses. After foreclosure, management periodically obtains updated valuations of the foreclosed assets and, if additional impairments are deemed necessary, the impairment is recorded in other expenses on the consolidated statement of operations. Total losses of $2,021 and $3,406 represent impairment charges recognized during the year ended December 31, 2012 and 2011, respectively related to the above other real estate owned.

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

Impaired Loans – The fair value of impaired loans with specific allocations of the allowance for loan losses is generally based on recent real estate appraisals. These appraisals may utilize a single valuation approach or a combination of approaches including comparable sales and the income approach. Adjustments are routinely made in the appraisal process by the independent appraisers to adjust for differences between the comparable sales and income data available. Such adjustments are usually significant and typically result in a Level 3 classification of the inputs for determining fair value.

Other Real Estate Owned (OREO) – OREO is measured at fair value, less costs to sell. Fair values are based on recent real estate appraisals. These appraisals may use a single valuation approach or a combination of approaches including comparable sales and the income approach. Adjustments are routinely made in the appraisal process by the independent appraisers to adjust for differences between the comparable sales and income data available. Such adjustments are usually significant and typically result in a Level 3 classification of the inputs for determining fair value.

Appraisals for both collateral-dependent impaired loans and real estate owned are performed by certified general appraisers (for commercial properties) or certified residential appraisers (for residential properties) whose qualifications and licenses have been reviewed and verified by the Bank. Once received, a member of the credit administration department reviews the assumptions and approaches utilized in the appraisal as well as the overall resulting fair value in comparison with independent data sources such as recent market data or industry-wide statistics. On a quarterly basis, the Bank compares the actual selling price of collateral that has been sold to the most recent appraised value to determine what additional adjustment should be made to the appraisal value to arrive at fair value.

(Continued)

(In thousands, except per share amounts)

NOTE 2 – FAIR VALUE MEASUREMENTS (Continued)

Fair Value Measurements (Continued)

The following table presents quantitative information about Level 3 fair value measurements for financial instruments measured at fair value on a non-recurring basis at December 31, 2012:

Description	Fair Value	Valuation Technique	Significant Unobservable Input	Range (Weighted Average)
Real Estate				
Commercial	15,684	Sales Comparison	a. Appraiser adjustments on sales comp data can on average from 5% to 10%	5% to 75% (16%)
		Management estimates	b. Management adjustments for depreciation in values depending on property types	
			c. Values adjusted for selling and holding costs typically set at 10%	
Real Estate Construction	4,698	Income Approach	a. Appraisers required to apply a discounted cash flow approach as sales data is limited	2% to 22% (8%)
		Management estimates	b. Management adjustments for depreciation in values depending on property types	
			c. Values adjusted for selling and holding costs typically set at 10%	
Commercial	7,549	Sales Comparison	a. Appraiser adjustments on sales comp data can range from 5% to 10%	5% to 50% (20%)
		Management estimates	b. Management adjustments for depreciation in values depending on property types	
			c. Selling and holding costs	
			d. Personal property collateral or unsecured loans are discounted based on management's estimate of loss given default	
Leasing	99	Management estimate	a. Personal property collateral is discounted based on management’s assessment of probability of default	10% to 35% (15%)
Consumer	4,435	Sales Comparison	a. Appraiser adjustments on sales comp data can on average range up to 10%	15% to 50% (19%)
		Management estimates	b. Personal property collateral is discounted based on management’s assessment of probability of default	
Other Real Estate:				
Raw Land	4,213	Sales Comparison	a. Appraiser adjustments on sales comp	13% to 50% (27%)
Commercial Real Estate	7,941	Sales Comparison	data can on average range up to 10%	13% to 50% (27%)
			b. Appraiser adjustments on land properties based on discounted cash flow approach	
			c. Selling and holding costs	

(Continued)

(In thousands, except per share amounts)

NOTE 2 – FAIR VALUE MEASUREMENTS (Continued)

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

December 31, 2012	Carrying Amount	Fair Value Measurements at Using: Level 1	Level 2	Level 3	Total
Financial assets:					
Cash and due from banks,	$ 139,548	$ 139,548	$ -	$ -	$ 139,548
Interest-bearing deposits In banks	16,000	16,000	-	-	16,000
Available-for-sale securities	395,495	-	395,495	-	395,495
FHLB stock	6,401	N/A	N/A	N/A	N/A
Loans and leases, net	1,009,238	-	-	1,029,545	1,029,545
Accrued interest receivable	6,591	-	-	-	6,591
Financial liabilities:					
Deposits	$ 1,459,757	$ 1,210,427	$ 250,769	$ -	$ 1,461,196
FHLB Advances	26,000	-	29,195	-	29,195
Subordinated debentures	12,000	-	11,873	-	11,873
Accrued interest payable	272	272	-	-	272

December 31, 2011	Carrying Amount	Fair Value Measurements at Using: Level 1	Level 2	Level 3	Total
Financial assets:					
Cash and due from banks,	$ 94,348	$ 94,348	$ -	$ -	$ 94,348
Available-for-sale securities	344,930	-	344,930	-	344,930
FHLB stock	7,068	N/A	N/A	N/A	N/A
Loans and leases, net	1,021,003	-	-	1,047,184	1,047,184
Accrued interest receivable	7,211	-	-	-	7,211
Financial liabilities:					
Deposits	$ 1,350,883	$ 1,082,065	$ 270,874	$ -	$ 1,352,939
FHLB Advances	29,000	-	32,777	-	32,777
Subordinated debentures	12,000	-	11,873	-	11,873
Accrued interest payable	352	352	-	-	352

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

(Continued)

NOTE 2 – FAIR VALUE MEASUREMENTS (Continued)

The following methods and assumptions were used by the Bank to estimate the fair values of its financial instruments at December 31, 2012 and December 31, 2011:

Cash and due from banks: The carrying amounts of cash and short-term instruments approximate fair values and are classified as Level 1.

Interest-bearing deposits in banks: The carrying amounts of interest-bearing deposits approximate fair values and are classified as Level 1.

Investment securities: For investment securities, fair values are based on quoted market prices, where available, and are classified as Level 1. If quoted market prices are not available, fair values are estimated using quoted market prices for similar securities and indications of value provided by brokers and are classified as Level 2.

Loans and leases: Fair values of loans, excluding loans held for sale, 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 also resulting in a Level 3 classification. The methods utilized to estimate the fair value of loans do not necessarily represent an exit price.

FHLB stock: It is not practicable to determine the fair value of FHLB stock due to restrictions placed on its transferability.

Deposits: The fair values disclosed for demand deposits 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 time deposits 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.

Federal Home Loan Bank Advances and Subordinated Debentures: The fair value of FHLB advances and subordinated debentures are determined based on the current market for like-kind instruments of a similar maturity and structure and are classified as Level 2.

Accrued interest receivable and payable: The carrying amount of accrued interest receivable and payable approximates fair value resulting in a Level 1 classification.

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.

(Continued)

(In thousands, except per share amounts)

NOTE 3 – AVAILABLE-FOR-SALE INVESTMENT SECURITIES

The amortized cost and estimated fair value of available-for-sale investment securities at December 31, 2012 and 2011 consisted of the following:

	2012			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Debt securities:				
U.S. Government agencies	$ 215,534	$ 780	$ (73)	$ 216,241
Obligations of states and political subdivisions	111,091	6,707	(23)	117,775
Government sponsored entities residential mortgage-backed securities	55,026	2,353	-	57,379
U.S. Treasuries	1,007	6	-	1,013
Other securities	2,996	91	-	3,087
	$ 385,654	$ 9,937	$ (96)	$ 395,495

	2011			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Debt securities:				
U.S. Government agencies	$ 152,841	$ 418	$ (94)	$ 153,165
Obligations of states and political subdivisions	120,703	7,244	(11)	127,936
Government sponsored entities residential mortgage-backed securities	53,139	2,604	-	55,743
U.S. Treasuries	2,530	19	-	2,549
Other securities	5,337	200	-	5,537
	$ 334,550	$ 10,485	$ (105)	$ 344,930

Net unrealized gains on available-for-sale investment securities totaling $9,841 and $10,380 were recorded, net of $4,138 and $4,364 in tax liabilities, as accumulated other comprehensive income within stockholders' equity at December 31, 2012 and 2011, respectively. There were no sales of available-for-sale investments during the years ended December 31, 2012 and 2011. There were no transfers of available-for-sale investment securities for the years ended December 31, 2012 and 2011.

