# THE PRIVATE BANK OF THE PENINSULA

## FINANCIAL STATEMENTS

## AS OF DECEMBER 31, 2007 AND 2006 AND

## FOR THE YEARS ENDED

## DECEMBER 31, 2007, 2006 AND 2005

## AND

## INDEPENDENT AUDITOR'S REPORT

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## INDEPENDENT AUDITOR'S REPORT

The Shareholders and
Board of Directors
The Private Bank of the Peninsula

We have audited the accompanying balance sheet of The Private Bank of the Peninsula as of December 31, 2007 and 2006 and the related statements of operations, changes in shareholders' equity and cash flows for each of the years in the three-year period ended December 31, 2007. These financial statements are the responsibility of the Bank's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of The Private Bank of the Peninsula as of December 31, 2007 and 2006 and the results of its operations and its cash flows for each of the years in the three-year period ended December 31, 2007, in conformity with accounting principles generally accepted in the United States of America.

Perry-Smith LLP

February 19, 2008

**THE PRIVATE BANK OF THE PENINSULA**
**BALANCE SHEET**
**December 31, 2007 and 2006**

| | 2007 | 2006 |
|---|---|---|
| **ASSETS** | | |
| Cash and cash equivalents | $ 7,631,417 | $ 2,862,867 |
| Federal funds sold | 16,890,000 | 13,030,000 |
| Total cash and cash equivalents | 24,521,417 | 15,892,867 |
| Interest bearing deposits in other banks | 4,845,000 | 2,600,000 |
| Available-for-sale investment securities (Note 2) | 22,066,000 | 8,542,600 |
| Loans, less allowance for loan losses of $1,536,534 in 2007 and $987,010 in 2006 (Notes 3 and 9) | 144,254,463 | 91,270,841 |
| Bank property and equipment, net (Note 4) | 651,828 | 579,103 |
| Cash surrender value of life insurance policies (Note 5) | 2,880,575 | 2,773,571 |
| Accrued interest receivable and other assets | 1,231,555 | 813,027 |
| Total Assets | $ 200,450,838 | $ 122,472,009 |
| **LIABILITIES AND SHAREHOLDERS' EQUITY** | | |
| Deposits: | | |
| Non-interest bearing | $ 29,495,022 | $ 22,635,234 |
| Interest bearing (Note 6) | 154,722,017 | 85,257,033 |
| Total deposits | 184,217,039 | 107,892,267 |
| Accrued interest payable and other liabilities | 653,055 | 448,586 |
| Total liabilities | 184,870,094 | 108,340,853 |
| Commitments (Note 9) | | |
| Shareholders' equity (Note 10 and 11): | | |
| Preferred stock - no par value; 5,000,000 shares authorized, no shares issued or outstanding | - | - |
| Common stock - no par value; 5,000,000 shares authorized; 1,889,375 and 1,864,125 shares issued and outstanding in 2007 and 2006, respectively | 18,857,568 | 18,580,525 |
| Additional paid-in capital | 548,677 | 320,401 |
| Accumulated deficit | (3,892,894) | (4,731,579) |
| Accumulated other comprehensive loss (Note 2) | 67,393 | (38,191) |
| Total shareholders' equity | 15,580,744 | 14,131,156 |
| | $ 200,450,838 | $ 122,472,009 |

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

**THE PRIVATE BANK OF THE PENINSULA**
**STATEMENT OF OPERATIONS**
**For the Years Ended December 31, 2007, 2006 and 2005**

| | 2007 | 2006 | 2005 |
|---|---|---|---|
| Interest income: | | | |
| Interest and fees on loans | $ 9,164,338 | $ 5,327,949 | $ 2,437,478 |
| Interest on Federal funds sold | 1,353,294 | 553,753 | 234,576 |
| Interest on investment securities | 535,586 | 629,333 | 598,486 |
| Total interest income | 11,053,218 | 6,511,035 | 3,270,540 |
| Interest expense: | | | |
| Interest on deposits (Note 6) | 4,745,586 | 2,114,630 | 770,036 |
| Net interest income | 6,307,632 | 4,396,405 | 2,500,504 |
| Provision for loan losses (Note 3) | 549,524 | 456,774 | 196,833 |
| Net interest income after provision for loan losses | 5,758,108 | 3,939,631 | 2,303,671 |
| Non-interest income: | | | |
| Service charges, fees and other income | 107,681 | 24,766 | 27,791 |
| Appreciation in cash surrender value of insurance contracts (Note 5) | 107,004 | 98,135 | 98,065 |
| Total non-interest income | 214,685 | 122,901 | 125,856 |
| Non-interest expenses: | | | |
| Salaries and employee benefits (Note 12) | 3,036,416 | 2,326,792 | 1,808,310 |
| Occupancy and equipment (Notes 4 and 9) | 873,625 | 657,008 | 580,108 |
| Other (Notes 4 and 14) | 1,224,067 | 1,305,840 | 871,135 |
| Total other expenses | 5,134,108 | 4,289,640 | 3,259,553 |
| Income before provision for income taxes | 838,685 | (227,107) | (830,026) |
| Provision for income taxes (Note 7) | - | - | - |
| Net income (loss) | $ 838,685 | $ (227,108) | $ (830,026) |
| Basic income (loss) per share (Note 10) | $ 0.45 | $ (0.12) | $ (0.45) |
| Diluted income (loss) per share (Note 10) | $ 0.43 | $ (0.12) | $ (0.45) |

