



# 2013 ANNUAL REPORT



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To Our Shareholders:

We are very pleased to report Bank of Southern California's financial results for 2013, again noting another profitable year. Year-end loan and deposit portfolios and total assets reflect solid growth over the prior year, as we continued to focus on organic growth.

Our company has enjoyed some real noteworthy successes over the past several years despite the challenges that many other banks have faced due to the recent recession and collapse of the real estate market. These past five years have been uncharted territory for banks, with an unprecedented number of bank failures, mergers and acquisitions, increased scrutiny from regulators, and thin margins. Community banks in particular have had to quickly adapt to the new realities of the banking environment. With the guidance of our board of directors and skilled and experienced management team we are pleased that we not only survived these difficult years, but we are a stronger company and better positioned to grow.

Many of our peers have had to shrink their balance sheets in recent years, but our strong capital position has allowed us to continue growing our customer base. In 2013, loan production was strong, booking nearly \$75 million in new loan commitments, a 220% increase over 2012. In the first quarter of 2014, loan and deposit demand continues to be strong, booking over \$16 million in new loan commitments and nearly \$15 million in new deposits, giving us a good start at another growth year for the bank.

We are experiencing increased demand and opportunities in our local markets to grow organically; however, we also anticipate that we will continue to see consolidation in our industry. In anticipation of that, we have worked hard to develop scalable operations; a relationship based sales culture, established strong risk management practices, and assembled a strong leadership team so we can take advantage of these opportunities as they arise.

We feel that 2014 will continue to provide us with more opportunity to grow, as local business and consumer confidence has grown stronger. As we look forward, we will continue to execute our strategy to serve the financial needs of our customers, manage risk, maintain strong capital and liquidity, and operate efficiently.

As we continue to grow the bank, we do so with the commitment of providing superior personal service to our customers. In fact, we have a formal, comprehensive customer service program designed to reinforce our core values of personal attention and responsiveness. The consistently high satisfaction levels and number of referrals we receive from our customers are solid proof of our strong service commitment.

We value your investment in the company and thank you for your continued confidence and support.



John Farkash  
Chairman of the Board



Nathan L. Rogge  
President and Chief Executive Officer

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## Independent Auditor's Report

Board of Directors and Shareholders of  
Bank of Southern California, N.A.

### *Report on Financial Statements*

We have audited the accompanying financial statements of Bank of Southern California N.A., which are comprised of the statements of financial condition as of December 31, 2013 and 2012, and the related statements of operations, comprehensive income, changes in shareholders' equity and cash flows for the years then ended, and the related notes to the financial statements.

### *Management's Responsibility for the Financial Statements*

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

### *Auditor's Responsibility*

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

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

### *Opinion*

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Bank of Southern California N.A. as of December 31, 2013 and 2012, and the results of its operations and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

*Vavrinek, Trine, Day & Co., LLP*

Laguna Hills, CA  
March 26, 2014

**BANK OF SOUTHERN CALIFORNIA, N.A.**

**STATEMENTS OF FINANCIAL CONDITION**  
**December 31, 2013 and 2012**

**ASSETS**

	2013	2012
Cash and Due from Banks	\$ 6,596,416	\$ 6,430,243
Excess Reserves at Federal Reserve Bank	20,785,000	16,690,000
<b>TOTAL CASH AND CASH EQUIVALENTS</b>	<b>27,381,416</b>	<b>23,120,243</b>
Investment Securities Available for Sale	3,981,462	8,045,954
Loans:		
Construction and Land Development	5,552,331	8,498,426
Real Estate - Other	116,409,683	112,167,875
Commercial and Industrial	34,885,491	26,257,030
Consumer	4,226,482	4,309,012
<b>TOTAL LOANS</b>	<b>161,073,987</b>	<b>151,232,343</b>
Allowance for Loan Losses	( 2,346,202)	( 2,449,061)
<b>NET LOANS</b>	<b>158,727,785</b>	<b>148,783,282</b>
Stock Investments, at Cost	1,604,550	1,585,250
Premises and Equipment	2,654,780	1,096,741
Goodwill and Other Intangibles	960,087	1,040,343
Other Real Estate Owned, net	345,001	-
Bank Owned Life Insurance	3,801,905	3,704,709
Accrued Interest and Other Assets	2,423,076	1,649,414
<b>TOTAL ASSETS</b>	<b>\$ 201,880,062</b>	<b>\$ 189,025,936</b>

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

**BANK OF SOUTHERN CALIFORNIA, N.A.**

**STATEMENTS OF FINANCIAL CONDITION**  
**December 31, 2013 and 2012**

**LIABILITIES AND SHAREHOLDERS' EQUITY**

	2013	2012
Deposits:		
Noninterest-Bearing Demand	\$ 57,590,603	\$ 55,097,599
Interest-Bearing NOW, Money Market and Savings Accounts	82,495,800	79,021,485
Time Deposits Under \$100,000	3,768,514	9,882,173
Time Deposits \$100,000 and Over	20,186,156	19,841,297
<b>TOTAL DEPOSITS</b>	<b>164,041,073</b>	<b>163,842,554</b>
Federal Home Loan Bank Advances	12,500,000	1,000,000
Accrued Interest and Other Liabilities	891,785	866,688
<b>TOTAL LIABILITIES</b>	<b>177,432,858</b>	<b>165,709,242</b>
Commitments and Contingencies - Notes E and L	-	-
Shareholders' Equity:		
Preferred Stock - 10,000,000 Shares Authorized, No Par Value; Issued and Outstanding 3,050 Shares in 2013 and 2012	3,042,682	3,026,122
Common Stock - 10,000,000 Shares Authorized, \$5.00 Par Value; Issued and Outstanding 3,268,393 in 2013 and 3,263,534 in 2012	16,341,965	16,317,670
Additional Paid-in Capital	13,085,558	13,048,707
Accumulated Deficit	( 8,015,502)	( 9,244,015)
Accumulated Other Comprehensive Income (Loss) - Net of Taxes	( 7,499)	168,210
<b>TOTAL SHAREHOLDERS' EQUITY</b>	<b>24,447,204</b>	<b>23,316,694</b>
<b>TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY</b>	<b>\$ 201,880,062</b>	<b>\$ 189,025,936</b>

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

**BANK OF SOUTHERN CALIFORNIA, N.A.**

**STATEMENTS OF OPERATIONS**  
**For the Years Ended December 31, 2013 and 2012**

	2013	2012
<b>INTEREST INCOME</b>		
Interest and Fees on Loans	\$ 7,864,058	\$ 8,356,958
Interest and Dividends on Investment Securities	270,052	363,636
Interest on Federal Funds Sold and Other Balances	29,398	43,640
<b>TOTAL INTEREST INCOME</b>	<b>8,163,508</b>	<b>8,764,234</b>
<b>INTEREST EXPENSE</b>		
Interest on Savings, NOW and Money Market Accounts	159,732	255,492
Interest on Time Deposits	301,099	524,275
Interest on Other Borrowings	15,716	15,715
<b>TOTAL INTEREST EXPENSE</b>	<b>476,547</b>	<b>795,482</b>
<b>NET INTEREST INCOME</b>	<b>7,686,961</b>	<b>7,968,752</b>
Provision for Loan Losses	100,000	110,000
<b>NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES</b>	<b>7,586,961</b>	<b>7,858,752</b>
<b>NONINTEREST INCOME</b>		
Service Charges, Fees and Other	571,482	621,002
Gain on Sale of Securities	66,109	52,706
Gain on Sale of Loans	471,324	58,429
Loss on Sale of Other Real Estate Owned	( 18,773)	( 20,330)
<b>TOTAL NONINTEREST INCOME</b>	<b>1,090,142</b>	<b>711,807</b>
<b>NONINTEREST EXPENSE</b>		
Salaries and Employee Benefits	4,302,934	4,049,624
Occupancy and Equipment Expenses	1,102,754	1,253,320
Other Expenses	2,473,342	2,507,337
<b>TOTAL NONINTEREST EXPENSE</b>	<b>7,879,030</b>	<b>7,810,281</b>
<b>INCOME BEFORE INCOME TAXES</b>	<b>798,073</b>	<b>760,278</b>
Income Tax Expense (Benefit)	( 447,000)	( 378,000)
<b>NET INCOME</b>	<b>\$ 1,245,073</b>	<b>\$ 1,138,278</b>
<b>NET INCOME PER SHARE - BASIC</b>	<b>\$ 0.38</b>	<b>\$ 0.33</b>
<b>NET INCOME PER SHARE - DILUTED</b>	<b>\$ 0.38</b>	<b>\$ 0.33</b>

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

**BANK OF SOUTHERN CALIFORNIA, N.A.**

**STATEMENTS OF COMPREHENSIVE INCOME**  
**For the Years Ended December 31, 2013 and December 31, 2012**

	<u>2013</u>	<u>2012</u>
Net Income	\$ 1,245,073	\$ 1,138,278
<b>OTHER COMPREHENSIVE INCOME (LOSS):</b>		
Change in Net Unrealized Gain (Loss)	( 232,452)	330,589
Reclassification of Gain Recognized in Net Income	<u>( 66,109)</u>	<u>( 52,706)</u>
	( 298,561)	277,883
Income Taxes (Benefit):		
Change in Net Unrealized Gain (Loss)	( 95,747)	135,970
Reclassification of Gain Recognized in Net Income	<u>( 27,105)</u>	<u>( 21,609)</u>
	<u>( 122,852)</u>	<u>114,361</u>
<b>TOTAL OTHER COMPREHENSIVE INCOME (LOSS)</b>	<u>( 175,709)</u>	<u>163,522</u>
<b>TOTAL COMPREHENSIVE INCOME</b>	<u>\$ 1,069,364</u>	<u>\$ 1,301,800</u>

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



**BANK OF SOUTHERN CALIFORNIA, N.A.**

**STATEMENT OF CHANGES IN SHAREHOLDERS' EQUITY  
For the Years Ended December 31, 2013 and December 31, 2012**

	<u>Preferred Stock</u>		<u>Common Stock</u>		<u>Additional</u>	<u>Accumulated</u>	<u>Accumulated</u>	<u>Total</u>
	<u>Shares</u>	<u>Amount</u>	<u>Shares</u>	<u>Amount</u>	<u>Paid-in</u>	<u>Deficit</u>	<u>Other</u>	<u>Shareholders'</u>
					<u>Capital</u>		<u>Income (Loss)</u>	<u>Equity</u>
<b>Balance at December 31, 2011</b>	4,354	\$ 4,277,774	3,263,534	\$ 16,317,670	\$ 13,083,112	\$(10,336,398)	\$ 4,688	\$ 23,346,846
Accretion of Redemption Value		45,895				(45,895)		-
Preferred Stock Redeemed	(1,304)	(1,297,547)			95,946			(1,201,601)
Dividends Paid					(222,140)			(222,140)
Stock-Based Compensation					91,789			91,789
Net Income						1,138,278		1,138,278
Other Comprehensive Income							163,522	163,522
<b>Balance at December 31, 2012</b>	<u>3,050</u>	<u>3,026,122</u>	<u>3,263,534</u>	<u>16,317,670</u>	<u>13,048,707</u>	<u>(9,244,015)</u>	<u>168,210</u>	<u>23,316,694</u>
Accretion of Redemption Value		16,560				(16,560)		-
Vested Restricted Share Award			4,859	24,295	(24,295)			-
Stock-Based Compensation					61,146			61,146
Net Income						1,245,073		1,245,073
Other Comprehensive Loss							(175,709)	(175,709)
<b>Balance at December 31, 2013</b>	<u>3,050</u>	<u>\$ 3,042,682</u>	<u>3,268,393</u>	<u>\$ 16,341,965</u>	<u>\$ 13,085,558</u>	<u>\$ (8,015,502)</u>	<u>\$ (7,499)</u>	<u>\$ 24,447,204</u>