(Continued)

(In thousands, except per share amounts)

NOTE 3 – AVAILABLE-FOR-SALE INVESTMENT SECURITIES (Continued)

Available-for-sale investment securities with unrealized losses at December 31, 2012 and 2011 are summarized and classified according to the duration of the loss period as follows:

	2012		2011	
	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses
Less than twelve months:				
U.S. Government agencies	$ 39,484	$ (73)	$ 1,983	$ (94)
Obligations of states and political subdivisions	3,822	(23)	68,607	(11)
	$ 43,306	$ (96)	$ 70,590	$ (105)

For the years ended December 31, 2012 and 2011, no securities were in a loss position for more than twelve months.

U.S. Government Agencies: Management believes that the unrealized losses on the Bank's investment in U.S. Government agencies is caused by the fluctuation in interest rates and is not attributable to changes in credit quality. Management intends to hold these investments until at least a recovery of fair value or until maturity. The Bank does not consider these investments to be other-than-temporarily impaired at December 31, 2012.

Obligations of States and Political Subdivisions: Management believes that the unrealized losses on the Bank's investment in obligations of states and political subdivisions are a result of the fluctuation in interest rates. The contractual cash flows of these investments are considered a general obligation of, or supported by specific revenues of, a state or local municipality and the Bank intends to hold these investments until at least a recovery of fair value or until maturity. Therefore, the Bank expects to collect all amounts due and does not consider these securities to be other-than-temporarily impaired at December 31, 2012.

(Continued)

(In thousands, except per share amounts)

NOTE 3 – AVAILABLE-FOR-SALE INVESTMENT SECURITIES (Continued)

Contractual Maturities: The amortized cost and estimated fair value of available-for-sale investment securities at December 31, 2012, by contractual maturity, are shown below. Expected maturities will differ from contractual maturities because the issuers of securities may have the right to call or prepay obligations with or without prepayment penalties.

	Amortized Cost	Estimated Fair Value
Within one year	$ 21,746	$ 22,008
After one year through five years	110,609	114,984
After five years through ten years	198,273	201,124
	330,628	338,116
Investment securities not due at a single maturity date:		
Government sponsored entities mortgage-backed securities	55,026	57,379
	$ 385,654	$ 395,495

The only significant concentration of investment securities (greater than 10% of stockholders' equity) in any individual security issuer at December 31, 2012 is certain U.S. Government sponsored entities mortgage-backed securities such as Federal National Mortgage Association and Federal Home Loan Mortgage Corporation and certain U.S. Government agencies such as Federal Home Loan Bank.

Investment securities with amortized costs of $151,165 and $180,490 and fair values of $158,554 and $188,278 as of December 31, 2012 and 2011, respectively, were pledged to secure public and trust deposits, FHLB borrowing arrangements (see Note 8) and for other purposes required or permitted by law.

NOTE 4 – LOANS AND LEASES

Loans and leases are reported net of deferred loan origination fees and costs of $291 in 2012 and $326 in 2011 and consist of the following at December 31:

	2012	2011
Real estate – commercial	$ 449,991	$ 486,079
Real estate – construction	57,830	92,399
Commercial	225,459	161,708
Lease financing	31,210	35,406
Consumer	280,379	277,162
Total	1,044,869	1,052,754
Less: Allowance for loan and lease losses	(35,631)	(31,751)
	$ 1,009,238	$ 1,021,003

(In thousands, except per share amounts)

NOTE 4 – LOANS AND LEASES (Continued)

The components of the Bank's leases receivable at December 31 are as follows:

	2012	2011
Future lease payments receivable	$ 33,772	$ 39,468
Residual interests	160	268
Deferred broker fees	824	
Unearned income	(3,546)	(4,330)
Net lease financing receivable	$ 31,210	$ 35,406

Future lease payments receivable are as follows:

Year Ending December 31,	
2013	$ 2,151
2014	5,817
2015	8,163
2016	8,541
2017	6,598
Thereafter	2,502
	$ 33,772

Certain loans have been pledged to secure borrowing arrangements (see Note 8).

Activity in the allowance for loan and lease losses for the years ended December 31, 2012 and 2011 was as follows:

	2012	2011
Balance, beginning of year	$ 31,751	$ 33,144
Provision for loan and lease losses	9,150	12,550
Loans charged-off	(7,568)	(15,471)
Recoveries	2,298	1,528
Balance, end of year	$ 35,631	$ 31,751

(In thousands, except per share amounts)

NOTE 4 – LOANS AND LEASES (Continued)

The following tables show the activity of the allowance for loan and lease losses for the year ended December 31, 2012 by portfolio segment, and the allocation of the allowance for loan and lease losses at December 31, 2012 and 2011 by portfolio segment and by impairment methodology:

	December 31, 2012					
	Real Estate – Commercial	Real Estate – Construction	Commercial	Lease Financing	Consumer	Total
Allowance for Credit Losses						
Beginning balance	$ 16,165	$ 3,286	$ 9,660	$ 1,042	$ 1,598	$ 31,751
Provision for loan and lease losses	1,767	3,092	2,894	21	1,376	9,150
Loans charged-off	(1,297)	(2,545)	(2,030)	(378)	(1,318)	(7,568)
Recoveries	279	764	363	366	526	2,298
Ending balance allocated to portfolio segments	$ 16,914	$ 4,597	$ 10,887	$ 1,051	$ 2,182	$ 35,631
Ending balance: individually evaluated for impairment	$ 3,331	$ 713	$ 3,102	$ 130	$ 1,319	$ 8,595
Ending balance: collectively evaluated for impairment	$ 13,583	$ 3,884	$ 7,785	$ 921	$ 863	$ 27,036
Loans						
Ending balance	$ 449,991	$ 57,830	$ 225,459	$ 31,210	$ 280,379	$1,044,869
Ending balance: individually evaluated for impairment	$ 20,137	$ 5,411	$ 14,175	$ 566	$ 5,761	$ 46,050
Ending balance: collectively evaluated for impairment	$ 429,854	$ 52,419	$ 211,284	$ 30,644	$ 274,618	$ 998,819

(Continued)

(In thousands, except per share amounts)

NOTE 4 – LOANS AND LEASES (Continued)

	December 31, 2011					
	Real Estate – Commercial	Real Estate – Construction	Commercial	Lease Financing	Consumer	Total
Allowance for Credit Losses						
Beginning balance	$ 17,500	$ 4,000	$ 9,140	$ 860	$ 1,644	$ 33,144
Provision for loan and lease losses	6,405	3,289	944	494	1,418	12,550
Loans charged-off	(7,896)	(4,055)	(1,164)	(608)	(1,748)	(15,471)
Recoveries	156	52	740	296	284	1,528
Ending balance allocated to portfolio segments	$ 16,165	$ 3,286	$ 9,660	$ 1,042	$ 1,598	$ 31,751
Ending balance: individually evaluated for impairment	$ 2,727	$ 1,135	$ 1,467	$ 109	$ 1,	$ 6,512
Ending balance: collectively evaluated for impairment	$ 13,438	$ 2,151	$ 8,193	$ 933	$ 524	$ 25,239
Loans						
Ending balance	$ 486,079	$ 92,399	$ 161,708	$ 35,406	$ 277,162	$1,052,754
Ending balance: individually evaluated for impairment	$ 27,050	$ 16,038	$ 8,025	$ 800	$ 5,531	$ 57,444
Ending balance: collectively evaluated for impairment	$ 459,029	$ 76,361	$ 153,683	$ 34,606	$ 271,631	$ 995,310