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

**THE PRIVATE BANK OF THE PENINSULA**
**STATEMENT OF CHANGES IN SHAREHOLDERS' EQUITY**
**For the Years Ended December 31, 2007, 2006 and 2005**

| | Common Stock | | Additional | Accumulated | Accumulated Other Comprehensive | Total Shareholders' | Total Comprehensive |
|---|---|---|---|---|---|---|---|
| | Shares | Amount | Paid-in Capital | Deficit | Income (Loss) | Equity | Income(Loss) |
| Balance, January 1, 2005 | 1,843,000 | 18,418,025 | 101,065 | (3,674,445) | (92,735) | 14,751,910 | |
| Comprehensive loss: | | | | | | | |
| Net loss | | | | (830,026) | | (830,026) | $ (830,026) |
| Net change in unrealized losses on available-for-sale investment securities | | | | | (46,514) | (46,514) | (46,514) |
| Total comprehensive loss | | | | | | | $ (876,540) |
| Stock options exercised | 9,625 | 96,250 | | | | 96,250 | |
| Stock based compensation (Notes 1 and 11) | | | 105,667 | | | 105,667 | |
| Balance, December 31, 2005 | 1,852,625 | 18,514,275 | 206,732 | (4,504,471) | (139,249) | 14,077,287 | |
| Comprehensive loss: | | | | | | | |
| Net loss | | | | (227,108) | | (227,108) | $ (227,108) |
| Net change in unrealized losses on available-for-sale investment securities | | | | | 101,058 | 101,058 | 101,058 |
| Total comprehensive loss | | | | | | | $ (126,050) |
| Stock options exercised | 11,500 | 66,250 | | | | 66,250 | |
| Stock based compensation (Notes 1 and 11) | | | 113,669 | | | 113,669 | |
| Balance, December 31, 2006 | 1,864,125 | 18,580,525 | 320,401 | (4,731,579) | (38,191) | 14,131,156 | |
| Comprehensive income: | | | | | | | |
| Net income | | | | 838,685 | | 838,685 | $ 838,685 |
| Net change in unrealized losses on available-for-sale investment securities | | | | | 105,584 | 105,584 | 105,584 |
| Total comprehensive income | | | | | | | $ 944,269 |
| Stock options exercised | 25,250 | 277,043 | | | | 277,043 | |
| Stock based compensation (Notes 1 and 11) | | | 228,276 | | | 228,276 | |
| Balance, December 31, 2007 | 1,889,375 | $ 18,857,568 | $ 548,677 | $ (3,892,894) | $ 67,393 | $ 15,580,744 | |

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

## THE PRIVATE BANK OF THE PENINSULA
## STATEMENT OF CASH FLOWS
### For the Years Ended December 31, 2007, 2006 and 2005

| | 2007 | 2006 | 2005 |
|---|---|---|---|
| Cash flows from operating activities: | | | |
| Net income (loss) | $ 838,685 | $ (227,108) | $ (830,026) |
| Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities: | | | |
| Loss on disposal of equipment | 6,187 | 7,327 | - |
| Provision for loan losses | 549,524 | 456,774 | 196,833 |
| Depreciation, amortization and accretion | 205,452 | 284,639 | 433,847 |
| Decrease(increase) in deferred loan fees and origination costs, net | 18,992 | (54,220) | 11,990 |
| Net increase in cash value of life insurance policies | (107,004) | (98,135) | (98,065) |
| Stock option compensation expense | 228,276 | 113,669 | 105,667 |
| Increase in accrued interest receivable and other assets | (418,555) | (170,741) | (258,534) |
| Increase in accrued interest payable and other liabilities | 204,468 | 256,389 | 31,404 |
| Net cash provided by (used in) operating activities | 1,526,025 | 568,594 | (406,884) |
| Cash flows used in investing activities: | | | |
| Purchase of available-for-sale investment securities | (21,993,541) | (3,000,000) | (10,000,000) |
| Proceeds from sales or calls of available-for-sale investment securities | 3,000,000 | - | - |
| Proceeds from maturities of available-for-sale investment securities | 5,550,000 | 10,950,000 | 8,500,000 |
| Net (increase)decrease in interest bearing deposits in other banks | (2,245,000) | 1,500,000 | (4,100,000) |
| Net increase in loans | (53,552,138) | (41,782,504) | (21,084,185) |
| Purchase of premises and equipment | (258,612) | (222,336) | (28,741) |
| Net cash used in investing activities | (69,499,291) | (32,554,840) | (26,712,926) |
| Cash flows from financing activities: | | | |
| Net increase in demand, interest bearing and savings deposits | 63,017,065 | 13,411,834 | 15,685,331 |
| Net increase in time deposits | 13,307,707 | 26,993,585 | 12,809,767 |
| Proceeds from exercise of stock options | 277,044 | 66,250 | 96,250 |
| Net cash provided by financing activities | 76,601,816 | 40,471,669 | 28,591,348 |
| Increase in cash and cash equivalents | 8,628,550 | 8,485,423 | 1,471,538 |
| Cash and cash equivalents at beginning of period | 15,892,867 | 7,407,444 | 5,935,906 |
| Cash and cash equivalents at end of year | $ 24,521,417 | $ 15,892,867 | $ 7,407,444 |
| Supplemental disclosure of cash flow information: | | | |
| Cash paid during the year for: | | | |
| Interest expense | 4,635,791 | 2,006,597 | 756,254 |
| Non-cash investing activities: | | | |
| Net change in unrealized gain(loss) on available-for-sale investment securities | 105,584 | 101,058 | (46,514) |

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

## 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

General

On September 6, 2002, the organizers of The Private Bank of the Peninsula (the "Bank") filed an application with the Federal Deposit Insurance Corporation. The application was approved on March 21, 2003 and the Bank opened for business on October 1, 2003. The Bank 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.

