

CALWEST BANCORP AND SUBSIDIARY
Irvine, California

CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2012 and 2011

CALWEST BANCORP AND SUBSIDIARY
Irvine, California

CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2012 and 2011

CONTENTS

INDEPENDENT AUDITOR'S REPORT	1
CONSOLIDATED FINANCIAL STATEMENTS	
CONSOLIDATED BALANCE SHEETS	3
CONSOLIDATED STATEMENTS OF OPERATIONS	5
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)	6
CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY	7
CONSOLIDATED STATEMENTS OF CASH FLOWS	8
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS	9
SUPPLEMENTARY INFORMATION	35

INDEPENDENT AUDITOR'S REPORT

Board of Directors and Shareholders
CalWest Bancorp and Subsidiary
Irvine, California

Report on the Financial Statements

We have audited the accompanying consolidated financial statements of CalWest Bancorp and Subsidiary, which comprise the consolidated balance sheets as of December 31, 2012 and the related consolidated statements of operations, comprehensive income (loss), changes in shareholders' equity, and cash flows for the year then ended, and the related notes to the consolidated financial statements.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

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

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

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

Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of CalWest Bancorp and Subsidiary as of December 31, 2012, and the results of their operations and their cash flows for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Other Matters

The consolidated financial statements of CalWest Bancorp and Subsidiary as of December 31, 2011, were audited by other auditors whose report dated March 5, 2012, expressed an unqualified opinion on those statements.

As discussed in Note 14 to the consolidated financial statements, the Company's wholly-owned subsidiary, South County Bank (the "Bank"), is operating under a Consent Order, which has resulted in increased regulatory oversight of the Bank by the Office of the Comptroller of the Currency (the "OCC"). The Bank's ability to meet the requirements of the Consent Order is dependent upon a number of factors, including, among other things, its ability to return to profitability and to raise additional capital. Management's plans in regards to these items are discussed in Note 18.

Our audit was conducted for the purpose of forming an opinion on the consolidated financial statements as a whole. The Supplementary Information is presented for purposes of additional analysis of the consolidated financial statements rather than to present the financial position, results of operations, and cash flows of the individual companies, and is not a required part of the consolidated financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the consolidated financial statements. The consolidating information has been subjected to the auditing procedures applied in the audits of the consolidated financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the consolidated financial statements or to the consolidated financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the consolidating information is fairly stated in all material respects in relation to the consolidated financial statements as a whole.

Crowe Horwath LLP

Crowe Horwath LLP

Costa Mesa, California
April 8, 2013

CALWEST BANCORP AND SUBSIDIARY
CONSOLIDATED BALANCE SHEETS
December 31, 2012 and 2011

	<u>2012</u>	<u>2011</u>
ASSETS		
Cash and due from bank	\$ 5,300,284	\$ 4,402,876
Federal funds sold and interest-bearing balances at the Federal Reserve Bank	<u>12,740,000</u>	<u>5,365,000</u>
Total cash and cash equivalents	18,040,284	9,767,876
Interest-bearing deposits in other banks	1,980,000	1,230,000
Investment securities:		
Available for sale	43,370,131	27,111,912
Held to maturity	<u>16,642,083</u>	<u>22,335,715</u>
Total investment securities	60,012,214	49,447,627
Loans held for sale	437,191	1,350,075
Loans:		
Real estate	43,524,701	44,162,505
Commercial and industrial	21,059,273	33,239,393
Consumer	<u>849,158</u>	<u>1,110,000</u>
Total loans	65,433,132	78,511,898
Net deferred loan fees and costs	(154,494)	(50,379)
Net discounts	(873,315)	(1,046,505)
Allowance for loan losses	<u>(3,549,366)</u>	<u>(3,896,550)</u>
Net loans	60,855,957	73,518,464
Federal Reserve Bank and Federal Home Loan Bank stock – at cost	1,103,850	1,365,850
Premises and equipment	82,762	125,808
Other real estate owned	549,074	1,015,079
Company owned life insurance	5,994,274	5,804,704
Accrued interest and other assets	<u>1,541,315</u>	<u>1,989,980</u>
 Total assets	 <u>\$150,596,921</u>	 <u>\$145,615,463</u>

(Continued)

CALWEST BANCORP AND SUBSIDIARY
CONSOLIDATED BALANCE SHEETS
December 31, 2012 and 2011

	<u>2012</u>	<u>2011</u>
LIABILITIES AND SHAREHOLDERS' EQUITY		
Deposits:		
Noninterest-bearing demand	\$ 47,282,957	\$ 50,141,815
Money market and NOW accounts	38,447,755	35,508,735
Savings	10,468,531	10,702,903
Time deposits under \$100,000	5,353,186	11,616,000
Time deposits \$100,000 and over	<u>39,883,658</u>	<u>25,776,000</u>
Total deposits	141,436,087	133,745,453
Other borrowings	-	1,000,000
Subordinated debentures	3,093,000	3,093,000
Subordinated notes	630,000	630,000
Accrued interest and other liabilities	<u>1,180,259</u>	<u>849,423</u>
Total liabilities	146,339,346	139,317,876
Shareholders' equity:		
Preferred stock – 5,000,000 shares authorized, 4,656 shares issued and outstanding, redemption value of \$4,889,000	4,801,974	4,755,414
Common stock – 50,000,000 shares authorized, par value \$5.00; 2,415,530 and 2,413,730 shares issued and outstanding in 2012 and 2011, respectively	12,076,733	12,067,733
Surplus	16,264,017	16,255,487
Accumulated deficit	(29,366,540)	(27,230,029)
Accumulated other comprehensive income	<u>481,391</u>	<u>448,982</u>
Total shareholders' equity	<u>4,257,575</u>	<u>6,297,587</u>
Total liabilities and shareholders' equity	<u>\$150,596,921</u>	<u>\$145,615,463</u>

See accompanying notes to consolidated financial statements

CALWEST BANCORP AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF OPERATIONS
December 31, 2012 and 2011

	<u>2012</u>	<u>2011</u>
Interest income		
Interest and fees on loans	\$ 3,773,912	\$ 4,476,402
Interest on investment securities	1,328,404	1,315,436
Other interest income	<u>111,066</u>	<u>101,799</u>
Total interest income	5,213,382	5,893,637
Interest expense		
Interest on money market and NOW accounts	154,379	200,928
Interest on savings deposits	38,931	68,620
Interest on time deposits	510,610	751,592
Interest on borrowings	<u>158,501</u>	<u>173,683</u>
Total interest expense	<u>862,421</u>	<u>1,194,823</u>
Net interest income	4,350,961	4,698,814
Provision for loan losses	1,981,000	189,145
Net interest income after provision for losses	2,369,961	4,509,669
Noninterest income		
Service charges and fees	636,563	668,048
Gain and servicing income on loans sold	238,415	345,522
Gain on sale of securities	557,044	390,708
Net loss on sale and write-down of other real estate owned	(235,345)	(3,987)
Earnings on company owned life insurance	189,570	618,131
Other income	<u>13,608</u>	<u>5,948</u>
Total noninterest income	1,399,855	2,024,370
Noninterest expense		
Salaries and employee benefits	2,662,424	2,760,601
Occupancy expenses	732,964	814,923
Furniture and equipment	118,296	204,526
Other expenses	<u>2,344,483</u>	<u>3,191,971</u>
Total noninterest expenses	<u>5,858,167</u>	<u>6,972,021</u>
Loss before income taxes	(2,088,351)	(437,982)
Income tax expense	<u>1,600</u>	<u>1,600</u>
Net loss	(2,089,951)	(439,582)
Preferred stock dividends and accretion of discount	<u>(300,332)</u>	<u>(300,332)</u>
Net loss available to common shareholders	<u>\$ (2,390,283)</u>	<u>\$ (739,914)</u>
Per share data:		
Net income (loss) – basic	<u>\$ (0.99)</u>	<u>\$ (0.31)</u>
Net income (loss) – diluted	<u>\$ (0.99)</u>	<u>\$ (0.31)</u>

See accompanying notes to consolidated financial statements

CALWEST BANCORP AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)
December 31, 2012 and 2011

	<u>2012</u>	<u>2011</u>
Net loss	\$ (2,089,951)	\$ (439,582)
Other comprehensive income:		
Unrealized holding gain/(loss) arising during the period	923,579	738,821
Reclassification adjustment for gains included in net loss	(557,044)	(390,708)
Tax effect	<u>(334,126)</u>	<u>—</u>
Total other comprehensive income	<u>32,409</u>	<u>348,113</u>
Comprehensive loss	<u>\$ (2,057,542)</u>	<u>\$ (91,469)</u>

See accompanying notes to consolidated financial statements

CALWEST BANCORP AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY
December 31, 2012 and 2011

	<u>Preferred Stock</u>		<u>Common Stock</u>		<u>Surplus</u>	<u>Accumulated Deficit</u>	<u>Accumulated Other Comprehensive Income</u>	<u>Total Shareholders' Equity</u>
	<u>Number of Shares</u>	<u>Amount</u>	<u>Number of Shares</u>	<u>Amount</u>				
Balance at January 1, 2011	4,656	\$ 4,708,854	2,413,730	\$ 12,067,733	\$ 16,203,310	\$(26,743,887)	\$ 100,869	\$ 6,336,879
Net loss	-	-	-	-	-	(439,582)	-	(439,582)
Accretion of preferred stock discount	-	46,560	-	-	-	(46,560)	-	-
Stock-based compensation	-	-	-	-	52,177	-	-	52,177
Change in unrealized gain on securities available for sale net of reclassification and tax effects	-	-	-	-	-	-	348,113	348,113
Balance at December 31, 2011	4,656	\$ 4,755,414	2,413,730	\$ 12,067,733	\$ 16,255,487	\$(27,230,029)	\$ 448,982	\$ 6,297,587
Net loss	-	-	-	-	-	(2,089,951)	-	(2,089,951)
Issuance of common stock	-	-	1,800	9,000	(9,000)	-	-	-
Accretion of preferred stock discount	-	46,560	-	-	-	(46,560)	-	-
Stock-based compensation	-	-	-	-	17,530	-	-	17,530
Change in unrealized gain on securities available for sale net of reclassification and tax effects	-	-	-	-	-	-	32,409	32,409
Balance at December 31, 2012	<u>4,656</u>	<u>\$ 4,801,974</u>	<u>2,415,530</u>	<u>\$ 12,076,733</u>	<u>\$ 16,264,017</u>	<u>\$(29,366,540)</u>	<u>\$ 481,391</u>	<u>\$ 4,257,575</u>

