

**California Business Bank**

**Financial Report**

**December 31, 2008 and 2007**

## Table of Contents

	<b>Page</b>
<b>Independent Auditors' Report</b>	1
<b>Financial Statements</b>	
Balance Sheets	2
Statements of Operations	3
Statements of Stockholders' Equity	4
Statements of Cash Flows	5
Notes to Financial Statements	6-30



## Independent Auditors' Report

Board of Directors  
California Business Bank  
Los Angeles, California

We have audited the accompanying balance sheets of California Business Bank as of December 31, 2008 and 2007, and the related statements of operations, stockholders' equity, and cash flows for the years then ended. These financial statements are the responsibility of the Bank's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of California Business Bank as of December 31, 2008 and 2007, and the results of its operations and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

*Hutchinson and Bloodgood LLP*

April 17, 2009

**California Business Bank**  
**Balance Sheets**  
**December 31, 2008 and 2007**

	<b>2008</b>	<b>2007</b>
<b>Assets</b>		
Cash and due from banks	\$ 1,665,603	\$ 1,426,254
Federal funds sold	<u>3,775,000</u>	<u>7,760,000</u>
Total cash and cash equivalents	5,440,603	9,186,254
Investments in securities available-for-sale	11,393,704	24,084,342
Federal Home Loan Bank (FHLB) Certificate of Deposit	2,250,000	--
FHLB stock, at cost	609,500	335,800
Loans, net	82,935,638	82,632,411
Premises and equipment, net	771,898	769,132
Accrued interest receivable	405,387	491,365
Foreclosed assets, net of allowance	2,188,710	--
Other assets	<u>722,169</u>	<u>341,997</u>
Total assets	<u>\$ 106,717,609</u>	<u>\$ 117,841,301</u>
<b>Liabilities and Stockholders' Equity</b>		
Deposits		
Non-interest bearing	\$ 18,314,678	\$ 16,680,371
Interest bearing	<u>66,795,605</u>	<u>77,550,443</u>
Total deposits	85,110,283	94,230,814
FHLB advances	6,000,000	5,000,000
Accrued interest payable	87,101	234,441
Other liabilities	<u>241,037</u>	<u>399,743</u>
Total liabilities	<u>91,438,421</u>	<u>99,864,998</u>
Commitments and contingencies (Note 14, 15 and 16)		
Stockholders' equity		
Common stock - no par value, 5,000,000 shares authorized; 1,878,737 shares issued and outstanding for 2008 and 2007	18,743,845	18,743,845
Additional paid-in-capital	643,048	565,679
Accumulated deficit	(4,188,654)	(1,453,919)
Accumulated other comprehensive income	<u>80,949</u>	<u>120,698</u>
Total stockholders' equity	<u>15,279,188</u>	<u>17,976,303</u>
Total liabilities and stockholders' equity	<u>\$ 106,717,609</u>	<u>\$ 117,841,301</u>

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

**California Business Bank**  
**Statements of Operations**  
**Years Ended December 31, 2008 and 2007**

	<b>2008</b>	<b>2007</b>
Interest income		
Interest and fees on loans	\$ 5,313,655	\$ 5,928,227
Interest on Federal funds sold	213,369	730,783
Interest on investment securities	<u>951,949</u>	<u>1,092,429</u>
Total interest income	<u>6,478,973</u>	<u>7,751,439</u>
Interest expense on deposits		
Money market	284,533	869,424
Savings and NOW	510,020	282,753
Time deposits of \$100,000 or greater	1,204,286	1,643,318
Time deposits less than \$100,000	<u>489,743</u>	<u>663,785</u>
Total Interest expense on deposits	2,488,582	3,459,280
Interest expense on Federal funds purchased	327	245
Interest expense on FHLB advances	<u>258,260</u>	<u>522</u>
Total interest expense	<u>2,747,169</u>	<u>3,460,047</u>
Net interest income	3,731,804	4,291,392
Provision for loan losses	<u>2,150,000</u>	<u>506,050</u>
Net interest income after provision for loan losses	<u>1,581,804</u>	<u>3,785,342</u>
Other income		
Customer service fees	230,886	54,976
Other fees	<u>--</u>	<u>224,988</u>
Total other income	<u>230,886</u>	<u>279,964</u>
Operating expenses		
Salaries and employee benefits	2,355,534	2,207,575
Occupancy and equipment expenses	475,747	410,871
Foreclosed assets expenses	565,821	--
Other operating expenses	<u>1,348,074</u>	<u>1,047,491</u>
Total operating expenses	<u>4,745,176</u>	<u>3,665,937</u>
Income (loss) before income tax benefit	(2,932,486)	399,369
Income tax benefit	<u>(197,751)</u>	<u>(170,480)</u>
Net income (loss)	<u>\$ (2,734,735)</u>	<u>\$ 569,849</u>
Basic earnings (loss) per share	<u>\$ (1.46)</u>	<u>\$ 0.31</u>
Diluted earnings (loss) per share	<u>\$ (1.46)</u>	<u>\$ 0.30</u>

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

**California Business Bank**  
**Statements of Stockholders' Equity**  
**Years Ended December 31, 2008 and 2007**

	Number of Shares Outstanding	Common Stock	Additional Paid-in-Capital	Accumulated Deficit	Accumulated Other Compre- hensive Income (Loss)	Total
Balance, December 31, 2006	1,846,425	\$ 18,420,725	\$ 256,470	\$ (2,023,768)	\$ (37,663)	<u>\$ 16,615,764</u>
Comprehensive income						
Net income	--	--	--	569,849	--	569,849
Change in net unrealized loss on securities available-for-sale, net of reclassification and tax effect	--	--	--	--	158,361	<u>158,361</u>
Total comprehensive income						<u>728,210</u>
Proceeds from exercise of stock options	32,312	323,120	--	--	--	323,120
Stock option compensation	<u>--</u>	<u>--</u>	<u>309,209</u>	<u>--</u>	<u>--</u>	<u>309,209</u>
Balance, December 31, 2007	1,878,737	18,743,845	565,679	(1,453,919)	120,698	<u>17,976,303</u>
Comprehensive loss						
Net loss	--	--	--	(2,734,735)	--	(2,734,735)
Change in net unrealized loss on securities available-for-sale, net of reclassification and tax effect	--	--	--	--	(39,749)	<u>(39,749)</u>
Total comprehensive income						<u>(2,774,484)</u>
Stock option compensation	<u>--</u>	<u>--</u>	<u>77,369</u>	<u>--</u>	<u>--</u>	<u>77,369</u>
Balance, December 31, 2008	<u>1,878,737</u>	<u>\$ 18,743,845</u>	<u>\$ 643,048</u>	<u>\$ (4,188,654)</u>	<u>\$ 80,949</u>	<u>\$ 15,279,188</u>