On December 20, 2007, the Board of Directors unanimously approved the formation of Peninsula Bank Holding Company (the "Holding Company") and the merger of the Bank into a wholly owned subsidiary of the Holding Company (the "Transaction"). The surviving entity will bear the name of The Private Bank of the Peninsula and former shareholders of the Bank will have their stock exchanged on a one for one basis with stock of the Holding Company. The Transaction was approved by the Federal Reserve Board on January 24, 2008.

The accounting and reporting policies of the Bank conform with accounting principles generally accepted in the United States of America and prevailing practices within the banking industry.

Use of Estimates

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

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.

Investment Securities

Investment securities are classified into the following categories:

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

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

Management determines the appropriate classification of its investments at the time of purchase and may only change the classification in certain limited circumstances. All transfers between categories are accounted for at fair value. All securities are classified as available-for-sale and there were no transfers between categories.

## 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Investment Securities (continued)

Gains and losses on the sale of securities are computed using the specific identification method. Interest earned on investment securities is reported in interest income, net of applicable adjustments for accretion of discounts and amortization of premiums. In addition, unrealized losses that are other than temporary are recognized in earnings for all investments.

Investment securities are evaluated for impairment on at least a quarterly basis and more frequently when economic or market conditions warrant such an evaluation to determine whether a decline in their value is other than temporary. Management utilizes criteria such as the magnitude and duration of the decline and the intent and ability of the Bank to retain its investment in the issues for a period of time sufficient to allow for an anticipated recovery in fair value, in addition to the reasons underlying the decline, to determine whether the loss in value is other than temporary. The term "other than temporary" is not intended to indicate that the decline is permanent, but indicates that the prospects for a near-term recovery of value are not necessarily favorable, or that there is a lack of evidence to support a realizable value equal to or greater than the carrying value of the investment. Once a decline in value is determined to be other than temporary, the value of the security is reduced and a corresponding charge to earnings is recognized.

Loans

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

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

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.

Loans held for sale, loan sales and servicing

The Bank accounts for the transfer and servicing of financial assets based on the financial and servicing assets it controls and liabilities it has incurred, derecognizes financial assets when control has been surrendered, and derecognizes liabilities when extinguished.

## 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Loans held for sale, loan sales and servicing (continued)

The Bank may from time to time originate loans that are either held for sale or sold in the secondary market. Loans held-for-sale are carried at the lower of cost or market value. Market value is determined by the specific identification method as of the balance sheet date or the date which the purchasers have committed to purchase the loans. At the time the loan is sold, the related right to service the loan is either retained, with the Bank earning future servicing income, or released in exchange for a one-time servicing-released premium. Loans subsequently transferred to the loan portfolio are transferred at the lower of cost or market value at the date of transfer. Any difference between the carrying amount of the loan and its outstanding principal balance is recognized as an adjustment to yield by the interest method. The Bank did not have any loans held for sale or servicing assets at December 31, 2007 or 2006. The Bank sold one loan in 2007 for which it would be required to repay the premium should there be substantial repayment within 90 days of sale.

Allowance for Loan Losses

The allowance for loan losses is maintained to provide for losses related to impaired loans and other losses that can be expected to occur in the normal course of business. The determination of the allowance is based on estimates made by management, to include consideration of the character of the loan portfolio, specifically identified problem loans, potential losses inherent in the portfolio taken as a whole and economic conditions in the Bank's service area.

Loans determined to be impaired or classified are individually evaluated by management for specific risk of loss. In addition, reserve factors are assigned to currently performing loans based on management's assessment of the following for each identified loan type: (1) inherent credit risk, (2) historical losses and, (3) where the Bank has not experienced losses, the loss experience of peer banks. Management also computes specific and expected loss reserves for loan commitments. These estimates are particularly susceptible to changes in the economic environment and market conditions.

The Bank's Loan Committee and Board review the adequacy of the allowance for loan losses at least quarterly, to include consideration of the relative risks in the portfolio and current economic conditions. The allowance is adjusted based on that review if, in the judgment of the Loan Committee, management and Board, changes are warranted.

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. The allowance for loan losses at December 31, 2007 and 2006 reflects management's estimate of possible losses in the portfolio.

Reserve for Undisbursed Loan Commitments

The Bank 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 and applies the factor to the unused portion of undisbursed lines of credit. This reserve totaled $203,000 and $137,000 at December 31, 2007 and 2006, respectively, and is included in accrued interest payable and other liabilities on the balance sheet.

## 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

### Bank Property and Equipment

Bank property and equipment are carried at cost. Depreciation is determined using the straight line method over the estimated useful lives of the related assets. The useful lives of furniture, fixtures and equipment are estimated to be 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.

### Income Taxes

Deferred tax assets and liabilities are recognized for the tax consequences of temporary differences between reported amounts 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. A valuation allowance is recognized if, based on the weight of available evidence, management believes it is more likely than not that some portion or all of the deferred tax asset will not be realized.

On January 1, 2007 the Bank adopted Financial Accounting Standards Board (FASB) Interpretation No. 48, *Accounting for Uncertainty in Income Taxes* (FIN 48). FIN 48 clarifies the accounting for uncertainty in income taxes recognized in an enterprise's financial statements in accordance with FASB Statement No. 109, *Accounting for Income Taxes*. FIN 48 prescribes a recognition threshold and measurement standard for the financial statement recognition and measurement of an income tax position taken or expected to be taken in a tax return. In addition, FIN 48 provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure and transition.

The provisions of FIN 48 have been applied to all tax positions of the Bank as of January 1, 2007. Only tax positions that met the more-likely-than-not recognition threshold on January 1, 2007 were recognized or continue to be recognized upon adoption. The Bank previously recognized income tax positions based on management's estimate of whether it was reasonably possible that a liability has been incurred for unrecognized income tax benefits by applying FASB Statement No. 5, *Accounting for Contingencies*. The adoption of FIN 48 did not have a material impact on the Bank's financial position, results of operations or cash flows.