See accompanying notes to consolidated financial statements

CALWEST BANCORP AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF CASH FLOWS
December 31, 2012 and 2011

	<u>2012</u>	<u>2011</u>
Cash flows from operating activities		
Net loss	\$ (2,089,951)	\$ (439,582)
Adjustments to reconcile net loss to net cash and cash equivalents provided by operating activities:		
Depreciation and amortization of premises and equipment	118,296	157,905
Net amortization (accretion)	545,834	98,819
Provision for loan losses	1,981,000	189,145
Gain on sale of loans	(173,584)	(278,605)
Gain on sale of securities	(557,044)	(390,708)
Loss and write downs of other real estate owned	235,345	104,464
Stock-based compensation expense	17,530	52,177
Earnings on company owned life insurance	(189,570)	(617,206)
Net change in loans held-for-sale	1,086,468	2,294,447
Other items	<u>445,375</u>	<u>1,502,621</u>
Net cash from operating activities	1,419,699	2,673,477
Cash flows from investing activities		
Net change in interest bearing deposits in other banks	(750,000)	(830,000)
Purchases of available-for-sale securities	(40,632,551)	(17,149,136)
Purchases of held-to-maturity securities	-	(6,325,794)
Proceeds from maturities of available-for-sale securities	5,573,584	7,300,866
Proceeds from maturities of held-to-maturity securities	4,820,648	2,926,855
Proceeds from the sale of available-for-sale securities	20,031,023	16,539,957
Net change in loans	10,152,887	16,648,841
Proceeds from sale of loans	-	4,840,926
Net change in FRB and FHLB stock	262,000	280,650
Proceeds from sale of other real estate owned	779,734	170,312
Proceeds from life insurance	-	1,323,728
Purchases of premises and equipment	<u>(75,250)</u>	<u>-</u>
Net cash from investing activities	162,075	25,727,205
Cash flows from financing activities		
Net change in demand deposits and savings accounts	(154,210)	(9,124,527)
Net change in time deposits	7,844,844	(18,235,475)
Repayment of other borrowings	<u>(1,000,000)</u>	<u>(5,533,691)</u>
Net cash from financing activities	6,690,634	(32,893,693)
Net change in cash	8,272,408	(4,493,011)
Cash and cash equivalents at beginning of year	<u>9,767,876</u>	<u>14,260,887</u>
Cash and cash equivalents at end of year	<u>\$ 18,040,284</u>	<u>\$ 9,767,876</u>
Supplemental disclosures of cash flow information		
Interest paid	\$ 867,655	\$ 1,118,060
Taxes paid	\$ 1,600	\$ 1,600
Loans transferred to other real estate owned	\$ 348,974	\$ -

See accompanying notes to consolidated financial statements

CALWEST BANCORP AND SUBSIDIARY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2012 and 2011

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Principles of Consolidation: The financial statements include the accounts of CalWest Bancorp and its subsidiary, South County Bank (the "Bank") collectively referred to herein as the "Company." All significant intercompany transactions have been eliminated. CalWest Bancorp has no significant business activity other than its investment in South County Bank. Accordingly, no separate financial information on the Company is provided, other than reflected in the consolidating schedules included as supplementary information.

Nature of Operations: The Bank has been organized as a single operating segment with two separate divisions, Inland Valley Bank and Surf City Bank. The Bank operates a full service branch in Redlands, California under the Inland Valley Bank division and a full service branch in Huntington Beach, California under the Surf City Bank division. In addition, the Bank operates two full service branches in Rancho Santa Margarita and Irvine, California under the name South County Bank N.A.

The Bank's primary source of revenue is providing loans to customers, who are predominately small and middle-market businesses and individuals.

Subsequent Events: The Company has evaluated subsequent events for recognition and disclosure through April 8, 2013, which is the date the financial statements were available to be issued.

Use of Estimates: The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. The allowance for loans losses and fair values of securities and other financial instruments are particularly subject to change.

Cash and Cash Equivalents: For purposes of reporting cash flows, cash and cash equivalents include cash, due from banks, federal funds sold and interest-bearing balances held at the Federal Reserve Bank ("FRB"). Generally, federal funds are sold for one-day periods.

Cash and Due from Banks: Banking regulations require that banks maintain a percentage of their deposits as reserves in cash or on deposit with the Federal Reserve Bank. The Company complied with the reserve requirements as of December 31, 2012 and 2011. The Company maintains amounts due from bank, which exceed federally insured limits. The Company has not experienced any losses in such accounts.

Interest-Bearing Deposits in Other Banks: Interest-bearing deposits in other banks mature within one year and are carried at cost.

Securities: Bonds, notes, and debentures for which the Company has the positive intent and ability to hold to maturity are reported at cost, adjusted for premiums and discounts that are recognized in interest income using the interest method over the period to maturity. Investments not classified as trading securities nor as held to maturity securities are classified as available-for-sale securities and recorded at fair value. Unrealized gains or losses on available-for-sale securities are excluded from net income and reported as an amount net of taxes as a separate component of other comprehensive income included in shareholders' equity. Premiums or discounts on held-to-maturity and available-for-sale securities are amortized or accreted into income using the interest method. Realized gains or losses on sales of available-for-sale securities are recorded using the specific identification method.

(Continued)

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Management evaluates securities for other-than-temporary impairment ("OTTI") on at least a quarterly basis, and more frequently when economic or market conditions warrant such an evaluation. For securities in an unrealized loss position, management considers the extent and duration of the unrealized loss, and the financial condition and near-term prospects of the issuer. Management also assesses whether it intends to sell, or it is more likely than not that it will be required to sell, a security in an unrealized loss position before recovery of its amortized cost basis. If either of the criteria regarding intent or requirement to sell is met, the entire difference between amortized cost and fair value is recognized as impairment through earnings. For debt securities that do not meet the aforementioned criteria, the amount of impairment is split into two components as follows; OTTI related to credit loss, which must be recognized in the income statement and; OTTI related to other factors, which is recognized in other comprehensive income. The credit loss is defined as the difference between the present value of the cash flows expected to be collected and the amortized cost basis. For equity securities, the entire amount of impairment is recognized through earnings.

Loans Held for Sale and Servicing Assets: Small Business Administration ("SBA") loans originated or purchased and intended for sale are carried at the lower of aggregate cost or fair value. Net unrealized losses, if any, are recorded as a valuation allowance and charged to earnings. Gains on sales of loans are recognized at the time of sale and include any servicing asset recognized. A valuation allowance is recorded against servicing assets when fair value is below the carrying amount. As of December 31, 2012 and 2011, the amount of the servicing asset recorded was \$170,543 and \$233,727, respectively.

Loans: Loans receivable that management has the intent and ability to hold for the foreseeable future or until maturity or payoff are reported at their outstanding unpaid principal balances reduced by any charge-offs, the allowance for loan losses and net of any deferred fees or costs on originated loans, or unamortized premiums or discounts on purchased loans.

Loan origination fees and certain direct origination costs are capitalized and recognized as an adjustment of the yield of the related loan.

Loans on which the accrual of interest has been discontinued are designated as nonaccrual loans. The accrual of interest on loans is discontinued when principal or interest is past due 90 days based on the contractual terms of the loan or when, in the opinion of management, there is reasonable doubt as to collectability. When loans are placed on nonaccrual status, all interest previously accrued but not collected is reversed against current period interest income. Income on nonaccrual loans is subsequently recognized only to the extent that cash is received and the loan's principal balance is deemed collectible. Interest accruals are resumed on such loans only when they are brought current with respect to interest and principal and when, in the judgment of management, the loans are estimated to be fully collectible as to all principal and interest.

Credit Risk and Concentrations: A significant portion of the Company's real estate loans are secured by real properties located in Southern California. Declines in the California economy and in real estate values could have a significant effect on the collectability of the Company's loans and on the level of the required allowance for loan losses.

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

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

The allowance consists of specific and general reserves. Specific reserves relate to loans that are individually classified as impaired. A loan is impaired when, based on current information and events, it is probable that the Bank will be unable to collect all amounts due according to the contractual terms of the loan agreement. Factors considered in determining impairment include payment status, collateral value and the probability of collecting all amounts when due. Measurement of impairment is based on the expected future cash flows of an impaired loan, which are to be discounted at the loan's effective interest rate, or measured by reference to an observable market value, if one exists, or the fair value of the collateral for a collateral-dependent loan. The Bank selects the measurement method on a loan-by-loan basis except that collateral-dependent loans for which foreclosure is probable are measured at the fair value of the collateral.

The Company recognizes interest income on impaired loans based on its existing methods of recognizing interest income on nonaccrual loans. Loans for which the terms have been modified resulting in a concession, and for which the borrower is experiencing financial difficulties, are considered troubled debt restructurings and classified as impaired with measurement of impairment based on expected future cash flows discounted using the loan's effective rate immediately prior to the restructuring.

