Avidbank Holdings, Inc.

CONSOLIDATED FINANCIAL STATEMENTS

AS OF DECEMBER 31, 2013 AND 2012
AND FOR THE YEARS ENDED
DECEMBER 31, 2013, 2012 AND 2011
AND
INDEPENDENT AUDITOR'S REPORT

INDEPENDENT AUDITOR'S REPORT

To the Shareholders and Board of Directors
Avidbank Holdings, Inc. and Subsidiary
Palo Alto, California

Report on the Financial Statements

We have audited the accompanying consolidated financial statements of Avidbank Holdings, Inc. and Subsidiary, which comprise the consolidated balance sheets as of December 31, 2013 and 2012, and the related consolidated statements of income, comprehensive income, changes in shareholders' equity, and cash flows for each of the years in the three year period ended December 31, 2013, and the related notes to the consolidated financial statements.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

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

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, 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 consolidated financial statements.

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

Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Avidbank Holdings, Inc. and Subsidiary as of December 31, 2013 and 2012, and the results of their operations and their cash flows for each of the years in the three year period ended December 31, 2013 in accordance with accounting principles generally accepted in the United States of America.

Crowe Horwath LLP

Crowe Horwath LLP

Sacramento, California
April 2, 2014

AVIDBANK HOLDINGS, INC. AND SUBSIDIARY
CONSOLIDATED BALANCE SHEETS
December 31, 2013 and 2012

	2013	2012
ASSETS		
Cash and due from banks	$ 16,905,371	$ 21,492,778
Federal funds sold	151,940,000	85,510,000
Total cash and cash equivalents	168,845,371	107,002,778
Available-for-sale investment securities (Notes 2 and 16)	58,983,000	55,343,000
Loans, less allowance for loan losses of $4,788,443 in 2013 and $4,479,813 in 2012 (Notes 3,4,10 and 16)	252,645,904	242,788,866
Federal Home Loan Bank stock	3,290,000	1,497,300
Property and equipment, net (Note 5)	1,175,414	1,291,306
Cash surrender value of Bank-owned life insurance policies (Note 6)	11,606,640	3,419,645
Accrued interest receivable and other assets	4,129,200	4,378,185
Total assets	$ 500,675,529	$ 415,721,080
LIABILITIES AND SHAREHOLDERS' EQUITY		
Deposits:		
Non-interest bearing	$ 158,363,606	$ 105,517,676
Interest bearing (Note 7)	291,940,526	269,476,235
Total deposits	450,304,132	374,993,911
Accrued interest payable and other liabilities	2,339,069	2,864,270
Total liabilities	452,643,201	377,858,181
Commitments and contingencies (Note 10)		
Shareholders' equity (Notes 11 and 12):		
Preferred stock - no par value; $1,000 liquidation preference; 5,000,000 shares authorized, 0 and 6,000 shares issued and outstanding at December 31, 2013 and 2012, respectively	-	5,951,578
Common stock - no par value; 10,000,000 shares authorized; 4,283,494 and 2,614,655 shares issued and outstanding at December 31, 2013 and 2012, respectively	42,249,735	27,618,879
Additional paid-in capital	2,280,997	1,936,976
Retained earnings	3,468,924	1,171,133
Accumulated other comprehensive Income, net of taxes (Note 2)	32,672	1,184,333
Total shareholders' equity	48,032,328	37,862,899
Total liabilities and shareholders' equity	$ 500,675,529	$ 415,721,080

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

AVIDBANK HOLDINGS, INC. AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF INCOME
For the Years Ended December 31, 2013, 2012 and 2011

	2013	2012	2011
Interest income:			
Interest and fees on loans	$ 14,498,431	$ 14,786,643	$ 12,850,434
Interest on Federal funds sold	268,177	142,420	97,648
Interest on taxable investment securities	1,553,234	2,080,576	1,903,203
Interest on tax-exempt investment securities	51,388	-	-
Total interest income	16,371,230	17,009,639	14,851,285
Interest expense:			
Interest on deposits (Note 7)	1,167,382	1,840,233	2,278,969
Net interest income	15,203,848	15,169,406	12,572,316
Provision for loan losses (Note 4)	245,286	480,000	435,260
Net interest income after provision for loan losses	14,958,562	14,689,406	12,137,056
Non-interest income:			
Service charges, fees and other income	529,010	359,422	251,046
Appreciation in cash surrender value of insurance contracts (Note 6)	186,995	107,595	107,335
Other income	-	-	216,948
Gain on sale of investment securities (Note 2)	748,047	336,565	68,168
Total non-interest income	1,464,052	803,582	643,497
Non-interest expenses:			
Salaries and employee benefits (Notes 3 and 13)	7,338,868	6,289,430	5,274,301
Occupancy and equipment (Notes 5 and 10)	2,240,671	1,881,693	1,571,452
Other (Note 15)	2,794,200	2,519,151	2,670,497
Total other expenses	12,373,739	10,690,274	9,516,250
Income before provision for income taxes	4,048,875	4,802,714	3,264,303
Provision for (benefit from) income taxes (Note 8)	1,540,432	2,058,000	(572,400)
Net income	$ 2,508,443	$ 2,744,714	$ 3,836,703
Preferred stock dividends and discount accretion	$ 210,652	$ 345,242	$ 555,242
Net income available to common shareholders	$ 2,297,791	$ 2,399,472	$ 3,281,461
Basic income per common share (Note 11)	$ 0.66	$ 0.92	$ 1.26
Diluted income per common share (Note 11)	$ 0.64	$ 0.91	$ 1.26

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

AVIDBANK HOLDINGS, INC. AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
For the Years Ended December 31, 2013, 2012 and 2011

	2013	2012	2011
Net Income	$ 2,508,443	$ 2,744,714	$ 3,836,703
Other Comprehensive Income:			
Unrealized (losses) gains on securities:			
Unrealized holdings (losses) gains	(1,171,390)	2,692,080	(285,214)
Less: reclassification for net gains included in net income	(748,047)	(336,565)	(68,168)
Other comprehensive (loss) income, before tax	(1,919,437)	2,355,515	(353,382)
Tax effect	767,776	(942,207)	141,354
Other comprehensive (loss) income	(1,151,661)	1,413,308	(212,028)
Total Comprehensive Income	$ 1,356,782	$ 4,158,022	$ 3,624,675

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

AVIDBANK HOLDINGS, INC. AND SUBSIDIARY
CONSOLIDATED STATEMENT OF CHANGES IN SHAREHOLDERS' EQUITY
For the Years Ended December 31, 2013, 2012 and 2011

	Preferred Stock		Common Stock		Additional	Retained Earnings	Accumulated Other Comprehensive Income (Loss),	Total Shareholders'
	Shares	Amount	Shares	Amount	Paid-in Capital	(Deficit)	Net of Tax	Equity
Balance, December 31, 2010	6,000	$ 5,861,094	2,602,276	$ 27,618,879	$ 1,401,032	$ (4,509,800)	$ (16,947)	$ 30,354,258
Net income						3,836,703		3,836,703
Other comprehensive loss:							(212,028)	(212,028)
Preferred stock dividends and accretion		45,242				(555,242)		(510,000)
Stock based compensation (Notes 1 and 11)					226,010			226,010
Balance, December 31, 2011	6,000	$ 5,906,336	2,602,276	$ 27,618,879	$ 1,627,042	$ (1,228,339)	$ (228,975)	$ 33,694,943
Net income						2,744,714		2,744,714
Other comprehensive income:							1,413,308	1,413,308
Preferred stock dividends and accretion		45,242				(345,242)		(300,000)
Stock options exercised			12,379		78,266			78,266
Stock based compensation (Notes 1 and 11)					231,668			231,668
Balance, December 31, 2012	6,000	$ 5,951,578	2,614,655	$ 27,618,879	$ 1,936,976	$ 1,171,133	$ 1,184,333	$ 37,862,899
Net income						2,508,443		2,508,443
Other comprehensive income:							(1,151,661)	(1,151,661)
Preferred stock dividends and accretion		48,422				(210,652)		(162,230)
Redemption of preferred stock Series A	(6,000)	(6,000,000)						(6,000,000)
Issuance of common stock			1,641,026	14,821,683				14,821,683
Repurchase of warrants				(190,827)				(190,827)
Stock options exercised			27,813		187,831			187,831
Stock based compensation (Notes 1 and 11)					156,190			156,190
Balance, December 31, 2013	-	$ -	4,283,494	$ 42,249,735	$ 2,280,997	$ 3,468,924	$ 32,672	$ 48,032,328

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

AVIDBANK HOLDINGS, INC. AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF CASH FLOWS
For the Years Ended December 31, 2013, 2012 and 2011