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 50 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 is reflected as a liability for unrecognized tax benefits in the accompanying balance sheet along with any associated interest and penalties that would be payable to the taxing authorities upon examination.

## 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Income Taxes (continued)

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

Stock-Based Compensation

Effective January 1, 2006, the Bank adopted the disclosure requirements of the Statement of Financial Accounting Standards No. 123(R), *Share-Based Payment* (SFAS 123(R)). There were 183,500 options granted in 2007 and 107,500 granted in 2006. Prior to January 1, 2006, the Bank accounted for these plans under the recognition and measurement principles of SFAS 123 *Accounting for Stock-Based* Compensation, which requires the Bank to record compensation cost for all share-based payments based on the estimated grant date fair values of the options.

SFAS 123(R) requires the cash flows resulting from the tax benefits resulting from tax deductions in excess of the compensation cost recognized for those options (excess tax benefits) to be classified as a cash flow from financing in the statement of cash flows. There were no excess tax benefits for the years ended December 31, 2007 and 2006.

The Bank bases the fair value of the options previously granted 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 Bank's stock. The risk-free rate is based on the U.S. Treasury yield curve and the expected term of the options. The "simplified" method described in SEC Staff Accounting Bulletin No. 107 was used to determine the expected term of the Bank's options in 2007 and 2006.

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

| | 2007 | 2006 | 2005 |
|---|---|---|---|
| Dividend yield | 0.00% | 0.00% | 0.00% |
| Expected volatility | 20.73% | 13.29% | 12.50% |
| Risk-free interest rate | 4.64% | 4.65% | 3.96% |
| Expected option life | 4 years | 4 years | 4 years |

Earnings (Loss) Per Share

Basic earnings (loss) per share (EPS), which excludes dilution, is computed by dividing income (loss) 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 Bank. The treasury stock method is applied to determine the dilutive effect of stock options in computing diluted EPS. However, diluted EPS are not presented when a net loss occurs because the conversion of potential common stock is antidilutive.

## 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Comprehensive Income (Loss)

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

Impact of New Financial Accounting Standards

*Accounting for Deferred Compensation and Postretirement Benefit Aspects of Endorsement Split-Dollar Life Insurance Arrangements*

In September 2006, the FASB ratified the consensuses reached by the Emerging Issues Task Force (the Task Force) on Issue No. 06-4 (EITF 06-4) *Accounting for Deferred Compensation and Postretirement Benefit Aspects of Endorsement Split-Dollar Life Insurance Arrangements*. A question arose when an employer enters into an endorsement split-dollar life insurance arrangement related to whether the employer should recognize a liability for the future benefits or premiums to be provided to the employee. EITF 06-4 indicates that an employer should recognize a liability for future benefits and that a liability for the benefit obligation has not been settled through the purchase of an endorsement type policy. An entity should apply the provisions of EITF 06-4 either through a change in accounting principle through a cumulative-effect adjustment to retained earnings as of the beginning of the year of adoption or a change in accounting principle through retrospective application to all prior periods. The provisions of EITF 06-4 are effective for fiscal years beginning after December 15, 2007. The Bank adopted the provisions of EITF 06-04 on January 1, 2008 and management does not believe that its adoption will have a material impact on the Bank's financial position, results of operations or cash flows.

*Fair Value Measurements*

In September 2006, the FASB issued Statement No. 157 (SFAS 157), Fair Value Measurements. SFAS 157 defines fair value, establishes a framework for measuring fair value and expands disclosures about fair value measurements. SFAS 157 applies whenever other standards require (or permit) assets or liabilities to be measured at fair value but does not expand the use of fair value in any new circumstances. In this standard, the FASB clarifies the principle that fair value should be based on the assumptions market participants would use when pricing the asset or liability. In support of this principle, SFAS 157 establishes a fair value hierarchy that prioritizes the information used to develop those assumptions. The provisions of SFAS 157 are effective for financial statements issued for fiscal years beginning after November 15, 2007 and interim periods within those fiscal years. The provisions should be applied prospectively, except for certain specifically identified financial instruments. The Bank adopted SFAS 157 on January 1, 2008 and management does not expect its adoption to have a material impact on the Bank's financial position, results of operations or cash flows.

## 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

*The Fair Value Option for Financial Assets and Financial Liabilities*

In February 2007, the FASB issued Statement No. 159 (SFAS 159), *The Fair Value Option for Financial Assets and Financial Liabilities - including an Amendment of FASB Statement No. 115.* This standard permits an entity to choose to measure many financial instruments and certain other items at fair value at specified election dates. The entity will report unrealized gains and losses on items for which the fair value option has been elected in earnings at each subsequent reporting date. The fair value option (a) may be applied instrument by instrument, with a few exceptions, such as investments otherwise accounted for by the equity method, (b) is irrevocable (unless a new election date occurs), and (c) is applied only to entire instruments and not to portions of instruments. The Bank adopted SFAS 159 on January 1, 2008 and management did not elect the fair value option for any of its financial instruments. There was no impact on the financial results of the Bank as a result of adoption.