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

General reserves cover non-impaired loans and are based on historical loss rates over the last twelve quarters for each portfolio segment, adjusted for the effects of qualitative or environmental factors that are likely to cause estimated credit losses as of the evaluation date to differ from the portfolio segment's historical loss experience. Qualitative factors include consideration of the following: changes in lending policies and procedures; changes in economic conditions, changes in the nature and volume of the portfolio; changes in the experience, ability and depth of lending management and other relevant staff; changes in the volume and severity of past due, nonaccrual and other adversely graded loans; changes in the loan review system; changes in the value of the underlying collateral for collateral-dependent loans; concentrations of credit and the effect of other external factors such as competition and legal and regulatory requirements.

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

CALWEST BANCORP AND SUBSIDIARY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2012 and 2011

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

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

Federal Reserve Bank ("FRB") and Federal Home Loan Bank ("FHLB") Stock: The Company is a member of the FRB and FHLB systems. Members are required to own a certain amount of stock based on the level of borrowings and other factors, and may invest in additional amounts. FRB and FHLB stock is carried at cost, classified as a restricted security, and periodically evaluated for impairment based on the ultimate recovery of par value. Both cash and stock dividends are reported as income.

Other Real Estate Owned: Assets acquired through or instead of loan foreclosure are initially recorded at fair value less costs to sell when acquired, establishing a new cost basis. If fair value declines subsequent to foreclosure, a valuation allowance is recorded through expense. Operating costs after acquisition are expensed.

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

Advertising Costs: The Company expenses the costs of advertising in the period incurred.

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

The Company has adopted guidance issued by the Financial Accounting Standards Board ("FASB") that clarifies the accounting for uncertainty in tax positions taken or expected to be taken on a tax return and provides that the tax effects from an uncertain tax position can be recognized in the financial statements only if, based on its merits, the position is more likely than not to be sustained on audit by taxing authorities. Interest and penalties related to uncertain tax positions are recorded as part of income tax expense.

Comprehensive Income: Comprehensive income (loss) consists of net income (loss) and other comprehensive income (loss). Other comprehensive income (loss) includes unrealized gains and losses on securities available for sale which are also recognized as separate components of equity.

Financial Instruments: In the ordinary course of business, the Company has entered into off-balance sheet financial instruments consisting of commitments to extend credit, commercial letters of credit, and standby letters of credit as described in Note 12. Such financial instruments are recorded in the financial statements when they are funded or related fees are incurred or received.

(Continued)

CALWEST BANCORP AND SUBSIDIARY
 NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
 December 31, 2012 and 2011

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Earnings (Loss) per Share ("EPS"): Basic EPS excludes dilution and is computed by dividing income or loss available to common shareholders by the weighted-average number of common shares outstanding for the period. Diluted EPS reflects the potential dilution that could occur if options or other contracts to issue common stock were exercised or converted into common stock or resulted in the issuance of common stock that then shared in the earnings of the entity. The factors used in the earnings per share computation follow:

	<u>2012</u>	<u>2011</u>
Basic EPS:		
Net loss	\$ (2,089,951)	\$ (439,582)
Less preferred stock dividends and accretion of discount	<u>(300,332)</u>	<u>(300,332)</u>
Net loss available to common shareholders	<u>\$ (2,390,283)</u>	<u>\$ (739,917)</u>
Weighted average shares outstanding	<u>2,414,630</u>	<u>2,413,730</u>
Basic EPS	<u>\$ (0.99)</u>	<u>\$ (0.31)</u>
Diluted EPS:		
Net loss available to common shareholders	<u>\$ (2,390,283)</u>	<u>\$ (739,917)</u>
Weighted average shares outstanding	2,414,630	2,413,730
Dilutive effects of stock options	<u>—</u>	<u>—</u>
Average shares and dilutive potential common shares	<u>2,414,630</u>	<u>2,413,730</u>
Diluted EPS	<u>\$ (0.99)</u>	<u>\$ (0.31)</u>

All outstanding stock options are considered antidilutive as of December 31, 2012 and 2011.

Stock-Based Compensation: Compensation cost is recognized for stock options issued to employees based on the fair value of these awards at the date of grant. A Black-Scholes model is utilized to estimate the fair value of stock options. Compensation cost is recognized over the required service period, generally defined as the vesting period. See Note 10 for additional information on the Company's stock option plan.

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

See Note 15 for more information and disclosures relating to the Company's fair value measurements.

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

(Continued)

CALWEST BANCORP AND SUBSIDIARY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2012 and 2011

NOTE 2 – SECURITIES (Continued)

<u>2011</u>	<u>Amortized Cost</u>	<u>Gross Unrealized Gains</u>	<u>Gross Unrealized (Losses)</u>	<u>Fair Value</u>
Available-for-sale securities:				
Mortgage-backed securities:				
residential	\$ 26,662,930	\$ 480,527	\$ (31,545)	\$ 27,111,912
Held-to-maturity securities:				
US Government and				
agency securities	\$ 1,010,470	\$ 150,110	\$ -	\$ 1,160,580
State and municipal securities	3,182,670	203,971	(1,209)	3,385,432
Mortgage-backed securities:				
residential	17,534,726	608,125	(4,914)	18,137,937
Corporate bonds	607,849	22,455	-	630,304
	<u>\$ 22,335,715</u>	<u>\$ 984,661</u>	<u>\$ (6,123)</u>	<u>\$ 23,314,253</u>

During 2012, the Company received proceeds of \$20,031,023 from the sale of available-for-sale investment securities resulting in gross gains of \$557,044 and no gross losses. During 2011, the Company received proceeds of \$16,539,957 from the sale of available-for-sale investment securities resulting in gross gains of \$433,274 and gross losses of \$42,566.

Investment securities carried at approximately \$17.8 million and \$41.8 million at December 31, 2012 and 2011, respectively, were pledged to secure public deposits and the borrowings discussed in Note 7.

The scheduled maturities of investment securities at December 31, 2012 are shown below. Securities not due at a single maturity date are shown separately.

	<u>Available-for-Sale</u>		<u>Held-to-Maturity</u>	
	<u>Amortized Cost</u>	<u>Fair Value</u>	<u>Amortized Cost</u>	<u>Fair Value</u>
Due in one year or less	\$ -	\$ -	\$ 561,127	\$ 568,784
Due in one year to five years	-	-	2,138,937	2,261,852
Due in five to ten years	-	-	1,242,061	1,433,602
Greater than ten years	-	-	845,039	901,798
Mortgage-backed securities: residential	<u>42,554,614</u>	<u>43,370,131</u>	<u>11,854,919</u>	<u>12,434,151</u>
	<u>\$ 42,554,614</u>	<u>\$ 43,370,131</u>	<u>\$ 16,642,083</u>	<u>\$ 17,600,187</u>

(Continued)

CALWEST BANCORP AND SUBSIDIARY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2012 and 2011

NOTE 2 – SECURITIES (Continued)

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

	<u>Less than 12 Months</u>		<u>Over 12 Months</u>		<u>Total</u>	
	<u>Unrealized</u> <u>Loss</u>	<u>Estimated</u> <u>Fair Value</u>	<u>Unrealized</u> <u>Loss</u>	<u>Estimated</u> <u>Fair Value</u>	<u>Unrealized</u> <u>Loss</u>	<u>Estimated</u> <u>Fair Value</u>
<u>2012</u>						
Mortgage-backed securities: residential	(57,951)	9,141,578	–	–	(57,951)	9,141,578
Corporate bonds	<u>(5)</u>	<u>200,000</u>	<u>–</u>	<u>–</u>	<u>(5)</u>	<u>200,000</u>
	<u>\$ (57,956)</u>	<u>\$ 9,341,578</u>	<u>\$ –</u>	<u>\$ –</u>	<u>\$ (57,956)</u>	<u>\$ 9,341,578</u>
<u>2011</u>						
Mortgage-backed securities: residential	\$ (36,459)	\$ 7,364,519	\$ –	\$ –	\$ (36,459)	\$ 7,364,519
State and municipal securities	<u>–</u>	<u>–</u>	<u>(1,209)</u>	<u>252,503</u>	<u>(1,209)</u>	<u>252,503</u>
	<u>\$ (36,459)</u>	<u>\$ 7,364,519</u>	<u>\$ (1,209)</u>	<u>\$ 252,503</u>	<u>\$ (37,668)</u>	<u>\$ 7,617,022</u>

At December 31, 2012, the Company had nine investment securities where total estimated fair value had declined from the Company's total amortized cost. Because the decline in market value is attributable to changes in interest rates, not credit quality, and the Company does not intend to sell these securities and it is not more likely than not that the Company will be required to sell the securities, the Company does not consider these investments to be other-than-temporarily impaired at December 31, 2012.

NOTE 3 – LOANS

The Company's loan portfolio consists primarily of loans to borrowers within Southern California. Although the Company seeks to avoid concentrations of loans to a single industry or based upon a single class of collateral, real estate and real estate associated businesses are among the principal industries in the Company's market area and, as a result, the Company's loan and collateral portfolios are, to some degree, concentrated in those industries.