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

**BANK OF SOUTHERN CALIFORNIA, N.A.**

**STATEMENTS OF CASH FLOWS**  
**For the Years Ended December 31, 2013 and 2012**

	2013	2012
<b>OPERATING ACTIVITIES</b>		
Net Income	\$ 1,245,073	\$ 1,138,278
Adjustments to Reconcile Net Income to Net Cash Provided by		
Operating Activities:		
Depreciation and Amortization	396,838	467,823
Gain on Sale of Loans	( 471,324)	( 58,429)
Provision for Loan Losses	100,000	110,000
Deferred Tax Benefits	( 462,000)	( 399,000)
Loss on Sale of Other Real Estate Owned and Fixed Assets	18,773	13,561
Stock-Based Compensation	61,146	91,789
Increase in Cash Surrender Value of Bank Owned Life Insurance	( 97,196)	( 29,709)
Gain on Sale of Available for Sale Securities	( 66,109)	( 52,706)
Net Changes in Other Assets and Liabilities	( 163,713)	( 88,547)
<b>NET CASH PROVIDED BY OPERATING ACTIVITIES</b>	561,488	1,193,060
<b>INVESTING ACTIVITIES</b>		
Proceeds from Sale of Available-for-Sale Securities	2,570,614	3,543,579
Proceeds from Maturities of Available-for-Sale Securities	1,261,426	1,751,554
Net Redemption (Purchase) of Stock Investments	( 19,300)	6,250
Purchase of Bank Owned Life Insurance	-	( 3,675,000)
Net (Funding) Repayment of Loans	( 17,232,129)	( 8,528,716)
Proceeds from Sale of Loans	7,260,376	3,587,868
Proceeds from Sale of Other Real Estate Owned	34,800	779,913
Purchases of Premises and Equipment, net of Sales Proceeds	( 1,874,621)	( 515,487)
<b>NET CASH USED BY INVESTING ACTIVITIES</b>	( 7,998,834)	( 3,050,039)
<b>FINANCING ACTIVITIES</b>		
Net Increase in Deposits	198,519	1,409,137
Net Advances from Federal Home Loan Bank	11,500,000	-
Redemption of Preferred Stock	-	( 1,201,601)
Dividends on Preferred Stock	-	( 222,140)
<b>NET CASH PROVIDED (USED) BY FINANCING ACTIVITIES</b>	11,698,519	( 14,604)
<b>INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS</b>	4,261,173	( 1,871,583)
Cash and Cash Equivalents at Beginning of Year	23,120,243	24,991,826
<b>CASH AND CASH EQUIVALENTS AT THE END OF THE YEAR</b>	\$ 27,381,416	\$ 23,120,243
<b>Supplemental Disclosures of Cash Flow Information:</b>		
Interest Paid	\$ 482,548	\$ 804,307
Taxes Paid	\$ 12,000	\$ 1,500
Loans Transferred to Other Real Estate Owned	\$ 398,574	\$ 340,881

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

**BANK OF SOUTHERN CALIFORNIA, N.A.**  
**NOTES TO FINANCIAL STATEMENTS**  
**December 31, 2013 and 2012**

**NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

Nature of Operations

Bank of Southern California, N.A. (the “Bank”) began business operations in December 2001 under the name Ramona National Bank. The name was changed to First Business Bank, N.A. in 2006 and to Bank of Southern California, N.A. in 2010. The Bank operates under a federal charter and its primary regulator is the Office of the Comptroller of the Currency (“OCC”). The Bank is organized as a single operating segment that operates six full-service offices, including two in San Diego, as well as Carlsbad, Ramona, Palm Springs, and La Quinta, California. The Bank acquired two branches in Palm Springs and La Quinta from another bank in December 2010. The Bank's primary source of revenue is interest earned on loans to clients, who are predominately small and middle-market businesses and individuals. Client deposits are insured by the Federal Deposit Insurance Corporation (“FDIC”) up to the maximum legal limit and the Bank is a member of the Federal Reserve Bank (“FRB”).

Use of Estimates in the Preparation of Financial Statements

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 that affect the reported amounts of assets and liabilities, 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.

Subsequent Events

The Bank has evaluated subsequent events for recognition and disclosure through March 26, 2014, the date the financial statements were available to be issued.

Reclassifications

Certain amounts in the 2012 financial statements have been reclassified to conform to the 2013 presentation. The reclassifications have no material effect on shareholders' equity, or net income, as previously reported.

Cash and Cash Equivalents

For purposes of reporting cash flows, cash and cash equivalents include cash and due from banks, excess reserves at the Federal Reserve Bank, and federal funds sold. Excess reserves at the Federal Reserve Bank earn interest, vary in amount every day, and are considered an alternative to federal funds sold. Generally, federal funds are sold for one-day periods.

**BANK OF SOUTHERN CALIFORNIA, N.A.**  
**NOTES TO FINANCIAL STATEMENTS**  
**December 31, 2013 and 2012**

**NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - CONTINUED**

Cash and Due From Banks

Banking regulations require that banks maintain a percentage of their deposits as reserves in cash or on deposit with the Federal Reserve Bank. The Bank's reserve requirement at December 31, 2013 was \$970,000 which was met by the Bank.

The Bank maintains amounts due from banks, which may exceed federally insured limits. The Bank has not experienced any losses in such accounts.

Investment Securities

Investment securities are classified as held-to-maturity when the Bank has the positive intent and ability to hold the securities to maturity. Investments classified as held-to-maturity securities are carried at amortized cost.

Investments not classified as trading securities nor as held-to-maturity securities are classified as available-for-sale securities and recorded at fair value. Unrealized gains or losses on available-for-sale securities are excluded from net income and reported as an amount net of taxes as a separate component of other comprehensive income included in shareholders' equity. Premiums or discounts on held-to-maturity and available-for-sale securities are amortized or accreted into income using the interest method. Realized gains or losses on sales of held-to-maturity or available-for-sale securities are recorded using the specific identification method.

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: OTTI related to credit loss, which must be recognized in the income statement and 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. The related write-downs are included in earnings as realized losses. In estimating OTTI losses, management considers: the length of time and the extent to which the fair value has been less than cost, the financial condition and near-term prospects of the issuer, and the intent and ability of the Bank to retain its investment in the issuer for a period of time sufficient to allow for any anticipated recovery in fair value.

**BANK OF SOUTHERN CALIFORNIA, N.A.**  
**NOTES TO FINANCIAL STATEMENTS**  
**December 31, 2013 and 2012**

**NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - CONTINUED**

Stock Investments

Stock investments primarily consist of Federal Reserve Bank stock and Federal Home Loan Bank stock and are carried at cost. Under certain conditions, these stocks may be sold back to the issuing institution at par value or book value. All stock investments are evaluated for impairment based on an estimate of the ultimate recoverability of cost.

Loans

Loans receivable that management has the intent and ability to hold for the foreseeable future or until maturity or payoff are reported at their outstanding unpaid principal balances reduced by any charge-offs and net of any deferred fees or costs on originated loans, or unamortized premiums or discounts on purchased loans. Loan origination fees and certain direct origination costs are capitalized and recognized as an adjustment of the yield of the related loan. Amortization of deferred loan fees is discontinued when a loan is placed on nonaccrual status.

Loans on which the accrual of interest has been discontinued are designated as nonaccrual loans. The accrual of interest on loans is generally discontinued when principal or interest is past due 90 days based on the contractual terms of the loan or earlier when, in the opinion of management, there is reasonable doubt as to collectability. On a case by case basis, loans past due 90 days may remain on accrual, if the loan is well collateralized, actively in process of collection and, in the opinion of management, likely to be paid current within the next payment cycle. When loans are placed on nonaccrual status, all interest previously accrued but not collected is generally reversed against current period interest income. Income on nonaccrual loans is subsequently recognized only to the extent that cash is received and the loan's principal balance is deemed collectible. Interest accruals are resumed on such loans only when they are brought current with respect to interest and principal and when, in the judgment of management, the loans are estimated to be fully collectable as to all principal and interest.

The Bank recognizes interest income on impaired loans based on its existing methods of recognizing interest income on nonaccrual loans.

**BANK OF SOUTHERN CALIFORNIA, N.A.**  
**NOTES TO FINANCIAL STATEMENTS**  
**December 31, 2013 and 2012**

**NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - CONTINUED**

Allowance for Loan Losses

The allowance for loan losses is a valuation allowance for probable incurred credit losses. Loan losses are charged against the allowance when management believes the uncollectibility of a loan balance is confirmed. Subsequent recoveries, if any, are credited to the allowance. Management estimates the allowance balance required using past loan loss experience, the nature and volume of the portfolio, information about specific borrower situations and estimated collateral values, economic conditions, and other factors. Allocations of the allowance may be made for specific loans, but the entire allowance is available for any loan that, in management's judgment, should be charged off. Amounts are charged-off when available information confirms that specific loans or portions thereof, are uncollectible. This methodology for determining charge-offs is consistently applied to each segment.

The Bank determines a separate allowance for each portfolio segment. The allowance consists of specific and general reserves. Specific reserves relate to loans that are individually classified as impaired. The Bank considers a loan to be impaired when it is probable that the Bank will be unable to collect all amounts due, principal and interest, according to the contractual terms of the loan agreement. Factors considered in determining impairment include payment status, collateral value and the probability of collecting all amounts when due. Measurement of impairment is based on the expected future cash flows of an impaired loan, which are to be discounted at the loan's effective interest rate, or measured by reference to an observable market value, if one exists, or the fair value of the collateral for a collateral-dependent loan. The Bank selects the measurement method on a loan-by-loan basis except that collateral-dependent loans for which foreclosure is probable are measured at the net realizable value of the collateral. Loans, for which the terms have been modified resulting in a concession, and for which the borrower is experiencing financial difficulties, are considered troubled debt restructurings and classified as impaired with measurement of impairment as described above.

If a loan is impaired, a portion of the allowance is allocated so that the loan is reported, net, at the present value of estimated future cash flows using the loan's existing rate or at the fair value of collateral if repayment is expected solely from the collateral.

Troubled debt restructurings are separately identified for impairment disclosures and are measured at the present value of estimated future cash flows using the loan's effective rate at inception. If a troubled debt restructuring is considered to be a collateral dependent loan, the loan is reported, net, at the fair value of the collateral. For troubled debt restructurings that subsequently default, the Bank determines the amount of reserve in accordance with the accounting policy for the allowance for loan losses.

General reserves cover non-impaired loans and are based on historical loss rates for each portfolio segment, adjusted for the effects of qualitative or environmental factors that are likely to cause estimated credit losses as of the evaluation date to differ from the portfolio segment's historical loss experience.

