



Report of Independent Auditors  
and Financial Statements for

**People's Bank  
of Commerce  
(an Oregon Banking Corporation)**

December 31, 2015 and 2014

**MOSS-ADAMS<sub>LLP</sub>**

Certified Public Accountants | Business Consultants

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Note: These financial statements have not been reviewed or confirmed for accuracy or relevance by the Federal Deposit Insurance Corporation.

## REPORT OF INDEPENDENT AUDITORS

To the Board of Directors and Stockholders  
People's Bank of Commerce

### **Report on Financial Statements**

We have audited the accompanying financial statements of People's Bank of Commerce (an Oregon Banking Corporation) (the Bank) which comprise the balance sheets as of December 31, 2015 and 2014, and the related statements of income, comprehensive income, changes in stockholders' equity, and cash flows for the years then ended, and the related notes to the financial statements.

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

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

### ***Auditor's Responsibility***

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

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

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

## REPORT OF INDEPENDENT AUDITORS (continued)

### *Opinion*

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of People's Bank of Commerce as of December 31, 2015 and 2014, and the results of its operations and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

*Moss Adams LLP*

Portland, Oregon

March 8, 2016

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**PEOPLE'S BANK OF COMMERCE**  
**BALANCE SHEETS**

|   | December 31,   |                |
|---|----------------|----------------|
|   | 2015           | 2014           |
| <b>ASSETS</b>   |                |                |
| Cash and cash equivalents   | \$ 24,202,855  | \$ 17,213,278  |
| Time deposits with other institutions   | 1,245,000      | 5,975,912      |
| Investment securities   |                |                |
| Available-for-sale, at fair value   | 36,719,351     | 21,081,844     |
| Held to maturity, at cost   | 8,208,026      | 6,298,321      |
| Restricted equity securities  | 257,700        | 171,800        |
| Loans held-for-sale   | 2,392,600      | 1,073,500      |
| Loans, net of allowance for loan losses, and unearned income  | 158,383,959    | 145,582,432    |
| Premises, equipment, and leasehold improvements, net of accumulated depreciation and amortization   | 5,127,864      | 3,966,922      |
| Other real estate owned   | 3,275,081      | 3,394,939      |
| Bank-owned life insurance   | 5,430,258      | 5,377,816      |
| Investment in real estate joint venture   | 2,594,431      | 2,646,151      |
| Accrued interest receivable and other assets  | 2,536,861      | 2,009,294      |
| Total assets  | \$ 250,373,986 | \$ 214,792,209 |
| <b>LIABILITIES</b>  |                |                |
| Noninterest-bearing demand deposits   | \$ 86,745,258  | \$ 67,332,096  |
| Interest-bearing demand and money market accounts   | 100,316,531    | 93,503,901     |
| Savings deposits  | 12,805,092     | 11,579,338     |
| Time deposits   | 24,608,189     | 18,152,613     |
| Total deposits  | 224,475,070    | 190,567,948    |
| Accrued interest payable and other liabilities  | 1,871,995      | 1,706,576      |
| Total liabilities   | 226,347,065    | 192,274,524    |
| <b>COMMITMENTS AND CONTINGENCIES (Notes 9 and 11)</b>   |                |                |
| <b>STOCKHOLDERS' EQUITY</b>   |                |                |
| Common stock, \$5 par value, 4,000,000 shares authorized; 2,166,236 and 1,962,869 shares issued and outstanding at December 31, 2015 and 2014, respectively | 10,831,180     | 9,814,345      |
| Surplus   | 12,209,022     | 10,673,972     |
| Retained earnings   | 915,753        | 1,836,642      |
| Accumulated other comprehensive income  | 70,966         | 192,726        |
| Total stockholders' equity  | 24,026,921     | 22,517,685     |
| Total liabilities and stockholders' equity  | \$ 250,373,986 | \$ 214,792,209 |

# PEOPLE'S BANK OF COMMERCE

## STATEMENTS OF INCOME

|  | Years Ended December 31, |                     |
|--|--------------------------|---------------------|
|  | 2015                     | 2014                |
| <b>INTEREST INCOME</b>                               |                          |                     |
| Interest and fees on loans                           | \$ 8,032,518             | \$ 7,304,093        |
| Interest on investment securities                    | 640,962                  | 432,170             |
| Interest on federal funds sold                       | 56,307                   | 43,669              |
| Total interest income                                | <u>8,729,787</u>         | <u>7,779,932</u>    |
| <b>INTEREST EXPENSE</b>                              |                          |                     |
| Time deposit accounts                                | 221,763                  | 208,230             |
| Interest-bearing deposit and savings accounts        | 195,944                  | 167,212             |
| Other borrowings                                     | 15                       | 6,735               |
| Total interest expense                               | <u>417,722</u>           | <u>382,177</u>      |
| NET INTEREST INCOME BEFORE PROVISION FOR LOAN LOSSES | 8,312,065                | 7,397,755           |
| PROVISION FOR LOAN LOSSES                            | <u>76,999</u>            | <u>24,830</u>       |
| NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES  | <u>8,235,066</u>         | <u>7,372,925</u>    |
| <b>NONINTEREST INCOME</b>                            |                          |                     |
| Service charges and other fees                       | 808,269                  | 711,892             |
| Gain on sale of loans                                | 810,118                  | 679,249             |
| Mortgage brokerage fees                              | 54,726                   | 92,172              |
| Gain on sale of investment securities                | 49,618                   | 3,160               |
| Other noninterest income                             | 420,390                  | 213,550             |
| Total noninterest income                             | <u>2,143,121</u>         | <u>1,700,023</u>    |
| <b>NONINTEREST EXPENSE</b>                           |                          |                     |
| Salaries and employee benefits                       | 4,945,655                | 4,526,353           |
| Occupancy and equipment                              | 1,192,451                | 1,022,290           |
| Data processing                                      | 355,409                  | 340,229             |
| Advertising and promotional                          | 203,539                  | 201,036             |
| Loss (gain) on sale of other real estate owned       | 119,858                  | (32,407)            |
| Supplies   | 101,909                  | 95,576              |
| Other noninterest expense                            | 1,542,896                | 1,224,022           |
| Total noninterest expense                            | <u>8,461,717</u>         | <u>7,377,099</u>    |
| INCOME BEFORE PROVISION FOR INCOME TAXES             | 1,916,470                | 1,695,849           |
| PROVISION FOR INCOME TAXES                           | <u>511,340</u>           | <u>499,780</u>      |
| NET INCOME   | <u>\$ 1,405,130</u>      | <u>\$ 1,196,069</u> |
| Basic earnings per share of common stock             | <u>\$ 0.65</u>           | <u>\$ 0.57</u>      |
| Diluted earnings per share of common stock           | <u>\$ 0.65</u>           | <u>\$ 0.56</u>      |



**PEOPLE'S BANK OF COMMERCE**  
**STATEMENTS OF COMPREHENSIVE INCOME**

|   | Years Ended December 31, |              |
|---|--------------------------|--------------|
|   | 2015                     | 2014         |
| NET INCOME  | \$ 1,405,130             | \$ 1,196,069 |
| Unrealized gain on securities                       |                          |              |
| Change in unrealized holding gain, pre-tax          | 182,191                  | 146,973      |
| Tax impact on change in unrealized holding gain     | (69,962)                 | (56,438)     |
| Reclassification adjustment for gains, pre-tax      | 15,472                   | (3,160)      |
| Tax impact on reclassification adjustment for gains | (5,941)                  | 1,213        |
| Other comprehensive income                          | 121,760                  | 88,588       |
| COMPREHENSIVE INCOME                                | \$ 1,526,890             | \$ 1,284,657 |

**STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY**

|   | Common Stock |               | Surplus       | Retained Earnings | Accumulated Other Comprehensive Income | Total Stockholders' Equity |
|---|--------------|---------------|---------------|-------------------|--|----------------------------|
|   | Shares       | Amount        |               |                   |  |                            |
| BALANCE, December 31, 2013  | 1,843,402    | \$ 9,217,010  | \$ 10,181,838 | \$ 1,551,103      | \$ 104,138                             | \$ 21,054,089              |
| Net income  | -            | -             | -             | 1,196,069         | -                                      | 1,196,069                  |
| Change in net unrealized gain on investment securities available-for-sale, net of taxes | -            | -             | -             | -                 | 88,588                                 | 88,588                     |
| 5% stock dividend   | 91,944       | 459,720       | 459,720       | (919,440)         | -                                      | -                          |
| Cash in lieu of fractional shares   | -            | -             | (1,071)       | (1,190)           | -                                      | (2,261)                    |
| Options exercised   | 2,433        | 12,165        | 6,051         | -                 | -                                      | 18,216                     |
| Restricted stock grants issued  | 26,140       | 130,700       | (130,700)     | -                 | -                                      | -                          |
| Restricted stock grants forfeited   | (1,050)      | (5,250)       | (4,850)       | 10,100            | -                                      | -                          |
| Stock-based compensation expense  | -            | -             | 162,984       | -                 | -                                      | 162,984                    |
| BALANCE, December 31, 2014  | 1,962,869    | \$ 9,814,345  | \$ 10,673,972 | \$ 1,836,642      | \$ 192,726                             | \$ 22,517,685              |
| Net income  | -            | -             | -             | 1,405,130         | -                                      | 1,405,130                  |
| Change in net unrealized gain on investment securities available-for-sale, net of taxes | -            | -             | -             | -                 | (121,760)                              | (121,760)                  |
| 5% stock dividend   | 98,254       | 491,270       | 442,143       | (933,413)         | -                                      | -                          |
| Cash in lieu of fractional shares   | (221)        | (1,105)       | (1,003)       | -                 | -                                      | (2,108)                    |
| 5% stock dividend   | 103,156      | 515,780       | 876,826       | (1,392,606)       | -                                      | -                          |
| Cash in lieu of fractional shares   | (265)        | (1,325)       | (2,249)       | -                 | -                                      | (3,574)                    |
| Options exercised   | 2,443        | 12,215        | 3,391         | -                 | -                                      | 15,606                     |
| Stock-based compensation expense  | -            | -             | 215,942       | -                 | -                                      | 215,942                    |
| BALANCE, December 31, 2015  | 2,166,236    | \$ 10,831,180 | \$ 12,209,022 | \$ 915,753        | \$ 70,966                              | \$ 24,026,921              |

See accompanying notes.