	2013	2012	2011
Cash flows from operating activities:			
Net income	$ 2,508,443	$ 2,744,714	$ 3,836,703
Adjustments to reconcile net income to net cash provided by operating activities:			
Gain on sale of investment securities	(748,047)	(336,565)	(68,168)
Provision for loan losses	245,286	480,000	435,260
Depreciation, amortization and accretion	1,079,867	952,799	964,602
(Decrease) increase in deferred loan origination fees, net	(229,324)	12,337	271,974
Earnings on bank-owned life insurance policies	(186,995)	(107,994)	(107,335)
Stock option compensation expense	156,190	231,670	226,010
Change in deferred income taxes	(250,000)	425,000	(1,915,000)
(Increase) decrease in accrued interest receivable and other assets	1,266,260	(638,550)	384,778
Increase in accrued interest payable and other liabilities	(473,644)	1,044,522	166,995
Net cash provided by operating activities	3,368,036	4,807,933	4,195,819
Cash flows used in investing activities:			
Purchase of available-for-sale investment securities	(27,696,313)	(28,218,176)	(80,979,524)
Proceeds from sales or calls of available-for-sale investment securities	20,504,302	57,067,040	56,922,387
Proceeds from principal payments on available-for-sale investment securities	1,724,085	40,235	122,771
Purchase of Federal Home Loan Bank stock	(1,792,700)	(212,000)	(289,000)
Purchase of bank-owned life insurance policies	(8,000,000)	-	-
Net increase in loans	(9,873,000)	(39,692,462)	(174,780)
Purchase of premises and equipment	(307,438)	(908,882)	(174,220)
Net cash used in investing activities	(25,441,064)	(11,924,245)	(24,572,366)
Cash flows from financing activities:			
Net increase in demand, interest bearing and savings deposits	91,205,582	65,055,057	23,401,741
Net increase (decrease) in time deposits	(15,895,361)	3,249,009	(1,399,785)
Net proceeds from exercise of stock options	187,831	78,266	-
Proceeds from issuance of common stock	14,821,683	-	-
Redemption of preferred stock	(6,000,000)	-	-
Repurchase of warrants	(190,827)	-	-
Cash dividends paid	(213,287)	(300,000)	(558,942)
Net cash provided by financing activities	83,915,621	68,082,332	21,443,014
Increase (decrease) in cash and cash equivalents	61,842,593	60,966,020	1,066,467
Cash and cash equivalents at beginning of period	107,002,778	46,036,758	44,970,291
Cash and cash equivalents at end of year	$ 168,845,371	$ 107,002,778	$ 46,036,758
Supplemental disclosure of cash flow information:			
Cash paid during the year for:			
Interest expense	$1,205,697	$1,840,233	$2,278,805
Income taxes	$2,185,000	$1,685,000	$1,285,000

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

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

General

Avidbank Holdings, Inc. (the "Company) was incorporated on December 17, 2007 and subsequently obtained approval from the Board of Governors of the Federal Reserve System to operate as a bank holding company. On April 2, 2008, Avidbank (the "Bank") consummated a merger with the Company effected through the exchange of one share of the Company's stock for each share of the Bank's stock. The reorganization represented an exchange of shares between entities under common control, and, as a result, assets and liabilities of the Bank were recognized at their carrying amounts in the accounts of the Company. Subsequent to the reorganization, the Bank continued its operations as previously conducted, but as a wholly-owned subsidiary of the Company.

The Bank is a California state-chartered institution and provides financial products and services to customers who are predominately small and middle-market businesses, professionals and individuals residing in San Mateo and Santa Clara Counties.

We have considered all events occurring from December 31, 2013 through April 2, 2014, the date the consolidated financial statements were available for issuance, and no subsequent events occurred requiring recognition or disclosure.

Principles of Consolidation

The consolidated financial statements include the accounts of the Company and the accounts of its wholly-owned subsidiary, the Bank. All significant intercompany balances and transactions have been eliminated. The accounting and reporting policies of the Company conform with accounting principles generally accepted in the United States of America and prevailing practices within the banking industry.

Use of Estimates

The preparation of financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions based on available information. These estimates and assumptions affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from these estimates. The allowance for loan losses, deferred tax assets, and fair values of financial instruments are particularly subject to change.

Reclassifications

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

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Cash and Cash Equivalents

For the purpose of the statement of cash flows, cash and cash equivalents consist of cash and due from banks and Federal funds sold. Generally, Federal funds are sold for one day periods. On the statement of cash flows, net cash flows are reported for customer loan and deposit transactions.

Investment Securities

Investment securities are classified into the following categories:

- Available-for-sale securities, reported at fair value, with unrealized gains and losses excluded from earnings and reported, net of taxes, as accumulated other comprehensive income (loss) within shareholders' equity.

- Held-to-maturity securities, which management has the positive intent and ability to hold, reported at amortized cost, adjusted for the accretion of discounts and amortization of premiums, which are recognized as adjustments to interest income.

Management determines the appropriate classification of its investments at the time of purchase and may only change the classification in certain limited circumstances. All transfers between categories are accounted for at fair value. At December 31, 2013 and 2012, all of the Company's securities were classified as available-for-sale and there were no transfers between categories during those years.

Gains and losses on the sale of securities are computed using the specific identification method on the trade date. Interest earned on investment securities is reported in interest income, net of applicable adjustments for accretion of discounts and amortization of premiums which are accounted for on the level-yield method without anticipation of prepayment. In addition, unrealized losses, if any, that are determined by management to be other than temporary are recognized in earnings in accordance with the methodology described below.

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

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Investment in Federal Home Loan Bank Stock

As a member of the Federal Home Loan Bank System, the Company is required to maintain an investment in the capital stock of the Federal Home Loan Bank (FHLB). The investment is carried at cost and periodically evaluated for impairment based on ultimate recovery of par value. At December 31, 2013 and 2012, FHLB stock totaled $3,290,000 and $1,497,300, respectively. Both cash and stock dividends are reported as income.

Loans

Loans are stated at principal balances outstanding net of deferred loan fees and costs, and an allowance for loan losses. Interest is accrued daily based upon outstanding loan balances. However, when a loan is past due 90 days or in the opinion of management, loans are considered to be impaired and the future collectability of interest and principal is in serious doubt, loans are placed on nonaccrual status and the accrual of interest income is suspended. Any interest accrued but unpaid is charged against income. Payments received on loans on nonaccrual status are applied to reduce principal to the extent necessary to ensure collection. Subsequent payments on these loans, or payments received on nonaccrual loans for which the ultimate collectability of principal is not in doubt, are applied first to earned but unpaid interest and then to principal. Loans are returned to accrual status when all the principal and interest amounts contractually due are brought current and future payments are reasonably assured.

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

A loan is considered impaired when, based on current information and events, it is probable that the Company will be unable to collect all amounts due (including both principal and interest) in accordance with the contractual terms of the loan agreement. Factors considered by management in determining impairment include payment status, the structure and nature of collateral, if any, and the probability of collecting scheduled principal and interest payments when due. Loans that experience insignificant payment delays and payment shortfalls generally are not classified as impaired. Management determines the significance of payment delays and the payment shortfalls on a case-by-case basis, taking into consideration all of the circumstances surrounding the loan and the borrower, including the length of the delay, the reasons for the delay, the borrower's prior payment record, and the amount of the shortfall in relation to the principal and interest owed. The amount of impairment, if any, on an impaired loan is measured based on the present value of expected future cash flows discounted at the loan's effective rate, except that as a practical expedient, impairment may be measured based upon the loan's observable market price or the fair value of collateral if the loan is collateral dependent. A loan is collateral dependent if the repayment of the loan is expected to be provided solely by the underlying collateral.

Allowance for Loan Losses

The allowance for loan losses is an estimate of probable credit losses inherent in the Company's loan portfolio that have been incurred as of the balance sheet date. The allowance is established through a provision for loan losses which is charged to expense. Additions to the allowance are expected to maintain the adequacy of the total allowance after credit losses and loan growth. Credit exposures determined to be uncollectible are charged against the allowance. Cash received on previously charged-off amounts is recorded as a recovery

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

<u>Allowance for Loan Losses (Continued)</u>

to the allowance. The overall allowance consists of two primary components: specific reserves related to impaired loans which are individually evaluated for impairment and general reserves for inherent losses related to loans that are collectively evaluated for impairment.

A restructuring of a debt constitutes a troubled debt restructuring (TDR) if the Company for economic or legal reasons related to the borrower's financial difficulties grants a concession to the borrower it would not otherwise consider. Restructured workout loans typically present an elevated level of credit risk as the borrowers are not able to perform according to the original contractual terms. Loans reported as TDRs are considered impaired and measured for impairment as described above. For troubled debt restructurings that subsequently default, the Company determines the amount of reserve in accordance with the accounting policy for the allowance for loan losses.

The determination of the general reserve for loans that are collectively evaluated for impairment is based on estimates made by management, to include, but not limited to, consideration of all historical losses since the bank opened by portfolio segment, internal asset classifications, and qualitative factors to include economic trends in the Company's service areas, industry trends, geographic concentrations, estimated collateral values, the Company's underwriting policies, the character of the loan portfolio, and probable losses inherent in the portfolio taken as a whole.

The Company determines a separate allowance for each portfolio segment (loan type). These portfolio segments include commercial, construction (including land and development loans), residential real estate (including home equity lines of credit), commercial real estate, asset based loans and consumer loans. The allowance for loan losses attributable to each portfolio segment, which includes both loans individually evaluated for impairment and loans that are collectively evaluated for impairment, are combined to determine the Company's overall allowance, which is included on the consolidated balance sheet.

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

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

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

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Allowance for Loan Losses (Continued)

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

Substandard-Impaired – A substandard loan is impaired when, based on current information and known or anticipated events, it is probable that the lender will be unable to collect all amounts due according to the terms of the original loan agreement. These loans are typically on nonaccrual and have many of the same weaknesses as substandard non-impaired loans.

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

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

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

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

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

Residential real estate (including home equity lines of credit) – Residential real estate loans are loans made with a residence serving as collateral. These are not typical mortgage loans and may have a variety of reasons for the borrowing including providing funding to a business or paying for large personal expenditures. These loans generally possess a lower inherent risk of loss than commercial real estate and construction loans and are often situations where the borrower is the occupant of the residence. The degree of risk in home equity loans depends primarily on the loan amount in relation to collateral value, the interest rate and the borrower's ability to repay in an orderly fashion. Economic trends determined by unemployment rates and other key economic indicators are closely correlated to the credit quality of these loans. Weak economic trends indicate that the borrowers' capacity to repay their obligations may be deteriorating.

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Allowance for Loan Losses (Continued)

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

Asset based – Asset based loans are advances generally made against receivables to companies generating consistent sales without yet having reached consistent profitability. These companies are subjected to an audit of their receivables and ineligible accounts are excluded from the borrowing base. The Company controls the entire receivables cash flow of the company and advances are made on a portion of eligible receivable balances. Receivables are monitored daily and borrowing capacity is calculated based upon contractual formulas. As a result of these controls, asset based lending loans typically possess less risk than unsecured commercial loans.