## 2. AVAILABLE-FOR-SALE INVESTMENT SECURITIES

The amortized cost and estimated fair value of available-for-sale investment securities at December 31, 2007 and 2006 consisted of the following:

| | 2007 | | | |
|---|---|---|---|---|
| | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Estimated Fair Value |
| Debt securities: | | | | |
| U.S. Treasuries | $ 14,997,906 | $ 1,394 | $ - | $ 14,999,300 |
| U.S. Sponsored Agencies | 7,000,701 | 65,999 | - | 7,066,700 |
| Total debt securities | $ 21,998,607 | $ 67,393 | $ - | $ 22,066,000 |

| | 2006 | | | |
|---|---|---|---|---|
| | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Estimated Fair Value |
| Debt securities: | | | | |
| U.S. Treasuries | $ 2,998,980 | $ - | $ (17,680) | $ 2,981,300 |
| U.S. Sponsored Agencies | 2,999,969 | - | (2,169) | 2,997,800 |
| Corporate bonds | 2,581,842 | - | (18,342) | 2,563,500 |
| Total debt securities | $ 8,580,791 | $ - | $ (38,191) | $ 8,542,600 |

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

Net unrealized gains(losses) on available-for-sale investment securities totaling $105,584 and $101,058 were recorded as other comprehensive income within shareholders' equity at December 31, 2007and 2006, respectively. Related tax assets and liabilities were not considered material for disclosure purposes.

Proceeds from the call of available-for-sale investment securities totaled $3,000,000 and there were no resulting gains or losses in the year ended December 31, 2007. There were no sales or calls of available-for-sale investment securities in the years ended December 31, 2006 or 2005.

The amortized cost and estimated fair value of investment securities at December 31, 2007 by contractual maturity are shown on the following page. 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.

Debt Securities by Contractual Maturity

| | Amortized Cost | Estimated Fair Value |
|---|---|---|
| Within one year | $ 14,997,906 | $ 14,999,300 |
| After one year through five years | 7,000,701 | 7,066,700 |
| Total debt securities | $ 21,998,607 | $ 22,066,000 |

Investment securities with amortized costs totaling $7,000,716 and fair values of $7,066,700 were pledged to secure public deposits at December 31, 2007. Investment securities with amortized costs totaling $4,498,929 and fair values of $4,480,166 were pledged to secure public deposits at December 31, 2006.

There were no investment securities with unrealized losses at December 31, 2007. Investment securities with unrealized losses at December 31, 2006 are summarized and classified according to the duration of the loss period as follows:

| | Less than 12 Months | | 12 Months or More | |
|---|---|---|---|---|
| Debt securities: | Fair Value | Unrealized Losses | Fair Value | Unrealized Losses |
| U.S. Treasuries | | | $ 2,981,300 | $ (17,680) |
| U.S. Sponsored Agencies | $ 2,997,800 | $ (2,169) | | |
| Corporate bonds | | | 2,563,500 | (18,342) |
| Total debt securities | $ 2,997,800 | $ (2,169) | $ 5,544,800 | $ (36,022) |

| | Total | |
|---|---|---|
| Debt securities: | Fair Value | Unrealized Losses |
| U.S. Treasuries | $ 2,981,300 | $ (17,680) |
| U.S. Sponsored Agencies | 2,997,800 | (2,169) |
| Corporate bonds | 2,563,500 | (18,342) |
| Total debt securities | $ 8,542,600 | $ (38,191) |

## 3. LOANS

Outstanding loans are summarized below:

| | December 31, 2007 | December 31, 2006 |
|---|---|---|
| Commercial | $ 29,132,983 | $ 19,597,061 |
| Construction | 34,652,448 | 23,976,836 |
| Real estate - residential | 21,686,222 | 13,779,953 |
| Real estate - commercial | 54,432,288 | 33,793,241 |
| Asset based lending | 2,209,146 | - |
| Other | 3,609,026 | 1,022,884 |
| Total outstanding loans | 145,722,113 | 92,169,975 |
| Deferred loan origination costs, net | 68,884 | 87,876 |
| Allowance for loan losses | (1,536,534) | (987,010) |
| Total loans net of reserve | $ 144,254,463 | $ 91,270,841 |

For the years ended December 31, 2007, 2006 and 2005, the Bank had no impaired loans or loans placed on nonaccrual status and there have been no losses charged to the allowance since inception.

Salaries and employee benefits totaling $439,541, $351,965 and $134,132 have been deferred as loan origination costs for the years ended December 31, 2007, 2006 and 2005.

## 4. BANK PROPERTY AND EQUIPMENT

Bank property and equipment consisted of the following:

| | December 31, 2007 | December 31, 2006 |
|---|---|---|
| Furniture and equipment | $ 536,124 | $ 500,863 |
| Leasehold improvements | 257,158 | 253,198 |
| Computer equipment | 471,476 | 265,761 |
| Gross property and equipment | 1,264,758 | 1,019,822 |
| Less accumulated depreciation and amortization | 612,930 | 440,719 |
| Property and equipment, net | $ 651,828 | $ 579,103 |

Depreciation included in occupancy and equipment expense totaled $179,701, $154,127and $136,161 for the years ended December 31, 2007,  2006 and 2005.

## 5. CASH SURRENDER VALUE OF LIFE INSURANCE POLICIES

During 2004, the Bank purchased single-premium life insurance policies on the lives of two key executives. Income earned on these policies, net of expenses, totaled $107,004, $98,135 and $98,065 for the years ended December 31, 2007, 2006 and 2005, respectively.