The following tables show the loan portfolio allocated by management's internal risk ratings at December 31, 2012 and 2011:

	December 31, 2012 Commercial Credit Exposure Credit Risk Profile by Internally Assigned Grade				
	Real Estate – Commercial	Real Estate – Construction	Commercial	Lease Financing	Total
Grade:					
Pass	$ 388,045	$ 38,307	$ 194,448	$ 30,169	$ 650,969
Special Mention	28,857	14,018	10,085	416	53,376
Substandard	33,089	5,505	20,926	625	60,145
Total	$ 449,991	$ 57,830	$ 225,459	$ 31,210	$ 764,490

(In thousands, except per share amounts)

NOTE 4 – LOANS AND LEASES (Continued)

	December 31, 2012 Consumer Credit Exposure Credit Risk Profile Based on Payment Activity	
	Consumer	Total
Grade:		
Performing	$ 278,910	$ 278,910
Non-performing	1,469	1,469
Total	$ 280,379	$ 280,379

	December 31, 2011 Commercial Credit Exposure Credit Risk Profile by Internally Assigned Grade				
	Real Estate – Commercial	Real Estate – Construction	Commercial	Lease Financing	Total
Grade:					
Pass	$ 406,433	$ 60,089	$ 124,276	$ 33,915	$ 624,713
Special Mention	36,458	19,147	11,066	621	67,292
Substandard	43,163	13,163	26,366	870	83,587
Total	$ 486,079	$ 92,399	$ 161,708	$ 35,406	$ 775,592

	December 31, 2011 Consumer Credit Exposure Credit Risk Profile Based on Payment Activity	
	Consumer	Total
Grade:		
Performing	$ 274,617	$ 274,617
Non-performing	2,545	2,545
Total	$ 277,162	$ 277,162

The following tables show an aging analysis of the loan portfolio by the time past due at December 31, 2012 and 2011:

	December 31, 2012					
	30-89 Days Past Due	Greater Than 90 Days	Nonaccrual	Total Past Due	Current	Total Loans
Real estate – commercial	$ 745	$ -	$ 18,154	$ 18,899	$ 431,092	$ 449,991
Real estate – construction	-	-	5,411	5,411	52,419	57,830
Commercial	758	2	2,163	2,923	222,536	225,459
Lease financing	288	61	152	501	30,709	31,210
Consumer	274	-	1,469	1,743	278,636	280,379
Total	$ 2,065	$ 63	$ 27,349	$ 29,477	$ 1,015,392	$ 1,044,869

(Continued)

(In thousands, except per share amounts)

NOTE 4 – LOANS AND LEASES (Continued)

	December 31, 2011					
	30-89 Days Past Due	Greater Than 90 Days	Nonaccrual	Total Past Due	Current	Total Loans
Real estate – commercial	$ -	$ -	$ 18,699	$ 18,699	$ 467,380	$ 486,079
Real estate – construction	-	-	15,378	15,378	77,021	92,399
Commercial	530	3	2,037	2,570	159,138	161,708
Lease financing	392	11	280	683	34,723	35,406
Consumer	461	-	3,264-	3,725	273,437	277,162
Total	$ 1,383	$ 14	$ 39,658	$ 41,055	$ 1,011,699	$ 1,052,754

The following tables show information related to impaired loans at and for the years ended December 31, 2012 and 2011:

	December 31, 2012				
	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized
With no related allowance recorded:	$ -	$ -	$ -	$ -	$ -
With an allowance recorded:					
Real estate – commercial	$ 27,493	$ 29,158	$ 3,331	$ 27,099	$ 1,715
Real estate – construction	$ 9,680	$ 22,776	$ 713	$ 16,531	$ 391
Commercial	$ 6,938	$ 7,089	$ 3,102	$ 6,326	$ 414
Lease financing	$ 884	$ 845	$ 130	$ 1,186	$ 50
Consumer	$ 8,677	$ 9,011	$ 1,319	$ 9,485	$ 456
Total:					
Real estate – commercial	$ 27,493	$ 29,158	$ 3,331	$ 27,099	$ 1,715
Real estate – construction	$ 9,680	$ 22,776	$ 713	$ 16,531	$ 391
Commercial	$ 6,938	$ 7,089	$ 3,102	$ 6,326	$ 414
Lease financing	$ 884	$ 845	$ 130	$ 1,186	$ 50
Consumer	$ 8,677	$ 9,011	$ 1,319	$ 9,485	$ 456

(Continued)

(In thousands, except per share amounts)

NOTE 4 – LOANS AND LEASES (Continued)

	December 31, 2011				
	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized
With no related allowance recorded:	$ -	$ -	$ -	$ -	$ -
With an allowance recorded:					
Real estate – commercial	$ 26,439	$ 27,990	$ 2,727	$ 26,705	$ 1,591
Real estate – construction	$ 20,795	$ 34,106	$ 1,135	$ 23,382	$ 472
Commercial	$ 7,776	$ 7,938	$ 1,467	$ 5,714	$ 402
Lease financing	$ 1,455	$ 1,393	$ 109	$ 1,488	$ 82
Consumer	$ 10,889	$ 10,936	$ 1,074	$ 10,292	$ 452
Total:					
Real estate – commercial	$ 26,439	$ 27,990	$ 2,727	$ 26,705	$ 1,591
Real estate – construction	$ 20,795	$ 34,106	$ 1,135	$ 23,382	$ 472
Commercial	$ 7,776	$ 7,938	$ 1,467	$ 5,714	$ 402
Lease financing	$ 1,445	$ 1,393	$ 109	$ 1,488	$ 82
Consumer	$ 10,889	$ 10,936	$ 1,074	$ 10,292	$ 452

Non-accrual loans totaled $27,349 and $39,658 at December 31, 2012 and 2011, respectively. Accruing loans that were past due 90 days or more totaled $63 at December 31, 2012, as compared to $14 at December 31, 2011.

Included in the impaired loans above are 99 and 101 loans in the amount of $38,285 and $56,274 that were considered to be troubled debt restructurings at December 31, 2012 and December 31, 2011, respectively.

For the years ended December 31, 2012 and 2011, the average recorded investment in impaired loans was $60,627 and $67,581, respectively. The Bank had $8,595 of specific allowance for loan and lease losses on impaired loans with a recorded investment of $53,672 at December 31, 2012 as compared to $6,512 of specific allowance for loan and lease losses on impaired loans with a recorded investment of $67,354 at December 31, 2011. Interest income on a cash basis was not significant. Foregone interest on non-accrual loans was $1,114 for the year ended December 31, 2012, compared with $2,781 for the year ended December 31, 2011.

Salaries and employee benefits totaling $2,295 and $1,654 have been deferred as loan and lease origination costs for the years ended December 31, 2012 and 2011, respectively.

The Bank has allocated $6,858 and $5,427 of specific reserves to customers whose loan terms have been modified in troubled debt restructurings as of December 31, 2012 and 2011. The Bank has committed to lend additional amounts totaling up to $383 and $3,795 as of December 31, 2012 and 2011 to customers with outstanding loans that are classified as troubled debt restructurings.