Consumer – Consumer loans are primarily loans to individuals that may be unsecured or secured by collateral other than real estate. The unsecured loans are generally revolving personal lines of credit to established clients. The Company also offers demand deposit lines of credit to certain checking account clients. The high quality of the clients who are offered these products has historically caused this loan product to have less risk of loss than commercial loan products.

Although management believes the allowance to be appropriate, ultimate losses may vary from its estimates. At least quarterly, the Board of Directors reviews the adequacy of the allowance, including consideration of the relative risks in the portfolio, current economic conditions and other factors. If the Board of Directors and management determine changes are warranted based on those reviews, the allowance is adjusted. In addition, the Company's primary regulators, the Federal Reserve Bank, the FDIC and the California Department of Business Oversight, as an integral part of their examination process, review the adequacy of the allowance. These regulatory agencies may require additions to the allowance based on their judgment about information available at the time of their examinations. The allowance for loan losses at December 31, 2013 and 2012 reflects management's estimate of probable credit losses in the Company's loan portfolio.

Reserve for Undisbursed Loan Commitments

The Company maintains a separate reserve for losses related to undisbursed loan commitments. Management estimates the amount of probable losses by applying the loss factors used in the allowance for loan loss methodology to an estimate of the expected usage of undisbursed lines of credit. This reserve was approximately $300,000 at December 31, 2013 and 2012, and is included in accrued interest payable and other liabilities on the consolidated balance sheet.

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Property and Equipment

Property and equipment are carried at cost less accumulated depreciation. Depreciation is determined using the straight line method over the estimated useful lives of the related assets. The useful lives of furniture, fixtures and equipment are estimated to be five to ten years. Leasehold improvements are amortized over the life of the asset or the term of the related lease, whichever is shorter. When assets are sold or otherwise disposed of, the cost and related accumulated depreciation or amortization are removed from the accounts, and any resulting gain or loss is recognized in income for the period. The cost of maintenance and repairs is charged to expense as incurred.

Bank-Owned Life Insurance

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

Income Taxes

Deferred tax assets and liabilities are recognized for the tax consequences of temporary differences between the reported amount of assets and liabilities and their tax bases. Deferred tax assets and liabilities are adjusted for the effects of changes in tax laws and rates on the date of enactment. The determination of the amount of deferred income tax assets, which are more likely than not to be realized, is primarily dependent on projections of future earnings, which are subject to uncertainty and estimates that may change given economic conditions and other factors. The recognition of deferred income tax assets is assessed and a valuation allowance is recorded if it is "more likely than not" that all or a portion of the deferred tax assets will not be realized. "More likely than not" is defined as greater than a 50% chance. All available evidence, both positive and negative, is considered to determine whether, based on the weight of that evidence, a valuation allowance is needed.

The Company considers all tax positions recognized in its financial statements for the likelihood of realization. When tax returns are filed, it is highly certain that some positions taken would be sustained upon examination by the taxing authorities, while others are subject to uncertainty about the merits of the position taken or the amount of the position that would be ultimately sustained. The benefit of a tax position is recognized in the financial statements in the period during which, based on all available evidence, management believes it is more likely than not that the position will be sustained upon examination, including the resolution of appeals or litigation processes, if any. Tax positions taken are not offset or aggregated with other positions. Tax positions that meet the more-likely-than-not recognition threshold are measured as the largest amount of tax benefit that is more than fifty percent likely of being realized upon settlement with the applicable taxing authority. The portion of the benefits associated with tax positions taken that exceeds the amount measured as described above, if any, is reflected as a liability for unrecognized tax benefits in the accompanying consolidated balance sheet along with any associated interest and penalties that would be payable to the taxing authorities upon examination. Interest expense and penalties associated with unrecognized tax benefits, if any, are included in the provision for income taxes in the statement of operations. The Company did not have any uncertain income tax positions and has not accrued for any interest or penalties as of December 31, 2013 and 2012.

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Income Taxes (Continued)

The Company uses a comprehensive model for recognizing, measuring, presenting and disclosing in the financial statements tax positions taken or expected to be taken on a tax return. A tax position is recognized as a benefit only if it is "more likely than not" the tax position would be sustained in a tax examination, with a tax examination being presumed to occur. The amount recognized is the largest amount of tax benefit that is greater than 50% likely of being realized on examination. For tax positions not meeting the "more likely than not" test, no tax benefit is recorded.

Stock-Based Compensation

Compensation cost is recognized for stock options and restricted stock awards based on the fair value of these awards at the date of grant. A Black-Scholes model is utilized to estimate the fair value of stock options, while the market price of the Company's common stock at the date of grant is used for restricted stock awards.

Compensation cost is recognized over the required service period, generally defined as the vesting period. For awards with graded vesting, compensation cost is recognized on a straight-line basis over the requisite service period for the entire award.

The Company reports the cash flows resulting from the tax benefits resulting from tax deductions in excess of the compensation cost recognized for options (excess tax benefits) as a cash flow from financing in the statement of cash flows. There were no excess tax benefits for the years ended December 31, 2013, 2012 and 2011.

Earnings Per Common Share

Basic earnings per share (EPS) 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, such as stock options, result in the issuance of common stock which shares in the earnings of the Company. The treasury stock method is applied to determine the dilutive effect of stock options in computing diluted EPS. However, conversion is not assumed when a net loss occurs because the conversion of potential common stock would be antidilutive.

Comprehensive Income

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

Loss Contingencies

Loss contingencies, including claims and legal actions arising in the ordinary course of business, are recorded as liabilities when the likelihood of loss is probable and an amount or range of loss can be reasonably estimated. Management does not believe there are any such matters that will have a material effect on the financial statements.

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Adoption of New Accounting Standards

In February 2013, the FASB amended existing guidance related to reporting amounts reclassified out of accumulated other comprehensive income. These amendments do not change the current requirements for reporting net income or other comprehensive income in financial statements. These amendments require an entity to provide information about the amounts reclassified out of accumulated other comprehensive income 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, if the amount reclassified is required under U.S. GAAP to be reclassified to net income in its entirety in the same reporting period. For other amounts that are not required under U.S. GAAP to be reclassified in their entirety to net income, an entity is required to cross-reference to other disclosures required under U.S. GAAP that provide additional details about those amounts. The effect of adopting this standard did not have a material effect on the Company's operating results or financial condition.

2. AVAILABLE-FOR-SALE INVESTMENT SECURITIES

The amortized cost and estimated fair value of available-for-sale investment securities at December 31, 2013 and 2012 consisted of the following:

	2013			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Debt securities:				
U.S. Agencies	$ 5,855,042	$ -	$ (362,042)	$ 5,493,000
U.S. Govt. Sponsored Agencies	5,664,753	114,247	-	5,779,000
Residential Mortgage-Backed Securities	16,061,030	-	(622,030)	15,439,000
Municipal Tax-Exempt Securities	1,212,423	-	(38,423)	1,174,000
Corporate Debt Securities	30,135,300	962,700	-	31,098,000
Total debt securities	$ 58,928,548	$ 1,076,947	$ (1,022,495)	$ 58,983,000

	2012			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Debt securities:				
U.S. Agencies	$ 6,177,541	$ 56,459	$ -	$ 6,234,000
U.S. Govt. Sponsored Agencies	9,721,474	227,526	-	9,949,000
Residential Mortgage-Backed Securities	6,401,625	24,375	-	6,426,000
Corporate Debt Securities	31,068,471	1,665,529	-	32,734,000
Total debt securities	$ 53,369,111	$ 1,973,889	$ -	$ 55,343,000

Net unrealized gains on available-for-sale investment securities totaling $54,452 were recorded as accumulated other comprehensive income, net of taxes of $21,780, within shareholders' equity at December 31, 2013. Unrealized gains on available-for-sale investment securities totaling $1,973,889 were recorded as accumulated other comprehensive income, net of taxes of $789,556, within shareholders' equity at December 31, 2012.

Proceeds from the sale or call of available-for-sale investment securities totaled $20,504,302, $57,067,040, and $56,922,387 for the years ended 2013, 2012 and 2011, respectively, with gross recognized gains of $748,047 in 2013, $336,565 in 2012 and $68,168 in 2011.

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

There were no investment securities with unrealized losses at December 31, 2012. Investment securities with unrealized losses at December 31, 2013 are summarized and classified according to the duration of the loss period as follows:

	2013					
	Less than 12 Months		12 Months or More		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Debt securities:						
U.S. Agencies	$ 5,493,000	$ (362,042)	$ -	$ -	$ 5,493,000	$ (362,042)
Residential Mortgage-Backed Securities	15,439,000	(622,030)	-	-	15,439,000	(622,030)
Municipal Tax-Exempt Securities	1,174,000	(38,423)	-	-	1,174,000	(38,423)
	$ 22,106,000	$ (1,022,495)	$ -	$ -	$ 22,106,000	$ (1,022,495)

U.S. Agencies - At December 31, 2013, the Company held one U.S. Agency security, which was in a loss position for less than 12 months. Management believes the unrealized losses on the Company’s investment in U.S. Agencies were caused by interest rate changes. Because the decline in market value is attributable to changes in interest rates and not credit quality, and because the Company does not intend to sell, and it is more likely than not that it will not be required to sell the investment until a recovery of fair value, which may be maturity, the Company does not consider the investment to be other-than-temporarily impaired at December 31, 2013.

Residential Mortgage-Backed Securities - At December 31, 2013, the Company held three residential mortgage-backed securities, all of which were in a loss position for less than 12 months. Management believes the unrealized losses on the Company’s investments in residential mortgage-backed securities were caused by interest rate changes. The contractual cash flows of those investments are guaranteed or supported by an agency or sponsored entity of the U.S. Government. Accordingly, it is expected that the securities would not be settled at a price less than the amortized cost of the Company’s investment. Because the decline in market value is attributable to changes in interest rates and not credit quality, and because the Company does not intend to sell, and it is more likely than not that it will not be required to sell those investments until a recovery of fair value, which may be maturity, the Company does not consider those investments to be other-than-temporarily impaired at December 31, 2013.