**PEOPLE'S BANK OF COMMERCE**  
**STATEMENTS OF CASH FLOWS**

|  | Years Ended December 31, |                     |
|--|--------------------------|---------------------|
|  | 2015                     | 2014                |
| <b>CASH FLOWS FROM OPERATING ACTIVITIES</b>  |                          |                     |
| Net income   | \$ 1,405,130             | \$ 1,196,069        |
| Adjustments to reconcile net income to net cash from operating activities:           |                          |                     |
| Deferred income taxes  | (138,008)                | (113,924)           |
| Provision for loan losses  | 76,999                   | 24,830              |
| Depreciation and amortization  | 325,423                  | 319,956             |
| Stock-based compensation expense   | 215,942                  | 162,984             |
| Amortization of premiums on investment securities                                    | 142,620                  | 169,307             |
| Realized gain on sale of investment securities                                       | (50,712)                 | -                   |
| Loss from write down of other real estate owned                                      | 119,858                  | -                   |
| Gain on sale of other real estate owned  | -                        | (32,407)            |
| Net appreciation of bank-owned life insurance  | (149,757)                | (151,345)           |
| Gain on sale of loans  | (810,118)                | (679,249)           |
| Proceeds from the sale of loans held-for-sale  | 36,505,510               | 30,291,623          |
| Production of loans held-for-sale  | (37,014,492)             | (30,041,954)        |
| Changes in cash due to changes in certain assets and liabilities:                    |                          |                     |
| Accrued interest receivable and other assets   | (313,656)                | (353,436)           |
| Accrued interest payable and other liabilities                                       | 165,419                  | 382,801             |
| Net cash from operating activities   | <u>480,158</u>           | <u>1,175,255</u>    |
| <b>CASH FLOWS FROM INVESTING ACTIVITIES</b>  |                          |                     |
| Net change in time deposits with other institutions                                  | 4,730,912                | (498,124)           |
| Purchase of investment securities available-for-sale                                 | (19,071,528)             | (13,540,175)        |
| Proceeds from payments, calls, and sales of investment securities available-for-sale | 3,554,886                | 5,409,853           |
| Purchase of investment securities held to maturity                                   | (2,320,141)              | (2,757,662)         |
| Purchase (redemption) of restricted equity securities                                | (85,900)                 | 10,300              |
| Net increase in loans  | (12,878,526)             | (24,317,107)        |
| Proceeds from sale of other real estate owned  | -                        | 756,870             |
| Purchase of bank-owned life insurance  | (144,447)                | (850,000)           |
| Bank-owned life insurance proceeds   | 241,762                  | -                   |
| Income from real estate joint venture  | 51,720                   | 21,677              |
| Payments made for purchase of premises, equipment, and leasehold improvements        | <u>(1,486,365)</u>       | <u>(797,578)</u>    |
| Net cash from investing activities   | <u>(27,407,627)</u>      | <u>(36,561,946)</u> |

**PEOPLE'S BANK OF COMMERCE**  
**STATEMENTS OF CASH FLOWS**

|  | Years Ended December 31, |                      |
|--|--------------------------|----------------------|
|  | 2015                     | 2014                 |
| <b>CASH FLOWS FROM FINANCING ACTIVITIES</b>                                    |                          |                      |
| Net increase in deposit accounts   | \$ 33,907,122            | \$ 32,300,777        |
| Payments on borrowings   | -                        | (775,000)            |
| Cash paid in lieu of fractional shares from stock dividend                     | (5,682)                  | (2,261)              |
| Proceeds from stock options exercised  | 15,606                   | 18,216               |
|  | <u>33,917,046</u>        | <u>31,541,732</u>    |
| <b>NET CHANGE IN CASH AND CASH EQUIVALENTS</b>                                 | 6,989,577                | (3,844,959)          |
| <b>CASH AND CASH EQUIVALENTS, beginning of year</b>                            | <u>17,213,278</u>        | <u>21,058,237</u>    |
| <b>CASH AND CASH EQUIVALENTS, end of year</b>                                  | <u>\$ 24,202,855</u>     | <u>\$ 17,213,278</u> |
| <b>SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION</b>                        |                          |                      |
| Cash paid for interest   | <u>\$ 443,818</u>        | <u>\$ 406,154</u>    |
| Cash paid for taxes  | <u>\$ 944,000</u>        | <u>\$ 560,000</u>    |
| <b>SUPPLEMENTAL DISCLOSURE OF NONCASH INVESTING ACTIVITIES</b>                 |                          |                      |
| Change in fair value of investment securities available-for-sale, net of taxes | <u>\$ (121,760)</u>      | <u>\$ 88,588</u>     |
| Transfers of loans to other real estate owned                                  | <u>\$ -</u>              | <u>\$ 2,431,691</u>  |

# PEOPLE'S BANK OF COMMERCE

## NOTES TO FINANCIAL STATEMENTS

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### **Note 1 - Organization and Summary of Significant Accounting Policies**

**Organization** – In July 1997, People's Bank of Commerce (the Bank) was incorporated and received regulatory approval to become a state-chartered institution authorized to provide banking services in the state of Oregon. The Bank is subject to the regulations of certain federal and state agencies and will undergo periodic examinations by those regulatory authorities.

The Bank, which is headquartered in Medford, Oregon, operates five full-service branches in Ashland, Central Point, Grants Pass, and Medford, Oregon, and provides banking services to businesses and individuals located primarily in Southern Oregon.

The Company declared two 5% stock dividends during 2015 and one during 2014. All per share amounts and calculations in the accompanying financial statements have been restated to reflect the effects of these stock dividends.

**Management's estimates and assumptions** – In preparing the financial statements, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities as of the date of the balance sheets, and revenues and expenses for the reporting periods. Actual results could differ significantly from management's estimates. Material estimates that are particularly susceptible to significant change in the near term relate to the determination of the allowance for loan losses, the valuation of investment securities available-for-sale, other real estate owned, deferred tax assets, and the fair value of financial instruments.

**Cash and cash equivalents** – Cash equivalents are generally short-term investments with a maturity of three months or less. Cash and cash

equivalents include cash on hand, amounts due from banks, and federal funds sold. Generally, federal funds are purchased and sold within a one-day period.

The Bank maintains balances in correspondent bank accounts which, at times, may exceed federally insured limits. Management believes that its risk of loss associated with such balances is minimal due to the financial strength of correspondent banks. The Bank has not experienced any losses in such accounts.

**Investment securities** – The Bank is required to specifically identify its investment securities as "available-for-sale," "held-to-maturity," or "trading accounts." The Bank holds no trading securities. However, debt securities that the Bank has the positive intent and ability to hold to maturity are classified as held-to-maturity and recorded at amortized cost. Securities not classified as held to maturity are classified as available-for-sale and recorded at fair value. Premiums and discounts are recognized in interest income using the effective interest method over the period to maturity.

Available-for-sale securities consist of bonds, notes, and debentures. Securities are generally classified as available-for-sale if the instrument may be sold in response to such factors as: (1) changes in market interest rates and related changes in prepayment risk, (2) needs for liquidity, (3) changes in the availability of and the yield on alternative instruments, and (4) changes in funding sources and terms. Unrealized holding gains and losses, net of taxes, on available-for-sale securities are reported as a net amount in a separate component of equity until realized.

## PEOPLE'S BANK OF COMMERCE NOTES TO FINANCIAL STATEMENTS

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### **Note 1 - Organization and Summary of Significant Accounting Policies (continued)**

Fair values for these investment securities are based on quoted market prices. Gains and losses on the sale of available-for-sale securities are determined using the specific-identification method.

Management reviews investment securities on an ongoing basis for the presence of other-than-temporary impairment (OTTI) or permanent impairment, taking into consideration current market conditions; fair value in relationship to cost; extent and nature of the change in fair value; issuer rating changes and trends; whether management intends to sell a security or if it is likely that the Bank will be required to sell the security before recovery of the amortized cost basis of the investment, which may be maturity; and other factors. For debt securities, if management intends to sell the security, or it is likely that the Bank will be required to sell the security before recovering its cost basis, the entire impairment loss would be recognized in earnings as an OTTI. If management does not intend to sell the security and it is not likely that the Bank will be required to sell the security, but management does not expect to recover the entire amortized cost basis of the security, only the portion of the impairment loss representing credit losses would be recognized in earnings. The credit loss on a security is measured as the difference between the amortized cost basis and the present value of the cash flows expected to be collected. Projected cash flows are discounted by the original or current effective interest rate depending on the nature of the security being measured for potential OTTI. The remaining impairment related to all other factors, which is the difference between the present value of the cash flows expected to be collected and fair value, is recognized as a charge to other comprehensive income. Impairment losses

related to all other factors are presented as separate categories within other comprehensive income.

**Loans held-for-sale** – Mortgage loans held-for-sale are carried at the lower of cost or estimated market value. Market value is determined on an aggregate loan basis. Market value adjustments that reduce the carrying value of loans held for sale are recorded within a valuation allowance account and charged to non-interest income.

**Loans, net of allowance for loan losses, and unearned income** – In the normal course of business, the Bank originates and services loans receivable from borrowers. Loans are stated at the amount of unpaid principal, net of an allowance for loan losses, and net of deferred loan fees or costs. Interest on loans is calculated using the simple-interest method on daily balances of the principal amount outstanding. Loan origination fees and certain direct origination costs are capitalized and recognized as an adjustment to the yield of the related loan.

Loans are classified as impaired when, based on current information and events, it is probable that the Bank will be unable to collect the scheduled payments of principal and interest when due, in accordance with the terms of the original loan agreement. The carrying value of impaired loans is based on the present value of expected future cash flows (discounted at each loan's effective interest rate) or, for collateral dependent loans, at fair value of the collateral. If the measurement of each impaired loan's value is less than the recorded investment in the loan, an impairment allowance is created by either charging the provision for loan losses or allocating an existing component of the allowance for loan losses.

## PEOPLE'S BANK OF COMMERCE

### NOTES TO FINANCIAL STATEMENTS

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#### **Note 1 - Organization and Summary of Significant Accounting Policies (continued)**

Loans, including impaired loans, are classified as non-accrual if the collection of principal and interest is doubtful. Generally, this occurs when a loan is past due as to maturity or payment of principal or interest by 90 days or more, unless such loans are well-secured and in the process of collection. If a loan or portion thereof is partially charged-off, the loan is considered a troubled debt restructuring and impaired. Loans that are less than 90 days past due may also be classified as non-accrual if repayment in full of principal and/or interest is in doubt.

When a loan is classified as non-accrual, all uncollected accrued interest is reversed against interest income and the accrual of interest income is terminated. Generally, any cash payments are applied as a reduction of principal outstanding. In cases where the future collectability of the principal balance in full is expected, interest income may be recognized on a cash basis. A loan may be restored to accrual status when the borrower's financial condition improves so that full collection of principal is considered likely.

A troubled debt restructuring is a formal restructure of a loan in which the Bank, for economic or legal reasons related to the borrower's financial difficulties, grants a concession to the borrower. The concessions may be granted in various forms, including reduction in the stated interest rate, reduction in the loan balance or accrued interest, and extension of the maturity date. Troubled debt restructurings are measured at the time of restructure for impairment, and are subjected to the Bank's impaired loan accounting policy.