(Continued)

CALWEST BANCORP AND SUBSIDIARY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2012 and 2011

NOTE 3 – LOANS (Continued)

The following table presents the activity in the allowance for loan losses for the years ended December 31, 2012 and 2011, and the recorded investment in loans and impairment method, by portfolio segment:

<u>2012</u>	<u>Real Estate</u>	<u>Commercial</u>	<u>Consumer</u>	<u>Total</u>
Allowance for loan losses:				
Beginning balance	\$ 1,724,977	\$ 2,113,940	\$ 57,633	\$ 3,896,550
Provision for loan losses	2,145,646	(32,188)	(132,458)	1,981,000
Charge-offs	(2,121,752)	(582,165)	(4,702)	(2,708,619)
Recoveries	37,684	212,708	130,043	380,435
Total ending balance	<u>\$ 1,786,555</u>	<u>\$ 1,712,295</u>	<u>\$ 50,516</u>	<u>\$ 3,549,366</u>
Allowance for loan losses:				
Specific	\$ 726,320	\$ 617,705	\$ -	\$ 1,344,025
General	1,060,235	1,094,590	50,516	2,205,341
	<u>\$ 1,786,555</u>	<u>\$ 1,712,295</u>	<u>\$ 50,516</u>	<u>\$ 3,549,366</u>
Loans evaluated for impairment:				
Individually	\$ 4,557,123	\$ 2,331,371	\$ -	\$ 6,888,494
Collectively	38,967,578	18,727,902	849,158	58,544,638
	<u>\$ 43,524,701</u>	<u>\$ 21,059,273</u>	<u>\$ 849,158</u>	<u>\$ 65,433,132</u>
<u>2011</u>	<u>Real Estate</u>	<u>Commercial</u>	<u>Consumer</u>	<u>Total</u>
Allowance for loan losses:				
Beginning balance	\$ 2,385,898	\$ 1,901,518	\$ 21,962	\$ 4,309,378
Provision for loan losses	(261,240)	430,933	19,452	189,145
Charge-offs	(428,563)	(537,701)	(10,412)	(976,676)
Recoveries	28,882	319,190	26,631	374,703
Total ending balance	<u>\$ 1,724,977</u>	<u>\$ 2,113,940</u>	<u>\$ 57,633</u>	<u>\$ 3,896,550</u>
Allowance for loan losses:				
Specific	\$ 417,000	\$ 437,000	\$ -	\$ 854,000
General	1,307,977	1,676,940	57,633	3,042,550
	<u>\$ 1,724,977</u>	<u>\$ 2,113,940</u>	<u>\$ 57,633</u>	<u>\$ 3,896,550</u>
Loans evaluated for impairment:				
Individually	\$ 5,207,696	\$ 3,611,065	\$ -	\$ 8,818,761
Collectively	38,954,809	29,628,328	1,110,000	69,693,137
	<u>\$ 44,162,505</u>	<u>\$ 33,239,393</u>	<u>\$ 1,110,000</u>	<u>\$ 78,511,898</u>

The Company categorizes loans into risk categories based on relevant information about the ability of borrowers to service their debt such as current financial information, historical payment experience, collateral adequacy, credit documentation, and current economic trends, among other factors. The Company analyzes loans individually by classifying the loans as to credit risk. This analysis typically includes larger, non-homogeneous loans such as commercial real estate and commercial and industrial loans. This analysis is performed on an ongoing basis as new information is obtained. The Company uses the following definitions for risk ratings:

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

(Continued)

CALWEST BANCORP AND SUBSIDIARY
 NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
 December 31, 2012 and 2011

NOTE 3 – LOANS (Continued)

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

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

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

The risk category of loans by class of loans was as follows as of December 31:

<u>2012</u>	<u>Pass</u>	<u>Special Mention</u>	<u>Substandard</u>	<u>Impaired</u>	<u>Total</u>
Real estate loans:					
Construction and land development	\$ 2,727,481	\$ —	\$ —	\$ —	\$ 2,727,481
Commercial real estate	21,561,467	1,281,658	1,499,772	2,638,900	26,981,797
Residential real estate	11,059,166	838,034	—	1,918,223	13,815,423
Commercial loans:					
Small business administration	2,996,847	206,181	903,128	471,450	4,577,606
Commercial and Industrial	11,630,483	1,908,683	1,082,580	1,859,921	16,481,667
Consumer loans	<u>800,928</u>	<u>48,230</u>	<u>—</u>	<u>—</u>	<u>849,158</u>
	<u>\$ 50,776,372</u>	<u>\$ 4,282,786</u>	<u>\$ 3,485,480</u>	<u>\$ 6,888,494</u>	<u>\$ 65,433,132</u>
<u>2011</u>					
Real estate loans:					
Construction and land development	\$ 1,391,000	\$ —	\$ —	\$ —	\$ 1,391,000
Commercial real estate	22,624,221	192,000	828,817	4,638,962	28,284,000
Residential real estate	12,164,114	1,000,000	754,657	568,734	14,487,505
Commercial loans:					
Small business administration	4,403,080	128,000	55,000	727,313	5,313,393
Commercial and industrial	22,259,798	1,555,000	1,227,450	2,883,752	27,926,000
Consumer loans	<u>1,110,000</u>	<u>—</u>	<u>—</u>	<u>—</u>	<u>1,110,000</u>
	<u>\$ 63,952,213</u>	<u>\$ 2,875,000</u>	<u>\$ 2,865,924</u>	<u>\$ 8,818,761</u>	<u>\$ 78,511,898</u>

(Continued)

CALWEST BANCORP AND SUBSIDIARY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2012 and 2011

NOTE 3 – LOANS (Continued)

Past due and nonaccrual loans presented by loan class were as follows as of December 31, 2012 and 2011:

	Still Accruing		Nonaccrual
	30-89 Days Past Due	Over 90 days Past Due	
<u>2012</u>			
Real estate loans:			
Construction and land development	\$ –	\$ –	\$ 2,638,900
Commercial real estate	–	–	1,918,222
Residential real estate	–		
Commercial loans:			
Small business administration	20,663	–	471,450
Commercial and industrial	24,142	–	1,859,922
	<u>\$ 44,805</u>	<u>\$ –</u>	<u>\$ 6,888,494</u>
<u>2011</u>			
Real estate loans:			
Commercial real estate	\$ 488,000	\$ –	\$ 4,638,962
Residential real estate	–	–	568,734
Commercial loans:			
Small business administration	–	–	727,313
Commercial and industrial	57,000	–	2,883,752
Consumer Loans	43,000	–	–
	<u>\$ 588,000</u>	<u>\$ –</u>	<u>\$ 8,818,761</u>

Information relating to individually impaired loans presented by class of loans was as follows as of December 31:

	Unpaid Principal Balance	Recorded Investment	Related Allowance	Average Recorded Investment	Interest Income Recognized
<u>2012</u>					
With an allowance recorded					
Real estate loans:					
Commercial real estate	\$ 1,738,467	\$ 1,467,243	\$ 355,424	\$ 1,577,738	\$ –
Residential real estate	1,913,549	1,834,815	370,896	1,874,941	16,162
Commercial loans:					
Small business administration	424,693	397,642	91,068	454,604	–
Commercial and industrial	1,799,754	1,649,669	526,637	1,794,848	15,235
With no related allowance recorded					
Real estate loans:					
Commercial real estate	\$ 3,286,610	\$ 1,171,657	\$ –	\$ 3,229,518	\$ –
Residential real estate	272,393	83,408	–	340,228	–
Commercial loans:					
Small business administration	255,099	73,808	–	227,428	–
Commercial and industrial	361,522	210,252	–	335,032	–
	<u>\$10,052,087</u>	<u>\$ 6,888,494</u>	<u>\$ 1,344,025</u>	<u>\$ 9,834,337</u>	<u>\$ 31,397</u>

(Continued)

CALWEST BANCORP AND SUBSIDIARY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2012 and 2011

NOTE 3 – LOANS (Continued)

Information relating to individually impaired loans presented by class of loans was as follows as of December 31:

<u>2011</u>	<u>Unpaid Principal Balance</u>	<u>Recorded Investment</u>	<u>Related Allowance</u>	<u>Average Recorded Investment</u>	<u>Interest Income Recognized</u>
With an allowance recorded					
Real estate loans:					
Commercial real estate	\$ 978,573	\$ 914,714	\$ 288,322	\$ 1,006,244	\$ 18,827
Residential real estate	367,046	256,918	128,968	376,323	-
Commercial loans					
Small business administration	299,012	299,012	126,369	1,494,499	-
Commercial and industrial	426,005	426,005	311,318	452,378	-
With no related allowance recorded					
Real estate loans:					
Commercial real estate	\$ 3,935,863	\$ 3,724,248	\$ -	\$ 3,865,774	\$ -
Residential real estate	426,465	311,816	-	453,979	-
Commercial loans					
Small business administration	886,233	428,301	-	935,471	-
Commercial and industrial	<u>2,568,208</u>	<u>2,457,747</u>	<u>-</u>	<u>2,652,774</u>	<u>13,865</u>
	<u>\$ 9,887,405</u>	<u>\$ 8,818,761</u>	<u>\$ 854,977</u>	<u>\$11,237,442</u>	<u>\$ 32,692</u>

Interest income of \$31,397 and \$32,692 was recognized on impaired loans in 2012 and 2011, respectively, which was on the cash basis. The Company allocated \$842,237 and \$670,006 of specific reserves on loans with a recorded investment of \$3,193,638 and \$5,889,826 whose terms have been modified in troubled debt restructuring as of December 31, 2012 and 2011, respectively. The Company has committed to lend no additional amounts to customers with outstanding loans that are classified as troubled debt restructurings as of December 31, 2012 and 2011.

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

	<u>Number of Contracts</u>	<u>Pre- Modification Investment</u>	<u>Post- Modification Investment</u>
Small business administration	1	\$ 2,845	\$ -
Commercial and industrial	<u>1</u>	<u>349,942</u>	<u>349,942</u>
	<u>2</u>	<u>\$ 352,787</u>	<u>\$ 349,942</u>

The modification of the terms of such loans included one or a combination of the following: an extension of the maturity date at a stated rate of interest lower than the current market rate for new debt with similar risk or a temporary forbearance with regard to the payment of principal or interest. Modifications involving an extension of the maturity date were for periods ranging from 6 months to 7 years. One modification was made involving a temporary forbearance of principal on an SBA loan for a period of one year.