During the period ending December 31, 2012, the terms of certain loans were modified as troubled debt restructurings. The modification of the terms of such loans included one or a combination of the following: a reduction of the stated interest rate of the loan; an extension of the maturity date at a stated rate of interest lower than the current market rate for new debt with similar risk; or a permanent reduction of the recorded investment in the loan.

(In thousands, except per share amounts)

NOTE 4 – LOANS AND LEASES (Continued)

Modifications involving a reduction of the stated interest rate of the loan were for periods ranging from 12 months to 5 years. Modifications involving an extension of the maturity date were for periods ranging from 6 months to 24 months.

The following table presents loans by class modified as troubled debt restructurings that occurred during the period ended December 31, 2012:

	Number of Loans	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment
Troubled debt restructurings:			
Real estate – commercial	7	$ 2,241	$ 2,241
Real estate – construction	-	-	-
Commercial	2	71	71
Lease financing	9	417	417
Consumer	5	578	567
Total	23	$ 3,307	$ 3,296

The troubled debt restructurings described above increased the allowance for loan losses by $1,431 and resulted in $2,028 in charge offs during the period ended December 31, 2012.

The following table presents loans by class modified as troubled debt restructurings for which there was a payment default within twelve months following the modification during the period ended December 31, 2012:

	Number of Loans	Recorded Investment
Troubled debt restructurings that subsequently defaulted:		
Real estate – commercial	1	$ 87
Consumer	1	73
Total	2	$ 160

A loan is considered to be in payment default once it is 30 days contractually past due under the modified terms.

The troubled debt restructurings that subsequently defaulted described above did not increase the allowance for loan losses and did not result in charge offs during the period ended December 31, 2012.

(Continued)

(In thousands, except per share amounts)

The following table presents loans by class modified as troubled debt restructurings that occurred during the period ended December 31, 2011:

	Number of Loans	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment
Troubled debt restructurings:			
Real estate – commercial	22	$ 17,968	$ 17,968
Real estate – construction	3	3,867	3,867
Commercial	6	4,181	4,181
Lease financing	7	430	430
Consumer	2	92	92
Total	40	$ 26,538	$ 26,538

The troubled debt restructurings described above increased the allowance for loan losses by $1,472 and resulted in no charge offs during the period ended December 31, 2011.

The following table presents loans by class modified as troubled debt restructurings for which there was a payment default within twelve months following the modification during the period ended December 31, 2011:

	Number of Loans	Recorded Investment
Troubled debt restructurings that subsequently defaulted:		
Real estate – commercial	2	$ 779
Consumer	2	32
Total	4	$ 811

A loan is considered to be in payment default once it is 30 days contractually past due under the modified terms.

The troubled debt restructurings that subsequently defaulted described above did not increase the allowance for loan losses and did not result in charge offs during the period ended December 31, 2011.

In order to determine whether a borrower is experiencing financial difficulty, an evaluation is performed of the probability that the borrower will be in payment default on any of its debt in the foreseeable future without the modification. This evaluation is performed under the Bank's internal underwriting policy.

(Continued)

(In thousands, except per share amounts)

NOTE 5 – FEDERAL HOME LOAN BANK STOCK

As a member of the Federal Home Loan Bank of San Francisco (FHLB), the Bank is required to own capital stock in an amount specified by regulation. At December 31, 2012 and 2011, the Bank owned 64,012 and 70,684 shares of $100 par value FHLB stock respectively. The stock is carried at cost and is redeemable at par with certain restrictions. The amount of stock required to be held is adjusted periodically based on a determination made by the FHLB.

NOTE 6 – BANK PREMISES AND EQUIPMENT

Bank premises and equipment at December 31 consist of the following:

	2012	2011
Land	$ 2,709	$ 2,709
Buildings	22,637	22,268
Leasehold improvements	6,588	6,575
Equipment	18,821	18,963
Construction in progress	753	546
	51,508	51,061
Less: accumulated depreciation and amortization	(35,023)	(33,289)
	$ 16,485	$ 17,772

Depreciation and amortization expense were $2,357 and $2,487 for the years ended December 31, 2012 and 2011, respectively.

NOTE 7 – INTEREST-BEARING DEPOSITS

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

	2012	2011
Savings	$ 278,480	$ 238,463
Money market	203,608	198,600
NOW accounts	211,581	178,065
Time, $100,000 or more	146,943	158,576
Other time	102,388	110,242
	$ 943,000	$ 883,946

The Bank's other time deposits included brokered deposits which totaled $5,580 or 0.4% and $10,646 or 0.8% of total deposits, respectively, for the years ended December 31, 2012 and 2011. Brokered deposits were entirely under the Certificate of Deposit Account Registry Service (CDARS) program, which allows the Bank's deposit customers to have the entire balance of their certificate of deposit account insured by the FDIC. There were no wholesale brokered certificates of deposit at December 31, 2012 and 2011.

(Continued)

(In thousands, except per share amounts)

NOTE 7 – INTEREST-BEARING DEPOSITS (Continued)

Aggregate annual maturities of time deposits at December 31, 2012 are as follows:

Year Ending December 31,	
2013	$ 177,520
2014	25,693
2015	26,487
2016	14,528
2017	5,103
	$ 249,331

NOTE 8 – FEDERAL HOME LOAN BANK ADVANCES AND OTHER LONG-TERM DEBT

Federal Home Loan Bank Advances: The Bank may borrow from the Federal Home Loan Bank, on either a short-term or long-term basis, up to 30% of its assets provided that adequate collateral has been pledged. As of December 31, 2012, the Bank has pledged investment securities with a carrying value of $50,385 and loans with a carrying value of $583,884 to secure this borrowing arrangement.

The following is a summary of the Bank's outstanding advances from the Federal Home Loan Bank of San Francisco and the weighted-average interest rate at December 31, 2012 and 2011:

2012		2011	
Amount	Weighted Average Rate	Amount	Weighted Average Rate
$ 26,000	4.47%	$ 29,000	4.50%

The annual maturities of the advances were as follows:

Year Ending	Amount	Weighted Average Rate
2013	$ 8,000	3.97%
2014	2,000	4.43%
2015	2,000	4.52%
2016	2,000	4.72%
2017	4,000	4.71%
Thereafter	8,000	4.77%
	$ 26,000	4.47%

(Continued)

(In thousands, except per share amounts)

NOTE 8 – FEDERAL HOME LOAN BANK ADVANCES AND OTHER LONG-TERM DEBT (Continued)

Subordinated Debentures: On June 15, 2005, the Bank issued $12,000 of Floating Rate Junior Subordinated Debentures due June 15, 2020. The purpose for issuing this subordinated debt, which qualifies as capital under regulatory risk-based capital standards, was to increase the Bank's Tier 2 capital. The Bank is not considered the primary beneficiary of the trust (variable interest entity); therefore, the trust is not consolidated in the Bank's financial statements, but rather the subordinated debentures are shown as a liability. The interest rate on the debentures is reset quarterly at the 3 Month LIBOR rate plus 1.80%, which was 2.11% at December 31, 2012. Payment on the debentures is interest only, payable quarterly, with all principal due at maturity. The Bank has the right to redeem all or any part of the debentures in multiples of $1 on any interest payment date on or after the interest payment date in June 2012. The bonds may be redeemed at par at a minimum of at least 30 and not more than 60 days prior to the redemption date. In addition, the Bank's ability to pay dividends is subject to certain covenants contained in the indenture related to the Bank's issuance of the debentures. The Bank is in compliance with all covenants as of December 31, 2012.

Lines of Credit: The Bank has no unsecured lines of credit with its correspondent banks as of December 31, 2012 and 2011.