**BANK OF SOUTHERN CALIFORNIA, N.A.**  
**NOTES TO FINANCIAL STATEMENTS**  
**December 31, 2013 and 2012**

**NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - CONTINUED**

Allowance for Loan Losses – Continued

The Bank reviews the historical loss rates for each portfolio segment and utilizes peer loss rates when the Bank does not have sufficient historical experience or otherwise feels historical experience is not indicative of the current loan portfolio. Qualitative factors include consideration of the following: changes in lending policies and procedures; changes in economic conditions, changes in the nature and volume of the portfolio; changes in the experience, ability and depth of lending management and other relevant staff; changes in the volume and severity of past due, nonaccrual and other adversely graded loans; changes in the loan review system; the existence and effect of any concentrations of credit; the effect of other external factors such as competition and legal and regulatory requirements; the quality and effectiveness of the risk rating system; and the quality of regulatory and other external credit reviews.

Portfolio segments identified by the Bank include construction and land development, real estate, commercial and industrial and consumer loans. Relevant risk characteristics for these portfolio segments generally include debt to income ratios or debt service coverage, credit scores, collateral type and loan-to-value ratios and financial performance.

Other Real Estate Owned

Real estate acquired through foreclosure or deed in lieu of foreclosure is recorded at fair value at the date legal title is transferred, establishing a new cost basis by a charge to the allowance for loan losses, if necessary. Other real estate owned is carried at the lower of the Bank's carrying value of the property or its fair value, less estimated carrying costs and costs of disposition. Fair value is based on current appraisals less estimated selling costs. Any subsequent write-downs are charged against operating expenses and recognized as a valuation allowance. Operating expenses of such properties, net of related income, and gains and losses on their disposition are included in other operating expenses.

Transfers of Financial Assets

Transfers of financial assets are accounted for as sales, when control over the assets has been surrendered. Control over transferred assets is deemed to be surrendered when; (1) the assets have been isolated from the Bank, (2) the transferee obtains the right (free of conditions that constrain it from taking advantage of that right) to pledge or exchange the transferred assets, and (3) the Bank does not maintain effective control over the transferred assets through an agreement to repurchase them before maturity.

Bank Owned Life Insurance

Bank owned life insurance is recorded at the amount that can be realized under insurance contracts at the date of the statement of financial condition, which is the cash surrender value adjusted for other charges or other amounts due that are probable at settlement.

**BANK OF SOUTHERN CALIFORNIA, N.A.**  
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**December 31, 2013 and 2012**

**NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - CONTINUED**

Loan Sales and Servicing of Financial Assets

The Bank originates SBA loans that may be sold in the secondary market. Servicing rights are recognized separately when they are acquired through sale of loans. Servicing rights are initially recorded at fair value with the income statement effect recorded in gain on sale of loans. Fair value is based on a valuation model that calculates the present value of estimated future cash flows from the servicing assets. The valuation model uses assumptions that market participants would use in estimating cash flows from servicing assets, such as the cost to service, discount rates and prepayment speeds. The Bank compares the valuation model inputs and results to published industry data in order to validate the model results and assumptions. Servicing assets are subsequently measured using the amortization method which requires servicing rights to be amortized into noninterest income in proportion to, and over the period of, the estimated future net servicing income of the underlying loans.

Servicing assets are evaluated for impairment based upon the fair value of the rights as compared to the carrying amount. Impairment is determined by stratifying rights into groupings based on predominant risk characteristics, such as interest rate, loan type and investor type. For purposes of measuring impairment, the Bank has identified each servicing asset with the underlying loan being serviced. A valuation allowance is recorded where the fair value is below the carrying amount of the asset. If the Bank later determines that all or a portion of the impairment no longer exists for a particular grouping, a reduction of the allowance may be recorded as an increase in income. The fair values of servicing rights are subject to significant fluctuations as a result of changes in estimated and actual prepayments speeds and changes in the discount rates.

Servicing fee income, which is reported on the income statement with service charges, fees and other income, is recorded for fees earned for servicing loans. The fees are based on a contractual percentage of the outstanding principal and recorded as income when earned. The amortization of servicing rights and changes in the valuation allowance are netted against loan servicing income.

Premises and Equipment

Land is carried at cost. Premises and equipment are carried at cost less accumulated depreciation and amortization. Depreciation is computed using the straight-line method over the estimated useful lives, which ranges from three to seven years for furniture and equipment and fifty-five years for premises. Leasehold improvements are amortized using the straight-line method over the estimated useful lives of the improvements or the remaining lease term, whichever is shorter. Expenditures for betterments or major repairs are capitalized and those for ordinary repairs and maintenance are charged to operations as incurred.

Advertising Costs

The Bank expenses the costs of advertising in the period incurred.



**BANK OF SOUTHERN CALIFORNIA, N.A.**  
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**NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - CONTINUED**

Income Taxes

Deferred income taxes are computed using the asset and liability method, which recognizes a liability or asset representing the tax effects, based on current tax law, of future deductible or taxable amounts attributable to events that have been recognized in the consolidated financial statements. A valuation allowance is established to reduce the deferred tax asset to the level at which it is “more likely than not” that the tax asset or benefits will be realized. Realization of tax benefits of deductible temporary differences and operating loss carryforwards depend on having sufficient taxable income of an appropriate character within the carryforward periods.

The Bank has adopted guidance issued by the Financial Accounting Standards Board (“FASB”) that clarifies the accounting for uncertainty in tax positions taken or expected to be taken on a tax return and provides that the tax effects from an uncertain tax position can be recognized in the financial statements only if, based on its merits, the position is more likely than not to be sustained on audit by the taxing authorities. Management believes that all tax positions taken to date are highly certain and, accordingly, no accounting adjustment has been made to the financial statements. Interest and penalties related to uncertain tax positions are recorded as part of income tax expense.

Preferred Stock

On April 10, 2009, the Bank received \$2,211,000 from the U.S. Treasury in exchange for the issuance 2,211 shares of the Bank’s Fixed Rate Non-Cumulative Perpetual Preferred Stock, Series A and 111 shares of the Bank’s Fixed Rate Non-Cumulative Perpetual Preferred Stock, Series B. The original aggregate redemption price of Series A and Series B Preferred Stock was \$2,322,000. The difference between the aggregate redemption price and the issuance proceeds, net of issuance costs, of \$141,135 is accreted against retained earnings over the estimated five-year life of the Preferred Stock and reduces the reported income available for common shareholders. The non-cumulative dividend rate on the Preferred Stock, Series A is 5% per year for the first five years and 9% per year thereafter. The non-cumulative dividend rate on the Preferred Stock, Series B is 9% per year. The Series B Preferred Stock may be redeemed after all of the Series A Preferred Stock has been redeemed.

On December 11, 2009, the Bank received \$2,032,000 from the U.S. Treasury in exchange for the issuance of 2,032 shares of the Bank’s Fixed Rate Non-Cumulative Perpetual Preferred Stock, Series C. The Series C redemption price is \$2,032,000. The issuance cost of \$18,832 is accreted against retained earnings over the estimated five-year life of the Preferred Stock reducing the reported income available for common shareholders. The non-cumulative dividend rate on the Preferred Stock, Series C is 5% per year for the first five years and 9% per year thereafter. The Series C Preferred Stock may be redeemed at par independent of the redemption of the Series A and B Preferred Stock.

In December, 2012, pursuant to an auction by the U.S. Treasury, the Bank redeemed 553 shares of Series A, 51 shares of Series B, and 700 shares of Series C, for an aggregate redemption price of \$1,201,601, and all remaining Preferred Stock was sold by the U.S. Treasury to independent investors. All significant terms of the preferred shares remain the same. The current aggregate redemption price of all outstanding preferred stock is \$3,050,000.

**BANK OF SOUTHERN CALIFORNIA, N.A.**  
**NOTES TO FINANCIAL STATEMENTS**  
**December 31, 2013 and 2012**

**NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - CONTINUED**

Dividends

The Bank has not declared or paid the non-cumulative dividends on its preferred stock since the US Treasury sold the unredeemed preferred stock to private investors in December 2012. Through the quarterly dividend scheduled for February 15, 2014, the Bank has not declared or paid the non-cumulative dividends for the five quarterly dividend periods. In the event that dividends payable on the preferred stock have not been paid for six or more quarters, whether or not consecutive, the Bank's authorized number of directors will be automatically increased by two and the holders of the preferred stock will have the right to elect two directors at the Bank's next annual meeting of shareholders or at a special meeting of shareholders called for that purpose. These directors will be elected annually and will serve until dividends on the preferred stock have been paid for at least four consecutive dividend periods.

In addition, the terms of our outstanding preferred stock prohibit the payment of dividends on our common stock or directly or indirectly purchasing, redeeming, or otherwise acquiring for consideration any of our outstanding common stock unless full dividends on all outstanding shares of preferred stock for the most recently completed dividend period have been or are contemporaneously declared and paid.

Comprehensive Income

Changes in unrealized gains and losses on available-for-sale securities is the only component of accumulated other comprehensive income for the Bank. The amount reclassified out of other accumulated comprehensive income related to gains on available-for-sale securities was \$66,109 and \$52,706 for 2013 and 2012, with the related tax effect of \$27,105 and \$21,609, respectively.

Financial Instruments

In the ordinary course of business, the Bank has entered into off-balance sheet financial instruments consisting of commitments to extend credit, commercial letters of credit, and standby letters of credit. The Bank is a contingent obligor under a letter of credit issued on its behalf to secure certain lease obligations. Such financial instruments are recorded in the financial statements when they are funded or related fees are incurred or received.

Disclosure about Fair Value of Financial Instruments

The Bank's estimated fair value amounts have been determined using available market information and appropriate valuation methods. However, considerable judgment is required to develop the estimates of fair value. Accordingly, the estimates are not necessarily indicative of the amounts the Bank could have realized in a current market exchange. The use of different market assumptions and/or estimation methods may have a material effect on the estimated fair value amounts.

**BANK OF SOUTHERN CALIFORNIA, N.A.**  
**NOTES TO FINANCIAL STATEMENTS**  
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**NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - CONTINUED**

Earnings Per Share (“EPS”)

Earnings per share present the net income or loss per common share, after consideration of the preferred shareholders interest in the net income or loss. Basic EPS excludes dilution and is computed by dividing income available to common shareholders by the weighted-average number of common shares outstanding for the period. Diluted EPS reflects the potential dilution that could occur if securities or other contracts to issue common stock were exercised or converted into common stock or resulted in the issuance of common stock that then shared in the earnings of the entity.

Goodwill

Goodwill is the excess purchase price over the fair value of all identifiable assets and liabilities acquired. Current accounting standards require that goodwill be reviewed for impairment at least annually. The Bank has performed a qualitative assessment for potential impairment as of December 31, 2013, and as a result of that assessment has determined that there has been no impairment to the goodwill recorded in a branch acquisition that was completed during the year ended December, 2010.