The allowance for loan losses is established through a provision for loan losses charged to expenses. Loans are charged against the

allowance for loan losses when management believes that the collectability of principal is unlikely. The allowance is an amount that management believes will be adequate to absorb possible losses on existing loans that may become uncollectible, based on evaluations of the collectability of loans and prior loan loss experience. These evaluations take into consideration such factors as changes in the nature and volume of the loan portfolio, overall portfolio quality, review of specific problem loans, and current economic conditions that may affect the borrower's ability to pay. Management carefully monitors changing economic conditions, the concentrations of loan categories and collateral, the financial condition of borrowers, the history of the loan portfolio, and historical peer group loan loss data to determine the adequacy of the allowance for loan losses. The allowance is based on estimates, and actual losses may vary from the estimates. No assurance can be given that adverse future economic conditions will not lead to delinquent loans, increases in the provision for loan losses, and/or charge-offs. In addition, regulatory agencies, as an integral part of their examination process, periodically review the estimated losses on loans. Such agencies may require the Bank to recognize additional losses based on their judgment about information available to them at the time of their examination.

**PEOPLE'S BANK OF COMMERCE**  
**NOTES TO FINANCIAL STATEMENTS**

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**Note 1 - Organization and Summary of Significant Accounting Policies (continued)**

**Premises, equipment, and leasehold improvements** – Premises, equipment, and leasehold improvements are stated at cost, less accumulated depreciation and amortization. Depreciation and amortization are computed principally by the straight-line method over the estimated useful lives of the assets, or lease term in the case of leasehold improvements, which range from two to forty years.

**Other real estate owned** – Property and assets acquired through foreclosure or deed in lieu of foreclosure are initially recorded at fair value and are subsequently stated at the lower of the carrying value of the loan or the fair value of the assets received, less estimated costs to sell, at the date the asset is acquired. Adjustments that reduce loan balances to the lower carrying value at the time of foreclosure are recognized as charge-offs in the allowance for loan losses. Subsequent impairment write-downs to net realizable value, if any, or any disposal gains or losses are included in noninterest income or expense. Costs relating to the development and improvement of property are capitalized and holding costs are charged to expense as incurred.

**Federal Home Loan Bank (FHLB) stock** – At December 31, 2015 and 2014, the Bank held FHLB stock with a par value of \$257,700 and \$171,800, respectively. As a member of the FHLB system, the Bank is required to maintain a minimum investment level in FHLB stock based on specific percentages of the Bank's outstanding mortgages, total assets, or FHLB advances. This security is reported at par value, which represents the Bank's cost.

Stock in the Des Moines FHLB is classified as restricted stock and is evaluated for impairment based on ultimate recoverability. The

determination of whether the investment is impaired is based on the Bank's assessment of the ultimate recoverability of par value rather than by recognizing temporary declines in value. The determination of whether a decline affects the ultimate recoverability is influenced by criteria such as (1) the significance of the decline in the net assets of the FHLB as compared to the capital stock amount for the FHLB and the length of time this situation has persisted, (2) commitments by the FHLB to make payments required by law or regulation and the level of such payments in relation to the operating performance of the FHLB, (3) the impact of the legislative and regulatory changes on institutions and, accordingly, on the customer base of the FHLB, and (4) the liquidity position of the FHLB. Management concluded that the Bank's FHLB stock investment was not impaired as of December 31, 2015.

**Investment in real estate joint venture** – During 2011, the Bank entered into a joint venture with another investor in a limited liability company formed to manage the construction and ownership of a new building that the Bank began to occupy at the end of 2012. The Bank accounted for its initial investment at 50% of total costs incurred to construct the new building. Following completion of construction and occupancy of the building, the Bank accounts for its investment in the limited liability company by following the equity method of accounting. Under this accounting treatment, the Bank recognizes its proportionate share of earnings and losses as a component of noninterest expense. During 2015 and 2014, the Bank recognized \$51,720 and \$21,677, respectively, in net income from its investment in the limited liability company.

# PEOPLE'S BANK OF COMMERCE

## NOTES TO FINANCIAL STATEMENTS

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### Note 1 - Organization and Summary of Significant Accounting Policies (continued)

**Income taxes** – Income taxes are accounted for using an asset and liability approach that requires the recognition of deferred tax assets and liabilities for the expected future tax consequences of temporary differences between the financial statement and tax basis of assets and liabilities at the applicable enacted tax rates. A valuation allowance is provided when it is more likely than not that some portion or all of the deferred tax assets will not be realized. The Bank evaluates the realizability of its deferred tax assets by assessing its valuation allowance and by adjusting the amount of such allowance, if necessary.

The Bank recognizes the tax benefit from uncertain tax positions only if it is more likely than not that the tax positions will be sustained on examination by taxing authorities, based on the technical merits of the position. The tax benefit is measured based on the largest benefit that has a greater than 50% likelihood of being realized upon ultimate settlement. The Bank does not anticipate that any amount of unrecognized tax benefits will significantly increase or decrease in the next 12 months. Additionally, the Bank recognizes interest and penalties related to income tax matters in income tax expense, although there were no interest and penalties recognized for the years ended December 31, 2015 and 2014.

**Off-balance sheet financial instruments** – The Bank holds no derivative financial instruments. However, in the ordinary course of business, the Bank enters into off-balance sheet financial instruments consisting of commitments to extend credit and standby letters of credit. These financial instruments are recorded in the financial statements when they are funded or related fees are incurred or received.

The Bank evaluates its exposure to off-balance sheet credit losses periodically for unfunded loan commitments and loans sold in the secondary market. The allowance for off-balance sheet credit losses is increased through charges to noninterest expense and is decreased by charge-offs or transfers to the allowance for loan losses at the time that the related loan is funded or the off-balance sheet credit exposure becomes probable and estimable. Management periodically evaluates the adequacy of this allowance based on the Bank's off-balance sheet credit loss experience, known and inherent risks in the portfolio, adverse situations which may increase the likelihood of loss, and current economic conditions. This reserve for unfunded loan commitments is included in the balance sheets under the caption "accrued interest payable and other liabilities."

**Advertising and promotional expenses** – Advertising and promotional costs are charged to expense during the period in which they are incurred.

**Earnings per share** – Basic earnings per share is computed by dividing net income available to stockholders by the weighted average number of common shares outstanding during the period, after giving retroactive effect to stock dividends and splits. Diluted earnings per share is computed similar to basic earnings per share except that the denominator is increased to include dilutive common equivalent shares for stock options assumed to be outstanding during the period utilizing the treasury-stock method.



**Note 1 - Organization and Summary of Significant Accounting Policies (continued)**

**Stock compensation plans** - The Bank has adopted stock-based compensation plans, and recognizes compensation expense based on the fair value of options or restricted stock awards on the date of grant. Share-based awards that do not require future service (i.e., fully vested awards at grant date) are expensed immediately. Share-based employee awards that require future service are amortized over the relevant service period. The Bank recognizes share-based compensation expense on a straight-line basis.

**Fair value measurements** - Fair value is defined as the price that would be received to sell an asset, or paid to transfer a liability, in an orderly transaction between market participants at the measurement date. The Bank determines fair value based upon quoted prices when available or through the use of alternative approaches, such as matrix or model pricing, when market quotes are not readily accessible or available. The valuation techniques used are based on observable and unobservable inputs. Observable inputs reflect market data obtained from independent sources, while unobservable inputs reflect the Bank's market assumptions. These two types of inputs create the following fair value hierarchy:

*Level 1* - Quoted prices in active markets for identical assets or liabilities.

*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-derived valuations whose inputs are observable or whose significant value drivers are observable.

*Level 3* - Unobservable inputs that are supported by little or no market activity and

that are significant to the fair value of the asset or liability. Unobservable inputs are used to measure fair value to the extent that observable inputs are not available. The Bank's own data used to develop unobservable inputs shall be adjusted for market consideration when reasonably available.

The Bank used the following methods and significant assumptions to estimate fair value for its assets measured and carried at fair value on a recurring or nonrecurring basis in the accompanying financial statements:

*Investment securities available-for-sale* - Investment securities available-for-sale are measured and carried at fair value on a recurring basis. For these securities, the Bank obtains fair value measurements from an independent pricing service. The fair value measurements consider observable data that may include dealer quotes, market spreads, cash flows, the U.S. Treasury yield curve, live trading levels, trade execution data, market consensus prepayment speeds, credit information, and the bond's terms and conditions, among other things (Level 1). When market quotes are not readily accessible or available, alternative approaches are utilized, such as matrix or model pricing (Level 2).

*Impaired loans* - Impaired loans are measured and adjusted to fair value on a non-recurring basis. Impaired loans are measured for impairment at the present value of expected future cash flows discounted at the loan's effective interest rate (Level 3), the loan's market price (Level 2), or the fair value of the collateral based on independent appraisals, less costs to sell, if the loan is collateral dependent (Level 3).

## PEOPLE'S BANK OF COMMERCE

### NOTES TO FINANCIAL STATEMENTS

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#### Note 1 - Organization and Summary of Significant Accounting Policies (continued)

*Other real estate owned* - Other real estate owned is measured and adjusted to fair value on a nonrecurring basis. On the date that other real estate owned is received in satisfaction of a loan receivable, it is measured at fair value, less cost to sell, based on recent independent appraisals (Level 3). Subsequent to the acquisition date, it is measured for impairment and written down to its fair value, less costs to sell, based on updated independent appraisals (Level 3).

The following methods and assumptions were used by the Bank in estimating fair values of assets and liabilities not carried at fair value on a recurring or nonrecurring basis:

*Cash and cash equivalents* - The carrying amounts reported in the balance sheets for cash and cash equivalents approximate their fair value at the balance sheet date.

*Investment securities held-to-maturity* - Investment securities held-to-maturity are carried at amortized cost. For these securities, the Bank obtains fair value measurements from an independent pricing service. The fair value measurements consider observable data that may include dealer quotes, market spreads, cash flows, the U.S. Treasury yield curve, live trading levels, trade execution data, market consensus prepayment speeds, credit information, and the bond's terms and conditions, among other things (Level 1). When market quotes are not readily accessible or available, alternative approaches are utilized, such as matrix or model pricing (Level 2).

*Restricted equity securities* - The Bank's investment in restricted equity securities are carried at par value which is expected to approximate fair value.

*Loans held-for-sale* - The carrying value of loans held-for-sale approximates fair value.

*Loans receivable, net* - For variable rate loans that re-price frequently and have no significant change in credit risk, fair value is equivalent to carrying value. Fair values for all 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.

*Borrowings* - The fair value of borrowings is estimated by discounting future cash flows using rates currently offered for notes payable of similar remaining maturities.