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

**California Business Bank**  
**Statements of Cash Flows**  
**Years Ended December 31, 2008 and 2007**

	<b>2008</b>	<b>2007</b>
<b>Cash Flows from Operating Activities</b>		
Net income (loss)	\$ (2,734,735)	\$ 569,849
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:		
Provision for loan losses	2,150,000	506,050
Provision for foreclosed asset losses	530,000	--
Depreciation and amortization of premises and equipment	231,030	193,179
Net amortization (accretion) of securities	59,133	(8,576)
Gain on sale of investments	(164,326)	--
Amortization of deferred loan fees and costs	(94,832)	(144,776)
Stock Option Compensation costs	77,369	309,209
Deferred income tax benefit	(130,235)	(277,085)
Net change in:		
Accrued interest receivable	85,978	(154,268)
Other assets	(209,113)	(40,077)
Accrued interest payable	(147,340)	158,951
Other liabilities	<u>(158,706)</u>	<u>214,385</u>
Net cash provided by (used in) operating activities	<u>(505,777)</u>	<u>1,326,841</u>
<b>Cash Flows from Investing Activities</b>		
Purchases of investment securities available-for-sale	(11,027,827)	(22,753,648)
Proceeds from maturities and paydowns of investment securities available-for-sale	23,743,085	15,503,288
Loans purchased	--	(4,426,901)
Loan originations and principal collections, net	(5,077,105)	(27,480,637)
Loan participation sold	--	1,717,467
Purchase of FHLB Certificate of Deposit	(2,250,000)	--
Purchase of FHLB stock	(273,700)	(133,600)
Purchase of premises and equipment	<u>(233,796)</u>	<u>(306,478)</u>
Net cash provided by (used in) investing activities	<u>4,880,657</u>	<u>(37,880,509)</u>
<b>Cash Flows from Financing Activities</b>		
Net increase (decrease) in deposits	(9,120,531)	25,966,713
Net increase in borrowings	1,000,000	5,000,000
Proceeds from issuance of common stock	--	323,120
Net cash provided by (used in) financing activities	<u>(8,120,531)</u>	<u>31,289,833</u>
Net decrease in cash and cash equivalents	(3,745,651)	(5,263,835)
Cash and Cash Equivalents at Beginning of Year	<u>9,186,254</u>	<u>14,450,089</u>
Cash and Cash Equivalents at End of Year	<u>\$ 5,440,603</u>	<u>\$ 9,186,254</u>
<b>Supplementary Cash Flow Information</b>		
Interest paid	\$ 2,747,169	\$ 3,460,047
Income taxes paid	\$ 184,000	\$ 800
Non-cash activities:		
Transfer of loans to foreclosed assets	\$ 2,718,710	\$ --

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

**California Business Bank**  
**Notes to Financial Statements**  
**December 31, 2008 and 2007**

---

**Note 1. Nature of Business**

California Business Bank (the Bank) was incorporated under the laws of the State of California on April 28, 2005, and commenced operations on November 1, 2005. The Bank is a community oriented commercial bank that offers a variety of banking services to individuals, small to medium sized businesses and high net worth individuals in Los Angeles and surrounding communities. Banking services include real estate, commercial and consumer loans, consumer and business checking accounts, savings accounts, certificates of deposit, merchant banking, money transfers, telephone banking, on-line banking and other services. The Bank operates from its corporate headquarters and banking office in Los Angeles, California. In June 2007, the Bank established in Rancho Cucamonga, California a Loan Production Office (LPO) and expanded it into a branch in 2008.

California Business Bank is a California state-chartered depository institution insured by the FDIC. As an insured depository institution, the Bank is subject to the regulations of certain federal and state agencies and undergoes periodic examination by those regulatory authorities.

**Note 2. Summary of Significant Accounting Policies**

***Use of Estimates***

In preparing financial statements in conformity with accounting principles generally accepted in the United States of America, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the balance sheet, and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Material estimates that are particularly susceptible to significant change in the near term relate to the determination of the allowance for loan losses and the valuation of deferred tax assets.

***Cash and Cash Equivalents***

For purposes of reporting cash flows, cash and cash equivalents include cash on hand, amounts due from correspondent banks and Federal funds sold on a daily basis.

***Investment Securities***

Debt securities that management 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 or trading, including equity securities with readily determinable fair values, are classified as "available for sale" and recorded at fair value, with unrealized gains and losses excluded from earnings and reported in other comprehensive income.

**California Business Bank**  
**Notes to Financial Statements**  
**December 31, 2008 and 2007**

---

**Note 2. Summary of Significant Accounting Policies (Continued)**

***Investment Securities (continued)***

Purchase premiums and discounts are recognized in interest income using methods approximating the interest method over the terms of the securities. Declines in the fair value of held-to-maturity and available-for-sale securities below their cost that are deemed to be other than temporary are reflected in earnings as realized losses. In estimating other-than-temporary impairment losses, management considers: 1) the length of time and extent to which the fair value has been less than cost, 2) the financial condition and near-term prospects of the issuer, and 3) the intent and ability of the Bank to retain its investment in the issuer for a period of time sufficient to allow for any anticipated recovery in fair value. Gains and losses on the sale of securities are recorded on the trade date and are determined using the specific identification method.

***Restricted Stock Investments***

Federal Home Loan Bank (FHLB) stock is carried at cost, and is evaluated for impairment based on an estimate of the ultimate recoverability of par value.

***Loans***

The Bank grants real estate, commercial and consumer loans to borrowing customers. A substantial portion of the loan portfolio is represented by commercial loans in the Los Angeles metropolitan area. The ability of the Bank's borrowers to honor their contracts is dependent upon the financial condition of the individual borrowers and the general economic conditions in the Bank's area.

Loans that management has the intent and ability to hold for the foreseeable future, until maturity or until paid off, are generally reported at their outstanding unpaid principal balances. These loans, as reported, have been reduced by net deferred loan fees, and the allowance for loan losses.

Interest income is accrued daily as earned on all loans. Interest is not accrued on loans that are generally 90 days or more past due. These loans are normally placed on non-accrual status unless they are well secured by collateral and in the process of collection. Interest income previously accrued on such loans is reversed against current period interest income. Interest income on non-accrual loans is generally recognized only to the extent of interest payments received.

Loan origination fees and costs are deferred and amortized as an adjustment of the loan's yield over the life of the loan using the interest method, which results in a constant rate of return or the straight-line method for lines of credit.

**California Business Bank**  
**Notes to Financial Statements**  
**December 31, 2008 and 2007**

---

**Note 2. Summary of Significant Accounting Policies (Continued)**

***Allowance for Loan Losses***

The allowance for loan losses is established as losses are estimated to have occurred through a provision for loan losses charged to expense. Loan losses are charged against the allowance when management believes the collectibility of the loan balance is unlikely. Subsequent loan loss recoveries, if any, are credited to the allowance.