## 6. INTEREST-BEARING DEPOSITS

| Interest-bearing deposits consisted of the following: | December 31, 2007 | December 31, 2006 |
|---|---|---|
| NOW accounts | $ 18,218,380 | $ 12,758,501 |
| Savings | 367,639 | 170,879 |
| Money market | 78,003,506 | 27,502,868 |
| Time, $100,000 or more | 40,601,385 | 38,043,480 |
| Other time | 10,331,107 | 6,781,305 |
| Brokered Deposits | 7,200,000 | - |
| Total interest-bearing deposits | $ 154,722,017 | $ 85,257,033 |

Aggregate annual maturities of time deposits and brokered deposits are as follows:

| Year Ending December 31, | |
|---|---|
| 2008 | $ 57,954,249 |
| 2009 | 36,821 |
| 2010 | 131,422 |
| 2011 | - |
| 2012 | 10,000 |
| Total time deposits | $ 58,132,492 |

Interest expense recognized on interest-bearing deposits for the years ended December 31, 2007, 2006 and 2005 consisted of the following:

| | 2007 | 2006 | 2005 |
|---|---|---|---|
| NOW accounts | $ 217,066 | $ 80,104 | $ 37,458 |
| Savings | 4,889 | 822 | 956 |
| Money market | 2,031,532 | 692,992 | 334,457 |
| Time, $100,000 or more | 1,821,897 | 1,130,374 | 326,625 |
| Other time | 468,157 | 210,338 | 70,540 |
| Brokered Deposits | 202,045 | - | - |
| Total interest expense | $ 4,745,586 | $ 2,114,630 | $ 770,036 |

At December 31, 2007, the Bank had one deposit relationship that exceeded 5% of total deposits. The aggregate total of this deposit relationship was $17,345,935. At December 31, 2006, the Bank had no deposit relationships that exceeded 5% of total deposits.

## 7. INCOME TAXES

The provision for income taxes for the years ended December 31, 2007, 2006 and 2005 consisted of the following:

| 2007 | Federal | State | Total |
|---|---|---|---|
| Current | $ - | $ - | $ - |
| Deferred | 149,000 | (53,000) | (202,000) |
| Valuation allowance | (149,000) | 53,000 | 202,000 |
| Provision for income taxes | $ - | $ - | $ - |

| 2006 | Federal | State | Total |
|---|---|---|---|
| Current | $ - | $ - | $ - |
| Deferred | (179,000) | (60,000) | (239,000) |
| Valuation allowance | 179,000 | 60,000 | 239,000 |
| Provision for income taxes | $ - | $ - | $ - |

| 2005 | Federal | State | Total |
|---|---|---|---|
| Current | $ - | $ - | $ - |
| Deferred | 309,000 | 100,000 | 409,000 |
| Valuation allowance | (309,000) | (100,000) | (409,000) |
| Provision for income taxes | $ - | $ - | $ - |

Deferred tax assets (liabilities) at December 31, 2007 and 2006 consisted of the following:

| | 2007 | 2006 |
|---|---|---|
| Deferred tax assets: | | |
| Net operating losses | $ 1,424,000 | $ 1,808,000 |
| Allowance for credit losses | 712,000 | 375,000 |
| Organization costs | 60,000 | 140,000 |
| Other | 17,000 | 49,000 |
| Share-base compensation | 127,000 | 58,000 |
| Deferred tax assets before valuation allowance | 2,340,000 | 2,430,000 |
| Valuation allowance | (1,683,000) | (1,929,000) |
| Total deferred tax assets | 657,000 | 501,000 |
| Deferred tax liabilities: | | |
| Accrual to cash conversion | (287,000) | (185,000) |
| Loan origination costs | (191,000) | (144,000) |
| Other | (27,000) | - |
| Future liability of State deferred tax asset | (152,000) | (172,000) |
| Total deferred tax liabilities | (657,000) | (501,000) |
| Net deferred tax asset | $ - | $ - |

## 7. INCOME TAXES (Continued)

A valuation allowance is provided to reduce deferred tax assets to a level which, more likely than not, will be realized. Due to the initial losses recognized during the first three years of operations, a valuation allowance has been recorded for all of the Bank's deferred tax assets. The need for this valuation allowance will be periodically reviewed and benefits will be recognized when they are determined to be realizable.

At December 31, 2007, the Bank had Federal and State net operating loss carryforwards (NOLs) of $3,176,000 and $3,172,000, respectively. The Federal NOLs expire in 2023 and State NOLs expire in 2013.

Status of Open Tax Years

We are subject to U.S. Federal income tax as well as California state income tax. Federal income tax returns for 2004 through 2006 and California income tax returns for 2003 through 2006 are currently open for Federal or state income tax examinations. There are no unrecognized tax benefits at December 31, 2007.

## 8. SHORT-TERM BORROWING ARRANGEMENTS

The Bank has unsecured Federal funds lines of credit totaling $12 million with four of its correspondent banks. There were no borrowings outstanding under these agreements at December 31, 2007 and 2006.

## 9. COMMITMENTS

Operating Leases

The Bank leases its branch and an administration office under a noncancellable operating lease. The lease expires in 2013 and has two five-year renewal options. The Bank also leases office space for a loan production office on a neighboring block in downtown Palo Alto. The loan production office lease also expires in 2013 and has one five-year renewal option.

Future minimum lease payments are as follows:

| Year Ending December 31, | | |
|---|---|---|
| 2008 | $ | 455,874 |
| 2009 | | 468,625 |
| 2010 | | 481,905 |
| 2011 | | 495,456 |
| 2012 | | 509,380 |
| Thereafter | | 249,896 |
| Future minimum lease payments | $ | 2,661,136 |

Rental expense included in occupancy and equipment expense totaled $399,110, $291,207 and $266,034 for the years ended December 31, 2007, 2006 and 2005.

## 9. COMMITMENTS (Continued)

Federal Reserve Requirements

Banks are required to maintain reserves with the Federal Reserve Bank equal to a percentage of their reservable deposits. The average amount of such reserve balances required at December 31, 2007 was $712,000.

Financial Instruments With Off-Balance-Sheet Risk

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

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

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

| | December 31, | |
|---|---|---|
| | 2007 | 2006 |
| Commitments to extend credit | $ 57,021,441 | $ 41,345,371 |
| Standby letters of credit | $ 88,647 | $ 53,520 |

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. 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, 2007 and 2006. The Bank recognizes these fees as revenue over the term of the commitment or when the commitment is used.