(Continued)

CALWEST BANCORP AND SUBSIDIARY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2012 and 2011

NOTE 3 – LOANS (Continued)

The determination of the allowance for loan losses related to troubled debt restructurings depends on the collectability of principal and interest, according to the repayment terms. The troubled debt restructurings that occurred in 2011 did not materially change the estimated collectability and therefore did not materially change the related allowance for loan loss amounts.

There were no troubled debt restructurings for which there was a payment default within twelve months following the modification during the period ended December 31, 2012.

NOTE 4 – PREMISES AND EQUIPMENT

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

	<u>2012</u>	<u>2011</u>
Furniture, fixtures, and equipment	\$ 1,753,655	\$ 1,869,394
Leasehold improvements	<u>851,739</u>	<u>843,087</u>
	2,605,394	2,712,481
Accumulated depreciation and amortization	<u>(2,522,632)</u>	<u>(2,586,673)</u>
	<u>\$ 82,762</u>	<u>\$ 125,808</u>

Depreciation expense was \$118,296 and \$204,526 for 2012 and 2011, respectively.

The Company leases its facilities under non-cancellable operating leases expiring at various dates through 2020. Future minimum annual payments for these leases are as follows:

	<u>Amount</u>
2013	\$ 392,598
2014	332,574
2015	284,142
2016	288,827
2017	297,491
Thereafter	<u>618,574</u>
Total minimum lease payments	<u>\$ 2,214,206</u>

The minimum rental payments shown above are given for the existing lease obligations and include annual rent adjustments. Rental expense, including related common area maintenance charges, was \$697,264 and \$754,321 for 2012 and 2011, respectively.

(Continued)

CALWEST BANCORP AND SUBSIDIARY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2012 and 2011

NOTE 5 – DEPOSITS

Scheduled maturities of time deposits for the next five years were as follows:

	<u>Amount</u>
2013	\$24,126,772
2014	10,862,264
2015	4,949,970
2016	3,479,557
2017	<u>1,818,281</u>
	<u>\$45,236,844</u>

NOTE 6 – SUBORDINATED DEBENTURES AND SUBORDINATED NOTES

On September 17, 2003, the Company issued \$3,093,000 of junior subordinated deferrable interest debentures (the “debentures”) to CalWest Statutory Trust I (the “Trust”). These debentures are subordinated to effectively all borrowings of the Company and are due and payable on September 17, 2033. Interest is payable quarterly on these debentures at three-month LIBOR plus 2.95% for an effective rate of 3.26% as of December 31, 2012. The Company has the option to defer interest payments on the subordinated debentures from time to time for a period not to exceed five years. The Company has elected to defer all interest payments due after the fourth quarter 2010 and approximately \$209,498 of due but unpaid interest is included in Accrued interest and other liabilities as of December 31, 2012.

The Company also purchased a 3% common interest in the Trust. The balance of the equity of the Trust is comprised of mandatorily redeemable preferred securities. The Federal Reserve Board has issued final regulations confirming that these types of mandatorily redeemable preferred securities qualify as Tier I Capital (up to 25% of other components of Tier I Capital) and the remainder as Tier II Capital.

In 2010, the Company issued \$630,000 of mandatorily convertible subordinated notes to various individuals. These notes are subordinated to effectively all borrowings of the Company and mature three years after issuance, at which time the Company can convert the notes to shares of common stock. The Company may prepay all or a portion of the notes prior to the conversion date. Interest is payable semi-annually at a rate of 8%, but the Company can defer interest payments until maturity. No payments of interest have been made on these subordinated notes and \$100,938 of due but unpaid interest has been included in Accrued Interest and Other Liabilities at December 31, 2012.

In 2013, the Company offered a one-year deferral of the conversion date of the notes to common stock. Through the date of issuance of the financial statements, holders of \$525,000 of the subordinated notes have accepted the deferral offer.

NOTE 7 – OTHER BORROWINGS

As a member of the Federal Home Loan Bank of San Francisco (“FHLBSF”), the Company may borrow against a line of credit with a maximum financing availability of 20% of its total assets, adjusted quarterly, subject to the pledge of eligible collateral as well as other terms and conditions.

(Continued)

CALWEST BANCORP AND SUBSIDIARY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2012 and 2011

NOTE 7 – OTHER BORROWINGS (Continued)

As of December 31, 2012, the Company had maximum financing availability of \$30,858,000 based on total assets with remaining borrowing capacity of \$19,377,827. Securities with a fair value of approximately \$20.4 million at December 31, 2012 have been on pledged on this arrangement. Reflected in the remaining borrowing capacity is a letter of credit in the amount of \$11 million issued on behalf of Company customers. The Company may also borrow from the discount window and other financing facilities available through the Federal Reserve Bank of San Francisco, subject to the pledge of eligible collateral. Securities with a fair value of approximately \$6.8 million were pledged on this arrangement as of December 31, 2012 which supports approximately \$6.5 million in related borrowing capacity. No amounts were outstanding on this arrangement as of December 31, 2012.

The Company may also borrow up to \$3.0 million overnight from its correspondent banks on a secured and unsecured basis. No amounts were outstanding and securities with a fair value of approximately \$5.0 million were pledged on the secured arrangements as of December 31, 2012.

NOTE 8 – INCOME TAXES

Income tax expense (benefit) for the years ended December 31 consists of the following:

	<u>2012</u>	<u>2011</u>
Current expense:		
Federal	\$ -	\$ -
State	<u>1,600</u>	<u>1,600</u>
	1,600	1,600
Deferred expense:		
Federal	(899,000)	(356,000)
State	<u>(242,000)</u>	<u>(126,000)</u>
	(1,141,000)	(482,000)
Change in valuation allowance	<u>1,141,000</u>	<u>482,000</u>
	<u>\$ 1,600</u>	<u>\$ 1,600</u>

A comparison of the federal statutory income tax rate of 34% to the Company's effective income tax follows:

	<u>2012</u>	<u>2011</u>
Federal statutory rate times financial statement income	\$ (710,000)	\$ (149,000)
Effect of:		
California franchise taxes	(159,000)	(84,000)
Tax-free income	(104,000)	(264,000)
Stock-based compensation	12,000	18,000
Valuation allowance	1,141,000	482,000
Other items – net	<u>(178,400)</u>	<u>(1,400)</u>
Total tax expense	<u>\$ 1,600</u>	<u>\$ 1,600</u>

(Continued)

CALWEST BANCORP AND SUBSIDIARY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2012 and 2011

NOTE 8 – INCOME TAXES (Continued)

The following is a summary of the components of the net deferred tax asset accounts recognized in the accompanying consolidated balance sheets:

	<u>2012</u>	<u>2011</u>
Deferred tax assets:		
Allowance for loan losses due to tax limitations	\$ 490,000	\$ 818,000
Net operating loss carryforwards	8,915,000	7,463,000
Depreciation differences	70,000	84,000
Deferred compensation plans	144,000	140,000
Nonaccrual loan interest	312,000	272,000
Other	<u>36,000</u>	<u>272,000</u>
	9,967,000	9,049,000
 Valuation allowance	 (9,725,000)	 (8,584,000)
Deferred tax liabilities:		
Deferred loan costs	(194,000)	(219,000)
Net unrealized gains on sale of available for sale securities	(334,000)	(185,000)
Other	<u>(48,000)</u>	<u>(61,000)</u>
	<u>(576,000)</u>	<u>(465,000)</u>
 Net deferred tax asset/(liability)	 <u>\$ (334,000)</u>	 <u>\$ _____</u>

A valuation allowance for deferred tax assets is recorded when it is more likely than not that some portion or all of the deferred tax assets will not be realized. The ultimate realization of deferred tax assets is dependent upon the generation of future taxable income and tax planning strategies which will create taxable income during the periods in which those temporary differences become deductible. Management evaluates the positive and negative evidence and determines the realizability of the deferred tax asset on a regular basis.

At December 31, 2012 and 2011, management reassessed the continuing need for this valuation allowance and determined that it was appropriate to maintain a full valuation allowance against the Company's deferred tax assets. Management will continue to evaluate the potential realizability of the deferred tax assets and will continue to maintain a valuation allowance to the extent it is determined that it is more likely than not that these assets will not be realized. At December 31, 2012 and 2011 management established a deferred tax asset valuation allowance of \$9.7 million and \$8.6 million, respectively.

At December 31, 2012, the Company had federal and state net operating loss carry-forwards of approximately \$21.5 million and \$22.6 million. Net operating loss carry-forwards, to the extent not used will begin to expire in 2028 and 2027, respectively.

The Company is subject to U.S. federal income tax as well as income tax of the State of California. The Company is no longer subject to examination by federal taxing authorities for tax years prior to 2009 and for state taxing authorities for tax years prior to 2008.

There were no significant unrealized tax benefits recorded as of December 31, 2012 and 2011, and the Company does not expect any significant increase in unrealized tax benefits in the next twelve months. Additionally, the Company has determined that no amounts were required to be recorded related to interest and penalties for the years ended December 31, 2012 and 2011.

(Continued)

CALWEST BANCORP AND SUBSIDIARY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2012 and 2011

NOTE 9 – OTHER EXPENSES

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

	<u>2012</u>	<u>2011</u>
Marketing and business promotion	\$ 114,830	\$ 112,822
Professional and consulting	500,109	1,023,891
Office expenses	159,430	170,465
Data processing	444,613	415,372
Directors expense	150,415	142,125
Loan expense	149,479	187,497
Regulatory assessments	472,018	577,235
Other expenses	353,589	562,564
	<u>\$ 2,344,483</u>	<u>\$ 3,191,971</u>

NOTE 10 – STOCK-BASED COMPENSATION

The shareholders approved the Company's 1999 Stock Option Plan in October 1999, under which 200,037 shares of the Company's common stock may be issued. In July 2003, the shareholders approved the 2003 Stock Option Plan under which 192,995 shares of the Company's common stock may be issued, raising the total shares available to 393,032. Under the terms of the Company's stock option plans, employees may be granted nonqualified stock options or incentive stock options and directors may be granted nonqualified stock options.