*Deposit liabilities* - Fair value disclosed for demand deposits equals their carrying amount, which represents the amount payable on demand. The carrying amounts for variable-rate-interest-bearing deposit accounts and certificates of deposit approximate their fair value at the balance sheet date. Fair value for fixed-rate certificates of deposit is estimated using a discounted cash flow calculation that applies interest rates currently being offered on certificates to a schedule of aggregate expected monthly maturities on time deposits.

*Off-balance sheet instruments* - The Bank's off-balance sheet instruments include unfunded commitments to extend credit and standby letters of credit. The fair value of these instruments is not considered practicable to estimate because of the lack of quoted market prices and the inability to estimate fair value without incurring excessive costs.

**Note 1 - Organization and Summary of Significant Accounting Policies (continued)**

The Bank assumes interest rate risk (the risk that general interest rate levels will change) as a result of its normal operations. Consequently, the fair value of the Bank's financial instruments will change when interest rate levels change, and that change may be either favorable or unfavorable to the Bank. Management attempts to match maturities of assets and liabilities to the extent believed necessary to minimize interest rate risk. However, borrowers with fixed-rate obligations are less likely to prepay in a rising rate environment and more likely to prepay in a falling rate environment. Conversely, depositors who are receiving fixed rates are more likely to withdraw funds before maturity in a rising rate environment and less likely to do so in a falling rate environment. Management monitors rates and maturities of assets and liabilities, and attempts to minimize interest rate risk by adjusting terms of new loans and deposits and by investing in securities with terms that mitigate the Bank's overall interest rate risk.

**Reclassifications** - Certain reclassifications have been made to the prior year financial statements to conform to the current year presentation. These reclassifications have no effect on previously reported net income, earnings per share, or retained earnings.

**Subsequent events** - Subsequent events are events or transactions that occur after the balance sheet date but before financial statements are issued. The Bank recognizes in the financial statements the effects of all subsequent events that provide additional evidence about conditions that existed at the date of the balance sheet, including the estimates inherent in the process of preparing the financial statements. The Bank's financial statements do not recognize subsequent events

that provide evidence about conditions that did not exist at the date of the balance sheet but arose after the balance sheet date and before financial statements are available to be issued. The Bank has evaluated subsequent events through March 8, 2016, which is the date the financial statements became available to be issued.

**PEOPLE'S BANK OF COMMERCE**  
**NOTES TO FINANCIAL STATEMENTS**

**Note 2 – Investment Securities**

|   | Amortized<br>Cost    | Gross<br>Unrealized<br>Gains | Gross<br>Unrealized<br>Losses Less<br>than 12 Months | Gross<br>Unrealized<br>Losses Greater<br>than 12 Months | Estimated<br>Fair<br>Value |
|---|----------------------|------------------------------|--|---|----------------------------|
| December 31, 2015                         |                      |                              |  |   |                            |
| Investment securities available-for-sale: |                      |                              |  |   |                            |
| U.S. government agency obligations        | \$ 27,698,356        | \$ 9,496                     | \$ (93,438)  | \$ (7,102)  | \$ 27,607,312              |
| SBA backed securities                     | 3,353,195            | 79,662                       | -  | (589)   | 3,432,268                  |
| Residential mortgage backed securities    | 2,024,903            | -                            | (23,818)   | -   | 2,001,085                  |
| Municipal securities                      | <u>3,527,693</u>     | <u>156,896</u>               | <u>(5,903)</u>                                       | <u>-</u>  | <u>3,678,686</u>           |
|   | <u>36,604,147</u>    | <u>246,054</u>               | <u>(123,159)</u>                                     | <u>(7,691)</u>  | <u>36,719,351</u>          |
| Investment securities held to maturity:   |                      |                              |  |   |                            |
| Municipal securities                      | <u>8,208,026</u>     | <u>288,424</u>               | <u>(2,182)</u>                                       | <u>-</u>  | <u>8,494,268</u>           |
| Total investment securities:              | <u>\$ 44,812,173</u> | <u>\$ 534,478</u>            | <u>\$ (125,341)</u>                                  | <u>\$ (7,691)</u>                                       | <u>\$ 45,213,619</u>       |
| December 31, 2014                         |                      |                              |  |   |                            |
| Investment securities available-for-sale: |                      |                              |  |   |                            |
| U.S. government agency obligations        | \$ 13,602,101        | \$ 15,762                    | \$ (9,895)   | \$ -  | \$ 13,607,968              |
| SBA backed securities                     | 4,206,958            | 106,794                      | -  | (1,717)   | 4,312,035                  |
| Municipal securities                      | <u>2,959,918</u>     | <u>201,923</u>               | <u>-</u>   | <u>-</u>  | <u>3,161,841</u>           |
|   | <u>20,768,977</u>    | <u>324,479</u>               | <u>(9,895)</u>                                       | <u>(1,717)</u>  | <u>21,081,844</u>          |
| Investment securities held to maturity:   |                      |                              |  |   |                            |
| Municipal securities                      | <u>6,298,321</u>     | <u>218,879</u>               | <u>(1,815)</u>                                       | <u>-</u>  | <u>6,515,385</u>           |
| Total investment securities:              | <u>\$ 27,067,298</u> | <u>\$ 543,358</u>            | <u>\$ (11,710)</u>                                   | <u>\$ (1,717)</u>                                       | <u>\$ 27,597,229</u>       |

At December 31, 2015, the Bank had 21 available-for sale investment securities in a loss position for less than 12 months, and four available-for-sale investment securities with amortized cost of \$3,296,675 in a loss position for greater than 12 months as shown in the table above. One of the Bank's held to maturity investment securities with amortized cost of \$360,000 was in a loss position for less than 12 months at December 31, 2015, as shown in the table above. At December 31, 2014, the Bank had five available-for sale investment securities with amortized cost of \$6,045,294 in a loss position for less than 12 months, and two available-for-sale investment securities with amortized cost of \$597,028 in a loss position for greater than 12 months as shown in the table above. One of the Bank's held to maturity investment securities with amortized cost of \$462,534 was in a loss position for less than 12 months at December 31, 2014, as shown in the table above.

**PEOPLE'S BANK OF COMMERCE**  
**NOTES TO FINANCIAL STATEMENTS**

**Note 2 – Investment Securities (continued)**

During the year ended December 31, 2015, two available-for-sale securities with a carrying value of \$1,350,996 were sold and a gain of \$15,472 was realized. During the year ended December 31, 2014, one available-for-sale security was sold with a carrying value of \$644,383 was sold and a gain of \$3,160 was realized. During the year the Bank sold a security classified as held-to-maturity as a result of a deterioration of the issuer's creditworthiness, with an amortized cost of \$383,265 and a gain of \$35,240 was realized. At December 31, 2015 and 2014, securities in the amount of \$2,872,426 and \$850,000, respectively, were pledged to secure public deposit.

The amortized cost and estimated fair value of investment securities by contractual maturity at December 31, 2015 are as follows:

|                                       | Available-for-Sale   |                            | Held-to-Maturity    |                            |
|---------------------------------------|----------------------|----------------------------|---------------------|----------------------------|
|                                       | Amortized<br>Cost    | Estimated<br>Fair<br>Value | Amortized<br>Cost   | Estimated<br>Fair<br>Value |
| Due within one year                   | \$ 574,107           | \$ 574,442                 | \$ -                | \$ -                       |
| Due from one year through five years  | 26,250,708           | 26,167,547                 | -                   | -                          |
| Due from five years through ten years | 7,431,718            | 7,495,430                  | 765,534             | 788,915                    |
| Due after ten years                   | 2,347,614            | 2,481,932                  | 7,442,492           | 7,705,353                  |
|                                       | <u>\$ 36,604,147</u> | <u>\$ 36,719,351</u>       | <u>\$ 8,208,026</u> | <u>\$ 8,494,268</u>        |

**Note 3 – Loans, Net of Allowance for Loan Losses, and Unearned Income**

The composition of loan balances is summarized as follows as of December 31:

|   | 2015                  | 2014                  |
|---|-----------------------|-----------------------|
| Real estate loans   | \$ 125,828,272        | \$ 108,422,806        |
| Commercial loans  | 20,483,791            | 26,465,201            |
| Construction loans  | 9,614,970             | 7,067,744             |
| Consumer loans  | 4,384,254             | 5,597,578             |
| Total loans   | 160,311,287           | 147,553,329           |
| Allowance for loan losses                                       | (1,963,798)           | (1,833,895)           |
| Deferred costs (unearned income), net                           | 36,470                | (137,002)             |
| Loans, net of allowance for loan losses,<br>and unearned income | <u>\$ 158,383,959</u> | <u>\$ 145,582,432</u> |

# PEOPLE'S BANK OF COMMERCE

## NOTES TO FINANCIAL STATEMENTS

### Note 4 – Allowance for Loan Losses

The following table displays the activity and allocation of the allowance for loan losses to significant segments of the loan portfolio at December 31:

|   | 2015                |                   |                  |                  |                  | Total               |
|---|---------------------|-------------------|------------------|------------------|------------------|---------------------|
|   | Real Estate         | Commercial        | Construction     | Consumer         | Unallocated      |                     |
| Allowance for loan losses                   |                     |                   |                  |                  |                  |                     |
| Beginning balance                           | \$ 1,383,955        | \$ 311,767        | \$ 63,728        | \$ 74,445        | \$ -             | \$ 1,833,895        |
| Charge-offs                                 | (10,839)            | (7,347)           | -                | (523)            | -                | (18,709)            |
| Recoveries                                  | 48,114              | 20,662            | 2,500            | 337              | -                | 71,613              |
| Provision for loan losses                   | 123,187             | (33,973)          | (9,575)          | (27,355)         | 24,715           | 76,999              |
| Ending balance                              | <u>\$ 1,544,417</u> | <u>\$ 291,109</u> | <u>\$ 56,653</u> | <u>\$ 46,904</u> | <u>\$ 24,715</u> | <u>\$ 1,963,798</u> |
| Ending balance                              |                     |                   |                  |                  |                  |                     |
| Loans individually evaluated for impairment | <u>\$ 161,796</u>   | <u>\$ 33,123</u>  | <u>\$ -</u>      | <u>\$ -</u>      | <u>\$ -</u>      | <u>\$ 194,919</u>   |
| Ending balance                              |                     |                   |                  |                  |                  |                     |
| Loans collectively evaluated for impairment | <u>\$ 1,382,621</u> | <u>\$ 257,986</u> | <u>\$ 56,653</u> | <u>\$ 46,904</u> | <u>\$ 24,715</u> | <u>\$ 1,768,879</u> |
|   |                     |                   |                  |                  |                  |                     |
|   | 2014                |                   |                  |                  |                  |                     |
|   | Real Estate         | Commercial        | Construction     | Consumer         | Unallocated      | Total               |
| Allowance for loan losses                   |                     |                   |                  |                  |                  |                     |
| Beginning balance                           | \$ 1,570,651        | \$ 267,806        | \$ 96,352        | \$ 25,883        | \$ -             | \$ 1,960,692        |
| Charge-offs                                 | -                   | (212,673)         | -                | (4,324)          | -                | (216,997)           |
| Recoveries                                  | 2,291               | 46,109            | 16,500           | 560              | -                | 65,460              |
| Provision for loan losses                   | (188,987)           | 210,525           | (49,124)         | 52,326           | -                | 24,740              |
| Ending balance                              | <u>\$ 1,383,955</u> | <u>\$ 311,767</u> | <u>\$ 63,728</u> | <u>\$ 74,445</u> | <u>\$ -</u>      | <u>\$ 1,833,895</u> |
| Ending balance                              |                     |                   |                  |                  |                  |                     |
| Loans individually evaluated for impairment | <u>\$ 172,528</u>   | <u>\$ 23,755</u>  | <u>\$ 13,343</u> | <u>\$ -</u>      | <u>\$ -</u>      | <u>\$ 209,626</u>   |
| Ending balance                              |                     |                   |                  |                  |                  |                     |
| Loans collectively evaluated for impairment | <u>\$ 1,211,427</u> | <u>\$ 288,012</u> | <u>\$ 50,385</u> | <u>\$ 74,445</u> | <u>\$ -</u>      | <u>\$ 1,624,269</u> |