At December 31, 2007, all loan commitments are for real estate mortgage and commercial loans and are generally secured by real estate with a loan-to-value ratio not to exceed 80%. In addition, the majority of the Bank's loan commitments have variable interest rates.

## 9. COMMITMENTS (Continued)

Significant Concentrations of Credit Risk

The Bank grants real estate mortgage, real estate construction, commercial and consumer loans to customers in San Mateo and Santa Clara Counties. Although the Bank 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 collectibility, however, a substantial decline in real estate values in the Bank's primary market area could have an adverse impact on the collectibility 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 Bank's real estate portfolio and by conservative underwriting.

At December 31, 2007, in management's judgment, a concentration of loans existed in construction and real estate related loans. At that date, approximately 76% of the Bank's loans were construction and real estate related, representing 24% and 52% of total loans, respectively.

At December 31, 2006, in management's judgment, a concentration of loans existed in construction and real estate related loans. At that date, approximately 78% of the Bank's loans were construction and real estate related, representing 26% and 52% of total loans, respectively.

Correspondent Banking Agreements

Tha Bank maintains funds on deposit with other federally insured financial institutions under correspondent banking agreements. Uninsured deposits totaled $5,194,885 at December 31, 2007.

## 10. SHAREHOLDERS' EQUITY

Dividends

Upon declaration by the Board of Directors, all shareholders of record will be entitled to receive dividends. The California Financial Code restricts the total dividend payment of any bank at any one time to the lesser of (1) the bank's retained earnings or (2) the bank's net income for its last three fiscal years, less distributions made to shareholders during the same three-year period. At December 31, 2007, no amounts were free of such restrictions.

**10. SHAREHOLDERS' EQUITY** (Continued)

Earnings(Loss) Per Share

A reconciliation of the numerators and denominators of the basic and diluted earnings(loss) per share computations for the years ended December 31, 2007, 2006, and 2005 is shown below:

| | Net Income (Loss) | Weighted Average Number of Shares Outstanding | Per Share Amount |
|---|---|---|---|
| December 31, 2007 | | | |
| Basic earnings per share | $ 838,685 | 1,873,107 | $ 0.45 |
| Effect of dilutive options | | 70,582 | |
| Diluted earnings per share | $ 838,685 | $ 1,943,689 | $ 0.43 |
| December 31, 2006 | | | |
| Basic loss per share | $ (227,108) | 1,856,943 | $ (0.12) |
| Effect of dilutive options | | | |
| Diluted loss per share | $ (227,108) | 1,856,943 | $ (0.12) |
| December 31, 2005 | | | |
| Basic loss per share | $ (830,026) | 1,848,625 | $ (0.45) |
| Effect of dilutive options | | | |
| Diluted loss per share | $ (830,026) | $ 1,848,625 | $ (0.45) |

Regulatory Capital

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

## 10. SHAREHOLDERS' EQUITY (Continued)

Regulatory Capital (Continued)

Quantitative measures established by regulation to ensure capital adequacy require 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 Bank meets all its capital adequacy requirements as of December 31, 2007 and 2006.

To be categorized as well capitalized, under the regulatory framework for prompt corrective actions, the Bank must maintain minimum total risk-based, Tier 1 risk-based and Tier 1 leverage ratios as set forth below:

| | 2007 | | 2006 | |
|---|---|---|---|---|
| | Amount | Ratio | Amount | Ratio |
| Leverage Ratio | | | | |
| The Private Bank of the Peninsula | $ 15,513,351 | 7.8% | $ 14,169,000 | 12.1% |
| Minimum requirement for "Well-Capitalized" institution | $ 9,953,869 | 5.0% | $ 5,839,000 | 5.0% |
| Minimum regulatory requirement | $ 7,963,095 | 4.0% | $ 4,671,000 | 4.0% |
| Tier 1 Risk-Based Capital Ratio | | | | |
| The Private Bank of the Peninsula | $ 15,513,351 | 9.4% | $ 14,169,000 | 12.5% |
| Minimum requirement for "Well-Capitalized" institution | $ 9,920,528 | 6.0% | $ 6,800,000 | 6.0% |
| Minimum regulatory requirement | $ 6,613,685 | 4.0% | $ 4,534,000 | 4.0% |
| Total Risk-Based Capital Ratio | | | | |
| The Private Bank of the Peninsula | $ 17,253,057 | 10.4% | $ 15,293,000 | 13.5% |
| Minimum requirement for "Well-Capitalized" institution | $ 16,534,213 | 10.0% | $ 11,335,000 | 10.0% |
| Minimum regulatory requirement | $ 13,227,370 | 8.0% | $ 9,068,000 | 8.0% |

## 11. SHARE-BASED PAYMENT

Stock Options

The Board of Directors adopted The Private Bank of the Peninsula 2003 Stock Option Plan that was subsequently approved by the shareholders. Under this plan, 552,900 shares of common stock are reserved for issuance to employees and Directors under incentive or nonstatutory agreements, of which 61,375 shares of common stock have been issued to date. The plan requires that the option price may not be less than the fair market value of the stock at the date the option is granted, and that the stock must be paid 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.