In May 2006, the shareholders approved the Company's 2006 Equity Based Compensation Plan under which 201,651 shares of the Company's common stock may be issued. The Company amended the Plan in 2011 and increased the number of shares available to be issued under the 2006 Plan to 1,110,651. The 2006 Plan authorizes the granting of incentive stock options, non-qualified stock options, stock appreciation rights, restricted stock awards and restricted stock units. Under the Plan vesting restrictions on awards may be time based and/or performance based. Participation in the 2006 Plan is open to all employees of the Company as well as the Company's directors. Under the terms of the 2006 Plan employees may be granted nonqualified stock options or incentive stock options and directors may be granted nonqualified stock options. Generally, all awards expire no later than ten years from the date of the grant.

(Continued)

CALWEST BANCORP AND SUBSIDIARY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2012 and 2011

NOTE 10 – STOCK-BASED COMPENSATION (Continued)

A summary of the status of the Company's stock option plan as of December 31, 2012, and changes during the year are presented below:

	<u>Shares</u>	<u>Weighted- Average Exercise Price</u>	<u>Weighted- Average Remaining Contractual Term</u>	<u>Aggregate Intrinsic Value</u>
Outstanding at beginning of year	137,076	\$ 7.57		
Granted	20,000	\$ 0.39		
Forfeited and expired	(38,218)	\$ 3.58		
Exercised	<u>—</u>	<u>\$ —</u>		
Outstanding at end of year	<u>118,858</u>	<u>\$ 7.76</u>	<u>2.42</u>	<u>—</u>
Vested and expected to vest	<u>118,858</u>	<u>\$ 7.65</u>	<u>2.42</u>	<u>—</u>
Options exercisable at year-end	<u>109,541</u>	<u>\$ 7.91</u>	<u>2.14</u>	<u>—</u>

As of December 31, 2012 there was an immaterial amount of remaining unrecognized compensation cost related to the outstanding stock options.

NOTE 11 – RELATED PARTY TRANSACTIONS

In the ordinary course of business, the Company has granted loans to certain directors and the companies with which they are associated. The balance of these loans outstanding at December 31, 2012 and 2011 was approximately \$595,000 and \$626,000, respectively.

NOTE 12 – COMMITMENTS

In the ordinary course of business, the Company enters into financial commitments to meet the financing needs of its customers. These financial commitments include commitments to extend credit and standby letters of credit. Those instruments involve to varying degrees, elements of credit and interest rate risk not recognized in the Company's financial statements. The Company's exposure to loan loss in the event of nonperformance on commitments to extend credit and standby letters of credit is represented by the contractual amount of those instruments. The Company uses the same credit policies in making commitments as it does for loans reflected in the financial statements.

As of December 31, 2012 and 2011, the Company had the following outstanding financial commitments whose contractual amount represents credit risk:

	<u>2012</u>	<u>2011</u>
Commitments to extend credit	<u>\$13,279,000</u>	<u>\$14,018,000</u>

(Continued)

NOTE 12 – COMMITMENTS (Continued)

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

The Company is involved in various matters of litigation which have arisen in the ordinary course of its business. In the opinion of management, the disposition of such pending litigation will not have a material effect on the Company's financial statements.

NOTE 13 – EMPLOYEE BENEFITS

The Company has entered into salary continuation agreements with certain executive officers. Under these agreements, the Company is obligated to provide, upon retirement, a 15 year benefit to the officers. The estimated present value of future benefits to be paid is being accrued over the period from the effective date of the agreements until the expected retirement dates of the participants. On May 5, 2010, certain officers entered into agreements that effectively converted the then existing liability under the salary continuation agreements of \$314,205 to shares of common stock of the Company.

The Company has also entered into split-dollar life insurance agreements with certain executive officers. The present value of the post-retirement cost of maintaining the life insurance policy is being accrued over the period from the effective date of the agreements until the expected retirement dates of the participants. The expense incurred for these agreements, net of forfeitures totaled approximately \$4,030 and \$40,624 for 2012 and 2011, respectively. Total accrued liability for these agreements as of December 31, 2012 and 2011, was \$30,199 and \$26,170, respectively.

The Company is a beneficiary of life insurance policies that have been purchased as a method of financing the benefits under these agreements. Income earned on the cash surrender value of these policies is tax-free to the Company and is utilized to reduce the overall costs of benefits provided to key officers.

NOTE 14 – REGULATORY MATTERS

Consent Order: On January 24, 2011 the Bank consented to the issuance of a Consent Order ("the Order") by the Office of the Comptroller of the Currency ("OCC"). The Order places significant requirements on the Bank, as summarized below.

The Bank must maintain Tier 1 Capital to total assets ratio of at least 9% and Total Capital to risk-weighted assets of at least 12% throughout the life of the Order. No dividends may be paid without the prior written consent of the OCC. The Bank must submit a written strategic plan to improve profits and maintain sufficient capital.

CALWEST BANCORP AND SUBSIDIARY
 NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
 December 31, 2012 and 2011

NOTE 14 – REGULATORY MATTERS (Continued)

The Order stipulates that the Board of Directors shall adopt policies and procedures to ensure that the Bank has effective senior management in place. In addition, the Bank must adopt and implement policies and procedures to strengthen management of overall risk exposures in certain areas, including loan portfolio management, criticized assets, nonaccrual loans and troubled debt restructurings, concentrations of credit, allowance for loan losses, loan review and liquidity risk management.

Effective with the date of the Order, the Bank was considered adequately capitalized under the FDIC's prompt corrective action rules. The Bank continues to be considered adequately capitalized under these rules as of December 31, 2012. As a result of being deemed adequately capitalized, the Bank was not able to accept, renew, or rollover any brokered deposit unless it has been granted a waiver of such prohibition by the FDIC and may not accept high rate deposits as defined by regulation. Remaining brokered deposits as of December 31, 2012, amounted to approximately \$1,952,000 which represents 1.4% of total deposits.

The Bank expects to work closely with the OCC to address the provisions of the Order. Regular updates have been submitted to report progress made in correcting the items addressed in the Order. The Order will remain in effect until terminated by the OCC. Failure to comply with terms of the Order may result in additional enforcement action against the Bank.

Capital Requirements: The Bank is subject to various regulatory capital requirements administered by the federal banking agencies. Failure to meet minimum capital requirements can initiate certain mandatory and possibly additional discretionary actions by regulators that, if undertaken, could have a direct material effect on the Company'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 their assets, liabilities, and certain off-balance-sheet items as calculated under regulatory accounting practices. Their capital amounts and classifications are also subject to qualitative judgments by the regulators about components, risk weightings, and other factors. Quantitative measures established by regulation to ensure capital adequacy require the Bank to maintain minimum amounts and ratios (set forth in the table below) of total and Tier 1 capital (as defined in the regulations) to risk-weighted assets (as defined), and of Tier 1 capital (as defined) to average assets (as defined).

The following table sets forth the Bank's actual capital amounts and ratios (dollar amounts in thousands):

	<u>Actual</u>		<u>Required For Capital Adequacy Purposes</u>		<u>To Be Adequately Capitalized Under the Consent Order</u>	
	<u>Amount</u>	<u>Ratio</u>	<u>Amount</u>	<u>Ratio</u>	<u>Amount</u>	<u>Ratio</u>
December 31, 2012						
Total capital (to risk-weighted assets)	\$ 8,583	11.57%	\$ 5,936	8.00%	\$ 8,905	12.00%
Tier 1 capital (to risk-weighted assets)	7,622	10.27%	2,968	4.00%	N/A	N/A
Tier 1 capital (to average assets)	7,622	5.11%	5,972	4.00%	13,436	9.00%

(Continued)

CALWEST BANCORP AND SUBSIDIARY
 NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
 December 31, 2012 and 2011

NOTE 14 – REGULATORY MATTERS (Continued)

	<u>Actual</u>		<u>Required For Capital Adequacy Purposes</u>		<u>To Be Adequately Capitalized Under the Consent Order</u>	
	<u>Amount</u>	<u>Ratio</u>	<u>Amount</u>	<u>Ratio</u>	<u>Amount</u>	<u>Ratio</u>
December 31, 2011						
Total capital (to risk-weighted assets)	\$ 10,617	12.43%	\$ 6,832	8.00%	\$ 10,249	12.00%
Tier 1 capital (to risk-weighted assets)	9,513	11.14%	3,416	4.00%	N/A	N/A
Tier 1 capital (to average assets)	9,513	6.30%	6,037	4.00%	13,583	9.00%

NOTE 15 – FAIR VALUE

Fair value is the exchange price that would be received for an asset or paid to transfer a liability (exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. There are three levels of inputs that may be used to measure fair values:

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

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

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

The Company used the following methods and significant assumptions to estimate fair value:

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

Collateral-Dependent Impaired Loans: The fair value of impaired loans with specific allocations of the allowance for loan losses is generally based on recent real estate appraisals. These appraisals may utilize a single valuation approach or a combination of approaches including comparable sales and the income approach. Adjustments are routinely made in the appraisal process by the independent appraisers to adjust for differences between the comparable sales and income data available. Such adjustments are usually significant and typically result in a Level 3 classification of the inputs for determining fair value.