**PEOPLE'S BANK OF COMMERCE**  
**NOTES TO FINANCIAL STATEMENTS**

**Note 4 – Allowance for Loan Losses (continued)**

The following table displays the activity and allocation of loans evaluated individually and collectively for impairment to significant segments of the loan portfolio at December 31:

|   | 2015           |               |              |              |                |
|---|----------------|---------------|--------------|--------------|----------------|
|   | Real Estate    | Commercial    | Construction | Consumer     | Total          |
| Loans   |                |               |              |              |                |
| Ending balance  | \$ 125,828,272 | \$ 20,483,791 | \$ 9,614,970 | \$ 4,384,254 | \$ 160,311,287 |
| Ending balance<br>Loans individually<br>evaluated for<br>impairment | \$ 1,384,935   | \$ 911,457    | \$ -         | \$ -         | \$ 2,296,392   |
| Ending balance<br>Loans collectively<br>evaluated for<br>impairment | \$ 124,443,337 | \$ 19,572,334 | \$ 9,614,970 | \$ 4,384,254 | \$ 158,014,895 |
|   |                |               |              |              |                |
|   | 2014           |               |              |              |                |
|   | Real Estate    | Commercial    | Construction | Consumer     | Total          |
| Loans   |                |               |              |              |                |
| Ending balance  | \$ 108,422,806 | \$ 26,465,201 | \$ 7,067,744 | \$ 5,597,578 | \$ 147,553,329 |
| Ending balance<br>Loans individually<br>evaluated for<br>impairment | \$ 1,419,803   | \$ 940,816    | \$ -         | \$ -         | \$ 2,360,619   |
| Ending balance<br>Loans collectively<br>evaluated for<br>impairment | \$ 107,003,003 | \$ 25,524,385 | \$ 7,067,744 | \$ 5,597,578 | \$ 145,192,710 |

The Bank's risk rating methodology assigns risk ratings ranging from 1 to 10, where a higher rating represents higher risk. Assignment of a risk rating is done on the individual loan rather than at the borrower level. Loans are graded from inception and on a continuing basis until the debt is repaid.

The risk rating categories can be generally described by the following groupings:

**Pass** – An acceptable asset carrying a normal degree of credit risk exhibiting the capacity to perform according to the repayment terms.

# PEOPLE'S BANK OF COMMERCE

## NOTES TO FINANCIAL STATEMENTS

### Note 4 – Allowance for Loan Losses (continued)

**Special Mention** – A special mention asset has potential weaknesses that deserve management’s close attention. If left uncorrected, these potential weaknesses may result in a deterioration of the repayment prospects for the asset or in the Bank’s credit position at some future date. Special mention assets are not adversely classified and do not expose an institution to sufficient risk to warrant adverse classification.

**Substandard** – A substandard asset is inadequately protected by the current sound worth and paying capacity of the obligor or of the collateral pledged. Assets so classified must have a well-defined weakness or weaknesses that jeopardize the liquidation of the debt.

**Doubtful** – Any asset classified doubtful has all the weaknesses inherent in one classified special mention with the added characteristic that the weaknesses make collection or liquidation in full, on the basis of currently existing facts, conditions, and value, highly questionable and improbable.

**Loss** – Assets classified loss are considered uncollectible and of such minimal value that the continuance as bankable assets are not warranted. This classification does not mean that the asset has absolutely no recovery or salvage value but that it is not practical or desirable to defer writing off this basically worthless asset even though a partial recovery may occur in the future.

The following table represents loan portfolio information by loan type and credit grade as of December 31:

|       |                 | 2015                  |                      |                     |                     |                       |
|-------|-----------------|-----------------------|----------------------|---------------------|---------------------|-----------------------|
|       |                 | Real Estate           | Commercial           | Construction        | Consumer            | Total                 |
| Grade |                 |                       |                      |                     |                     |                       |
|       | Pass            | \$ 118,481,293        | \$ 17,890,057        | \$ 9,614,970        | \$ 4,384,254        | \$ 150,370,574        |
|       | Special Mention | 4,555,951             | 523,352              | -                   | -                   | 5,079,303             |
|       | Substandard     | 2,791,028             | 2,070,382            | -                   | -                   | 4,861,410             |
|       | Loss            | -                     | -                    | -                   | -                   | -                     |
|       | <b>Total</b>    | <b>\$ 125,828,272</b> | <b>\$ 20,483,791</b> | <b>\$ 9,614,970</b> | <b>\$ 4,384,254</b> | <b>\$ 160,311,287</b> |
|       |                 | 2014                  |                      |                     |                     |                       |
|       |                 | Real Estate           | Commercial           | Construction        | Consumer            | Total                 |
| Grade |                 |                       |                      |                     |                     |                       |
|       | Pass            | \$ 99,569,655         | \$ 23,928,972        | \$ 7,067,744        | \$ 5,597,578        | \$ 136,163,949        |
|       | Special Mention | 6,173,310             | 713,733              | -                   | -                   | 6,887,043             |
|       | Substandard     | 2,679,841             | 1,822,496            | -                   | -                   | 4,502,337             |
|       | Loss            | -                     | -                    | -                   | -                   | -                     |
|       | <b>Total</b>    | <b>\$ 108,422,806</b> | <b>\$ 26,465,201</b> | <b>\$ 7,067,744</b> | <b>\$ 5,597,578</b> | <b>\$ 147,553,329</b> |



**PEOPLE'S BANK OF COMMERCE**  
**NOTES TO FINANCIAL STATEMENTS**

**Note 4 – Allowance for Loan Losses (continued)**

Past due loans are loans for which principal and interest were not paid timely according to the contractual payment terms. The following table represents loans past due by loan category as of December 31:

|              | 2015                     |                          |                                     |                   |                       |                       |
|--------------|--------------------------|--------------------------|-------------------------------------|-------------------|-----------------------|-----------------------|
|              | 30 – 59 Days<br>Past Due | 60 – 89 Days<br>Past Due | Greater than<br>90 Days<br>Past Due | Total Past<br>Due | Current               | Total<br>Loans        |
| Real estate  | \$ 501,650               | \$ -                     | \$ -                                | \$ 501,650        | \$ 125,326,622        | \$ 125,828,272        |
| Commercial   | 51,754                   | 76,247                   | -                                   | 128,001           | 20,355,790            | 20,483,791            |
| Construction | -                        | -                        | -                                   | -                 | 9,614,970             | 9,614,970             |
| Consumer     | -                        | -                        | -                                   | -                 | 4,384,254             | 4,384,254             |
|              | <u>\$ 553,404</u>        | <u>\$ 76,247</u>         | <u>\$ -</u>                         | <u>\$ 629,651</u> | <u>\$ 159,681,636</u> | <u>\$ 160,311,287</u> |
|              | 2014                     |                          |                                     |                   |                       |                       |
|              | 30 – 59 Days<br>Past Due | 60 – 89 Days<br>Past Due | Greater than<br>90 Days<br>Past Due | Total Past<br>Due | Current               | Total<br>Loans        |
| Real estate  | \$ -                     | \$ 18,730                | \$ -                                | \$ 18,730         | \$ 108,404,076        | \$ 108,422,806        |
| Commercial   | -                        | 89,431                   | -                                   | 89,431            | 26,375,770            | 26,465,201            |
| Construction | -                        | -                        | -                                   | -                 | 7,067,744             | 7,067,744             |
| Consumer     | -                        | -                        | -                                   | -                 | 5,597,578             | 5,597,578             |
|              | <u>\$ -</u>              | <u>\$ 108,161</u>        | <u>\$ -</u>                         | <u>\$ 108,161</u> | <u>\$ 147,445,168</u> | <u>\$ 147,553,329</u> |

As of December 31, 2015 and 2014, no loans were carried on nonaccrual status.

**PEOPLE'S BANK OF COMMERCE**  
**NOTES TO FINANCIAL STATEMENTS**

**Note 4 – Allowance for Loan Losses (continued)**

The following table represents a comparison of impaired loans with and without specific allowance recorded for the period ended December 31:

|                                    |              | 2015                |                          |                   |                             |                            |
|------------------------------------|--------------|---------------------|--------------------------|-------------------|-----------------------------|----------------------------|
|                                    |              | Recorded Investment | Unpaid Principal Balance | Related Allowance | Average Recorded Investment | Interest Income Recognized |
| With no related allowance recorded |              |                     |                          |                   |                             |                            |
|                                    | Real estate  | \$ 95,880           | \$ 95,880                |                   | \$ 97,587                   | \$ 10,698                  |
|                                    | Commercial   | -                   | -                        |                   | -                           | -                          |
|                                    | Construction | -                   | -                        |                   | -                           | -                          |
|                                    | Consumer     | -                   | -                        |                   | -                           | -                          |
|                                    |              | <u>\$ 95,880</u>    | <u>\$ 95,880</u>         |                   | <u>\$ 97,587</u>            | <u>\$ 10,698</u>           |
| With allowance recorded            |              |                     |                          |                   |                             |                            |
|                                    | Real estate  | \$ 1,289,055        | \$ 1,289,055             | \$ 161,796        | \$ 1,304,875                | \$ 66,033                  |
|                                    | Commercial   | 911,457             | 911,457                  | 33,123            | 925,481                     | 48,744                     |
|                                    | Construction | -                   | -                        | -                 | -                           | -                          |
|                                    | Consumer     | -                   | -                        | -                 | -                           | -                          |
|                                    |              | <u>\$ 2,200,512</u> | <u>\$ 2,200,512</u>      | <u>\$ 194,919</u> | <u>\$ 2,230,356</u>         | <u>\$ 114,777</u>          |
| Total                              |              |                     |                          |                   |                             |                            |
|                                    | Real estate  | \$ 1,384,935        | \$ 1,384,935             | \$ 161,796        | \$ 1,402,462                | \$ 76,731                  |
|                                    | Commercial   | 911,457             | 911,457                  | 33,123            | 925,481                     | 48,744                     |
|                                    | Construction | -                   | -                        | -                 | -                           | -                          |
|                                    | Consumer     | -                   | -                        | -                 | -                           | -                          |
|                                    |              | <u>\$ 2,296,392</u> | <u>\$ 2,296,392</u>      | <u>\$ 194,919</u> | <u>\$ 2,327,943</u>         | <u>\$ 125,475</u>          |