Municipal Tax-Exempt Securities - At December 31, 2013, the Company held one obligation of a state and political subdivision security, which was in a loss position for less than 12 months. Management believes the unrealized losses on the Company’s investment in municipal tax-exempt securities were caused by interest rate changes. Because the decline in market value is attributable to changes in interest rates and not credit quality, and because the Company does not intend to sell, and it is more likely than not that it will not be required to sell the investment until a recovery of fair value, which may be maturity, the Company does not consider the investment to be other-than-temporarily impaired at December 31, 2013.

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

The amortized cost and estimated fair value of available-for-sale investment securities at December 31, 2013 by contractual maturity are shown below. Expected maturities will differ from contractual maturities because the issuers of the securities may have the right to call or prepay obligations with or without call or prepayment penalties.

	Amortized Cost	Fair Value
Within one year	$ 4,006,610	$ 4,149,000
One to five years	27,805,039	28,752,000
Five to ten years	5,203,469	5,149,000
Beyond ten years	5,855,049	5,494,000
	42,870,167	43,544,000
Investment securities not due at a single maturity date: residential mortgage-backed securities	16,061,030	15,439,000
	$ 58,931,197	$ 58,983,000

Investment securities with amortized costs totaling $1,650,141 and fair values of $1,696,564 were pledged to secure public deposits at December 31, 2013. Securities with amortized costs totaling $6,220,282 and fair values of $6,686,432 were pledged to the Federal Reserve for discount window borrowing at December 31, 2013. Investment securities with amortized costs totaling $4,024,687 and fair values of $4,138,797 were pledged to secure public deposits at December 31, 2012. Securities with amortized costs totaling $31,509,881 and fair values of $32,759,580 were pledged to the Federal Reserve for discount window borrowing at December 31, 2012.

3. LOANS

Outstanding loans are summarized below:

	December 31	
	2013	2012
Commercial	$ 62,699,957	$ 48,700,979
Construction	39,433,627	59,086,969
Residential real estate	12,436,131	16,683,348
Commercial real estate	96,846,398	88,713,709
Asset based	45,106,114	31,925,513
Consumer	1,462,853	2,938,218
Total outstanding loans	257,985,080	248,048,736
Deferred loan origination fees, net	(550,733)	(780,057)
Allowance for loan losses	(4,788,443)	(4,479,813)
Total loans net of allowance for loan losses	$ 252,645,904	$ 242,788,866

3. LOANS (Continued)

Salaries and employee benefits totaling $548,099, $502,533 and $396,711 have been deferred as loan origination costs for the years ended December 31, 2013, 2012 and 2011, respectively.

From time to time, the Bank pledges loans as collateral under a short-term borrowing arrangement through the Discount Window of the Federal Reserve Bank. At December 31, 2013, there were no loans pledged. (Note 9) The Bank has entered into a blanket lien agreement providing for the pledging of Call Report loan categories for borrowing capacity with the Federal Home Loan Bank. The bank has pledged a total of $173,307,242 of loans for borrowing capacity of $70,431,453 at December 31, 2013.

4. ALLOWANCE FOR LOAN LOSSES

Changes in the allowance for loan losses during the years ended December 31, 2013, 2012 and 2011 were as follows:

	2013	2012	2011
Balance, beginning of year	$ 4,479,813	$ 4,375,754	$ 4,420,964
Provision charged to operations	245,286	480,000	435,260
Losses charged to allowance	(327,819)	(622,724)	(598,143)
Recoveries	391,163	246,783	117,673
Balance, end of year	$ 4,788,443	$ 4,479,813	$ 4,375,754

4. ALLOWANCE FOR LOAN LOSSES (Continued)

Allocation of the Allowance for Loan Losses by Portfolio Segment and Impairment Methodology as of and for the years ended December 31, 2013 and 2012:

	Commercial	Construction	Residential Real Estate	Commercial Real Estate	Asset Based	Consumer	Unallocated	Total
Balance, at January 1, 2012	$ 738,204	$ 764,932	$ 215,327	$ 1,643,391	$ 489,004	$ 81,794	$ 443,102	$ 4,375,754
Provision for loan losses	(297,453)	253,825	189,018	(134,187)	568,249	(39,950)	(59,502)	480,000
Loans charged-off	(19,557)	-	(173,457)	-	(429,710)	-	-	(622,724)
Recoveries	237,019	-	8,500	-	1,234	30	-	246,783
Balance, at December 31, 2012	$ 658,213	$ 1,018,757	$ 239,388	$ 1,509,204	$ 628,777	$ 41,874	$ 383,600	$ 4,479,813
Provision for loan losses	753,964	(536,054)	(55,385)	(165,851)	563,812	(79,370)	(235,830)	245,286
Loans charged-off	(312,611)	-	-	(15,208)	-	-	-	(327,819)
Recoveries	289,164	-	-	25,138	-	76,861	-	391,163
Balance, at December 31, 2013	$ 1,388,730	$ 482,703	$ 184,003	$ 1,353,283	$ 1,192,589	$ 39,365	$ 147,770	$ 4,788,443

4. ALLOWANCE FOR LOAN LOSSES (Continued)

December 31, 2013	Commercial	Construction	Residential Real Estate	Commercial Real Estate	Asset Based	Consumer	Unallocated	Total
Allowance for loan losses:								
Ending balance	$ 1,388,730	$ 482,703	$ 184,003	$ 1,353,283	$ 1,192,589	$ 39,365	$ 147,770	$ 4,788,443
Ending balance: individually evaluated for impairment	$ 196,000	$ -	$ -	$ 73,628	$ -	$ -	$ -	$ 269,628
Ending balance: collectively evaluated for impairment	$ 1,192,730	$ 482,703	$ 184,003	$ 1,279,655	$ 1,192,589	$ 39,365	$ 147,770	$ 4,518,815
Loans:								
Ending balance	$ 62,699,957	$ 39,433,627	$ 12,436,131	$ 96,846,398	$ 45,106,114	$ 1,462,853		$ 257,985,080
Ending balance: individually evaluated for impairment	$ 1,491,667	$ -	$ -	$ 522,944	$ -	$ -		$ 2,014,611
Ending balance: collectively evaluated for impairment	$ 61,208,290	$ 39,433,627	$ 12,436,131	$ 96,323,454	$ 45,106,114	$ 1,462,853		$ 255,970,469

4. ALLOWANCE FOR LOAN LOSSES (Continued)

December 31, 2012	Commercial	Construction	Residential Real Estate	Commercial Real Estate	Asset Based	Consumer	Unallocated	Total
Allowance for loan losses:								
Ending balance	$ 658,213	$ 1,018,757	$ 239,388	$ 1,509,204	$ 628,777	$ 41,874	$ 383,600	$ 4,479,813
Ending balance: individually evaluated for impairment	$ -	$ -	$ -	$ 81,000	$ -	$ -	$ -	$ 81,000
Ending balance: collectively evaluated for impairment	$ 658,213	$ 1,018,757	$ 239,388	$ 1,428,204	$ 628,777	$ 41,874	$ 383,600	$ 4,398,813
Loans:								
Ending balance	$ 48,700,979	$ 59,086,969	$ 16,683,348	$ 88,713,709	$ 31,925,513	$ 2,938,218		$ 248,048,736
Ending balance: individually evaluated for impairment	$ -	$ -	$ -	$ 875,905	$ -	$ -		$ 875,905
Ending balance: collectively evaluated for impairment	$ 48,700,979	$ 59,086,969	$ 16,683,348	$ 87,837,804	$ 31,925,513	$ 2,938,218		$ 247,172,831

4. ALLOWANCE FOR LOAN LOSSES (Continued)

Commercial Credit Exposure
Credit Risk Profile by Internally Assigned Grade as of December 31, 2013

	Commercial	Construction	Residential Real Estate	Commercial Real Estate	Asset Based	Consumer	Total
Grade:							
Pass	$ 56,506,912	$ 36,794,423	$ 11,828,680	$ 93,250,482	$ 37,911,383	$ 1,052,751	$237,344,632
Special Mention	3,679,999	2,381,234	-	2,769,867	6,369,398	142,000	15,342,498
Substandard-Non-Impaired	1,021,379	257,970	607,451	303,105	825,333	268,102	3,283,339
Substandard-Impaired	1,491,667	-	-	522,944	-	-	2,014,611
Total	$ 62,699,957	$ 39,433,627	$ 12,436,131	$ 96,846,398	$ 45,106,114	$ 1,462,853	$257,985,080

Commercial Credit Exposure
Credit Risk Profile by Internally Assigned Grade as of December 31, 2012

	Commercial	Construction	Residential Real Estate	Commercial Real Estate	Asset Based	Consumer	Total
Grade:							
Pass	$ 47,147,069	$ 56,127,978	$ 16,059,684	$ 85,688,126	$ 31,002,283	$ 2,938,218	$238,963,358
Special Mention	542,333	2,958,991	-	-	923,230	-	4,424,554
Substandard-Non-Impaired	1,011,577	-	623,664	2,149,678	-	-	3,784,919
Substandard-Impaired	-	-	-	875,905	-	-	875,905
Total	$ 48,700,979	$ 59,086,969	$ 16,683,348	$ 88,713,709	$ 31,925,513	$ 2,938,218	$248,048,736

4. ALLOWANCE FOR LOAN LOSSES (Continued)

Past Due and Nonaccrual Loan Detail as of December 31, 2013

	30-89 Days Past Due	90 Days and Still Accruing	Nonaccrual	Total Past Due	Current	Total
Commercial	$ -	$ -	$ 1,491,667	$ 1,491,667	$ 61,208,290	$ 62,699,957
Construction	-	-	-	-	39,433,627	39,433,627
Residential Real Estate	-	-	-	-	12,436,131	12,436,131
Commercial Real Estate	-	-	522,944	522,944	96,323,454	96,846,398
Asset Based	-	-	-	-	45,106,114	45,106,114
Consumer	-	-	-	-	1,462,853	1,462,853
Total	$ -	$ -	$ 2,014,611	$ 2,014,611	$ 255,970,469	$ 257,985,080