Intangible Asset

A core deposit intangible of \$508,287 resulted from the purchase of two branches in Coachella Valley in December 2010, and is being amortized over a period of approximately seven years. Amortization expense for each of the periods ended December 31, 2013 and 2012 was \$80,256. Future amortization expense is approximately \$80,256 each year through 2016. Accumulated amortization as of December 31, 2013 and 2012 was \$247,456 and \$167,200, respectively. Intangible assets subject to amortization are evaluated periodically to determine recoverability of their carrying value when economic conditions indicate impairment may exist. These conditions would include an ongoing negative performance history and a forecast of anticipated performance that is significantly below management's initial expectation for the acquired entity. Intangible assets are evaluated for impairment at the lowest level for which identifiable cash flows are largely independent of the cash flows of other groups of assets and liabilities. If the projected undiscounted cash flows is less than the carrying amount of the assets, the assets will be written down to the estimated fair value in the period the determination is made. As of December 31, 2013, management believes that no impairment of the intangible assets exists.

Stock-Based Compensation

The Bank recognizes the cost of employee services received in exchange for awards of stock options and restricted stock grants, or other equity instruments, based on the grant-date fair value of those awards. This cost is recognized over the period which an employee is required to provide services in exchange for the award, generally the vesting period.

**BANK OF SOUTHERN CALIFORNIA, N.A.**  
**NOTES TO FINANCIAL STATEMENTS**  
**December 31, 2013 and 2012**

**NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – CONTINUED**

Fair Value Measurement

Fair value is the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. Current accounting guidance establishes a fair value hierarchy, which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. The guidance describes three levels of inputs that may be used to measure fair value:

Level 1: Quoted prices (unadjusted) for identical assets or liabilities in active markets that the entity has the ability to access as of the measurement date.

Level 2: Significant other observable inputs other than Level 1 prices such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data.

Level 3: Significant unobservable inputs that reflect a Bank's own assumptions about the assumptions that market participants would use in pricing an asset or liability.

Adoption of New Accounting Standards

In February 2013, the Financial Accounting Standards Board issued Accounting Standards Update 2013-02, *Comprehensive Income* ("Topic 220") - *Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income* ("ASU 2013-02"). This ASU requires an entity to provide information about the amounts reclassified out of accumulated other comprehensive income by component. In addition, an entity is required to present, either on the face of the statement where net income is presented or in the notes, significant amounts reclassified out of accumulated other comprehensive income by the respective line items of net income but only if the amount reclassified is required under Generally Accepted Accounting Principles ("GAAP") to be reclassified to net income in its entirety in the same reporting period. For other amounts that are not required under GAAP to be reclassified in their entirety to net income, an entity is required to cross-reference to other disclosures required under GAAP that provide additional detail about those amounts. ASU 2013-02 is effective prospectively for annual and interim periods beginning after December 15, 2012 for public entities and annual periods beginning after December 15, 2013 for nonpublic entities. The adoption of this ASU did not have a material impact on the Bank's financial position, results of operations, or cash flows.

**BANK OF SOUTHERN CALIFORNIA, N.A.**  
**NOTES TO FINANCIAL STATEMENTS**  
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**NOTE B - INVESTMENT SECURITIES**

Investment securities have been classified in the statements of financial condition according to management's intent. The carrying amount of investment securities available for sale and their approximate fair values at December 31 were as follows:

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
<b>December 31, 2013</b>				
U.S. Government and Agency				
Mortgage-Backed Securities	\$ 2,345,581	\$ 16,635	\$( 4,699)	\$ 2,357,517
Municipal Securities	539,197	-	( 3,623)	535,574
Taxable Municipals	1,109,394	-	( 21,023)	1,088,371
	<u>\$ 3,994,172</u>	<u>\$ 16,635</u>	<u>\$( 29,345)</u>	<u>\$ 3,981,462</u>
<b>December 31, 2012</b>				
Asset-Backed Securities				
Federal Family Education Loans	\$ 1,582,287	\$ 44,377	\$ -	\$ 1,626,664
U.S. Government and Agency				
Mortgage-Backed Securities	3,418,729	57,397	( 4,690)	3,471,436
Municipal Securities	513,165	46,268	-	559,433
Taxable Municipals	2,245,922	142,499	-	2,388,421
	<u>\$ 7,760,103</u>	<u>\$ 290,541</u>	<u>\$( 4,690)</u>	<u>\$ 8,045,954</u>

The amortized cost and estimated fair value of all investment securities as of December 31, 2013 by contractual maturities are shown below. Expected maturities may differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

	Available-for-Sale	
	Amortized Cost	Fair Value
Due in One Year or Less	\$ 718,807	\$ 722,206
Due from One Year to Five Years	1,226,110	1,231,964
Due from Five to Ten Years	320,662	322,345
Due after Ten Years	1,728,593	1,704,947
	<u>\$ 3,994,172</u>	<u>\$ 3,981,462</u>

**BANK OF SOUTHERN CALIFORNIA, N.A.**  
**NOTES TO FINANCIAL STATEMENTS**  
**December 31, 2013 and 2012**

**NOTE B - INVESTMENT SECURITIES - CONTINUED**

The gross unrealized loss and related estimated fair value of investment securities that have been in a continuous loss position for less than twelve months and over twelve months at December 31, 2013 and 2012 are as follows:

	Less than Twelve Months		Over Twelve Months		Total	
	Unrealized		Unrealized		Unrealized	
	Losses	Fair Value	Losses	Fair Value	Losses	Fair Value
<b>December 31, 2013:</b>						
Mortgage-Backed						
Securities	\$( 4,699)	\$ 329,115	\$ -	\$ -	\$( 4,699)	\$ 329,115
Municipal Securities	( 3,623)	535,574	-	-	( 3,623)	535,574
Taxable Municipals	( 21,023)	1,088,370	-	-	( 21,023)	1,088,370
	<u>\$( 29,345)</u>	<u>\$ 1,953,059</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$( 29,345)</u>	<u>\$ 1,953,059</u>
<b>December 31, 2012:</b>						
Mortgage-Backed						
Securities	<u>\$( 4,690)</u>	<u>\$ 512,426</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$( 4,690)</u>	<u>\$ 512,426</u>
	<u>\$( 4,690)</u>	<u>\$ 512,426</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$( 4,690)</u>	<u>\$ 512,426</u>

As of December 31, 2013 and 2012, there were no investment securities that had been in a continuous loss position for over twelve months. Management evaluates investment securities for other-than-temporary impairment taking into consideration the extent and length of time the fair value has been less than cost, the financial condition of the issuer and whether the Bank has the intent and ability to retain the investment for a period of time sufficient to allow for any anticipated recovery in fair value. As of December 31, 2013, no unrealized losses are deemed to be other-than-temporary.

The Bank had gross gains on sales of investment securities of \$66,109 and \$52,706 for the years ended December 31, 2013 and 2012, respectively.

The Bank may pledge investment securities to collateralize credit lines, secure public deposits, and for other purposes as permitted or required by law. Investment securities carried at \$2,337,208 and \$3,442,905 at December 31, 2013 and 2012, respectively, were pledged to secure credit facilities at the Federal Home Loan Bank of San Francisco ("FHLB") and at the Federal Reserve ("FRB") discount window.

**BANK OF SOUTHERN CALIFORNIA, N.A.**  
**NOTES TO FINANCIAL STATEMENTS**  
**December 31, 2013 and 2012**

**NOTE C - STOCK INVESTMENTS, at COST**

As a member of the FRB System, the Bank must hold FRB stock in an amount equal to 3% of the Bank's common stock and additional paid-in capital, less accumulated deficit. An investment in the equity stock of the FHLB of San Francisco is required for membership; the required investment is a function of the Bank's outstanding mortgage assets and outstanding advances from the FHLB.

The table below summarizes the Bank's stock investments at December 31:

	<u>2013</u>	<u>2012</u>
Federal Reserve Bank	\$ 699,550	\$ 724,350
Federal Home Loan Bank	845,000	800,900
Pacific Coast Bankers Bank	<u>60,000</u>	<u>60,000</u>
	<u>\$ 1,604,550</u>	<u>\$ 1,585,250</u>

**NOTE D - LOANS**

The Bank's loan portfolio consists primarily of loans to borrowers within its markets of San Diego County, California and the Coachella Valley of California. Although the Bank seeks to avoid concentrations of loans to a single industry or based upon a single class of collateral, real estate and real estate associated businesses are among the principal industries in the Bank's market area. The Bank's loan portfolio concentration in real estate secured credit at December 31, 2013 was 76%.

The Bank has originated loans that it services for others, including loans partially-guaranteed by the SBA, some of which have been sold in the secondary market, as well as commercial real estate loans for investors and other participating financial institutions. The portfolio of loans serviced for other parties was \$9,561,358 at December 31, 2013 and \$2,828,179 at December 31, 2012.

The Bank has pledged loans with a carrying value of \$57,289,000 to collateralize credit facilities at the FHLB of San Francisco and the FRB as of December 31, 2013.

A summary of the changes in the allowance for loan losses as of December 31 follows:

	<u>2013</u>	<u>2012</u>
Beginning Balance	\$ 2,449,061	\$ 2,731,854
Additions to the Allowance Charged to Expense	100,000	110,000
Recoveries on Loans Charged Off	417,781	105,656
	<u>2,966,842</u>	<u>2,947,510</u>
Less Loans Charged Off	( 620,640)	( 498,449)
Ending Balance	<u>\$ 2,346,202</u>	<u>\$ 2,449,061</u>

**BANK OF SOUTHERN CALIFORNIA, N.A.**  
**NOTES TO FINANCIAL STATEMENTS**  
**December 31, 2013 and 2012**

**NOTE D – LOANS – CONTINUED**

A summary of allowance of loan losses and loan balance disclosed by portfolio segment and also by loans individually evaluated and loans collectively evaluated for impairment as of December 31, 2013 and 2012 and for the years then ended follows:

	Construction and Land Development	Real Estate - Other	Commercial & Industrial	Consumer	Total
<b>December 31, 2013</b>					
Allowance for Loan Losses:					
Beginning of Year	\$ 365,683	\$ 1,421,340	\$ 588,400	\$ 73,638	\$ 2,449,061
Provisions	(250,228)	164,851	211,940	(26,563)	100,000
Charge-offs	(19,092)	(584,423)	(17,125)	-	(620,640)
Recoveries	39,737	342,641	3,640	31,763	417,781
End of Year	<u>\$ 136,100</u>	<u>\$ 1,344,409</u>	<u>\$ 786,855</u>	<u>\$ 78,838</u>	<u>\$ 2,346,202</u>
Specific Reserves	\$ -	\$ 68,209	\$ 115,801	\$ 6,995	\$ 191,005
General Reserves	136,100	1,276,200	671,054	71,843	2,155,197
	<u>\$ 136,100</u>	<u>\$ 1,344,409</u>	<u>\$ 786,855</u>	<u>\$ 78,838</u>	<u>\$ 2,346,202</u>
Loans Evaluated for Impairment:					
Individually	\$ -	\$ 3,005,681	\$ 329,557	\$ 603,019	\$ 3,938,257
Collectively	5,552,331	113,404,002	34,555,934	3,623,463	157,135,730
	<u>\$ 5,552,331</u>	<u>\$ 116,409,683</u>	<u>\$ 34,885,491</u>	<u>\$ 4,226,482</u>	<u>\$ 161,073,987</u>
<b>December 31, 2012</b>					
Allowance for Loan Losses:					
Beginning of Year	\$ 184,004	\$ 1,517,129	\$ 898,191	\$ 132,530	\$ 2,731,854
Provisions	181,679	347,362	(331,792)	(87,249)	110,000
Charge-offs	-	(446,651)	(48,824)	(2,974)	(498,449)
Recoveries	-	3,500	70,825	31,331	105,656
End of Year	<u>\$ 365,683</u>	<u>\$ 1,421,340</u>	<u>\$ 588,400</u>	<u>\$ 73,638</u>	<u>\$ 2,449,061</u>
Specific Reserves	\$ 167,070	\$ 475,685	\$ 141,956	\$ -	\$ 784,711
General Reserves	198,613	945,655	446,444	73,638	1,664,350
	<u>\$ 365,683</u>	<u>\$ 1,421,340</u>	<u>\$ 588,400</u>	<u>\$ 73,638</u>	<u>\$ 2,449,061</u>
Loans Evaluated for Impairment:					
Individually	\$ 620,020	\$ 4,788,207	\$ 510,979	\$ -	\$ 5,919,206
Collectively	7,878,406	107,379,668	25,746,051	4,309,012	145,313,137
	<u>\$ 8,498,426</u>	<u>\$ 112,167,875</u>	<u>\$ 26,257,030</u>	<u>\$ 4,309,012</u>	<u>\$ 151,232,343</u>