**PEOPLE'S BANK OF COMMERCE**  
**NOTES TO FINANCIAL STATEMENTS**

**Note 4 – Allowance for Loan Losses (continued)**

|                                    |              | 2014                   |                                |                      |                                   |                                  |
|------------------------------------|--------------|------------------------|--------------------------------|----------------------|-----------------------------------|----------------------------------|
|                                    |              | Recorded<br>Investment | Unpaid<br>Principal<br>Balance | Related<br>Allowance | Average<br>Recorded<br>Investment | Interest<br>Income<br>Recognized |
| With no related allowance recorded |              |                        |                                |                      |                                   |                                  |
|                                    | Real estate  | \$ 166,710             | \$ 166,710                     |                      | \$ 260,218                        | \$ 78,203                        |
|                                    | Commercial   | -                      | -                              |                      | -                                 | -                                |
|                                    | Construction | -                      | -                              |                      | -                                 | -                                |
|                                    | Consumer     | -                      | -                              |                      | -                                 | -                                |
|                                    |              | <u>\$ 166,710</u>      | <u>\$ 166,710</u>              |                      | <u>\$ 260,218</u>                 | <u>\$ 78,203</u>                 |
| With allowance recorded            |              |                        |                                |                      |                                   |                                  |
|                                    | Real estate  | \$ 1,253,093           | \$ 1,253,093                   | \$ 172,528           | \$ 1,824,880                      | \$ 62,281                        |
|                                    | Commercial   | 170,195                | 170,195                        | 23,755               | 310,940                           | 5,260                            |
|                                    | Construction | 770,621                | 770,621                        | 13,343               | 2,240,903                         | 45,013                           |
|                                    | Consumer     | -                      | -                              | -                    | -                                 | -                                |
|                                    |              | <u>\$ 2,193,909</u>    | <u>\$ 2,193,909</u>            | <u>\$ 209,626</u>    | <u>\$ 4,376,723</u>               | <u>\$ 112,554</u>                |
| Total                              |              |                        |                                |                      |                                   |                                  |
|                                    | Real estate  | \$ 1,419,803           | \$ 1,419,803                   | \$ 172,528           | \$ 2,085,098                      | \$ 140,484                       |
|                                    | Commercial   | 170,195                | 170,195                        | 23,755               | 310,940                           | 5,260                            |
|                                    | Construction | 770,621                | 770,621                        | 13,343               | 2,240,903                         | 45,013                           |
|                                    | Consumer     | -                      | -                              | -                    | -                                 | -                                |
|                                    |              | <u>\$ 2,360,619</u>    | <u>\$ 2,360,619</u>            | <u>\$ 209,626</u>    | <u>\$ 4,636,941</u>               | <u>\$ 190,757</u>                |

**Troubled debt restructurings** – At December 31, 2015 and 2014, impaired loans of \$2,296,392 and \$2,293,329, respectively, were classified as troubled debt restructured loans. The restructurings were granted in response to borrower financial difficulty, and generally provide for a temporary modification of loan repayment terms.

The types of modifications offered can generally be described in the following categories:

**Rate modification** – A modification in which the interest rate is modified.

**Term modification** – A modification in which the maturity date, timing of payments, or frequency of payments is changed.

**Payment modification** – A modification in which the payment amount is changed.

**Combination modification** – Any other type of modification, including the use of multiple types of modifications.

There were no newly restructured loans that occurred during the years ended December 31, 2015 and 2014.

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## NOTES TO FINANCIAL STATEMENTS

### Note 5 – Premises, Equipment, and Leasehold Improvements

The composition of premises, equipment, and leasehold improvements is summarized as follows as of December 31:

|  | 2015                | 2014                |
|--|---------------------|---------------------|
| Land   | \$ 583,248          | \$ 583,248          |
| Bank premises  | 2,783,839           | 2,783,839           |
| Furniture and equipment  | 1,772,201           | 1,872,991           |
| Leasehold improvements   | 144,807             | 175,309             |
| Construction in Progress   | 2,079,164           | 706,146             |
|  | 7,363,259           | 6,121,533           |
| Less accumulated depreciation and amortization   | (2,235,395)         | (2,154,611)         |
| Premises, equipment, and leasehold improvements,<br>net of accumulated depreciation and amortization | <u>\$ 5,127,864</u> | <u>\$ 3,966,922</u> |

Depreciation and amortization expense for the years ended December 31, 2015 and 2014, was \$325,423 and \$319,956, respectively.

### Note 6 – Time Deposits

Time certificates of deposit of \$250,000 and over totaled \$2,061,152 and \$808,475 at December 31, 2015 and 2014, respectively.

As of December 31, 2015, the scheduled maturities for all time deposits are as follows:

|                           |            |                      |
|---------------------------|------------|----------------------|
| Years ending December 31, | 2016       | \$ 10,892,177        |
|                           | 2017       | 3,863,594            |
|                           | 2018       | 5,615,478            |
|                           | 2019       | 3,074,684            |
|                           | 2020       | 1,136,276            |
|                           | Thereafter | <u>25,980</u>        |
|                           |            | <u>\$ 24,608,189</u> |

### Note 7 – Borrowings

**Federal Home Loan Bank advances** – As a member of the Federal Home Loan Bank of Des Moines (FHLB), the Bank has entered into an “Advances, Security, and Deposit Agreement” with the FHLB. Borrowings under the credit arrangement are collateralized by the Bank’s

FHLB stock as well as deposits or other instruments, which may be pledged. As of December 31, 2015 and 2014, the Bank had no outstanding borrowings with the FHLB. Borrowings of \$775,000 were carrying an interest rate of 2.91% and matured in 2014. As of December 31, 2015, the Bank had \$16,423,724 in available borrowing capacity with FHLB.

**Federal funds line of credit** – The Bank has obtained lines of credit totaling \$7,000,000 with two correspondent banks. One federal fund line for \$3,000,000 will expire or renew at the discretion of the correspondent bank. A second line for \$4,000,000 was established with a term extending from June 30, 2014 through June 30, 2016. There were no balances outstanding on these lines of credit as of December 31, 2015 and 2014.

### Note 8 – Income Taxes

The provision for income taxes consists of the following as of December 31:

|                             | 2015              | 2014              |
|-----------------------------|-------------------|-------------------|
| Current income taxes        |                   |                   |
| Federal                     | \$ 508,155        | \$ 481,432        |
| State                       | 141,193           | 132,272           |
| Total current income taxes  | <u>649,348</u>    | <u>613,704</u>    |
| Deferred income taxes       |                   |                   |
| Federal                     | (111,128)         | (91,735)          |
| State                       | (26,880)          | (22,189)          |
| Total deferred income taxes | <u>(138,008)</u>  | <u>(113,924)</u>  |
| Provision for income taxes  | <u>\$ 511,340</u> | <u>\$ 499,780</u> |

**PEOPLE'S BANK OF COMMERCE**  
**NOTES TO FINANCIAL STATEMENTS**

**Note 8 – Income Taxes (continued)**

Net deferred income taxes, recorded as other assets, represent the tax effect of differences in timing between financial income and taxable income. Net deferred tax assets, in the accompanying balance sheets, include the following components as of December 31:

|  | 2015         | 2014       |
|--|--------------|------------|
| Deferred tax assets (liabilities)                            |              |            |
| Allowance for loan losses                                    | \$ 628,559   | \$ 598,518 |
| Unrealized gains on investment securities available-for-sale | (44,238)     | (120,141)  |
| Prepays  | (82,964)     | (156,702)  |
| Supplemental executive retirement plan                       | 484,941      | 418,368    |
| Split-dollar liability                                       | 57,964       | 29,047     |
| Intangible assets - permits and licenses                     | (40,316)     | 519        |
| Reserve for off-balance sheet instruments                    | 24,469       | (68,541)   |
| Depreciation and organization costs                          | (90,533)     | (36,415)   |
| Non-accrual interest   | 476          | 55,215     |
| Stock-based compensation                                     | 30,667       | 32,116     |
| Accrued bonuses  | 94,018       | 73,814     |
| Loan origination costs                                       | (80,352)     | -          |
| Other  | 68,962       | 11,945     |
|  | \$ 1,051,653 | \$ 837,743 |
| Net deferred tax assets                                      |              |            |

A valuation allowance has not been recognized as an offset to the net deferred tax assets since management believes it is more likely than not that all deferred tax assets will be utilized in future periods.

The following summarizes the differences between the provision for income taxes for financial statement purposes and the federal statutory rate of 34.00% for the years ended December 31, 2015 and 2014:

| RATE RECONCILIATION:                 |           |       |
|--------------------------------------|-----------|-------|
|                                      | 2015      |       |
| Federal, at statutory rate           | 651,600   | 34.0% |
| State, net of federal benefit        | 96,130    | 5.0%  |
| Tax-exempt interest, net of expenses | (116,120) | -6.1% |
| Bank-owned life insurance            | (114,612) | -6.0% |
| Other                                | (5,658)   | -0.3% |
|                                      | 511,340   | 26.6% |
| Tax expense, at effective rate       |           |       |
|                                      | 2014      |       |
| Federal, at statutory rate           | 576,741   | 34.0% |
| State, net of federal benefit        | 85,086    | 5.0%  |
| Tax-exempt interest, net of expenses | (83,528)  | -4.9% |
| Bank-owned life insurance            | -         | 0.0%  |
| Other                                | (78,519)  | -4.6% |
|                                      | 499,780   | 29.5% |
| Tax expense, at effective rate       |           |       |

**Note 9 – Financial Instruments with Off-Balance Sheet Risk**

In the normal course of business to meet the financing needs of its customers, the Bank is a party to financial instruments with off-balance sheet risk. These financial instruments include commitments to extend credit and the issuance of letters of credit. These instruments involve, to varying degrees, elements of credit and interest-rate risk in excess of the amount recognized in the balance sheets. The contractual amounts of those instruments reflect the extent of involvement the Bank has in particular classes of financial instruments.