(Continued)

CALWEST BANCORP AND SUBSIDIARY
 NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
 December 31, 2012 and 2011

NOTE 15 – FAIR VALUE (Continued)

Other Real Estate Owned: Assets acquired through or instead of loan foreclosure are initially recorded at fair value less costs to sell when acquired, establishing a new cost basis. These assets are subsequently accounted for at lower of cost or fair value less estimated costs to sell. Fair value is commonly based on recent real estate appraisals which are updated no less frequently than annually. These appraisals may utilize a single valuation approach or a combination of approaches including comparable sales and the income approach. Adjustments are routinely made in the appraisal process by the independent appraisers to adjust for differences between the comparable sales and income data available. Such adjustments are usually significant and typically result in a Level 3 classification of the inputs for determining fair value. Real estate owned properties are evaluated on a quarterly basis for additional impairment and adjusted accordingly.

Appraisals for both collateral-dependent impaired loans and other real estate owned are performed by certified general appraisers (for commercial properties) or certified residential appraisers (for residential properties) whose qualifications and licenses have been reviewed and verified by the Company. Once received, a member of the Credit Department reviews the assumptions and approaches utilized in the appraisal as well as the overall resulting fair value in comparison with independent data sources such as recent market data or industry-wide statistics.

The following table provides the hierarchy and fair value for each major category of assets and liabilities measured at fair value at December 31:

	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Total</u>
<u>2012</u>				
Assets measured at fair value on a recurring basis:				
Securities available for sale	\$ —	\$ 43,370,131	\$ —	\$ 43,370,131
Assets measured at fair value on a non-recurring basis:				
Collateral-dependent impaired loans, net of specific reserves:				
Commercial real estate	\$ —	\$ —	\$ 914,662	\$ 914,662
Residential real estate	—	—	1,091,387	1,091,387
Small business administration	—	—	39,886	39,886
Commercial and industrial	—	—	58,753	58,753
Other real estate loans, net of valuation allowances:				
Commercial real estate	\$ —	\$ —	\$ 272,474	\$ 272,474
Residential real estate	—	—	276,600	276,600
<u>2011</u>				
Assets measured at fair value on a recurring basis:				
Securities available for sale	\$ —	\$ 27,111,912	\$ —	\$ 27,111,912
Assets measured at fair value on a non-recurring basis:				
Collateral-dependent impaired loans, net of specific reserves				
Commercial real estate	\$ —	\$ —	\$ 1,404,000	\$ 1,404,000
Other real estate loans, net of valuation allowances				
Commercial real estate	\$ —	\$ —	\$ 1,015,000	\$ 1,015,000

(Continued)

NOTE 15 – FAIR VALUE (Continued)

Assets measured at fair value on a non-recurring basis are summarized below. The following valuation techniques and unobservable inputs are noted by loan type:

Commercial real estate – This impaired loan is measured for impairment using the fair value of the collateral as it is classified as a collateral dependent loan. The fair value of collateral is estimated using an independent third party appraisal. The appraisal of the collateral securing the loan uses a blend of the income and sales comparison approaches. A significant unobservable input in the income approach is the income capitalization rate of 7.5%. Adjustments of up to 26% were made to the collateral value based on sales comparisons in the area.

Residential real estate – These impaired loans are measured for impairment using the fair value of the underlying collateral. These estimates are generally developed by third party certified appraisers based on any differences between the subject property and sales comparisons in the surrounding area. Adjustments to the fair values of the collateral from sales comparisons ranged from -3% to 15% to arrive at fair value.

Commercial and industrial – These impaired loans are measured for impairment using the fair value of the assets of the underlying business. These estimates are generally developed internally from statements provided by the borrowers. Adjustments to the values are typically made for the types of assets, and the age and condition of those assets. These estimates are developed by management based on their knowledge of the borrower and the assets, and are typically significant; for impaired commercial and industrial loans as of December 31, 2012, assets used as collateral were discounted up to 40% from borrowers' stated values.

Small business administration – These impaired loans are measured for impairment using the fair value of the assets of the underlying business. These estimates are generally developed internally from statements provided by the borrowers. Adjustments to the values are typically made for the types of assets, and the age and condition of those assets. These estimates are developed by management based on their knowledge of the borrower and the assets, and are typically significant; for impaired small business administration loans as of December 31, 2012, assets used as collateral were discounted up to 15% from borrowers' stated values.

Write-downs of other real estate owned charged against income totaled approximately \$5,679 and \$97,600 for the periods ended December 31, 2012 and 2011, respectively.

Fair Values of Financial Instruments:

The fair value of a financial instrument is the amount at which the asset or obligation could be exchanged in a current transaction between willing parties, other than in a forced or liquidation sale. Fair value estimates are made at a specific point in time based on relevant market information and information about the financial instrument. These estimates do not reflect any premium or discount that could result from offering for sale at one time the entire holdings of a particular financial instrument.

Because no market value exists for a significant portion of the financial instruments, fair value estimates are based on judgments regarding future expected loss experience, current economic conditions, risk characteristics of various financial instruments, and other factors. These estimates are subjective in nature, involve uncertainties and matters of judgment and, therefore, cannot be determined with precision. Changes in assumptions could significantly affect the estimates.

CALWEST BANCORP AND SUBSIDIARY
 NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
 December 31, 2012 and 2011

NOTE 15 – FAIR VALUE (Continued)

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

The carrying amounts and estimated fair values of financial instruments at December 31 are as follows (in thousands):

	<u>Carrying Amount</u>	<u>Fair Value Measurements Using:</u>			<u>Total Fair Value</u>
		<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	
<u>2012</u>					
Financial assets					
Cash and due from banks	\$ 5,300	\$ 5,300	\$ –	\$ –	\$ 5,300
Federal funds sold and interest-bearing balances at FRB	12,740	12,740	–	–	12,740
Interest-bearing deposits in other banks	1,980	1,980	–	–	1,980
Securities available-for-sale	43,370	–	43,370	–	43,370
Securities held-to-maturity	16,642	–	17,600	–	17,600
Loans held-for-sale	437	–	–	437	437
Net loans	60,856	–	–	61,945	61,945
FRB and FHLB stock	1,104	N/A	N/A	N/A	N/A
Accrued interest receivable	473	–	266	207	473
Financial liabilities					
Deposits	\$ 141,436	–	\$ 135,548	–	\$ 135,548
Subordinated debentures	3,093	–	–	3,093	3,093
Subordinated notes	630	–	–	630	630
Accrued interest payable	330	–	20	310	330
<u>2011</u>					
Financial assets					
Cash, due from banks and federal funds sold			\$ 4,403		\$ 4,403
Federal funds sold and interest-bearing deposits at FRB			5,365		5,365
Interest-bearing deposits			1,230		1,230
Securities available-for-sale			27,112		27,112
Securities held-to-maturity			22,336		23,314
Loans held-for-sale			1,350		1,350
Net loans			73,518		71,677
FRB and FHLB stock			1,366		N/A
Accrued interest receivable			454		454
Financial liabilities					
Deposits			\$ 133,745		\$ 132,015
Other borrowings			1,000		1,000
Subordinated debentures			630		630
Trust preferred stock			3,093		3,093
Accrued interest payable			178		178

(Continued)

NOTE 15 – FAIR VALUE (Continued)

The methods and assumptions, not previously presented, used to estimate fair values are described as follows:

(a) Cash and Due from Banks, Federal Funds Sold and Interest Bearing Deposits, and Interest-Bearing Deposits In Other Banks

The carrying amounts of cash and short-term instruments approximate fair values and are classified as Level 1.

(b) FRB and FHLB Stock

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

(c) Net Loans

Fair values of loans are estimated as follows: for variable rate loans that reprice frequently and with no significant change in credit risk, fair values are based on carrying values resulting in a Level 3 classification. Fair values for other loans are estimated using discounted cash flow analyses, using interest rates currently being offered for loans with similar terms to borrowers of similar credit quality resulting in a Level 3 classification. Impaired loans are valued at the lower of cost or fair value as described previously. The methods utilized to estimate the fair value of loans do not necessarily represent an exit price.

(d) Deposits

The fair values disclosed for demand deposits (e.g., interest and non-interest checking, savings, and certain types of money market accounts) are, by definition, equal to the amount payable on demand at the reporting date (i.e., their carrying amount) resulting in a Level 2 classification. The carrying amounts of variable rate, fixed-term money market accounts and certificates of deposit approximate their fair values at the reporting date resulting in a Level 2 classification. Fair values for fixed rate certificates of deposit are estimated using a discounted cash flows calculation that applies interest rates currently being offered on certificates with similar maturities resulting in a Level 2 classification.

(e) Subordinated Debentures and Notes

The fair values of the Company's subordinated debentures and notes are estimated using discounted cash flow analyses based on the current borrowing rates for similar types of borrowing arrangements resulting in a Level 3 classification.

(f) Accrued Interest Receivable/Payable

The carrying amounts of accrued interest approximate fair value and are classified within the same fair value level as the related asset or liability.

(g) Off-balance Sheet Instruments

Fair values for off-balance sheet, credit-related financial instruments are based on fees currently charged to enter into similar agreements, taking into account the remaining terms of the agreements and the counterparties' credit standing. The fair value of commitments is not material.

NOTE 16 – SENIOR PREFERRED STOCK

On January 23, 2009, the Company entered into a Purchase Agreement with the United States Department of the Treasury (the "Treasury"), pursuant to which the Company issued and sold 4,656 shares of the Company's Preferred Stock as Fixed Rate Cumulative Perpetual Preferred Stock, Series A (the "Series A Preferred Stock") and 233 shares of Fixed Rate Cumulative Perpetual Warrant Preferred Stock, Series B (the "Series B Preferred Stock") for an aggregate purchase price of \$4,656,000 in cash. The redemption of both Series A and Series B Preferred Stock is \$4,889,000. The discount of \$233,000 plus estimated issuance costs of \$25,000 is accreted against retained earnings over the estimated five-year life of the Preferred Stock reducing the reported income available for common shareholders.