**BANK OF SOUTHERN CALIFORNIA, N.A.**  
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**NOTE D – LOANS – CONTINUED**

The Bank's methodology for estimating the allowance for loan losses results in a range of potential reserves, including an estimate primarily based on the Bank's historical loss factors for collective impairment and also a high and low range based on analysis of peer data for collective impairment factors.

The Bank categorizes loans using risk ratings based on relevant information about the ability of borrowers to service their debt such as current financial information, historical payment experience, collateral adequacy, credit documentation, and current economic trends, among other factors. Larger, non-homogeneous loans such as commercial real estate and commercial and industrial loans are analyzed individually for risk rating assessment. This analysis is performed on an ongoing basis as new information is obtained. The Bank uses the following definitions for risk ratings:

**Pass** – Loans classified as pass include loans not meeting the risk ratings defined below.

**Special Mention** - Loans classified as special mention have a potential weakness that deserves management's close attention. If left uncorrected, these potential weaknesses may result in deterioration of the repayment prospects for the loan or of the institution's credit position at some future date.

**Substandard** - Loans classified as substandard are inadequately protected by the current net worth and paying capacity of the obligor or of the collateral pledged, if any. Loans so classified have a well-defined weakness or weaknesses that jeopardize the liquidation of the debt. They are characterized by the distinct possibility that the institution will sustain some loss if the deficiencies are not corrected.

**Impaired** – A loan is considered impaired, when, based on current information and events, it is probable that the Bank will be unable to collect all amounts due according to the contractual terms of the loan agreement. Additionally, all loans classified as troubled debt restructurings are considered impaired.

**BANK OF SOUTHERN CALIFORNIA, N.A.**  
**NOTES TO FINANCIAL STATEMENTS**  
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**NOTE D – LOANS – CONTINUED**

Based on the most recent analysis performed, the risk category of loans by class of loans as of December 31, 2013 and 2012 follows:

	Pass	Special Mention	Substandard	Impaired	Total
<b>December 31, 2013</b>					
Construction and Land Development	\$ 5,552,331	\$ -	\$ -	\$ -	\$ 5,552,331
Real Estate -Other:					
1-4 Family Residential	44,673,623	-	-	-	44,673,623
Multifamily Residential	5,616,213	-	-	-	5,616,213
Commercial Real Estate and Other	62,390,542	636,687	86,937	3,005,681	66,119,847
Commercial and Industrial	33,919,667	131,736	504,531	329,557	34,885,491
Consumer	3,623,463	-	-	603,019	4,226,482
	<u>\$ 155,775,839</u>	<u>\$ 768,423</u>	<u>\$ 591,468</u>	<u>\$ 3,938,257</u>	<u>\$ 161,073,987</u>
<b>December 31, 2012</b>					
Construction and Land Development	\$ 7,878,406	\$ -	\$ -	\$ 620,020	\$ 8,498,426
Real Estate -Other:					
1-4 Family Residential	40,982,090	-	-	81,516	41,063,606
Multifamily Residential	8,009,611	-	-	-	8,009,611
Commercial Real Estate and Other	57,718,179	669,788	-	4,706,691	63,094,658
Commercial and Industrial	25,237,084	130,642	378,325	510,979	26,257,030
Consumer	4,309,012	-	-	-	4,309,012
	<u>\$ 144,134,382</u>	<u>\$ 800,430</u>	<u>\$ 378,325</u>	<u>\$ 5,919,206</u>	<u>\$ 151,232,343</u>

**BANK OF SOUTHERN CALIFORNIA, N.A.**  
**NOTES TO FINANCIAL STATEMENTS**  
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**NOTE D – LOANS – CONTINUED**

A summary of past due loans, loans still accruing over 90 days and nonaccrual loans as of December 31, 2013 and 2012 follows:

	Still Accruing		Nonaccrual
	30-89 Days Past Due	Over 90 Days Past Due	
<b>December 31, 2013</b>			
Construction and Land Development	\$ -	\$ -	\$ -
Real Estate:			
1-4 Family Residential	-	-	-
Multifamily Residential	-	-	-
Commercial Real Estate and Other	-	-	223,621
Commercial and Industrial	188,207	-	329,557
Consumer	-	-	-
	<u>\$ 188,207</u>	<u>\$ -</u>	<u>\$ 553,178</u>
<b>December 31, 2012</b>			
Construction and Land Development	\$ -	\$ -	\$ 620,020
Real Estate:			
1-4 Family Residential	-	-	81,516
Multifamily Residential	-	-	-
Commercial Real Estate and Other	-	-	4,706,691
Commercial and Industrial	15,697	-	510,979
Consumer	-	-	-
	<u>\$ 15,697</u>	<u>\$ -</u>	<u>\$ 5,919,206</u>

**BANK OF SOUTHERN CALIFORNIA, N.A.**  
**NOTES TO FINANCIAL STATEMENTS**  
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**NOTE D – LOANS – CONTINUED**

Below is a summary of the Bank's recorded investment in impaired loans disclosed by loan type outstanding at December 31, 2013:

<b>December 31, 2013</b>	Unpaid Principal Balance	Recorded Investment	Related Allowance	Average Recorded Investment	Interest Income Recognized
<b>With no Related Allowance Recorded</b>					
Construction and Land Development	\$ -	\$ -	\$ -	\$ 87,222	\$ -
Real Estate:					
1-4 Family Residential	-	-	-	30,991	1,151
Multifamily Residential	-	-	-	-	-
Commercial Real Estate and Other	50,341	-	-	715,751	-
Commercial and Industrial	377,753	178,683	-	179,033	-
Consumer	-	-	-	-	-
<b>With an Allowance Recorded</b>					
Construction and Land Development	-	-	-	-	-
Real Estate:					
1-4 Family Residential	-	-	-	-	-
Multifamily Residential	-	-	-	-	-
Commercial Real Estate and Other	3,043,191	3,005,681	68,209	2,277,381	151,641
Commercial and Industrial	234,369	150,874	115,801	259,906	-
Consumer	686,842	603,019	6,995	608,552	54,051
	<u>\$ 4,392,496</u>	<u>\$ 3,938,257</u>	<u>\$ 191,005</u>	<u>\$ 4,158,836</u>	<u>\$ 206,843</u>

**BANK OF SOUTHERN CALIFORNIA, N.A.**  
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**NOTE D – LOANS – CONTINUED**

Below is a summary of the Bank's recorded investment in impaired loans disclosed by loan type outstanding at December 31, 2012:

<b>December 31, 2012</b>	Unpaid Principal Balance	Recorded Investment	Related Allowance	Average Recorded Investment	Interest Income Recognized
<b>With no Related Allowance Recorded</b>					
Construction and Land Development	\$ -	\$ -	\$ -	\$ -	\$ -
Real Estate:					
1-4 Family Residential	-	-	-	-	-
Multifamily Residential	-	-	-	-	-
Commercial Real Estate and Other	1,486,185	1,207,886	-	1,149,027	31,893
Commercial and Industrial	392,058	192,387	-	201,079	-
Consumer	-	-	-	-	-
<b>With an Allowance Recorded</b>					
Construction and Land Development	723,670	620,020	167,070	664,076	-
Real Estate:					
1-4 Family Residential	101,672	81,516	24,455	84,512	-
Multifamily Residential	-	-	-	-	-
Commercial Real Estate and Other	3,498,805	3,498,805	451,230	1,760,301	34,426
Commercial and Industrial	376,146	318,592	141,956	388,589	888
Consumer	-	-	-	-	-
	<u>\$ 6,578,536</u>	<u>\$ 5,919,206</u>	<u>\$ 784,711</u>	<u>\$ 4,247,584</u>	<u>\$ 67,207</u>

No additional funds are committed to be advanced on impaired loans. The Bank received cash payments and recognized \$206,843 of interest income on impaired loans in 2013 and \$67,207 in 2012. Interest foregone on impaired loans was \$88,508 in 2013 and \$150,111 in 2012. The principal balance of impaired loans that was guaranteed by the SBA was \$178,683 and \$687,723 at December 31, 2013 and 2012, respectively.

At December 31, 2013 and 2012, the Bank had approximately \$3,459,000 and \$1,927,000 in recorded investment in loans identified as troubled debt restructurings, respectively, and had allocated approximately \$100,000 and \$360,000 as specific reserves for these loans, respectively.

During the years ended December 31, 2013 and 2012, the terms of a certain loans were modified as a troubled debt restructuring. The modification of the terms included an extension of a maturity date at a rate of interest that was considered to be lower than the current market rate for new debt with similar risk and an additional advance of principal without a corresponding improvement in the credit or an increase in the interest rate. Management believes that the restructured terms of these loans improve the probability of repayment for each of the loans. Since the restructurings, the loans have been performing in accordance with the modified terms.

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**NOTE D – LOANS – CONTINUED**

The following table presents loans by class modified as troubled debt restructurings that occurred during the years ending December 31:

	Number of Loans	Pre-Modification Recorded Investment	Post-Modification Recorded Investment
<b>December 31, 2013</b>			
Construction and Land Development	-	\$ -	\$ -
Real Estate:			
1-4 Family Residential	-	-	-
Multifamily Residential	-	-	-
Commercial Real Estate and Other	1	2,782,059	2,782,059
Commercial and Industrial	1	119,872	119,872
Consumer	-	-	-
	<u>2</u>	<u>\$ 2,901,931</u>	<u>\$ 2,901,931</u>
<b>December 31, 2012</b>			
Construction and Land Development	1	\$ 620,020	\$ 620,020
Real Estate:			
1-4 Family Residential	-	-	-
Multifamily Residential	-	-	-
Commercial Real Estate and Other	1	1,307,076	1,307,076
Commercial and Industrial	-	-	-
Consumer	-	-	-
	<u>2</u>	<u>\$ 1,927,096</u>	<u>\$ 1,927,096</u>

There were no troubled debt restructurings for which there was a payment default within twelve months following the modification during the years ended December 31, 2013 and 2012. A loan is considered to be in payment default once it is 90 days contractually past due under the modified terms.