The allowance for loan losses is evaluated on at least a quarterly basis by management. The allowance is based on management's periodic review of the collectibility of all loans in light of historical loan loss experiences, the nature and volume of the loan portfolio, adverse situations that may affect a borrower's ability to repay, the estimated value of any underlying collateral, and prevailing economic conditions. This evaluation is inherently subjective as it requires estimates that are susceptible to significant revision as more information becomes available.

The allowance consists of specific, general and unallocated components. The specific component relates to loans that are classified as doubtful, substandard or special mention. For such loans that are also classified as impaired, an allowance is established when the discounted cash flows (or collateral value or observable market price) of the impaired loan is lower than that of the carrying value of that loan. The general component covers non-classified loans and is based on historical loss experience adjusted for qualitative factors. An unallocated component is maintained to cover uncertainties that could affect management's estimate of probable losses. The unallocated component of the allowance reflects the margin of imprecision inherent in the underlying assumptions used in the methodologies for estimating specific and general losses in the portfolio.

A loan is considered impaired when, based on current information and events, it is probable that a creditor will be unable to collect the scheduled payments of principal or interest when due according to the contractual terms of the loan agreement. Factors considered by management in determining impairment include payment status, collateral value, and the probability of collecting scheduled principal and interest payments when due. Loans that experience insignificant payment delays and payment shortfalls generally are not classified as impaired. Management determines the significance of payment delays and payment shortfalls on a case-by-case basis, taking into consideration all of the circumstances surrounding the loan and the borrower, including the length of delay, the reasons for the delay, the borrower's prior payment record, and the amount of the shortfall in relation to the principal and interest owed. Impairment is measured on a loan-by-loan basis by either the present value of expected future cash flows discounted at the loan's effective interest rate, the loan's obtainable market price, or the fair value of the collateral if the loan is collateral-dependent.

**California Business Bank**  
**Notes to Financial Statements**  
**December 31, 2008 and 2007**

---

**Note 2. Summary of Significant Accounting Policies (Continued)**

***Foreclosed Assets***

Assets acquired through, or in lieu of, loan foreclosure are held for sale and are initially recorded at fair value less cost to sell at the date of foreclosure, establishing a new cost basis. Subsequent to foreclosure, valuations are periodically performed by management and the assets are carried at the lower of carrying amount or fair value less cost to sell. Revenue and expenses from operations and changes in the valuation allowance are included in net expenses from foreclosed assets.

***Transfers of Financial Assets***

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

***Premises and Equipment***

Premises and equipment are stated at cost less accumulated depreciation and amortization. Depreciation is provided for in amounts sufficient to relate the cost of depreciable assets to operations over their estimated service lives. Leasehold improvements are amortized over the term of the lease or the service lives of the improvements, whichever is shorter. The straight-line method of depreciation is followed for financial reporting purposes, while both accelerated and straight-line methods are followed for income tax purposes.

***Earnings (Loss) Per Share***

The Bank follows Statement of Financial Accounting Standards (SFAS) No. 128, *Earnings Per Share*. Basic earnings (loss) per share represents income (loss) available to common stock divided by the weighted-average number of common shares outstanding during the period. Diluted earnings (loss) per share reflect additional common shares that would have been outstanding if dilutive potential common shares had been issued, as well as any adjustment to income that would result from the assumed conversion. Potential common shares that may be issued by the Bank relate solely to outstanding stock options, and are determined using the treasury stock method.

**California Business Bank**  
**Notes to Financial Statements**  
**December 31, 2008 and 2007**

---

**Note 2. Summary of Significant Accounting Policies (Continued)**

***Earnings (Loss) Per Share (continued)***

The weighted-average number of shares outstanding for the years ended December 31 was as follows:

	2008	2007
Average number of common shares outstanding	1,878,737	1,848,284
Effect of dilutive options	<u>          --</u>	<u>      41,578</u>
Average number of common shares outstanding used to calculate diluted earnings (loss) per common share	<u>  1,878,737</u>	<u>  1,889,862</u>

***Off-Balance Sheet Financial Instruments***

In the ordinary course of business, the Bank has entered into off-balance sheet financial instruments consisting of commitments to extend credit, commitments under credit card advancements, and standby letters of credit. Such financial instruments are recorded in the financial statements when they become payable. The credit risk associated with these commitments is considered by management and is reserved for at a level deemed adequate to provide for known and inherent losses.

***Income Taxes***

Deferred income taxes are recognized for estimated future tax effects attributable to income tax carry forwards as well as temporary differences between income tax and financial reporting purposes. Valuation allowances are established when necessary to reduce the deferred tax asset to the amount expected to be realized. Deferred tax assets and liabilities are reflected at currently enacted income tax rates applicable to the period in which the deferred tax assets or liabilities are expected to be realized or settled. As changes in tax laws or rates are enacted, deferred tax assets and liabilities are adjusted accordingly through the provision for income taxes.

**California Business Bank**  
**Notes to Financial Statements**  
**December 31, 2008 and 2007**

---

**Note 2. Summary of Significant Accounting Policies (Continued)**

***Income Taxes (continued)***

The Bank adopted Financial Accounting Standards Board (FASB) Interpretation No. 48, *Accounting for Uncertainty in Income Taxes, an interpretation of FASB Statement 109*, as of January 1, 2008. Interpretation 48 prescribes a recognition threshold and a measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. Benefits from tax positions are recognized in the financial statements only when it is more likely than not that the tax position will be sustained upon examination by the appropriate taxing authority that would have full knowledge of all relevant information. A tax position that meets the more-likely-than-not recognition threshold is measured at the largest amount of benefit that is greater than 50% likely of being realized upon ultimate settlement. Tax positions that previously failed to meet the more-likely-than-not recognition threshold are recognized in the first subsequent financial reporting period in which that threshold is met. Previously recognized tax positions that no longer meet the more-likely-than-not recognition threshold are derecognized in the first subsequent financial reporting period in which that threshold is no longer met. Adoption of Interpretation 48 did not have a significant impact on the Bank's financial statements.

***Stock-Based Compensation Plans***

The Bank accounts for stock option awards under SFAS No. 123(R) (revised 2004), *Share-Based Payment*. SFAS No. 123(R) requires that the compensation cost relating to share-based payment transactions be recognized in financial statements. That cost is measured based on the fair value of the equity or liability instruments issued. SFAS No. 123(R) covers a wide range of share-based compensation arrangements including stock options, restricted share plans, performance-based awards, share appreciation rights, and employee share purchase plans. The effect of SFAS No. 123(R) is to require entities to measure the cost of employee services received in exchange for stock options based on the grant-date fair value of the award, and to recognize the cost over the period the employee is required to provide services for the award. SFAS No. 123(R) permits entities to use any option-pricing model that meets the fair value objective in the Statement.