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

Commitments to extend credit are agreements to lend to customers as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Since many of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. The amount of collateral obtained, if deemed necessary by the Bank upon extension of credit, is based on management's credit evaluation of the counter party. Collateral held varies but may include accounts receivable, inventory, property and equipment, and income-producing properties.

**PEOPLE'S BANK OF COMMERCE**  
**NOTES TO FINANCIAL STATEMENTS**

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**Note 9 – Financial Instruments with Off-Balance Sheet Risk (continued)**

Letters of credit written are conditional commitments issued by the Bank to guarantee the performance of a customer to a third party. Those guarantees are primarily issued to support bonding requirements for real estate developers and contractors. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loan facilities to customers. The Bank holds cash, marketable securities, or real estate as collateral supporting those commitments for which collateral is deemed necessary.

A summary of the notional amounts of the Bank's financial instruments with off-balance sheet risk as of December 31, 2015, is as follows:

|  | <u>2015</u>          |
|--|----------------------|
| Commitments to extend credit             |                      |
| Commercial                               | \$ 11,975,756        |
| Construction                             | 15,920,101           |
| Residential                              | 17,906,672           |
| Consumer                                 | <u>2,233,273</u>     |
|  | <u>\$ 48,035,802</u> |
| Commercial and standby letters of credit | <u>\$ 314,145</u>    |

**Note 10 – Concentrations of Credit Risk**

All of the Bank's loans, commitments, and commercial and standby letters of credit have been granted to customers in the Bank's market area. The majority of such customers are also depositors of the Bank. Concentrations of credit by type of loan are set forth in Note 3. During 2015, the Bank's loan policy did not allow the extension of credit to any single borrower or group of related borrowers in excess of \$1,000,000 on an unsecured basis and \$2,000,000 on a secured basis, without approval from the Senior Loan Committee.

**Note 11 – Commitments and Contingencies**

**Lease commitments** – As of December 31, 2015, the Bank leased branch office space under two operating lease agreements. One of the branch leases expires in 2018 while the other branch lease expires in 2036.

Future minimum lease payments associated with the office space lease and other agreements are as follows:

|                           |            |           |                  |
|---------------------------|------------|-----------|------------------|
| Years ending December 31, | 2016       | \$        | 411,404          |
|                           | 2017       |           | 419,076          |
|                           | 2018       |           | 426,846          |
|                           | 2019       |           | 352,701          |
|                           | 2020       |           | 355,276          |
|                           | Thereafter |           | <u>1,888,514</u> |
|                           |            | <u>\$</u> | <u>3,853,817</u> |

For the years ended December 31, 2015 and 2014, rent expense was \$435,415 and \$411,292, respectively. As discussed in Note 1, the Bank pays rent to a related party as part of a real estate joint venture. Rent paid to the related party was \$263,013 and \$257,856 for the years ended December 31, 2015 and 2014, respectively.

**Legal contingencies** – The Bank may become a defendant in certain claims and legal actions arising in the ordinary course of business. As of December 31, 2015, the Bank was not involved in any current matters expected to have a material adverse effect on its financial condition or results of operations.

**PEOPLE'S BANK OF COMMERCE**  
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**Note 12 – Transactions with Related Parties**

Certain directors, executive officers, and principal stockholders are customers of and have had banking transactions with the Bank in the ordinary course of business, and the Bank expects to have such transactions in the future. All loans and commitments to lend included in such transactions are made in compliance with applicable laws on substantially the same terms (including interest rates and collateral) as those prevailing at the time for comparable transactions with other persons and, in the opinion of the management of the Bank, do not involve more than the normal risk of collection or present any other unfavorable features.

The amount of loans and loan commitments outstanding to directors, executive officers, and principal stockholders with the Bank was as follows as of December 31:

|                              | 2015                | 2014                |
|------------------------------|---------------------|---------------------|
| Balance, beginning of year   | \$ 1,288,057        | \$ 2,718,598        |
| Loans made                   | 3,924,784           | 2,717,422           |
| Loans repaid                 | <u>(2,477,271)</u>  | <u>(4,147,963)</u>  |
| Balance, end of year         | <u>\$ 2,735,570</u> | <u>\$ 1,288,057</u> |
| Outstanding loan commitments | <u>\$ 5,712,360</u> | <u>\$ 1,745,113</u> |

In addition, the Bank has a loan to its other 50% member in the limited liability company that owns its headquarters building. The loan carries an interest rate of 6.25%, matures in December of 2037, and is collateralized by member's interest in the land on which the building is located. The loan was originated for the purpose of funding the partner's portion of construction costs of the new administrative office and had a balance of \$1,983,131 as of December 31, 2015.

Related party deposits held by the Bank at December 31, 2015 and 2014, were \$19,890,021 and \$16,570,705, respectively.

**Note 13 – Stock-Based Compensation Plans**

Under its stock-based compensation plans, the Bank may grant nonqualified stock options and restricted stock awards to its directors, officers, and employees for up to 282,966 shares of common stock. The exercise price of each option must be at least equal to 100% of the market price of the Bank's stock on the date of grant. An option's maximum term is 10 years.

The following summarizes stock option activity under the plans, adjusted for stock dividends:

|   | Number of Shares | Weighted Average Exercise Price | Aggregate Intrinsic Value | Weighted Average Contractual Term |
|---|------------------|---------------------------------|---------------------------|-----------------------------------|
| Options under grant as of December 31, 2014 | <u>75,905</u>    | \$ 7.32                         |                           | 6.65                              |
| Options expired                             | (1,484)          | \$ 11.93                        |                           |                                   |
| Options exercised                           | (2,443)          | \$ 6.04                         |                           |                                   |
| Adjustment for stock dividends              | <u>7,378</u>     |                                 |                           |                                   |
| Options under grant as of December 31, 2015 | <u>79,356</u>    | \$ 7.23                         |                           | 5.87                              |
| Options exercisable as of December 31, 2015 | <u>64,175</u>    | \$ 6.57                         | \$ 197,659                | 5.71                              |

The Bank determines fair value of stock options at grant date using the Black-Scholes pricing model that takes into account the stock price at the grant date, the exercise price, the expected life of the option, the volatility of the underlying stock, the expected dividend yield, and the risk-free interest rate over the expected life of the option. The expected term of options granted is derived from historical data on employee exercise and post-vesting employment termination behavior. The risk-free rate for periods within the contractual life of the option is based on the U.S. Treasury yield curve in effect at the time of the grant. Expected volatility is based on the historical volatility of an index of comparable bank stocks.

## PEOPLE'S BANK OF COMMERCE

### NOTES TO FINANCIAL STATEMENTS

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#### Note 13 - Stock-Based Compensation Plans (continued)

The Black-Scholes option valuation model requires the input of highly subjective assumptions, including the expected life of the stock-based award and stock price volatility. These assumptions represent management's best estimates, but involve inherent uncertainties and the application of management judgment. As a result, if other assumptions had been used, the Bank's recorded stock-based compensation expense could have been materially different. Additionally, the effects of applying this accounting model are not indicative of future amounts that may be realized by the option holders upon exercise.

The Bank expenses stock options on a straight-line basis over the options' related vesting term. As of December 31, 2015, there was \$49,346 of unrecognized compensation expense related to the granting of stock options. That cost is expected to be recognized over a weighted average period of 2 years.

The following table summarizes restricted stock award activity under the plan for the year ended December 31, 2015:

|  | <u>Number<br/>of Shares</u> | <u>Weighted<br/>Average<br/>Fair Value</u> |
|--|-----------------------------|--|
| Restricted stock awards unvested at<br>December 31, 2014 | <u>70,159</u>               | \$ 8.53                                    |
| Awards vested  | (23,851)                    | \$ 8.53                                    |
| Adjustment for<br>stock dividends                        | <u>4,747</u>                |  |
| Restricted stock awards unvested at<br>December 31, 2015 | <u>51,055</u>               | \$ 8.36                                    |

As of December 31, 2015, there was \$421,179 of unrecognized stock-based compensation expense related to nonvested restricted stock awards. The cost is expected to be recognized over a weighted average period of 4 years.

Total compensation expense recognized for stock-based compensation plans was \$215,942 and \$162,984 for the years ended December 31, 2015 and 2014, respectively.

#### Note 14 - Employee Benefit Plans and Agreements

The Bank adopted a 401(k) plan in which substantially all employees participate. Employees may contribute the maximum amount permissible under federal tax laws. The Bank contributes 3% of each eligible employee's compensation under a safe harbor provision. For the years ended December 31, 2015 and 2014, the Bank's expense attributable to the plan was \$123,652 and \$94,303, respectively.

In December 2005, the Bank entered into supplemental retirement plans with key executive officers. In 2006, to support its obligations under these plans and to provide death benefits to selected employees, the Bank acquired bank-owned life insurance. The Bank's liability pursuant to these supplemental retirement plans was \$1,391,493 and \$1,213,817 as of December 31, 2015 and 2014, respectively. These amounts are included on the balance sheet among "accrued interest payable and other liabilities." For 2015 and 2014, compensation expense related to these plans was \$211,552 and \$199,505, respectively. Payments of \$33,876 and were made during the years ended December 31, 2015 and 2014. During the year ended December 31, 2015 the bank collected \$241,762 in death benefit proceeds on a bank-owned life insurance policy. No proceeds were collected during the year ended December 31, 2014.