Past Due and Nonaccrual Loan Detail as of December 31, 2012

	30-89 Days Past Due	90 Days and Still Accruing	Nonaccrual	Total Past Due	Current	Total
Commercial	$ -	$ -	$ -	$ -	$ 48,700,979	$ 48,700,979
Construction	-	-	-	-	59,086,969	59,086,969
Residential Real Estate	-	-	-	-	16,683,348	16,683,348
Commercial Real Estate	-	-	875,905	875,905	87,837,804	88,713,709
Asset Based	-	-	-	-	31,925,513	31,925,513
Consumer	-	-	-	-	2,938,218	2,938,218
Total	$ -	$ -	$ 875,905	$ 875,905	$ 247,172,831	$ 248,048,736

4. ALLOWANCE FOR LOAN LOSSES (Continued)

Impaired Loan Detail with a Related Allowance as of December 31, 2013

	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized	Interest Income Recognized on a Cash Basis
Commercial	$ 1,491,667	$ 1,491,667	$ 196,000	$ 3,231,923	$ -	$ -
Commercial Real Estate	522,944	522,944	73,628	721,561	-	-
Total	$ 2,014,611	$ 2,014,611	$ 269,628	$ 3,953,484	$ -	$ -

Impaired Loan Detail with a Related Allowance as of December 31, 2012

	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized	Interest Income Recognized on a Cash Basis
Commercial Real Estate	$ 875,905	$ 875,905	$ 81,000	$ 889,299	$ -	$ -
Total	$ 875,905	$ 875,905	$ 81,000	$ 889,299	$ -	$ -

The recorded investment in loans includes accrued interest receivable and loan origination fees, net. For purposes of this disclosure, the unpaid principal balance is not reduced for any related loan loss allowance.

As of December 31, 2013 and 2012, the Company had a recorded investment in troubled debt restructurings of $522,944 and $875,905, respectively. The Company has allocated $73,628 and $81,000 of specific reserves for those loans at December 31, 2013 and 2012, respectively. The Company has not committed to lend any additional amounts on loans identified as troubled debt restructurings.

During the years ending December 31, 2013 and 2012, the terms of certain loans were modified as troubled debt restructurings. The modification of the terms of such loans included one or a combination of the following: a reduction of the stated interest rate of the loan; an extension of the maturity date at a stated rate of interest lower than the current market rate for new debt with similar risk; or a permanent reduction of the recorded investment in the loan.

4. ALLOWANCE FOR LOAN LOSSES (Continued)

There were no troubled debt restructurings that occurred during the year ended December 31, 2013.

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

	Number of Loans	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment
Troubled Debt Restructurings:			
Commercial	1	$ 875,905	$ 875,905

The troubled debt restructuring described above increased the allowance for loan losses by $81,000 and resulted in no charge-offs during the year ending December 31, 2012.

There were no troubled debt restructurings which defaulted within twelve months following the modification during the years ended December 31, 2013 or 2012.

5. PROPERTY AND EQUIPMENT

Property and equipment consisted of the following:

	December 31, 2013	December 31, 2012
Leasehold improvements	$ 1,002,415	$ 926,909
Furniture and equipment	698,931	594,506
Computer equipment	1,780,546	1,653,039
Gross property and equipment	3,481,892	3,174,454
Less accumulated depreciation and amortization	2,306,478	1,883,148
Property and equipment, net	$ 1,175,414	$ 1,291,306

Depreciation included in occupancy and equipment expense totaled $423,330, $313,846,and $291,881 for the years ended December 31, 2013, 2012 and 2011, respectively.

6. CASH SURRENDER VALUE OF LIFE INSURANCE POLICIES

The Bank owned single-premium life insurance policies on the lives of two former key executives in 2013, 2012 and 2011. In addition, the Bank purchased single premium life insurance policies on certain key current employees in 2013. Income earned on these policies, net of expenses, totaled $186,995, $107,595 and $107,335 for the years ended December 31, 2013, 2012 and 2011, respectively.

7. INTEREST-BEARING DEPOSITS

Interest-bearing deposits consisted of the following:

	December 31, 2013	December 31, 2012
NOW accounts	$ 18,990,862	$ 17,292,527
Savings	11,736,215	17,390,604
Money market	210,588,872	168,273,166
Time, $100,000 or more	46,111,402	62,025,136
Other time	4,513,175	4,494,802
Total interest-bearing deposits	$ 291,940,526	$ 269,476,235

7. INTEREST-BEARING DEPOSITS (Continued)

Aggregate annual maturities of time deposits are as follows:

Year Ending December 31,	
2014	$ 40,963,855
2015	2,688,899
2016	1,654,905
2017	2,410,146
2018	2,906,772
Total time deposits	$ 50,624,577

Interest expense recognized on interest-bearing deposits for the years ended December 31, 2013, 2012 and 2011 consisted of the following:

	2013	2012	2011
NOW accounts	$ 39,605	$ 38,934	$ 44,378
Savings	40,561	75,456	60,124
Money market	540,541	1,001,157	1,381,294
Time, $100,000 or more	511,266	669,082	712,196
Other time	35,409	55,604	80,977
Total interest on deposits	$ 1,167,382	$ 1,840,233	$ 2,278,969

At December 31, 2013, the Company had one deposit relationship that exceeded 5% of total deposits. At $41.8 million, the deposit relationship represented 9.3% of total deposits. At December 31, 2012, the Company had no deposit relationships that exceeded 5% of total deposits.

8. INCOME TAXES

The provision for (benefit from) income taxes for the years ended December 31, 2013, 2012 and 2011 consisted of the following:

2013	Federal	State	Total
Current	$ 1,309,070	$ 481,362	$ 1,790,432
Deferred	(213,000)	(37,000)	(250,000)
Provision for income taxes	$ 1,096,070	$ 444,362	$ 1,540,432

2012	Federal	State	Total
Current	$ 1,449,000	$ 184,000	$ 1,633,000
Deferred	64,000	361,000	425,000
Provision for income taxes	$ 1,513,000	$ 545,000	$ 2,058,000

2011	Federal	State	Total
Current	$ 978,200	$ 364,400	$ 1,342,600
Deferred	55,000	5,000	60,000
Valuation allowance	(1,217,000)	(758,000)	(1,975,000)
Benefit from income taxes	$ (183,800)	$ (388,600)	$ (572,400)

8. INCOME TAXES (Continued)

Deferred tax assets (liabilities) at December 31, 2013 and 2012 consisted of the following:

	2013	2012
Deferred tax assets:		
Allowance for loan losses	$ 1,360,000	$ 1,299,000
State tax	158,000	63,000
Accrued expenses	237,000	151,000
Other	148,000	145,000
Share-base compensation	459,000	429,000
Total deferred tax assets	$ 2,362,000	$ 2,087,000
Deferred tax liabilities:		
Other	$ (54,000)	$ (45,000)
Property and equipment	(66,000)	(108,000)
Loan origination costs	(302,000)	(241,000)
Unrealized gain on available for sale investment securities	(22,000)	(790,000)
Total deferred tax liabilities	(444,000)	(1,184,000)
Net deferred tax asset	$ 1,918,000	$ 903,000

8. INCOME TAXES (Continued)

The provision for (benefit from) income taxes differs from amounts computed by applying the statutory Federal income tax rate to income before income taxes. The effects of these differences are as follows:

	Years Ended December 31,					
	2013		2012		2011	
	Amount	Rate %	Amount	Rate %	Amount	Rate %
Federal income tax expense, at statutory rate	$ 1,376,600	34.0	$ 1,633,000	34.0	$1,110,000	34.0
State franchise tax expense, net of Federal tax expense	317,700	7.8	121,000	2.5	240,000	7.4
Share-based compensation	28,100	0.7	40,000	0.8	42,000	1.3
Deferred tax valuation allowance	-	-	-	-	(1,975,000)	(60.5)
Tax-exempt income from life insurance policies	(63,600)	(1.6)	(37,000)	(0.8)	(36,400)	(1.1)
Meals and Entertainment	23,200	0.6	31,000	0.6	-	-
Other	(141,568)	(3.5)	270,000	5.8	47,000	1.4
Total income tax (benefit) expense	$ 1,540,432	38.0	$ 2,058,000	42.9	$ (572,400)	(17.5)

The total amount of unrecognized tax benefits, related to potentially uncertain tax positions, including interest and penalties, at December 31, 2013, is not considered material for disclosure purposes. The amount of tax benefits that would impact the effective rate, if recognized, is not expected to be material. The Company does not anticipate any significant changes with respect to unrecognized tax benefits within the next twelve months.

Status of Open Tax Years

The Company is subject to U.S. Federal income tax as well as California state income tax. Federal income tax returns for 2010 through 2013 and California income tax returns for 2009 through 2013 are currently open for Federal or state income tax examinations.

9. SHORT-TERM BORROWING ARRANGEMENTS

The Company had unsecured Federal Funds lines of credit totaling $10,000,000 with its correspondent banks at December 31, 2013 and at December 31, 2012. There were no borrowings outstanding under these agreements at December 31, 2013 and 2012.

The Company has a short-term borrowing arrangement with the Federal Reserve Bank through the Discount Window. The Company has pledged certain securities to secure borrowings. The borrowing capacity under the agreement varies depending on the amount and type of securities pledged. There were no borrowings outstanding under the agreement at December 31, 2013 or 2012, and the Company had $6,045,739 of readily available borrowing capacity at December 31, 2013 based on currently pledged investments.