Compensation cost related to the non-vested portion of awards outstanding as of January 1, 2007 was based on the grant-date fair value of those awards as calculated under the original provisions of SFAS No. 123(R); that is, the Bank was not required to re-measure the grant-date fair value estimate of the unvested portion of awards granted prior to the effective date of SFAS No. 123(R).

**California Business Bank**  
**Notes to Financial Statements**  
**December 31, 2008 and 2007**

---

**Note 2. Summary of Significant Accounting Policies (Continued)**

**Recent Accounting Pronouncements**

In May 2008, FASB issued SFAS No. 162, *The Hierarchy of Generally Accepted Accounting Principles*, which identifies the sources of accounting principles and the framework for selecting the principles used in the preparation of financial statements of nongovernmental entities that are presented in conformity with accounting principles generally accepted (GAAP) in the United States of America (the GAAP hierarchy). The sources of accounting principles that are generally accepted are categorized in descending order of authority as follows: a. FASB Statements of Financial Accounting Standards and Interpretations, FASB Statement 133 Implementation Issues, FASB Staff Positions, and American Institute of Certified Public Accountants (AICPA) Accounting Research Bulletins and Accounting Principles Board Opinions that are not superseded by actions of the FASB. b. FASB Technical Bulletins and, if cleared by the FASB, AICPA Industry Audit and Accounting Guides and Statements of Position. c. AICPA Accounting Standards Executive Committee Practice Bulletins that have been cleared by the FASB, consensus positions of the FASB Emerging Issues Task Force (EITF), and the Topics discussed in Appendix D of *EITF Abstracts* (EITF D-Topics). d. Implementation guides (Q&As) published by the FASB staff, AICPA Accounting Interpretations, AICPA Industry Audit and Accounting Guides and Statements of Position not cleared by the FASB, and practices that are widely recognized and prevalent either generally or in the industry. The adoption of SFAS No. 162 did not have an impact on the Branch's financial statements.

**Note 3. Investment Securities**

The amortized cost and fair value of investment securities by contractual maturity at December 31 were as follows:

	2008			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Securities available for sale:				
U.S. agency securities				
Due within 1 year	\$ --	\$ --	\$ --	\$ --
Due after 1 year through 5 years	5,283,983	--	(22,983)	5,261,000
Mortgage-backed securities	<u>5,985,185</u>	<u>147,519</u>	<u>--</u>	<u>6,132,704</u>
	<u>\$ 11,269,168</u>	<u>\$ 147,519</u>	<u>\$ (22,983)</u>	<u>\$ 11,393,704</u>

**California Business Bank**  
**Notes to Financial Statements**  
**December 31, 2008 and 2007**

**Note 3. Investment Securities (Continued)**

	2007			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Securities available for sale:				
U.S. agency securities				
Due within 1 year	\$ 3,999,787	\$ 1,973	\$ --	\$ 4,001,760
Due after 1 year through 5 years	3,998,997	16,563	--	4,015,560
Mortgage-backed securities	13,060,816	146,817	--	13,207,633
Collateral mortgage obligations	<u>2,819,632</u>	<u>39,757</u>	<u>--</u>	<u>2,859,389</u>
	<u>\$ 23,879,232</u>	<u>\$ 205,110</u>	<u>\$ --</u>	<u>\$ 24,084,342</u>

The Bank had \$8,506,000 in securities pledged as collateral to the State of California and \$2,764,000 in securities pledged as collateral to FHLB as of December 31, 2008.

Information pertaining to securities with gross unrealized losses at December 31, 2008, aggregated by investment category and length of time that individual securities have been in a continuous loss position, follows:

	Less Than 12 Months		12 Months or More	
	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value
Securities available for sale				
Federal agency securities	\$ 22,983	\$ 5,261,000	\$ --	\$ --
Mortgage-backed securities	<u>--</u>	<u>--</u>	<u>--</u>	<u>--</u>
	<u>\$ 22,983</u>	<u>\$ 5,261,000</u>	<u>\$ --</u>	<u>\$ --</u>

Management evaluates securities for other-than-temporary impairment at least on a quarterly basis, and more frequently when economic or market concerns warrant such evaluation. Consideration is given to (1) the length of time and the extent to which the fair value has been less than cost, (2) the financial condition and near-term prospects of the issuer, and (3) the intent and ability of the Bank to retain its investment in the issuer for a period of time sufficient to allow for any anticipated recovery in fair value.

**California Business Bank**  
**Notes to Financial Statements**  
**December 31, 2008 and 2007**

---

**Note 4. FHLB Certificate of Deposit**

As of December 31, 2008, the Bank had a certificate of deposit with FHLB in the amount of \$2,250,000. The certificate of deposit is pledge as collateral to secure FHLB advances. The certificate of deposit has maturity of January 15, 2009 and at an interest rate of 0.01%.

**Note 5. FHLB Stock Investments**

FHLB stock investments amounted to \$609,500 and \$335,800 at December 31, 2008 and 2007, respectively, and are recorded at cost.

The Bank is a member of the FHLB of San Francisco, and as such is required to hold shares of FHLB stock based on 1% of total regulatory assets.

**Note 6. Loans and Allowance for Loan Losses**

The composition of the Bank's loan portfolio at December 31 was as follows:

	2008	2007
Commercial loans	\$ 53,204,639	\$ 53,909,299
Commercial real estate loans	23,487,837	15,781,524
Construction loans	7,182,145	13,739,916
SBA loans	907,936	150,000
Installment loans	<u>155,536</u>	<u>128,595</u>
	84,938,093	83,709,334
Allowance for loan losses	(2,035,000)	(1,085,000)
Net deferred loan fees and premiums	<u>32,545</u>	<u>8,077</u>
Net loans	<u>\$ 82,935,638</u>	<u>\$ 82,632,411</u>

The changes in the allowance for loan losses as of December 31 are summarized as follows:

	2008	2007
Balance at beginning of year	\$ 1,085,000	\$ 578,950
Provision for loan losses	2,150,000	506,050
Amount charged-off, net of recoveries	<u>(1,200,000)</u>	<u>--</u>
Balance at end of year	<u>\$ 2,035,000</u>	<u>\$ 1,085,000</u>

**California Business Bank**  
**Notes to Financial Statements**  
**December 31, 2008 and 2007**

---

**Note 6. Loans and Allowance for Loan Losses (Continued)**

The following is a summary of information on impaired and non-accrual loans at December 31:

	2008	2007
Impaired loans without a valuation allowance	\$ 1,058,410	\$ --
Impaired loans with a valuation allowance	<u>998,180</u>	<u>--</u>
Total impaired loans	<u>\$ 2,056,590</u>	<u>\$ --</u>
Valuation allowance for impaired loans	\$ 489,000	\$ --
Total non-accrual loans	\$ 2,056,590	\$ --
Total loans past-due 90 days or more and still accruing	\$ --	\$ --

The average balance of impaired loans during 2008 was approximately \$1,752,000. Interest income of approximately \$18,000 was not recognized on impaired loans, while such loans were considered impaired during the year ended December 31, 2008. No additional funds were committed to be advanced in connection with impaired loans.