**PEOPLE'S BANK OF COMMERCE**  
**NOTES TO FINANCIAL STATEMENTS**

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**Note 15 - Earnings Per Share**

The following table illustrates the computations of basic and diluted earnings per share for the years ended December 31 (adjusted for the 2015 and 2014 stock dividends):

|                                      | <u>Net<br/>Income</u> | <u>Weighted<br/>Average<br/>Shares</u> | <u>Per<br/>Share<br/>Amount</u> |
|--------------------------------------|-----------------------|--|---------------------------------|
| For the year ended December 31, 2015 |                       |  |                                 |
| Basic income per share               | \$ 1,405,130          | 2,166,236                              | <u>\$ 0.65</u>                  |
| Stock options                        |                       | <u>12,073</u>                          |                                 |
| Diluted income per share             | \$ 1,405,130          | <u>2,178,309</u>                       | <u>\$ 0.65</u>                  |
| For the year ended December 31, 2014 |                       |  |                                 |
| Basic income per share               | \$ 1,196,069          | 2,103,125                              | <u>\$ 0.57</u>                  |
| Stock options                        |                       | <u>16,617</u>                          |                                 |
| Diluted income per share             | \$ 1,196,069          | <u>2,119,742</u>                       | <u>\$ 0.56</u>                  |

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**Note 16 – Fair Value of Financial Instruments**

Assets are displayed at fair value in the table below based upon recurring or nonrecurring measurement status. Recurring assets are initially measured at fair value and are required to be re-measured at fair value in the financial statements at each reporting date. Assets measured on a nonrecurring basis are assets that, due to an event or circumstance, were required to be re-measured at fair value after initial recognition in the financial statements at some time during the reporting period.

|   | Carrying Value       | Fair Value Measurements Using                                  |   |   |
|---|----------------------|--|---|---|
|   |                      | Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) |
| <u>Recurring items as of December 31, 2015</u>    |                      |  |   |   |
| Investment securities available-for-sale          |                      |  |   |   |
| U.S. government agency obligations                | \$ 27,607,312        | \$ -   | \$ 27,607,312                                 | \$ -                                      |
| SBA backed securities                             | 3,432,268            | -  | 3,432,268                                     | -   |
| Residential mortgage backed securities            | 2,001,085            | -  | 2,001,085                                     | -   |
| Municipal securities                              | 3,678,686            | -  | 3,678,686                                     | -   |
|   |                      |  |   |   |
| Total investment securities available-for-sale    | <u>\$ 36,719,351</u> | <u>\$ -</u>  | <u>\$ 36,719,351</u>                          | <u>\$ -</u>                               |
| <u>Nonrecurring items as of December 31, 2015</u> |                      |  |   |   |
| Loans measured for impairment                     | \$ 2,005,593         | \$ -   | \$ -  | \$ 2,005,593                              |
| Other real estate owned                           | \$ 3,275,081         | \$ -   | \$ -  | \$ 3,275,081                              |
| <u>Fair Value Measurements Using</u>              |                      |  |   |   |
|   | Carrying Value       | Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) |
| <u>Recurring items as of December 31, 2014</u>    |                      |  |   |   |
| Investment securities available-for-sale:         |                      |  |   |   |
| U.S. government agency obligations                | \$ 13,607,968        | \$ -   | \$ 13,607,968                                 | \$ -                                      |
| SBA backed securities                             | 4,312,035            | -  | 4,312,035                                     | -   |
| Municipal securities                              | 3,161,841            | -  | 3,161,841                                     | -   |
|   |                      |  |   |   |
| Total investment securities available-for-sale    | <u>\$ 21,081,844</u> | <u>\$ -</u>  | <u>\$ 21,081,844</u>                          | <u>\$ -</u>                               |
| <u>Nonrecurring items as of December 31, 2014</u> |                      |  |   |   |
| Loans measured for impairment                     | \$ 1,984,283         | \$ -   | \$ -  | \$ 1,984,283                              |
| Other real estate owned                           | \$ 3,394,939         | \$ -   | \$ -  | \$ 3,394,939                              |

**PEOPLE'S BANK OF COMMERCE**  
**NOTES TO FINANCIAL STATEMENTS**

**Note 16 – Fair Value of Financial Instruments (continued)**

The following tables disclose fair value information about all financial instruments, whether carried or not carried at fair value on the balance sheet, where it is practicable to estimate that value.

|   |                        | Fair Value at December 31, 2015 |  |  |  |
|---|------------------------|---------------------------------|--|--|--|
|   | <u>Carrying Amount</u> | <u>Total</u>                    | Quoted Prices in<br>Active Markets<br>for Identical<br>Assets<br>(Level 1) | Significant Other<br>Observable<br>Inputs<br>(Level 2) | Significant<br>Unobservable<br>Inputs<br>(Level 3) |
| <b>Financial assets</b>   |                        |                                 |  |  |  |
| Cash and cash equivalents   | \$ 24,202,855          | \$ 24,202,855                   | \$ 24,202,855  | \$ -   | \$ -   |
| Time deposits with other institutions                                   | 1,245,000              | 1,245,000                       | 1,245,000  | -  | -  |
| Investment securities available-for-sale                                | 36,719,351             | 36,719,351                      | -  | 36,719,351   | -  |
| Investment securities held to maturity                                  | 8,208,026              | 8,494,268                       | -  | 8,494,268  | -  |
| Restricted equity securities  | 257,700                | 257,700                         | 257,700  | -  | -  |
| Loans held-for-sale   | 2,392,600              | 2,392,600                       | -  | 2,392,600  | -  |
| Loans receivable, gross   | 160,311,287            | 131,077,309                     | -  | -  | 131,077,309  |
| <b>Financial liabilities</b>  |                        |                                 |  |  |  |
| Noninterest-bearing demand deposits                                     | \$ 86,745,258          | \$ 86,745,258                   | \$ 86,745,258  | \$ -   | \$ -   |
| Interest-bearing demand, money market<br>accounts, and savings deposits | 113,121,623            | 113,121,623                     | -  | 113,121,623  | -  |
| Time certificates of deposit  | 24,608,189             | 23,224,933                      | -  | 23,224,933   | -  |
|   |                        | Fair Value at December 31, 2014 |  |  |  |
|   | <u>Carrying Amount</u> | <u>Total</u>                    | Quoted Prices in<br>Active Markets<br>for Identical<br>Assets<br>(Level 1) | Significant Other<br>Observable<br>Inputs<br>(Level 2) | Significant<br>Unobservable<br>Inputs<br>(Level 3) |
| <b>Financial assets</b>   |                        |                                 |  |  |  |
| Cash and cash equivalents   | \$ 17,213,278          | \$ 17,213,278                   | \$ 17,213,278  | \$ -   | \$ -   |
| Time deposits with other institutions                                   | 5,975,912              | 5,975,912                       | 5,975,912  | -  | -  |
| Investment securities available-for-sale                                | 21,081,844             | 21,081,844                      | -  | 21,081,844   | -  |
| Investment securities held to maturity                                  | 6,298,321              | 6,515,385                       | -  | 6,515,385  | -  |
| Restricted equity securities  | 171,800                | 171,800                         | 171,800  | -  | -  |
| Loans held-for-sale   | 1,073,500              | 1,073,500                       | -  | 1,073,500  | -  |
| Loans receivable, gross   | 147,553,329            | 122,856,329                     | -  | -  | 122,856,329  |
| <b>Financial liabilities</b>  |                        |                                 |  |  |  |
| Noninterest-bearing demand deposits                                     | \$ 67,332,096          | \$ 67,332,096                   | \$ 67,332,096  | \$ -   | \$ -   |
| Interest-bearing demand, money market<br>accounts, and savings deposits | 105,083,239            | 105,083,239                     | -  | 105,083,239  | -  |
| Time certificates of deposit  | 18,152,613             | 17,375,496                      | -  | 17,375,496   | -  |

The Bank normally intends to hold the majority of its financial instruments until maturity; it does not expect to realize many of the estimated amounts disclosed. The disclosures also do not include estimated fair value amounts for items which are not defined as financial instruments but which have significant value. These include such off-balance sheet items as core deposit intangibles on non-acquired deposits. The Bank does not believe that it would be practicable to estimate a representational fair value for these types of items as of December 31, 2015 and 2014.

# PEOPLE'S BANK OF COMMERCE

## NOTES TO FINANCIAL STATEMENTS

### Note 17 – Regulatory Matters

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

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

As of the most recent notifications from its regulatory agencies, the Bank was categorized as well-capitalized under the regulatory framework for prompt corrective action. To be categorized as adequately capitalized, the Bank must maintain minimum total risk-based capital, Tier 1 risk-based capital, and Tier 1 leverage capital ratios as set forth in the following table. There are no conditions or events since that notification that management believes may have changed the Bank's category.

| (in thousands)                                       | Actual    |       | For Capital Adequacy Purposes |       | To Be Well-Capitalized under Prompt Corrective Action Provisions |        |
|--|-----------|-------|-------------------------------|-------|--|--------|
|  | Amount    | Ratio | Amount                        | Ratio | Amount   | Ratio  |
| <u>December 31, 2015</u>                             |           |       |                               |       |  |        |
| Total capital to risk-weighted assets                | \$ 25,923 | 14.2% | \$ 14,653                     | ≥8.0% | \$ 18,316  | ≥10.0% |
| Tier 1 capital to risk-weighted assets               | 23,896    | 13.1% | 10,990                        | ≥6.0% | 10,990   | ≥8.0%  |
| Common Equity Tier 1 Capital to risk-weighted assets | 23,896    | 13.1% | 8,242                         | ≥4.5% | 11,905   | ≥6.5%  |
| Tier 1 capital to average assets                     | 23,896    | 9.9%  | 9,660                         | ≥4.0% | 12,074   | ≥5.0%  |
| <u>December 31, 2014</u>                             |           |       |                               |       |  |        |
| Total capital to risk-weighted assets                | \$ 24,083 | 15.0% | \$ 12,875                     | ≥8.0% | \$ 16,094  | ≥10.0% |
| Tier 1 capital to risk-weighted assets               | 22,175    | 13.8% | 6,438                         | ≥4.0% | 9,656  | ≥6.0%  |
| Tier 1 capital to average assets                     | 22,175    | 10.5% | 8,459                         | ≥4.0% | 10,574   | ≥5.0%  |

**Note 17 – Regulatory Matters (continued)**

The Federal Reserve and the Federal Deposit Insurance Corporation approved final capital rules in July 2013, which substantially amend the existing capital rules for banks. These new rules reflect, in part, certain standards initially adopted by the Basel Committee on Banking Supervision in December 2010 (which standards are commonly referred to as “Basel III”) as well as requirements contemplated by the Dodd-Frank Act.

Under the new capital rules, effective January 1, 2015, the Bank adopted requirements for a new capital ratio of common equity Tier 1 capital to risk-weighted assets. Common equity Tier 1 capital generally consists of accumulated surplus and common stock (subject to certain adjustments). The Bank will also be required to establish and phase-in a “conservation buffer,” consisting of a common equity Tier 1 capital amount equal to 2.5% of risk-weighted assets by 2019. An institution that does not meet the conservation buffer requirement will be subject to restrictions on certain activities including payment of dividends, stock repurchases, and discretionary bonuses to executive officers. The phase-in begins in 2016 and increases until fully phased-in by 2019.

The prompt corrective action rules are modified to include the common equity Tier 1 capital ratio and to increase the Tier 1 capital ratio requirements for the various thresholds. For example, the requirements for the Bank to be considered well-capitalized under the rules will be a 5.0% leverage ratio, a 6.5% common equity Tier 1 capital ratio, an 8.0% Tier 1 capital ratio, and a 10.0% total capital ratio. To be adequately capitalized, those ratios are 4.0%, 4.5%, 6.0%, and 8.0%, respectively.

The rules modify the manner in which certain capital elements are determined. The rules

make changes to the methods of calculating the risk-weighting of certain assets, which in turn affects the calculation of the risk-weighted capital ratios. Higher risk weights are assigned to various categories of assets, including credit facilities that finance the acquisition, development or construction of commercial real estate, certain exposures or credits that are 90 days past due or are nonaccrual status, securitization exposures, and in certain cases mortgage servicing rights and deferred tax assets.