As a member of the Federal Home Loan Bank (FHLB) of San Francisco, the Bank is eligible to use the FHLB's facilities for short and long term borrowing. Borrowing capacity is based on the amount of stock ownership in the FHLB and all borrowings are based on pledged assets or a blanket lien against Call Report loan categories. There were no borrowings outstanding from the FHLB at December 31, 2013 or 2012. The borrowing capacity at December 31, 2013 was $70.4 million based upon a blanket lien against Call Report loan categories.

10. COMMITMENTS

Operating Leases

The Company leases its branch and its administrative offices under a noncancellable operating lease. The lease expires in 2018 and has two five-year renewal options. The Company also leases office space for loan production offices in Redwood City and San Jose, California. The Redwood City loan production office lease expires in 2019 and has one three-year renewal option. The San Jose loan production office lease expires in 2016 and has one three-year renewal option. However, in January 2014, the Company terminated its original San Jose office lease and entered into a new five year contract for addditional space in the same building.

The following is a schedule by year of future minimum rental payments required under operating leases that have initial or remaining noncancellable lease terms in excess of one year as of December 31, 2013:

Year Ending December 31,	Leases
2014	$ 1,305,127
2015	1,359,596
2016	1,405,033
2017	1,451,830
2018	1,250,512
Thereafter	187,200
	$ 6,959,299

10. COMMITMENTS (Continued)

Operating Leases (continued)

Net rent expense included in occupancy and equipment expense totaled $1,097,670, $837,578 and $749,181 for the years ended December 31, 2013, 2012, and 2011, respectively. Sublease income totaled $127,125, $408,022 and $419,464 for the years ended December 31, 2013, 2012 and 2011, respectively. All sublease arrangements on abandoned leased premises were terminated as of December 31, 2013.

Federal Reserve Requirements

Banks are required to maintain reserves with the Federal Reserve Bank equal to a percentage of their reservable deposits. The amount of such reserve balances required at December 31, 2013 was $9.3 million.

Financial Instruments With Off-Balance-Sheet Risk

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

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

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

	December 31,	
	2013	2012
Commitments to extend credit	$ 111,263,884	$ 115,953,149
Standby letters of credit	$ 2,570,547	$ 1,515,517

Commitments to extend credit consist primarily of unfunded single-family residential and commercial real estate construction loans and commercial revolving lines of credit. Construction loans are established under standard underwriting guidelines and policies and are secured by deeds of trust, with disbursements made over the course of construction. Commercial revolving lines of credit have a high degree of industry diversification. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Since many of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements.

10. COMMITMENTS (Continued)

Financial Instruments With Off-Balance-Sheet Risk (continued)

Standby letters of credit are generally secured and are issued by the Bank to guarantee the performance of a customer to a third party. The credit risk involved in issuing standby letters of credit is essentially the same as that involved in extending loans to customers. The fair value of the liability related to these standby letters of credit, which represents the fees received for issuing the guarantees, was not significant at December 31, 2013 and 2012. The Company recognizes these fees as revenue over the term of the commitment or when the commitment is used.

At December 31, 2013, most loan commitments were for construction and commercial loans. For those loan committments secured by real estate, loan-to-value ratios generally did not exceed 65%. In addition, the majority of the Company's loan commitments had variable interest rates.

Significant Concentrations of Credit Risk

The Company grants real estate mortgage, real estate construction, commercial and consumer loans primarily to customers in the California counties of San Mateo and Santa Clara. Although the Company has a diversified loan portfolio, a substantial portion of its portfolio is secured by commercial and residential real estate. Management believes the loans within this concentration have no more than the normal risk of collectability, however, a substantial decline in real estate values in the Company's primary market area could have an adverse impact on the collectability of these loans. Personal and business income represent the primary sources of repayment for a majority of these loans and management believes the risks presented by the concentration is further mitigated by diversification of property types within the Company's real estate portfolio and by conservative underwriting.

At December 31, 2013, in management's judgment, a concentration of loans existed in construction and real estate related loans. At that date, approximately 57.7% of the Company's loans were construction and real estate related, representing 15.3% and 42.4% of total outstanding loans, respectively.

At December 31, 2012, in management's judgment, a concentration of loans existed in construction and real estate related loans. At that date, approximately 66.3% of the Company's loans were construction and real estate related, representing 23.8% and 42.5% of total outstanding loans, respectively.

10. COMMITMENTS (Continued)

Contingencies

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

11. SHAREHOLDERS' EQUITY

Dividends

The Company's ability to pay cash dividends is dependent on dividends paid to it by the Bank and limited by California law. Under California law, the holders of common stock of the Company are entitled to receive dividends when and as declared by the Board of Directors, out of funds legally available, subject to certain restrictions. California General Corporation Law prohibits the Company from paying dividends on its common stock unless: (i) its retained earnings, immediately prior to the dividend payment, equals or exceeds the amount of the dividend or (ii) immediately after giving effect to the dividend, the sum of the Company's assets (exclusive of goodwill and deferred charges) would be at least equal to 125% of its liabilities (not including deferred taxes, deferred income and other deferred liabilities) and the current assets of the Company would be at least equal to its current liabilities, or, if the average of its earnings before taxes on income and before interest expense for the two preceding fiscal years was less than the average of its interest expense for the two preceding fiscal years, at least equal to 125% of its current liabilities.

Dividends paid from the Bank to the Company are restricted under certain Federal laws and regulations governing banks. In addition, the California Financial Code restricts the total dividend payment of any bank in any one year to the lesser of (1) the bank's retained earnings or (2) the bank's net income for its last three fiscal years, less distributions made to shareholders during the same three-year period, without the prior approval of the California Department of Business Oversight. At December 31, 2013, $3,459,000 million was free of such restrictions.

Participation in the TARP Program

On January 30, 2009, the Company entered into a Letter Agreement (the “Purchase Agreement”) with the United States Department of the Treasury (“Treasury”), pursuant to which the Company issued and sold 6,000 shares of the Company’s Fixed Rate Cumulative Perpetual Preferred Stock, Series A (the “Series A Preferred Stock”) and (ii) a warrant (the “Warrant”) to purchase 81,670 shares of the Company’s common stock, no par value (the “Common Stock”), for an aggregate purchase price of $6,000,000 in cash. The Series A Preferred Stock qualified as Tier 1 capital and paid cumulative dividends quarterly at a rate of 5% per annum for the first five years, and 9% per annum thereafter. On July 31, 2013, the Company repurchased the 6,000 shares of Series A Preferred Stock from the Treasury for $6,000,000. On August 28, 2013, the Company redeemed the Warrant for $190,827.

11. SHAREHOLDERS' EQUITY (Continued)

Issuance of Common Stock

During 2013, the Company issued 1,641,026 shares of common stock in connection with raising $14,822,000 of capital (net of issuance costs of $1,178,000). $6,190,827 of the proceeds were used to redeem 6,000 shares of Series A Preferred Stock and related Warrant.

Earnings Per Common Share

A reconciliation of the numerators and denominators of the basic and diluted earnings per common share computations for the years ended December 31, 2013, 2012 and 2011 is shown below:

	Net Income	Less Preferred Stock Dividends and Accretion	Net Income Available to Common Shareholders	Weighted Average Number of Shares Outstanding	Per Share Amount
December 31, 2013					
Basic income per common share	$ 2,508,443	$ (210,652)	$ 2,297,791	3,474,788	$ 0.66
Effect of dilutive options				90,702	-
Diluted income per common share	$ 2,508,443	$ (210,652)	$ 2,297,791	3,565,490	$ 0.64
December 31, 2012					
Basic income per common share	$ 2,744,714	$ (345,242)	$ 2,399,472	2,610,998	$ 0.92
Effect of dilutive options				19,086	-
Diluted income per common share	$ 2,744,714	$ (345,242)	$ 2,399,472	2,630,084	$ 0.91
December 31, 2011					
Basic income per common share	$ 3,836,703	$ (555,242)	$ 3,281,461	2,602,276	$ 1.26
Effect of dilutive options				3,310	-
Diluted income per common share	$ 3,836,703	$ (555,242)	$ 3,281,461	2,605,586	$ 1.26

There were 477,060, 580,566 and 448,522 options excluded from the calculation of diluted earnings per share in 2013, 2012 and 2011 respectively, because they were anti-dilutive.

11. SHAREHOLDERS' EQUITY (Continued)

Regulatory Capital

The Company and Bank are subject to certain regulatory capital requirements administered by the Board of Governors of the Federal Reserve System and the FDIC. Failure to meet these minimum capital requirements can initiate certain mandatory, and possibly additional discretionary, actions by regulators that, if undertaken, could have a direct material effect on the Company's consolidated 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 Company's and 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 Company and the Bank to maintain minimum amounts and ratios of total and Tier 1 capital to risk-weighted assets and of Tier 1 capital to average assets. Each of these components is defined in the regulations. Management believes that the Company and the Bank met all their capital adequacy requirements as of December 31, 2013 and 2012.