As of December 31, 2007, there were no impaired loans, no loans past due over 90 days or on a non-accrual basis.

Loans serviced for others consist of loan participations sold and are not included in the accompanying balance sheets. The unpaid principal balance of loans serviced for others was \$13,586,456 and \$9,896,812 at December 31, 2008 and 2007, respectively.

**Note 7. Foreclosed Assets**

At December 31, 2008, foreclosed assets consist of participation interests in residential real property in the amount of \$2,188,710. The valuation allowance amounted to \$530,000 at December 31, 2008. Expenses including the provision for losses applicable to foreclosed assets amounted to approximately \$566,000 for the year ended December 31, 2008. There were no foreclosed assets at December 31, 2007.

**California Business Bank**  
**Notes to Financial Statements**  
**December 31, 2008 and 2007**

---

**Note 8. Related Party Transactions**

In the ordinary course of business, the Bank grants loans to certain officers, directors and companies with which they are associated. All such loans and commitments to lend are made under terms that are consistent with the Bank's normal lending policies. The gross available balance and outstanding balance of such loans at December 31 are as follows:

	2008	2007
Balance at beginning of year	\$ 6,466,068	\$ 4,438,806
New loans and advances	1,664,622	5,516,207
Principal payments	<u>(2,283,433)</u>	<u>(3,488,945)</u>
Balance at end of year	<u>\$ 5,847,257</u>	<u>\$ 6,466,068</u>
Gross available balance	<u>\$ 487,846</u>	<u>\$ 479,683</u>

As of December 31, 2008, there were \$487,846 in undisbursed lines of credit to directors and other related parties.

Deposits from related parties held by the Bank at December 31, 2008 and 2007 totaled \$9,123,588 and \$10,724,143, respectively.

**Note 9. Premises and Equipment**

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

	2008	2007
Equipment and furniture	\$1,252,389	\$ 1,050,856
Leasehold improvements	<u>74,328</u>	<u>74,328</u>
	1,326,717	1,125,184
Less accumulated depreciation and amortization	<u>(554,819)</u>	<u>(356,052)</u>
	<u>\$ 771,898</u>	<u>\$ 769,132</u>

Depreciation and amortization expense for the years ended December 31, 2008 and 2007 amounted to \$231,030 and \$193,179, respectively.

**California Business Bank**  
**Notes to Financial Statements**  
**December 31, 2008 and 2007**

---

**Note 10. Deposits**

The composition of deposits as of December 31 was as follows:

	2008	2007
Non-interest bearing demand	\$ 18,314,678	\$ 16,680,371
Interest bearing demand	1,650,670	4,422,227
Money market and savings	24,069,436	31,431,791
Time deposits under \$100,000	7,510,385	13,337,424
Time deposits \$100,000 and over	<u>33,565,114</u>	<u>28,359,001</u>
	<u>\$85,110,283</u>	<u>\$94,230,814</u>

As of December 31, 2008, the schedule of maturities for time deposits was as follows:

2009	\$ 40,267,175
2010	<u>808,324</u>
	<u>\$41,075,499</u>

**Note 11. FHLB Borrowings**

As a member of the FHLB, the Bank may borrow funds collateralized by securities or qualified loans up to 25% of its asset base. The Bank had advances from FHLB of \$6,000,000 and \$5,000,000 as of December 31, 2008 and 2007, respectively, with a weighted average interest rate of 3.16%. \$1,000,000 has a maturity date of January 30, 2009 and \$5,000,000 will mature on December 31, 2009.

**Note 12. Lines of Credit**

***Marshall & Ilsley Bank***

The Bank has a \$5,000,000 Federal funds line of credit and a \$3,000,000 letter of credit available with Marshall and Ilsley Bank. At December 31, 2008 and 2007, the Bank had no borrowings outstanding.

***Pacific Coast Bankers Bank***

The Bank has a \$5,000,000 Federal funds line of credit with Pacific Coast Bankers Bank. At December 31, 2008 and 2007, the Bank had no borrowings outstanding.

**California Business Bank**  
**Notes to Financial Statements**  
**December 31, 2008 and 2007**

---

**Note 12. Lines of Credit (Continued)**

***Nexity Bank***

The Bank has a \$4,000,000 Federal funds line of credit with Nexity Bank. At December 31, 2008 and 2007, the Bank had no borrowings outstanding.

**Note 13. Income Taxes**

The following is a summary of the provision for income taxes (benefit) for the years ended December 31:

	2008	2007
Current tax provision (benefit)		
Federal	\$ --	\$ 363,109
State	800	118,584
Benefit of loss carry backs and carry forwards	<u>(68,316)</u>	<u>(375,088)</u>
	<u>(67,516)</u>	<u>106,605</u>
Deferred tax benefit		
Federal	(76,706)	(211,069)
State	<u>(53,529)</u>	<u>(66,016)</u>
	<u>(130,235)</u>	<u>(277,085)</u>
	<u>\$ (197,751)</u>	<u>\$ (170,480)</u>

The components of the net deferred tax asset at December 31 are as follows:

	2008	2007
Deferred tax assets		
Allowance for loan losses	\$ 694,933	\$ 434,164
Allowance for foreclosed assets	218,118	--
Pre-opening expenses	216,778	235,098
Net operating loss carry forwards	746,190	--
Other	<u>370</u>	<u>--</u>
	1,876,389	669,262
Valuation allowance	<u>(1,232,076)</u>	<u>(262,635)</u>
	<u>644,313</u>	<u>406,627</u>

**California Business Bank**  
**Notes to Financial Statements**  
**December 31, 2008 and 2007**

---

**Note 13. Income Taxes (Continued)**

	2008	2007
Deferred tax liabilities		
Unrealized gains	\$ (51,252)	\$ (84,412)
Accumulated depreciation	(101,625)	(71,233)
Cash basis of reporting for tax purposes	(114,273)	(51,683)
FHLB stock dividends	<u>(21,095)</u>	<u>(6,626)</u>
	<u>(288,245)</u>	<u>(213,954)</u>
Net deferred tax asset	<u>\$ 356,068</u>	<u>\$ 192,673</u>

As of December 31, 2008, the Bank had net operating loss carry forwards of approximately \$1,787,000 and \$1,937,000 for federal and state tax purposes, respectively, which are available to offset future taxable income. The federal net operating loss carry forward expires after the year 2028. The state net operating loss carry forward expires after the year 2018.

**Note 14. Off-Balance Sheet Activities**

***Credit-Related Financial Instruments***

The Bank is a party to financial instruments with off-balance-sheet risk to meet the financing needs of its customers in the normal course of business. These financial instruments generally include commitments to grant loans, unadvanced lines of credit, standby letters of credit and commercial letters of credit. Such commitments involve, to varying degrees, elements of credit and interest rate risk in excess of the amount recognized in the balance sheets.