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**NOTE E - PREMISES AND EQUIPMENT**

A summary of premises and equipment as of December 31 follows:

	2013	2012
Land & Building	\$ 1,821,679	\$ -
Leasehold Improvements	1,490,916	1,476,196
Furniture, Fixtures, and Equipment	1,074,440	1,046,093
Computer Equipment	485,628	475,753
	4,872,663	2,998,042
Less Accumulated Depreciation and Amortization	( 2,217,883)	( 1,901,301)
	\$ 2,654,780	\$ 1,096,741

The Bank leases its Ramona banking premises from its principal shareholder, under an operating lease expiring on April 30, 2017, with two five-year renewal options. The Bank believes the terms of the lease are no less favorable to the Bank than could have been obtained from unaffiliated third parties. The Bank pays fixed monthly lease payments, which are increased annually by 3%, and its prorata share of common area operating expenses for the property.

The Bank has a ten-year lease for its main banking office and corporate headquarters in Del Mar Heights, California, with an independent landlord. The Bank is responsible for common area maintenance, taxes and insurance to the extent they exceed the 2008 base year amounts. The lease expires on December 31, 2017 and the Bank has one renewal option for a period of five years. Monthly lease payments are subject to a fixed 3.5% increase on an annual basis. A third party correspondent bank issued a performance letter of credit for \$775,000 to the landlord on behalf of the Bank to support the Bank's obligations under the lease.

The Bank opened a deposit production office in Carlsbad, California in September 2008 which was expanded to a full service branch in February 2009. In addition to rent, the Bank is responsible for common area operating expenses. The original lease term for this branch was six months and the parties have agreed to six month extensions since then with the current expiration in March 2014.

The Bank acquired two branches located in Palm Springs and La Quinta, California from another bank in December 2010 and entered into three year leases for each of the offices. In February of 2013, the Bank purchased the branch office located in La Quinta from the landlord and, therefore, is no longer subject to that lease obligation, which has been excluded from the table below. In January 2014, the Bank assumed the lease of a branch office in Palm Desert acquired from another bank and simultaneously vacated its leased branch office in Palm Springs; the lease on the Palm Desert branch is included in the table below.

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**NOTE E - PREMISES AND EQUIPMENT - CONTINUED**

At December 31, 2013, the future lease rentals payable under non-cancellable operating lease commitments to related parties and others are as follows:

Years Ending December 31,	<u>Related Party</u>	<u>Others</u>
2014	\$ 32,564	\$ 471,714
2015	33,541	435,068
2016	34,548	408,847
2017	11,629	422,811
Thereafter	-	-
Total	<u>\$ 112,282</u>	<u>\$ 1,738,440</u>

The minimum rental payments shown above are given for the existing lease obligations and are not a forecast of future rental expense. Total rental expense was \$479,654 and \$572,997 for the years ended December 31, 2013 and 2012, respectively.

**NOTE F - DEPOSITS**

At December 31, 2013, the scheduled maturities of time deposits are as follows:

Due in One Year or Less	\$ 15,948,670
Due from One to Three Years	7,263,000
Due over Three Years	743,000
Total Time Deposits	<u>\$ 23,954,670</u>

**NOTE G - BORROWING ARRANGEMENTS**

The Bank has a credit facility with the Federal Home Loan Bank of San Francisco ("FHLB"), under which the Bank may enter borrowing agreements under various terms and conditions, subject to pledging qualifying collateral, such as investment securities and loans. The Bank had investment securities with a carrying value of \$2,337,208 and loans with a carrying value of \$53,071,000 pledged with the FHLB at December 31, 2013. At December 31, 2013, the Bank had one advance for \$12,500,000 outstanding with the FHLB that bears interest at the rate of 0.06% at December 31, 2013, and matured January 2, 2014. Available borrowing capacity from the FHLB at December 31, 2013, based upon collateral pledged was \$12,799,000.

The Bank has a \$5,000,000 overnight credit line on an unsecured basis from a correspondent bank. The line is subject to annual review. The Bank had no overnight borrowings under this correspondent line at December 31, 2013 or 2012.

The Bank has credit availability at the Federal Reserve discount window to the extent of collateral pledged. The Bank had pledged loan collateral at December 31, 2013 with a book value of \$4,218,000. The Bank had no discount window borrowings at December 31, 2013 or 2012.



**BANK OF SOUTHERN CALIFORNIA, N.A.**  
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**NOTE H - INCOME TAXES**

The Bank is subject to Federal and California franchise tax. Income tax returns for the years ending after December 31, 2010 are open to audit by the Federal authorities and income tax returns for the years ending after December 31, 2009 are open to audit by California authorities.

The income tax (benefit) expense for the years ended December 31, is comprised of the following:

Current Taxes:	<u>2013</u>	<u>2012</u>
Federal	\$ 12,696	\$ 17,256
State	<u>2,304</u>	<u>3,744</u>
	15,000	21,000
Deferred	<u>(462,000)</u>	<u>(399,000)</u>
Total (Benefit) Expense	<u><u>\$ (447,000)</u></u>	<u><u>\$ (378,000)</u></u>

A comparison of the federal statutory income tax rates to the Bank's effective income tax rates at December 31 follows:

	<u>2013</u>		<u>2012</u>	
	<u>Amount</u>	<u>Rate</u>	<u>Amount</u>	<u>Rate</u>
Federal Taxes	\$ 271,000	34.0%	\$ 258,000	34.0%
State Taxes	53,000	6.6%	55,000	7.2%
Valuation Allowance	(746,000)	(93.5%)	(688,000)	(90.5%)
Increase in Cash Surrender Value	(33,000)	(4.1%)	(10,000)	(1.3%)
Other	<u>8,000</u>	<u>1.0%</u>	<u>7,000</u>	<u>0.9%</u>
	<u><u>\$ (447,000)</u></u>	<u><u>(56.0%)</u></u>	<u><u>\$ (378,000)</u></u>	<u><u>(49.7%)</u></u>

**BANK OF SOUTHERN CALIFORNIA, N.A.**  
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**NOTE H - INCOME TAXES - CONTINUED**

Deferred taxes are a result of differences between income tax accounting and generally accepted accounting principles with respect to income and expense recognition. The following is a summary of the components of the net deferred tax asset accounts recognized in the accompanying statements of financial condition at December 31:

	<u>2013</u>	<u>2012</u>
Deferred Tax Assets:		
Operating Loss Carryforwards	\$ 2,818,000	\$ 3,121,000
Allowance for Loan Losses	582,000	601,000
Stock-Based Compensation	121,000	117,000
Depreciation Differences	64,000	18,000
Other	<u>443,000</u>	<u>400,000</u>
	<u>4,028,000</u>	<u>4,257,000</u>
Valuation Allowance	<u>( 2,441,000)</u>	<u>( 3,187,000)</u>
Deferred Tax Liabilities:		
Deferred Loan Costs	( 103,000)	( 84,000)
Unrealized Gain on Securities	-	( 118,000)
Other	<u>( 125,000)</u>	<u>( 94,000)</u>
	<u>( 228,000)</u>	<u>( 296,000)</u>
Net Deferred Tax Assets	<u>\$ 1,359,000</u>	<u>\$ 774,000</u>

The valuation allowance for deferred tax assets was established after considering many factors, including the size of the deferred tax assets, especially the operating loss carryforwards, and the Bank's history of taxable income, in order to reduce the deferred tax asset to a level deemed "more likely than not" to be realized. At December 31, 2013, the Bank has net operating loss carryforwards of approximately \$6,800,000 for Federal income and \$7,300,000 for California franchise tax purposes. Federal and California net operating loss carryforwards, to the extent not used will expire in 2030.

**BANK OF SOUTHERN CALIFORNIA, N.A.**  
**NOTES TO FINANCIAL STATEMENTS**  
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**NOTE I - OTHER EXPENSES**

Other expenses for the years ended December 31 are comprised of the following:

	2013	2012
Data Processing	\$ 583,822	\$ 668,581
Legal, Audit and Professional	343,115	306,505
Marketing, Advertising and Public Relations	194,705	185,693
Telephone, Training and Office	261,266	207,887
Regulatory Assessments	210,689	227,579
Deposit Administration and Online Banking	292,569	264,329
Loan Administration	79,501	100,864
Loan Collections and OREO Expense	219,611	297,908
Insurance and Correspondent Charges	130,682	153,252
Other Expenses	157,382	94,739
	\$ 2,473,342	\$ 2,507,337

**NOTE J – EARNINGS PER SHARE (“EPS”)**

The following is a reconciliation of net income and shares outstanding to the income and number of shares used to compute EPS:

	2013		2012	
	Income	Shares	Income	Shares
Net Income as Reported	\$ 1,245,073		\$ 1,138,278	
Accretion of Preferred Stock	(16,560)		(45,895)	
Weighted-Average Shares Outstanding		3,263,739		3,263,534
<b>Used in Basic EPS</b>	1,228,513	3,263,739	1,092,383	3,263,534
Dilutive Effect of Outstanding:				
Stock Options	-	-	-	-
Restricted Stock Grants	-	5,886	-	2,704
<b>Used in Dilutive EPS</b>	\$ 1,228,513	3,269,625	\$ 1,092,383	3,266,238

At December 31, 2013 and 2012 there were 244,877 and 233,977 stock options, respectively, that could potentially dilute earnings per share that were not included in the computation of diluted earnings per share because to do so would have been anti-dilutive.

**BANK OF SOUTHERN CALIFORNIA, N.A.**  
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**NOTE K - RELATED PARTY TRANSACTIONS**

In the ordinary course of business, the Bank has granted loans to certain directors and their related interests with which they are associated. In the Bank's opinion, all loans and loan commitments to such parties are made on substantially the same terms including interest rates, and collateral, as those prevailing at the time for comparable transactions with unrelated clients.

The balance of these loans outstanding and activity in related party loans for the periods ended December 31, 2013 and 2012 follows:

	<u>2013</u>	<u>2012</u>
Balance at Beginning of Year	\$ 3,521,566	\$ 622,049
Credit Granted, Including Renewals	2,250,000	2,969,537
Repayments	<u>(2,233,414)</u>	<u>(70,020)</u>
	<u>\$ 3,538,152</u>	<u>\$ 3,521,566</u>

Deposits held by the Bank from directors and their related interests at December 31, 2013 and 2012, amounted to \$5,676,440 and \$5,257,474 respectively.

**NOTE L – COMMITMENTS AND CONTINGENCIES**

In the ordinary course of business, the Bank enters into financial commitments to meet the financing needs of its customers. These financial commitments include commitments to extend credit and standby letters of credit. Those instruments involve to varying degrees, elements of credit and interest rate risk not recognized in the Bank's financial statements.

Commitments to extend credit are agreements to lend to a client as long as there is no violation of any condition established in the contract. Since many of the commitments are expected to expire without being drawn upon, the total amounts do not necessarily represent future cash requirements. The Bank evaluates each client's credit worthiness on a case-by-case basis. Collateral may or may not be required based on management's credit evaluation of the customer. The majority of the Bank's commitments to extend credit and standby letters of credit are secured by real estate.