11. SHAREHOLDERS' EQUITY (Continued)

Regulatory Capital (Continued)

As of December 31, 2013, the most recent notification from the FDIC categorized the Bank as well-capitalized under the regulatory framework for prompt corrective action. There are no conditions or events since that notification that management believes have changed the Bank's category. To be categorized as well-capitalized, under the regulatory framework for prompt corrective actions, the Company and the Bank must maintain minimum total risk-based, Tier 1 risk-based and Tier 1 leverage ratios as set forth in the table below:

	2013		2012	
	Amount	Ratio	Amount	Ratio
Leverage Ratio				
Avidbank Holdings, Inc.	$ 48,022,785	9.89%	$ 36,678,966	8.88%
Minimum regulatory requirement	$ 19,418,356	4.00%	$ 16,523,649	4.00%
Avidbank	$ 46,902,225	9.66%	$ 36,582,200	8.86%
Minimum requirement for "Well-Capitalized" institution	$ 24,272,945	5.00%	$ 20,654,561	5.00%
Minimum regulatory requirement	$ 19,418,356	4.00%	$ 16,523,649	4.00%
Tier 1 Risk-Based Capital Ratio				
Avidbank Holdings, Inc.	$ 48,022,785	12.78%	$ 36,678,966	10.78%
Minimum regulatory requirement	$ 15,032,700	4.00%	$ 13,607,409	4.00%
Avidbank	$ 46,902,225	12.45%	$ 36,582,200	10.75%
Minimum requirement for "Well-Capitalized" institution	$ 22,549,049	6.00%	$ 20,411,114	6.00%
Minimum regulatory requirement	$ 15,032,700	4.00%	$ 13,607,409	4.00%
Total Risk-Based Capital Ratio				
Avidbank Holdings, Inc.	$ 52,720,503	14.03%	$ 40,931,281	12.03%
Minimum regulatory requirement	$ 30,065,399	8.00%	$ 27,214,818	8.00%
Avidbank	$ 51,599,943	13.70%	$ 40,834,515	12.00%
Minimum requirement for "Well-Capitalized" institution	$ 37,581,749	10.00%	$ 34,018,523	10.00%
Minimum regulatory requirement	$ 30,065,399	8.00%	$ 27,214,818	8.00%

12. SHARE-BASED PAYMENT

Stock Options

In 2013, the Company received shareholder approval to increase the number of authorized shares of common stock from 5 million to 10 million shares. In addition, approval was granted to reserve an additional 411,578 shares for issuance for employees, consultants and directors under the 2013 Equity Incentive Plan. There were 66,650 options granted in 2013 under the plan. The prior stock option plan (2008 Stock Option Plan) will continue to be administered with respect to grants of options outstanding as of the date of such shareholder approval, but no new shares will be issued from that plan. Under the 2013 Equity Incentive Plan, the Company is able to provide stock-based awards to employees, directors, and contractors. Awards under the 2013 Equity Incentive Plan may be in the form of, but not limited to, the following; stock options, restricted stock or units, performance based shares or units, and other stock-based awards as determined by the Board of Directors. The 2013 Equity Incentive Plan specifies that the option price may not be less than the fair market value of the stock at the date the option is granted, and that the stock must be paid for in full at the time the option is exercised. All options expire on a date determined by the Board of Directors, but not later than five years from the date of grant. Upon grant, options vest ratably over a four year period.

There were 81,650 new options granted in 2013, and 213,000 new options granted in 2012. As of December 31, 2013, there were 344,928 remaining options available to be granted under the 2013 Equity Incentive Plan.

12. SHARE-BASED PAYMENT (Continued)

Stock Options (Continued)

A summary of option activity under the Plan for the years ended December 31, 2013 and 2012 follows:

	Number of Stock Options Outstanding	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term (in Years)	Aggregate Intrinsic Value
Options outstanding at December 31, 2011	571,832	$ 7.66	3.70 years	$ 5,400
Options granted	213,000	$ 8.49		
Options exercised	(12,379)	$ 6.32		
Options forfeited	(106,701)	$ 11.23		
Options outstanding at December 31, 2012	665,752	$ 7.38	3.49 years	$ 1,628,432
Options granted	81,650	$ 8.57		
Options exercised	(27,813)	$ 6.75		
Options forfeited	(85,177)	$ 8.37		
Options outstanding at December 31, 2013	634,412	$ 7.65	2.84 years	$ 1,807,983
Options vested or expected to vest at December 31, 2013	510,299	$ 7.54	2.75 years	$ 1,509,186
Options exercisable at December 31, 2013	256,387	$ 7.00	2.30 years	$ 897,900

The Company determines the fair value of options on the date of grant using a Black-Scholes option pricing model that uses assumptions based on expected option life, the level of estimated forfeitures, expected stock volatility and the risk-free interest rate. Stock volatility is based on the historical volatility of the Company's stock. The risk-free rate is based on the U.S. Treasury yield curve and the expected term of the options. For options granted, historical data was used based on the actual term the Company's options were held to estimate the expected term of the stock option grants.

12. SHARE-BASED PAYMENT (Continued)

Stock Options (Continued)

The fair value of each option is estimated on the date of grant using the following assumptions:

	2013	2012	2011
Dividend Yield	N/A	N/A	N/A
Expected volatility	21.06%	31.83%	35.90%
Risk-free interest rate	0.61%	0.42%	0.84%
Expected option life	3.0 years	3.2 years	3.2 years

The weighted-average grant-date fair value of options granted during 2013, 2012 and 2011 was $1.59, $1.93 and $1.76, respectively.

Options in the amount of 27,813 were exercised in 2013 with cash proceeds received of $187,831. Options in the amount of 12,379 were exercised in 2012 with cash proceeds received of $78,266. No options were exercised in 2011. The intrinsic value of options exercised in 2013 was $93,345. The intrinsic value of options exercised in 2012 was $29,972. The tax benefit recognized from stock option exercises in 2013 and 2012 was not significant.

A summary of the status of the Company's non-vested options as of 12/31/13 and changes during the year ended December 31, 2013, is presented below:

Non-vested options	Options	Weighted Average Exercise Price
Non-vested at January 1, 2013	504,152	$ 6.74
New options granted	81,650	8.57
Vested	(140,027)	7.32
Forfeited	(67,750)	7.30
Non-vested at December 31, 2013	378,025	$ 7.13

As of December 31, 2013, the unrecognized compensation cost related to non-vested stock option awards totaled $357,798. That cost is expected to be amortized on a straight-line basis over a weighted average period of fourteen months. The total fair value of vested options was $489,552 at December 31, 2013. The expensed cost of vested options was $155,790, $216,353, and $226,010 in 2013, 2012 and 2011, respectively.

13. EMPLOYEE 401(k) PROFIT SHARING PLAN

The Bank adopted The Private Bank of the Peninsula 401(k) Profit Sharing Plan and Trust, effective October 28, 2003. All employees 21 years of age or older become eligible to participate in the plan on the first day of the month following employment with the Bank. Eligible employees may elect to make tax deferred contributions of their salary up to the maximum amount allowed by law. The Bank may make additional contributions to the plan at the discretion of the Board of Directors. Bank contributions vest at a rate of 25% annually for all employees. Bank contributions for the years ended December 31, 2013, 2012 and 2011 totaled $132,312, $120,844 and $57,497, respectively.

14. RELATED PARTY TRANSACTIONS

During the normal course of business, the Company enters into transactions with related parties, including directors and officers. The following is a summary of the aggregate activity involving related party borrowers during 2013:

Balance, January 1, 2013	$ 5,247,923
Additions	1,650
Amounts repaid	(785,721)
Balance, December 31, 2013	$ 4,463,852
Undisbursed commitments to related parties, December 31, 2013	$ 3,350

15. OTHER EXPENSES

Other expenses for the years ended December 31, 2013, 2012 and 2011 consisted of the following:

	2013	2012	2011
Data processing	$ 427,159	$ 358,451	$ 320,236
Advertising and marketing	239,675	220,717	254,782
Supplies and printing	57,378	37,605	49,025
Professional fees	452,050	271,697	420,862
Legal fees	186,765	94,484	134,004
Director's fees	205,000	117,750	159,750
Insurance and bonding	59,395	70,604	79,161
FDIC and DFI assessments	430,079	408,292	594,181
Credit reports and appraisals	28,106	11,218	22,465
Correspondent bank charges	276,077	262,314	168,217
Off-balance sheet loss provision	-	65,450	50,278
Other	432,516	600,569	417,536
Total other expenses	$ 2,794,200	$ 2,519,151	$ 2,670,497

16. FAIR VALUE

The Company discloses the fair value of financial instruments for which it is practicable to estimate that value. Although management uses its best judgment in estimating fair value, there are inherent weaknesses in any estimates that are made at a discrete point in time based on relevant market data, information about the financial instruments, and other factors. Estimates of fair value of instruments without quoted market prices are subjective in nature and involve various assumptions and estimates that are matters of judgment. Changes in the assumptions used could significantly affect these estimates.

Fair Value Hierarchy

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

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

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

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

Management monitors the availability of observable market data to assess the appropriate classification of financial instruments within the fair value hierarchy. Changes in economic conditions or model-based valuation techniques may require the transfer of financial instruments from one fair value level to another. In such instances, the transfer is reported at the beginning of the reporting period.

Management evaluates the significance of transfers between levels based upon the nature of the financial instrument and size of the transfer relative to total assets, total liabilities or total earnings.

Methods and assumptions used to estimate the fair value of each major classification of financial instruments were:

Cash and cash equivalents and Federal Funds sold: The current carrying amount approximates estimated fair value resulting in a Level 1 classification.

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

Available-for-sale investment securities and interest-bearing deposits in other banks: For available-for-sale investment securities and interest-bearing deposits in other banks, fair values are based on quoted market prices, where available (Level 1 classification). If quoted market prices are not available, fair values are estimated using quoted market prices for similar securities and deposits and indications of value provided by brokers (Level 2 classification).

16. FAIR VALUE (Continued)

Loans: Fair values of loans are estimated as follows: For variable rate loans that reprice frequently and with no significant change in credit risk, fair values are based on carrying values resulting in a Level 3 classification. Carrying value is calculated as the present value of expected cash flows and approximates fair value. Fair values for other loans are estimated using discounted cash flow analyses, using interest rates currently being offered for loans with similar terms to borrowers of similar credit quality resulting in a Level 3 classification. Impaired loans are initially valued at the lower of cost or fair value. Impaired loans carried at fair value generally receive specific allocations of the allowance for loan losses. For collateral dependent loans, fair value is commonly based on recent real estate appraisals. These appraisals may utilize a single valuation approach or a combination of approaches including comparable sales and the income approach. Adjustments are routinely made in the appraisal process by the independent appraisers to adjust for differences between the comparable sales and income data available. Such adjustments are usually significant and typically result in a Level 3 classification of the inputs for determining fair value. Non-real estate collateral may be valued using an appraisal, net book value per the borrower’s financial statements, or aging reports, adjusted or discounted based on management's historical knowledge, changes in market conditions from the time of the valuation, and management’s expertise and knowledge of the client and client’s business, resulting in a Level 3 fair value classification. Impaired loans are evaluated on a quarterly basis for additional impairment and adjusted accordingly. The methods utilized to estimate the fair value of loans do not necessarily represent an exit price.