NOTE 9 – INCOME TAXES

The expense (benefit) from income taxes for the years ended December 31, 2012 and 2011 consisted of the following:

	Federal	State	Total
2012			
Current	$ 4,521	$ 365	$ 4,896
Deferred	(298)	1,531	1,233
Provision for income taxes	$ 4,233	$ 1,896	$ 6,129
2011			
Current	$ 500	$ 698	$ 1,198
Deferred	3,116	1,121	4,237
Provision for income taxes	$ 3,616	$ 1,819	$ 5,435

(Continued)

(In thousands, except per share amounts)

NOTE 9 – INCOME TAXES (Continued)

Deferred tax assets (liabilities) are comprised of the following at December 31, 2012 and 2011:

	2012	2011
Deferred tax assets:		
Allowance for loan losses	$ 13,457	$ 11,278
Deferred compensation	5,726	5,327
Postretirement benefits	1,420	2,145
Restructuring reserve	498	694
Net operating loss	1,865	3,221
Tax credits	4,586	5,883
Nonaccrual interest	1,105	1,033
OREO property	1,128	1,985
Bank premises and equipment	539	-
State taxes	47	294
Other	132	595
Total deferred tax assets	30,503	32,455
Deferred tax liabilities:		
Deferred loan costs	(875)	(621)
Unrealized gains on available-for-sale investment securities	(4,138)	(4,364)
Prepaid expenses	(330)	(308)
Pension expenses	(631)	(28)
FHLB stock dividends	(387)	(427)
Bank premises and equipment	-	(81)
Other	(573)	(578)
Total deferred tax liabilities	(6,934)	(6,407)
Net deferred tax assets	$ 23,569	$ 26,048

The effective tax rate, as a percentage of income before income taxes, differs from the statutory Federal income tax rate as follows:

	Year Ended December 31,	
	2012	2011
Federal income tax expense, at statutory rate	35.0%	35.0%
State franchise tax, net of Federal tax effect	6.7	6.8
Tax-exempt interest on obligations of states and political subdivisions	(5.8)	(7.3)
Cash surrender value of life insurance	(2.7)	(2.8)
Tax credits	(1.4)	(1.7)
Other	1.5	0.9
Effective tax rate	33.3%	30.9%

(Continued)

(In thousands, except per share amounts)

NOTE 9 – INCOME TAXES (Continued)

The Bank files income tax returns in the United States jurisdiction and the State of California jurisdiction. The Bank is no longer subject to Federal income tax examinations by tax authorities for years before 2008. The Bank is no longer subject to California income tax examinations by tax authorities for years before 2007.

For the year ended December 31, 2012, the Bank has available for carryover $26,464 million of state net operating losses. The state net operating losses expire in 2030. The Bank also has available for carryover $3,346 of federal minimum tax credits and $1,153 of federal general business credits. The general business credits expire beginning in 2027. The minimum tax credits of $134 may be carried forward indefinitely.

The Bank recognizes interest accrued and penalties related to unrecognized tax benefits in tax expense. During the years ended December 31, 2012 and 2011, the Bank recognized no interest or penalties.

NOTE 10 – RELATED PARTY TRANSACTIONS

During the normal course of business, the Bank enters into transactions with related parties, including Directors and executive officers. The following is a summary of the aggregate activity involving related party borrowers during 2012:

Balance, January 1, 2012	$ 12,809
Disbursements	2,644
Amounts repaid	(4,333)
Balance, December 31, 2012	$ 11,120
Undisbursed commitments to related parties, December 31, 2012	$ 4,125

NOTE 11 – COMPREHENSIVE INCOME (LOSS)

Comprehensive income (loss) includes net (loss) income and other comprehensive income (loss). Other comprehensive income (loss) for the Bank includes unrealized gains and losses on investment securities classified as available-for-sale, and changes in the funded status of defined benefit pension plans and the deferred compensation trust.

(Continued)

(In thousands, except per share amounts)

NOTE 11 – COMPREHENSIVE INCOME (LOSS) (Continued)

Components of other comprehensive (loss) income and related tax effects for the years ended December 31, 2012 and 2011 are as follows:

	2012	2011
Change in unrealized gain on available-for-sale investment securities	$ (539)	$ 3,495
Tax effect	226	(1,513)
Changes in unrealized gain on available-for-sale investment securities, net of tax	(313)	1,982
Changes in defined benefit pension plan liabilities	2,993	(10,469)
Tax effect	(1,372)	4,716
Changes in defined benefit pension plans, net of tax	1,621	(5,753)
Change in deferred compensation trust liabilities	503	(461)
Tax effect	(212)	189
Changes in deferred compensation trust, net of tax	291	(272)
Other comprehensive income (loss)	$ 1,599	$ (4,043)

NOTE 12 – RETIREMENT PLAN

The following presents the reconciliations of plan benefit obligations and plan assets from beginning of year to end of year. The Bank uses a December 31 measurement date for the Plan.

	2012	2011
Change in benefit obligation:		
Benefit obligation at beginning of year	$ 45,846	$ 36,857
Service cost	859	751
Interest cost	1,866	1,895
Benefits paid	(4,164)	(1,471)
COLA amendment	-	2,430
Actuarial loss	1,600	5,384
Benefit obligation at end of year	$ 46,007	$ 45,846
Change in plan assets:		
Fair value of plan assets at beginning of year	$ 45,914	$ 43,097
Employer contribution	-	4,000
Benefits paid	(4,164)	(1,471)
Actual return on plan assets	5,757	288
Fair value of plan assets at end of year	$ 47,507	$ 45,914
Funded status at end of year	$ 1,500	$ 68

(Continued)

(In thousands, except per share amounts)

NOTE 12 – RETIREMENT PLAN (Continued)

Amounts recognized in accumulated other comprehensive income at December 31 consist of:

	2012	2011
Net actuarial loss	$ 15,022	$ 17,631
Prior service cost (credit)	589	674
	$ 15,611	$ 18,305

The accumulated benefit obligation was $46,007 and $45,846 at December 31, 2012 and 2011. The Bank does not expect to contribute to the Plan in 2013.

The following presents the Plan investments, including their fair value and method of fair value determination, as of December 31, 2012 and 2011.

2012	Total	Quoted Prices in Active Markets for Identical Assets (Level 1)	Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Cash and equivalents	$ 764	$ 764	$ -	$ -
Equity securities:				
U.S. large-cap (a)	22,815	22,815	-	-
U.S. large-cap balanced fund (b)	-	-	-	-
U.S. small-cap (c)	2,985	2,985	-	-
International large-cap (d)	6,303	6,303	-	-
Fixed income securities:				
U.S. Government agencies (e)	892	-	892	-
U.S. corporate bond funds (f)	3,943	3,943	-	-
U.S. Total Bond Market fund (g)	9,805	9,805	-	-
Total	$ 47,507	$ 46,615	$ 892	$ -

(Continued)

(In thousands, except per share amounts)

NOTE 12 – RETIREMENT PLAN (Continued)

2011	Total	Quoted Prices in Active Markets for Identical Assets (Level 1)	Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Cash and equivalents	$ 1,297	$ 1,297	$ -	$ -
Equity securities:				
U.S. large-cap (a)	18,700	18,700	-	-
U.S. large-cap balanced fund (b)	6,818	6,818	-	-
U.S. small-cap (c)	2,270	2,270	-	-
International large-cap (d)	4,450	4,450	-	-
Fixed income securities:				
U.S. Government agencies (e)	1,326	-	1,326	-
U.S. corporate bond funds (f)	2,067	2,067	-	-
U.S. Total Bond Market fund (g)	8,986	8,986	-	-
Total	$ 45,914	$ 44,588	$ 1,326	$ -

(a) This category comprises low-cost equity index funds not actively managed that track the S&P 500, as well as actively managed funds that track the Russell 100 value index.
(b) This category includes a tactical asset allocation fund with a target of approximately 60% equities and 40% bonds. The allocation between a passively managed U.S. large cap equity fund and a long term bond fund is actively managed to overweight the broad asset class deemed to be most undervalued on a relative basis.
(c) This category represents low-cost actively managed and broadly diversified U.S. small cap equity funds.
(d) This category represents low cost index enhanced and broadly diversified Non U.S. large cap international funds.
(e) This category represents individual government agency fixed income debentures of a short to intermediate term to maturity.
(f) This category represents low-cost actively managed U.S. investment grade bond funds.
(g) This category represents a low-cost bond index fund passively managed to track the broad U.S. fixed income markets.