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

**BANK OF SOUTHERN CALIFORNIA, N.A.**  
**NOTES TO FINANCIAL STATEMENTS**  
**December 31, 2013 and 2012**

**NOTE L – COMMITMENTS AND CONTINGENCIES - CONTINUED**

As of December 31, 2013 and 2012, the Bank had the following outstanding financial commitments whose contractual amount represents potential credit risk to the Bank, and potential financial obligations of the Bank:

	2013	2012
Commitments to Extend Credit	\$ 43,406,300	\$ 27,073,990
Letters of Credit Issued to Customers	502,869	1,070,325
	\$ 43,909,169	\$ 28,144,315

The Bank carries a reserve for off-balance sheet credit risk in other liabilities for potential losses on commitments to extend credit and potential recourse on sold loans. The balance of the reserve was \$50,000 at December 31, 2013 and December 31, 2012.

The Bank evaluates the loss exposure for unfunded commitments to extend credit following the same principles used for the allowance for loan losses, with consideration for experienced utilization rates on client credit lines and the inherently lower risk of unfunded commitments relative to disbursed commitments.

**NOTE M – STOCK-BASED COMPENSATION PLAN**

Under the Bank’s 2001 Stock Option Plan (the “2001 Plan”), as amended, stock options were granted to eligible employees and directors. The 2001 Plan terminated November 8, 2011, in accordance with its term; however stock options previously granted under the Plan remain valid in accordance with their terms. Under the terms of the 2001 Plan, officers and key employees were granted either nonqualified or incentive stock options and directors, who were not also an officer or employee, were granted nonqualified stock options. Under the 2001 Plan, stock options were granted at prices not less than 100% of the fair market value of the stock on the date of grant; options granted expired no later than ten years from the date of the grant; and option grants generally vest over five years. The Plan provides for accelerated vesting if there is a change of control, as defined in the Plan.

In November 2011, the board of directors adopted the Omnibus Equity Incentive Plan (the “Omnibus Plan”). The Omnibus Plan provides for the grant of stock options, including incentive stock options, and restricted share awards. The Omnibus Plan provides that any director, employee or consultant of the Bank shall be eligible to be designated a participant in the Omnibus Plan for purposes of receiving awards. The Board has the power to determine the terms of the awards, including the exercise price, the number of shares subject to each award, the vesting and exercisability of the awards and the form of consideration payable upon exercise. Stock options expire no later than ten years from the date of the grant. Subject to adjustment in certain circumstances, the aggregate number of shares of the Bank’s common stock that may be issued pursuant to awards granted under the Omnibus Plan is 544,907. The Plan provides for accelerated vesting if there is a change of control, as defined in the Plan.

The Bank recognized stock-based compensation cost of \$61,146 and \$91,789 in 2013 and 2012, respectively.

**BANK OF SOUTHERN CALIFORNIA, N.A.**  
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**NOTE M – STOCK-BASED COMPENSATION – CONTINUED**

The fair value of each option grant is estimated on the date of grant using the Black-Scholes option pricing model. The following table provides the weighted-average assumptions used in the pricing model, and the weighted-average grant date fair value, for option grants made in 2013 and 2012:

	<u>2013</u>	<u>2012</u>
Expected Volatility	39.42%	40.83%
Expected Term (Years)	6.5	6.5
Expected Dividends	None	None
Risk Free Rate	0.71%	0.83%
Weighted-Average Grant Date Fair Value	\$ 2.34	\$ 2.30

Since the Bank's shares have a very limited volume of historical trades, the expected volatility is based on an index of the historical volatility of similar banks that have a longer trading history at higher volumes. The expected term represents the estimated average period of time that the options remain outstanding. Since the Bank does not have sufficient historical data on the exercise of stock options, the expected term is based on the "simplified" method that measures the expected term as the average of the vesting period and the contractual term. The risk free rate of return reflects the grant date yield on U.S. Treasury bonds with maturities comparable to the expected term of the options.

A summary of changes in outstanding stock options during 2013 and options exercisable at December 31, 2013 is presented below:

	<u>Shares</u>	<u>Weighted- Average Exercise Price</u>	<u>Weighted- Average Remaining Contractual Term</u>	<u>Aggregate Intrinsic Value</u>
Outstanding at Beginning of Year	233,977	\$ 8.76		
Granted	15,000	\$ 5.87		
Exercised	-	\$ -		
Forfeited or Expired	<u>( 4,100)</u>	<u>\$ 5.66</u>		
Outstanding at End of Year	<u>244,877</u>	<u>\$ 8.63</u>	<u>4.9 Years</u>	<u>None</u>
Options Exercisable	<u>191,817</u>	<u>\$ 9.42</u>	<u>4.1 Years</u>	<u>None</u>

Additionally, during December 2011, the Bank granted 17,009 shares of restricted stock valued at \$5.35 per share, of which 4,859 shares vested in 2013. The remaining unvested shares vests evenly over the next five years through 2018 and will result in annual stock-based compensation expense of \$13,000 per year through 2018.

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**NOTE M – STOCK-BASED COMPENSATION – CONTINUED**

As of December 31, 2013, there was \$181,394 of total unrecognized compensation cost related to the outstanding stock options and restricted stock that will be recognized over a weighted-average period of approximately 2.4 years as shown below:

2014	\$ 54,642
2015	50,822
2016	40,321
2017	19,724
2018	15,885
	<u>\$ 181,394</u>

Future levels of compensation cost recognized related to stock-based compensation awards may be impacted by new awards and/or modifications, repurchases and cancellations of existing awards. Under the terms of the Plan, vested options generally expire ninety days after the director or employee terminates the service affiliation with the Bank.

**NOTE N - REGULATORY MATTERS**

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

Quantitative measures established by regulation to ensure capital adequacy require the Bank to maintain minimum amounts and ratios (set forth in the table below) of total and Tier 1 capital (as defined in the regulations) to risk-weighted assets (as defined), and of Tier 1 capital (as defined) to average assets (as defined).

As of December 31, 2013, the most recent notification from the Office of the Comptroller of the Currency categorized the Bank as “well-capitalized” under the regulatory framework for prompt corrective action. As of December 31, 2013, the Bank’s capital level and ratios indicate that it is “well-capitalized” under the regulatory framework for prompt corrective action, (“PCA”).

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**NOTES TO FINANCIAL STATEMENTS**  
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**NOTE N - REGULATORY MATTERS - CONTINUED**

To be categorized as well-capitalized, the Bank must maintain minimum ratios as set forth in the table below. Management believes, as of December 31, 2013, that the Bank meets all capital adequacy requirements to which it is subject. The following table also sets forth the Bank's actual capital amounts and ratios (dollar amounts in thousands):

	Actual		Amount of Capital Required			
			To be Adequately Capitalized under PCA Provisions		To be Well-Capitalized under PCA Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
<b>As of December 31, 2013:</b>						
Total Capital (to Risk-Weighted Assets)	\$ 24,632	16.9%	\$ 11,693	8.0%	\$ 14,617	10.0%
Tier 1 Capital (to Risk-Weighted Assets)	22,798	15.6%	5,847	4.0%	8,770	6.0%
Tier 1 Capital (to Average Assets)	22,798	12.2%	7,463	4.0%	9,329	5.0%
<b>As of December 31, 2012:</b>						
Total Capital (to Risk-Weighted Assets)	\$ 23,246	18.8%	\$ 9,908	8.0%	\$ 12,385	10.0%
Tier 1 Capital (to Risk-Weighted Assets)	21,687	17.5%	4,954	4.0%	7,431	6.0%
Tier 1 Capital (to Average Assets)	21,687	11.3%	7,687	4.0%	9,609	5.0%

Under federal law, a national bank generally may not pay cash dividends in excess of the bank's net profits, if it would impair the bank's capital, if the bank is in default on the payment of any assessment due to the FDIC, or if the bank has not paid all cumulative dividends on outstanding preferred stock. In addition, unless and until a bank's additional paid in capital account is equal to its common stock account, no dividend can be declared until the bank has carried to its additional paid-in capital account not less than one-tenth of its net profits for the preceding two consecutive half-years (in the case of annual dividends). The Bank cannot legally pay dividends on common stock at this time and the Bank intends to follow a policy of retaining earnings, if any, for the purpose of increasing its net worth and reserves. Accordingly, the Bank does not anticipate that cash dividends will be declared on common shares for the foreseeable future.

In 2009 the Bank issued three series of preferred stock to the U. S. Treasury for a combined par value of \$4,354,000. In 2012, the Bank redeemed an aggregate par value of \$1,304,000 of the preferred stock. All three series of preferred stock feature non-cumulative dividends as described in Note A. The Bank has no legal capacity to pay dividends and therefore, if the Bank declares a quarterly dividend, the Bank must make application to the Office of the Comptroller of the Currency for permission to pay any dividends declared. Although the Bank has not declared dividends since the quarterly dividend due November 15, 2012, the OCC has granted the Bank permission to pay dividends as a reduction of capital surplus each time the Bank has made an application to pay such dividends. Dividends declared and paid have been charged against additional paid-in capital. The dividends are considered a distribution of permanent capital and do not reduce earnings available to the common shares.



**BANK OF SOUTHERN CALIFORNIA, N.A.**  
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**NOTE O - FAIR VALUE OF FINANCIAL INSTRUMENTS**

The fair value of a financial instrument is the amount at which the asset or obligation could be exchanged in a current transaction between willing parties, other than in a forced or liquidation sale. Fair value estimates are made at a specific point in time based on relevant market information and information about the financial instrument. These estimates do not reflect any premium or discount that could result from offering for sale at one time the entire holdings of a particular financial instrument. Because no market value exists for a significant portion of the financial instruments, fair value estimates are based on judgments regarding future expected loss experience, current economic conditions, risk characteristics of various financial instruments, and other factors. These estimates are subjective in nature, involve uncertainties and matters of judgment and, therefore, cannot be determined with precision. Changes in assumptions could significantly affect the estimates.

Fair value estimates are based on financial instruments both on and off the balance sheet without attempting to estimate the value of anticipated future business, and the value of assets and liabilities that are not considered financial instruments. Additionally, tax consequences related to the realization of the unrealized gains and losses can have a potential effect on fair value estimates and have not been considered in many of the estimates.

The following methods and assumptions were used to estimate the fair value of significant financial instruments:

Financial Assets

The carrying amounts of cash, deposits due from banks, and interest bearing deposits with banks, including excess reserves at the Federal Reserve Bank, are considered to approximate fair value. The fair values of investment securities are based on quoted market prices for similar securities. The fair value of loans are estimated by discounting estimated future cash flows at an appropriate market rate given the term of the related loans.

Financial Liabilities

The carrying amounts of deposit liabilities payable on demand are considered to approximate fair value. For fixed maturity deposits, fair value is estimated by discounting estimated future cash flows using currently offered rates for deposits of similar remaining maturities. The fair value of long-term debt is based on rates currently available to the Bank for debt with similar terms and remaining maturities.

Off-Balance Sheet Financial Instruments

The fair value of commitments to extend credit and standby letters of credit is estimated using the fees currently charged to enter into similar agreements. The fair value of these financial instruments is not material.