The Series A Preferred Stock qualifies as Tier 1 capital and pays cumulative dividends at a rate of 5% per annum for the first five years and 9% per annum thereafter. The Series A Preferred Stock may be redeemed by the Company after three years if certain other conditions are met. The Series B Preferred Stock also qualifies as Tier 1 capital and pays cumulative dividends at a rate of 9% per annum. The Series B Preferred Stock may only be redeemed after all of the Series A Preferred Stock has been redeemed. If dividends on the Preferred Stock are not paid in full for six quarterly dividend periods, whether or not consecutive, the Treasury will have the right to elect 2 directors. The right to elect directors will end when dividends have been paid for all prior dividend periods. For as long as any Preferred Stock is outstanding and held by the Treasury, no dividends may be declared on common shares unless approved by the Treasury.

The Company has not paid dividends since the August 15, 2010 payment. The Company does not accrue a liability for dividends until they are declared and therefore dividends in arrears of \$570,982 have not been reflected as a reduction of shareholders' equity as of December 31, 2012.

In the Purchase Agreement, the Company agreed that, until such time as the Treasury ceases to own any debt or equity securities of the Company acquired pursuant to the Purchase Agreement, the Company will take all necessary action to ensure that its benefit plans with respect to its senior executive officers comply with Section 111(b) of the Emergency Economic Stabilization Act of 2008 (the "EESA"), as amended by the American Recovery and Reinvestment Act of 2009, and as implemented by any guidance or regulation under the EESA that has been issued and is in effect, from time to time, and has agreed to not adopt any benefit plans with respect to, or which covers, its senior executive officers that do not comply with the EESA, and the applicable executives have consented to the foregoing.

NOTE 17 – LOANS ACQUIRED IN EXCHANGE OF ASSETS

In 2010, the Company executed agreements to sell a classified loan and a piece of property held in other real estate owned with a carrying value of \$1,639,932 for \$1,900,261 and also provide cash of \$5,700,784 in exchange for a pool of home equity lines of credit ("HELOC's") with a par value of \$7,601,045.

Accounting standards require that assets received in full satisfaction of receivables be recorded at their purchase date fair value. A discount of \$1,333,994 was recorded to reduce the par value of the HELOC's to reflect a fair value of \$6,332,451. The discount was recorded, net of the excess sales price over carrying value of \$260,329, and resulted in the recognition of a loss on the sale of the other real estate of \$886,684, a charge-off on the loan of \$62,690 and a charge to miscellaneous expense of \$124,291.

The discount is being recognized as interest income over the life of the HELOC's with \$173,190 and \$202,799 recognized into income in 2012 and 2011, respectively. The remaining balance of the discount is \$873,315 as of December 31, 2012.

NOTE 18 – MANAGEMENT’S PLANS

The Company has incurred losses from operations in 2012 and 2011 of \$2.09 million and \$440 thousand, primarily due to decreasing net interest rate margins and provisions for loan losses. The Company’s interest income declined from \$5.89 million in 2011 to \$5.21 million in 2012. This was partially offset by a decline in interest expense during this period of \$332 thousand to \$862 thousand in 2012; however the net interest income decreased \$348 thousand during 2012 to \$4.35 million from \$4.70 million in 2011. As shown in Note 3, during 2012 the Company provided \$1.98 million to the allowance for loan losses during 2012 compared to \$189 thousand in 2011, and recognized net charge offs of \$2.33 million and \$602 thousand during those same periods, respectively. Impaired loans at December 31, 2012 and 2011 were \$6.89 million and \$8.82 million, respectively. These accumulated losses have caused the Bank’s capital to deteriorate to a level that is no longer in compliance with the two minimum capital ratios set forth in the Bank’s Order from the OCC, as discussed in Note 14. The Bank is also out of compliance with certain other requirements of the Order.

In response to the noncompliance with the Order and the recurring net losses discussed above, the Company has executed key strategic initiatives during 2012 and 2011 to shrink the loan portfolio and problem loans. Total loans decreased by \$13.08 million during the year. Nonaccrual and impaired loans decreased by \$1.93 million during 2012, from \$8.82 million to \$6.89 million. In addition to this, the Company has implemented cost-cutting measures including restructuring leases of its branch facilities and limiting other expenditures. These measures resulted in reductions in noninterest expenses from \$6.97 million in 2011 to \$5.86 million in 2012. Management believes these actions will improve long term profitability. Management has also developing a capital restoration plan that will include raising additional capital through various channels.

The Company believes that the successful completion of all or a significant portion of its plans, which include but are not limited to those actions described above, will help the Bank to meet the requirements of the Order, but there can be no assurance that the successful completion of its plans will enable the Bank to meet the requirements of the current or future regulatory enforcement actions imposed by its regulatory agency.

SUPPLEMENTARY INFORMATION

CALWEST BANCORP AND SUBSIDIARY
CONSOLIDATING BALANCE SHEETS
As of December 31, 2012

	South County Bank	CalWest Bancorp	Eliminating Entries	Consolidated Balance
Assets				
Cash and due from banks	\$ 5,300,284	\$ 103,687	\$ (103,687)	\$ 5,300,284
Federal funds sold and interest-bearing balances at the FRB	12,740,000	-	-	12,740,000
Interest-bearing deposits in other banks	1,980,000	-	-	1,980,000
Investment securities available for sale	43,370,131	-	-	43,370,131
Investment securities held to maturity	16,642,083	-	-	16,642,083
Loans held for sale	437,191	-	-	437,191
Loans, net	60,855,957	-	-	60,855,957
FRB and FHLB stock, at cost	1,103,850	-	-	1,103,850
Premises and equipment	82,762	-	-	82,762
Other real estate owned	549,074	-	-	549,074
Company owned life insurance	5,994,274	-	-	5,994,274
Accrued interest and other assets	<u>1,448,315</u>	<u>8,196,316</u>	<u>(8,103,316)</u>	<u>1,541,315</u>
	<u>\$ 150,503,921</u>	<u>\$ 8,300,003</u>	<u>\$ (8,207,003)</u>	<u>\$ 150,596,921</u>
Liabilities and Shareholders' Equity				
Deposits	\$ 141,539,774	\$ -	\$ (103,687)	\$ 141,436,087
Other borrowings				
Subordinated debentures and notes	-	3,723,000	-	3,723,000
Accrued interest and other liabilities	<u>860,831</u>	<u>319,428</u>	<u>-</u>	<u>1,180,259</u>
Total liabilities	<u>142,400,605</u>	<u>4,042,428</u>	<u>(103,687)</u>	<u>146,339,346</u>
Shareholders' equity				
Preferred stock	-	4,801,974	-	4,801,974
Common stock	10,658,905	12,067,733	(10,658,905)	12,067,733
Surplus	15,881,336	16,273,017	(15,881,336)	16,273,017
Accumulated deficit	(18,918,316)	(29,366,540)	18,918,316	(29,366,540)
Accumulated other comprehensive income	<u>481,391</u>	<u>481,391</u>	<u>(481,391)</u>	<u>481,391</u>
Total shareholders' equity	<u>8,103,316</u>	<u>4,257,575</u>	<u>(8,103,316)</u>	<u>4,257,575</u>
	<u>\$ 150,503,921</u>	<u>\$ 8,300,003</u>	<u>\$ (8,207,003)</u>	<u>\$ 150,596,921</u>

CALWEST BANCORP AND SUBSIDIARY
CONSOLIDATING STATEMENT OF OPERATIONS
For the Year Ended December 31, 2012

	South County Bank	CalWest Bancorp	Eliminating Entries	Consolidated Balance
Interest income				
Interest and fees on loans	\$ 3,773,912	\$ -	\$ -	\$ 3,773,912
Interest on investment securities	1,328,404	-	-	1,328,404
Other interest income	<u>111,066</u>	<u>312</u>	<u>(312)</u>	<u>111,066</u>
Total interest income	5,213,382	312	(312)	5,213,382
Interest expense				
Interest on money market and NOW accounts	154,691	-	(312)	154,379
Interest on savings deposits	38,931	-	-	38,931
Interest on time deposits	510,610	-	-	510,610
Interest on borrowings	<u>933</u>	<u>157,568</u>	<u>-</u>	<u>158,501</u>
Total interest expense	<u>705,165</u>	<u>157,568</u>	<u>(312)</u>	<u>862,421</u>
Net interest income	<u>4,508,217</u>	<u>(157,256)</u>	<u>-</u>	<u>4,350,961</u>
Provision for loan losses	1,981,000	-	-	1,981,000
Noninterest income				
Service charges and fees	636,563	-	-	636,563
Gain and servicing income on loans sold	238,415	-	-	238,415
Gain on sale of securities	557,044	-	-	557,044
Net loss and write-down of other real estate owned	(235,345)	-	-	(235,345)
Earnings on company owned life insurance	189,570	-	-	189,570
Other income	<u>13,608</u>	<u>-</u>	<u>-</u>	<u>13,608</u>
Total noninterest income	1,399,855	-	-	1,399,855
Noninterest expense				
Salaries and employee benefits	2,662,424	-	-	2,662,424
Occupancy expenses	732,963	-	-	732,963
Furniture and equipment	118,297	-	-	118,297
Other expenses	<u>2,320,770</u>	<u>23,713</u>	<u>-</u>	<u>2,344,483</u>
Total noninterest expense	5,834,454	23,713	-	5,858,167
Loss before taxes and loss from subsidiary	(1,907,382)	(180,969)	-	(2,088,351)
Income taxes	1,600	-	-	1,600
Loss from subsidiary	<u>-</u>	<u>(1,908,982)</u>	<u>1,908,982</u>	<u>-</u>
Net loss	<u>\$ (1,908,982)</u>	<u>\$ (2,089,951)</u>	<u>\$ 1,908,982</u>	<u>\$ (2,089,951)</u>