In accordance with the "Prudent Expert" rule, the Plan attempts to achieve a balance of risk and reward that will provide the Plan with the greatest risk-adjusted return on assets. The maximization of risk-adjusted return is accomplished by broadly diversifying assets within the major financial asset classes and by maintaining a discipline to the target asset allocation of the Plan. The Plan is managed through a relatively passive approach to asset allocation. The Investment Manager maintains the policy asset allocation listed below except for those unusual and well documented market related events that may dictate otherwise. Stated below is the policy asset allocation at market values of Plan assets. This is the long term asset allocation desired by the Board, which should approximate the actual average asset allocation over a three to five year period. In practice asset allocation is monitored on a monthly basis and at such time as any of the minimum or maximum target asset allocations are pierced, a rebalancing transaction is required to bring all asset allocations back to policy target ranges.

(Continued)

(In thousands, except per share amounts)

NOTE 12 – RETIREMENT PLAN (Continued)

Also stated are the maximum and minimum asset allocation levels at market for each asset category as well as the weighted average expected return for each asset class.

	Minimum	Policy	Maximum	Weighted Average Expected Return
Equity	50%	65%	80%	6%
Fixed income	25%	35%	45%	2%
Cash and equivalents	0%	0%	5%	0%

The allocation by asset category of the pension plan assets at December 31 is as follows:

	2012	2011
Asset category:		
Equity	67%	70%
Fixed income	31%	27%
Other	2%	3%
Total	100%	100%

The primary investment objective for the Plan assets is to achieve maximum rates of return commensurate with safety of principal, given the asset mix, credit quality and diversification guidelines and restrictions approved by the retirement committee. The asset allocation is reviewed quarterly to determine whether the portfolio mix is within an acceptable range of target allocation. Target asset allocations are based on asset and liability studies with the goal to enhance the expected return of the retirement portfolio while maintaining acceptable levels of risk.

The components of 2012 and 2011 net periodic benefit cost are as follows:

	2012	2011
Service cost	$ 859	$ 751
Interest cost	1,866	1,895
Expected return on plan assets	(3,520)	(3,397)
Amortization of unrecognized prior service cost	85	(283)
Amortization of unrecognized actuarial loss	1,972	803
Total net periodic cost	$ 1,262	$ (229)
Net loss (gain)	$ (637)	$ 8,492
Prior service cost		2,430
Amortization of prior service cost	(85)	283
Amortization of net gain	(1,972)	(804)
Total recognized in other comprehensive income	(2,694)	10,401
Total recognized in net periodic benefit cost and other comprehensive income	$ (1,432)	$ 10,172

(Continued)

(In thousands, except per share amounts)

NOTE 12 – RETIREMENT PLAN (Continued)

The estimated net loss and prior service costs for the defined benefit pension plan that will be amortized from accumulated other comprehensive income into net periodic benefit cost over the next fiscal year are $2,057 and $521 as of December 31, 2012 and 2011, respectively.

The weighted average assumptions used to determine benefit obligations at December 31:

	2012	2011
Discount rate	4.00%	4.25%
Rate of compensation increase	4.00%	4.00%

The weighted average assumptions used to determine net periodic benefit cost at December 31:

	2012	2011
Discount rate	4.25%	5.25%
Rate of compensation increase	4.00%	4.00%
Expected return of plan assets	8.00%	8.00%

The expected return on retirement plan assets is developed using inflation expectations and risk factors to arrive at a long-term nominal expected return for each asset class. The nominal expected return for each asset class is then weighted based on the target asset allocation to develop the expected long-term rate of return on plan assets.

The following benefit payments, which reflect expected future service, as appropriate, are expected to be paid as follows:

Year Ending December 31,	Pension Benefits
2013	$ 1,577
2014	1,793
2015	1,973
2016	2,146
2017	2,281
2018 through 2022	12,791

(Continued)

(In thousands, except per share amounts)

NOTE 13 – POSTRETIREMENT HEALTHCARE PLAN

The following presents the postretirement healthcare plan's combined funded status:

	2012	2011
Change in benefit obligation:		
Benefit obligation at beginning of year	$ 5,368	$ 4,773
Service cost	62	70
Interest cost	208	234
Benefits paid	(306)	(315)
Plan participant contribution	76	60
Actuarial loss (gain)	(72)	546
Benefit obligation at end of year	$ 5,336	$ 5,368
Change in plan assets:		
Fair value of plan assets at beginning of year	$ 2,405	$ 2,762
Other payments	(35)	(38)
Plan participant contribution	76	60
Benefits paid	(306)	(315)
Employer contribution	1,500	-
Actual return on plan assets	320	(64)
Fair value of plan assets at end of year	$ 3,960	$ 2,405
Plan assets less benefit obligation at end of year	$ (1,376)	$ (2,963)

Amounts recognized in accumulated other comprehensive income at December 31 consist of:

	2012	2011
Net actuarial loss	$ 1,068	$ 1,438
Prior service cost (credit)	(417)	(488)
	$ 651	$ 950

The accumulated benefit obligation was $5,336 and $5,368 at December 31, 2012 and 2011. The Bank does not expect to contribute to the Plan in 2013.

	2012	2011
Components of net periodic benefit costs:		
Service cost	$ 62	$ 70
Interest cost	208	234
Expected loss on plan assets	(183)	(144)
Amortization of unrecognized prior service cost	70	(70)
Amortization of net actuarial loss	161	53
Total net periodic benefit cost	$ 178	$ 143

(Continued)

(In thousands, except per share amounts)

NOTE 13 – POSTRETIREMENT HEALTHCARE PLAN (Continued)

	2012	2011
Net (gain) loss	$ (208)	$ 753
Amortization of net gain	(161)	(53)
Amortization of prior service cost	70	70
Total recognized in other comprehensive income	(299)	770
Total recognized in net periodic benefit cost and other comprehensive income	$ (121)	$ 913

The estimated net loss and prior services costs for the defined benefit pension plan that will be amortized from accumulated other comprehensive income into net periodic benefit cost cover the next fiscal year are $96 and $149 as of December 31, 2012 and 2011, respectively.

The following table represents the assumed health care trend rates at December 31:

	2012	2011
Health care trend rate assumed for next year	5.50%	5.50%
Rate to which the cost trend rate is assumed to decline	5.50%	5.50%
Year that the rate reaches the ultimate trend rate	2010	2010

The following presents the Plan investments, including their fair value and method of fair value determination, as of December 31, 2012 and 2011.

2012	Total	Quoted Prices in Active Markets for Identical Assets (Level 1)	Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Cash	$ 202	$ 202	$ -	$ -
Equity securities:				
U.S. large-cap (a)	2,296	2,296	-	-
U.S. small-cap (b)	325	325	-	-
International large-cap (c)	640	640	-	-
Fixed income securities:				
Obligations of states and political subdivisions (d)	497	-	497	-
Total	$ 3,960	$ 3,463	$ 497	$ -

(Continued)

(In thousands, except per share amounts)

NOTE 13 – POSTRETIREMENT HEALTHCARE PLAN (Continued)

2011	Total	Quoted Prices in Active Markets for Identical Assets (Level 1)	Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Cash	$ 24	$ 24	$ -	$ -
Equity securities:				
U.S. large-cap (a)	1,517	1,517	-	-
U.S. small-cap (b)	188	188	-	-
International large-cap (c)	309	309	-	-
Fixed income securities:				
Obligations of states and political subdivisions (d)	367	-	367	-
Total	$ 2,405	$ 2,038	$ 367	$ -

(a) This category comprises low-cost equity index funds not actively managed that track the S&P 500.
(b) This category represents low-cost actively managed and broadly diversified U.S. small cap equity funds.
(c) This category represents low cost index enhanced and broadly diversified Non U.S. large cap international funds.
(d) This category represents individual tax exempt state, municipalities and local government agency fixed income debentures of a short to intermediate term to maturity.