**BANK OF SOUTHERN CALIFORNIA, N.A.**  
**NOTES TO FINANCIAL STATEMENTS**  
**December 31, 2013 and 2012**

**NOTE O – FAIR VALUE OF FINANCIAL INSTRUMENTS – CONTINUED**

The estimated fair value of financial instruments at December 31 is summarized as follows:

	2013		2012	
	Carrying Value	Fair Value	Carrying Value	Fair Value
<b>Financial Assets:</b>				
Cash and Due From Banks	\$ 6,596,416	\$ 6,596,416	\$ 6,430,243	\$ 6,430,243
Excess Reserves at the Federal Reserve Bank	20,785,000	20,785,000	16,690,000	16,690,000
Investment Securities Available for Sale	3,981,462	3,981,462	8,045,954	8,045,954
Loans, net	158,727,785	158,808,000	148,783,282	148,484,000
FHLB, FRB and Banker's Bank Stock	1,604,550	1,604,550	1,585,250	1,585,250
Accrued Interest Receivable	500,717	500,717	385,152	385,152
<b>Financial Liabilities:</b>				
Deposits	164,041,073	163,950,000	163,842,554	163,911,000
FHLB Advances	12,500,000	12,500,000	1,000,000	1,000,000
Accrued Interest Payable	12,960	12,960	18,961	18,961

**NOTE P – FAIR VALUE MEASUREMENT**

The following is a description of valuation methodologies used for assets and liabilities recorded at fair value:

Securities: The fair values of securities available for sale are determined by obtaining quoted prices on nationally recognized securities exchanges (Level 1) or matrix pricing, which is a mathematical technique used widely in the industry to value debt securities without relying exclusively on quoted prices for specific securities but rather by relying on the securities' relationship to other benchmark quoted securities (Level 2).

Collateral-Dependent Impaired Loans: The Bank does not record loans at fair value on a recurring basis. However, from time to time, fair value adjustments are recorded on these loans to reflect partial write-downs, through charge-offs or specific reserve allowances, that are based on the current appraised or market-quoted value of the underlying collateral. The fair value estimates for collateral-dependent impaired loans are generally based on recent real estate appraisals or broker opinions, obtained from independent third parties, which are frequently adjusted by management to reflect current conditions and estimated selling costs (Level 3).

**BANK OF SOUTHERN CALIFORNIA, N.A.**  
**NOTES TO FINANCIAL STATEMENTS**  
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**NOTE P – FAIR VALUE MEASUREMENT - CONTINUED**

Other Real Estate Owned: Nonrecurring adjustments to certain commercial and residential real estate properties classified as other real estate owned (OREO) are measured at the lower of the carrying amount or fair value, less costs to sell. The fair value of OREO is generally based on recent real estate appraisals or broker opinions, obtained from independent third parties, which are frequently adjusted by management to reflect current conditions and estimated selling costs (Level 3).

Appraisals for other real estate owned and collateral dependent loans are performed by certified general appraisers whose qualifications and licenses have been reviewed and verified by the Bank. Once received, a member of the loan department reviews the assumptions and approaches utilized in the appraisal as well as the overall resulting fair value. The Bank also determines what additional adjustments, if any, should be made to the appraisal values on any remaining other real estate owned to arrive at fair value. No significant adjustments to appraised values have been made as a result of this review process as of December 31, 2013.

The Bank has no liabilities measured and recorded at fair value as of December 31, 2013. The Bank had no assets measured at fair value on a recurring basis using significant unobservable inputs (Level 3) during 2013.

The following table provides the hierarchy and fair value for each major category of asset measured at fair value at December 31, 2013:

	Fair Value Measurements Using			Total
	Level 1	Level 2	Level 3	
<b>Assets measured at fair value on a recurring basis</b>				
Securities Available for Sale	\$ -	\$ 3,981,462	\$ -	\$ 3,981,462
<b>Assets measured at fair value on a non-recurring basis</b>				
Collateral-Dependent Impaired				
Loans, Net of Specific Reserves	\$ -	\$ -	\$ 178,683	\$ 178,683
Other Real Estate Owned	\$ -	\$ -	\$ 345,001	\$ 345,001

**BANK OF SOUTHERN CALIFORNIA, N.A.**  
**NOTES TO FINANCIAL STATEMENTS**  
**December 31, 2013 and 2012**

**NOTE P – FAIR VALUE MEASUREMENT - CONTINUED**

Collateral-dependent impaired loans, which are measured for impairment using the fair value of the collateral, had a carrying value of \$206,383 and specific reserves of \$21,700 at December 31, 2013. Quantitative information about the Bank's nonrecurring Level 3 fair value measurements as of December 31, 2013, is as follows:

	Fair Value <u>Amount</u>	Valuation <u>Technique</u>	Unobservable <u>Input</u>	Weighted Average <u>Adjustment</u>
Collateral-Dependent Impaired Loans	\$178,683	3rd Party Appraisals	Selling Costs and Management Adjustments	10%
Other Real Estate Owned	\$345,001	3rd Party Appraisals	Selling Costs and Management Adjustments	14%

The following table provides the hierarchy and fair value for each major category of asset measured at fair value at December 31, 2012:

	Fair Value Measurements Using			Total
	Level 1	Level 2	Level 3	
<b>Assets measured at fair value on a recurring basis</b>				
Securities Available for Sale	\$ -	\$ 8,045,954	\$ -	\$ 8,045,954
<b>Assets measured at fair value on a non-recurring basis</b>				
Collateral-Dependent Impaired Loans, Net of Specific Reserves	\$ -	\$ -	\$ 4,278,835	\$ 4,278,835

Collateral-dependent impaired loans, which are measured for impairment using the fair value of the collateral, had a carrying value of \$4,897,135 and specific reserves of \$618,300 at December 31, 2012. Quantitative information about the Bank's nonrecurring Level 3 fair value measurements as of December 31, 2012, is as follows:

	Fair Value <u>Amount</u>	Valuation <u>Technique</u>	Unobservable <u>Input</u>	Weighted Average <u>Adjustment</u>
Collateral-Dependent Impaired Loans	\$4,278,835	3rd Party Appraisals	Selling Costs and Management Adjustments	10%

**BANK OF SOUTHERN CALIFORNIA, N.A.**  
**NOTES TO FINANCIAL STATEMENTS**  
**December 31, 2013 and 2012**

**NOTE Q – SUBSEQUENT EVENT – BRANCH ACQUISITION**

Effective January 17, 2014, the Bank acquired the Palm Desert branch office of AmericanWest Bank. Concurrent with the closing of this acquisition, the Bank closed its branch office in Palm Springs and consolidated its customers and staff into the new Palm Desert branch office. As a result of the acquisition, the Bank assumed \$18.9 million in deposit liabilities and received \$10.2 million in pass-grade loans, \$8.3 million in cash and \$57 thousand of other net assets in the form of furniture, fixtures and accrued interest.

The acquisition was accounted for using the purchase method of accounting. The fair value of the assets and liabilities acquired is summarized below:

Cash and Cash Equivalents	\$ 8,258,730
Loans	10,217,234
Fixed Assets, Accrued Interest and Other Assets	57,159
Core Deposit Intangible	80,996
Fair Value of Assets Acquired	18,614,119
Deposits	18,914,023
Accrued Interest Payable	659
Fair Value of Liabilities Assumed	18,914,682
Goodwill	\$ 300,563

Goodwill recorded in this transaction is deductible for income tax purposes. The core deposit intangible will be amortized over the expected account retention period, which was originally estimated at approximately 9 years or 108 months. The core deposit intangible will be evaluated periodically to determine the reasonableness of the projected amortization period by comparing actual deposit retention to projected retention. The Bank's core deposit intangible amortization expense is estimated at \$9,000 for each of the next five years.

## Board of Directors

**John Farkash** | Chairman of the Board

**Thomas H. Blair, Jr.** | Media Consultant

**Irwin L. Golds** | CEO and Co-founder of Capitis Real Estate

**Lester Machado, MD, DDS, FRCS (Ed)** | Oral and Maxillofacial Surgeon

**Joseph E. Matranga, C.P.A.** | President and Founder of Matranga & Company, CPA's

**Nathan L. Rogge** | President and CEO of Bank of Southern California

## Executive and Senior Management

**Nathan L. Rogge** | President and Chief Executive Officer

**James H. Burgess** | Executive Vice President and Chief Financial Officer

**Robert A. Marshall** | Executive Vice President and Chief Credit Officer

**Pamela C. Isaacson** | Executive Vice President and Chief Administrative Officer

**Tony DiVita** | Senior Vice President and Director of Sales and Marketing

## Office Locations

### Del Mar

12265 El Camino Real, Suite 100

San Diego, CA 92130

Phone: (858) 847-4700

Fax: (858) 847-4701

Manager: Katsumasa Sean Oshika

### Carlsbad

3142 Tiger Run Court, Suite 107

Carlsbad, CA 92010

Phone: (760) 599-7044

Fax: (760) 599-7074

Manager: Sandy Apodaca

### Ramona

1315 Main Street

Ramona, CA 92065

Phone: (760) 788-8788

Fax: (760) 789-5576

Manager: Alyssa Otis

### Downtown San Diego

1620 5<sup>th</sup> Avenue, Suite 120

San Diego, CA 92101

Phone: (619) 849-5741

Fax: (619) 849-5760

Manager: Irene Zimmerman

### Palm Desert

42005 Cook Street, Suite 301

Palm Desert, CA 92211

Phone: (760) 346-6139

Fax: (760) 346-8670

Manager: Angela Henderson

### La Quinta

47-000 Washington

La Quinta, CA 92253

Phone: (760) 771-0654

Fax: (760) 771-9548

Manager: Crystal Munoz

## Professional Consultants

Vavrinek Trine Day & Co., LLP | Independent Auditor

Horgan, Rosen, Beckham & Coren, L.L.P. | Legal Counsel

## Common Stock Information

**Stock Exchange Listing** | The common stock is quoted on the OTC Bulletin Board (OTCBB) under the symbol FBBN

**Computershare Investor Services** | Transfer Agent



WE DON'T JUST MEASURE OUR SUCCESS BY THE NUMBERS...

“ This is a bank that gives you the feeling you're dealing with **PEOPLE WHO KNOW YOU PERSONALLY** and have the flexibility to respond to you as an individual. ”

“ I've been a customer at Bank of Southern California for ten years, and **THEY ARE AS GOOD AS IT GETS.** ”

“ **OUR LOAN RATES ARE COMPETITIVE,** we don't pay "extras" for checking or online banking, and **WE RECEIVE VERY PERSONALIZED CUSTOMER SERVICE.** ”

“ I have been a customer of the bank for 8 years and it's been the best banking relationship I've ever had. **OVER AND ABOVE IS STANDARD PRACTICE.** ”

“ **THEY UNDERSTAND SMALL BUSINESS** and the needs of small business owners. ”

“ It isn't easy to find a bank that **WORK AS A TRUE PARTNER** with a small business, but Bank of Southern California has been just that! They provide the services that I need and are always willing to listen. ”

“ What separates this bank is the attitude of their people...It's nice to be **A PERSON INSTEAD OF A NUMBER.** ”

WE MEASURE OUR SUCCESS BY WHAT  
OUR CUSTOMERS SAY ABOUT US.