## 11. SHARE-BASED PAYMENT (Continued)

Stock Options (Continued)

A summary of option activity under the Plan for the years ended December 31, 2007 and 2006 follows:

| | Number of Stock Options Outstanding | Weighted Average Exercise Price | Weighted Average Remaining Contractual Term ( in Years) | Aggregate Intrinsic Value |
|---|---|---|---|---|
| Options outstanding at January 1, 2006 | 262,200 | $ 10.43 | | |
| Options granted | 107,500 | $ 14.24 | | |
| Options exercised | (26,500) | $ 10.00 | | |
| Options cancelled | (37,750) | $ 11.36 | | |
| Options outstanding at December 31, 2006 | 305,450 | $ 11.69 | | |
| Options granted | 183,500 | $ 15.27 | | |
| Options exercised | (25,250) | $ 10.97 | | |
| Options cancelled | (16,250) | $ 12.71 | | |
| Options outstanding at December 31, 2007 | 447,450 | $ 13.16 | 2.88 years | $ 642,988 |
| Options vested or expected to vest at December 31, 2007 | 412,176 | $ 13.01 | 2.79 years | $ 636,914 |
| Options exercisable at December 31, 2007 | 184,825 | $ 10.62 | 1.33 years | $ 604,981 |

The weighted-average grant-date fair value of options granted during 2007, 2006 and 2005 was $3.81, $2.92 and $2.50, respectively.

The total intrinsic value of options exercised in the years ended December 31, 2007, 2006 and 2005 was $97,106, $91,625 and $27,069, respectively.

Cash received from options exercised for the years ended December 31, 2007, 2006 and 2005 was $277,043, $66,250, and $96,250, respectively.

## 11. SHARE-BASED PAYMENT (Continued)

Stock Options (Continued)

A summary of the status of the Company's nonvested shares as of December 31, 2007 and changes during the year ended December 31, 2007, is presented below:

| Non-vested Shares | Shares | Weighted Average Exercise Price |
|---|---|---|
| Non-vested at January 1, 2007 | 164,237 | $ 13.00 |
| Granted | 183,500 | 15.27 |
| Vested | (68,862) | 11.66 |
| Cancelled | (16,250) | 12.71 |
| Non-vested at December 31, 2007 | 262,625 | $ 14.96 |

As of December 31, 2007, the unrecognized compensation cost related to non-vested stock option awards totaled $561,482. That cost is expected to be amortized on a straight-line basis over a weighted average period of 1.53 years and will be adjusted for subsequent changes in estimated forfeitures. The total fair value of vested options was $312,747 for the year ended December 31, 2007.

## 12. EMPLOYEE RETIREMENT 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 30 days of 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 20% annually for all employees. Bank contributions for the years ended December 31, 2007, 2006 and 2005 totaled $18,972, $17,099 and $14,423, respectively.

## 13. RELATED PARTY TRANSACTIONS

During the normal course of business, the Bank enters into transactions with related parties, including Directors and officers. These transactions include borrowings from the Bank with substantially the same terms, including rates and collateral, as loans to unrelated parties. The following is a summary of the aggregate activity involving related party borrowers during 2007:

| | |
|---|---|
| Balance, January 1, 2007 | $ 577,605 |
| Disbursements | 4,936,435 |
| Amounts repaid | (1,445,618) |
| Balance, December 31, 2007 | $ 4,068,422 |
| Undisbursed commitments to related parties, December 31, 2007 | $ 2,256,369 |

## 14. OTHER EXPENSES

Other expenses for the years ended December 31, 2007, 2006 and 2005 consisted of the following:

| | 2007 | 2006 | 2005 |
|---|---|---|---|
| Data processing | $ 173,461 | $ 170,734 | $ 155,180 |
| Advertising and marketing | 128,091 | 117,345 | 98,391 |
| Supplies and printing | 42,723 | 67,088 | 52,304 |
| Professional fees | 313,487 | 491,783 | 227,572 |
| Insurance and bonding | 54,327 | 49,736 | 53,373 |
| Other | 511,978 | 409,154 | 284,315 |
| Total Other Expenses | $ 1,224,067 | $ 1,305,840 | $ 871,135 |

## 15. FAIR VALUE OF FINANCIAL INSTRUMENTS

SFAS No. 107, "Disclosures about Fair Value of Financial Instruments," requires that the Bank disclose the fair value of financial instruments for which it is practicable to estimate that value. Although management uses its best judgement 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 judgement. Changes in the assumptions used could significantly affect these estimates.

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

Cash and cash equivalents: The current carrying amount approximates estimated fair value.

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. 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.

Loans: The carrying amount of loans is net of deferred loan fees or costs and the allowance for loan losses. To estimate the fair value of the Bank's loans, which are primarily adjustable rate and intermediate fixed rate commercial real estate and construction loans, the Bank segments each loan collateral type into categories based on maturity date.

Investments in life insurance: Both the carrying amount and the fair value of investments in life insurance reflect the total cash surrender value of each policy.

## 15. FAIR VALUE OF FINANCIAL INSTRUMENTS (Continued)

Customer deposits: The fair value of deposits with no stated term such as demand deposit accounts, NOW accounts, MMDA accounts and savings accounts is the carrying amount reported on the consolidated balance sheet. 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, 2007 or 2006.

| | December 31, 2007 | | December 31, 2006 | |
|---|---|---|---|---|
| | Carrying Amount | Fair Value | Carrying Amount | Fair Value |
| | (In thousands) | | | |
| Financial assets: | | | | |
| Cash and due from banks | $ 7,631 | $ 7,631 | $ 2,863 | $ 2,863 |
| Federal funds sold | 16,890 | 16,890 | 13,030 | 13,030 |
| Interest-bearing deposits in other banks | 4,845 | 4,845 | 2,600 | 2,600 |
| Available-for-sale investment securities | 22,066 | 22,066 | 8,543 | 8,543 |
| Loans | 144,254 | 145,426 | 91,271 | 90,871 |
| Bank owned life insurance | 2,881 | 2,881 | 2,774 | 2,774 |
| Accrued interest receivable | 904 | 904 | 618 | 618 |
| Financial liabilities: | | | | |
| Deposits | $ 184,217 | $ 183,962 | $ 107,892 | $ 108,036 |
| Accrued interest payable | 234 | 234 | 125 | 125 |