The Bank's exposure to potential credit loss is represented by the contractual amount of these commitments. The Bank uses the same credit policies in making commitments as it does for normal lending activities.

At December 31, the following lending commitments were outstanding whose contract amounts represent potential credit risk:

	Contract Amount	
	2008	2007
Commitments to extend credit	\$ 21,891,657	\$ 32,225,484
Standby letters of credit	\$ 1,466,748	\$ 1,165,000

**California Business Bank**  
**Notes to Financial Statements**  
**December 31, 2008 and 2007**

---

**Note 14. Off-Balance Sheet Activities (Continued)**

***Credit-Related Financial Instruments (continued)***

Commitments to extend credit are agreements to lend to customers as long as there is no default of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Since some of the commitments may expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. The Bank evaluates each customer's creditworthiness on a case-by-case basis. The amount of collateral obtained if deemed necessary by the Bank upon extension of credit is based on management's credit analysis. Collateral held varies but may include cash on deposit, accounts receivable, inventory, equipment, income-producing commercial properties, residential properties, and properties under construction.

Standby and commercial letters of credit are conditional commitments issued by the Bank to guarantee the performance of a customer to a third party. All letters of credit issued have expiration dates within one year. The credit risk involved in issuing letters of credit is generally less than that involved in extending loans to existing Bank borrowers.

FASB Interpretation No. 45, *Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Guarantees of Indebtedness of Others*, requires a guarantor to recognize, at the inception of a guarantee, a liability equal to the fair value of the obligation undertaken in issuing the guarantee. Newly issued or modified guarantees that are not derivative contracts would be recorded on the Bank's balance sheet at their fair value at inception.

The Bank considers standby letters of credit to be guarantees under FIN 45. There were \$1,466,748 and \$1,165,000 outstanding standby letters of credit as of December 31, 2008 and 2007, respectively. The amount of the liability related to such guarantees is insignificant.

***Operating Lease Commitments***

The Bank leases its Los Angeles facility under an operating lease through September 2010, with an option to extend the lease term for two five-year periods. The lease also provides for predetermined rent increases during the term of the lease. In June 2007, the Bank opened a Rancho Cucamonga facility which has an operating lease term of two years. At December 31, 2008, future minimum rental payments were as follows:

Years Ending December 31,

2009	\$ 177,147
2010	<u>140,245</u>
	<u>\$ 317,392</u>

**California Business Bank**  
**Notes to Financial Statements**  
**December 31, 2008 and 2007**

---

**Note 15. Other Commitments and Contingencies**

Total rental expense for the years ended December 31, 2008 and 2007 was \$182,356 and \$164,538, respectively.

***Employment Agreement***

The Bank has entered into a three-year employment agreement with certain key officers. The agreement provides for an annual base salary plus other benefits. Employment may be terminated for cause, as defined, without incurring obligations. In the event of termination without cause, the officers are entitled to severance compensation equal to one year's salary and certain medical and auto expenses.

**Note 16. Concentration Risk**

The Bank grants commercial, real estate, construction and installment loans to businesses and individuals primarily in Los Angeles and surrounding communities. Most loans are secured by business assets, commercial real estate, and/or residential real estate. Loans secured by real estate represent 52% and 47% of total loans at December 31, 2008 and 2007, respectively.

The Bank had \$3,775,000 and \$7,760,000 in Federal funds sold to commercial banks at December 31, 2008 and 2007, respectively. It also had \$1,469,336 and \$1,361,002 on deposit with correspondent commercial banks, at December 31, 2008 and 2007, respectively.

Deposit accounts totaling \$35,234,550 or 41% and \$37,006,786 or 39% of total deposits were under the control of three customers at December 31, 2008 and 2007, respectively. One depositor controlled \$14,149,741 or 17% of total deposits at December 31, 2008.

**Note 17. 401(k) PLAN**

During 2006 the Bank adopted a 401(k) Plan that went into effect as of August 1, 2006 whereby substantially all employees who have attained the age of 21 and have completed at least six months of service are eligible to participate. Employees may contribute up to the maximum allowable under the Internal Revenue Code of their annual compensation to the 401(k) Plan each year. The Bank makes matching contributions of 50% up to a maximum of 6% of salaries. The Bank's matching contributions amounted to \$23,919 and \$25,959 for the years ended December 31, 2008 and 2007, respectively.

**California Business Bank**  
**Notes to Financial Statements**  
**December 31, 2008 and 2007**

---

**Note 18. Restrictions on Dividends**

Federal and state banking regulations place certain restrictions on dividends paid to shareholders. The total amount of dividends that may be paid at any date is generally limited to the lesser of the Bank's retained earnings or net income for the last three years, subject to minimum capital requirements. As of December 31, 2008, the Bank was restricted from paying dividends.

**Note 19. Stock-Based Compensation**

On October 27, 2005, the Board of Directors approved the reservation of 553,927 shares of common stock for use in a stock option plan. Under the October 2005 Stock Option Plan, the Bank may grant options to its directors, officers and employees for up to 30% of the number of shares of common stock outstanding at the time of grant. Both incentive stock options and non-qualified stock options may be granted under the plan. At December 31, 2008, a total of 392,255 options were outstanding and 161,672 options were available for future granting. The exercise price of these options may not be less than the fair market value of the common stock on the date granted. Among 488,995 options that have been granted, 190,250 options are non-qualified stock options and are fully exercisable at the date of grant. The incentive stock options issued are exercisable at 33-1/3% each year starting from the grant date and become fully vested after two years. All options expire 10 years after the date of grant. It is the Bank's policy to issue new shares of stock as options are exercised, rather than purchase stock from existing stockholders.

The fair value of each option grant is estimated on the date of grant using the Black-Scholes option-pricing model with the following weighted-average assumptions:

	2008	2007
Dividend yield	0.00%	0.00%
Expected life	10 years	10 years
Expected volatility	33.05%	24.25%
Risk-free interest rate	3.74%	5.16%

Expected lives of less than the 10 years contractual term are assigned to non-qualified options for which early exercise could result in significant tax benefits to the option holder. The risk-free interest rates match the rates on U.S. Treasury bonds with maturities similar to the expected lives of the options. The expected volatility is based on historical volatility.

Notwithstanding options granted in the future, the estimated pre-tax compensation expense related to options outstanding at December 31, 2008 for each of the future years ending December 31 is as follows:

2009	\$ 44,279
2010	52,183
2011	4,349

**California Business Bank**  
**Notes to Financial Statements**  
**December 31, 2008 and 2007**

---

**Note 19. Stock-Based Compensation (Continued)**

Future expense related to stock option awards would be impacted by new awards and/or modifications, repurchases and cancellations of existing awards.