In accordance with the "Prudent Expert" rule, the Plan attempts to achieve a balance of risk and reward that will provide the Plan with the greatest risk-adjusted return on assets. The maximization of risk-adjusted return is accomplished by broadly diversifying assets within the major financial asset classes and by maintaining a discipline to the target asset allocation of the Plan. The Plan is managed through a relatively passive approach to asset allocation. The Investment Manager maintains the policy asset allocation listed below except for those unusual and well documented market related events that may dictate otherwise. Stated below is the policy asset allocation at market values of plan assets. This is the long term asset allocation desired by the Board, which should approximate the actual average asset allocation over a three to five year period. In practice, asset allocation is monitored on a monthly basis and at such time as any of the minimum or maximum target asset allocations are pierced, a rebalancing transaction is required to bring all asset allocations back to policy target ranges.

(In thousands, except per share amounts)

NOTE 13 – POSTRETIREMENT HEALTHCARE PLAN (Continued)

Also stated are the maximum and minimum asset allocation levels at market for each asset category as well as the weighted average expected return for each asset class.

	Minimum	Policy	Maximum	Weighted Average Expected Return
Equity	70%	80%	90%	7%
Fixed income	10%	20%	30%	1%
Cash and equivalents	0%	0%	20%	0%

The allocation by asset category of the postretirement healthcare plan assets at December 31 is as follows:

	2012	2011
Asset category:		
Equity	82%	84%
Fixed income	13%	15%
Other	5%	1%
Total	100%	100%

The primary investment objective for the Plan's assets is to achieve maximum rates of return commensurate with safety of principal, given the asset mix, credit quality and diversification guidelines and restrictions approved by the retirement committee. The asset allocation is reviewed quarterly to determine whether the portfolio mix is within an acceptable range of target allocation. Target asset allocations are based on asset and liability studies with the goal to enhance the expected return of the retirement portfolio while maintaining acceptable levels of risk. The target asset allocation for the portfolio is 80% equity and 20% fixed income.

The Bank uses a December 31 measurement date for the Plan. For measurement purposes, the healthcare trend rate of 5.5% was used in 2012 and 2011. They will remain at that level thereafter except where the Bank's contribution limit applies. The healthcare cost trend rate assumptions have a significant effect on the amounts reported, but their impact is lessened because the Bank limits its annual increase at twice the 1991 average premium rate. To illustrate, increasing the assumed healthcare cost trend rates by 1.0% in each year would not change the accumulated postretirement benefit obligation as of December 31, 2012 or December 31, 2011. In addition, the aggregate of the service and interest components of net periodic postretirement benefit cost would not change as of December 31, 2012 or December 31, 2011.

Further, decreasing the assumed healthcare cost trend rates by 1.0% in each year would not change the accumulated postretirement benefit obligation as of December 31, 2012 or 2011. In addition, the aggregate service and interest components of net periodic postretirement benefit cost for the year would not change as of December 31, 2012 or December 31, 2011.

(Continued)

(In thousands, except per share amounts)

NOTE 13 – POSTRETIREMENT HEALTHCARE PLAN (Continued)

The weighted average assumptions used to determine benefit obligations at December 31 are as follows:

	2012	2011
Discount rate	4.00%	4.00%
Rate of compensation increase	N/A	N/A

The weighted average assumptions used to determine net periodic benefit cost at December 31 are as follows:

	2012	2011
Discount rate	4.00%	5.00%
Expected return of plan assets	5.50%	5.50%
Rate of compensation increase	N/A	N/A

The expected return on retirement plan assets is developed using inflation expectations and risk factors to arrive at a long-term nominal expected return for each asset class. The nominal expected return for each asset class is then weighted based on the target asset allocation to develop the expected long-term rate of return on plan assets.

The plan assets are invested in a 501(c)(9) Voluntary Employees' Beneficiary Association trust which is subject to unrelated business income tax. The plan assets were funded by the Bank initially on December 31, 1991 and periodic contributions have been made since then. As of December 31, 2012, these investments included liquid investments, fixed income debt securities and equity securities.

The Medicare Prescription Drug, Improvement and Modernization Act of 2003 was signed into law on December 8, 2003. The Plan was designed to provide only for healthcare premiums and, consequently, the measures of the postretirement benefit obligations and net periodic postretirement benefit cost do not reflect effects of the Act.

The following benefit payments, which reflect expected future service, as appropriate, are expected to be paid:

Year Ending December 31,	Pension Benefits
2013	$ 319,213
2014	$ 329,567
2015	$ 345,176
2016	$ 358,492
2017	$ 365,650
2018 through 2022	$ 1,844,716

(Continued)

(In thousands, except per share amounts)

NOTE 14 – COMMITMENTS AND CONTINGENCIES

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 to meet the financing needs of its customers. These financial instruments represent commitments to originate fixed and variable rate loans and lines of credit and involve, to varying degrees, elements of interest rate risk and credit risk in excess of the amount recognized in the Bank's consolidated balance sheet. The Bank's exposure to credit loss in the event of nonperformance by the other party for commitments to extend credit and letters of credit is represented by the contractual amount of those instruments. The Bank uses the same credit policies in making commitments to originate loans and lines of credit as it does for on-balance sheet instruments.

The following financial instruments represent off-balance-sheet credit risk at December 31:

	2012	2011
Commitments to extend credit	$ 195,218	$ 193,912
Standby letters of credit	35,107	35,755
Total loan commitments	$ 230,325	$ 229,667

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. Each customer's creditworthiness is evaluated on a case-by-case basis. The amount of collateral obtained, if deemed necessary upon extension of credit, is based on management's credit evaluation of the borrower. Collateral held varies, but may include deposit accounts, accounts receivable, inventory, equipment and deeds of trust on residential real estate, land held for development and income-producing commercial properties.

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

The fair value of the liability related to commitments to extend credit and standby letters of credit, which represents the fees received for issuing the guarantees, was not significant at December 31, 2012 and 2011. The Bank recognizes these fees as revenue over the term of the commitment or when the commitment is used.

(Continued)

(In thousands, except per share amounts)

NOTE 14 – COMMITMENTS AND CONTINGENCIES (Continued)

Leases: The Bank leases certain branch premises under operating lease agreements. The leases expire on various dates through 2028 and have renewal options for up to five years. At December 31, 2012, minimum commitments under these noncancellable leases with initial or remaining terms of one year or more are as follows:

Year Ending December 31,	
2013	$ 1,609
2014	1,549
2015	1,293
2016	998
2017	717
Thereafter	1,323
	$ 7,489

Rent expense under operating leases was $1,597 and $1,686 for the years ended December 31, 2012 and 2011, respectively.

Federal Reserve Requirement: Federal Reserve Board regulations require the Bank to maintain reserve balances on deposit with the Federal Reserve Bank. The average amount of reserves required at the Federal Reserve Bank for the years ended December 31, 2012 and 2011 were $1,091 and $3,103, respectively.