The carrying amounts of accrued interest receivable and payable are consistent with the asset/liability they are associated with.

Customer deposits: The fair values disclosed for demand deposits (e.g., interest and non-interest checking, passbook savings, and certain types of money market accounts) are, by definition, equal to the amount payable on demand at the reporting date (i.e., their carrying amount) resulting in a Level 1 classification. The carrying amounts of variable rate, fixed-term money market accounts and certificates of deposit approximate their fair values at the reporting date resulting in a Level 2 classification Fair values for fixed rate certificates of deposit are estimated using a discounted cash flows calculation that applies interest rates currently being offered on certificates to a schedule of aggregated expected monthly maturities on time deposits resulting in a Level 2 classification.The intangible value of long term relationships with depositors is not taken into account in estimating the fair values disclosed. Management believes that the Bank's non-term accounts, as a continuing source of less costly funds, provide significant additional value to the Bank that is not reflected below. The fair value of deposits with a stated maturity is based on the present value of contractual cash flows discounted by the replacement rates for securities with similar remaining maturities.

Commitments to extend credit: The majority of the Bank's commitments to extend credit carry current market interest rates if converted to loans. Because these commitments are generally unassignable by either the Bank or the borrower, they have value only to the Bank and the borrower. The estimated fair value of the Bank's commitments to extend credit, including letters of credit, approximates the recorded deferred fee amounts and was not material at December 31, 2013 or 2012.

16. FAIR VALUE (Continued)

The carrying amounts and estimated fair values of financial instruments, at December 31, 2013 and December 31, 2012 are as follows:

	Carrying Amount	Fair Value Measurements at 12/31/2013 Using: Level 1	Level 2	Level 3	Total
Financial assets:					
Cash and due from banks	$ 16,905,371	$ 16,905,371	$ -	$ -	$ 16,905,371
Federal funds sold	151,940,000	151,940,000	-	-	151,940,000
Available-for-sale investment securities	58,983,000	-	58,983,000	-	58,983,000
Loans	252,645,904	-	-	255,276,519	255,276,519
Federal Home Loan Bank stock	3,290,000	NA	NA	NA	NA
Accrued interest receivable	1,131,796	-	427,200	704,596	1,131,796
Financial liabilities:					
Deposits	450,304,132	399,679,556	51,023,339	-	450,702,895
Accrued interest payable	21,428	6	21,422	-	21,428

	Carrying Amount	Fair Value Measurements at 12/31/2012 Using: Level 1	Level 2	Level 3	Total
Financial assets:					
Cash and due from banks	$ 21,492,778	$ 21,492,778	$ -	$ -	$ 21,492,778
Federal funds sold	85,510,000	85,510,000	-	-	85,510,000
Available-for-sale investment securities	55,343,000	-	55,343,000	-	55,343,000
Loans	242,788,866	-	-	248,649,099	248,649,099
Federal Home Loan Bank stock	1,497,300	NA	NA	NA	NA
Accrued interest receivable	1,203,932	-	434,974	768,958	1,203,932
Financial liabilities:					
Deposits	$ 374,993,911	$ 308,473,973	$ 66,911,604	$ -	$ 375,385,578
Accrued interest payable	59,743	6	59,737	-	59,743

16. FAIR VALUE (Continued)

Assets Recorded at Fair Value

The following tables present information about the company's assets and liabilities measured at fair value on a recurring and nonrecurring basis as of December 31, 2013 and December 31, 2012:

Recurring Basis

The Company is required or permitted to record the following assets at fair value on a recurring basis as follows:

	2013			
Description	Fair Value	Level 1	Level 2	Level 3
U.S. Agencies	$ 5,493,000	$ -	$ 5,493,000	$ -
U.S. Govt. Sponsored Agencies	5,779,000	-	5,779,000	-
Residential Mortgage-Backed Securities	15,439,000	-	15,439,000	-
Municipal Tax-Exempt Securities	1,174,000	-	1,174,000	-
Corporate Debt Securities	31,098,000	-	31,098,000	-
Available-for-sale securities	$ 58,983,000	$ -	$ 58,983,000	$ -

	2012			
Description	Fair Value	Level 1	Level 2	Level 3
U.S. Agencies	$ 6,234,000	$ -	$ 6,234,000	$ -
U.S. Govt. Sponsored Agencies	9,949,000	-	9,949,000	-
Residential Mortgage-Backed Securities	6,426,000	-	6,426,000	-
Corporate Debt Securities	32,734,000	-	32,734,000	-
Available-for-sale securities	$ 55,343,000	$ -	$ 55,343,000	$ -

Fair values for available-for-sale investment securities are based on quoted market prices for similar securities (Level 2). During the years ended December 31, 2013 and December 31, 2012, there were no significant transfers in or out of Levels 1,2 or 3.

16. FAIR VALUE (Continued)

Non-recurring Basis

The Company may be required, from time to time, to measure certain assets and liabilities at fair value on a non-recurring basis. At December 31, 2013 and 2012, the impairment calculations of all impaired loans held by the Company were based on a discounted cash flow analysis, as the loan was determined to not be collateral dependent. As such, at December 31, 2013 and 2012, the Company had no assets whose fair value was determined on a non-recurring basis.

The Company did not identify any liabilities that are required to be presented at fair value at December 31, 2013 or 2012.

17. PARENT ONLY CONDENSED FINANCIAL STATEMENTS

PARENT ONLY BALANCE SHEETS
December 31, 2013 and 2012

ASSETS

	2013	2012
Cash and cash equivalents	$ 1,120,560	$ 104,366
Investment in Bank subsidiary	46,911,768	37,758,533
Total assets	$ 48,032,328	$ 37,862,899

LIABILITIES AND SHAREHOLDERS' EQUITY

	2013	2012
Preferred stock	$ -	$ 5,951,578
Common stock	42,249,735	27,618,879
Additional paid-in capital	2,280,997	1,936,976
Retained earnings	3,468,924	1,171,133
Accumulated other comprehensive income, net of taxes	32,672	1,184,333
Total shareholders' equity	48,032,328	37,862,899
Total liabilities and shareholders' equity	$ 48,032,328	$ 37,862,899

PARENT ONLY STATEMENTS OF INCOME
For the years ending December 31, 2013 and 2012

	2013	2012
INCOME		
Dividends declared by subsidiary - eliminated in consolidation	$ 162,276	$ 300,000
Other income	6,680	-
Total income	168,956	300,000
EXPENSES	-	-
Income before undistributed net income of subsidiary	168,956	300,000
Equity in undistributed net income of subsidiary	2,339,487	2,444,714
Net income	$ 2,508,443	$ 2,744,714

17. PARENT ONLY CONDENSED FINANCIAL STATEMENTS (Continued)

PARENT ONLY STATEMENT OF CASH FLOWS
For the Years Ended December 31, 2013 and 2012

	2013	2012
Cash flows from operating activities:		
Net income	$ 2,508,443	$ 2,744,714
Adjustments to reconcile net income to net cash provided by operating activities:		
Warrant income	6,680	-
Undistributed net income of subsidiary	(2,339,487)	(2,444,714)
Net cash provided by operating activities	175,636	300,000
Cash flows from investing activities:		
Investment in subsidiary bank	(8,000,000)	-
Net cash (used in) investing activities	(8,000,000)	-
Cash flows from financing activities:		
Proceeds from issuance of common stock	14,821,683	-
Redemption of preferred stock	(6,000,000)	-
Proceeds from exercise of employee stock options	187,831	78,266
Cash dividends paid	(168,956)	(300,000)
Net cash provided by (used in) financing activities	8,840,558	(221,734)
Increase in cash and cash equivalents	1,016,194	78,266
Cash and cash equivalents at beginning of period	104,366	26,100
Cash and cash equivalents at end of year	$ 1,120,560	$ 104,366

OFFICERS and DIRECTORS

OFFICERS

Mark D. Mordell
Chairman and Chief Executive Officer

Ronald E. Oliveira
President and Chief Credit Officer

Steve Leen
Executive Vice President and Chief Financial Officer

Dori Hamilton
Executive Vice President and Chief Banking Officer

Kenneth D. Brenner
Head of Strategic Relationships

Larry LaCroix
Executive Vice President - Corporate Finance

Mark V. Schoenstein
Executive Vice President, Manager - Construction Lending

Nicole L. Bader
Senior Vice President - Senior Loan Officer

Lisa O. Felleman
Senior Vice President and Controller

Chris Greene
Senior Vice President - Corporate Banking

Jeffrey Javier
Senior Vice President - Relationship Manager

Jon Krogstad
Senior Vice President - Relationship Manager

Joe Maleti
Senior Vice President - Commercial Real Estate Lending

Fergal J. O'Boyle
Senior Vice President - Construction Lending

Patrick K. Pierce
Senior Vice President - Credit Administration

Gina Stephens
Senior Vice President - BSA Officer

Susan J. Wells
Senior Vice President - Relationship Manager

Sarah Wesner
Senior Vice President - Corporate Banking

DIRECTORS

Mark D. Mordell, Chairman

Kenneth D. Brenner

Kristofer W. Biorn

David V. Campbell

Lisa B. Hendrickson

Bryan C. Polster

Roxy H. Rapp

Daniel P. Vetras

Avidbank Holdings, Inc., headquartered in Palo Alto, California offers innovative financial solutions and services. We specialize in the following markets: commercial & industrial, corporate finance, asset-based lending, real estate construction and commercial real estate lending, and real estate bridge financing.

Avidbank advances the success of our clients by providing them with financial opportunities and serving them as we wish to be served - with mutual effort, ingenuity and trust - creating long-term banking relationships.

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