A summary of the status of the Bank's stock option plan as of December 31 and changes during the year then ended are as follows:

	2008		2007	
	Shares	Weighted-Average Exercise Price	Shares	Weighted-Average Exercise Price
Outstanding at beginning of period	396,576	\$ 10.02	427,471	\$ 10.00
Granted	49,774	10.40	5,750	11.62
Exercised	--	--	(32,312)	10.00
Forfeited	<u>(54,095)</u>	10.11	<u>(4,333)</u>	10.00
Outstanding at December 31	<u>392,255</u>	\$ 10.06	<u>396,576</u>	\$ 10.02
Options exercisable at year-end	348,399	\$ 10.01	390,743	\$ 10.01
Weighted-average fair value of options granted during year		\$ 4.10		\$ 5.54
Weighted-average remaining contractual life of options outstanding and options exercisable		7.2 years		7.9 years

No options were exercised in 2008. At December 31, 2008, there was no intrinsic value for options exercisable and options expected to vest in the future as the market value of the stock at December 31, 2008, is less than the weighted-average exercise price for these options.

**California Business Bank**  
**Notes to Financial Statements**  
**December 31, 2008 and 2007**

**Note 19. Stock-Based Compensation (Continued)**

Information pertaining to options outstanding at December 31, 2008 is as follows:

Exercise Price	<u>Options Outstanding</u>			<u>Options Exercisable</u>	
	Number Outstanding	Weighted-Average Remaining Contractual Life	Weighted-Average Exercise Price	Number Exercisable	Weighted-Average Exercise Price
\$10.00	339,231	6.8 years	\$ 10.00	339,231	\$ 10.00
\$10.00	7,000	7.5 years	\$ 10.00	7,000	\$ 10.00
\$11.50 to 11.90	3,250	8.2 years	\$ 11.65	2,168	\$ 11.65
\$10.40	<u>42,774</u>	9.1 years	\$ 10.40	<u>--</u>	\$ 10.40
Options outstanding at end of year	<u>392,255</u>	7.2 years	\$ 10.06	<u>348,399</u>	\$ 10.03

  

	Number of Shares	Weighted-Average Grant Date Fair Value
Non-vested options, December 31, 2007	5,833	\$ 3.20
Granted	42,774	\$ 3.83
Vested	(3,285)	\$ 3.50
Forfeited	<u>(1,466)</u>	\$ 3.62
Non-vested options, December 31, 2008	<u>43,856</u>	

**Note 20. Minimum Regulatory Capital Requirements**

The Bank is subject to various regulatory capital requirements administered by the federal banking regulators. 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 requirements that involve quantitative measures of the Bank's assets, liabilities and certain off-balance-sheet items as calculated under regulatory accounting practices. The 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 capital ratios as set forth in the following table. Management believes that the Bank met all capital adequacy requirements to which it is subject as of December 31, 2008.

**California Business Bank**  
**Notes to Financial Statements**  
**December 31, 2008 and 2007**

**Note 20. Minimum Regulatory Capital Requirements (Continued)**

As of December 31, 2008, the most recent notification from the FDIC categorized the Bank as well capitalized under the regulatory framework for prompt corrective action. To be categorized as well capitalized, the Bank must maintain minimum capital ratios as set forth in the following table and must not be operating under a Cease and Desist Order. There are no conditions or events since the notification that management believes have changed the Bank's category. The Bank's actual capital amounts and ratios as of December 31, 2008 and 2007 are also presented in the table (dollars in thousands).

	2008					
	Actual		Minimum Capital Requirement		Minimum To Be Well Capitalized	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
Total capital to risk-weighted assets	\$16,340	18.1%	\$7,233	8%	\$9,041	10%
Tier 1 capital to risk-weighted assets	\$15,198	16.8%	\$3,617	4%	\$5,425	6%
Tier 1 capital to average assets	\$15,198	13.4%	\$4,545	4%	\$5,682	5%
	2007					
	Actual		Minimum Capital Requirement		Minimum To Be Well Capitalized	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
Total capital to risk-weighted assets	\$18,820	19.9%	\$7,558	8%	\$9,448	10%
Tier 1 capital to risk-weighted assets	\$17,854	18.9%	\$3,779	4%	\$5,669	6%
Tier 1 capital to average assets	\$17,854	15.4%	\$4,651	4%	\$5,814	5%

**California Business Bank**  
**Notes to Financial Statements**  
**December 31, 2008 and 2007**

---

**Note 21. Comprehensive Income**

Accounting principles generally accepted in the United States of America require that recognized revenue, expenses, gains and losses be included in net income. Although certain changes in assets and liabilities, such as unrealized gains and losses on available-for-sale securities, are reported as a separate component of the equity section of the balance sheet, such items, along with net income, are components of comprehensive income.

The components of other comprehensive income (loss) and related tax effects are as follows:

	<u>Years Ended December 31,</u>	
	2008	2007
Unrealized holding gains (loss) on securities available for sale	\$ (80,574)	\$ 263,052
Reclassification for gains (losses) realized in income	<u>          --</u>	<u>          --</u>
Net unrealized gains(losses)	(80,574)	263,052
Tax effect	<u>40,825</u>	<u>(104,691)</u>
Other comprehensive income (loss), net of tax	<u>\$ (39,749)</u>	<u>\$ 158,361</u>

The components of accumulated other comprehensive income (loss) included in stockholders' equity are as follows:

	<u>Years Ended December 31,</u>	
	2008	2007
Net unrealized holding gains on securities available for sale	\$ 124,536	\$ 205,110
Tax effect	<u>(43,587)</u>	<u>(84,412)</u>
Net of tax amount	<u>\$ 80,949</u>	<u>\$ 120,698</u>

**California Business Bank**  
**Notes to Financial Statements**  
**December 31, 2008 and 2007**

---

**Note 22. Fair Value of Financial Instruments**

Effective January 1, 2008, the Bank partially adopted SFAS No. 157, *Fair Value Measurements*, which defines fair value, establishes a framework for measuring fair value and expands disclosures about fair value measurements. SFAS No. 157 applies only to fair value measurements already required or permitted by other accounting standards and does not impose requirements for additional fair value measures. SFAS No. 157 was issued to increase consistency and comparability in reporting fair values. The Bank's adoption of SFAS No. 157 did not have a material impact on the Bank's financial condition or results of operations.

In February 2008, FASB issued Staff Position No. FAS 157-2, or FSP 157-2, which delays the effective date of SFAS No.157 for certain nonfinancial assets and nonfinancial liabilities, such as foreclosed assets, to fiscal years beginning after November 15, 2008, and interim periods within those fiscal years. The delay is intended to allow additional time to consider the effect of various implementation issues that have arisen, or that may arise, from the application of SFAS No. 157. The Bank has elected to apply the deferral provisions in FSP 157-2 and therefore has only partially applied the provisions of SFAS No. 157. The Bank deferred adoption of SFAS No. 157 with respect to nonfinancial assets and nonfinancial liabilities to January 1, 2009. The Bank does not believe that such adoption will have a material impact on the financial statements, but will result in additional disclosures related to the fair value of nonfinancial assets.