Correspondent Banking Agreements: The Bank maintains funds on deposit with other federally insured financial institutions under correspondent banking agreements. The Bank was participating in the Federal Deposit Insurance Corporation's (FDIC) Transaction Account Guarantee Program. Under that program, through December 31, 2010, all noninterest-bearing transaction accounts were fully guaranteed by the FDIC for the entire amount in the account. Coverage under the Transaction Account Guarantee Program was in addition to and separate from the coverage available under the FDIC's general deposit insurance rules. Although coverage under the Transaction Account Guarantee Program expired December 31, 2010, the FDIC adopted a final rule amending its deposit insurance regulations on November 15, 2010 to implement Section 343 of the Dodd-Frank Wall Street Reform and Consumer Protection Act providing for unlimited deposit insurance for noninterest-bearing transaction accounts for two years starting December 31, 2010.

Contingencies: The Bank is involved in legal proceedings arising in the normal course of business. In the opinion of management, the outcomes of such proceedings will not have a material adverse effect on the Bank's financial position or results of operations.

Postretirement Benefits: The Bank has salary continuation agreements in place to provide nonqualified defined benefit retirement income for certain executive officers of the Bank. In connection with establishing these agreements, the Bank purchased split-dollar single premium life insurance policies on each participant. The agreements provide that each executive will receive annual benefits over their lifetime commencing with the month following their normal retirement date.

(Continued)

NOTE 14 – COMMITMENTS AND CONTINGENCIES (Continued)

The Bank accrues for these future benefits from the effective date of the agreements until the executives' expected final payment dates in a systematic and rational manner. As of December 31, 2012 and 2011, the Bank had accrued $10,587 and $9,406, respectively, for potential benefits payable. This payable approximates the then present value of the benefits expected to be provided at retirement. The expense recognized under these agreements totaled $1,747 and $691 for the years ended December 31, 2012 and 2011, respectively.

The Bank has also established a deferred compensation plan for certain members of management for the purpose of providing the opportunity to defer compensation. At December 31, 2012 and 2011, the liability for accrued deferred compensation, including interest earned, totaled $3,295 and $3,237, respectively.

The Bank has also executed split-dollar life insurance agreements with certain employees in connection with the salary continuation agreements and deferred compensation plan whereby the Bank has effectively agreed to maintain a life insurance policy during the employees' postretirement period. The Bank had accrued a liability at December 31, 2012 and 2011 in the amount of $2,001 and $2,136, respectively, representing the actuarial present value of the costs to maintain life insurance during the employees' postretirement period.

The cash surrender value of life insurance purchased in connection with these agreements totaled $35,041 and $33,907 as of December 31, 2012 and 2011, respectively.

Restructuring Activities: During 2008, the Bank recorded a restructuring liability of $2,129, included in interest payable and other liabilities, consisting of estimated discounted future costs of closing/restructuring two branch operations. In 2009, the Bank decided to keep one of the two branches and as a result reversed $998 of the liability.

The primary categories of future costs are lease payments for branch buildings net of estimated future sublease income, the book value of unamortized tenant improvements, the book value of furniture and equipment net of estimated salvage proceeds, and other direct costs associated with restructuring these operations. These future costs will be charged against the liability each month as they are incurred. The restructuring liability totaled $966 and $1,078 at December 31, 2012 and December 31, 2011, respectively.

NOTE 15 – REGULATORY MATTERS

Troubled Asset Relief Program (TARP): On December 19, 2008, 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) 43,000 shares of the Bank's Fixed Rate Non-Cumulative Perpetual Preferred Stock, Series A (the "Series A Preferred Stock") for a purchase price of $43,000,000 and (ii) warrants to purchase 2,150 shares of the Bank's Fixed Rate Non-Cumulative Perpetual Preferred Stock, Series B stock, (the "Series B Preferred Stock") for $0.01 per share under the Treasury’s TARP Capital Purchase Program. The Series B Preferred Stock has a redemption cost of $1,000 per share for a total of $2,150. The Treasury exercised the warrants on December 19, 2008.

(Continued)

NOTE 15 – REGULATORY MATTERS (Continued)

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

The Series A Preferred Stock and the Series B Preferred Stock 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 Series B Preferred Stock will be subject to any contractual restrictions on transfer, except that the Treasury and its transferees shall not affect any transfer of the Series A or Series B Preferred Stock which would require the Bank to become subject to the periodic reporting requirements of Section 13 or 15(d) of the Exchange Act.

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

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

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

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

(Continued)

NOTE 15 – REGULATORY MATTERS (Continued)

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

The Bank recorded a discount on the Series A Preferred Stock at approximately the liquidation preference of the Series B Preferred Stock, which approximates the relative fair value of the two instruments. The discount recorded on the Series A Preferred Stock will be amortized on the level-yield method over five years.

In 2012, as part of the strategy for winding down its remaining bank investments under the TARP Capital Purchase Program, the Treasury conducted private auctions of securities issued by certain institutions that participated in the program. On July 26, 2012, the Treasury conducted an auction of the Bank's 43,000 share of Series A Preferred Stock and 2,150 shares of Series B Preferred Stock. In the auction, the Bank successfully bid on 20,000 shares of its Series A Preferred Shares, which were retired on the purchase date and are no longer outstanding. The remaining 23,000 shares of Series A Preferred Stock and 2,150 shares of Series B Preferred Stock remain outstanding but are now owned by private investors and are transferable.

Several of the Purchase Agreement's covenants relating to the Series A Preferred Stock and the Series B Preferred Stock terminated at the time that Treasury sold the securities to investors. As a result of the Treasury' sale of these securities, the Bank is no longer required to ensure that its benefit plans with respect to its senior executive officers comply with Section 111(b) of the EESA. Neither Treasury nor the new holders of the preferred shares have the right to unilaterally amend the terms of the Purchase Agreement. In addition, the Bank may increase the amount of cash dividend on the common stock without the approval of the Treasury or the current holders of the Series A Preferred Stock and Series B Preferred Stock. Finally the Bank is no longer prohibited from paying dividends on its common stock or repurchasing any equity securities or trust preferred securities, provided that it has declared and paid (or set aside for payment) full dividends on the Series A Preferred Stock and the Series B Preferred Stock for the latest completed dividend period.

Dividend Restrictions: 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. In addition, subject to prior regulatory approval, any state banking association may request an exception to this restriction.

(In thousands, except per share amounts)

NOTE 15 – 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 consolidated 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 following table. The most recent notification from the FDIC categorized the Bank as well capitalized under these guidelines. Management believes that the Bank met all its capital adequacy requirements to which they are subject to as of December 31, 2012 and 2011. In 2012, the Board of Directors of the Bank passed a Board Resolution to maintain a minimum Tier 1 capital to average assets ratio of 8%. At December 31, 2012 and 2011, this ratio was 9.2% and 9.9%, respectively.

	Actual		For Capital Adequacy Purposes		To Be Well Capitalized Under Prompt Corrective Action Provisions	
	Amount	Ratio	Minimum Amount	Minimum Ratio	Minimum Amount	Minimum Ratio
December 31, 2012						
Total capital (to risk-weighted assets)	$ 180,173	15.0%	$ 96,444	8.0%	$ 120,555	10.0%
Tier 1 capital (to risk-weighted assets)	$ 152,847	12.7%	$ 48,222	4.0%	$ 72,333	6.0%
Tier 1 capital (to average assets)	$ 152,847	9.2%	$ 66,537	4.0%	$ 83,171	5.0%
December 31, 2011						
Total capital (to risk-weighted assets)	$ 182,902	15.2%	$ 96,275	8.0%	$ 120,344	10.0%
Tier 1 capital (to risk-weighted assets)	$ 155,647	12.9%	$ 48,137	4.0%	$ 72,206	6.0%
Tier 1 capital (to average assets)	$ 155,647	9.9%	$ 62,384	4.0%	$ 77,978	5.0%