The application of SFAS No. 157 in situations where the market for a financial asset is not active was clarified by the issuance of FSP 157-3, *Determining the Fair Value of a Financial Asset When the Market for That Asset Is Not Active*, in October 2008. FSP 157-3 became effective immediately and did not significantly impact the methods by which the Bank determines the fair values of its financial assets.

SFAS No. 157 establishes a fair value hierarchy for valuation inputs that gives the highest priority to quoted prices in active markets for identical assets or liabilities and the lowest priority to unobservable inputs. The fair value hierarchy is as follows:

- *Level 1 Inputs* - Unadjusted quoted prices in active markets for identical assets or liabilities that the reporting entity has the ability to access at the measurement date.
- *Level 2 Inputs* - Inputs other than quoted prices included in Level 1 that are observable for the asset or liability, either directly or indirectly. These might include quoted prices for similar assets or liabilities in active markets, quoted prices for identical or similar assets or liabilities in markets that are not active, inputs other than quoted prices that are observable for the asset or liability (such as interest rates, volatilities, prepayment speeds, credit risks, etc.) or inputs that are derived principally from or corroborated by market data by correlation or other means.

**California Business Bank**  
**Notes to Financial Statements**  
**December 31, 2008 and 2007**

**Note 22. Fair Value Measurement (Continued)**

- *Level 3 Inputs* - Unobservable inputs for determining the fair values of assets or liabilities that reflect an entity's own assumptions about the assumptions that market participants would use in pricing the assets or liabilities.

Financial assets and financial liabilities measured at fair value on a recurring basis include the following:

*Securities Available for Sale.* Securities available for sale at December 31, 2008 consist of U.S. Government agency bonds rated AAA by S&P and high-quality US agency mortgage-backed securities. Securities classified as available for sale are reported at fair value utilizing Level 2 inputs. 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.

The following table summarizes financial assets measured at fair value on a recurring basis as of December 31, 2008, segregated by the level of the valuation inputs within the fair value hierarchy utilized to measure fair value:

	<i>Fair Value Measurements Using</i>			<i>Total</i>
	<i>Quoted Prices In Active Markets for Identical Assets (Level 1)</i>	<i>Significant Other Observable Inputs (Level 2)</i>	<i>Significant Unobservable Inputs (Level 3)</i>	
Investment securities available for sale	--	\$11,393,704	--	\$11,393,704

The fair value of a financial instrument is the price that would be received to sell the financial instrument in an orderly transaction between market participants at the measurement date. Fair value is best determined based upon quoted market prices. However, in many instances, there are no quoted market prices for the Bank's various financial instruments. In cases where quoted market prices are not available, fair value is based on estimates using present value or other valuation techniques. Those techniques are significantly affected by the assumptions used, including the discount rate and estimates of future cash flows. Discount rates on loans can vary significantly depending on the risk profile of the loan and the borrower's deposit relationship with the Bank. Accordingly, the fair value estimates may not be realized in the immediate settlement of the instrument. In accordance with SFAS No. 107, certain financial instruments and all non-financial instruments are excluded from its disclosure requirements. Accordingly, the aggregate fair value amounts presented may not necessarily represent the underlying fair value of the Bank.

**California Business Bank**  
**Notes to Financial Statements**  
**December 31, 2008 and 2007**

---

**Note 22. Fair Value Measurement (Continued)**

The following methods and assumptions were used by the Company in estimating fair value disclosures for financial instruments:

**Cash and Cash Equivalents** - The carrying amounts reported in the balance sheet for cash and short-term instruments approximate their fair values.

**Interest-Bearing Deposits in Other Banks** - The fair value of interest-bearing deposits in other banks is estimated by discounting future cash flows using current offering rates for deposits with similar characteristics.

**Investment Securities** - Fair values for investment securities are based on quoted market prices.

**Stock Investments** - The carrying values of stock investments approximate fair value based on the redemption provisions of the stock.

**Loans** - The fair value of performing fixed rate loans is estimated by discounting future cash flows using the Company's current offering rate for loans with similar characteristics. The fair value of performing adjustable rate loans is considered to be the same as book value. The fair value of non-performing loans is estimated at the fair value of the related collateral or, when, in management's opinion, foreclosure upon the collateral is unlikely, by discounting future cash flows using rates that take into account management's estimate of excess credit risk.

**Commitments to Extend Credit and Standby Letters of Credit** - The Company does not generally enter into long-term fixed rate commitments or letters of credit. These commitments are generally at prices that are at currently prevailing rates. These rates are generally variable and, therefore, there is no interest rate risk exposure. Accordingly, the fair market value of these instruments is equal to the carrying amount of their net deferred fees. The net deferred fees associated with these instruments are not material. The Company has no unusual credit risk associated with these instruments.

**Deposits** - The fair value of deposits is determined as follows: (i) for saving accounts, money market accounts and other deposits with no defined maturity, fair value is the amount payable on demand; (ii) for variable-rate term deposits, fair value is considered to be the same as book value; and (iii) for fixed-rate term deposits, fair value is estimated by discounting future cash flows using current offering rates for deposits with similar characteristics.

**FHLB Advances** - The fair values of FHLB advances are estimated using discounted cash flow analyses based on the Bank's current borrowing rate for FHLB advances.

**Accrued Interest** - The carrying amounts of accrued interest approximate fair value.

**California Business Bank**  
**Notes to Financial Statements**  
**December 31, 2008 and 2007**

---

**Note 22. Fair Value Measurement (Continued)**

The estimated fair values and related carrying amounts of the Bank's financial instruments at December 31 are as follows:

	2008	
	Carrying Amount	Fair Value
Financial assets		
Cash and cash equivalents	\$ 5,440,603	\$ 5,440,603
Investment securities available for sale	11,393,704	11,393,704
FHLB Certificate of Deposit	2,250,000	2,250,000
FHLB Stock, at cost	609,500	609,500
Loans, net	82,935,638	83,103,106
Accrued interest receivable	405,387	405,387
Financial liabilities		
Deposits	85,110,283	85,375,327
FHLB advances	6,000,000	6,000,000
Accrued interest payable	87,101	87,101
	2007	
	Carrying Amount	Fair Value
Financial assets		
Cash and cash equivalents	\$ 9,186,254	\$ 9,186,254
Investment securities available for sale	24,084,342	24,084,342
FHLB Stock, at cost	335,800	335,800
Loans, net	82,632,411	82,139,567
Accrued interest receivable	491,365	491,365
Financial liabilities		
Deposits	94,230,814	94,432,016
FHLB advances	5,000,000	5,000,000
Accrued interest payable	234,441	234,441